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Final Report
on

Promotion of Private Investment in the Agro-Food Sector

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- Opinions and judgments expressed are the authors' only. FAO proposes the text as basis for starting the discussion among scholars and policy makers on the issues related to the subject of the study.

EXECUTIVE SUMMARY

During the last four decades economic growth in Syria has advanced at a rate of 4.6% per year on average (between endpoints of the 1963-1999 period). This is a good rate of growth in the long term for many countries. Unfortunately, the growth in population in Syria is also quite high (3.3% average over the same period). Growth has accompanied the rapid growth in population, which is a real achievement, but per capita income has remained stagnant in the long-term, alternating ups and downs. The economy has progressed on a cyclical pattern of periods of rapid growth followed by periods of stagnation or decline. The 1990s have been a period of growth, but not enough to go beyond the per capita product of 1980, and several factors constrain the continuation of the growth trend in subsequent years. The growth of agricultural production has followed a similar path.

Since the 1980s, but especially since 1991, new legislation has allowed and encouraged private investment in agriculture, industry and transportation. Under such regime more than 1600 projects have been approved, though not all have been implemented yet. However, the implementation of one third of the projects in the industrial sector, including more than 250 in the agribusiness sector, has implied a number of positive impacts. The projects have increased total investment, have contributed to the balance of payments and to the trade balance, have increased production and exports, especially in the agribusiness sector. Impact on employment, however, has been generally very low, though somewhat more significant in the case of agro-industry because of the pulling effect on agricultural employment.

Apart from direct promotion policies giving investors tax holidays and other advantages, there has been a sustained tendency to liberalise economy after several decades of rigid central planning. This process has accelerated lately with new laws authorising private banking and other significant measures to improve the macro environment for private investment.

This study has analysed the regime for promotion of investment and other factors conditioning private economic activity, and has presented a number of policy recommendations. They are divided into improvements in the direct promotion regime for private investment, and improvements in the macro environment. Finally, some specific recommendations are included regarding private investment in agricultural production.

Improvements in the investment promotion regime

The following specific **policy recommendations** arise for the improvement of the present investment promotion regime in Syria:

i. Create and implement an autonomous Syrian Agency for Private Investment (SAPI) instead of the current Investment Office. The current Investment Council should become the Board of Directors of the SAPI. A body of representatives of the private sector should be appointed as an Advisory Council. A charge of up to 0.5% should be applied to all investments effectively accomplished by authorised projects, to cover the expenses of the Agency. The functions of the agency include not only processing tax exemptions and other legal benefits for private investment projects, but also promotion of investment opportunities in Syria; advice and consulting service for the development of investment projects; services of market

information, finance sources and project databank; monitoring the development of investments; and other related functions.

ii. Simplify the application and authorisation process for investment projects under Law No.10. Previous and posterior approvals in the concerned Ministries should be eliminated, since the Ministers give their approval within the Investment Council. Other simplifications also should be introduced as explained in the text.

iii. Investors should be given legal access to foreign currency, especially for input procurement, profit remittances and capital repatriation in case of projects producing for the domestic market. Also, Syrian investors with capital in local currency should be given legal means of acquiring currency for importing equipment and inputs. The implementation of this policy implies a wider, freer and more efficient exchange market, and a flexible exchange rate (or a currency-board monetary system). If the foreign exchange regime is not directly liberalised, then at least it should be relaxed for authorised investment projects. The recent allowance of a freer market for foreign exchange, open initially only for personal needs such as tourism, should be extended, albeit gradually, to foreign currency transactions for business purposes.

iv. The current regime of time periods allotted for construction and for tax exemption should be replaced by a tax credit system, applicable to all investments made in the project at any time. After establishing a tax credit rate, for instance 40%, any investment would generate a tax credit equal to 40% of its value. Any income tax on profits obtained after that investment should be not paid but deducted from the tax credit, until the credit is exhausted. Further investments in the same projects generate additional tax credits. Also, reinvestment of profits should be income-tax exempt, and importation of equipment should be duty free at all times. Zero customs duties for capital goods as a general measure is recommended, but even in the absence of such a general policy, at least authorised projects should have the possibility of importing capital goods at no tariff, to foment incorporation of foreign capital and its embodied technology.

v. Steps must be taken to simplify and made more clear and transparent the conditions to obtain State-owned land on lease or freehold for the purpose of building facilities for investment projects.

vi. Land for industrial investment projects should be pre-allocated in industrial zones near important cities, with provision of basic services (industrial-strength electricity, telephony, water, sanitation, roads or railways). Any project licensed under Law No.10 should be given easy access to industrial zones.

Improvements in the macro scenario

The main fronts of action

To enhance the general environment for private investment in the Syrian economy, this study has prepared a number of policy options. As a general recommendations, it has found that changes should be pursued in a **gradual** but also in an **integrated** manner. Reforms cannot be sudden, but they cannot be adopted piecemeal either. It is necessary to progress gradually and steadily **on many fronts at once.** The analysis and policy options have been organised in several main fronts of action.

A. Resource allocation policies
Taxes
Trade
Prices and subsidies
B. Money and banking
Foreign exchange liberalisation and currency convertibility
Banking reform
Independence of monetary institutions and policy
Development of capital markets

C. Reduction of inefficiencies and overhead costs
Administrative reform of the public sector
Improvements in basic infrastructures and services

Resource allocation policies

This section deals with various sorts of policies that have in common the capacity to affect the allocation of private resources. The include the tax structure, foreign trade policy, mechanisms related to price setting for various goods, and certain aspects specific to the agricultural sector: improvements in the planning system, and improvements in the regulations for irrigation water use.

Tax reform

Implement a thorough tax reform based on a few essential taxes, abolishing all the rest. The basic taxes should be: Value Added Tax; Income Tax for corporations and physical persons; Taxes on assets (productive or not); Customs Duties.

VAT. The suggested VAT tax should be 10%. VAT rebates for exports should be implemented.

Income tax. Income brackets for income taxes should be updated. The lowest bracket for corporate and individual income taxes might be 250,000 SP. The highest bracket might be applied above 50 million SP.[1] The brackets should be updated annually, based on the Consumer Price Index. The income tax rates should be increasing marginal rates. The lowest bracket should be tax exempt to protect small incomes. The lowest bracket of corporate income tax (up to 250,000 SP) should have a zero income tax. The highest marginal rate should be 30% (which becomes 39.90% when the War Effort Surcharge of 30% and the local administrative charge of 3% is added). Intermediate brackets should have rates from 10% to 25%. For instance, 10% for the 250,000 to 1m SP bracket, 20% for the 1m to 5m SP bracket, 25% for the 5m to 50m bracket, and 30% for the top bracket above 50m SP.

Individual income tax. Individuals should be taxed for their total income, not for specific categories of income such as wages or rents. Total income includes capital income (distributed profits, withdrawals from companies, shareholder dividends and interest), capital gains after the sale of assets, income from rental of real estate, salaries and wages, and income from independent work. The first income bracket should be exempt. Taxable income in subsequent brackets should be taxed at increasing rates. The

[1] Values of income brackets and suggested tax rates are only an indication of the order of magnitude recommended, and do not mean that something specific is behind the suggestions. Final design of the tax structure would surely adjust the figures.

top marginal rate for individual incomes should not exceed 30% (which becomes 39.90% when the War Effort Surcharge of 30% and the local administrative charge of 3% is added). The brackets may be the same as for corporate income tax. Distributed dividends that have been taxed at corporate level should not be taxed again as individual income: proof of corporate income tax been paid on the dividends creates the right to deduct dividend income from total income.

Taxes on assets. It is suggested that personal not-productive wealth above a certain amount (for instance, above the equivalent of U$S 100,000) be taxed at a rate in the order of 1%, and productive assets (stock shares, business facilities, heavy duty vehicles, machinery and equipment) at a lower rate such as 0.5%. Taxable items of personal non-productive wealth include residential dwellings, real estate, cars and other vehicles except heavy-duty means of transportation. Personal liquid assets held in bank accounts should not be taxable. Valuation of assets should be updated yearly based on market values and price indexes.

Foreign trade

Establish a simple tariff system, with relatively few categories of goods. All quantitative or otherwise non-tariff restrictions should be converted into tariffs. The list of prohibited items should disappear, or include only dangerous items (such as weapons, illegal drugs or other similar items). The list of imports that can be done freely and the list of goods that can be imported with export proceedings only should be also cancelled. All importable items (i.e. all except those few that remain explicitly banned such as weapons or illegal drugs) should be included in the tariff, without using any other list. Items whose importation is not desired may be assigned a very high customs tariff. Initially, tariffs might be as high as desired, as long as quantitative or otherwise non-tariff restrictions are all converted into tariffs. The current "unified surcharge" should be integrated with the tariff, so that only one concept (the tariff) is applied. Duties should be computed on the dollar value of the imports at CIF level converted into domestic currency at the **market rate of exchange**. The maximum rate in the tariff should not exceed 50%, since under the current system the highest effective tax is about that level. In the context of negotiations, the tariff structure would then gradually converge towards more amenable levels for trade agreements with other countries and for eventual membership in the WTO.

Capital goods should have zero or very low customs duties (including productive machinery, special building materials for industrial facilities, computing and telecommunications equipment and software, heavy duty means of transportation, and spare parts for all the above categories). Family cars and light utility vehicles such as pickups and vans should **not** be included, though light utility vehicles may have a lower tariff than cars, for which probably the highest rate will be applied).

Export licenses should be abolished, and also most import licenses. Only import licenses for a few sensitive and very specific products may be retained. Anyone should be able to import or export, with the only requirement of going through the necessary banking and customs formalities. Any tax, charge or surcharge on exports should be abolished. Value Added Tax on items exported should be rebated.

Develop a serious and competitive system of grading and standards, applicable equally to imports, exports and domestic uses. Promote modern systems for ensuring quality such as ISO certifications and HACCP certification.

Continue negotiations for trade agreements with the European Union. The main policy objective should be to join the agreement as soon as possible, letting certain specific and sensitive points of disagreement to be adjusted later once the agreement has been signed and ratified. The political and commercial importance of actually reaching the agreement is much more important than any specific point of negotiation, as this kind of agreements are not static arrangements: concessions not won at the time of signing the pact may be re-negotiated and modified afterwards, from the better position of a member of the Mediterranean partnership.

Prices and subsidies

Realign subsidised prices with international/border prices. In particular, realign producer prices of strategic crops at levels compatible with parity prices. Replace subsidies embodied in the price of strategic products with direct payments to producers. In particular, introduce direct payments to producers of strategic crops, pay competitive (parity) prices for those crops, market the derived products such as flour and bread also at competitive prices. If necessary, support consumers of basic food items through some suitable mechanism, though this is not deemed necessary with the current levels of subsidisation of the final products.

Eliminate any requirement for private companies to request authorisation for changing the price of items that do not carry a fixed official price, or are not specifically regulated for some reason. Once controlled prices are realigned, gradually establish bands of permitted variation in the indicative or obligatory lists of prices, and proceed towards further liberalisation of prices and final abolition of official and indicative prices.

Money and banking

Foreign exchange and currency convertibility

The foreign exchange market should be fully legalised and gradually liberalised. The next step after the recent authorisation to convert domestic currency into foreign currency for personal purposes at the Commercial Bank should be a similar authorisation for private companies licensed under Law No.10, for legitimate operations such as import of equipment, repair parts and other inputs, profit remittances and capital repatriation. Next step is full authorisation to all banks to exchange currency. Dealing in foreign currency should be totally de-penalised.

As the general foreign exchange market develops, the special Export Proceedings Market should disappear. Alternatively, that market may be used as the basis for the new open foreign exchange market, by simple enlarging the right to operate in it.

The Central Bank would ensure that sufficient foreign currency reserves are held in the banking system to satisfy demand for foreign currency. Adjustments in the market rate of exchange may be achieved by Central Bank intervention (or not intervention) in the exchange market. A specific rule may impose that Central Bank intervention on behalf of the currency should never compromise more than a certain percentage (such as 20% over a period of six months) of international reserves. The Treasury should make additional contributions of foreign currency to enhance the reserve position of the Central Bank and thus contribute to currency stability. The long-term objective of that reserve-building activity should be to achieve that net international reserves of the Central Bank (foreign assets less foreign liabilities) are at least equal to the sum of domestic circulation plus deposits of banks and other liabilities of the Central Bank.

Banking regulation

Authorising private banks requires strict banking oversight by the Central Bank. For this purpose, rigorous **prudential rules** should be enacted, regarding minimum capital requirements, obligatory reserves, and rules for credit risk assessment at private and official banks. Application of the Basle Rules is recommended, though certain allowances should be made more strict (for instance, higher levels of minimum capital to establish a bank). Commercial banks should be required to report their day to day operations to the Central Bank, who should also regulate the way in which banks conduct credit operations. In particular, banks should not concentrate their credit in a limited number of debtors, should not engage in operations with high risk potential, and should be financially penalised for accepting deposits at rates much above the average of the banking system (for instance, accepting deposits at rates exceeding a certain margin over the average may not have deposit insurance).

Central Bank statute

The Central Bank should be given **autonomy** to conduct monetary policy with the sole objectives of defending the value of the national currency and promote long-term growth in production and employment. The main instruments for monetary policy should be the **discount rate**, the level of **obligatory reserves**, and direct **intervention in the foreign exchange market** within limits allowed in terms of percentage of net foreign assets. The Central Bank will have **strict limits for financing the Treasury** and for **rescuing troubled banks**. It could purchase State bonds only up to a certain maximum percentage of its foreign exchange reserves (for instance, up to a 20% of reserves). It could lend money to solvent banks in case of transitory liquidity needs, but it cannot advance credit to insolvent banks, which should be let to close with due protection for small and medium depositors. Deposit insurance should be ensured for total deposits of up to a certain amount per depositor (e.g. the equivalent of $10,000 per depositor), but not to be paid by the Central Bank. Funds for deposit insurance will be held at a Deposit Insurance Fund formed by contributions from commercial banks, plus a contribution from the Treasury, plus a commitment of eventually providing fresh funds from the Central Bank up to a certain percentage of Central Bank net international reserves (again up to 20%).

Obligatory bank reserves should be set at relatively high levels, such as 20% of deposits (with higher rates of obligatory reserve for checking and savings accounts and lower for time deposits or other medium- and long-term deposits). To reduce the cost of obligatory reserves and keep interest rates down, **obligatory reserves should be remunerated.** The obligatory reserves would be held by commercial banks at their accounts in the Central Bank, who would pay interest to the banks at a suitable rate. Commercial banks should be free to establish their own active and passive interest rates, though some regulatory instruments may be used to penalise high active rates.

Capital markets

After banking operations are improved and private banks are established with adequate banking oversight, introduce various financial instruments with free access for people and corporations. Accounts in foreign currency should be allowed for people and corporations.

Once the above is in place, develop a market for public and private securities. Authorise private companies to issue negotiable debt instruments to be exchanged in that market.

Once the above is in place, implement the decision to create a stock market in Syria. Regulate stock operations and the issue of stock shares by corporations. Severely control insider trading, and regulate derivative trading and other destabilising practices. Also, permit residents to engage legally in operations with foreign capital markets.

Reduction of inefficiencies and overhead costs

Administrative reform of the public sector

A thorough reform of the public sector should eliminate redundant procedures, modernise operations, introduce computer-based information systems, reinforce training of State personnel, modernise rules for public service and the public servant career, and other relevant reforms.

More efficient basic infrastructures and services

Steps should be taken to improve the expansion and maintenance of basic infrastructure and services, if necessary by requiring the services of private firms for specific operations. Main priorities should be: modernisation of ports and logistic facilities for export; modernisation of tax collection and customs; modernisation of State banks; rapid expansion of telephone networks and Internet services, and improvements in power plants and electricity networks.

Specific issues for agricultural investment

Improve and decentralise agricultural planning

Introduce initiative and innovation in the rigidly planned strategic-crop sector in a gradual manner. A growing percentage of available land, water, credit and inputs presently allocated to strategic crops should not be allocated by plan, but letting farmers decide on the best allocation of those funds. Start with 10% of the resources allocated in this manner, and gradually progress towards higher percentages.

Replacing price subsidies with direct subsidies to producers (and perhaps also focalised subsidies to poor consumers) would raise the price of bread and flour in the market. This will probably cause a decrease in waste and an increase in efficiency. This result may allow to maintain the level of effective human consumption with a lower gross production of wheat, freeing valuable resources for other crops. An increase in the price of bread would probably necessitate a realignment of wage rates and/or subsidies to poor consumers, and thus it should be considered carefully and implemented gradually.

Promote foreign investment in agricultural export products

Foreign capital and technology is needed to expand production of specific high-quality agricultural products, especially fruit and vegetables, for export to the European Union and other markets.

Develop improved rural finance

Improve and diversify sources and modes of financing agricultural activity and rural industry and marketing.

Promote rural micro-finance and the development of adequate banking techniques to reach small farmers through group credit at reasonable administrative costs with sustainable rates of interest and credit conditions.

Promote the gradual upgrade of small producers to the status of normal bank customers.

Improve marketing of agricultural products

Promote integration of farmers into vertical commodity chains for production, processing, domestic marketing and export of selected agricultural products

Improve administrative procedures for export, and logistic and port facilities, for rapid dispatch of perishable commodities to their destination by ship or air.

On-farm investment for modernisation of irrigation systems

Modernisation of irrigation systems in Syria involves shifting all gravity and flood systems to pressurised sprinklers and drip irrigation. **Metering water** is essential to create incentives for investing in the modernisation of systems. The form of payment for irrigation should consist of a **basic fee** for the use of irrigation water, plus **penalties of increasing value for exceeding allotted amounts of water.**

Secure funds for financing the conversion of 50% of irrigated lands to sprinklers and drip irrigation in ten years. The cost is about $120 million per year, only for new irrigation equipment. Another $30-40 million per year are necessary for other investments: improvements in off-farm irrigation infrastructure; technical assistance to farms to modernise cultivation systems, change crop schedule, and learn to access new markets. Upgrading the equipment is only one step: upgrading the farms and the farmers should follow.

Create incentives for better use of irrigation

Incentives to economise irrigation water in public irrigation schemes should be established, starting with metering the water supplied to each farm. Each farmer would pay a **fixed fee** for the use of irrigation water **up to a certain amount** dependent on water supply. A system of **fines** for excess use of water above the allotted amount should be enacted. The fines would be an increasing function of the amount of excess.

Follow-up project profiles

Follow up projects have been outlined to provide technical assistance for upgrading the Investment Office created by Law No.10 of 1991, to provide technical assistance for the development of rural finance, and to prepare a long-term program of agricultural development and investment.

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Part I: Background

1. Introduction

1.1. The project

Project GCP/SYR/006/ITA is a technical co-operation programme executed by FAO, with financial support from the Government of Italy, to assist the Government of Syria in the design and implementation of effective agricultural policies. Its main activities are studies of specific policy issues, and training of local professionals from the staff of the Ministry of Agriculture and Agrarian Reform (MAAR). Its institutional setting is the Centre for Agricultural Policy in Damascus.

1.2. The study

The Government of Syria has implemented legislation since the 1980s to promote private investment in selected fields, including agricultural production and related industries concerned with supplying agricultural inputs, and processing and marketing agricultural products. The latest and most important of the instruments of promotion implemented by the Government of Syria is the Investment Promotion Law of 1991 (Law 10/91). More than 1600 investment projects have been granted the benefits stipulated by that Law, among them about 300 projects in agribusiness, most of them for processing agricultural products.

The results of the policy of promotion are encouraging, but not sufficient. The study points to identify the impacts of the existing legislation, the problems and shortcomings that should be solved, and the policy options that should be addressed in order to improve the economic environment for private investment in agribusiness, broadly defined as agricultural production and processing and marketing of agricultural products. The terms of reference for the study are detailed in as an Annex to this report.

1.3. Implementation of the study

The implementation of the study was carried out between January and May, 2001. It involved one International Consultant, two National Consultants, and a team of Trainees from the MAAR staff that are undertaking training activities at the Centre. The International Consultant visited the country twice, for a total of nine weeks. The two National Consultants collaborated with the study for a period of two months each.

Research activities involved assembling secondary data from the Investment Office (the body governing the administration of promotion incentives for investment projects), and performing a qualitative survey on a small sample of 24 private companies that have benefited from incentives granted by the Investment Promotion Law. The interviews were carried out in March and April, 2001.

1.4. Task force

International Consultant and Director of the Study: Hector Maletta

National Consultants: Dr Hussam Morad and Mr Mohammad al-Khalaf

Trainees: Mr Bashar Nahas, Mr Basel El-Bawab, Mr Yahia Dahsh, Mr Samer Bregly, Mr Abdullah Saiid, Mr Fayez Mansour, Mr Ghassan Mansour, Mrs Rowaida Hasbani, Mrs Ghoseina Khadour

All the trainees are Agronomists / Agricultural Engineers working at the Ministry of Agriculture. They are engaged in training activities in the Project. Normally they work three days a week in the Project and a similar period at the Ministry.

1.5. Acknowledgements

All the people involved in the study worked very efficiently in their allotted tasks. The International Consultant's work would have been impossible without their help. Also, it is necessary to note the valuable help received from the Project's staff, including the CTA Emad el Hawary, the National Director Atieh el Hindy, the Agricultural Economist Ciro Fiorillo, translators Asma Mattar and Rola Diab, secretaries Raja al Awa, Shahed Aloush and Razan Hassan, computer technician Mr Nassouh Keilani, and drivers (who are much more than drivers!) Mazen Boukai and Suhail Maila, and the staff of the Centre for Extension and Agricultural Policy which hosts the project. Talks with other consultants in the project were also very helpful, especially the stimulating comments of Alexander Sarris, as well as those of Saad Ahmed from FAORNE. Helpful support from the FAOR office in Syria was also a very important contribution to the study.

The ideas and opinions that finally made their way into this final report are, of course, the sole responsibility of the author.

2. The Syrian economy and the agribusiness sector

2.1. The Syrian economy

2.1.1. An overview of the Syrian economy

Syria, one of the oldest civilised areas on Earth, sits on a **territory** of 185,000 square kilometres on the Western shores of the Mediterranean Sea, tucked between Turkey, Iraq, Jordan and Lebanon. Only 32% of the land is arable, but water supply is the main limiting factor to expand cultivation. **Population** by the year 2000 is estimated at 16.3 million.[2] It is expected to reach 22.7 million by 2015. It grew very fast in recent decades, well above 3% per year, but that demographic transition caused by a declining mortality is already in the wane, as fertility is now also declining. Population grew by 2.7% a year in 1955-99, is estimated to be growing now at a rate of 2.6% per year, and is expected to grow at a decreasing rate (2.2% on average) in the 2001-2015 period. The supply of labour, however, is still growing at a higher rate (slightly over 3% a year), chiefly due to the entry into the labour force of the larger cohorts resulting from the rapid increase in population during the 1970s and 1980s, and also due, to some extent, to the growing (though still low) mobilisation of female labour.

Gross Domestic Product in 1999, computed at market prices and in current terms, was estimated at 821.33 billion Syrian Pounds.[3] At the prevailing market exchange rate this amounts to about 16.4 billion US dollars, or slightly over 1000 USD per capita (with population officially estimated at 15.9 million in 1999).

In the long run, GDP has grown at the respectable rate of 4.61% over the period 1963-99, which is no mean achievement given the enormous economic, political and external problems faced by Syria during this long period. However, growth was strongly **cyclical**, with periodical ups and downs, and there has been also a **high population growth rate** (3.27% a year on average over the same period). The result of these two trends is that economic performance has accompanied population growth, which is more than many countries have achieved, but has not been able to take off in per capita terms as shown in the following graph.

The cyclical behaviour of national output shows two marked periods of growth: one in the 1970s, mostly sparkled by the upsurge in oil prices and an expansion in foreign aid occurring in those years (mainly from Arab countries), and another period of growth starting in 1990 and lasting to the recession of 1999-2000 (caused by a severe drought). This latter period of growth may be attributed chiefly to an expansion in **oil production** (especially from new fields in the Deir Ez Zor area), and an upsurge in **private investment and production**, most relevant to the subject matter of this study.

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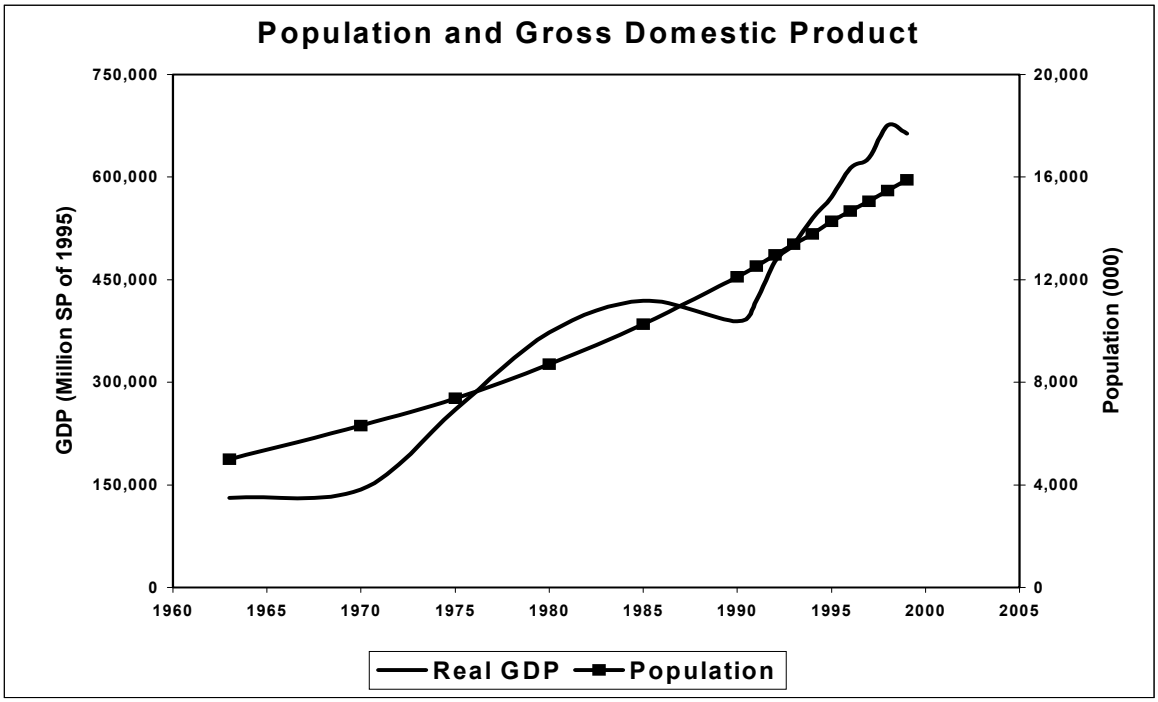
[2] Central Bureau of Statistics, **Statistical Abstract 2000**, p. 64. All population and macroeconomic statistical data used in this report are official Syrian figures, except a few specific (and explicit) estimates of the author or other sources when an official figure is not available. Detailed figures are given at the Statistical Annex at the end of this report.

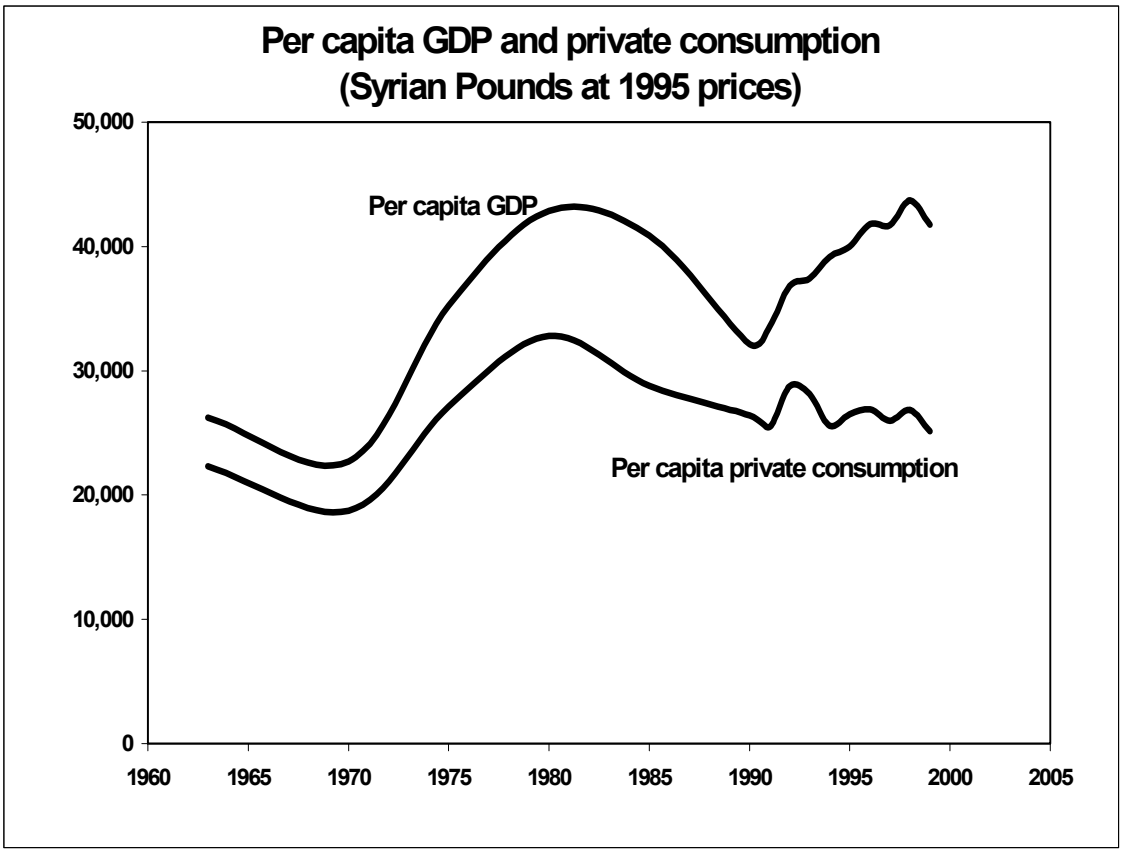
[3] Central Bureau of Statistics, **Statistical Abstract 2000**, Table 28/16, p.537.



The cyclical pattern of growth, even with a positive trend, implies that **per capita growth** has been weak and with even sharper fluctuations. In fact, the resumption of growth in the 1990s has not been enough to get above the level of per capita GDP attained by 1980.

The 1960s were a period of decline in per capita production and consumption (and in fact, also in investment). Syria enjoyed rapid per capita growth during the 1970s, favoured among other factors by the sharp increase in oil prices in the world market, but GDP per capita declined along the 1980s in the wake of a complex economic crisis including a large increase in public spending in the late 1970s, accompanied with a gaping trade deficit that peaked in 1980-85, representing nearly a third of GDP. After 1980 the Government drastically reduced fiscal spending, and enacted incentives for private investment, that after a while caused growth to resume in the 1990s. Net real economic growth per capita has been nil over the 1980-99 period, as the recovery of the 1990s was not strong enough to make up for the decline of the 1980s. The annual rate of per capita growth in 1980-99 was slightly negative (-0.04%) and over the entire 1963-99 period there was a meagre 1.30% per year.

GDP per capita in 1998-99 is about the same than in 1980, and the long-term trend of per capita product is one of stagnation. Moreover, private consumption per capita has been declining since 1980, in spite of the growth in GDP per capita achieved in the 1990s.



The poor performance of per capita GDP over the long run is even more serious from the point of view of **private consumption,** as commented before and seen in the precedent graph. Real private consumption per capita **has been steadily declining since 1980** (except for a short-lived surge in the early 1990s). In 1999 it was barely 12% above the level of 1963, and below the level of 1975. Thus **the average level of consumption of the Syrian population has been falling for twenty years, and has changed very little along nearly forty years.** Almost none of the growth in per capita GDP along the latest four decades has gone into increases of private consumption. In particular, **during the 1990s per capita GDP went up after a decade of decline, but per capita private consumption continued to go down.**[4]

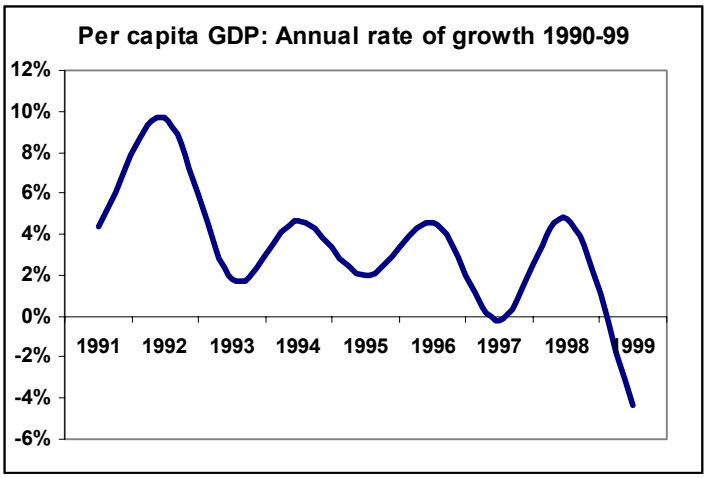
Moreover, according to many qualitative references, there has been in the meantime a large increase in upscale or luxury consumption, out of private wealth that is concentrated in a tiny minority of the population, and there have been also large outflows of Syrian capital going abroad. Therefore **the per capita consumption of ordinary people and lower income groups must have gone down faster than average consumption**.

In absolute terms, therefore, as has been shown, **the economy grew at a cumulative rate of 4.61% per year over the 1963-99 period**, which is not a poor performance in

[4] The decline in per capita consumption in the 1990s, in spite of the growth in per capita output, was mainly because of increases in public spending, back to real per capita levels comparable to those of 1980. The increase in private investment and the reversion of the trade deficit also contributed to keep private consumption down.

itself. But population was also increasing very fast. After so much effort, **net growth per capita is quite low**, and **per capita consumption has been declining for 20 years**. At the average rate of per capita growth resulting for the 1963-1999 period, **it would take nearly 54 years to double the level of per capita GDP of 1963**. This is too long and too little for a country that started the period with a very low level of income per capita. What is needed is **faster growth**, and a growth pattern with **less marked oscillations**. Otherwise, the result would continue to be a **slow and fluctuating** per capita growth. It is also needed that growth shows **also in private consumption.**

These results are a matter of great concern, and they are surely at the roots of Syrian efforts to promote private investment in recent years. In fact, the moderate growth registered in the 1990s is in large measure attributable to the rapid expansion in private investment under the 1991 Investment Promotion Law, and the effect of other liberalisation policies that started in that period. But it is also felt that something else is needed if growth is to be stronger and more sustained, for Syria to break the long spell of ups and downs, with little long-term growth, in which it has stayed since 1980 (or indeed since 1963). **During the 1990s there was growth, but at decreasing rates.**



There was, in fact, an encouraging burst of growth at the beginning of the 1990s, spurred by optimistic hopes of sweeping reform after the announcement of measures like the Investment Promotion Law. However, reforms were less than sweeping, and the trade deficit started growing again. While efforts were displayed to recover macro equilibrium, growth slowed down since 1993, and remained at low-growth levels in the rest of the period, quite independently of the additional slump caused by drought at the end of the decade. The per capita rate of growth gradually fell during the 1990s, as if leading to a new period of stagnation or decline.

Distribution of income in Syria is quite uneven, though not extremely so: areas with high concentrations of people living in extreme poverty conditions are relatively rare, though wide sectors of the population have indeed a low standard of living. Considerable wealth is on display in certain areas of Damascus and other cities, while the average wage rate in the private sector is about $150 per month, or $1800 per year, and much less in the public sector where the mean monthly pay is about $60. At the going average rates of labour force participation (see Statistical Annex) and the overall distribution of public and private employment, the above figures mean that a wage-supported average

household would have a per capita income of about $300 per year, less than a third of per capita national product.

Low and controlled prices for basic food items, especially for bread, make basic food affordable at the prevailing wage rates, but many other items of consumption are out of reach for ordinary Syrian families. Since the main food subsidies have been for sugar and cereal products, the average diet is based on huge amounts of carbohydrates: adequate food sources of vitamin, minerals and protein may be difficult to afford in a sufficient amount for many low-income families. Household appliances, many of which are on the banned import list, are quite expensive. The extent of income insufficiency is probably growing, as the real level of average private consumption tends to decrease year after year, as mentioned before, while upscale conspicuous consumption is apparently not.

Indicators of basic well-being show a somewhat more encouraging picture. Infant mortality has been brought down from 135 per thousand live births in 1960, to 28 in 1996. Apparent food consumption stands at about 3100 calories/day per capita, in line with most developed countries (though this may involve some overstatement, as explained later, and food consumption is heavily concentrated on bread and sugar at the expense of animal protein sources, fruit and vegetables). More than 90% of school-age children are attending school, and the gender gap in this respect has narrowed: girls' enrolment rates are about 91% of the rates attained by boys. Only 14% of the population have no access to safe water (though as much as 33% have no proper sanitation). Available (but very rough) estimates of poverty incidence suggest that it afflicts about **one third** of the population. No direct measurement of poverty has been taken yet.[5]

The benefits of economic growth have not been distributed evenly. A large proportion of the increases in output have gone to maintain and increase basic food consumption, especially calorie intake, and also to investments in basic infrastructure, and to cover the requirements of national defence. As a result, non-food civilian consumption and also productive fixed investment tend to be stagnant or declining, and personal income devoted to non-food needs is insufficient and also stagnant or in decline. The actual standard of living of the Syrian people, including its peasant sector as well as the urban workers and middle class (public employees, petty commerce, etc), has not kept pace with per capita GDP, and many people do overwork to make ends meet, or live on very limited means. For many sectors of the population, especially the urban lower and lower-middle classes, the standard of living is perceived as having declined in a perceptible measure. All these distributive issues call for action to accelerate growth and to promote a better distribution of income and wealth.

Macroeconomic situation. There has been a rather careful macroeconomic management in recent years, resulting in a very low rate of inflation, in line with international levels (a deflation indeed in 1998-1999), and a remarkable monetary stability: the rate of exchange of the Syrian Pound in the parallel market (both the informal domestic market and in neighbouring countries) has stayed nearly flat (between 46 and 50 SP to the dollar) for ten years, and reserves at the Central Bank are steadily rising. The multiple rates of exchange that operated until the early 1990s have been gradually eliminated,

[5] Besides the possibility of carrying out a special survey to assess the poverty situation, raw data from the Multiple Purpose Survey and the 1994 Census might be re-processed for a preliminary direct measurement and analysis of poverty and living conditions. That kind of analysis has not yet been carried out up to the time of writing. Some external technical assistance might be needed for this purpose.

and the weighted average rate of exchange has gradually converged towards market rates (from about 20 SP to the dollar in the early 1990s to 48.83 SP/USD in 1999), thus achieving in fact a gradual unification of exchange rates and a great reduction of the official/parallel spread of the rates of exchange.[6] The long-standing official rate of 11.25 SP to the dollar still survives as an accounting unit for some purposes. For instance the official figures for foreign trade are still published in SP converted from foreign currencies at the 11.20/11.25 rates for exports and imports, in spite of actual trade being conducted at market rates.

The remarkable stability of the macroeconomic situation is undoubtedly a result of tight monetary policies and careful management, but it is also an effect of the many policies that control and repress demand, such as the ban imposed on many imports, restrictions on foreign exchange, price controls, and subsidies applied to some items through State-owned monopolies for marketing and processing. **A sudden removal of these policies would undoubtedly destabilise the economy**, unless much care is put into **combining, sequencing and organising** the removal of restrictions.

Foreign indebtedness. The country has a significant foreign debt**.** Officially recognised debts (medium-term and long-term) amount to about $5.6 billion or 33% of GDP, as of the end of 1999. Besides, there is a debt originally with the Soviet Union, denominated in rubles, whose equivalent in US dollars is still being negotiated (Russian Federation estimates point to an amount of about $6 billion, another third of GDP). The indebtedness situation is not regarded as a very pressing factor presently though regularising arrears and resuming debt service would be a key factor to facilitate access of Syria to international finance markets.. Debt service takes only about 10-15% of export revenues, and the country has resumed paying arrears on its debt to the World Bank.

Foreign trade. According to National Accounts there was in 1999 a negative but not very large deficit in foreign trade of physical commodities**,** resulting from imports of $3823 million, and exports of $3471 million, for a balance of -$351.7 million. This deficit has been lately declining in absolute value since 1993, when it was about -$2 billion. It should be noted that **broad foreign trade** (comprising physical commodities plus non-financial services) has had a **positive balance** of $236.7 million in 1999, after a long string of deficit years.[7]

Oil exports represent much of total merchandise exports. In 1999, oil exports were officially reported as worth 24,473 million SP or about $2,185 million, i.e. 63% of all exports. In 1998, exports of oil were 15,472 million SP, which was 48% of all exports and worth $1,381 million (the significant difference between the two years is due to the low prices for oil prevailing in 1998).

Second only to oil as a single product in the export schedule is **cotton.** Exports of **cotton fibre** in 1999 were counted as 1,786 million SP, equivalent to $159 million or 6.2% of total exports. To this it should be added a revenue of 115.9 million SP ($10

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[6] However, the difference between the 46.50 SP paid officially for exports and the about 50 SP needed in the free market to purchase dollars for importing inputs or sending profit remittances abroad is still hurting the profitability of many private companies. The same effect is caused by the obligation to exchange 25% of export revenues at the official rate (this obligation may be lifted by the Investment Council for projects licensed under the Investment Promotion Law of 1991).

[7] See Central Bureau of Statistics, **Statistical Abstract 2000**, p.559. Previous years up to 1998 have negative balances at current prices, but the figures at constant 1995 prices show surpluses also for 1997 and 1998 (see statistical tables in the Annex).

million) from **textile** exports (yarn mostly). As these figures show, most of the cotton is exported as ginned fibre, and ginning is for the most part the only value added in Syria to this farm product.

Oil products and cotton fibre exports are done by the public sector, and in 1999 they accounted for about 70% of all exports. Other items exported by the State amount to 5% of total export revenue. The private sector accounts for about a quarter of exports, of which about 3/4 are final consumption items, and the rest (rather surprisingly) mostly capital goods. Little if any intermediate products are exported by the private sector. Above one half of private exports are food and beverages, which are 4/5 primary agricultural products and 1/5 processed foodstuffs and beverages. An additional 28-30% of private exports are textiles, apparel and leather products. Fruit and vegetables (raw or processed) are the main components of private agricultural exports.

The trade balance in the long run. In the late 1970s a significant trade deficit developed, peaking at about -$3 billion in 1980 (after a period of rapid GDP growth).[8] The problem subsisted until the mid-1980s, creating **a trade deficit of about a third of GDP** and ultimately a fiscal and financial crisis in 1986. A number of measures were adopted during the 1980s to counter this alarming imbalance, including a move to increase oil production (which has subsequently remained nearly constant for years). The trade deficit diminished steadily during the late 1980s (while GDP growth decelerated) and turned into a trade surplus in 1989-91 as per capita GDP touched the trough of its decade-long decline. Subsequently, as growth resumed, the trade balance slipped again into deficit territory, peaking at about -$2 billion SP in 1993, but improved ever since, reaching near equilibrium in 1999 when the balance of commodity trade was just -$0.35 billion, as mentioned before. This result was obtained at the price of slowing growth, and in spite of the severe drought, by using existing stocks of wheat to cover domestic demand instead of recurring to imports. Rising oil prices also helped, and there was also a lower domestic demand for imports due to recession.

There is a **close inverse correlation between growth rates and the trade balance**. When per capita GDP is declining or stagnant, the foreign trade balance tends to improve. When the economy is growing in per capita terms, trade deficits increase. So, the deficit grew during the 1970s, when the economy was growing fast, and was gradually reduced during the 1980s (economic decline) and the 1990s (moderate growth). There was still a deficit in the early 1990s (faster growth) but it turned into surplus in the late 1990s (slower growth and finally recession). The pattern of economic growth in Syria, then, is **cyclical**, marked by periods of growth that stop when the resulting trade deficit grows too large, and periods of decline or stagnation while the foreign trade balance improves. This pattern, furthermore, seems to have put a **ceiling on the overall growth**

[8] Data on foreign trade, reported here in US dollars, are based on figures in Syrian Pounds reported by the Central Bureau of Statistics in the **Statistical Abstract 2000**, specially chapter 9, pp.297-345, and equivalent issues for previous years. In these publications, trade is reported in Syrian Pounds using the old official exchange rates of 11.20 SP/dollar for exports and 11.25 for imports, still in use for this purpose, though actually most foreign trade payments and receipts are converted at rates between 46 SP (official) and about 50 SP (free market) per dollar. The official export-import trade statistics in Syrian Pounds, therefore, do not reflect the real opportunity cost of foreign trade in terms of domestic resources. For analytical purposes it is better to use the dollar figures, obtained by converting the Syrian Pound figures into dollars at the reported rates of 11.20 and 11.25. Other official statistics in Syrian Pounds like the balance of payments use other rates of exchange, and thus are not comparable with foreign trade figures..

performance of the country, which has not gone further, as yet, than the amount of per capita national product achieved by 1980.

However, growth in exports during the 1990s somewhat improved the situation. The high level of GDP/capita in 1980 was achieved with a large trade deficit, and was therefore intrinsically non sustainable, while the same level has been reached in the late 1990s with a much lower trade gap, mainly due to increased oil export revenues and lower food imports. This significant difference points to the rigorous conduct of fiscal and monetary policy in Syria during the 1990s, in contrast with more profligate spending in the late 1970s and early 1980s. Improvements in the trade balance during the growth of the 1990s are also due to exports of wheat surpluses (that unfortunately cannot be expected to persist indefinitely in the future).[9] The improvements in trade balances are additionally due to a healthy increase in private exports and import substitution due in large part to the expansion of private investment during the 1990s, and **this** factor is likely to continue increasing, **if the right policies are applied** for encouraging private economic activity.

The **current account balance of payments** has been positive in the late 1990s. The broad balance of trade, including not only physical commodities but also real services, is near equilibrium (and slightly positive in 1999), net factor payments are negative, and there is an important inflow of transfer payments (composed of State sector transfers, which are probably foreign aid, and remittances from Syrian workers abroad). According to the Central Bank of Syria, in 1999 the current account showed a surplus of 9,814m SP or $201 million, and the capital account showed a net inflow of capital of 2,833 m SP or $58 million (including declared capital movements plus "errors and omissions").[10] This translated into an **increase of reserves** of 12,647m SP or $259 million, continuing a positive trend in the stocks of foreign assets in the banking system. From 1994 to 1999 the net foreign currency position of the banking system (comprising the Central Bank and the Commercial Bank of Syria) increased by a yearly $466 million. **The build-up of reserves in the 1990s is a very important factor to ensure the solvency of the public sector and the stability of the exchange rate.**

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[9] The area under wheat cannot be expanded at the recent rate because rain-fed areas are already occupied (and, overall, in the decline), and irrigated areas are over-using water resources. Even allowing for improvements in irrigation efficiency the gains in irrigated area would probably be limited, hardly above 20% for all the country, and even more limited for low-value crops such as wheat (most of the gains would probably be used for more valuable products, especially for export, such as fruit). A significant increase in yields is also unlikely on a countrywide basis: current yields in irrigated wheat are about 4 MT/Ha, whereas experimental farm yields are between 5 and 6 MT/Ha, a difference of 25 to 50 percent that gives little hope of a significant increase in the countrywide yield of irrigated wheat. If water use would allow a 20% increase in the irrigated area planted with wheat, and irrigated wheat yields increase by a further 25% on a national basis, this would translate into a 50% increase in irrigated wheat output, or 31% in total wheat production. Distributed over ten years, this implies a rate of growth of wheat output of 2.73% per year, equivalent to the expected rate of population increase. Those improvements in watewr use efficiency and irrigated wheat yields are thus required just to accompany population growth, and could hardly be repeated for a second time in the subsequent decade. Therefore wheat surpluses are not likely to persist in the medium and long term, and may well turn again into a deficit in the coming years. See later sections on agricultural production and prospects.

[10] The figures in Syrian Pounds for the balance of payments are not comparable with those of foreign trade because of different accounting rates of foreign exchange. According to the **Statistical Abstract**, Balance of Payment statistics use the **weighted average rate of exchange** that in 1999 was 48.83 SP per dollar.

Errors and omissions in the balance of payments were in 1999 about the same absolute size than the current account surplus, but with a negative sign: -9521 million SP or -$195 million. They represent in all probability an **unaccounted-for net capital outflow**. In this particular year 1999, however, the registered net flow of capital was positive and, even taking errors and omissions into account, the banking system foreign reserves increased with the positive current account balance. In other years the reverse was true, but in the late 1990s reserves have been generally growing.

Beyond the official figures of the balance of payments, which are imperfect by all accounts, it seems that there has been over the years a **steady outflow of private capital abroad**. Private savings that are not invested in physical assets in Syria tend to be transferred abroad for investment or safekeeping in other countries, reflecting chiefly the lack of investment opportunities in Syria and the shortcomings of both the local banking system and the local business environment. There are few hard data of the amount of capital involved in this process of capital emigration, but the few indications that exist point to more than U$S 20 billion transferred by Syrians into other countries, including mainly Lebanon, the Gulf and European countries, and kept there (with the accruing proceeds) in the form of financial or physical assets. The annual drain is believed to be in the range of U$S 500 million to U$S 1 billion (about 3-6% of official GDP), but these figures cannot be confirmed, and according to some accounts they might be even larger. The issue is important in the context of this study because a significant part of the foreign funds invested under the Investment Promotion Law of 1991 are assets owned by Syrian nationals and held abroad. Repatriation of Syrian capital has been one of the goals of the Investment Promotion Law.

2.1.2. A centrally planned economy

The Syrian economy has been governed for more than three decades by a comprehensive system of centralised planning. A number of sectors (including four categories of agricultural products and their processing and distribution chains: cereals, cotton, tobacco and sugar beets) are considered "strategic". The processing and primary distribution of strategic crops are under State monopoly and/or strict production and price regulations. Until recent moves towards liberalisation, even non-strategic products had their prices fixed by the State, and any modification by private companies should be previously authorised. There has been a very rigorous control of foreign exchange (to the point of making it a crime for Syrians to be in possession of foreign currency), as well as a whole set of multiple exchange rates. The banking system has been completely state-owned for many years. There is still a long list of prohibited imports, and even non-prohibited imports must be previously authorised. Stiff tariffs for imports and also export excise taxes are also a part of the macro institutional arrangement. Huge subsidies for strategic crops and food products have contributed to ensure access to basic food for the entire population.

This made of Syria a centrally planned, nearly closed economy. National security considerations dictated the priority of food self-sufficiency, and also the need of a substantial amount of military expenditure. The domestic price system became quite distorted as compared with international prices, and also there have been gross misalignments between cost and price for different products (with the Government paying for the difference), for instance between the cost of production of wheat and flour, and the retail price of bread.

A chronic shortage of foreign currency has made the Government aware of the necessity of promoting exports to improve the competitiveness of the country's products in foreign markets, especially as the development of industries for the domestic market causes a sustained increase in the demand for imported machinery and materials. This necessity alone pushes for a modernisation of the economy and a greater openness to foreign capital. Also, the rapid growth of population and long years of absolute or relative stagnation pose enormous growth demands on an economy whose per capita product has shown zero effective growth for the last twenty years. The various crisis faced by the country, especially those of 1980-81 and 1986, have prompted the start of a process of economic liberalisation that after a period of tentative steps took a more solid hold in the 1990s.

2.1.3. The process of economic liberalisation

The enormous external gaps of the early 1980s, the wearing-off of the benefits derived from the oil-price increases of the 1970s, and later the momentous changes in the international scene (chiefly the demise of the Soviet Union and the increasing international liberalisation of capital flows), among other factors, prompted the Government to move towards giving a larger role to market forces in the operation of the Syrian economy. This process has proceeded along two parallel tracks: promotion of private investments and a gradual loosening of economic controls.

Direct investment promotion. Legislation to promote investment is one of the key ingredients of the process. Decree 10 of 1981 promoted joint-ventures between private capital and the State. In 1986 a new Decree No. 10 promoted **agricultural** joint ventures. Private investment under this legislation of the 1980s progressed very little, as there was little interest in joint-venture companies. The process took on more strength when a new investment law was enacted at the beginning of the 1990s (Law 10/91), and has started to accelerate lately (1999-2001) with Decree 7 of 2000 (improving the regime established by Law 10/91), and with a number of measures and decisions adopted shortly before and especially after President Bashar Assad replaced the late President Hafez Al-Assad in July 2000.

Reforms in the macro environment. The policy of promoting investment through the granting of special privileges, expressed in the Decrees of 1981 and 1986 and the Laws 10/91 and 7/99, was initially based on the idea of **keeping the overall setting of the centrally-planned, State-controlled economy in place, with minor adjustments**. This greatly reduced the attractiveness of the incentives granted by the investment promotion legislation, since the overall economic system was not a very friendly environment for private investment.

During the 1990s, this started to change. Several moves by the government pointed to correcting some of the distortions caused by the rigid planning scheme, such as a gradual reduction in some subsidies, a gradual convergence of some prices towards international levels, a gradual trend towards unification of exchange rates. Recently this process has been proceeding faster. A number of Government decisions and new (adopted or announced) legislative measures have started to change the overall setting of the economic system, and thus the conditions under which private companies operate. This includes allowing for **private banks** (which may be up to 49% in foreign hands), an announced (but yet not enacted) reform of monetary policy including the **convertibility of the currency**, steps towards **liberalising the foreign exchange market**, a new **export promotion strategy**, a *de facto* **deregulation of many prices**, and more. All these re-

cent or expected reforms point towards more liberalisation of the economy, a greater reliance on market forces, and an economy more open to international trade and finance flows (Decree 7/2000 of 1999, reforming the Investment Law of 1991, is a case in point). The wide array of multiple exchange rates has been made gradually to converge towards market rates, domestic prices has been gradually adjusted for several key products to align them with international levels, compulsory official prices have been turned into merely indicative for many products, the price of non-strategic products is in practice left to market forces, and so on.

All this is relevant from the point of view of the present study, since creating an adequate environment for investment in agricultural production, processing and marketing requires not only a legal regime for private companies, but also certain wider economic and institutional reforms, both at macro level and at the level of the sectors concerned. Investment promotion cannot be considered in isolation from the overall process of reform. This suggests that this study, as foreseen in the Terms of Reference, should deal not only with the specific regulations and legislative framework for private investment, such as Law No.10, but also with other macroeconomic and sectoral policies. The reform process itself is underway, and measures were being announced or enacted even while this report was being prepared. It may be premature to give an assessment of the macro scenario before the current wave of reforms is completed. However, it is expected than many of these initiatives are given legal status and start to be implemented during or immediately after the development of the present study.

2.2. The agricultural sector

2.2.1. Natural resources

Syria has about 6 million Ha of cultivable land plus 8.3m Ha of natural pasture and steppe land. About 5.5m Ha are actually cultivated while the other 0.5m Ha (8% of arable land) remain uncultivated. In turn, about 13% of cultivated land is estimated to be in fallow in any given year. Thus, the amount of land actually tilled is about 4.8 million Ha per year, involving some lands that are cropped twice a year. As of 1997, some 1.2m Ha (and about 1.27m Ha in 2000) were under irrigation, while the remaining 3.6 million Ha were rain-fed. Most of the crops are annual. Only 11% of irrigated crops and 17% of rain-fed crops are trees or other permanent crops.

The country has been divided in five Agricultural Settlement Zones (ASZ), chiefly according to the amount of rainfall. They generally show a pattern of decreasing rainfall from West and Northwest towards the South and Southeast. Zones I to IV are strips of territory located along an approximately right angle following the Western and Northern borders. The following table shows the main features of the five ASZ.

Land area in Syria by Agriculture Settlement Zones

ASZ	Rainfall (mm)	Land Area (000 Ha)	% area	Approximate location
I	> 350	2,071	15%	Coastal areas, some areas in SW, and very narrow strip along the border with Turkey
II	250-350[a]	2,473	13%	Narrow right-angle strip East and South of ASZ I
III	About 250[b]	1,306	7%	Narrow right-angle strip East and South of ASZ II
IV	200-250[c]	1,833	10%	Narrow right-angle strip East and South of ASZ III
V	<200	10,208	55%	Large landmass East and South of ASZ IV
Total		17,891	100%	

a. This range of rainfall is attained in two out of every three seasons on average.
b. Officially defined as "above 250 mm in more than half of the seasons".
c. Officially defined as "between 200 and 250 in more than half of the seasons".
The sum of the zones does not add up exactly due to rounding. The total, in turn, does not add up to the entire national territory due to the exclusion of areas not suitable for agricultural settlement, such as bodies of water.
Source: MAAR and CBS

The use of surface water and underground aquifers for irrigation seems to have reached some limitations recently. Prolonged irrigation by flooding has salinised soils in several areas, and all the major basins are presently over-exploited (extraction is above replacement levels), causing lowering of aquifers and water tables, some springs going dry, many wells yielding less water, and new wells having to be dug deeper. All this has prompted the adoption by agricultural planners and policy-makers of measures oriented towards saving and rationing water, completing a thorough basin-by-basin water balance survey, and implementing more efficient irrigation systems across the country in the next four or five years. Carrying out all these policies, and especially the latter, is a difficult task, and some policy issues related to private investment in this regard are raised in the Third Part of this report.

2.2.2. Resource utilisation

An extensive programme of land reclamation has been underway, proceeding chiefly through de-rocking. Much of the uncultivated fertile land in Syria requires heavy de-rocking, and this is often beyond the means of ordinary peasants. The public sector undertakes much of the heavy (mechanised) work, and there have been several internationally-funded projects to this purpose (with contributions mainly from IFAD). Also, tree-planting has been encouraged and supported by the government, enlarging planted forests and fruit trees, often over new lands. Private land is de-rocked by Government-owned machinery or supported by the State against loans to be paid back by the farmers after the fruit trees subsequently planted reach the age of commercial production. The government doesn't plant fruit trees; it only produces the seedlings and delivers them to farmers at symbolic prices for planting, and only forest trees are planted by the government because the forests are state properties. Reclamation affects only unused land of acceptable agricultural quality: cultivation of the Al Badia has been banned and left for natural grazing. However, in the meanwhile other crop lands have been abandoned because of soil degradation.[11] The net result is that the overall amount of land being

[11] This was imposed by the planning system due to environmental considerations. Up to 1994 crops used to be planted in all agroclimatic zones albeit with different intensive rates which were usually low in the 3rd, 4th and 5th zones. After 1995, cultivation was banned in these lands, which caused a reduction in the planted area. This also meant a reduction in registered fallow lands because land that is now not plantable is not subject to the fallow rate any more.

cropped has not changed much in the last 20 years, in spite of extensive land reclamation. Cultivable land was 6.06m Ha in 1979 and 5.99m Ha in 1997, and effectively cultivated land went actually down, from 5.6m Ha to 5.5m Ha, over the same period, with little oscillations over the years except a reported (and temporary) large increase in cultivation in 1989-90, at the expense of fallow land. Rain-fed crops have expanded from 3.35 to 3.63 million Ha (showing probably the net effect of de-rocking and land reclamation), and the amount of fertile non cropped land has remained nearly constant at about half a million Ha over the entire 1980-97 period (Central Bureau of Statistics, Statistical Abstracts 1996 and 1998).

Demographic growth and the goal of food self-sufficiency have caused a growing intensification of natural resource use. This is visible in the trend towards a decreasing share of fallow land, which fell from 1.7m Ha in 1980 to only 0.7m Ha in 1997. It is also evident from the rapid increase in the demand for water: irrigated land grew from 0.5 m Ha in 1980 to 1.2 m Ha in 1997 (most of the growth occurring in the 1990s). Annual water demand from agriculture nearly doubled from 1975-80 to the 1990s.

About 20% of cultivated land (all of it irrigated) is cropped twice, including an intensive crop after a winter crop, while rain-fed land is only for winter crops. Thus the overall average cultivation intensity on **cultivated** land is about 120%, or about 117% of **arable** land when fallow land is included.

2.2.3. Farms

According to the 1994 Agricultural Census, about 610,000 agricultural holdings existed in Syria. Only half a million had been registered in the 1970 and 1981 Censuses, thus marking an increase in the number of farm units, consistent with the increase in population and the expansion of irrigation and land reclamation. The average size of holdings in 1994 was about 8 Ha of cultivable land (down from 11 Ha in 1970), of which 1.9 Ha irrigated, though these figures varied between regions according to the quantity and quality of land available, the extent of irrigation, and other factors. These figures do not include families devoted to livestock raising in the Badia region of nearly desert steppes. Range lands, chiefly located in the Badia (Agricultural Settlement Zone 5 especially) are under public (State) property and treated as free-access commons, and thus not counted as agricultural holdings. Livestock is privately held and fed on the commons. Private agricultural holdings in that region are very small and very few, concentrated in oases.

Land Reform achieved a vast process of land distribution in the 1960s and 1970s, thus enlarging the middle range of farms (above 10 Ha and below 100 Ha). However, the distribution of farmland by size of farms is still quite unequal. The average size of holdings is under 10 Ha, except in Al-Hassakeh (25.51 Ha) and Raqqa (29.95). Aleppo has a mean size of 10.91 Ha, and the rest have less. These numbers are inclusive of all types of farm land and thus do not take the wide range of variation in land quality and water availability into account. Irrigated areas are usually quite small (normally around 1-2 Ha per holding) though some larger irrigated units exist.

Distribution of agricultural holdings and farm area by size, 1994		
Size class	**% of farms**	**% of farm area**
Less than 10 Ha	75.4%	23.5%
10-100 Ha	23.8%	58.7%
More than 100 Ha	0.8%	17.8%
Total	100.0%	100.0%
Source: Agricultural Census. Taken from FAO, Country profile: The State of Food and Agriculture in Syria, Project GCP/SYR/006/ITA, 1999.		

2.2.4. Farmers organisations

The main organisations of farmers in Syria are the Agricultural Co-operatives, which in fact are semi-public organisations which have an essential role in the preparation and implementation of the national production plan. Agricultural co-operatives are organised in Farmers Unions at the district and governorate levels, up to the Federation o Farmers Unions at the national level. So in effect the Unions are groups of co-operatives, that are in turn a group of farmers associated on a geographical basis. There are about 5,000 Agricultural Co-operatives with 842,000 member farmers farming about 2.4 million hectares of cultivable land, and thus covering about 60% of all farm land in Syria and a similar percent of all farm holdings. These co-operatives are farmer associations related to the planning process, and thus they are neither Soviet-style collective farming enterprises nor marketing enterprises (like the agricultural co-operatives found in Western countries).[12]

Apart from the co-operatives and unions, another important associative institutions are the Agricultural Chambers. An individual farmer may be a member of both a Co-operative (and its related Union) and a Chamber, though that is a rather exceptional occurrence. In practice, both kinds of organisation operate separately with different farmers. There are 14 Agricultural Chambers (one per governorate) and a national Federation of Agricultural Chambers. They have about 300,000 participant farmers. Chambers concentrate their activities in support services, such as milling olives, providing product certifications, storage, refrigerating units. Chambers also take care of organising the participation of their members in foreign or international exhibitions (mainly in France, Italy and Germany), as well as activities in the field of human capital development (training courses, seminars, scientific and technical events, scholarships, etc.). The Federation of Agricultural Chambers is also involved in a project to create an agency for promoting fruit and vegetables exports and marketing abroad, and has also commissioned a feasibility study for a large fruit and vegetables processing and marketing enterprise, still only in blueprints.

The active role of agricultural co-operatives and unions in the implementation of the central planning process has given them a character of **para-statal** institutions. Nominally a social sector formed by associated farmers, they in fact behave as appendages of the State apparatus, or so are they perceived by farmers and other economic actors. To a lesser extent, even the Agricultural Chambers are seen in the same light. In fact, no autonomous farmers' organisations apart from these actually exist in Syria.

[12] A government-sponsored project started in 1998 to create 24 new co-operatives dedicated only to marketing agricultural products. There were to be one for crops and one for livestock products in each governorate except Damascus. Few of these new organisations have been effectively implemented, and few farmers have joined them yet. The first batch of these new co-operatives includes one formed by 45 apple producers in Sweida, and some reportedly being formed by orange growers in Tartous and Lattakia.

2.2.5. Crop structure

The following tables show the area and production for the main crops in a recent year (before the latest and very severe drought). As these tables show, most of the land devoted to annual crops is planted with wheat and barley. As a single crop, cotton is a distant third. In fruit trees the most extended are olives, but apples, pistachio and citrus are also very important in area and production. Among citrus, 90% of the area is devoted to oranges and mandarines in similar amounts; lemons are less extended. The high percentage of fruit trees not yet producing (i.e. in the process of growth before entering production) is indicative of the rapid increase in fruit plantations in recent years.

Area planted and production of main annual crops, 1998(*)

Crops	Area (000 Ha)	Output (000 MT)
Wheat	1,721.4	4,111.6
Barley (grain)	1,542.6	868.8
Barley (grazing)	41.5	372.7
Maize	72.6	285.0
Lentils	142.6	154.1
Chickpeas	108.0	84.6
Sugar beets	28.7	1,202.2
Vegetables	283.2	-
Cotton	274.6	1,017.8

(*) Area cropped twice a year is counted twice, which occurs mainly with vegetables. Total tonnage for vegetables would be meaningless and is not shown, because it involves many heterogeneous products.
Source: FAO Project GCP/SYR/006/ITA, **Country profile: The state of Food and Agriculture in Syria,** Damascus, 1999, based on the MAAR Annual Agricultural Statistical Abstract.

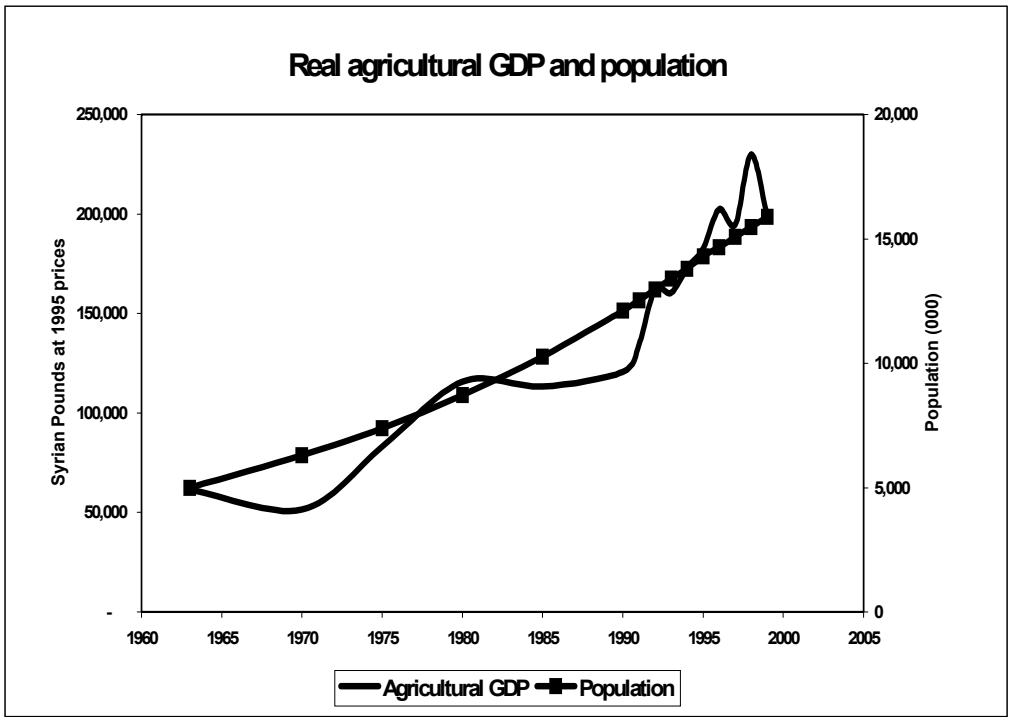
Fruit trees: Area planted, number of trees and production, 1998

	Area planted (000 Ha)	Total trees (000)	Trees in production (000)	Production (000 MT)
Olives	459.7	62,300	36,700	785.0
Apples	48.5	16,150	9,700	362.0
Pistachio	59.4	10,096	4,026	35.7
Citrus	25.9	9.252	6.860	693.5
Apricots	12.4	3,187	2,443	67.2
Cherries	19.3	5,523	3,027	56.0

Source: FAO Project GCP/SYR/006/ITA, **Country profile: The state of Food and Agriculture in Syria**, Damascus, 1999, based on MAAR, Annual Agricultural Statistical Abstract..

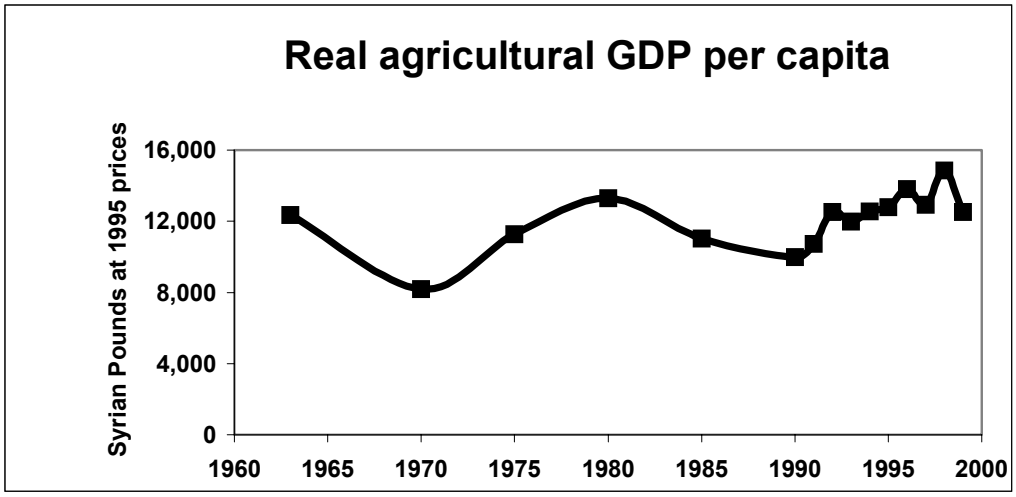
2.2.6. Production and growth

The sustained efforts of the Syrian people and government to increase agricultural production, and especially of staple food products, have paid off by having the sector growing roughly accompanying the growth in population over the long term.



Population growth has been very fast in Syria (3.27% per year on average over the 1963-1999 period), almost equal to the net growth of agricultural GDP in the same period (3.31%). As a result, the **long term trend of agricultural GDP has accompanied population growth**, though with **marked cyclical oscillations**. It declined during the 1960s and 1980s, and increased during the 1970s and 1990s, although the positive tendency of the last decade has been punctuated by short-term setbacks caused by climatic factors like the drought of 1999. The sustainability of the recent growth performance is a question to be addressed. Much of the growth in agricultural output during the 1990s depended on expansions in irrigated area at the beginning of the decade, that could hardly be repeated in the coming years.

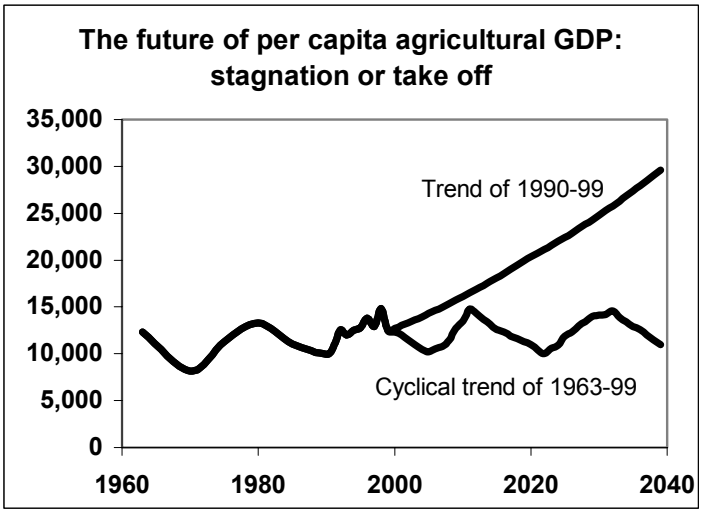
Also, it is necessary to ask whether the growth in agricultural production in 1963-1999 has been sufficient. In fact, the observed growth in agricultural GDP (abstracting from short term fluctuations) was substantial as seen before, but **not enough to outpace the rapid population growth** that in the 1990s was 3.06% on average. As a result, **per capita agricultural product has increased very little over the long term,** and the increase of the 1990s has not gone much beyond the per capita levels of 1963 or 1980. Since growth in GDP almost equals growth in population, **per capita product is not growing significantly in the long term, but oscillates around a nearly stable trend.**



After the long decline of the 1980s, the growth in per capita agricultural GDP during the 1990s has been encouraging. The linear trend of the decade indicates a rate of growth per capita of 2.4% per year, and more than 5% in total agricultural GDP. In two good years (1996 and 1998) per capita agricultural GDP has actually been slightly above the level of 1980. But the performance of the 1990s has not been enough to overcome the long-term stagnation: the average level of per capita agricultural product in 1996-99 is about the same prevailing in 1980 or 1963. The agricultural sector seems to be running very fast just to stay in the same place. Whether the future will be a new oscillation or sustained growth taking off in per capita terms also, will depend on policies adopted now and in the coming years.

There is in fact doubt about the possibility of maintaining or rising the level of per capita growth in the immediate future unless some more fundamental changes occur in the agricultural sector and the macroeconomic system. The main constraint for that is **water**, that limits agricultural growth, but also the **general economic scenario**. The priority for the agricultural sector, as for the economy as a whole, is to achieve **sustained growth** (with smoother oscillations), and to have also **a rate of growth well above population increase**, to allow for a steady increase in agricultural production per capita, both for domestic consumption and for export.

To maintain the record of the 1990s (2.4% growth trend per capita, or about 5% growth trend on average) would imply a further expansion of output from irrigated agriculture, but water utilisation is already dangerously above the recommended levels. **Irrigating more hectares with less water, and increasing the yields and the economic returns of irrigated crops, are imperative challenges for the 21st Century.**



Private investment and modern technology would be key factors to ensure that the agricultural sector could grow in a sustained manner during the coming years and decades. This would imply, among other things, investments in the modernisation of agricultural production, modernisation of irrigation systems in order to economise water, crop improvements aiming at better yields, widespread introduction and development of new profitable crop and livestock activities, especially for export, and provision of more extensive and better post-harvest facilities with good integration into agro-industrial production and marketing chains.

2.2.7. Agricultural products

The staple foodstuff in Syria is **wheat**. About 1.7m Ha are planted with that crop (of which 0.69m are irrigated). Production has oscillated around 4m MT in the late 1990s, though a fall has occurred in 1999-2000 due to drought. Total area devoted to wheat in 1980 was 1.45m Ha, that later decreased to about 1.2m in the late 1980s, to grow again to 1.7m (thus surpassing the 1980 level) Ha in the late 1990s, mostly due to expansion in irrigated wheat areas. Rain-fed wheat areas have been around one million Ha since 1980, with variations in area (as well as yields) mostly due to varying climatic conditions, oscillating between a high of 1.27m Ha in 1980 and 1.12m Ha in 1983 to low years of 0.87m Ha in 1986 and 1988. Latest figures for rain-fed wheat are slightly over 1m Ha, the reduction caused mostly by a ban of cultivation in low-productivity land that has been in force since 1995. Most of the wheat area is concentrated in a few Governorates: out of the million Ha of rain-fed wheat, two thirds are in Aleppo and Al-Hassakeh. Of the 0.69m Ha of irrigated wheat, more than one half is in Al-Hassakeh, and a further 25% in Aleppo and Al-Raqqa. The average yield of wheat is 3.6 MT/Ha under irrigation and 1.6 MT/Ha rain-fed, for a mean yield of about 2.4 MT/Ha for all wheat in Syria. Irrigated wheat production in 1998 was 2.5m MT while rain-fed wheat output was 1.6m MT.

Wheat production per capita is quite high (about 250 kg per capita), and apparent human consumption is estimated at about 215-220 kg/year per capita in recent years.[13]

[13] FAO, FAOSTAT System, Food Balance Sheets, based on national statistical information.

This is a very high figure, even for a country with the high level of bread consumption that is typical in Syria, and it possibly may involve an overestimation of effective human consumption.[14]

Wheat being the most strategic of strategic crops, it is heavily controlled by centralised planning. Farming is private, but all production is bought by a Government-owned enterprise, the General Organisation for Cereals Trade and Processing (GOCTP). This company in turn adds the new wheat to the national stock, and sells wheat for current consumption to the General Company for Mills (GCM). This organisation hires State-owned or private milling companies to produce flour and other by-products, and finally sells the flour to (State-owned or private) bakeries to produce bread, and to other establishments producing other wheat products like pasta or biscuits. Most of the flour is standard Syrian (40% hard wheat, 60% soft wheat). The State manages a huge strategic stock and has the monopoly for any wheat imports or exports. The GOCTP imports or exports wheat as necessary according to current production and stock management. The production of wheat at farms receives credit in money and in kind (in the form of fertiliser and other inputs) that is repaid when the harvest is bought. A complete and well-informed account of the problems related to wheat in Syria can be found in the report on strategic crops prepared by Mike Westlake, consultant to Project GCP/SYR/006/ITA.

Barley occupies a large amount of land (1.5m Ha, almost as much as wheat). This crop is mostly destined to animal feed (though there is also some human consumption in the form of beer). Almost all the barley area is rain-fed (only 3,900 Ha of irrigated land are with barley, chiefly in Hama and Al-Raqqa)). The geographical distribution of barley is similar to wheat: Aleppo, Al-Hassakeh and Al-Raqqa contain 1.18m Ha of barley, or nearly 80% of the national area for this crop. Most of the rest (about 15% of the total area) is in Homs and Hama.

Another key crop is **cotton**, grown exclusively under irrigation on about 275,000 Ha producing one million MT of cotton fibre. Main cotton producing areas are located in Al-Hassakeh (101,000 Ha), Al-Raqqa (48,000 Ha) and Aleppo (45,000 Ha), these three areas making about 70% of the total cotton area in the country. Yields, however, are higher in Ghab (4.5 MT/Ha) and Hama (4.1 MT/Ha) than in the areas mentioned before where they stand at about 3.6 MT/Ha. Syrian cotton is exported mainly to the European Union, where it enjoys zero tariff.

Other strategic crops are **sugar beets** and **tobacco**. Sugar beet processing covers about 25% of domestic demand for sugar. Besides supplying domestic demand, tobacco production contributes also to agricultural exports. Pricing, marketing and (partially) processing of these strategic crops (wheat, barley, cotton, sugar beets and tobacco) is in the hands of State-owned enterprises.

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[14] Actual household consumption may be somewhat lower than suggested by apparent consumption measured at the Food Balance Sheets. The Ministry of Agriculture found for 1994 in its study on the current nutrition situation that average consumption of bread was 378g per day, plus 33g of crushed wheat and 28g of other wheat products (mainly pasta and biscuits), for a total of 439g (416g in rural areas and 460g in urban areas). The approximate wheat equivalent of these products is about 478g, so that the implicit average consumption per capita was 174kg of wheat per year. This is only 80% of the Food Balance Sheet's apparent consumption figure, which probably underestimates other uses of wheat. The Household Expenditure Survey of 1998 is not yet available; the precedent one, carried out in 1985-86, shows results quite similar to the 1994 estimates, in fact with slightly **lower** physical consumption, and cereal products representing 5.34% of food expenditure and 2.6% of total household consumption expenditure.

Pulse production is another important crop sector, mainly consisting of **chickpeas** and **lentils**. They are not regarded as strategic, and so processing and marketing is in large measure in private hands. About 142,000 Ha are devoted to lentils and 108,000 to chickpeas (almost all rain-fed). Production is about 154,000 MT of lentils and 85,000 MT of chickpeas. Syria has also a significant production of olives, citrus, other fruit and vegetables. Among the latter, tomato is the most important. In the fruit sector the most relevant are citrus, apples and pistachio. The olive, fruit and vegetable sectors are among the most promising areas for private investment and possible expansion of exports within the agricultural sector.

Livestock production accounts for about a third of all agricultural production. About 13m sheep, 1.1m goats and about 7,000 camels are kept in Syria, raised mostly in range land at the Badia. Besides, there are about 0.8m head of cattle (including about 1200 buffalo). Each year about 120,000 MT of mutton, 32,000 MT of beef and some 5,000 MT of goat meat are consumed in Syria along with 0.5m MT of sheep milk, 0.75m MT of cow milk and 80,000 MT of goat milk. Extraction and consumption of fish is still quite low (9,000 MT per year). Poultry production is presently at about 100 MT per year and has been growing steadily.

2.2.8. Agricultural trade

In 1998, before the 1999 drought but during a spell of very low oil prices that depressed non-agricultural exports, Syrian exports totalled U$S 2.9bn, of which 25.5% (i.e. $740m) were primary or processed agricultural products not including textile products, and $283m in cotton fibre not manufactured into yarn, for a total of $1.02bn of exports of raw or processed agricultural products (some yarn and garments are also exported). In 1995, before the drop in oil prices and without climatic problems, total exports were $3.9bn and agricultural exports amounted to $820m or 21% of the total.

As mentioned before, cotton fibre is one of the main exports of the country, second only to oil, contributing about 6% of total exports and 28% of agricultural exports. Fruit and vegetables as a whole contribute nearly 8% of total exports and 37% of agricultural exports. In recent years (1995-98) some cereal surpluses have been exported, but the amounts vary widely over the years. In 1995 cereal products yielded an export revenue of $88.5m, i.e. 2.2% of total exports and 10% of farm exports. In 1999 there was a cereal deficit due to drought, but instead of resorting to imports the government ran down its stocks. Live sheep exports are of similar importance (about 10% of agricultural exports).

At the same time, in 1998 Syria imported $271m of primary agricultural products, $66m of processed food and beverages, and $107m of forestry-related products (mostly paper), for a total of $344m. In the same year, agricultural exports were, as said before, $1.02 billion. Thus in 1998 broadly defined agricultural trade yielded a positive balance of $679m (according to FAO definitions, FAOSTAT statistical system). This has not been usual in the past. By 1995 agricultural trade was roughly in balance, with only a slight deficit, and previously it has shown a regular deficit because of the shortfall of local production to cover domestic demand, and little development of farm exports besides cotton. The effort of Syria to achieve self-sufficiency through massive intervention and subsidies in the agricultural sector, and the impulse of private exports in the 1990s (mainly in the fruit and vegetables sector) have contributed to this reversion of the balance. In the past, after yielding a small positive balance in the 1960s, agricultural trade turned increasingly negative in the 1970s and up to the mid-1980s. After 1985 the

trend reversed and the negative balance has been diminishing since (though the drought in 1999-2000 may have temporarily affected that positive trend). There were positive balances only in 1996-98, reversed in 1999 as an effect of drought conditions.

However, the deficits and surpluses observed in the 1990s have been relatively small as compared with the overall Syrian flows of trade. Moreover, given the expected increase in domestic demand due to an increasing population, and constraints (mainly water availability) affecting future expansions of farm output, this situation may change for the worse unless emphasis is put on encouraging further growth in agricultural productivity and exports in the near future. In other words, the positive trend of the agricultural trade balance since 1986 to 1998 may not be sustainable in the future unless important changes are brought about in the efficiency of the agricultural and agribusiness sectors.

Issues about specific agricultural exports.[15]

Fruit and Vegetables. Syria enjoys a comparative advantage in fruit and vegetable exports such as citrus, apples, grapes, tomato, potato, olives and other fruit and vegetables. The following table shows the total value of Syrian exports of these commodities, and its main destinations.

Exports of fruit, vegetables and truffles (value in U$S million)				
Year	**Total exports**	**Gulf countries**	**Lebanon**	**Other countries**
1997	274	151	113	10
1998	291*	175	72**	44
1999	357	245	41	71
(*) Including $54m from truffles. (**) Including $39m from truffles.				

The main destination for the Syrian exports of fruit and vegetables is the Gulf area which accounts for 55% - 67% of the total. Data concerning Syrian exports to Lebanon, however, are unreliable due to inaccuracy and insufficient registration. The increase in fruit and vegetables exports to other countries indicates that new markets have been opened (for tomato, apples, potato, etc.) in European countries (Eastern and Western).

Conserved food. The industry has been recently introduced in Syria after the establishment of private firms. However, dried apricot sheets (*kamar eddin*) is a traditional food export that should be further promoted. In 1998, the total value of conserved food was around $ 33.5 million, reduced to $ 22 million in 1999 due to the reduction of *kamar eddin* export. The main export destinations of this group of products are Egypt, Jordan and Saudi Arabia.

Olive oil and other edible oils. The value of olive oil exports increased form $ 1.1 million in 1998 to $ 7.5 million in 1999. The value of cotton seed oil exports was $ 6.8 million in 1999. Cotton seed oil production started in the 1950s but has been increased lastely, especially by the private sector after the issuance of Law No.10. Soybean oil production, also recently started by private firms, relies mostly on imported soybeans, since local production of soybeans is exceedingly small and (up to now) less competitive.

[15] The considerations below have been largely based (unless otherwise stated) on the proposed **Export Strategy** prepared by the Ministry of Economy and Foreign Trade (Damascus, 2000).

Pulses. The value of exported pulses such as chickpeas, beans and lentils was $45 million in 1999, but the annual production is not stable due to climatic factors.

Sweets, Chocolate and Pasta Products. The increase in sweets, chocolate and pasta resulted mainly from the establishment of private firms under Law no. 10. However, the export value decreased from $13 million in 1997 to $10 million in 1998 and further to $7 million in 1999 as a result of the high custom tariffs on production inputs and the implicit export taxes imposed on the final product (income tax + agricultural production tax). Pasta industry can improve further, starting from the beginning of 2001, due to the fact that pasta producers have been allowed to import wheat and flour required for this industry at reasonable facilities.

Cumin, Aniseed and Coriander Seeds. Cumin, aniseed and coriander production fluctuates according to annual rainfall. The total value of this group of exports was $23.5 million in 1997, $20.7 million in 1998 and $30 million in 1999.

Wheat and barley. Wheat and barley exports (a State monopoly in the case of wheat) vary according to rainfall. Surpluses of wheat surplus, which is the main food staple in Syria, can only be exported in the following year.

Raw Tobacco Leaves. Syrian tobacco is distinguished for its unique flavour. Its marketing is restricted to the General Establishment for Tobacco. The total value of tobacco exports was $ 8.6 million in 1997, $ 3.7 million in 1998 and $ 7.8 million in 1999. Due to the importance of this product, it should be processed before export in order to benefit from the value added (currently, local processing of tobacco is limited, and performed by a small number of State-owned plants). International companies might be allowed to process Syrian tobacco both for export and local consumption, as an alternative for the international brands that are smuggled into the country.

Livestock Sector. *Awasi* sheep are as important as other strategic exports due to the comparative advantage they enjoy in the Gulf market. The value of exported live *awasi* sheep was $ 46 million in 1997, $ 49 million in 1998 and $ 55 million in 1999. This value is expected to go up to $ 75 million after the Prime Minister's decision no. 1 of April 7, 2000 allowing all exporters to export awasi sheep male and releasing the link between sheep import and export (formerly sheep exporters were allowed to export only if they present a documentary evidence that they imported twice the number of heads to be exported).

The poultry and beef industries are still limited to domestic consumption and should be promoted in order to access foreign markets. Other dairy products such as white cheese, ghee and eggs can achieve exportable surplus if specialised companies enter the sector.

Cotton and textile sector. Textile industry (cotton, wool and mixed yarn) is one of the traditional activities in Syria that employs a significant proportion of the labour force (around one million workers in different parts of the production chain). It is highly recommended to promote this industry and benefit from the value added that can increase the export potential.

Raw cotton (seed and ginned cotton).Raw cotton production has significantly increased during the past few years to reach one million ton. The marketing and processing of this product is restricted to the General Establishment for Cotton Ginning and Marketing, working as follows:

- The establishment procures raw cotton from producers at prices determined by the Supreme Agricultural Council (SAC). The latest price determined under SAC decision no. 23 of December 12, 1995 was 30.80 SP/kg (equivalent to about $0.60).

- One kg of seed cotton produces 350 gr. of cotton fibre and 630 gr. of cotton seed, so the cost of production of ginned cotton is 87.86 SP/kg, i.e. about $1.76.
- The General Establishment for Cotton Ginning and Marketing sells cotton fibre to local spinning plants at cost price and exports the surplus at international market prices which have significantly decreased in the latest years to about $1 per kg.

- The following table indicates the produced, sold and exported seed and ginned cotton (1997-1999)

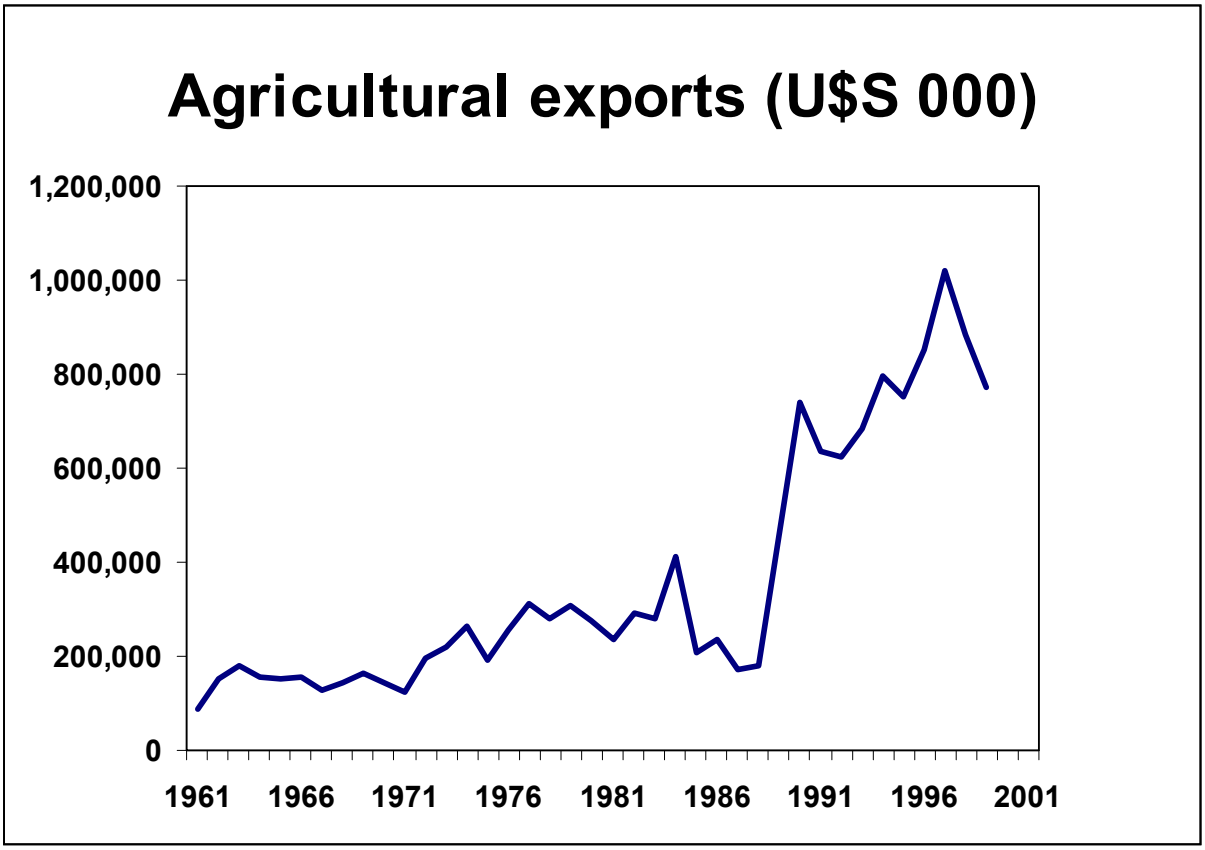
Production, processing and marketing of cotton (in tonnes)					
Year	**Raw cotton**	**Ginned cotton**	**To spinning plants**	**Exportable surplus**	**%**
1997	728170	257955	76714	181241	70%
1998	1012801	274339	80689	234995	85%
1999	981121	293880	86040	207840	70%

The General Establishment for Cotton Ginning and Marketing during the period 1982-1999 showed a deficit of around SP 32 billion (about $640 million) due to the low prices of exported cotton compared to prices paid to farmers. Ginned cotton exports account for 70% of the total cotton production. The domestic price of cotton delivered to domestic spinning plants are 30% above international prices, and this of course has negatively influenced the competitiveness of Syrian textile industry.

Domestic Cotton Yarn. Ginned cotton sold to public spinning factories is priced at cost plus a 2% profit margin. Prices range between 86-92.5 SP/kg according to cotton quality, which means that the price of domestic cotton yarn is 30% higher than the comparable international price. Domestic textile producers are now allowed to buy cotton yarn at international prices plus freight and insurance costs, which gives a significant push to cotton garment industry.

Long term growth in agricultural exports. Agricultural exports were showing a rather sluggish behaviour in Syria, oscillating around $200m up to the late 1980s. Then they started suddenly a rapid period of growth that lasted until the late 1990s, reaching as much as one billion dollars before the drought-induced fall in 1998-99.

Comparing the top year (1997) with the last one before the upsurge (1989), the rate of increase for all agricultural exports was 10.5% per year. A few commodities explain much of the increase between those two years, as shown in the following table. The heavily subsidised and State-monopolised exports of cotton fibre, plus the wheat exports allowed in the late 1990s due to production exceeding domestic demand, explain 60% of the observed growth. It is important to remark on the domestic costs of these two export categories. Cotton exports are about $270m in the late 1990s, but at the cost of a deficit in the processing phase: the cumulative losses of the State enterprise for cotton were $640m in 1982-1999, or $35.5 million per year on average. In the case of wheat, total exports in the top year (1997) were $190m, but the proportional GOCTP losses on wheat operations (apportioned to the amount exported) were about $200m. In other words, the domestic costs greatly exceeded the export revenue.



The rest of the relevant agricultural export items come from private producers and exporters. Tomatoes, pistachios and lentils contributed 6-8% each to total export growth. Grapes, mushrooms and fresh vegetables (excluding tomatoes) contributed 2-4% each. Sheep and goat, and also pastries in which the Syrians excel, make however significant **negative** contributions to total growth since (contrary to the general tendency) they contracted their exports during the period, especially live sheep that detracted 17% from the overall growth of other items. It should be remarked that live sheep exports have grown again in 1998-1999. Among all the products that showed positive growth, the selected ones explain about three quarters. The rest is made of a large number of products with small contributions to total growth but many with very rapid growth rates, which shows a tendency to export diversification. Among all those that decreased, the three selected explain about 70%. The observed decrease in some products (e.g. sheep) was caused by specific restrictions to trade, and has been reversed in more recent years (1998-2000) as explained earlier.

Growth in selected agricultural exports, 1989-97

	Annual % growth rate 1989-97	% contribution to agricultural export growth		
		All products	Products increasing	Products decreasing
Wheat	58.59%	33.13%	33.13%	
Cotton fibre	13.50%	28.02%	28.02%	
Tomatoes	19.65%	8.21%	8.21%	
Pistachios	41.75%	6.93%	6.93%	
Lentils	10.58%	6.78%	6.78%	
Grapes	50.51%	3.80%	3.80%	
Anise, Badian Fennel	42.97%	3.36%	3.36%	
Other vegetables, fresh	37.24%	2.96%	2.96%	
Mushrooms, truffles	35.47%	2.69%	2.69%	
Crude organic materials	14.00%	2.04%	2.04%	
Goats	-24.28%	-2.80%		-2.80%
Pastry	-25.76%	-3.05%		-3.05%
Sheep	-13.27%	-17.35%		-17.35%
Subtotal	**10.73%**	**74.72%**	**97.91%**	**-23.19%**
Other products	**9.88%**	**25.28%**	**34.72%**	**-9.45%**
Total	**10.50%**	**100.00%**	**132.64%**	**-32.64%**
Source: Statistical Abstract, 1995 and 2000 editions.				

A more detailed look at the trade figures shows that the increase in fruit and vegetables, some of which continue to grow even in the otherwise poor years 1998 and 1999, is mostly made of **fresh** products. Increases in **manufactured** food products (the ones produced by the agribusiness companies licensed under Law No.10) are of lesser significance in the overall growth of agricultural exports, though their rates of increase are very high in some cases. Thus, in spite of the relative importance of these companies in terms of investment, **their output had not yet show up in comparably high increases of agribusiness exports** by the year 1997 reflected in the above table. Some of the products of these new industries (e.g. olive oil, tomato paste and some others) are rapidly increasing their exports in 1997-99, and thus it can be expected that their impact starts to be perceptible in the following years.

2.2.9. Self-sufficiency and food subsidies

Chiefly for national security reasons, Syria has been pursuing food self-sufficiency on a product-by-product basis in recent decades. This includes a level of production that covers all domestic demand, and a massive stock of basic products kept by the government. In fact, the recent fall in production due to the drought conditions prevailing in 1999-2000 has been compensated not by imports but by running down part of the existing stocks, that are to be replenished as soon as the drought effects are over.

This policy concentrates on wheat, which is by far the principal staple of the Syrian diet, and other strategic food crops such as sugar beets, but it has been applied also to the promotion of a variety of products such as potatoes, chickpeas, lentils, milk, barley (for animal feed), oilseeds such as sunflower and soybeans, and others (cottonseed for vegetable oil should also be included in this list, but cotton crops are promoted also, or mainly, to cover domestic textile requirements and the export of fibre). Besides supporting producers, the food supply policy includes also direct State intervention in

essential food exports and imports, including all cereals (those locally produced and also those, like rice, that are only imported).

Apart from supporting producers (with prices above international levels) and consumers (by selling some of the processed products below cost), the system also bears the cost of keeping huge stocks of agricultural products, adding to the overall costs of self-sufficiency. For instance, wheat is paid 11800 SP per tonne to the producers, and goes into storage; wheat leaving storage towards the milling process has a cost (production plus storage) of about 18000 SP/tonne (the price paid by the General Company for Mills to the General Organisation for Cereal Trade and Processing). From a tonne of wheat, about 780 kg of flour are derived, and the flour is sold at 7500 SP per tonne (i.e. about 5850 SP for the flour content of a tonne of wheat), plus the small value of the residual bran. One tonne of flour is made into 1150-1200 kg of bread, which sells at 9 SP/kg, which means that consumers pay about 7020 SP for the bread derived from a tonne of wheat, about 60% of the price paid for the wheat not counting the costs of stocking, milling, baking and distribution. The balance is ultimately expressed in losses of the GOCTP and GCM and paid from the Price Stabilisation Fund (PSF) that also pays other similar losses corresponding to other products such as sugar. All told, PSF outlays concerning wheat and other products have been between 2.3% and 3.0% of GDP during the 1994-1999 period.[16]

The opportunity cost of wheat is the parity price of imported wheat of the same quality. According to estimates by Mike Westlake in his study of strategic crops, in 1999 the farm-gate parity price was about 7199 SP/MT for hard wheat, and 6,497 SP/MT for soft wheat, both based on imports put in silos at Damascus (the costs were slightly different for wheat put in silos at Al Hassakeh, thus determining a farm-gate parity price of 7,062 SP/MT at that locality). To this should be added the cost of stocking, milling, baking and distribution to arrive at the parity price of bread. **Without including the costs of stocking**, Westlake estimated that the parity price of bread in 1999 was 10.51 SP/kg, in comparison with an actual average price of 8.57 SP/kg at public and private bakeries.[17]

The rapid increase of Syrian population has pushed the government into costly arrangements to comply with this national commitment to self-sufficiency. Irrigation has been greatly extended (or perhaps over-extended) in spite of limited water availability, and fiscal costs to cover subsidies both to producers and consumers have been increasing steadily. The fiscal costs in 1999 of intervention in cereals, expressed in the payments from the Price Stabilisation Fund to the GOCTP, GCM and other State companies, including producer and consumer subsidies but not including the cost of stocking, and therefore very conservatively estimated, amount to nearly 3% of GDP.[18] The total economic loss to the country is likely to be larger if account is taken of stocking costs,

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[16] International Monetary Fund, **Syrian Arab Republic - Recent economic developments**, Washington DC, August 2000, p.43, and Mike Westlake, **Strategic crop study**, FAO, Project GCP/SYR/006/ITA, Damascus, 2000.

[17] The cost of handling and stocking may be estimated, according to Westlake data, at about 6000 SP per ton of wheat (difference between the price GOCPT pays for wheat, and the price it charges for wheat sold to GCM). This would add 5.38 SP/kg to the cost of bread, bringing it from 10.51 to 15.89 SP/kg.

[18] Mike Westlake (consultant), **Strategic crops study**, Project GCP/SYR/006/ITA, FAO, 2000.

efficiency losses, other (open or hidden) subsidies to other strategic and non-strategic crops such as sugar and cotton, and other related factors.[19]

The goal of food self-sufficiency is a matter with wide ramifications that touches many aspects of agricultural and investment policies in Syria. It impinges on several aspects regarding private investment in agriculture and agro-industry. One of the most salient of those aspects is the fact that very scarce natural resources, like land and water, are being used to produce strategic crops at costs well above international levels, and even more distant from the subsidised prices paid by the Syrian consumer (especially for products derived from sugar beets and wheat). This has several **consequences for this study.**

In the first place, this use of natural resources detracts from the availability of land and water for more efficient uses. As the output required for self-sufficiency in strategic crops increases, more land and water is devoted to this scope, and less remains for other, more competitive crops. **Private investment in those crops is hence hampered.**

Second, and perhaps more important, the continuing increase in population will require **big investments in the farms** along the coming years. The production of basic crops (especially wheat, barley and sugar beets) should have to expand greatly in the coming decade, just to keep pace with population, and this growth could only come from irrigated areas, and mostly through horizontal expansion of those areas and consequently through increased demand for water. Since this prospect is technically unfeasible (all the water basins are already over-exploited), the government is seriously involved in a plan to modernise all the irrigation systems, passing from flood irrigation to pressurised systems based on sprinklers or drip pipes, in a dramatic move to produce substantial economies in water demand for irrigation. This ambitious program implies a massive process of on-farm investment in irrigation systems, besides off-farm investments that are also necessary. The on-farm investments are huge, and will necessitate substantial **private investments** in the coming years, both on the part of small holders and larger agricultural enterprises (just the cost of new on-farm equipment for all the irrigated areas would be around U$S 2.4 billion, nearly equivalent to 60% of agricultural GDP).

Third, the State has reserved for itself the monopoly of processing and marketing strategic crops and their products, thus **preventing private investment** from intervening in most of the activities related to those crops, and leaving much of the allocation of resources for those crops outside the influence of market forces. Even those activities in which the private sector is allowed to participate in relation to strategic crops (for instance, mills hired by the State to process wheat into flour) are not guided entirely by market forces but by administrative decisions of the State and its enterprises. Thus, **private investments in those sectors is restricted and guided by distorted incentives.**

Fourth, this policy has significant fiscal costs that bear a negative influence on the overall macroeconomic equilibrium, makes large demands from the banking system (absorbing most of the available credit), and affects in many ways the general course of the national economy, increasing country risk and overhead costs, and undoubtedly **de-**

[19] In fact, this estimate does not take into consideration other subsidies still existing, like the preferential rates of interest paid to the ACB by farmers in co-operatives (4.5% for loans under 50,000 SP, and 5.5% above that amount, against 5.5% and 7.5% respectively applied to the private sector). The Government also sells diesel fuel (used, among other equipments, by farm machinery) at a lower price ($0.10 per litre) than the cost of production and distribution ($0.25), compensating that discount by charging more for gasoline ($0.40 per litre), so that farm fuel costs are mostly subsidised by car owners.

terring private investors (Syrian and foreign) from committing their capitals in Syria, and **restricting credit** for those that actually invest.

As will be pointed out later, creating an adequate environment for private investment in agriculture and agro-industry would involve some issues regarding the policy of self-sufficiency, which should be carefully examined to find ways of **achieving its goals in a more efficient way.**

2.2.10. The role of the planning system in agriculture

For strategic crops (wheat, barley, tobacco, sugar beets, cotton), production is planned in physical and financial terms down to the farm level. At each administrative level targets are set for area farmed and expected output, all the way down to the amount of land to be planted with each crop at each season on each individual farm. Agricultural co-operatives are the main institutions charged with implementing the planning system at the local level, and thus assigning in effect production targets at individual farm level, and correspondingly allocating credit and agricultural inputs to the farms.[20]

Penalties have been established for farmers planting less or more than allotted by the planning system, though divergences are very frequent, and sanctions very seldom enforced. In turn, credit from the Agricultural Co-operative Bank (ACB) is allocated to farmers in accordance to their allotted crops and estimated costs of production; part of the credit is delivered in kind (fertiliser and other inputs) and part in cash. As most of the output for strategic crops is purchased by a government-owned company, and this company is in fact obliged to buy all the output that is offered to it by farmers, credit repayment is deducted from payments to farmers at the end of the annual agricultural cycle. In other words, the State-owned purchasing company acts as a collecting agent for the ACB.

The rigid system of planning being applied for strategic crops in Syria leaves little room for entrepreneurship, innovation and competition. In large measure planning rests on habit and precedent. The amounts of inputs and output allocated for each strategic crop in each area and ultimately for each farmer depend chiefly on how much land is allocated for each crop, and this is largely determined by how much was allocated in the precedent years (plus some yearly incremental changes mandated by the Plan), so that district-level or farm-level targets of production and allocation of inputs are mostly based on fixed coefficients, except when allocating planning targets to new crops or newly irrigated land. This system tends to favour stability of production, but it also **discourages innovations and changes in the crop schedule.** Accustomed to be told their production targets and to receive their inputs from the Government in a largely compulsory way, and to sell their product to the Government at a fixed price, farmers growing strategic crops develop a dependent attitude rather than an entrepreneurial one.

Only minor amounts of farm resources are free from the constraints of planning. Farms below 0.5 Ha are not required to follow the plan, and larger farms may devote up to 10% (sometimes up to 15%) of their land to other activities apart from strategic crops,

[20] The co-operatives are service co-operatives, among other aspects, in the sense that they carry out all the paperwork related to obtaining loans (in kind or cash). They also receive the loans and distribute them to the members. Farmers who are not coop members have to do the paperwork by themselves.

and include those other crops in the production plan they present to the Agricultural Co-operative Bank to access credit in cash and kind. However, little encouragement for diversification exists, since the price of strategic crops is fixed, the sale of the harvest is assured, and the price corresponds to the actual cost of production, and not to opportunity costs or parity prices. Other crops would have more marketing risks, prices would be more competitive, and there is little supply of technical advice for alternative crops.

Since 1990 a measure of flexibilisation has been introduced into the planning system, which is now considered to be of an "indicative" rather than compulsive nature. To a certain extent, prices are also used as a tool for enforcing plan targets. In practice, however, strategic crop farmers are followers of State-dictated production plans, takers of State-delivered concessional credit, and sellers of all their output to one single purchaser at a fixed price. This **hardly encourages them to adopt an entrepreneurial attitude, i.e. to take risks and make decisions**. The very fact that this system has been operating for a long time is in itself a powerful obstacle for Syrian farmers to change and to become more efficient and competitive. A substantial effort should be devoted, in the event of a liberalisation of agricultural planning, to changing the ways of the farmers through training and incentives, to strengthening farmers' organisations; and to technological transfers in such fields as farm management and marketing. This is another key reason for any such transition to be gradual.

This is a key factor for this study on private investment. **Faced with the need to invest in their farms, those farmers usually balk**. For instance, the expected modernisation of the irrigation systems (from gravity-ridden systems that flood the fields to pressurised irrigation distributed through drips and sprinklers) requires extensive farm-level investments for which motivation may be lacking. Also, loose ways to distribute water do not encourage farmers to economise on that vital element. A **compulsory** scheme to force farmers into modernising their irrigation equipment is on its way, but this hardly would produce the necessary skills, the necessary changes in farmers' attitude, or improve the willingness of the farmers to use the new equipment wisely. **An adequate environment for investment by existing farms in the area of strategic crops may require a much more flexible planning system, and appropriate set of incentives to economise on water, and also the development of an adequate system of grading and standards, as well as encouragement for innovation at farm level.**

Making the planning system more flexible may help in that encouragement. Four specific avenues for policy change to this effect are being addressed in this report, albeit in a general way: **replacing price subsidies with direct payments to producers** in order to realign prices with international levels; introducing the right **incentives**, chiefly for the economical use of water; gradually **decentralising the planning system for strategic crops**; and gradually making the **pricing system more flexible**.

The first mechanism will **align all the prices** along the processing chain, so that flour and bread will also involve no losses for the marketing and processing enterprise, GOCTP. Besides, as a result of price realignment, probably there would be a reduction in waste. An optimisation of the stockpile requirements may also imply a lower production of wheat without affecting food security or consumption.

Some direct subsidy to consumers may have to be put also in place to replace the subsidy implicit in the low price of bread, but possibly this may be avoided. If the price realignment happens gradually, wage rates and other prices would adjust also gradually, thus permitting most people to adapt to a changed set of relative prices. If this is not

enough, targetted consumer subsidies may be introduced in many ways, some more efficient than others. International experience suggests the following:

- Direct delivery of free or subsidised food through institutional channels to special groups: pregnant women and mothers with infants (through the public health-care system), schoolchildren (through the public school system), communal stores in poor neighbourhoods or communities, etc.
- Rationing cards or coupons for specific socioeconomic groups such as low-skill workers, inhabitants of poor or remote locations, etc.

An alternative to these cumbersome methods is to implement the price realignment in a gradual manner, combined with adequate (and also gradual) adjustments in money wages. Thus direct consumer subsidies would be avoided, concentrating only on direct payments to producers.

As the price of bread would increase, and bread figures prominently in consumption baskets, the price level would also increase, but this "inflation" would be a temporary phenomenon. If the increase in wages (and the markup margins of small producers and traders) is compensated by some reductions in other prices through gains in efficiency or other means, and monetary policy continues to be restrictive, even that temporary burst of inflation may be avoided, or kept to a minimum.

The second line of policy reform points to create **incentives** for economising on water. Presently, farmers on public irrigation schemes pay a fixed fee for operation and maintenance (recently raised to an annual 3500 SP or U$S 70 per Ha), and have then the right to flood their fields at will with the water that is supplied without metering. There is strong resistance to pricing irrigation water. However, the government is installing meters, which would facilitate the transition. In case the resistance to pricing is met with a decision not to price water directly, then a system of **fines for excess use of water** should be put in place. The fee would remain fixed, but according to the proposal outlined here any excess use of water above an allotted equitable amount would be fined at **increasing rates** depending on the amount of the excess. Some more details are given in the next section of this report.

The third line of reform is **decentralisisation**. This would **transfer decision over one part of the resources to local co-operatives and farmers**. This implies that a growing percentage of the resources (starting with the modest 10% now allowed) will not be dependent on the plan but allocated by the farmers themselves.[21] However, realigning the price of strategic crops will be necessary for farmers to be encouraged to shift to other crops. Otherwise, the high price of wheat (reflecting their own cost of production) would not encourage diversification nor the search for more profitable crops. Also, effective ways to deliver technical assistance and to market the new products should be made available. If the mechanism works, the percent of local allocation might be gradually increased to 20% or 30% and then more.

[21] Under the current "indicative" and partially participative planning system, the plan starts at the grass root level with the participation of the farmers in the co-operatives. After that it is presented to the higher authorities for approval and enforcing. So farmers are already involved in the decision making process. But in practice the plan targets are set from above, and no portion of the land may receive credit except if allocated according to plan.

The fourth avenue of change proposed, would in fact would be a later step in this process of reform, would be the **gradual liberalisation of prices for the strategic crops.** To start with, official prices could be maintained, but with a **band of variation** according to market forces.

2.2.11. Issues related to water and irrigation

Faced with a growing population, a shortage of cultivable land, and with a commitment to achieve physical self-sufficiency in food consumption, the Government has tried to enlarge the resource base by subsidising land reclamation by de-rocking, and also by investment in the expansion of areas under irrigation. Irrigated land has nearly doubled in recent years, from around 550,000 Ha in 1980-84 to about 1,275,000 in 1999. Irrigation comes mainly from underground sources. About 710,000 Ha are irrigated from wells, 187,000 Ha directly pumped by farmers from rivers and springs, and 378,000 Ha are public irrigation schemes.

But this increase in irrigation in turn put great pressure on the relatively scarce water supplies, causing a general lowering of water tables and underground aquifers, salinisation of irrigated land, and other undesirable effects.[22] In fact, further expansion of agricultural production based on an enlargement of irrigated areas with the current irrigation technology (mostly flooding ridden by gravity) is not technically possible nor sustainable, unless irrigation schemes are modernised, shifting from flood irrigation to pressurised systems. Technical modernisation of irrigation systems (sprinklers and drip irrigation) and a more rational pricing of irrigation services are hence essential to keep agriculture from falling behind demographic growth and to avoid environmental damage.

Recently the Government has announced a plan to modernise all (or most) irrigation systems in the country on the next four years, and about one billion SP (some U$S 20m) of annual credit disbursement to farmers have been estimated as necessary for that purpose. The average cost per Ha is estimated at U$S 2000 for the new irrigation equipment to be installed. Implementation procedures are still being worked out, but they would mainly consist of farmers contracting suppliers for the acquisition and installation of modern sprinklers or drip irrigation systems; the ACB would pay the suppliers after verifying that the system is in place, and the farmer would repay the amount plus interest on a number of years. Though the system is already in place and the credit available since August 2000, there has not been many takers yet. Demand is supposed to surge in 2001 as the season progresses.

A company making and installing drip irrigation systems, interviewed for the present study, reports that some aspects of the credit delivery system present some problems, and pointed out also that the amount of money allocated is (by far) not sufficient to get the task done: the cost of a modern system (varying with the system chosen and the kind of crop) may be anywhere between $1000 and $4000 per hectare, so that the estimated yearly allowance of $20m would finance only 5,000 to 20,000 Ha per year, i.e. from

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[22] As for 1998 the annual availability of internal renewable water resources was estimated at 456 cubic metres per capita, but annual fresh water withdrawals amounted to a yearly 1069 cubic metres per capita, i.e. 2.2 times the available amount (see Project GCP/SYR/006/ITA, **Country profile: The State of Food and Agriculture in Syria**, FAO, Damascus, 1999, Basic Data, p. v). A thorough analysis of the problems concerning water and irrigation may be found in the report on **Technical and Economic Results of the Agricultural Water Management Improvement Project (SYR/90/001) in the Syrian Arab Republic**, Damascus, 1996. See also Gareth Edwards-Jones' report on environmental impacts of agricultural production practices in Syria, prepared for FAO project GCP/SYR/006/ITA, Damascus, 2001.

20,000 to 80,000 in four years, whereas the total amount of irrigated land is more than 1.2m Ha, of which a significant proportion is in State irrigation schemes. The average cost of new farm equipment might be about $2000 per Ha, as the Government estimates, not counting other related on-farm and off-farm investments (including some land levelling, some new off-farm infrastructure, training, technical assistance, etc.). The present installed capacity of the companies making irrigation systems in Syria is not enough to cover even the one billion SP now allotted, and much less to cover the entire demand of new systems if the modernisation proceeds at full speed. Thus, **the process would involve a significant impact on imports of irrigation equipment.**

Some of the systems may not need modernising, and some may be unfeasible, so the target should be less than the total amount of existing irrigated land. **To modernise only 50% of the total irrigated areas in ten years, i.e. about 60,000 Ha per year, the annual cost of on-farm equipment would be about $120 million, equivalent to 6 billion SP per year, six times the amount allocated in 2001.**[23] At least a **further 20-30%, and probably more, would be necessary** for other physical investments, and to support the enormous change to be undertaken by farmers, under the new irrigation systems, in their way of conducting production and marketing.

The Government is planning to make the conversion to modernised irrigation **compulsory** in the near future. This approach could certainly achieve the installation of the new equipment on the farms, but **it could not possibly achieve a change in the frame of mind of the peasants, including changes in the way in which production is carried out, and may not even entail a real economy in water use.** For the modernisation of irrigation systems to be effective and sustainable, it should arise from the **farmer's decision to modernise**. But farmers are not likely to do so unless there are **real incentives to modernise**. For instance, farmers that use too much water are not penalised in any way. Farmers strongly resist the application of payments per cubic meter of water.[24] They may not be encouraged to economise on water, and less so to take loans and invest, unless some **existing disincentives are removed**. Irrigation services are now charged a fixed fee, without metered charges per cubic meter of water. The **fixed fee** per hectare for the use of water, formerly 360 SP, has recently increased to 1000 SP per year, i.e. U$S 20. But there is no metering, thus **increasing the water**

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[23] The total cost of modernising all the irrigated areas involves an on-farm investment of $2.4 billion, not counting other on-farm investments outside irrigation facilities, and not counting related off-farm investments. This amount is nearly five times the entire outstanding credit portfolio of the Agricultural Co-operative Bank; it was also equivalent to eight times its annual amount of credit extended, and 85 times the amount it annually lends in medium and long term loans. As of 1999, the Bank had a portfolio of 25180 million SP, and during 1989 it extended credit for 123.4 million SP in long term loans, 1278.1 million SP in medium term loans and 8807.4 million SP in short term loans in cash and kind (**Statistical Abstract 2000**, pp.483 and 486). For the above comparison of irrigation-modernising investments needs against ACB credit availability, these amounts were converted to dollars at a rate of 50 SP.

[24] Some argue that water should be free, because it is a gift of Nature, and the Koran says that gifts of Nature are meant to be free. "Selling water" is then not favoured. However, irrigation systems, canals, pumps, wells and dams are not a gift of Nature, and the charges are not for the water but for the cost of operating and maintaining the systems, and the involved cost of extracting, transporting and delivering water to the farm (amortisation of infrastructure is not charged in the fee). Operation and maintenance costs increase as more water is used. The water itself is free, but the use of the system has a cost that must be reckoned with. From the point of view that water is a gift of Nature, it should not be allowed to be wasted, or to be used in wasteful ways, and wasters should be penalised for not sharing the water equitably with their fellow producers.

fee may in fact encourage farmers to use even more water. Some other payment system should be used.

The State irrigation schemes are introducing meters anyway, and some way of applying a new system for charging the cost of irrigation service must be found, to create incentives for economising water. One system could be based on the concept of **fines or surcharges for excess use**. Under that system, farmers will continue to be charged a **fixed fee**, but this fee will cover only a certain (metered) amount of water delivered to the farm. Any excess will be "fined" with extra charges, and the fine rate would be increasing as excesses are larger. This kind of scheme may be resisted at first, but less than a direct pricing of the cubic meter of water. It could be construed as a way of achieving a more orderly and just sharing of the water, not allowing it to be wasted, and as a way of penalising those that do not share the available water equitably.

On-farm and off-farm investment in the modernisation and improvement of irrigation systems will then be a chief factor determining agricultural production growth in Syria in the first decade of the 21st Century and afterwards. This in turn poses many difficult challenges related to the institutional framework, the organisation and promotion of those investments, the management of the modernised irrigation schemes, and the resulting changes in production and marketing. The last chapter of this report is devoted to discuss the implications for the private investment regime resulting from the investments required for sustainable growth in per capita agricultural production.

2.3. Processing and marketing of farm products

The agro-business sector in Syria has been dominated during many years by State-owned companies, which held a monopoly or extremely dominant position in almost all sub-sectors up to 1991, when private agro-related firms were authorised under Investment Law 10.[25]

2.3.1. The public agribusiness sector

The **public sector** owns and operates a large number of corporations, controlled by various Ministries (Agriculture, Industry, Supplies, Economy and Foreign Trade), devoted to activities related to the farming sector. This includes pre-existing private companies that were nationalised in the 1960s or 1970s and new companies directly created by the Government. This **State-owned agri-business sector** comprises several kinds of companies. A first group includes companies that supply farms with **physical inputs and support services**. Some of them provide only services (such as the General Establishment for Agricultural Mechanisation, that provides mechanisation services to farms). In addition the State runs companies devoted to process farm products producing intermediate goods to be used in farms, such as the General Establishments for Fodder and for Seed Multiplication. Finally, this group also comprises such companies as the General Foreign Trade Organisation for Chemicals and Foodstuffs (known as GEZA), which imports farm inputs such as fertiliser and pesticides (GEZA does not deal directly with farmers; it is responsible for importing the required inputs and delivering them to ACB, which in turn gives loans in kind to the farmers.).

[25] Some private companies established under previous legislation survived the process of nationalisation, and continue to operate up to the present, and also some joint-ventures were launched after legislation to that purpose was passed in 1981 and 1986.

The State also owns a number of companies engaged in specific branches of **agricultural production**, such as the General Establishments for State Farms, for Poultry, for Fish, and for Cattle. The most important part of the State involvement in agri-business, however, lies in the **processing** stage of the agro-food system. The State owns and runs corporations for processing and marketing agricultural products, co-ordinated by the General Organisation for Food Industries that oversees 22 companies with 27 factories producing various products such as flour, dairy products, fruit preserves, bread, biscuits and many others.

The State also controls **agricultural credit** through the Agricultural Co-operative Bank (ACB), that up to the year 2001 monopolises credit to farms. Such credit is usually channelled through Farmers Unions and its member co-operatives. Credit to industrial and commercial agri-business firms is also (up to now) monopolised respectively by the Industrial Bank of Syria and the Commercial Bank of Syria. The recent passing of a law authorising private banking has not yet taken effect. Finally, the State is also involved (though marginally) in **retail marketing of food products** through the General Establishment for Retail, that keeps shops in every Syrian town with market shares that can be estimated between 5% and 10%. They are, however, an important outlet for State food processing companies. A significant proportion of bread is made at State-owned bakeries, that also retail the product. Besides, there is a General Organisation for Fruit and Vegetables, that buys local products and has a monopoly for importing fruit and vegetable products. All the retail operations of the State have limited capacity and small market shares, and there is a widespread opinion that the quality of the goods and the service is in many cases inferior to those found at private retailers.[26]

It is not possible to estimate the market share of State-owned agribusiness firms, except in special cases where they are monopolies, because in many sectors total industry output is unknown. However, some market shares have been estimated (in terms of installed capacity), for instance in tomato paste and yoghurt, where the State sector controlled 53% and 65% respectively in 1997 (D. Rama, op.cit., p.25). The State sector deals mainly with the domestic market. Only three State companies export more than 10% of their sales, and all of these export through GEZA or through spot contracts paid in cash or through letter of credit. State companies are **highly centralised in their decision-making**, that rests chiefly on overseeing umbrella entities like the General Organisation for Food Industries or the intervening ministries (Agriculture, Supply, Economy and Trade, or Industry). Centralisation regards not only strategic matters such as investments, but also short term decisions such as discounts or promotions.

2.3.2. The private agribusiness sector

Private agribusiness companies are mostly those licensed under Investment Law 10 of 1991, though some older companies also exist. Up to the year 2000, about 1,600 investment projects have been authorised by the Investment Council in all the sectors covered by Law 10/91. Of those, about 260 projects (and almost as many companies) are related to agriculture and agribusiness. They cover many different processing activities, like fruit juices, pasta, olive oil, other vegetable oils, meat products, etc. Although the Law applies also to agricultural production projects, few firms have

[26] See Daniele Rama (consultant), Implications for the Agricultural Sector of Recent Developments in Private and Public Agricultural Marketing and Processing Activities in Syria, FAO, Project GCP/SYR/006/ITA, December 2000, p.36.

applied for farming projects. The few that actually applied are chiefly dairy farms, but there are also some other initiatives such as a fish farm, olive plantations and sheep raising. In most cases, agricultural production is only part of the business, that also involves industrial processing. In later sections of these reports a more detailed analysis is offered on private agribusiness firms, the problems and challenges they face, and the main policy options for promoting their development. A recent analysis of the processing and marketing of agricultural products (Daniele Rama, op. cit., p.46-50) led to the following policy implications:

i. Restructuring horizontal and vertical organisations of farmers, re-orienting agricultural co-operatives and Agricultural Chambers as efficient marketing agencies.

ii. Development and restructuring of support services, mainly market information systems, especially for foreign markets, and services oriented to the transfer of technology to farmers (research, extension and training).

iii. Liberalisation of the price system

iv. Exchange market reform for easier access to foreign exchange

v. Reduce foreign trade restrictions

vi. Increase efforts to promote private investment in agribusiness

vii. Improve business environment by removing uncertainties and strengthening market-related institutions, such as protection of intellectual property, clear procedures for the resolution of disputes, etc.

viii. Development of an effective financial sector, including private banking, a stock market, and a securities market.

The private sector in agribusiness production and commodity chains. One of the goals of this study according to its Terms of Reference is to ascertain the relative importance and participation of the public and private sector for specific commodity chains within the agricultural and agribusiness sector broadly defined. The goal, in fact, was to *"ascertain the weight of public and private enterprises by agricultural commodity chains and by vertical articulation of the overall agribusiness system, and assess the effects of public presence on the degree of competitiveness of the sector and on entrance possibilities for private initiatives, pointing out activities characterised by potentially higher opportunities for private entrants."*

Much of these aspects are being examined in this report in a general way and usually with relevant examples. However, unfortunately data limitations prevent the achievement of the goals as stated. Reconstructing the structure of each commodity chain, including the volumes of inputs and outputs involved at each link of the chain, greatly exceeds the possibilities offered by the presently available sources of information.

Some information on specific commodities could be found in the sectoral studies undertaken by FAO within the same Project GCP/SYR/006/ITA which has sponsored the present study, such as those on strategic crops, the citrus sector, olive oil and livestock products. There was a specific study on the agribusiness marketing and processing sector (directed by FAO consultant Daniele Rama), that devoted to commodity chains and vertical articulations much more time than allowed for that matter in the present study, and obtained very meagre results, all of which are being used in this study. Some additional information will be presented, besides the data presented by Rama, on the relative importance of the public and private sectors on specific **products**, but with little chance of extending these results to **commodity chains** or to the various **vertical articulations** to which the products are related. That analysis is in fact quite important for

policy-making purposes, and a special research project should be developed to that purpose, but any such effort is outside the scope of the present study. The available information about the relative importance of public and private production for specific agro-industrial products will be presented later, in the context of an analysis of the impact of the private investment promotion regime.

3. Design and scope of the present study

3.1. Coverage

The main class of private investments to be covered by the present study are those approved under Law No.10 of 1991. As mentioned before, there are other private companies in the agribusiness sector that are not covered by that regulatory framework. This includes firms established before 1991 under other licensing regulations, such as Legislative Decree No.348 of 1969, and Decree No.10 of 1986 on private investment. Investments not covered by Law No.10 of 1991 include also the following categories:

- Projects that do not reach the minimum threshold of capital investment required for eligibility to Law No.10 benefits (10 million SP, about U$S 200,000). This may be the case of many agricultural production endeavours.
- Projects that may have qualified for approval under that Law but investors chose not to apply, or withdrew their application, or their application was rejected. Most of these projects were no-starters, but some established themselves anyway. One of the chief reasons for investors to opt out of Law No.10 seems to be the requirement to invest in brand-new machinery, since some of these companies found investment opportunities linked to the purchase of used equipment. Some of these projects remained at the level of blueprints, but some were carried out outside the benefits of the Investment Law.

About 1600 projects have been authorised under Law No.10 since its inception in 1991 to the year 2000. Of that number, about 300 pertain to the agribusiness sector (including some agricultural production projects, and mainly processed food and non-food items, as well as some projects to produce agricultural inputs).

The vast majority of the licensed investments in agribusiness pertain to the **processing** stage in the agribusiness chain. Very few have been oriented to **agricultural production** proper. Few if any projects under Law No.10 purport to furnish **support services** for agricultural production (such as cold storage). Firms devoted solely to **marketing**, without being involved in the processing phase, are not explicitly permitted under Law No.10, though in practice the law has been interpreted as granting its benefits without that exception. Many transport projects of course offer transportation services for agricultural products, but according to the Investment Office there are no cases of transport projects (approved under Law No.10) that devote themselves solely or chiefly to the transportation of agribusiness products. It was thus decided to exclude transportation companies from the present study, though the provision of adequate transport facilities is also an essential ingredient for the development of an efficient agribusiness sector, and transportation companies usually provide also related services such as market information, storage, etc.

3.2. Overall conceptual approach

The promotion of private investment in Syria, starting in 1981 and developed especially in the 1990s under Law No. 10/91, relies on **direct promotion** through tax exemptions and other incentives, without altering much the overall setting of the economic system. This approach has worked to a certain extent, but it is understood now that broader aspects of the economic system should be reformed for private investment to have a larger and sustained impact on economic growth.

Thus, the study has dealt with the two levels of policies for encouraging private investment: **direct promotion** on the one hand, and **systemic economic reform** on the other. This crucial theoretical distinction influences the whole methodological setting of the study.

Information on the impact of direct promotion policies includes data provided by the official agencies involved, and primary data collected from a sample of investment projects carried out by private companies. Information on possible systemic reforms aimed at improving the investment environment will come from analysis of the existing macroeconomic scenario and from empirical findings about problems faced by existing private companies.

3.3. Sources of information

Empirical information on the private sector of Syria is scarce. Thus, besides data furnished by the Investment Office on licensed companies, one major instrument of inquiry should be the conduct of a survey of the private agribusiness sector, focusing mainly on companies licensed under Law No.10 by including also other firms. A proper, statistically representative survey was outside the scope of the present study, but the input of first-hand information from the companies themselves was deemed a necessary element for any study of this kind. In consequence, it was decided to perform a **qualitative survey** covering a limited number of companies, not with the aim of attaining statistically significant and representative results, but of getting qualitative evidence in the guise of case studies.

Besides, secondary information was gathered on a number of matters, chiefly the following:

- Information on the institutional rules and the operation and results of the main macroeconomic policies affecting the environment for private investment.
- The existing regulatory framework for private investment, including Laws No.10 (991) and No. 7 (1999), its attendant procedural norms such as Decree No.7 of 1991, and the actual practices and procedures followed in this matter.
- Regulations concerning the main factors affecting the establishment and management of private companies in the agribusiness sector, such as access to foreign currency, price regulation, input procurement, quality standards regulations, and the like.
- Empirical studies of specific sectors, especially those performed with FAO assistance under Project GCP/SYR/006/ITA.
- Statistical data on the development of the private sector companies licensed under Law No.10 since 1991, to assess their characteristics, the efficiency of the licensing system, and the companies' performance.

3.4. Phases of the study

The study was designed and implemented during the period January-May 2001. It involved a first mission of the International Consultant (13 January - 3 February), a period of data collection by National Consultants and Trainees, and a second mission of the International Consultant (25 March - 5 May). The study involved the following phases:

Phase I (Design of the study)

During the first mission, guidelines were established for interviews with executives of private companies operating at different points and sub-sectors within the agribusiness sector. The interviews would be conducted by the International and National Consultants plus a task force of Trainees assigned to the study. A semi-structured form of interview was adopted. The study, therefore, did not use a formal questionnaire but a set of guidelines and a checking list of problems and subjects to investigate (included as Annex 1). It is expected that this approach would create a better atmosphere to extract information from the owners or managers interviewed, and is also better suited to elicit information on problems faced by firms, that are not easily foreseen in a formal questionnaire.

The selection of the companies to be interviewed was not random. A set of criteria was established for that selection. The selection criteria will be the following four:

Sub-sector. The selection would cover firms in as many as possible relevant sectors, which are primarily the following:

Cereal processing
Fruit and vegetable processing
Dairy products (including milk production and milk processing)
Meat processing
Vegetable oils
Beverages (alcoholic and non-alcoholic)
Cotton processing
Fertiliser and other agricultural inputs
Other (e.g. fish, cold storage, animal feeds, etc.)

Geographical location. The study would cover firms located in different parts of the country, covering chiefly the main cities such as Damascus, Aleppo, Homs, Lattakia.

Capital ownership. The study will cover firms with and without non-Syrian shareholders, and with and without public sector involvement in ownership.

Size. The study will include both firms that are relatively smaller and relatively larger.

Of course, this set of four criteria cannot be satisfied exhaustively, for neither all the combined possibilities are actually existent, nor can they be covered in a very limited study like the present one. The aim was only to have sufficient variety in all criteria, even if not all the combined possibilities can be studied.

Phase II (Data collection)

A team of trainees and two National Consultants were involved in interviews with firms in different agribusiness sub-sectors. The trainees devoted to this task one of the three days they work at the Project each week, and on occasion an additional day out of the three days they work at the Ministry. The interviews were fairly long: normally only one company could be interviewed on a given day by any specific team, and many involved repeated visits. Due to this time factor, the initial number of interviews envisaged (about 40) was reduced by half. In the end, 24 companies were surveyed.

The interviews covered companies all over the country, from Sweida in the South to Raqqa, Lattakia and Aleppo in the North, including Damascus and other areas such as Homs and Hama. The Trainees performed the interviews in small teams composed of two trainees each. Each team interviewed three agribusiness companies for a total of 12.

Besides, the International and National Consultants completed another 12 interviews for a total of 24. As a general rule, one of trainees in each team was to conduct the conversation while the other one wrote down what transpired, though this was not intended to be a rigid division of labour. From each interview a report was prepared by the Trainees (mainly in Arabic). The National Consultants did a preliminary assessment of the reports' quality, asking for clarifications or amplifications if necessary. The final interview reports were then translated into English, sometimes in summarised form due to time and human-resources constraints. Comments from the Investment Office were obtained about some of the companies and the problems they complained about.

Phase III (Data analysis)

This phase was developed during the Second Mission of the International Consultant. It included six more interviews conducted by the International Consultant himself (accompanied and assisted by the National Consultants) in Damascus, Rural Damascus, Sweida, Hama, Homs and Raqqa. A total of 24 companies were thus interviewed for the study.

Analysis of interviews. Data analysis in this case is not of a statistical nature, but is intended more as a set of case studies, to be used as a source of ideas and as an instrument to give insight into the problems encountered by private companies under the current legal and institutional setting, both for establishing and operating the firm. Reports from the interviews were used as the basis for this activity.

Analysis of secondary information. Besides the analysis of the interviews, three other sets of data were analysed:

- Data provided by the Investment Office on agribusiness companies that have applied for licensing under Law No. 10. This covers applications filed since 1991 through 2000. Most of these companies have been licensed, but a few were rejected or withdrew their applications. Out of those approved, also quite a few never started operating. This information was used to ascertain trends in private investment in agribusiness during the 1990s, as established in the Terms of Reference for this study (Annex 1).
- Regulatory regime for private investment (including procedural rules and practices), gathered from the Investment Office, besides information on this matter provided by the firms interviewed. Most of this information had been already gathered during the first mission.
- Information on other policies relevant for private investment, such as policies regarding foreign currency, foreign trade, taxes, price setting, credit, sanitary controls, quality standards and regulations, etc. This also includes information about changes in policy already decided or under consideration to be implemented soon.

3.5. Contents of the study

The overall purpose of the study was decomposed in the following specific aims:

- To assess **trends** in private investment in the business sector since 1991 to 2000
- To assess the **impact** of the Investment Law on the Syrian economy
- To analyse **problems** faced by private companies in the agribusiness sector

- To propose possible **improvements in the legal regime governing the promotion of private investments** (Law 10/91 and related legislation)
- To analyse and propose possible **improvements in the investment environment broadly defined**, including macroeconomic and institutional aspects.

The following sections in Part II of this report analyse these aspects, to draw finally some conclusions and recommendations, aimed at improving the institutional and economic environment to attract private investment towards the agribusiness sector in Syria. As an additional output, some international co-operation projects are identified and briefly outlined, to help Syria build a better environment for promoting private investment in the agribusiness sector.

Part II: Analysis and results

4. The current private investment promotion regime

4.1. Private investment before 1991

Syria has been following the approach of economic system diversity in which all sectors collaborate side by side to achieve the goal of economic growth. However, in practice the central-planning system developed in Syria during recent decades was characterised by a copious number of restrictions for private investment. All the essential levers of the economy were in the hands of the State, and strict controls were in place for all kinds of private economic activity.

Opening a business was (and still is) relatively easy for a Syrian, since he or she need only to register in order to obtain a fiscal license, as in many other countries. But no possibilities existed for non-Syrians to acquire land, and very little legal room for a foreigner to operate a business. Nowadays it is possible (through very complicated) for a foreign corporation to establish a branch in Syria, but not so up to the 1980s.There were very high barriers for importing equipment and inputs, and many items were directly banned. There were very high levels of taxation on business income (up to very recently any annual income above U$S 20,000 would pay a direct income tax of 66%, including 45% tax plus surcharges, and other taxes on real estate and fixed assets).

The national currency was not convertible. Obtaining foreign currency was practically impossible: banks would not deliver foreign currency in exchange for Syrian Pounds, and the possession of foreign currency was illegal. Even exporting was penalised by export taxes, multiple exchange rates, and cumbersome procedures. Any import operation, even if the particular item was not in the list of banned imports, had to be explicitly authorised on a one-by-one basis. A large proportion of all economic activity was legally off-limits for private agents and reserved only to the State. Banks in Syria would not make loans or extend credit to their customers, except in very specific cases (such as programmed credit for farmers). The price of goods and services was largely determined by the planning system. Even in the case of prices that were nominally not set by the State, authorisation was needed to change them.

The main private agents operating in Syria were **farmers** and **merchants**, since farming and retailing were two activities never nationalised. Private manufacturing was very limited, and subject to restrictions linked to the planning system. Most agricultural production (comprising all strategic crops, that were more numerous then) was sold solely to the State, at fixed prices. Most wholesale purchases made by merchants were made at fixed prices from State suppliers. Even the decision of a farmer to plant a certain crop, and the amount of that crop to be planted, was determined by the planning system, and there were penalties for farmers who grew non-programmed crops or changed the amount planted (this was especially so for strategic crops, but they represented the vast majority of all crops).

Starting with Decree 10/81, and later with Decree 10/86 and Law 10/91, the Government of Syria offered investors the opportunity to side-step this scenario by way of granting **special privileges** to certain **authorised investments**. These investment would take the form of **joint-venture** enterprises, whereby private capital would be associated with the State. **The overall system of restrictions was not essentially modified**, but specific investment projects were allowed to benefit from special exemptions and privileges. Those exemptions and privileges were granted only for a **limited number of years**, and so the projects would eventually come to operate **under the ordinary**

institutional environment and restrictions prevailing in the Syrian economy. The 1981 decree concerned only joint-ventures of private (mostly foreign) capital and the State in certain sectors such as international hotels and others, and the 1986 decree extended the privileges to agricultural joint ventures. However, the privileges granted by those Decrees was apparently not sufficient to mobilise a large number of investments, and anyway they did not cover totally private companies. In an attempt to compensate for these shortcomings, during the years 1981-1990 the Government also introduced small adjustments in various aspects of the overall economic environment.

In practice, the process of private investment really took hold with the Investment Law 10 of 1991. The present study will be concerned only with the legal framework created by the Law of 1991, disregarding the Decrees of 1981 and 1986, because of limitations in the time and resources allocated to the study.

During the 1990s, the small and piecemeal adjustments to general economic regulations that had started in the 1980s took renewed force and speed. A number of steps were taken with the clear purpose of achieving a gradual **liberalisation of the economic environment**. This has proceeded, however, in the same fashion: **by very gradual steps and in a piecemeal faction**.

Creating an investment-friendly environment, in fact, involves both sorts of policies: a regime of specific privileges and incentives, and a larger change in the overall institutional and macroeconomic environment. The latter is still underway at the time of writing, and the process is expected to continue into the future.

4.2. Investment Promotion legislation in the 1990s

This section summarises the provisions of the Investment Promotion Law 10/91, its attendant Decree 7/91 concerning operational details of the Law's implementation, and the recent Decree 7/2000 that modifies some provisions of the 1991 law.

4.2.1. Investment Promotion Law No. 10 of 1991

This key piece of legislation, signed by President Hafez Al-Assad on May 4th, 1991, contains two introductory articles that set the Law's scope and basic definitions (Articles 1 and 2), and six chapters, covering articles 3 to 39, that spell out the full provisions of the Law.

According to Article 1, the law 'governs capital investments by Syrian Arab nationals, both resident and non-resident, and by nationals of Arab and foreign countries in development projects within the framework of general economic, social and political development plans of the State'. Article 2 defines the core terminology used throughout the law, such as 'Project', 'Investor' and others.

Eligibility rules. Chapter I of the Law concerns eligibility rules. Article 3 defines the fields of investment covered:

- **Agricultural projects**, including plant and animal production, and processing of agricultural products (more detailed specifications are provided in Decree No.7 of 1991, as explained later).
- **Industrial** projects open to the private sector and the joint (public and private) sector
- **Transport** projects (car-rental, buses and mini-buses, and others)
- **Other** projects which the Supreme Investment Council decides to include within the scope of this Law.

Article 4 spells out other eligibility or prioritisation conditions for a project to access the benefits granted by the Law:

- The project should be **in line with the objectives of the State Development Plan**
- **Local resources** are to be used as much as possible
- The project should contribute to economic **growth** and provide **employment** opportunities.
- It should lead to **increased exports** and **more rational imports**
- It should use **up-to-date machinery**, suitable to the needs of the national economy.

In addition projects are required to require investments above ten million Syrian Pounds (about U$S 200,000).

Implementing authority. Chapter II designates the authorities in charge of implementing the Law's provisions. A single decisional authority is established, namely the **Supreme Investment Council**, a body presided over by the President of the Council of Ministers, and composed also of the two Vice-Presidents of the Council of Ministers (for Economic Affairs and for Services) and Ministers in the concerned departments (Agriculture, Transport, Supply, Economy and Foreign Trade, Industry, Planning, Finance).

Below this Council it is established a specialised agency, the **Investment Office**, within the jurisdiction of the Vice-President for Economic Affairs, Council of Ministers. The director of the Investment Office serves also as Secretary to the Council. The Investment Office is to carry out the reception of projects previously submitted by investors to the corresponding Ministry, the submission of projects to the Council, the implementation of that body's decisions, and the monitoring of the investment projects as they are carried out and put into operation. The subsequent procedural decree No.7 of 1991 (article 3) grants its Director the rank of a Vice-Minister.

The Office is an administrative unit without any autonomy in terms of decisional power or budget. It works on a very limited staff, and according to the Law it limits its intervention to receiving the projects, submitting them to the Council, and implementing the Council's decisions. It does little on the matter of monitoring the projects as they are put into operation, a very important shortcoming which is addressed later in this report. Presently, authorities are concerned that the status of the Office should be upgraded to give it more autonomy and a wider mandate to promote private investment, another idea that is also addressed in the policy options and recommendations included in this report.

Benefits granted. Chapter III of the Law refers to **exemptions, advantages and facilities granted to projects** under the Law. Article 11 authorises the **importation of any equipment and materials** needed for the operation of the project (though the number of vehicles imported needs to be authorised by competent authorities). The imports do not need to comply with existing provisions concerning import prohibition, suspension or monopoly, from rules requiring direct import from the country of origin, and foreign exchange regulations. Capital goods imported to be used solely for the purposes of the project (Article 12) are also exempted from all taxes, fiscal and municipal duties, custom duties or other charges. Instead, supplies and materials needed for the operation of the projects are subject to import duties and other taxes that apply. The imported goods may be sold at their residual value only with the Supreme Investment Council approval,

and taxes would be levied on them at that stage depending on the state of the goods. A separate rule (article 32, second paragraph) subjects to income tax any capital gains resulting from the sale of project assets.

Article 13 spells out the direct tax exemptions granted to investment projects licensed under this law. All projects as well as their shares, funds, profits and dividends shall be exempted from all **taxes on income** and from **real estate taxes** on the properties used for the purpose of the projects. This exemption is granted for seven years after commencement of production for joint (public-private) projects, and for five years for private companies (with or without foreign participation). For projects that have exported at least 50% of their production, the tax exemption may be extended for two additional years. To enjoy the full period of direct tax exemptions, the commencement of production (Article 14) should not be later than three years after approval (any excess construction time will be deducted from the period of tax exemption).

Notice that the tax exemption covers only direct taxes on income and real estate. No tax exemption is granted for indirect taxes (other than customs duties and other minor taxes on imported equipment or inputs). Private companies licensed under this Law should have to pay all indirect taxes on their raw materials, stamp duties and other taxes existing in the country. **The tax on equipment assets is also not exempted.**

Projects are authorised to open a **foreign-currency account** in the Commercial Bank of Syria. The investor should deposit in that account 100% of the project capital in foreign currency and the full amount of loans obtained in foreign currency, as well as 75% of export revenue in foreign currency. The account may be debited for all project expenses including transfers abroad as provided by the Law. The funds will be accepted with no questions asked about their origin. Interest at applicable rates shall be paid for the balance of funds deposited in the authorised account. The Commercial Bank of Syria is obliged to keep the necessary foreign currency reserves for those funds to be at the investor's disposal at all times (Article 17).

Though the Law is not explicit about this, in practice investors are not required to deposit 100% of the capital **in advance**, but only **as investment disbursements are to be made**. This minimises the time spent by the funds in the allotted foreign-currency account, if the investor prefers to have the funds deposited elsewhere, and do not impose an unnecessary financial burden on the investor. However, this is not clear in the letter of the law. On the other hand, foreign capital brought into the country not in foreign currency but directly in the form of imported equipment is not included in the requirement to deposit the capital in the account.

Joint State-private projects. Chapter IV refers to joint projects, with at least 25% public sector ownership. These projects will take the form of corporations or limited liability companies.

Foreign investment. Chapter V deals with foreign investment. This concept covers several categories:

- **Funds in foreign currency** transferred from abroad by Syrian, Arab or foreign nationals through a bank operating in Syria
- **Imported equipment, supplies and materials** required by the project
- **Profits, returns or reserves** resulting from the foreign capital invested, when they are **reinvested** to increase the project's capital or **to invest in other projects** approved under this Law.

- **Intangible assets** such as patents or trademarks duly registered according to international rules.

The two first categories are the most important. Foreign capital, in short, can be brought to the country in the form of foreign currency or in the form of imported equipment. The latter may be paid directly to suppliers from funds held abroad, and then imported into Syria. The other two categories are also important: they recognise reinvested profits and money balances as foreign capital (thus allowed to be repatriated), and also recognise intangible assets and intellectual property as part of the foreign investment, though no procedure is established in the Law for the valuation of such assets.

Article 24 concerns **foreign capital repatriation and profit remittances**. It authorises non-resident investors to transfer abroad (after at least five years of commencement of operation) their capital invested in the project, on the basis of the project net worth but *not exceeding the original amount of the investment brought from abroad*. They are thus not authorised to transfer abroad any capital accumulated through reinvestment or otherwise not brought to the country from abroad (**this significant limitation was later relaxed by Decree 7/2000**). Also, this article 24 rules that in the case of difficulties preventing the implementation of the project, capital repatriation to foreign countries is also allowed after six months of the original transfer from abroad, and in special cases even before six months, but this must be authorised by the Supreme Investment Council Also, Article 24 authorises the transfer abroad of interest and profit accruing from the investment of foreign capital. Article 25 calls for the Central Bank to permit capital, interest or profit transfers abroad, either in the original foreign currency of investment, or in any other convertible foreign currency.

The Law itself and the attached declaration of grounds and motivations clearly states that the authorities are not obliged to provide foreign currency in exchange for Syrian Pounds for the purpose of remittances abroad or for importing any goods. The foreign currency should come from the original investment or from the 75% of export proceeds the companies may keep in foreign currency. However, **no provision is made for the case of companies with foreign capital that do not engage in exports but produce only for the domestic market.** This, it is said, has created some problems for the concerned companies, since they are authorised to transfer profits or salaries abroad but are not permitted legally to buy the necessary foreign currency. No provision exists that limits foreign investment solely to companies devoted to the export market, and in fact many produce for the domestic market (totally or partially). As a result, if required, foreign currency for those purposes would have to be acquired in the parallel (black) market, something **corporations from developed countries may find difficult to justify.**

This necessity of accessing the parallel market, besides, implied a significant loss (relative to the cost of foreign currency acquired in the official market) when multiple exchange rates were in force and the differences were wide. It is less relevant now since the applicable bank rate for such transfers abroad or import payments (if effected through the official exchange rate) would be 46 Syrian Pounds per US dollar, quite close to the going parallel market rate of about 50 SP to the dollar (as per the end of January, 2001). However, the loss remains until all exchange rates are finally unified at free market levels.

Other provisions. Chapter VI contains various other general provisions. They include some general procedural rules for submitting and approving a project (Article 27). Any project (in the form of a short feasibility study) should be submitted to the competent Ministry, which is to refer it with its opinion to the Investment Council within 30 days.

The Council, in turn, is to decide on the matter within a further 30 days. This detour through the competent Ministry is intended to establish that the project does not collide with other regulations, with the national development plan, or with existing policies; however, on occasion it has been a motive for delaying a project unnecessarily, as Ministry officers may be inclined to disapprove of a project that would create competition for existing State enterprises, even if this creation of competition and private investment is explicitly authorised in the Investment Law (for instance, it seems that a private project for producing beer was delayed for several months recently, on precisely those grounds).

Obligations of investors. Article 28 spells out the obligations of the owners of approved projects. They include keeping accounting books according to Commercial Law, providing annual balance sheets and other information on a regular basis, and keeping a separate account on all funds and operations that benefit from exceptions or facilities granted by the Law. These records must be open for inspection at all times. Article 29 enables the Council to suspend the benefits in the presence of any infringement of the Law on the part of the company. According to Article 30, all custom duties and related fines and charges would have to be paid if a company put the imported equipment or inputs to any other use than authorised; if the infraction is repeated the exemption privileges of the company under Law No.10 may be cancelled by the Investment Council (as it in fact occurred with some transportation companies). Article 31 enables the Council to extend the facilities of Law No.10 to projects existing independently of Law No.10, "except exemption from taxes and duties". It also establishes that foreign workers or experts may transfer abroad up to 50% of their pay, and 100% of their end-of-service indemnity.

4.2.2. Decree No.7 of 1991

The Executive Order (or Decree) No. 7 of 1991 provides detailed instructions for the implementation of Law No 10. Some of the more relevant provisions are mentioned below.

Article 3, elaborating on the investment fields covered by the Law, specifically states that agricultural projects comprise "Plant and animal production, as well as all ancillary, connective or complementary activities, such as construction of greenhouses, refrigerated storage facilities, fruit and vegetable sorting, packing and wrapping facilities (whether or not the goods are produced by the same project)."

Besides this, the investment fields continue to comprise also projects for the processing of agricultural products (either plant or animal products), other industrial projects, as well as projects in the field of transport and (upon Council approval) in other sectors.

However, the Investment Council as a general rule has not favoured projects exclusively devoted to agricultural production, and in fact few ever applied. Most projects including agricultural activities (crop or livestock) comprise also investments for industrial processing of the resulting products.

Article 13, paragraph (b) states again that the project is responsible for ensuring all its requirement in foreign currencies by lawful means, and no official authority shall bear any responsibility to provide any amount of foreign currency for the project or its owners. In connection to this, Article 14 grants that using foreign currency in their possession or bringing foreign currency held abroad, investors are not to be held criminally liable under the provisions of any existing penal law (this is in reference to

older legal provisions, not yet formally abolished, that penalise the possession of foreign currency by Syrian nationals).

Though this is clear enough, the problem remains of obtaining foreign currency for projects oriented to the domestic market. As said before, the importance of the problem has diminished since the difference between the official and parallel rates of exchange has narrowed, but it is a problem anyway. Anyway, there is still a 10% difference between the official rate for exports and imports (46 SP per dollar) and the market rate at which the currency is to be obtained (about 50 SP per dollar). As 25% of export proceedings is exchanged compulsorily in Syrian Pounds at the official rate, this in effect imposes a tax of about 2.5% on export proceedings due to the difference in exchange rates. This problem will be solved when a complete unification of exchange rates is attained.

Article 35 establishes that joint sector agricultural companies (i.e. with at least 25% participation of the State in its ownership) shall be ruled by Legislative Decree No.10 of 1986, and not by the Investment law, i.e. Law No.10 of 1991.

It is worth noting that the provisions of Decree 10 of 1986 have not enjoyed a great success with investors. In fact, this was the chief motive underlying the much wider benefits granted by Law No.10 of 1991. All the authorities consulted in this regard consider that there is not much interest of private investors in that kind of joint-venture, and thus the attention of this study should focus exclusively on the Law No.10 of 1991 and its subsequent by-laws and modifications.

4.2.3. Decree 7 of 2000

The new norm the Government approved in 2000 modifies several articles of the Investment Law No.10 of 1991 in view of the experience accumulated in the intervening years. Its general thrust is to ease restrictions and facilitate the operation of private investments, and it is regarded as a significant step towards further liberalisation of the investment atmosphere.

Property rights of foreign investors. Article 1 allows the Investment council to authorise non-Syrian investors to own and lease the land and real estates necessary for the establishment or expansion of the project, thus superseding a general provision that keeps foreigners from land ownership in the country. This article also establishes that upon the cancellation or final liquidation of the project, non-Syrian investors must relinquish to others the lands of the projects and the building constructed thereon, with the Council approval if the new owner is to be non-Syrian. This provision permits foreign investors to recover their investment in infrastructure.

Applicability of benefits granted by previous laws. Article 2 makes clear that after the completion of the tax exemption period for projects approved under Law No.10, those projects may still enjoy tax exemptions granted by previous legislation, such as those granted to sea transportation by Decree 174 (1952) and by Decree 85 (1949) to agricultural projects.

Long-maturing projects. Article 3 modifies article 14 of the Law 10 of 1991, in the sense that projects with longer maturation periods may be granted (by exceptional decision of the Investment Council, and at its discretion) an extension of two additional years over the three years allowed by Law No.10 for the implementation or construction period, before the commencement of the five-year period of tax exemption.

However, this provision only extends the maturation or construction period for two additional years, which may be too little for some cases, as in projects involving planting and growing olive trees that achieve full productive maturity after 15 years.

Priority projects. Article 4 modifies article 15 of the law, ruling that an extension of the tax exemption period may also be granted if the project is deemed of basic importance to the national economy, or if the project is established in one of the "developing" governorates (Raqqa, Al Hassakeh, Deir Ez Zor).

Foreign exchange and export revenue. Article 5 modifies article 16 of the law, which regulates the distribution of export revenues and the management of funds in foreign currency. It adds a paragraph stating that **the percentage of export revenue that owners may retain** (which the law fixed at 75%) **may be exceeded by a decision of the Council.** Also, it permits the companies and projects licensed under the Law to open accounts abroad, provided the amounts deposited therein do not exceed 50% of the capital paid in foreign currency. Finally, investors may also be permitted to transfer their funds in foreign currency into domestic currency **at the semi-official exchange rate "prevailing in neighbouring countries"** (46.50 SP to the dollar).

Joint projects. Article 6 modifies article 19 of the Law. It states that the State participation in joint projects may be paid either in cash or in kind (e.g. in real estate or equipment, including second hand machinery). It also regulates that joint projects established in the form of share-holding corporations or limited-liability companies may be drawn without adhering to existing regulations such as the Trade Law 149 (1949), thus in effect deregulating several aspects of the constitution, by-laws and internal workings of the joint companies. A third paragraph authorises the Council to extend the above deregulation **also to non-joint projects**.

Stamp tax exemption. Article 7 modifies article 22 of the law, which also concerned joint companies. The exemption from stamp taxes is thereby extended to non-joint companies, provided at least 50% of their shares are opened to the public. **Other companies, that are in fact the vast majority at present, are not exempt**.

Foreign capital repatriation and reinvested profits. Article 8 improves on the allowance for foreign capital repatriation. Instead of the provision of Law No.10, that restricted the amount to be repatriated to the amount initially invested, the new legal text allows for repatriation of the foreign investor's share in the firm's capital "on basis of the actual project value on the date of relinquishment". This is consistent with the provision of Article 23 of the Law, where it is stipulated that "foreign capital" is comprised not only of the amount contributed from abroad, but also profits, returns and reserves resulting from the investment in foreign capital. This part of the definition of foreign capital is best spelt out in Decree No.7 of 1991, article 30, that includes in foreign capital all "profits, returns and reserves resulting from the investment of foreign capital in development projects, whether they accrue in foreign or domestic currency, provided they are used to increase the capital of the concerned project or invested in other projects approved under the provisions of the Investment Law". In other terms, reinvested profits from foreign investment are considered foreign capital, and thus the final amount of foreign capital in the project will be larger than the original amount of foreign investment. Again, this provision (which explicitly refers to profits or returns that accrue either in foreign or domestic currency) raises the question of how the companies would be able to (lawfully) raise the necessary funds in foreign currency to effect the repatriation of capital when the project does not generate enough export revenues to cover those needs.

Furthermore, it should be noted that under these provisions, reinvestments or new fresh investments **in the same project** cannot enjoy an extension of the tax exemption period, nor generate an exemption period of their own, unless they are made **under a separate project** duly presented to and authorised by the Investment Council. This is an important limitation since investment is a continuing activity for an expanding and successful company. The recommendations of this study include some suggestions to overcome this limitation.

Guarantees for private property and resolution of disputes. Article 9 greatly improves on the guarantees for private property in the projects. It expands article 26 of the 1991 Law establishing that the projects and investments licensed under the provisions of the Law shall suffer no confiscation, expropriation or limitations in the disposal of the investment ownership or its returns, unless it is for the purpose of public interest for a fair indemnity. This provision is similar to the relevant legislation in most Western countries. This article also regulates the resolution of disputes: they are primarily subjected to Syrian courts, but the parties may resort to the Arab Investment Court formed in 1980 within the Agreement for investment of Arab capitals in Arab countries, or according to the provisions of any agreement for investment protection signed between Syria and the country of the investor.

Extending the coverage of investment promotion benefits. Finally, Article 10 of Law No.7 modifies Article 31 of the Law No.10 of 1991, permitting the Government to extend the benefits of Law No.10 to other kinds of investments, including those existing before the date of said Law, including holding companies, which are thereby able to benefit from tax exemptions granted by Law No.10.

This rapid revision of the changes introduced in 1999 shows that all of them point to a liberalisation and expansion of the benefits granted by Law No.10, either correcting some perceived insufficiency, lack of clarity or shortcoming in the original Law, or enlarging its coverage. It is clear that the intention of the Law is to open more fields to private investment, and to increase the facilities and advantages granted to it.

4.3. The institutional and macroeconomic environment

The pieces of legislation revised above (Law No.10 and Decree No.7 of 1991, and Decree 7/2000) form the core of the legal framework directly promoting regulating private investment promotion in Syria. But besides, the overall institutional and macroeconomic setting and a number of Government policies and legislation have a substantial bearing on the prospects for private investment in Syria, since they define key aspects of any investment project, including the price of inputs and outputs, the rules regarding credit, regulations concerning environmental protection, and much more. Thus these features of the Syrian macroeconomic setting and policies should be considered as a legal and economic framework indirectly regulating and directly influencing the profitability of private investment.

4.3.1. The planning system

Few private investment initiatives directly deal with the planning sector as such, but it anyway exercises an influence. To begin with, authorising an investment project at the Investment Council requires the previous approval of the concerned Ministry (Industry, Agriculture) to ensure that the proposal is consistent with the goals and priorities of the National Development Plan, and does not interfere with activities undertaken by the

State within the framework of the State-led centrally-planned economy. This stage of the authorisation process may delay or stop a project in certain cases.

Besides this, the very fact that the planning system is in place means that to undertake a private economic activity, and more so in the case of a sizeable investment project, any would-be private investor has to be previously **authorised**. Under such a planning system, private agents do **not** have the right to undertake an enterprise **unless the State planning system authorises it**. This presupposes that "the State knows better", i.e., that the entrepreneur may fail to know or care about all the issues concerning his project, especially its macro repercussions, and the State, instead, will have the ability to ascertain whether the project is a worthwhile contribution to the public good. The entrepreneur will be concerned only with his possible private profits, while the planning system will look for the social utility of the project.

This idea could work finely if the State planning system has **perfect information** and applies impeccable **evaluation criteria**. Unfortunately, this is often not the case, just because of human limitations. Information available to the State may be imperfect, and the correct evaluation criteria (that are indeed mandated in the Investment Law and other pieces of legislation) are applied also imperfectly. For instance, the approved projects have all passed muster at the corresponding Ministries, apart from being approved by the Investment Council, and one of the criteria to be applied is that the projects promote employment (see article 4 of the Investment Promotion Law No.10/91); however, as will be seen in the next chapter of this report, the employment impact of the projects is exceedingly small. If the planning agencies had better information on the most profitable and appropriate technologies to be used in Syria given the existing supply of capital and labour in the country, they would have recommended other technological choices that increase the impact on employment, but probably those planning agencies had not the necessary information for that.

In another example, one State agency may delay or reject a private project because it would create unwanted competition for a State-owned enterprise, which is currently operating in an inefficient manner and would thus be harmed by the new private project, that would possibly intend to sell the same goods with better quality or at a cheaper price. This criterion of preserving the State-owned inefficient companies is **not** among the criteria stipulated by the Law, and it implies a real cost for the people (who would not have access to better or cheaper goods unless the new project is authorised). But that unwise criterion could be applied nonetheless, because in practice State agencies and its personnel do not always apply impeccable evaluation criteria but are often persuaded to preserve the current status quo, often without questioning whether that status quo should not perhaps be changed in the interest of the country and its population.

The most important and relevant impact of the planning system on private investment is the fact that a large portion of the economic activity has been for many years under strict planning and reserved to the State sector, thus in effect precluding any private investment. Many such restricted sectors still exist at the moment, including purchasing, processing and marketing strategic crops, which directly affects agribusiness.

Another very important impact is that most prices are based on compulsory or indicative official prices set by the public sector. Even the indicative prices are in effect almost compulsory because many traders, farmers or other agents take them as their base price and do not alter them easily or very often. Apart from being fixed and sometimes involving an implicit tax or subsidy, the official prices are **usually the same for all varieties and qualities of the product**, and thus **do not permit the development of finer**

grading of the products or the establishment of much-needed standards of quality. Insofar as the rigid price system is in place, little can be done to develop in Syria a more adequate system of quality standards and thus help introduce Syrian products in world markets. Under the present system, such improvements are to be introduced by the companies themselves on a one by one basis, and they often cannot obtain raw materials of the required quality because the price system is not discriminative enough to reward higher quality with a higher price.

Also, even for prices that are theoretically free, authorisation must be sought from the government to change the price of the product (either to raise it or to lower it). The license to adjust prices is presently granted easily, but it could in theory be denied. Many companies resort to "special promotion" or "special discount" schemes to side-step the requirement of governmental authorisation for price decisions.

4.3.2. The banking and credit system

The banking system in Syria is very far from being an adequate financial system of the type found in most market economies. Its most salient characteristic is its public ownership. Despite the recent introduction of legislation to allow for private banks, until the time of writing the entire banking system is State-owned.

However, many countries have operated and still operate with State-owned Banks without this impeding the normal operation of the market. One such example is Costa Rica, where banks were nationalised decades ago. State-owned banks, besides, coexist with private banks in many countries, including most developed countries and especially those of Western Europe. Such a mixed system is to be established in Syria when private banks are opened under new legislation passed in 2001. But nonetheless, the present condition of the State-owned banks is quite unsuitable to serve as serious conduit of private business. Much is to be done to improve the efficiency of the public-sector banks, if they are to have any participation in fulfilling the financial needs of the private sector.

Much of banking credit is taken by the public sector. The share of private borrowers on total credit has been increasing, but still now more than two thirds of the available funds are allocated to the public sector. Most public corporations borrow from the Commercial Bank of Syria. **More than 90% of credit to the public sector goes to the State-owned organisations in charge of purchasing and marketing cereals and cotton.** Thus, in effect, **the intervention of the public sector to control and subsidise strategic crops creates a crowding-out effect in the entire financial system**.

Besides, all banks have an obligation to buy Treasury Securities in the amount of 7.5% of their total deposits, and obligatory reserves are also set at 7.5% of deposits. Interest rates are administratively set by the Government and have remained unchanged for years, in spite of changing levels of inflation. In fact, the decline in inflation and the period of deflation in recent times meant that **real interest rates have gone up.** The lending rates for private sector borrowing are 7.5% to 9%, which in 1999 implied a real rate of 9.6% to 11.1% given a deflation rate of 2.1% (consumer prices). Public sector and co-operative sector operations enjoy a lower rate (5.5%). Passive rates paid for deposits have also risen in real terms: nominal rates are 7%-8% for time deposits, i.e. 9.1% to 10.1% in real terms during 1999. Spreads between active and passive rates are small, about 1%, meaning that banks cannot adequately cover their operation costs, which are difficult to assess precisely but should be higher than that small spread. This is a further factor reducing the banks' ability to improve their administrative efficiency. Apart from

detracting from the banks' profitability and requiring support from the public budget to keep the banks functioning, much of the real consequences of this deficit in covering administrative costs is bore by customers in the form of delays and difficulties in banking operations, and acts as a drag in the overall efficiency of the economic system.

A law authorising private banks to operate in Syria has been issued in April 2001. Private banks may include banks with up to 49% foreign ownership. Foreign banks established in Lebanon will have also the possibility of opening branches in Syria. This significant new legislation is expected to give rapid results as private banks start to sprout out across the country. However, other steps are still in process or missing. The most significant one is the lack of an adequate and updated legislation about **Central Bank functions and autonomy**, and most crucially about **bank oversight and regulation**. Announcements in January 2001 of a complete overhaul of monetary policy arrangements, re-enacting the long-dormant Money and Credit Council and making the currency convertible have not materialised yet. Specific legislation on bank oversight and regulation are expected to be approved soon. More adequate and transparent norms and practices to conduct monetary policy are also still absent.

4.3.3. Foreign trade and foreign exchange

Restrictions to foreign trade are numerous and of various kinds. In spite of a steady process of piecemeal liberalisation that has been going on for years, many restrictions remain.

Since the overall economic system operates with a non convertible currency, there is a strong commitment to control all outflows of payments, which explains the harsh restrictions on foreign exchange, flows and capital, and imports. On the other hand, the government has also established restrictions on exports, especially of foodstuffs, based on the idea of exporting mainly the surplus after satisfying domestic demand, to ensure that domestic demand is adequately covered with local production, or minimise imports in case production is not enough to cover domestic needs.

This approach does not take into account any **gains from trade**. The idea that producing **A** for export, and then import **B**, is better than producing **B** at a higher cost is applied to non-essential items, but not to necessaries such as food. Considerations of national security have dictated a radical policy of self-sufficiency and thus barred that possibility. This in turn has created the need to minimise imports of any kind and also a tendency to restricts some exports. However, as this approach has obvious problems, especially the tendency to create external gaps and ultimately to breed financial crisis, steps have been gradually taken to liberalise this scheme with specific measures that ease restrictions on a piecemeal fashion.

For import purposes, the traditional trade regime (now under gradual reform) consisted of three lists:

- **Restricted list**. This comprises all goods that can only be imported by the public sector, including for instance medicines or automobiles.
- **Negative list**. This includes all prohibited imports.
- **Permitted list**. This is the list of imports that in principle can be made by the private sector, but subject to various restrictions especially related to the means of payment.

The list of permitted imports is in turn divided into three groups according to the method that may be used for payment. One group is in the **unrestricted payment list**, comprising imported items that can be financed through any private source of foreign

exchange, though the availability of foreign currency should be certified by the Commercial Bank of Syria. This method of payment covers about 3/4 of all private sector imports at present. Another portion of the permitted imports is on the **export proceedings payment list**, comprising imports that can only be purchased using the portion of export proceeds retained by exporters (exporters normally can retain 75% of their revenue in foreign currency, though this ceiling does not apply to several commodities such as fruit juices and others, and since 1999 can be raised up to 100% in the case of investment projects protected by Law No.10 of 1991), and is also exempted for agricultural exports. The available proceeds of exports are traded at a market of export proceeds, where they can be bought by interested importers. About 18% of private imports go this way. Finally, there is a **workers remittances payment list**, comprising goods that can only be financed with workers remittances, duly documented at the Commercial Bank of Syria. This method covers about 7% of private imports.

Besides the restrictions embedded in the lists and the requirements regarding payment, every import operation (in fact every individual item imported) needs a license issued by the Ministry of Economy and Foreign Trade, and all operations should also be registered at the Ministry of Supply. All importers, besides, should have a previous license to operate as such, as do all exporters. Exports also need licensing and similar procedures.

A complicated tariff system, presently under reform and simplification, has evolved in Syria over the years. It consisted of a very differentiated tariff affecting different categories of goods, further complicated by the use of specific rates of foreign exchange for each particular category. So (until the recent unification of the accounting exchange rate used for imports and exports) one category may have a 50% tariff on its CIF value converted into Syrian Pounds at the rate of 11.25 per dollar, while another category may have the same tariff but using the 46.50 SP/dollar rate. This system, still in force in its essentials at the beginning of 2001 in spite of partial simplification, was reportedly soon to be changed and simplified.[27] Before the reforms, it greatly complicated calculations related to nominal and effective protection. Besides, the tariff itself was not, up to quite recently, a simple percent rate, since it comprised different border duties and surcharges. Though several of these have been later collapsed into a "unified tax", parts of the complexity remains in place. Imports are charged first the tariff, then a 30% increase of the tariff for the War Effort Surcharge, and a further 3% of the tariff for a local administrative charge.

There are also other trade restrictions of several kinds. For instance, it is forbidden to import an item from a country different from the country of origin, and quality standards for imports may be over-restrictive. The traditional trade policies also included export taxes and the export of some goods was banned, or restricted to the public sector. Domestic taxes were seldom rebated or exempted for goods destined to be exported, thus in fact reducing the competitiveness of Syrian exports (most countries exempt exports from domestic taxes). For instance, the 9.5% to 12% agricultural production tax was paid for exported products; it was later lifted for fruit and vegetables and recently eliminated for all farm exports (Decree No.10 of 2001).

[27] Some reforms have been actually introduced after the completion of the fieldwork for this study. The details have not been incorporated into this description.

Reforms to trade policy adopted during the 1990s include a gradual expansion of the permitted list and a corresponding reduction in the restricted and negative lists. The permitted list has expanded to include about 10,000 items. Export taxes have been lifted.

Parallel to restrictions to trade were **restrictions on foreign exchange**. The law making possession of foreign currency a crime has been lifted only in 2000 (though dealing in foreign currency is still punishable with up to three years in prison, down from 15 years previously). For many years, a system of multiple exchange rates existed, though it has been gradually unified recently. Banks are not authorised to deal in foreign currency exchange. Only the Commercial Bank of Syria is legally authorised to intervene in foreign trade payments in foreign currency, and has been also authorised recently (January 2001) to sell foreign currency in small amounts for personal purposes (such as foreign travel), though explicitly not yet for commercial purposes. For all practical purposes the domestic currency is in fact not legally convertible. Exchange is mostly carried out informally at the parallel market.

There is indeed a market where exporters can sell their excess foreign currency to authorised parties to pay for imports or other legally specified needs. Access to that market is very restricted, and volume is low. The rate prevailing is similar and often slightly higher than the free (parallel) market rate, the premium reflecting the fact of this being the only legal way of obtaining foreign currency in exchange for Syrian Pounds.

Thus the overall economic environment in which private investors operate has been changing in the direction of a more liberal system ever during the last ten years or more. But many features of the old centrally-planned, State-led system remain in place. A decision to create a stock market was taken nine years ago, but it has not been yet implemented. Procedures related to business and trade remain extremely complicated and uncertain, which creates many delays and difficulties and creates incentives to proceed through informal channels when possible. The general picture is of a very rigid system on its way to gradually become more friendly to private investment. However, the process of liberalisation has not proceeded at a constant pace. The liberalisation process that started in 1991 with the investment law and other measures faced some troubles that are expected to be overcome after the issuance and implementation of Decree no. 7 of 2000 and other measures.

5. Trends in private investment in agribusiness, 1991-2000

From late 1991 up to December 1999, a total of 1613 investment projects were approved by the Investment Council in all sectors. The rate of approval of projects in this period was of about 16 projects per monthly session of the Council. The total committed (or approved) investment was 352.7 billion SP, roughly equivalent to 7.67 billion dollars (the official rate of 46 SP per dollar is used for this conversion). As the figure covers eight effective years (the Investment Law was promulgated in mid-1991, so few projects were approved in that year), this implies an average committed investment of U$S 0.95 billion per year. On an average GDP of about $13 billion in the period, it would amount (if materialised) to some 8% of GDP per year. The evolution of the approvals over time is showed in the following table.

Projects approved and capital committed by sector, 1991-1999

	Agricul-ture	Industry	Transp. & other	Total	Agricul-ture	Industry	Transp. & other	Total
1991		63	40	103	0.0	13.2	5.5	18.7
1992		106	158	264	0.0	16.5	14.0	30.5
1993		113	45	158	0.0	19.0	4.7	23.7
1994	7	146	53	206	0.7	77.5	1.6	79.8
1995	16	81	65	162	2.9	40.4	13.0	56.3
1996	11	82	116	209	1.6	60.6	3.7	65.9
1997	5	73	95	173	0.6	33.5	2.8	36.9
1998	13	40	160	213	4.0	15.9	2.5	22.4
1999	4	42	79	125	0.7	22.6	-4.8	18.5
Total	56	746	811	1613	10.5	299.2	43.0	352.7

In 1999 a number of transportation projects were cancelled or adjusted, resulting in a negative net commitment of capital in that sector.
Source: Investment Office.

The 1613 projects approved over the decade of the 1990s committed a total 352.7 billion SP, equivalent to about $7.67 billion at a rate of 46 SP per dollar. Agricultural projects are few (3%), including mostly production of ancillary inputs such as irrigation pipes or projects involving some plant or animal production in view of some ulterior industrial development. The Investment Council, in fact, has not favoured direct investment in agricultural production under Law No.10. The vast majority of the investments were committed to projects in the industrial sector (about 85% of the total investment). Transportation projects where very numerous, about one half of the total, but of lesser size, so that they represent only 12% of total investment.

The following tables show the details of the projects by sub-sectors as well as the committed totals of investment in foreign currency, investment in imported equipment, and new jobs.

Projects approved by the Investment Council, 1991-1999
(amounts in thousand Syrian Pounds)

	Projects	Total investment (000 SP)	%	In foreign currency (000 SP equiv)	%	% in foreign currency
Crops and trees (*)	34	5,777,197	1.6	2,984,155	1.1	51.7
Livestock & dairy production (**)	17	4,353,877	1.2	3,077,845	1.1	70.7
Irrigation equip., wells & farm inputs	5	406,661	0.1	337,277	0.1	82.9
Total of agricultural sector (***)	**56**	**10,537,735**	**3.0**	**6,399,278**	**2.3**	**60.7**
Food and animal feed (****)	265	68,869,064	19.5	41,595,016	15.3	60.4
Textiles & clothing	110	36,988,610	10.5	28,809,308	10.6	77.9
Wood products, furniture	5	408,856	0.1	255,101	0.1	62.4
Paper products, printing, publishing	20	5,034,052	1.4	4,210,041	1.5	83.6
Chemical industries, paint	99	27,324,432	7.7	22,665,484	8.3	82.9
Non metal products & bldg materials	60	127,941,408	36.3	110,461,984	40.5	86.3
Basic metal industries	45	8,463,135	2.4	6,524,844	2.4	77.1
Metal products & tools	100	18,120,405	5.1	12,216,617	4.5	67.4
Various industries inc. jewellery	2	115,505	0.0	57,704	0.0	50.0
Medicine & medical products	32	5,367,473	1.5	3,508,295	1.3	65.4
Tourism, entertainment & cinema	9	564,280	0.2	277,630	0.1	49.2
Total of the manufacturing sector	**746**	**299,197,984**	**84.9**	**230,582,016**	**84.6**	**77.1**
Electricity & power	2	1,735,432	0.5	1,633,887	0.6	94.1
Land transportation & car rental	801	39,257,632	11.1	32,217,824	11.8	82.1
Marine transportation	2	1,197,018	0.3	1,178,793	0.4	98.5
Total of transportation sector	**805**	**42,190,080**	**12.0**	**35,030,504**	**12.8**	**83.0**
Mining	**1**	**50,000**	**0.0**	**43,000**	**0.0**	**86.0**
Other activities	**5**	**750,787**	**0.2**	**571,819**	**0.2**	**76.2**
TOTAL	**1,613**	**352,725,824**	**100.0**	**272,626,624**	**100.0**	**77.3**

(*) Most projects include also livestock activities and related processing plants (e.g. olive trees and olive oil factory; olive trees and raising sheep).
(**) Most projects include also related processing plants (e.g. milk production and processed dairy products)
(***) Includes agricultural production plus the production of agricultural equipment, inputs and services.
(****) Includes some projects for producing agricultural inputs, breeding animals or providing services to farms, that should have to be classified in the agricultural sector for the sake of consistency.
Source: Investment Office. Percentages may not add up exactly to 100 because of rounding.

The projects included a programme total of 204.86 billion SP of equipment to be imported, which means about $4.45 billion, at a rate of nearly 550 million dollars per year. One salient feature of the precedent table lies in the final columns. The creation of nearly 100,000 new jobs by means of a total investment of 7.67 billion dollars means that **the cost of one additional job is U$S 76,705 on average**, mounting to almost U$S 100,000 in the manufacturing sector and up to U$S 249,112 in some specific sectors like "Non metal products and building materials", concerning mainly cement production plants. Agricultural production and processing shows average figures, at 65,866 and 78,818 dollars per job respectively, but still quite high even for mechanised modern agriculture and high-tech agro-industry.

As estimated before, the proposed investments would represent (if executed) about 8% of GDP per year, and aim to create about 10,000 jobs per year on average. With a labour force of about 4.5 million in 1999 (see Statistical Annex), this involves a 0.22% direct

increase in overall employment by investing 8% of GDP, or a direct investment elasticity of employment of about 0.028%, a very low impact indeed.[28] Even allowing for a reasonable employment multiplier in other sectors, both backwards and forwards, say a multiplier of 2 or 3 which would be quite good, investing 1% of GDP in this kind of projects would entail a (direct plus indirect) increase in overall employment of about 0.056% (with a multiplier of 2) or 0.084% (with a multiplier of 3), which is a mere fraction of the expected figure of about 0.15.[29] **Investments authorised under Law 10, therefore, have a very low expected impact on overall employment.**

Programmed imported equipment, expected employment, and planned capital/labour intensity
Approved investment projects, 1991-1999

	Imported equipment (000 SP equiv)	%	% of total invest.	Jobs	Investment per job	
					SP	U$S
Crops and trees	2,176,385	1.1	37.7	2,043	2,827,801	61,474
Livestock	1,758,647	0.9	40.6	1,111	3,918,881	85,193
Irrigation equip., wells & farm inputs	190,434	0.1	46.8	324	1,255,127	27,285
Total of the agricultural sector	**4,135,466**	**2.0**	**39.2**	**3,478**	**3,029,826**	**65,866**
Food and animal feed	28,559,015	13.9	41.5	18,995	3,625,642	78,818
Textiles & clothing	20,827,950	10.2	56.3	19,311	1,915,417	41,639
Wood products, furniture	150,346	0.1	36.3	199	2,054,553	44,664
Paper products, printing, publishing	2,635,902	1.3	52.4	1,243	4,049,921	88,042
Chemical industries, paint	15,123,887	7.4	55.3	5,053	5,407,566	117,556
Non metal products & bldg materials	87,975,480	42.9	68.8	11,165	11,459,150	249,112
Basic metal industries	3,245,672	1.6	38.4	2,901	2,917,316	63,420
Metal products & tools	6,716,988	3.3	37.1	6,919	2,618,934	56,933
Various industries inc. jewellery	48,165	0.0	41.7	103	1,121,408	24,378
Medicine & medical products	2,188,817	1.1	40.9	1,905	2,817,571	61,252
Tourism, entertainment & cinema	203,975	0.1	36.1	317	1,780,063	38,697
Total of the manufacturing sector	**167,694,224**	**81.9**	**56.0**	**65,111**	**4,595,199**	**99,896**
Electricity & power	**1,423,350**	**0.7**	**82.0**	**196**	**8,854,245**	**192,484**
Land transportation & car rental	30,083,752	14.7	76.6	30,591	1,283,307	27,898
Marine transportation	1,104,894	0.5	92.3	257	4,657,658	101,253
Total transportation sector	**31,188,646**	**15.2**	**73.9**	**30,848**	**1,367,676**	**29,732**
Mining	**37,500**	**0.0**	**75.0**	**70**	**714,286**	**15,528**
Other activities	**383,932**	**0.2**	**51.1**	**264**	**2,843,890**	**61,824**
TOTAL	**204,863,040**	**100.0**	**58.1**	**99,967**	**3,528,423**	**76,705**

Source: Based on data from the Investment office. Rate of exchange used: 46 S.P. per US dollar. See notes of the precedent table regarding the classification of projects by sector.

The low employment impact of these investments should be a matter of grave concern. Investing so much should create vastly more employment, especially in a country with a

[28] The investment elasticity of employment is the percent increase in employment resulting from investing 1% of GDP. It may involve only directly created employment, or include also indirect job creation.

[29] The direct + indirect investment elasticity of employment is about 0.15 in a country like Syria, i.e. about two or three times the figures (0.056% or 0.084%) emerging from approved investment projects. The basis for the 0.15 figure are assumptions of a gross marginal capital-output ratio of 4, and a product elasticity of employment of about 0.6 (the latter meaning that a 1% growth in GDP produces a 0.6% increase in employment). Thus a gross investment ratio of 20% of GDP (the value in Syria as of late) would produce a GDP growth rate of about 5%, and an increase of about 3% in employment (near the historical record in Syria), showing a total investment elasticity of employment of about 3/20=0.15.

growing population, an abundant labour supply, and a severe scarcity of capital, where moreover local capital is fleeing the country and foreign capital seldom comes except when given exceptional incentives. But it is not so. The projects are programmed with little effect on employment. This calls for some explicit considerations in order to explain the high capital intensity of the projects approved. The first consideration is that the figures concern **programmed** investment, not **actual** investment. Some projects may have invested less than programmed, or may have made economies when actually purchasing the buildings and equipment required. However, almost all the companies interviewed for this study declared that they had invested as much as programmed, and in some cases even more. Though the survey did not involve any attempt to audit the investments, it is noticeable that seldom a company appears to be investing below its allotted authorisation. However, it may well be that some companies may have overstated their investment needs to get a safe level of authorised tax exemption, since the amount they could subsequently invest without taxes is determined by the investment authorised at the time of approval. If they ask for a lower amount, they may face problems later when their actual investment must be higher than the authorised level.

A second consideration is that, if these figures reflect the true level of capital intensity, then the existing investment framework must be encouraging a very high level of mechanisation at the expense of creating employment, which is hardly a desirable policy in a country with an abundant and rapidly growing labour force. One possible explanation could be that the incentives granted by the Investment Law are determining that investments are disproportionately capital-intensive at the expense of the creation of employment. But that cannot be the whole explanation. The Investment Law allows for importing equipment at zero tariff, but that hardly compensates for the very low dollar-equivalent wage rates prevailing for industrial workers in the country (significantly less than one dollar per hour in most cases). The machines imported in Syria under Law # 10 are usually the same expensive machines operated in Europe by workers earning ten or twenty times more than in Syria. A rational choice of techniques of production should never lead to the adoption of heavily capital-intensive technologies, even if no taxes are levied on the imported equipment.

If that previous explanation is thus not fully convincing, then other explanations should be found. One of the promising avenues for research is the hypothesis that the existing investment framework may contain incentives for overstating the amounts invested. Those amounts may be overstated through over-invoicing the capital goods purchased for the project, or by illegally selling part of the imported goods to other companies that do not enjoy the tax exemptions granted by Law number 10 (a transaction forbidden by Article 30 of the Law). Apart from the case of making gains from selling tax-exempt items at much-higher domestic prices, such overstatement may serve also the purpose of justifying eventually a higher amount of profit remittances and capital repatriation (thus facilitating future capital flight). Another similar purpose may be to legitimise the possession of undeclared capital held abroad, by way of declaring an investment higher than the actual cost of the imported equipment brought into the country. This purpose might be attractive to some Syrian investors with capital held abroad. The Syrian authorities apparently do not perform any audit on the actual value of the equipment imported for the approved projects, and they probably do not have the means to perform such checks on so many projects. If this kind of explanation were true, then the actual employment impact of the investments effectively made by the authorised companies may be higher than it appears to be. This matter should be studied more closely, and in the meantime a recommendation is in order for the Investment Office: **it should intensi-**

fy its efforts to audit the value of the equipment and infrastructure invested in the projects. It should also enforce the rule that projects be prioritised according to their impact on employment, as stipulated by the Investment Law. Another sensible recommendation is to revise the set of incentives established in the Law in order to avoid excessively encouraging projects with high capital/labour ratios.

Agribusiness projects. About a third of the industrial and agricultural projects are in the agribusiness sector. The most frequent category of agribusiness project is the production of edible oils, including olive oil and other vegetable oils. Second is the dairy sector, including dairy farms and dairy processing. Vegetable processing and marketing is also important. Surprisingly, fruit processing is not that important on the whole. At the beginning of the 1990s, most of the initial projects for processing farm products were primarily concerned with fruit juice production (since there was interest to absorb the current and expected citrus output surplus), and also sorting, packing and cooling fruits and vegetables, and with the production of pasta and canned food. Such projects were restricted to the public sector before the issuance of the Investment Law, as was also the case of vegetable oil from cottonseeds. Many of these initial projects, however, didn't continue because local markets were soon saturated and there was no accessible foreign markets to absorb the surplus, especially in citrus and the fruit and vegetable sectors. As a result, agro-related investments shifted to dairy products, olive oil and milling cereals. The latter, however, has lately stopped because the installed milling capacity already exceeds current Syria's needs. The following table shows a distribution of 227 agriculture-related projects approved up to 1998.

Approved agricultural production and processing projects, 1992-98

Activity	**Projects**
Crops and fruit trees (mostly olives)	34
Livestock & dairy production	17
Irrigation equip., tube wells & farm inputs	5
Olive oil + animal feed	23
Other vegetable oils + animal feed	38
Sorting, storage and cooling (*)	33
Dairy products	20
Pasta	8
Canned food	7
Milling cereals	15
Fruit juice	5
Appetisers & baby-food preparations	6
Animal feed	12
Yeast	2
Other agricultural processing	2
Total	**227**
(*) For fruit and vegetables. Source: Investment Office.	

Unfortunately it is not possible to perform a similar analysis of investment and employment regarding specifically the agribusiness projects. The Investment Office has not processed data concerning the capital invested in each particular branch of agribusiness.

6. The operation of the Law 10 regime

This chapter deals with the actual experience of companies licensed under Law No.10 since its inception in 1991 up to the year 2000. No formal survey is available, and thus the information reflected here comes only from qualitative interviews with 24 companies in various parts of the country and across different sectors of agribusiness. It also benefits from information and comments from the Investment Office, especially through its Deputy Director Mr Mohammad al-Khalaf, who also acted as a National Consultant during the study.

To protect the confidentiality of the survey, information or opinion provided by the companies interviewed, as well as information received from the Investment Office on individual companies, has not been reproduced in detail or in any way allowing identification of the firms or persons involved.

6.1. The administrative process

According to information provided by the Investment Office, the following are the stages necessary to put a private investment project into operation with the benefits granted by Law 10/91.

1. An **economic feasibility study** of the project should be prepared. The study should also include the following information:
   - investor information;
   - capital to be invested in foreign and local currency;
   - legal status;
   - estimated investment costs;
   - funding method;
   - required machines and equipment, including means of transportation if any;
   - production capacity;
   - labour requirements;
   - imported materials.
2. The study is presented, together with an application, **to the ministry concerned**. For instance, agricultural projects applications are presented to the Ministry of Agriculture, and industrial projects to the Ministry of Industry, directly or through the corresponding office of the Ministry in the Governorate concerned.
3. After **clearance**, the application is forwarded by the Ministry to the **Investment Office** (which operates under the Prime Minister's Office).[30]
4. The Investment Office gives the project **technical clearance** and **submits** it to the Investment Council.
5. A **decision** is made within a month by the **Investment Council** which meets once per month and whenever is necessary.
6. After that, **the ministry concerned** issues another decision, in accordance with the decision of the Council.

[30] This detour through the concerned Ministry may delay clearance of the project if Ministry officials feel that it may hurt existing (especially State-owned) companies in the sector. There is no set period for the Ministry to forward the project to the Investment Office, nor automatic treatment in case of delay.

7. The investor organises the **establishment documentation**, setting up the company that would carry out the investment project (this could be omitted if the company is already established). [31]

8. A **commercial registration record** is obtained from the **Ministry of Supply representative office in the governorate concerned** (this also is omitted if the company already exists).

9. A declaration of the steps taken is presented to the Investment Office, which issues a **certification.**

10. Based on that certification the investor obtains the **import licenses** for the required machines and equipment, from the office of the Ministry of Economy in the governorate concerned.

11. The investor need to secure **land** for the premises on which the project would operate, through land purchases from private owners, or obtaining a land lease from the Government. The latter may involve significant delays.

12. Securing the provision of basic services to the site (water, electricity, telephone lines) often involves applying for an extension of existing networks, since there are no industrial zones in Syria except in the free zones.[32] If network extension proves impossible or too expensive, the company should secure the services on its own account through accessing independent water sources, generating its own electricity, and acquiring mobile telephony (the latter is in its initial stages by 2001).

13. If necessary, **construction of new facilities** is to be undertaken, for which a **construction permit** must be obtained.

14. After obtaining the construction permit, the facilities must be built. Upon completion, the investor must obtain a **certification** from the governorate concerned, to ascertain the completion of the physical facilities.

15. Based on the import licenses (obtained at step 10) the investor must proceed with the import, channelling the **import documentation** through the Commercial Bank of Syria.

16. Imported equipment must arrive in the country, be **disembarked** at the entry port, pass **customs clearance** and be transported to the site of the project (for which **transit permits** and the payment of **transit charges** are required) before being installed and start operating.

17. Once the facilities and equipment are (albeit partially) in place, an **administrative license** is required from the Ministry of Industry to actually start production.

18. When finally all the above is completed, production may start.

Acquisition of land for the construction of facilities (especially acquiring a lease on State-owned real estate) may prove a complicated process and a major cause for delays

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[31] In most cases, the projects were undertaken with newly-created and especially incorporated companies. However, projects may be presented by an existing company, and one company may implement more than one project.

[32] The free zones established in Lattakia, Aleppo and Damascus are only for processing imported inputs and exporting the output. They are not considered in the present study.

in implementing a project. A simplification of the rules and procedures for obtaining a lease on State-owned land (especially for a project already licensed under Law No.10) should be a significant step forward. Probably the best way to solve this problem along with another frequent trouble (lack of electricity or other basic services) could be solved through establishing **Industrial and Business Zones** in selected parts of the country, where land could be easily obtained by approved investment projects, and all basic services are in place.

The above-described process to get a project actually going is indeed lengthy, uncertain and complex. For some companies it may take longer than the three years granted by Law No.10, before the tax exemption period of five years starts running. In fact, many companies have not been able to complete the process and become fully operational in three or more years, as will be seen below, not because of their tardiness but as a result of the complications arising from the established procedures.

The process can be simplified in several ways. The most obvious suggestion is to eliminate the requirement (step 2) to clear all projects through the concerned Ministry before submitting them to the Investment Council. The Ministries in question are all represented in the Investment Council, and the technical clearances can all be done by the Investment Office itself. Another similar simplification could be the elimination of the decision taken by the concerned Ministry (step 6) after the Investment Council has granted the project the benefits of the Law, if the Council decision could be taken automatically as a Ministry decision (since the Ministry is represented in the Council).

While other steps seem logically necessary or appropriate, the actual procedures are always complex and their accomplishment is slow and uncertain. Officials often find that the applicable legislation is in doubt, especially if recent or exceptional. At each step, for instance to obtain a license at the Governorate, or to get the project passing through the Ministry and forwarded to the Investment Office, several internal desks or departments must intervene, each taking at least one or likely more days to complete its part in the process. Much redundant procedures in the form of duplicates and counter-signatures are required, and the paperwork must often go back and forth several times between the intervening desks, before reaching final resolution. All this in fact tends to lower the effective quality of the intended controls, greatly increases transaction costs, and is also a powerful incentive for using informal channels to get things done.

As reported by companies interviewed for this study, in the best of cases the process never takes less than one year from submitting a project to being able to operate. It often takes much more: the average seems to be about 3-4 years. Even the initial and purely administrative stages represented by steps 1-9 often take many months, up to three years in more than a few cases.

The Investment Office and Investment Council are quick enough: the Council meets by Law at least every two months, and often meets once a month. Normally a project is decided upon by the Council within a month of having been forwarded by the concerned Ministry. But the other aspects of the administrative process are not so time-efficient.

This analysis shows how the creation of an investment-friendly environment is not only a matter of promulgating adequate legislation (such as was intended with Law No.10) but of reforming the State apparatus in order to ease the process of investment instead of hindering it. In this particular administrative process, a detailed study of each step may indicate specific modifications in forms and procedures in order to speed up and simplify project implementation.

6.2. From the blueprint to operation

As a result of the complicated process above described many projects never start operating, or start much later than originally expected, as shown in the following table which refers only to projects in agriculture and manufacturing, not including transportation.

Projects with a total license have completed the investment process for all the capital authorised. A partial license means part of the production process is not yet in place because some of the investments are yet to be made or completed. This may not be only because of delays but also because of the technical or economic schedule of the investments over time.

Status at December 2000 of agricultural and industrial projects approved until 1999

Year	Projects approved in agriculture and manufacturing	Projects with a complete industrial register license	Projects with a partial industrial register license	Projects in process	Projects which have not started implementation by Dec 31, 2000
1991	62	46	10	6	--
1992	98	64	24	10	--
1993	82	24	15	17	26
1994	144	14	20	19	91
1995	90	5	7	22	56
1996	95	8	4	23	60
1997	71	6	2	27	36
1998	83	2	3	54	24
1999	85	---	--	18	67
TOTAL	**810**	**169**	**85**	**196**	**360**

Source: Investment Office. Excludes projects in transportation and other sectors.

Only 20% of the projects approved until 1999 was totally operational by the end of 2000, and 44% never started the administrative and physical implementation process. Reordering the above table in a more meaningful way yields the following.

Implementation of approved agricultural and industrial projects
As of December 31, 2000

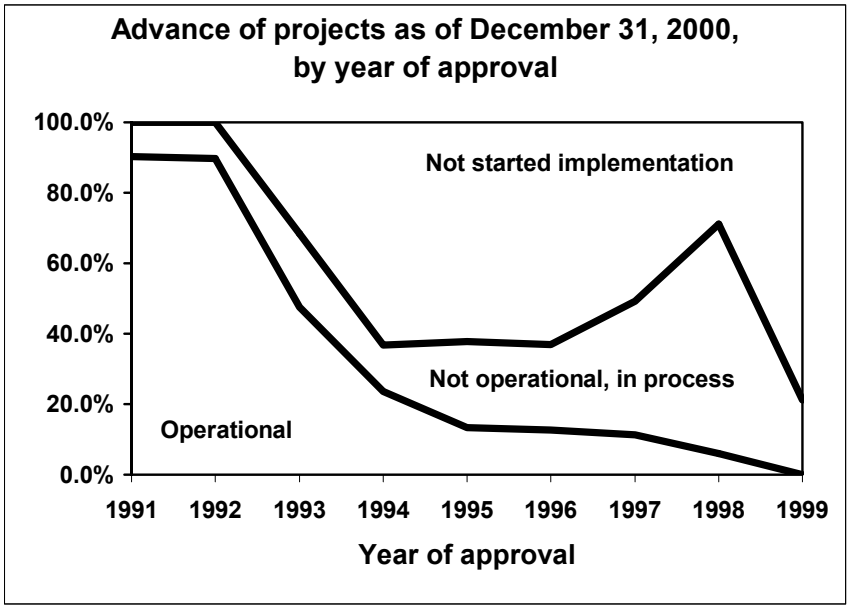
	Number of projects				Percent of projects			
Year	**Approved**	**Started procedures**	**Operational (*)**	**Still in process**	**Approved**	**Started procedures**	**Started operation**	**Still in process**
1991	62	62	56	6	100.0%	100.0%	90.3%	9.7%
1992	98	98	88	10	100.0%	100.0%	89.8%	10.2%
1993	82	56	39	17	100.0%	68.3%	47.6%	20.7%
1994	144	53	34	19	100.0%	36.8%	23.6%	13.2%
1995	90	34	12	22	100.0%	37.8%	13.3%	24.4%
1996	95	35	12	23	100.0%	36.8%	12.6%	24.2%
1997	71	35	8	27	100.0%	49.3%	11.3%	38.0%
1998	83	59	5	54	100.0%	71.1%	6.0%	65.1%
1999	85	18	0	18	100.0%	21.2%	0.0%	21.2%
TOTAL	**810**	**450**	**254**	**196**	**100.0%**	**55.6%**	**31.4%**	**24.2%**

(*) Partial or total industrial license as of December 31, 2000.
Source: Investment office. Excludes transportation projects.

As shown in the table above, at the end of the year 2000, and out of a total of 810 agricultural and industrial projects, only 169 (a 20%) were fully operational, and

another 85 (little more than 10%) had obtained a partial license indicating that the project is operational but some investments have not yet been executed.

This can be due to a delay in implementation, but also to an investment schedule that is to be implemented during an extended period for technical reasons (e.g. an interviewed company's project is to grow olive trees that reach full production in 15 years, and build an olive-oil factory that should be ready not before the 12th year of the trees). However, only 31% of the projects were totally or partially operational. A large number of projects had not started development (many of them have been abandoned, and a few were too recent by the end of 2000). No-starters with more than one or two years since approval are probably **abandoned** projects.



The attached graph helps to understand some of the dynamics behind the figures. Looking backwards from the year 2000, it can be seen that the great majority of projects approved in 1991-92, and more than half of those approved in 1993, are operational. But only a small fraction of those approved from 1994 onwards have ever become operational before the end of 2000.

The above table and graph show clearly the increase in no-starters for projects approved since 1993, reflecting changing perceptions of the liberalisation process. An encouraging upward surge in projects that start the procedures was registered in projects approved in 1998, however (though not for those approved in 1999, probably because of the economic slump occurred in that year).

From the data available it could be estimated that among the projects that **have** started the procedures towards becoming operational after been approved by the Investment Council, **41% remain mired in the administrative process after two years of struggle, and 33% are still in that situation after three years of initiating the proce-**

dures.[33] The fact that a project does not advances may be also due to voluntary reasons. Some of these projects, indeed, have been abandoned by investors in view of the delays and the changing investment climate alluded above. After initial enthusiasm after promulgation of the Investment Law in 1991, investor optimism ebbed after 1993, possibly motivating some to abandon the projects or to delay them indefinitely. Stalled growth in the late 1990s should not have given them more encouragement.

The mains feature transpiring from these data, then, is that 44% of the projects **never went beyond the approval stage**, and that a large number of projects that initiated implementation **were not yet operational** by the end of 2000. In addition to no-starters, by the end of 2000 there were still projects from all the years back to 1991, that had initiated the administrative procedures for implementation after the Investment Council's approval, but were still stranded at some point in the many-step process described above, and probably abandoned by the investors long time ago.[34]

In the transportation sector the situation is not better. Out of 692 transportation projects analysed until December 1998, 230 were fully operational, 178 were partially operational, 3 were cancelled for violation of Article 30 of the Law (application of imported equipment to non-authorised objectives, presumably private use of the vehicles), and the remaining 281 (about 41%) are no-starters. No breakdown by years has been obtained for this sector, which is anyway outside the scope of this study.

Even allowing from dropouts motivated by changing economic conditions or deteriorating expectations about the economic reform process in Syria, these figures clearly show also that the Investment Council seal of approval for a project does not mean that an investment is effectively carried out. In all probability the delays are reflecting, at least partially, the discouraging effect of the many steps to be accomplished before a project becomes operational, and the time it takes to complete some of them.

The Investment Office has not prepared a table showing the amount of **committed capital** corresponding to implemented and non-implemented projects, nor it monitors the actual process of investment in the implemented companies, thus the amount of capital actually invested under Law No.10 is not directly known. However, based on the number of projects involved it can be estimated that by the end of 2000 **about 31% of the committed capital had been invested** (this assumes that small and large projects have the same likelihood of being abandoned or delayed).

The total committed investment from projects approved up to 1999 was about $7.67 billion, of which $6.73 billion were industrial and agricultural, with a rate of execution of 31%. Assuming the implemented projects are of average size, this means the implemented investments amount to about $2.11 billion. The 811 projects in transportation (including a few in other sectors), with a committed capital of $0.93 billion, have a rate of

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[33] Of a total 810 industrial and agricultural projects, excluding no-starters, and also excluding 168 approved less than three years before the end of 2000 (i.e. approved in 1998-99), there remain 373 projects that started implementation and **should** have completed it by the end of 2000. Of those, 123 (33%) were still in process. By the same token the rate of non-operativeness is 41% if only projects approved in 1999 are excluded for being too recent. In conclusion, of the projects that effectively start the administrative procedures after approval, 41% remain unoperative for delays in the administrative process after two years of approval, and 33% of them are still "in process" after three years of approval.

[34] From the information available it is not possible to distinguish between delayed projects that are still "alive" and those that have been abandoned by the investors. The Office often cancels projects after two years or more of inactivity following approval.

execution of 70%. Thus **the presumed effective investment resulting from projects approved until 1999 under Law No.10 should be about $3.05 billion**, or an average of $338 million per year from1992 to 2000. The agricultural and industrial projects alone would have generated a total investment of $235 million per year along the 1992-1999 period.

These results are important to evaluate the impact of the investment process spurred by the Investment Promotion Law, but in the present context it is mentioned only to document the **relatively low rate of execution** of the investments committed by projects approved under the Law. This state of affairs is the joint effect of the changing economic conditions and expectations on the one hand, and the discouraging effects of the complex administrative process involved in the implementation of approved projects.

6.3. Problems of linkages with agricultural production

Vertical connection and integration of farms, processing plants and marketing is still in its infancy in Syria. The few projects presented at the Investment Office dealing with agricultural production were mostly a combined project involving primary and processed production. This reveals that investors fear that adequate systems for industry to establish working linkages with farm production may be defective.

In some cases, the problem is financial. Farmers sell their production after the harvest, because they ordinarily lack storage facilities to wait for a better price (if their product is storable), and want the payment in a very short time, well before the processed products can be produced and put on the market, and the revenue obtained by the industrial company. Agribusiness firms, then, need a much larger amount of working capital than would be otherwise required. One fruit processing firm interviewed for the study, with a fixed capital of about $8 million, requires about $4 million working capital each year to procure fruit from producers. The scarcity and lack of timeliness of credit offered by the Industrial and Commercial Banks compounds the problem. Bank credit seems to be scarce for such needs, and on the other hand the banks and other concerned Government entities apparently expect private companies established under Law No.10 to provide for all their financial needs with their own capital, and not to draw on the banks' resources for that purpose.

A most common problem for the operational factories is the quality standards of the raw materials that the agricultural sector provides. Thus, lentils and chickpeas may include a significant amount of heterogeneity in the quality and colour of the seeds.[35] Tomatoes also may include a distressing proportion of bad quality units unsuitable for processing, as is also the case with apples or apricots.[36]

6.4. Problems concerning relations with State-owned companies

Some interviewed companies deal with the GOCTP through contracts for milling grain into flour. Others buy raw materials from them. Except for occasional delays in payments in the first case, no significant problems seem to exist on that front, or at least little was manifest in the interviews.

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[35] A crusher interviewed for this study owns a high-tech electronic sorting machine for lentils, on which a large amount of capital was invested, because of the significant amount of bad seeds he gets.

[36] This is a complaint common enough among fresh fruit and vegetables exporters and among manufacturers of processed fruit and vegetables, as confirmed with several companies in the survey for this study.

In some cases, the existence of a State-owned company was a significant obstacle to get the authorisation for the project. The concerned Ministry (though legally required to dispatch the project in one month) in some specific cases has oufind ways to delay the project for months, before forwarding it to the Investment Office and Council, because of fears that the new private competitor may threaten the State-owned company if authorised.

Likewise, some government officials think that the tobacco sector should cease to be considered strategic, but that it is still in that position just because there are State-owned tobacco manufacturing companies that may suffer from the opening of the tobacco sector to the private sector.

6.5. Problems concerning access to foreign inputs

There are two main problems in this respect. One concerns the difficulties involved in importing the inputs, a common feature of all foreign trade operations. Every time a shipment of inputs is needed it may take months to get on its way, and more to be delivered at the factory gate. The licensing process is a big part of this, and the financial process at the Commercial Bank is another. There are also frequent complications at the customs. One company also complained about procedures and payments necessary for transit from the port to the factory (which in that particular case involved crossing a large part of the country and several governorates).

6.6. Problems concerning taxes and subsidies

The Investment Promotion Law temporarily exempts the company from income tax, customs duties for capital goods, and real estate taxes. But there is a whole array of other taxes to be paid for which the Law grants no exemption nor holiday. Some of the taxes are low enough (just because the monetary values have not been updated in a long time, but they might be any moment), but the payment involves administrative complications that could have been avoided.

In some cases, there seems to be some uncertainty about what taxes are to be applied. For instance, after the Agricultural Production Tax was lifted for vegetables that are exported or sold to processing establishments, a company complained it was charged with the tax when exporting produce, in spite of the tax having been lifted for that case.

Another problem is the sudden jump from zero to a very high tax after the end of the exemption period. Since the income tax is so high (more than 60% including the tax, the War Effort Surcharge and some other administrative charge), having to detract that percentage from net profit puts a big strain on the profitability of the projects. Several companies have reached tax-paying maturity in 1998-99, thus they had to start paying in a very bad year, plagued by recession and reduced profits. One of the interviewed owners (a large one, by the way) confessed frankly that a significant portion of his company's operations were made unofficially, for otherwise the income tax would kill the company in one or two years. In practice many companies are declaring little or no profit, and go to great extents of "creative accountancy" for that purpose.[37]

[37] This is a major motive for understating economic activity in the private sector. The real level of private production, and the real level of increase in its economic output during recent years, may be significantly understated in official records because of this factor. Incidentally, this also tends to underestimate the economic impact of the Investment Law, since only registered production goes into official statistics and

All indications suggest in this regard that the corporate tax is presently on the wrong side of the Laffer curve. As is well known, the Laffer curve indicates the level of taxation over which any increment in the tax rate would produce a reduction, not an increase, in tax revenue. It seems that a reduction in the corporate income tax rates, especially if coupled with other measures to improve tax auditing, would actually increase revenue.

Apart from the tax rates being too high, the corporate income tax is further increased by out-of-date tax brackets. The top bracket (charged with the maximum rate) starts at one million SP, a relatively small amount by corporate standards (about U$S 20,000 per year). Nearly all corporation income, if any profit is declared, is taxed at the top rate.

6.7. Problems concerning foreign exchange

The main problem is foreign currency access, faced mainly by companies devoted only or primarily to the domestic market, and it stems from the requirement of acquiring foreign currency **by lawful means** for the purpose of importing inputs or for whatever other such purpose such as profit remittances. In fact, there are no such lawful means available. Restrictions to access foreign currency prevent them to obtain the currency at the Commercial Bank (its recent liberalisation of the sale of foreign currency is only for personal purposes and relatively small amounts, not for commercial purposes), and the Export Proceedings Market is also off-limits in that case. In practice most companies resort to the parallel market, but any important foreign company (especially an European company, obliged to follow the rules) would be in trouble having to use unofficial channels to obtain foreign currency. Currency convertibility and more liberalisation in the foreign exchange regime is required for this purpose, and the government has apparently the purpose of progressing towards those measures, but the progress has not been completed yet.

Another problem is the difference between the exchange rates prevailing for different operations. Exports proceedings exchanged at the Commercial Bank (25% of them are so required) are exchanged at the rate of 46 SP per dollar, while import costs have to be purchased at market rates (about 50 SP per dollar). This 9% difference adds to transaction costs, some taxes, financial charges during exporting or importing, to eat away much of the profits from trade or production.

6.8. Problems concerning credit

The problems with credit originate in the primitive state of the banking system in Syria, soon to be profoundly modified by the recently issued Banking Law allowing for private banks to operate in the country for the first time in several decades. Up to now, the problems are manifold and the complaints are abundant: credit is scarce, bank procedures are clumsy and inefficient, transactions are lengthy, bank officials often do not have the necessary skills for any not very usual financial operation, real rates of interest have become too high in a period of zero inflation or deflation as in 1998-2001, the terms of the letters of credit are very rigid, and collateral requirements are completely out of proportion.

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national accounts. If all production from these firms were overtly declared, their impact would be reckoned to be much higher.

A company reported to the survey that when it was facing a short term credit problem, it applied for a loan to the Industrial Bank of Syria.. Only 10% of the amount was granted on short term credit (one year), but for that purpose the entire company was written down as collateral, thus precluding any further use of the assets as collateral for additional credit.

6.9. Problems concerning pricing

Most of the projects deal with products whose price is not set by the State sector. However, there is a requirement that every change in prices is to be authorised by the authorities. In practice, in most cases this is a formality, but nonetheless is a serious restriction.

Some of the companies prefer to change the characteristics of the product, defining it as a "new product", instead of trying to change the price of an existing product. The existence of this practice reveals that pricing is still a process in which serious government activity exists.

Regarding procurement of agricultural items, also, there are problems with the pricing system. Even though official prices are meant to be purely indicative, in practice they are taken as obligatory, and attempts to introduce quality differentials may be resisted.

The main difficulty reported by companies is their relative inability, or difficulty, to establish price differentials according to quality, timeliness and other similar considerations. This is in part because of the stickiness of official price regulations, and also because of the lack of habit of farmers about facing price competition.

Farmers in Syria, as all Syrians, are habituated to price bargaining and haggling from centuries ago, so there is not a problem with the culture of competing for price. The probable problem lies in the farmers risk aversion. They probably fear to let prices be set by competition, because they fear the prices they finally obtain for their output falls below their costs, especially if only one big industry is purchasing the production for processing or marketing. So reducing price risk is one objective to pursue along with better pricing practices and price flexibility.

One of the ways to do so is agricultural contracting. In many cases, processing plants authorised under Law No.10 buy the output of nearby farmers directly, and so they could announce their grading and standard requirements well in advance, along with the percentage price differentials according to quality or other considerations. The price and the quantity and quality of the product may be established in advance through **contracts** between producing plants and their supplier farms, either on an individual or group basis. A good contract signed in advance takes away uncertainties on both sides. Techniques and good practices for agricultural contracting are well-known in many countries, and a special study or technical assistance may help introducing such techniques and practices in the agribusiness sector of Syria.

6.10. Problems of access to foreign markets

Accessing foreign markets is difficult if the producer lacks adequate information. Agribusiness companies in Syria do not have any standard access to international marketing and pricing information, nor to international demands for their products. Most of the cases in which a company enters a foreign export deal arise because of personal contacts or the experience of the owner as an entrepreneur in other countries.

The public sector in Syria does not have any export promotion and market information facility. Similar services may be also provided by business Chambers, but no organised

system yet exists for that purpose. There is yet very little access to Internet in the country, although it is improving lately. Telephone lines are poor, and there is only one Internet provider, owned by the State, with very limited capabilities to accept connections either dialup, dedicated line connections or other systems. ASDL connections, the most common system for corporate access to Internet, are not yet available in Syria. Dialup connection is inexpensive, but the possibilities of connection are few, and the link is highly unstable. The cost of having a dedicated telephone line for Internet Access has carried until early 2001 an installation fee of U$S 1000, and a monthly payment of U$S 1500, which is out of proportion with the cost of this service in other countries, putting it out of reach for most small and medium-size Syrian companies. There are also limitations for accessing certain Internet services and Websites (as, for instance, alternative e-mail services other than the one offered by the official Syrian provider, or most importantly, access to secure servers to transmit sensitive business information in encrypted form). Transmission velocity is very slow, especially on business days and hours. There is also limited knowledge of e-business and very little use of its possibilities. Very few companies have Internet Websites, and (as far as was ascertained in the survey) none has any regular business activity on line.

Flexibility of supply response is very limited. Lack of vertically connected commodity chains with adequate standards and grading, as well as other factors, such as efficient banking services, determines that the companies are often unable to respond quickly to demand, or to changes in demand specifications. Lengthy and costly official procedures for export are often a major problem to comply with foreign demand on time. Obtaining the license for export, arranging financial matters at the Commercial Bank, going through customs and other related requirements may delay unnecessarily the expedition of exports, and many times put the Syrian exporter in the embarrassing position of not being able to deliver on time.

50 kilometers may be a long way to go

A Syrian food processing company licensed under Law No.10 is located on the road from Damascus to Beirut, a short distance from the Lebanese border. It recently received an order for two or three truckloads of their products to be delivered at a Lebanese city near the border, and it was an urgent order. The expected export revenue was U$S 25,000, and the expected profit was about U$S 5,000 once production and transportation costs were deducted.

Processing the small export operation through all the concerned Syrian official offices took more than two weeks of paperwork, and the total cost of the transaction, formal and informal, was about U$S 5,000. The products arrived later than requested, producing one unsatisfied customer, and the added transaction costs made the deal non-profitable.

7. The economic impact of private investment

7.1. Methodological problems

The evaluation of the impact of the existing or some future investment promotion regime could be done in various ways. There exist some analytical models that achieve a complete analysis of the short and long term impact of one given policy, such as the **Policy Analysis Matrix** method, but often these approaches require detailed information that is seldom available. Besides, short-term effects are more easily ascertained than long-term impacts, and thus the analysis is often **myopic**.

In the particular case of this study, using PAMs is in practice not feasible at the time of writing, because of insufficient data. There is not enough information on the results achieved by the companies installed under Law 10, their operation and profitability: the Investment Office does not keep an accurate monitoring system, and the study itself was not able to perform a representative survey (only a few enterprises were interviewed in a qualitative manner) because of time and resource constraints. Thus the only alternative is to attempt a more simple approach.

Estimates of the impact of industrial projects authorised under Law No.10 are given below. The impact of agricultural projects is difficult to estimate in view of the scant number of such projects and their embryonic stage of development. Transportation projects are not considered.

For industrial projects, two kinds of impact are estimated. On the one hand, the direct and direct impact on **employment**, and on the other, estimates of the contribution of the projects to the increase in **investment**. It is not possible to estimate their impact on economic growth, because no data is available on the level of production of the projects. However, some conclusions may be drawn from increases in **private industry output** during the 1990s. Some consideration is also given to the impact on **foreign trade** and on the **balance of payments.**

7.2. Impact on employment

Available figures from the Investment Office allow for some approximate estimates of the impact of Investment Promotion on several separate aspects, especially the **direct** impact because the **indirect** repercussions are more difficult to assess.[38]

One of the aspects to be assessed is **employment**. If all the approved industrial projects had been carried out to completion, some 65,000 new jobs would have been **directly** created. As showed before, this represents a negligible increase in existing employment. Even allowing for **multiplier effects** in other sectors, the impact would still be low, though in the particular sub-sector involved the effect could be relatively larger.

[38] The indirect effect are measured by means of multiplier analysis. Multiplier effects can be backwards or forwards. Backward multiplier effects of an increase of production in one sector come from the additional demand of domestic raw materials and other domestic inputs required by the expanding sector. Forward multiplier effects take account of the additional activity in subsequent phases of the productive chain such as transport, further processing, marketing, etc., and also the additional production and employment generated by the additional tax revenue that is directly or indirectly created as a consequence of the new investment, and the additional private consumption and investment generated by income from the increased output in the given sector. Estimations of multiplier effects of this kind need a general equilibrium approach, and might be accomplished to some extent with the aid of an input-output matrix for the economy as a whole. The necessary information is far beyond the data available in Syria.

Besides, the **actual** employment created as a result of industrial projects under Law No.10 is lower than 65,000 jobs, because there are many approved projects that never started, projects that ended up hiring less workers than expected, and projects approved very recently that are still in the process of implementing the investment itself and are not yet operational. There are no exact figures about these aspects, but at least the no-starters can be identified, and also the projects that are still in the implementation phase without having entered the production stage or without having reached full production regime. As has been shown before, only 31% of the projects have become operational.

Based on those results, and assuming that actual implementation is not related to the size of the projects, it can be estimated that between the inception of the Investment Law in 1991 and the year 2000, manufacturing projects under the Investment Promotion regime have **directly** created about 20,000 jobs, i.e. a 31% percent of the total number of jobs foreseen in all manufacturing projects approved by the Investment Council. With an optimistic hypothesis of an overall employment multiplier of about 3, the total (direct plus indirect) impact on employment should be 60,000 jobs approximately along the period considered (1992-2000), i.e. some 6700 new jobs per year. This may be still an overstatement, since the actual multiplier may be lower and, besides, many of the companies and not yet working at full capacity, and have recruited only part of the labour they would eventually need when they attain full capacity utilisation.

If those numbers are true, however, they would mean **an annual increase of 0.16% in total employment**, with a total investment equivalent to $2.11bn or $234m per year (1.8% of the average GDP in the period). The estimated total investment-elasticity of employment is, as anticipated before, very low, with a value of about 0.089 (an increase of 0.089% in employment is directly or indirectly achieved by investing 1% of GDP in this kind of industrial projects). To create a 3% increase in employment, as needed to keep pace with the increase in the labour force, the total investment necessary would be 33% of GDP (the usual investment ratio in Syria is only 20% of GDP).

The specific impact of **agribusiness projects** on agricultural and food-industry employment are also relatively small. Projects in that sector have created, as estimated before, some 740 new jobs per year. It is difficult to estimate the actual size of employment in the agro-industry sector, but based on partial evidence from employment data, the structure of production and the output/labour ratios in the public industrial sector, it should be about 33% of all industrial employment, i.e. about 170,000 workers, of which about 100,000 are in the public agro-food sector and 70,000 would be in the private agro-food industry (agricultural production employment in the approved projects is very small and is neglected in this estimate).

Thus, the new jobs created by the implemented projects represent a yearly increase of about 1% on private employment in agro-food industries, and a 0.4% increase on the overall agro-food sector employment. Again, the increase is quite small compared to an expected increase of 3% in the labour force. The Law 10 projects would be cover only 13% of the annual increase in agro-industry employment. Since the private sector is increasing faster than the public sector in this industry, the 1% annual increase in employment coming from the Law 10 projects represent probably not more than 20% of

the total increase in the number of workers employed in the private agro-food industry.[39]

The indirect impact of agribusiness projects on employment is only a matter of speculation. It is well-known that agro-industry normally has a much larger employment multiplier than other branches of the manufacturing sector, because of the higher labour intensity of agriculture, especially for fruit, vegetables and other non-mechanised parts of agriculture. If a multiplier of 3 is acceptable for all the manufacturing sector, a multiplier of 5 to 10 is realistic for agro-industry, especially for factories related to labour-intensive agricultural products such as fruit, dairy products and vegetables. This means that the 740 new jobs per year created directly by the agribusiness firms established in 1992-99 may have a total effect of creating between 3700 and 7400 new jobs per year in the economy. On a total labour force of 4.1 million (average for the 1990s), this would mean an annual increase of employment of 0.09% to 0.18%, achieved with an investment of $62 million per year. As this amount is about 0.47% of the average GDP of the 1990s, the resulting direct and indirect investment elasticity of employment is 0.09/0.47=0.19 with the conservative hypothesis of a multiplier of 5, and an elasticity of 0.18/0.47=0.38 if the multiplier is 10. These elasticities are substantially above the 0.089 elasticity estimated before for total manufacturing. According to this result, investing 1% of GDP produces a 0.19% to 0.38% increase in overall employment, **if the investments are in agro-industry**. Investments in all branches of industry would need to invest an amount equivalent to 33% of GDP to get a 3% in employment, as needed to absorb the proportion of industry in the demographic increase of the labour force. Investments in agro-industry would achieve the same goal by investing only between 7.9% and 15.8% of GDP. In other words, **a way of increasing the employment impact of projects under Law No.10 would be to encourage projects in agro-industry.**[40]

In conclusion, therefore, it may be stated that **the employment impact of private investment projects under Law No.10 for the period 1992-2000 has been very small, but projects in agro-industry have a significantly larger impact.**

7.3. Impact on investment

Total investment in the 1992-1999 period was about $3 billion. Gross fixed investment **in the industrial sector** was about $0.95 billion per year during the 1990s. Gross **private** fixed investment in all sectors was about $1.5 billion during the same period. The latter figure includes residential investment, which amounted to about $500m, thus leaving an estimate of **non-residential private investment** of about $1 billion per year. Total (public and private) investment in industrial and commercial buildings and in machinery and equipment was about $1.2 billion per year on average. Considering budgeted investments by the State-sector industrial companies, it may be estimated that **private industrial investment** registered in the National Accounts amounted to about

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[39] The main reason for this is that private bakeries (largely untouched by the Law No.10 because they are mostly small establishments, below the Law's threshold) are growing fast: the private production of bread has increased its participation in total bread production from 45% in 1990 to 62% in 1999. Thus, increase in agro-industry employment is explained in large proportion by increases in bakery jobs, outside the effects of Law No.10.

[40] For the indirect effects to materialise, however, additional investment might be needed in the concerned sectors, e.g. agriculture. If a new fruit juice plant pulls the farmers to grow new fruit trees and hire more workers, the investment in new trees should also be taken also into account for a more accurate estimate of the multiplier effects of investment.

$400m per year. Actual investments by companies licensed under Law No.10 in all sectors, as seen before, can be estimated at about $264 million per year in the same period, i.e. about 66% of the total. The rest is supposed to be investments by pre-existing private companies, outside the regime of Law No.10.

In fact, prior to this Law the figures for investment were much lower. In 1990-91 total investment was $2 billion, total private investment was $1 billion, total private non-residential investment was $700m, total industrial investment was $400m, and private industrial investment could be estimated at about $120 million only. The following table shows the estimated impact of the Law, during the period 1992-2000, related to various concepts of investment. For this table, only manufacturing projects are considered.

Estimated impact on annual investment of industrial projects under Law No.10, in the period 1992-1999

	1990-91 average	1992-99 average	Increase between averages	% increase	Invest. Law No.10	% Law No.10
Total investment	$1,091m	$ 3,092m	$2,001m	183%	$338m	16.9%
Industrial investment	$210m	$886m	$676m	222%	$235m	34.8%
Private investment	$1,180m	$1,673m	$490m	36%	$338m	69.0%
Private industrial investment (*)	$120m	$400m	$280m	133%	$235m	83.9%

(*) Estimated. Not published in National Accounts tables. Investment by public industrial companies deducted from total industrial investment.
Source: Based on National Accounts and data from the Investment Office.

The last column shows the estimated **direct** impact of industrial projects resulting from the implementation of Law No.10, as a percentage of the total increase in each concept of investment. Thus, these projects have contributed 16.9% of the total increase in investment, 34.8% of the increase in industrial investment, 69% of the increase in private investment, and 83.9% of the increase in private industrial investment. Multiplier investment effects are not included. Therefore, and unlike the conclusion concerning employment, private industrial investment under Law No.10 has had a **significant impact on investment.**

7.4. Impact on production

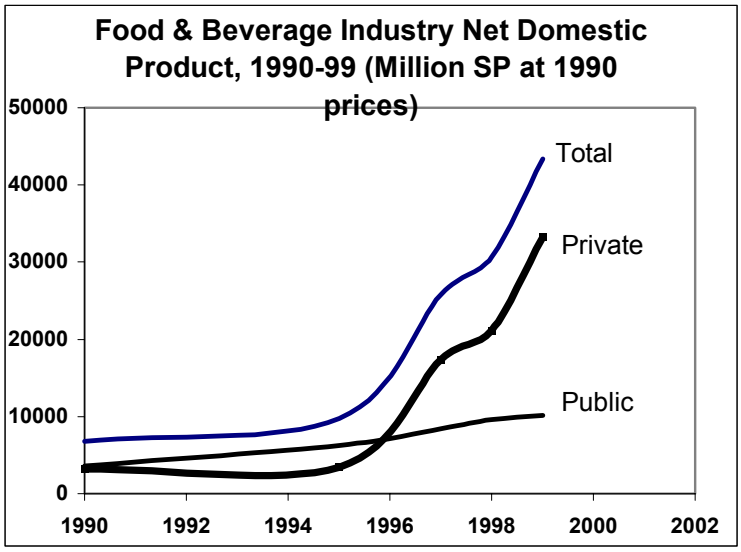
It is not possible to evaluate the actual or expected production of the companies licensed under Law No.10. Only projected **capacity (in physical terms)** was included in the projects' documentation, and even that information has never been processed nor given a monetary value for the purpose of aggregation. No record exists of the production levels attained by those projects that effectively are operating. There are only aggregated information for the public and private sector. The following analysis concentrates in the food, beverages and tobacco industry, and a number of specific commodities.

The data shows clearly that little progress was made until 1994 in this respect, chiefly because the new investments resulting from projects approved since 1991 took about three years on average to start operation. Growth of private production accelerated in 1994-99, while the State sector mostly stayed behind, and the percent participation of the private sector in the total output of each commodity shows its growing importance within the industrial sector.

Food, beverages and tobacco industry: Net Domestic Product by sector, 1990-1999 (million SP)

Sector	Price base	1990	1995	1997	1998	1999
Net Domestic Product						
Total	**Current prices**	6813	8255	16,038	19413	31851
Private	**Current prices**	3199	2938	10,802	13363	22296
Public	**Current prices**	3614	5317	5236	6050	9555
	% private (*)	46.95%	35.59%	67.35%	68.84%	70.00%
Wholesale price index, foodstuffs		100	118	161	158	149
Real Net Domestic Product						
Total	**1990 prices**	6813	9740	25821	30673	43353
Private	**1990 prices**	3199	3467	17391	21114	33221
Public	**1990 prices**	3614	6274	8430	9559	10133
	Index of real NDP					
Total		100	143	379	450	636
Private		100	108	544	660	1038
Public		100	174	233	264	280
Annual growth rates of real NDP						
			1990-95	**1995-97**	**1997-98**	**1998-99**
Total			7.4%	62.8%	18.8%	41.3%
Private			1.6%	124.0%	21.4%	57.3%
Public			11.7%	15.9%	13.4%	6.0%

(*) 1999 estimated.
Source: Industrial sector statistics in **Statistical Abstract**, 1995, 1996 and 2000.



The rapid growth in private industrial food production contrasts with the comparatively slower State sector, but even the State sector grew quite fast in the 1990s. Whereas the private sector in 1990-99 grew at an average yearly rate of 29.7%, the State food sector increased its Net Domestic Product by an annual 12.1%. The whole sector grew at 22.8% per year.

Along the 1990s, and under the influence of the regime for private investment embodied in Law No.10 and related legislation, the private sector has increased its relative participation in the production of many specific commodities. Even within the limitations of the available information, and with some caution about the validity of drawing conclu-

sions from shaky data, the records of the Ministry of Industry offer very useful guidance about this matter. The situation in 1990 clearly represents the participation the private sector had been allowed to retain under the policies of great emphasis on the industrial role of the State, previous to the recent liberalisation of private investment. The situation in 1994 and 1998 allows for an evaluation of the growing importance of the private sector in a number of agro-industrial products.

The food and beverages industry has grown a cumulative 18% in 1990-95, and a further 9% in 1995-97, with a decline of 3% in 1997-99 due to the adverse economic and climatic conditions prevailing. This implies an overall rate of growth of 2.52% per year along the period 1990-99, that was 3.66% per year in 1990-97 before the slump in 1998-99. This growth was (up to 1997) slightly ahead of population growth, estimated at 3.16% in 1990-97, and about 3.05% for 1990-99 because of the declining demographic rate of growth.[41] For certain specific products information is available about the relative participation of public and private producers in total output and growth during the 1990s, as shown in the following table. The absolute figures of production, and the rates of growth in production by the private sector, are in the statistical annex. The data show also an increased **participation of the private sector** in several commodity chains, as reflected in the following table.

Percent participation of the private sector in the production of selected foods, 1990-98

Products	**1990**	**1994**	**1995**	**1998**
Cereals				
Bread	45.00%*	54.00%*	56.43%	62.46%
Biscuits	64.90%	60.99%	58.86%	75.07%
Macaroni	74.52%	73.98%	66.10%	85.47%
Beer	0.00%	0.00%	0.00%	0.00%
Edible oils				
Olive oil	100.00%	100.00%	100.00%	100.00%
Vegetable oil	0.00%	0.00%	0.81%	35.14%
Dairy				
Pasteurised milk	n.a.	n.a.	10.46%	9.80%
Chocolate	100.00%	100.00%	93.45%	96.57%
Beverages				
Mineral water	0.00%	0.00%	0.00%	0.00%
Arak	n.a.	n.a.	20.07%	16.91%
Wine **	0.00%	0.00%	0.00%	0.00%
Other alc.bev.	n.a.	n.a.	92.35%	95.79%
Soft drinks	n.a.	n.a.	89.60%	93.23%
Fruit juices	n.a.	n.a.	100.00%	100.00%
Canned food	7.32%	21.78%	18.84%	41.11%

(*) Estimated, based on the estimated increase in consumption of wheat, and estimates of a stable State production of bread in 1990-95.

(**)There are indications that some private wine producers exist. They are not included in the source.

Data come from the Ministry of Industry, taken from the **Statistical Abstract** of 1995 and 2000.

[41] Official data on population and industrial sector production indexes taken from **Statistical Abstract**, 1995 and 2000 editions. The rate of increase of population was adjusted downwards by the authorities of the Central Statistics Bureau, to 2.7 for 1997-2000, and is expected to continue falling. The projected average rate for 2001-2015 is 2.2% per year.

In the **cereal sector**, the participation of the private sector increased in the production of **bread**, **biscuits** and **macaroni**. Up to 1998 there was no private competition to the State breweries, but later a **beer** project was accepted under Law No.10 for this purpose, and therefore soon the private sector would be making a dent in this formerly State-monopolised industry. In the flour-based products cited before, private industry participates (as of 1998) between 62% and 85%. However, the production of flour remains under State control (though it is produced not necessarily in State-owned mills, since part of the **milling** is out-sourced by the GOCTP.

The **olive oil** sector is 100% private, and there has been also an important foray of the private sector in the formerly State-dominated **vegetable oil** industry where in 1998 it had a 35% market share (up from nearly zero a few years earlier). About 10% of **pasteurised milk** is being produced by private dairy processing companies (more are underway under Law No.10), and nearly all **chocolate** products are private.

In the beverages industry, mineral water is a State de facto monopoly, as was beer up to quite recently, and also wine is reportedly produced only at State wineries (in quite small quantities).[42] The State production of the traditional *arak* liquor based on aniseed is more than 80%, with a private market share that in the late 1990s has slipped from 20% to 16%. Other **alcoholic beverages** and the important **soft-drinks** sector are dominated by the private sector with more than 90% of the market. **Fruit juices** are 100% private, and have grown mostly by recent investments licensed under Law No.10. Finally, private companies supply 41% of all **canned foods** in 1998, up from about 20% of the total output of these products in 1994-95, and only 7% in 1990.

There seems to be room for the private sector to make dents in the *de facto* State monopoly in some sectors such as wine-making, margarine and butter, and yoghurt (where no private organised production is on record at the Ministry of Industry), and to increase its penetration in other sectors such as pasteurised milk and other dairy products, canned food and vegetable oil. In all the these products there has been an important increase in the participation of private producers along the 1990s, and it could be expected that most future growth in those products, as in others with high private shares, will come from the private sector. In all the sectors where the share of private producers increased, nearly all the progress made by the private sector can be traced directly to new companies sparkled by Law No.10 during the 1990s, which can thus be said to have had a **noticeable impact on production in the relevant sectors, and to have completely transformed the food and beverages industry**, from a State-dominated sector into one where the dynamic private sector prevails, and rapid growth has occurred since 1994.

7.5. Impact on foreign trade

Investments affect foreign trade in several ways: increasing exports of finished products, increasing imports of inputs and machinery, and decreasing imports of formerly imported finished products.

The impact of the projects on the import of inputs is more important from the point of view of policy than the impact on the import of equipment, since the latter is financed normally with foreign investment, and puts no pressure on the country's supply of for-

[42] Monopoly for bottled mineral water results from State monopoly of water sources, chiefly mountain springs, from which the product is derived. Processing and bottling the water has not been allowed to the private sector yet.

eign currency. Imported inputs, instead, are a regular and recurrent cost in many projects, which would increase in volume and value as the projects develop. Those inputs may include raw materials such as imported oilseeds for a vegetable oil factory, ancillary inputs such as chemicals or packaging materials needed in the process of making vegetable oil or fruit preserves, and machine spare parts (the latter may be classified as capital goods). They may even include intangible inputs such as payments for foreign licenses. The indirect impact on input importation includes the new inputs needed in sectors related to the investment (e.g. more fertiliser for farms producing the oilseeds locally). Unfortunately, available data are not sufficient to estimate this kind of impact in any meaningful way.

The impact of the projects on the imports of capital goods, instead, can be estimated from the committed investments in machinery and equipment and the rate of actual implementation of the projects. The industrial and agricultural projects involved equipment imports (for projects approved up to 1999) of 171 billion SP or about $3.73 billion, of which about 31% or $1,171 million would have been already invested. Transportation projects involved a commitment of 32.6 billion SP of which 70% has been imported, i.e. $496 million, for a total of $1.67 billion. As these imports have been implemented during a period of nine years (1992-2000), the added flow of imports per year would be about $185m for all projects, of which $130 million are for projects in the industrial sector.

The annual average value of imports of machinery and equipment (or its parts and accessories) in the 1992-99 period was about $190m. Since the annual amount of private imports of equipment in 1990-91 was much lower (about $23m), the increase in private annual imports of machinery and equipment between 1990-91 and 1992-99 was about $167m. **Machinery imports generated by the projects, estimated at $130m per year, are thus responsible of about 78% of the increase in private imports of equipment.**

The impact on **exports** is also hard to assess, since no data are available on the level of production or the destination of the projects' output. Several products of agribusiness projects such as processed fruit and vegetables have a clear orientation to foreign markets, but the exports of such products has not increased significantly in recent years (they have been stagnant since 1994, though somewhat higher than in 1990-91). It is probable that most of the potential increase in exports derived from private investment projects licensed under Law No.10 would only occur in subsequent years, as more companies learn to access foreign markets and adapt their production to foreign demand, and the government also achieves trade agreements with potential destination countries (mainly the European Union, but also other Arab countries and those formerly in the Socialist bloc).[43] In the meantime, **assessment of the impact of the Investment Law on exports is premature.** However, some idea may be gathered from the behaviour of private-sector exports of processed agricultural products during the 1990s.

Between 1994 and 1999, the current dollar value of exports of processed food and beverages fell from 183.8 to 125.2 million dollars, a fall of 32%. It affected both private and public exports, but on average the private sector fell much less (-16%) than the public sector (-91%).

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[43] This would be an instance of the well-know "**J-shaped curve**" for the trade balance resulting from a process of investment in the production of exportable goods. The trade balance worsens before improving, because input and machinery imports grow immediately, while exports start growing only after a certain "maturation and learning" period has elapsed.

Private and State exports of food and beverages, 1994-1999

	1994	1999	% variation
Value (U$S 000)			
Total	183,778	125,241	-32%
Private	143,384	121,075	-16%
Public	40,394	3,625	-91%
Share of private sector	78.0%	96.7%	
Quantity (MT)			
Total	209,033	138,370	-34%
Private	86,042	129,380	50%
Public	122,991	8,990	-93%
Unit value (U$S/kg)			
Total	0.88	0.91	3%
Private	1.67	0.94	-44%
Public	0.33	0.40	23%

Source: Central Bureau of Statistics, **Statistical Abstract** (1995 and 2000).

The fall was due mainly to large falls in the international price of food products and a shift in the export commodity mix towards products that have a lower price/volume ratio. In fact, the private sector **increased its volume by 50%** in the period, whereas the public sector decreased it by 93%. And the fall in prices hit (on the whole) only the private sector whose unit values fell by -44% while the unit export value for the State actually increased by 23%.

As a consequence, **the participation of the private sector in exports of food and beverages actually increased from 78% to near 97%** over the same period. This implies that among food and beverages exporters, **those in the private sector were more competitive**, and therefore they weathered the decline in foreign markets purchases better than the public sector, in spite of the explicit or implicit subsidies available to the latter.

In conclusion on this, private agribusiness companies have not made yet a substantial contribution to the volume of food exports from the country, which was adversely affected by external factors in the 1990s. However, they represent already a very high proportion of total food-industry exports (97%) in 1999), and their **higher** competitiveness **prevented the contraction from being worse.** In the future, private food exporters are not expected to make large gains in market share, since they already control 97% of all Syrian food-industry exports. Their progress will be seen in the expansion of food exports, which may grow significantly when more companies recently licensed enter into exports. A trade agreement with the European Union, as well as more aggressive marketing in Arab countries and Eastern Europe, and the establishment of better grading and standards, would greatly enhance that prospect.

7.6. Impact on the balance of payments

The impact of the projects on the **balance of payments** can only be gauged through their impact in the inflow of **private capital** in the form of private flows of **foreign direct investment.** Impacts on the current account occur under the form of increased imports and exports of goods and services, and also through profit remittances, but these are not directly measurable at the moment.

The projects licensed up to 1999 contained a total commitment to invest $5.92 billion in foreign currency, of which it could be estimated that not more than $1.8 billion correspond to projects that have started operation, at a rate of as much as $300 per year

along the period 1994-99.[44] The actual figure is in all probability significantly lower, since not all projects have implemented their full investment schedule, some foreign currency entered the country it before 1994, and some investment was not made by bringing the foreign currency to the country but by directly importing the equipment, as permitted by the Law. A reasonable estimate of foreign currency actually brought to the country for investments authorised under Law No.10 would be about $200m per year in the 1994-99 period.

Comparison with balance of payments figures is problematic, since such figures are far from clear in Syria, and significant flows are apparently not registered, or are registered under other headings than normally expected. According to the Central Bank of Syria and IMF estimates, foreign direct investment (FDI), which was quite low at the beginning of the 1990s, increased sharply to $251m in 1994, but fell to $100 in 1995 and remained between $80 and $90 thereafter, for an average of $115m (excluding the start in 1999 of foreign investment in gas extraction, which is independent of Law No.10).[45]

Errors and omissions that are usually interpreted as net flows of private capital were positive in 1994-98, varying around an average of $95m per year. Added to the former figure for registered FDI, this adds up to about $210m per year of FDI, which is consistent with the previous estimate of $200m per year in foreign currency inflows determined by foreign direct investment connected to Law No.10. **In other words, it appears that the Investment Promotion Law is responsible for about 90% of all declared monetary flows of private direct foreign investment flowing into Syria during the 1990s.**

According to the same sources, during the 1994-99 period the net foreign currency position of the banking system increased at a rate of $466m per year, of which the estimated $200m contributed by the projects represented about 43%. Thus, **foreign direct investment in projects licensed under Law No.10 contributed about 43% of the increase during the 1994-99 period of net foreign assets held in the Syrian banking system.**

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[44] Given the time required to complete administrative procedures, to acquire land and to build the facilities, little if any import of machinery originated in Law No.10 would have taken place in 1992-93.

[45] Based on IMF, **Syrian Arab Republic - Recent Economic Developments**, August 2000, p.50. The figures are the result of a rearrangement by the IMF of data from the Central Bank of Syria, plus some IMF estimates.

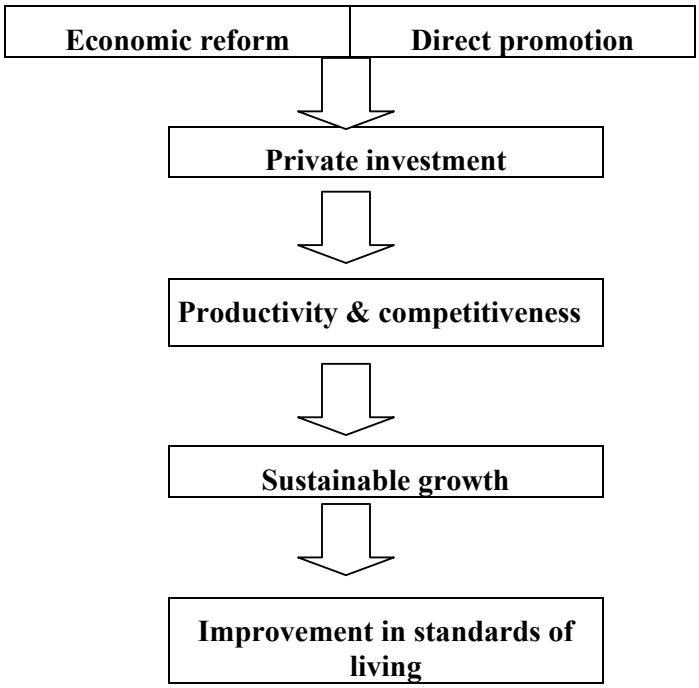
Part III: Policy issues and options

8. General policy framework

8.1. The general conditions for sustained growth

As seen before, the pattern of economic growth in Syria along recent decades tends to be checked by the accompanying growth of a trade deficit. Growth encourages imports more than exports; accelerating growth creates (in spite of oil exports) a larger foreign trade deficit; and the deficit is reduced or reversed only in periods of decline or stagnation. This "external gap" situation (quite common in developing countries during the 1970s and 1980s) puts a check on the growth possibilities of the country. In recent times it has experienced such reversals of growth in the early 1960s, around 1980, and in 1994-95. Thus **growth in Syria is cyclical**: a period of faster growth causes a widening trade gap, and this determining a period of slower growth, stagnation or decline while the trade balance improves. The operation of these forces has determined a **stagnant long-term trend in GDP per capita since 1980**.

A sustained process of growth requires overcoming this pattern. It should be overcome only by a strong commitment to **increase exports**, which in turn requires a rapid **growth in productivity and competitiveness**. This in turn implies **economic reform** and **direct promotion of private investment** as the means to put the country again on the road of **sustainable growth**, in an environment of increasing productivity and competitiveness where exports grow strongly and steadily, leading to higher levels of production and income, and a general improvement in the standards of living. The following diagram summarises these relations.



8.2. Global and specific policy options

This study deals with policy options for encouraging private investment in agribusiness in Syria. Encouraging private investment involves **two types of policies:**

- **Global or macro policies:** Improving the general economic and institutional environment for private economic activity
- **Specific promotion policies:** Giving specific incentives for private investment

Macro policies, the first set of policies mentioned, offers no special privilege to investors, but establishes the **overall setting of the economic system** in a manner that is suitable for **private economic activity of all kinds** (including investment, but including also trading, consumption, saving and other activities). When the economy in question comes from a past of heavy State intervention or centralised planning, many of the elements necessary for private economic activity, an especially for private investment, are absent or underdeveloped, necessitating **economic reform** to put them in place. This set of systemic policies aims at creating the general requirements of an economy in which private decisions to consume, to save or to invest play a significant role. That kind of economy is generally called a **market economy**, though this does not mean that the public sector plays an irrelevant role: in fact, as will be seen, **the State, the law and public institutions are an essential ingredient of a market economy.** In effect, there is not such thing as a "pure market economy". All "market" economies are, in effect, **mixed economies**, where the public and private sector complement each other, and perform different but important functions. A "social sector" of co-operatives, consumer associations, non-governmental charitable organisations, and suchlike, is also a common feature in all so-called "market" economies. **The public, private and social sectors have all specific and complementary roles to play in a market economy.**

Macro policies in this context include **institutional** as well as **economic** aspects. The institutional components consist of installing and keeping in force the basic institutions of the market, such as private property, the rule of the law, peaceful resolution of disputes through an independent judiciary, etc.. The economic components aim at ensuring a stable value of money, a sound macroeconomic management (smoothing the tendencies towards recession or inflation), an efficient and not too heavy tax structure, etc.

Specific promotion policies, instead, give private economic agents some **specific incentives to invest** (as distinct from merely consuming, trading, saving or other economic activities). These incentives aim at encouraging investment either in general (in any sector) or especially in certain sectors (e.g. in manufacturing rather than services). The incentives granted may be of various forms, such as tax exemptions, subsidies, special rights negated to other private actors, land grants, reduced prices for public utilities, etc.

Without the **minimum conditions** of a market economy, private investment will not happen, not at least in a significant and sustained manner, except under exceptionally generous encouragement. But even in market economies, it is often the case that private investment has to be **promoted.** Promotion of investment may arise in order to stimulate growth either in the **short** or the **long** term.

Investment promotion as a short term policy. Saving and investment may often proceed at different paces, creating at times a situation of excess investment (leading probably to inflation), and at other times determining a condition of insufficient investment, likely determining recession and unemployment. Those two situations often follow each other in a cyclical manner, calling for an alternation between **restrictive and expansive macroeconomic policies**. Expansive policies, widely studied in Macroeconomics since the work of Keynes, call for policies aimed at **stimulating investment (and growth) in the short term**, till economic activity resumes and the stimuli (usually in the form of public spending) can be withdrawn. Restrictive policies are used to dam-

pen aggregate demand and reduce the supply of money, in order to correct imbalances in foreign trade, and stabilise prices.

Short-term promotion of investment, like short-term macroeconomic stabilisation, is not the matter of this study. It is a requirement of every market economy, and is the daily work of economic policy, to apply the right policies at all times in order to create a smooth course of economic growth and price stability, minimising traumatic oscillations between inflation and recession. When a recession occurs or is expected, short-term promotion of employment is often considered as a valid policy course. It proceeds usually through fiscal instruments (government deficit spending), or through monetary expansion via a lower rate of interest. When the recession is over and the economy is expanding, short-term policy usually shifts to a tighter monetary stance (causing interest rates to go up) and restrictive fiscal policy (cut spending to reduce fiscal deficit). Short-term investment promotion is, therefore, just a component of short-term macroeconomic management. It is not intended to promote economic growth, but to smooth the fluctuations of the economic cycle.

Long-term promotion of investment. The kind of investment promotion that concerns this study is **promotion of sustained investment over the long-term**, which points to generate **long-term economic growth**. The use of specific or direct promotion policies is based on the assumption that **the prevailing economic conditions tend to discourage investors** from taking the long-term risk of developing production facilities and increasing their economic activity. The discouragement of investors does not result from scarce natural or human resources, or limited potential of the country, but from **macro shortcomings** of the economy, which are often not easily overcome, and also from **uncertainty** about the future, especially the medium-term and long-term future. Uncertainty may be of an economic, social or political nature, but uncertainty of any kind tends to discourage investors. As an old saying goes, *capital is cowardly*, and flees any possibility of economic disruption. As capital is private, and is not inclined to obey orders from governments but to follow its own interest, **encouraging sustained long-term investment is essentially a matter of creating conditions in which investing is perceived by investors as a profitable activity over the long run.** Temporary advantages are not enough, obviously. If an investor is told that he would not pay income tax for five years, but that after five years he would have to pay two thirds of his profits as tax, he would not fell much encouragement for long-term investment. At most, he would try to invest in some activity that permits rapidly recovering the investment and make a net profit within five years, so that he needs not to care about the taxes that would befell him afterwards. **Long-term promotion of investment requires long-term advantages for investors.**

Open economies and investment. The necessity of promoting investment through specific or systemic policies is reinforced by the interrelation of national economies within an increasingly globalised world economic system. Much of the world's capital has now freedom to circulate between countries, and the attempt of keeping domestic capital by force within the borders of the country is an increasingly helpless endeavour. **Governments are forced to compete with each other to attract capital (both domestic and foreign) to invest in their countries rather than elsewhere.** Investors will compare the conditions prevailing in all countries and decide their investments accordingly. Each country has the right of adopting the policies and the institutional setting of its own choice, but it is no longer able to keep the capital of its residents within the borders. If its institutional setting is perceived as hostile to investment, if its macroeconomic management is inept, if its specific promotion policies are weak or inadequate, in-

vestment will be low and national economic growth will be disappointing. As a consequence, **adopting and maintaining an attractive global economic system and a convenient specific regime for private investment is imperative in order to have sustained growth in today's interconnected world economy.**[46]

A correct policy for encouraging investment is often a combination of macro and specific policies. In developed and stable economies, direct promotion is often not so relevant, because the country has a global economic system very receptive and friendly for investment. Developed countries with huge markets and a totally liberalised economy may not need much direct promotion, though they usually have some. Direct promotion is more necessary in **developing or emerging economies**, where the system itself may harbour inefficiencies and restrictions, the general institutional environment may not be friendly for investors, and investing in the country may be perceived as risky and uncertain. But in those cases, **direct promotion only is not enough: global policies of economic reform are also needed.**

Clearly, the situation of Syria is the latter. The country needs to proceed with macro policies to reform the institutional and economic setting, but in the meantime it also needs strong specific policies to promote investment. In the 1960s and 1970s a rigid system of central planning was established, and the economy was for all practical purposes closed to private trade and investment. The existing investment promotion regime in Syria has been enacted without major modifications of the basic centrally planned system developed during the 1960s and 1970s. In the 1980s and 1990s a gradual process of liberalisation started, but its progress has been partial and with alternating and unpredictable shifts between accelerating or putting the brakes on economic reform. Thus, uncertainty is still present, and the economic system is afflicted by many shortcomings. Therefore, **apart from the need of proceeding with economic reform, securing sustainable growth in Syria calls also for a substantial amount of specific policies for promotion of private investment.** The various Investment Promotion Decrees and Laws (from 1981 to 1999) gave investors a number of **temporary privileges**, such as import licenses or tax exemptions, in an effort to make the investment projects look more profitable **in spite of the shortcomings of the overall system**. These policies had **two major defects**:

- **The advantages in the promotion policy were mostly temporary**
- **Direct promotion was strong but macro reforms were weaker**

The benefits granted were **temporary**. This is generally thought to be correct as regards special privileges such as tax exemptions, but long-term projects should be viable even after the privileges are removed. A deadline for the benefits means that after a certain number of years the private companies would have to operate in the same rigidly controlled environment of a centrally planned economy, with heavy explicit or implicit taxation and restriction of private economic activity, and then much of their initial profitability may disappear. This important limitation of the policy option chosen by Syria in the 1980s and 1990s severely affected the nature and extent of the projects. **If the rigidities were meant to remain in place, it would not be wise to encourage investments**

[46] There is always the alternative of closing the economy, forget about private economic activity, and set up a closed centrally planned economy. Nothing prevents it. However, most countries think this is not advisable in the present circumstances of the world, especially after the collapse of many such economies around 1990 and the severe and often insurmountable difficulties encountered by the very few countries that insist on that stance.

that are only profitable if those rigidities are removed or the investors are exempted from their consequences. Investors, under those conditions, would prefer projects that yield most of their profit in the very first years, disregarding long-term growth, and this would be a very negative feature with grave implications for Syrian economic development.

Under such an arrangement, a rational businessman would look for immediate advantages to be obtained during the period of construction and tax exemption, disregarding long-term gains because in the long term the company would have to work in an centrally-planned economy that may be supposed to be hostile to private investments. This tends to stimulate investments that aim at reaping most of their profits within the period of exemption or "tax holiday", and less incentives to develop extended business plans for the long term. There might be investments, but their long-term impact on growth and employment would be very limited. **Investment and growth created by a purely specific policy of direct promotion with temporary benefits tend to be spasmodic and not sustainable.**

That has been in fact the case. In spite of liberalisation measures starting as early as 1981, the Syrian economy has had nearly zero net per capita growth in 1980-99. There has been growth in the 1990s, much of it due to private investment and the Investment Law, but in ten years it has not been sufficient to offset and overcome the decline of the 1980s. Many projects were abandoned, the sustainability of projects after the expiry of tax holidays is problematic, many companies are not utilising their full capacity, and the subsistence of macro impediments for private economic activity hinders the enterprises in manifold ways. The employment impact of the projects licensed under the Investment Promotion Law was extremely small. Since the benefits were concentrated on favouring imports of machinery, capital investment per worker tended to be higher than expected for an economy like Syria, thus defeating the purpose of creating employment. Such as excessive reliance on capital-intensive technologies, apart of not creating employment, means probably that excessive resources are used for the investments when more production could be obtained with less capital. It may also create conditions for an excessive flow of profit remittances and capital repatriations in the future.

Although the resulting growth of the private sector in manufacturing and transportation has had many positive effects in the Syrian economy, **much more would be needed** to spark sustainable growth in output, income and employment. Something can be done by modifying some stipulations in the Investment Law, but even that would not be enough. **The missing element is deeper and wider change at macro level**. Unless major institutional and macroeconomic reforms are enacted, the operation of an investment promotion regime is not enough to sustain growth, and may even cause deleterious effects.

Subsequent sections of this report will discuss options for Syria related to both kinds of policies, i.e. **systemic or macro policies** aimed at creating a general favourable economic environment and **specific promotion policies** granting incentives for investors. In particular, the next chapter deals with issues about improving the existing legal framework for investment promotion, under the assumption that the overall economic system is **not** subject to sweeping changes, but only to the gradual and piecemeal adjustments that have been adopted in Syria along recent years. The subsequent chapter will discuss issues and policies to improve the macro environment for private investment.

9. Improving the investment promotion regime

In this chapter it is assumed that no substantial changes are introduced in the general macroeconomic framework of Syria, except some possible specific adjustments needed in the Investment Promotion Law or in other regulations concerning, for instance, foreign currency or foreign trade.

9.1. The role and status of the Investment Office

Presently, the Investment Office is a small department belonging to the Office of the Prime Minister. It has no budget except the salaries of its very limited staff. It has no autonomous status as an Agency for Private Investment, as many similar public services are organised in other countries. It has only three professional staff, none of them an economist. It has very limited computing resources, with the result that most of its work is done by hand: it has no computerised database with information about the projects received, approved and implemented. It cannot perform any follow-up or monitoring of the process of investment at the hundreds of companies whose projects are approved year after year, except in a very limited way through contacts or visits when some particular necessity arises.

This institution needs a complete restructuring and an institutional upgrade. The following elements should be taken into account.

- **Investment Agency**. The Investment Office should be upgraded to become an autonomous entity. One possible name for the new institution could be: **The Syrian Agency for Private Investment (SAPI)**.
- **Autonomy**. The SAPI should have institutional and administrative autonomy, under some adequate juridical definition according to Syrian Law. It should be an autonomous organisation created by the Syrian Government.
- **Self-financing.** The SAPI should finance itself, mainly through a **small charge** on all the effective investments carried out after licensed under Law No.10, as is the usual practice in many countries. Every time an investor deposits new capital in monetary form at the intervening Bank in Syria, or any time new capital is brought into the country directly in the form of imported equipment, a charge of about 0.5% should be applied at the customs, and transferred to the account of the SAPI.[47] Other resources open to the SAPI would be: (a) contributions from the budget; (b) fees for consultancy services rendered; (c) contributions from the private sector or from public international institutions for the purpose of doing evaluations and feasibility studies for possible investments; (d) other sources as approved by the Investment Council. Those resources will be used to finance the operational expenses of the SAPI (salaries, equipment, etc.) plus expenses related to the promotion of private investment.
- **Board of directors**. The Board of Directors of the SAPI would be formed by all members of the Investment Council, and will appoint the Manager of the Agency. Besides the Board of Directors there should be an Advisory

[47] To avoid applying the contribution twice, imported equipment that was paid with funds transferred from the project account in Syria will not pay the contribution again at the customs, if the investor shows evidence that the contribution has been already debited in the account.

Council composed of one representative from each national-level sectoral Chamber or relevant business association in Syria, on behalf of the Private Sector. Representatives of the private sector do not participate in the Board of Directors, and therefore do not have the right to vote for or against specific projects. However, they monitor the work of the SAPI and contribute to its improvement.

- **Functions**. Besides considering and approving (or rejecting) investment projects for the benefits granted by Law No.10 and related legislation, the SAPI will have other functions as well: (a) to promote private investment in Syria, through promotion activities in the country and abroad; (b) to develop and maintain a database on possible investment opportunities and projects for which some additional capital (national or foreign) would be required; (c) to connect the Agency with other similar agencies and co-operation institutions in the public and private sector of other countries, in order to promote joint-ventures between Syrian and foreign companies and entrepreneurs, and generally to promote financial and technological co-operation and association of investment projects in Syria with worldwide sources of capital, knowledge, trade opportunities and technology; (d) to exchange information about venture capital, investment opportunities, international quality standards, financing opportunities and other related matters with the commercial department of Syrian Embassies abroad, international institutions, and foreign specialised governmental agencies and business organisations; (e) to provide information services to Syrian entrepreneurs and foreign investors regarding investment opportunities in Syria and regarding possible sources of finance capital abroad; (f) to monitor the process of implementation and the actual development of the investment projects licensed under Law No.10; (g) to provide support services for the companies in matters such as obtaining licenses, importing equipment, developing new products, complying with international standards and trade regulations in other countries, developing new markets, evaluating new projects, improving management, etc.

The implementation of this significant upgrade in the nature, magnitude and scope of the present Investment Office will need substantial amounts of **technical assistance** and **institutional strengthening**. One of the **Project Profiles** annexed to this report deals with the provision of assistance for those purposes, which should include national and international experts in several fields (institution building, legal advice, investment support services, training, market information systems, etc.), and also computer equipment and systems, training activities in Syria and abroad, and fellowships and exchanges with similar agencies in other relevant countries.

9.2. Simplification of the authorisation process.

Project application. Presently, an investment project must be presented at the relevant Ministry (Agriculture, Industry, Transport or others), and then be forwarded by that Ministry to the Investment Office. The ostensible purpose of this step is to make sure that the project is consistent with the National Development Plan. However, the relevant Ministry is already represented in the Investment Council, and could present any objections directly there. In practice, this step in not necessary, and may cause unjustified delays: some investment projects have been withheld at some Ministry for months, simply because of administrative delays or because some department at the

Ministry was considering whether the project may hurt the interests of some State-owned company in the same or related line of business.

In fact, if a project is an investment in fields authorised by the Investment Promotion Law (agriculture, industry and transport, plus exceptional cases in other sectors that should be approved by the Council), their conformity with national objectives is already assured, since the Investment Law involves already a statement of the national priorities. Hurting an established State-owned company is **not** a legal reason to deny authorisation for a private investment: the State-owned company (except in strategic sectors) **must** allow for private competition. The existence of private competition is **good** for any State-owned company, because it causes the latter to improve its operations and become more competitive. Even if finally the State company does not succeed, and may ultimately be closed, that would be to the entire benefit of the Syrian people, and in total conformity with the legal framework of Syria whereby any State company (outside strategic sectors) **is not supposed to be exempt from private competition.**

In consequence, it is to be recommended that new investment projects be presented directly to the Investment Office (or Agency). Approval from the Investment Council (or the future Board of Directors of the Investment Agency) will be deemed equivalent to approval by the relevant Ministries.

Ex post intervention of Ministries. Sectoral ministerial decision for licensing the investment **after** it has been approved by the Council is also not necessary. Presently, projects approved by the Council need a further formal decision from the concerned Ministry, which is again a motive for delays. In fact, **the Minister has already decided** when he participated in the decision by the Investment Council in favour of approving that project. The communication from the Investment Office that the Council has approved the project (in which the relevant Ministry has already participated and decided) should be considered sufficient and **should replace any specific decision by the concerned Ministry.** If the project is approved, it should not need any specific Ministerial license to set up the investment or to start operation.

Since the Office will also communicate the approval to other concerned Ministries that also participate in the Council (chiefly the Planning and Supply Ministries), there is also no need that the investor should go to these ministries to seek a decision authorising the investment. **Therefore it is also recommended that the Council sends adequate formal communication of its decisions to all the concerned Ministries, and that this communication be taken as sufficient grounds to register the project as a private investment that has received the protection of Law No.10.**

The documented decision of the Council should also be deemed sufficient evidence that the project may open a foreign-currency account and be exempted from customs duties for imported equipment. At every State service whose intervention is necessary, such as the customs or the Commercial Bank, **presentation of the written decision of the Investment Council would be sufficient to get the treatment established by the Law.**

Thus the investor should only go again to public offices to seek an industrial license to operate when the investment is in place, as any Syrian business does when opening a factory or a shop. At this stage there is nothing to decide about the investment itself, only to register the fact that a new private establishment has been opened and will start operation. These operating licenses are only for the purpose of registry, and may also be for zoning considerations (the industrial plant should not be located in a residential area where no such establishments are permitted). The issue of that license should usually be

a brief routine procedure not involving any complication, exactly similar to the registering of any new business establishment.

9.3. Access to foreign currency

Up to the time of writing the Syrian currency was not convertible into foreign currency, except in very exceptional circumstances.[48] The rules established in the Investment Law No.10 and its attendant by-laws and amendment confirms this general feature. The State is under no obligation of providing foreign currency for the needs of the authorised company, and the law establishes that the investor should procure foreign currency **by lawful means** whenever such currency is needed for the purchase of imported equipment and inputs, for profit remittances or capital repatriation.

All this works reasonably well for projects where the initial capital is brought into the country in foreign currency, and the sales are mostly for export. But serious problems arise for **national investors** and especially for **foreign investors producing for the domestic market**.

Regarding national investors, there is no legal provision for acquiring foreign currency for the investment itself. National investors are authorised to invest any foreign currency in their possession and not be penalised for it by any existing legislation.[49] This allows the national investor to buy foreign currency in the parallel or informal market for the purposes of the project, for which he should be dealing with a person that deals in foreign currency, and that by that activity is committing a crime (the abolition of penalties for possession of foreign currency issued in 2000 maintains the penalisation of **dealing** in foreign currency, which is punished with up to three years in prison). This is an ambiguous legal situation for the national investor, especially if it is an established company. To give the national investor full access to foreign currency (short of a complete liberalisation of the foreign exchange market), the Law should provide lawful means to obtain that currency, such as authorising the Commercial Bank to sell foreign currency for the purpose of importing equipment and inputs for projects approved under Law No.10.

National or foreign investors producing exclusively or mostly for the domestic market will also lack any lawful means of obtaining foreign currency for continuing needs of imported inputs (raw materials, ancillary inputs, payment for use of foreign patents or licenses, etc.) all along the life of the project. Also, foreign investors not exporting much of their output would lack any lawful means of acquiring foreign currency for profit remittances or eventually for capital repatriation. This latter limitation is the most important one, since **foreign corporations will not accept having to acquire foreign currency informally** (the legislation of their country of origin may prohibit them to do so, and their internal rules of accounting will necessitate formal proof of purchase of foreign currency, not to expose the company to any need of dealing with murky informal dealers). Also in this case, the Law should provide means of acquiring the foreign

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[48] Starting in January 2001, the Commercial Bank is allowed to sell foreign currency for tourism or other personal purposes, in limited amounts, but explicitly **not** (yet) for business purposes. Foreign currency from export proceedings can also be legally bought at the Export Proceedings Market, but only for specific authorised purposes and by specifically authorised economic agents.

[49] The law that made a crime the possession of foreign currency was in force in 1991. It has been finally abolished in 2000.

currency legally, **at least for any project authorised under Law No.10 if the general foreign exchange market is not already liberalised.**

9.4. Tax credit and tax holiday

Law No.10 grants a **temporary tax exemption** (or for short, a **tax holiday**) for all approved projects. The exemption covers corporate income tax, real estate tax, and customs duties for imported equipment. It does not cover other customs duties (for imported inputs) nor other domestic taxes. The duration of the holiday is for the period of **construction** (normally up to three years that could be extended for another two in special cases) and for the **first five years of operation** (that could also be extended for **another two years** if the company has been exporting more than 50% of its output). Thus the maximum allowance is five years for construction and seven years for operation, a total of twelve years. This regime presents some limitations that should be addressed.

9.4.1. International competitiveness of tax benefits

The first of these limitations is that other Arab countries (such as Egypt) grant **longer periods** (ten years of operation instead of five or seven, for instance). Thus some companies interested in having a presence in the Eastern Mediterranean Arab countries may prefer to install themselves in Egypt instead of Syria, because of the superior conditions offered there.

This is an example of **competition between nations** to attract capital in the globalised world of today. The legal regime of each nation is completely autonomous, each nation is totally sovereign and may adopt the legal regime of its choice without any interference, but it **must** take into account the legislation of other countries, thus reducing its own margin of freedom. **The internal legal regime should be internationally competitive**.

9.4.2. Long investment schedules

Another problem concerns the difference between the periods granted and the investment schedule of each project. Some projects are technically designed in such way that investments are made in several phases, **before and after starting operation,** and often beyond the limits of the given tax exemption. The attached box gives an example from the interviews carried out for this study.

The example in the attached box shows clearly how a rigid period of tax holiday (even with the possibility of extending it as permitted by the Law) may not be sufficient to attract investments. This problem may apply especially to projects involving agricultural production that may often take years to develop their potential when growing trees are involved, or when the project foresees extensive land de-rocking, levelling, terracing, installing irrigation or other endeavours that may take a long time to complete.

Long-growing trees and the Investment Law

A project licensed under Law No.10 (owned by a foreign investor from another Arab country) has programmed an extensive plantation of **olive trees** in the northern Governorate of Raqqa. The company plans to open an **olive oil factory** when the trees start producing sufficient amounts of olives. Since olive trees start producing in sufficient volume after about 12 years of planted, and achieve full productive maturity at about 15 years, the project in effect has a construction period of about 13-15 years. The factory should be installed approximately 12-14 years after plantation of the trees, to be ready when production of olives acquires sufficient volume, and production of olive oil would start probably at years 13 to 15, long after expiration of the exemption period.

According to the present legislation, the profits obtained from production of olive-oil would not have any income tax exemption. Investments in the oil factory would not have any exemption for customs duties. If the oil factory is built much before the trees mature, it should not be economical (it would remain idle, or would have to use olives from other producers, not necessarily available in the same area). This project, in fact, has a total construction period of 15 years, but the law does not authorise so long a period for starting operation. This is a real case authorised by the Council (the trees are already planted), illustrating the difficulties created by contradictions between the periods of tax holiday established by the legislation, and the actual periods needed by specific projects.

9.4.3. Reinvestments and expansions

An investment project normally covers the initial investment needed to set up a productive operation, but it cannot foresee the subsequent investment that could be needed to expand operations when the company is doing well, or to incorporate new technology when the initial equipment becomes less competitive because of the appearance of new methods of production at competitor companies. In fact, **the process of investment never ends**. Normally, part of the profits are **reinvested** in the same company, and only the remainder is distributed as dividends to owners or shareholders.

The present legislation does not foresee any tax benefit for reinvestment, nor it considers that the investment process may never end. Each project's tax exemption is limited to the investment initially authorised. Any further exemption **must take the form of a new project**, which is not realistic: **the same project would need more investment**, especially if the project is successful and needs expanding, but also if new circumstances arise that make the initial investment insufficient or inadequate. Setting up another project, going again through the same steps as in the first instance, opening a separate bank account, etc., creates unnecessary complications. In fact, it may be impossible, since the profits of the expanded factory may not be separable between profits from the first investment (that should pay taxes) and profits from the expansion (that are still exempt).

From the point of view of a government interested in fomenting private investment, **further investment in the same projects is equivalent to investment in new projects.** In fact, **expansions and reinvestments are often preferable** to new projects, since some **fixed costs or transaction costs will be avoided** (for instance, acquiring more land may not be necessary), and also because reinvestments and expansions are also **less risky**, since the company already exists and is operating, thus proving that it is viable and could reinvest or raise new capital, unlike new proposals that may well turn out to be not really profitable when the blueprint is put in practice.

9.4.4. Partial solutions

Flexible construction periods. One possible solution is to make the construction period totally flexible, allowing the Council to grant extensions **of any duration** for the construction period when the project involves a developing phase that would delay full productive maturity for many years. The technical nature of the project would dictate the number of years necessary for construction and development.

This ad-hoc solution may appear to solve problems like that of the olive-oil company, which involve a very long period for the oil factory to start full operation. But it cannot address the problem of reinvestments and expansions after operation has commenced, and especially after the tax holiday has expired.

Besides, many projects start operating with a reduced capacity, but even that reduced production turns them into operating enterprises, and the period of five years starts running at once. A company may operate at 10% during several years, until it expands its market penetration, thus obtaining very little profit (in relation to the capital invested) during its first five years of operation, and start turning out its real profit only afterwards, when it has to pay the full income tax. **A partial solution consisting of a flexible construction period would not be adequate.**

Flexible tax-exempt periods of operation. Another possible partial solution would be that the Council be enabled to extend the period of tax exemption after operation has commenced, when circumstances so dictate. For instance, it may be conceived that this solution may be used to extend the period of exemption for those companies that in their first five years of operation do not operate at full capacity because of external factors (e.g. that the trees are not yet fully mature, or that the firm has to establish itself in the market before been able to operate at full capacity, or that the first years have coincided with a period of economic recession that contracted the size of the potential market).

This approach may solve **some** of the problems, but it is open to many possibilities of inadequate application. It may be difficult to distinguish between companies that are constrained by unavoidable external factors, from those that are operating poorly because of their own lack of managerial ability or defects in the project design. The first case deserve an extension, but not the second case. **There is too much room for wrong or arbitrary decisions for this approach to be used.**

Besides, this approach is not capable of dealing with the problem of reinvestments and expansions after the company is in full operation and its period of exemption has expired.

Also, this approach may have important **fiscal costs**, since the company may delay indefinitely the moment of starting paying taxes on its profits, if it is granted successive extensions of the tax exemption period because of new investments.

9.4.5. A superior solution: tax credits for investment

A more adequate and creative solution would be to replace completely the time allowances and exemptions established by the Law with **tax credits for investment**. According to this approach, **any** investment generates a **tax credit**, in the amount of a given tax credit rate calculated on the investment. This tax credit rate should correspond closely to the tax rate that applies to corporate profits.

Assume for the sake of exposition that the tax credit rate is 40%. This means that an investment of $1,000,000 generates a tax credit of $400,000. This applies to **any** investment, comprising the initially proposed investments or other investments that should be made afterwards. The tax credit is granted when the investment is effectively

made, i.e. when the company uses resources to expand its facilities, to acquire new equipment (or spare parts for the old equipment it already possesses), or expands its working capital by depositing fresh money in its account.

Any not-distributed profit is also considered an investment, and thus generates a tax credit that offsets the tax that may be due on that part of the profits. This is equivalent to applying the corporate income tax only to distributed profits, exempting not-distributed profits from that tax. Distributed profits include dividends for shareholders and withdrawals by the owners.

Once a tax credit is earned, the company may avoid paying profit taxes (or other authorised taxes, such as real estate taxes or machinery taxes) up to that amount ($400,000) until the credit is exhausted. The tax credit may be used at any time, with **no time limitations**.

This tax-credit approach solves at once most the problems mentioned before. Replacing the period of exemption with a provision for tax credit ensures that the company is free to plan its own investment schedule in an efficient way, and greatly reduces the administrative supervision required by the present provisions of the Law. With this approach, the Investment Office needs only granting tax credits every time the company documents an investment. The tax credit documentation is then used by the company to justify deductions on any authorised tax until the tax credit is exhausted.

9.4.6. Duty free equipment

Besides using tax credits to reduce payments of income, real estate and machinery taxes, any investment **made at whatever time** for an approved project should be **exempt from customs duties** on imported equipment.

Adopting the additional rule that **all** imports of equipment are **duty free** (or pay only a nominal very low duty) solves the problem of importing equipment after expiration of the tax holidays. **The tax credit is not to be used against duties for imported equipment, but only against corporate income tax, real estate tax and machinery tax.**

The matter of customs duties for imported equipment is of great importance for creating an adequate environment for investment, and should be considered especially. Granting tariff protection to domestic industries producing capital goods is not considered a wise option for developing countries. Any domestic producers of equipment should be internationally competitive or disappear.[50] Such industries, if producing equipment at prices above international levels, would impose an unnecessary additional cost on all domestic producers, reducing their international competitiveness. Besides, machinery and equipment contain **embodied technology**, and thus restricting their importation limits the ability of domestic companies to access the latest technology at competitive

[50] Many of the companies interviewed for this study have shown impressive capabilities to perfect or improve technology. One of the companies (devoted to grain milling) has in fact a separate division to produce a cost-efficient machine for grinding , that it even exported to several customers abroad. Another company (making pasta) has introduced in their equipment an interesting and simple additional device for cooling pasta packages, that has been duly noticed by the Italian suppliers of the machines and may end up been introduced in future versions of the machinery (whether the Syrian company would get any patent royalty for this innovation would depend on the success of its efforts to patent the improvement before the Italians do, and this in turn will depend on the agreement of Syrian legislation with international patent law and agreements). Other such examples of Syrian ingenuity abound.

prices. It is obviously impossible for developing countries to match the resources applied by developed countries to create new technology, except in particular cases.

Many developing countries have established a zero (or near zero) tariff for imported equipment, including all machinery and equipment for agriculture, mining, manufacturing, construction, cargo transportation, collective transportation of passengers, telecommunications, etc., and also all computing and other information-management equipment (hardware and software). [51] In a world economy based on technology, information and knowledge, letting technology into the country is to the benefit of everybody. Of course, only heavy duty vehicles should be considered as "capital goods", excluding ordinary family cars or light utility vehicles that may be used as family cars. **Therefore, it is strongly recommended that imports of productive equipment should pay no customs duties, or a very low custom duty covering the cost of customs operations but not implying reduced competitiveness for the users of that equipment.** The existing tariff on machinery and equipment **may be lifted altogether**, which is the best option, or it may be lifted **only for projects licensed under Law No.10**. Exempting all equipment (even for pre-existing companies not covered by the provisions of Law No.10, or computing equipment for all users) may be a very wise move. But exempting at least the projects of Law No.10 is essential from the standpoint of the present study.[52]

9.5. Updating the corporate income tax

There is in Syria a corporate income tax (taxing company profits before they are reinvested or distributed), a tax on personal income from capital (interest, dividends, etc.), and an income tax on wages and salaries. There is, oddly enough, no income tax on property rents (i.e. on income consisting of rental payments for property rented or leased to others).

Corporate income taxes in Syria currently present several problems:

- **Tax rates (with surcharges included) are far too high**, reaching more than 60% of declared profit; an excessive rate which would encourage evasion and understatement of income.[53]
- **The income brackets for the tax are outdated**. They were defined long ago and now correspond to very low levels of profit: the top bracket starts at one million Syrian Pounds, the equivalent of $20,000, so even small companies are charged at the top rate.
- **There is no minimum taxable income**: Syrian companies are taxed from the first Syrian Pound they earn, even for very small amounts, unlike most

[51] However, computer equipment for personal use is to be considered as a capital good, improving the general ability of the population to operate modern information processing technology, and should also be exempt of customs duties or pay only a very small duty. Exempting only computers bought by companies may promote tax fraud by deviating the equipment to other users, thus requiring costly supervision. Exempting all computer equipment is simpler and better.

[52] Duty exemption for capital goods should also be extended to imported building materials and accessories for productive facilities, especially because some factories and other facilities need specific building materials and accessories not produced locally, that may not qualify as machines or equipment. The duty exemption should also cover spare parts for equipment.

[53] The top bracket rate is 45%, increased with the War Effort Surcharge (30% on the tax), and local administrative charges (3% on the tax) to about 60.3% presently.

countries where the tax is charged only for incomes above a certain minimum threshold.[54]

- **Loose rules and limited tax auditing and cross-checks permit companies to inflate costs or understate receipts** in order to reduce taxable income, or to appear suffering a loss when in fact they operate profitably.[55]

9.5.1. Tax brackets and tax rates

The solution to the first three problems are simple: **update the brackets**, **exempt the bottom bracket, and lower the top rate.** Updating the brackets involves two steps: first, the brackets should be established at updated values, according to the current value of Syrian currency. Second, there should be a simple mechanism for automatic updating. For instance, for each successive year the amounts should be updated according to variations in the Retail Price Index or the Wholesale Price Index (both in the Laspeyres version) that should be made known to the public each month by the Central Statistics Bureau.[56]

The tax rate for the top bracket should be a maximum of 40%, **all included**, with no additional surcharges). All the tax rates should be applied **on the incremental margin**, i.e. calculated on the excess income above the bracket's lower bound. **Reinvested profits should not pay the tax**, in order to discourage distribution of profits and encourage investment. The following example illustrates this idea with updated values in Syrian Pounds, to be applied to profits that are not reinvested.

An example of income tax with increasing marginal rates
Maximum marginal rate: 30%

Not reinvested income brackets (SP per year)	Taxable income in each bracket (SP)	Marginal tax rate
Below 250,000	Up to 250,000	0%
Above 250,000 to 1,000,000	Up to 750,000	10%
Above 1,000,000 to 5,000,000	Up to 4,000,000	20%
Above 5,000,000 to 50,000,000	Up to 45,000,000	25%
Above 50,000,000	Excess of 50,000,000	30%

[54] There is a minimum taxable income for wages: no income tax is paid on the first 1000 SP. But there is no such threshold for the corporate income tax. Even if the 1000 SP is applied to companies, the amount is not significant for a corporation. One possible way of introducing the concept, besides a universal threshold to corporate profit tax, is to establish a zero corporate income tax on a certain amount of profit per employee (for instance, a monthly amount of 1000 SP could be deducible from taxable corporate income for each hired worker in the company). This way, a company would pay less income tax if it hires more workers.

[55] Several companies interviewed in the course of this study declared that operating entirely in the clear would lead them to bankruptcy, because of the high tax burden they would suffer. There seem to be large loopholes in commercial law or its practical application, allowing companies to avoid paying taxes by understating sales or overstating costs. Taxes like VAT that encourage economic agents to check on each other that taxes are paid do not exist yet in Syria.

[56] The CBS currently publishes two versions of the indexes, using Laspeyres and Paasche formulas. According to international use the Laspeyres version is the most common. The best formula, in fact, would be the **geometric mean of the Laspeyres and Paasche indexes**, that is known as **Fisher's Ideal Index** (obtained as the square root of the product of Laspeyres and Paasche indexes).

These tax rates are suggested in order that the War Effort Surcharge (WES) and the local administrative surtax are added to them. Then the maximum rate (30%) plus the 30% increase of the WES will be 39%. Adding also the local administrative charge of 3% of the tax would bring the maximum total tax rate to 39.9%.

Suppose a company has a total profit of 100 million SP, and reinvests 25 million. Taxable income would therefore be 75 million SP (about U$S 1.5 million at current market exchange rates). The following table shows the tax assessed for the company at the rates resulting from the precedent table:

Example of corporate income tax assessment
Total not-reinvested profit in this example: 75 million SP

Not reinvested profit bracket	Taxable marginal income	Basic tax rate	Total tax rate(*)	Total tax to be paid
Below 250,000	250,000	0.0%	0.00%	0
Above 250,000 to 1,000,000	750,000	10.0%	13.30%	99,750
Above 1,000,000 to 5,000,000	4,000,000	20.0%	26.60%	1,064,000
Above 5,000,000 to 50,000,000	45,000,000	25.0%	33.75%	15,187,500
Above 50,000,000	25,000,000	30.0%	39.90%	9,975,000
TOTAL	**75,000,000**			**26,326,250**
(*) Includes the pure tax rate increased by 30% for the War Effort Surcharge and 3% for the local administrative charge. The tax assessed represents total payment for the corporate income tax. No other surcharges apply.				

The total tax on this hypothetical taxable corporate income of 75 million SP would be 26,326,250 SP, i.e. about 35% of the taxable income obtained. This level of taxation of corporate income is consistent with international levels and (coupled with tax deductions for reinvestment) will encourage production and investment without depriving the Treasury of much needed fiscal revenue.[57]

An effective top tax rate of taxation (all included) above 40% would probably be counter-productive, creating more evasion and tax fraud, and deterring investment (even if reinvested profits are exempted) because such a rate of taxation in an emerging economy would detract too much form the profitability of any investment project, and make the investor think of investing elsewhere, where marginal top rates are usually not above that figure.

9.5.2. Fighting corporate tax fraud

Tax evasion and the accompanying fraud is impossible to eliminate altogether. But regarding taxes on the net revenue of corporations, the tax system should be designed in such a way that it becomes more difficult or more expensive for the companies to avoid the tax, thus encouraging compliance and deterring fraud.

[57] Decree 7/2000 (Article 1, section 4-A) established that joint State-private companies as well as shareholding companies that offer shares to the public would pay an income tax rate of 25%, and exempted them from the charges applied by local authorities (3% of the pure tax) including the War Effort Surcharge, and will be exempted from the local additional surcharge. The rates recommended here are higher, because they would apply to all private corporations except those with better rates as established in the current legislation.

One of the key aspects is **moderate** taxation. If taxation is too high, the benefits from tax fraud increase. The above recommendations on the rate of taxation for Syrian corporations are moderate enough to be applicable. Another way of attacking the problem is establishing the **Value Added Tax (VAT)**. This tax requires that anybody buying materials and selling products should charge the VAT on his sales, and deduct the VAT already paid for the materials. To do that, he should ask the supplier the documentation justifying that the VAT is being paid on the sale of the materials. In fact, **any payer of VAT becomes a supervisor of his supplier's compliance with tax law**. VAT is difficult to implement in economies with a large informal sector, where a myriad of small farmers or small shopkeepers and tradesmen operate outside formalities and with little regard for accounting. This is the case of Syria. Therefore, implementing the VAT may be difficult, and initial coverage incomplete. However, it is better to start applying it, gradually creating in taxpaying companies and shops the habit of regularly registering their operations.

One way of encouraging sellers to register their operations may be to link their bank credit ceilings to declared wealth, sales and income. When extending credit to persons or corporations, banks normally look for two things: collateral and solvency. Collateral requirements require that the borrower has enough wealth as to ensure recovery of the loan. Solvency requires that he has sufficient turnover and sufficient net income to gradually repay the debt. Bank regulations may request that banks are not permitted to recognise solvency much beyond declared turnover and declared profits, nor to recognise collateral much beyond the assessed value of assets. This way, persons and corporations are strongly encouraged to declare more income and to update the fiscal valuation of their assets in order to enjoy a higher credit ceiling, thus countervailing the tendency to understate income and wealth in order to pay less taxes.[58] Asset valuation, besides, is to be set at approximate market values and be updated frequently by means of price indexes and other devices.

Another approach that could be used is **taxing presumed income**. According to this approach, all companies would be presumed to have at least a minimum profit of about 5% to 8% of their invested capital once the facilities are operational. The fiscal valuation of the invested capital is also to be updated suitably. Income tax would be applied to the resulting **presumed profit**, and the resulting amount should either be paid or deducted from the outstanding tax credit if any. The burden of proof for claimants of lower profits rests with the taxpayer.

This mechanism has the drawback that it may tend to encourage companies to hide their actual profits in excess of the allotted minimum, but would ensure a Treasury revenue for the amount corresponding to the minimum profit. It has also the drawback of generating litigation by people or companies that allege not having reached the presumed profit. This device could be a complement of the VAT, since the application of the VAT (even if imperfect because of the large informal sector) would ensure that large portions of the operations are indeed made with all the formalities legally required. Other controls should be used, such as random inspections, to ensure that the companies are not involved in substantial amounts of tax evasion. Stiff penalties (including jail) for

[58] Once ordinary people start having credit cards and bank accounts, and start borrowing personal loans for housing (mortgage loans) or for other purposes, anybody would need to declare more income in order to enjoy more credit. Extension of these financial facilities to a larger proportion of the Syrian population, thus, will improve the general efficiency of the tax system, and reduce the extent of the informal sector.

tax offenders are also to be recommended in this regard, to ensure that a tax-paying culture develops in the country. Penalties (including the duration of jail terms) should be proportional to the amounts, and bail restrictions may apply for large offenders.

These possible adjustments in corporate income tax do not involve a major change in the tax system. However, they would contribute not only to facilitate the operation of companies under Law No.10, but also to improve the macro environment for private investment. In the next chapter, devoted to macro policies, some additional recommendations for tax reform are included. But before arriving at that chapter, however, other recommendations for the existing macro environment should be considered.

9.6. Investment in agricultural development

Only a few projects under the Investment Law (involving about 3% of all programmed investments) concerned agricultural production proper. Moreover, several of those projects are not purely agricultural endeavours, but include also manufacturing facilities that often make up most of the proposed investment. Of those approved, very few have actually commenced operations.

One of the reasons why so few agricultural production firms (i.e. farms) were established under Law No.10 might be the **minimum scale of investment** required to be eligible for the benefits of the Investment Law. As said before, there is a minimum threshold of 10 million SP (some U$S 200,000) for eligibility under Law 10/91. Most agricultural projects need only domestic inputs such as labour and seedlings, involving (in the scales of production most common in Syria) an investment of less than U$S 200,000 and little (if any) imported equipment. The main exception is dairy farms, of which there are several that applied for and received Law No.10 coverage, and also agricultural projects that also involve developing their own processing facilities (such as an olive-oil factory for an olive plantation, or a cheese factory for a dairy farm).

It appears that the Investment Council has not generally favoured approval of investments projects for agricultural production. The few that were authorised were mixed agricultural-industrial projects, or intended to add an industrial operation later on (like planting olives with a view to set up an olive oil factory a few years later), or were projects oriented to provide agricultural **inputs** (such as irrigation pipes).

In fact, many of the projects dealing with agricultural production would invest most of the money on attached processing plants. The subsequent construction of an olive-oil factory, obtaining tax exemptions for the factory, may be the main purpose of applying for the benefits of the Investment Law.[59]

However, in the context of a thorough modernisation of agricultural production technology, **much more investment in agriculture would be needed**, and most of it should enjoy the benefits granted by the Law. Examples may include projects involving pressurised irrigation in the form of sprinklers or drip systems, projects involving heavy farm machinery, and those involving on-farm after-harvest facilities for sorting, processing, cold storage, transportation or other non-farm (but on-farm) activities.

It is important to note that many of the obstacles for private investments in the industrial (processing) agribusiness sector result from low-quality or non steady supplies of agri-

[59] It is a paradox that the one project with these characteristics may end up without any tax exemption for the factory, if the latter is built only when the trees are mature, unless the tax exemption time limitations are lifted, as explained before.

cultural raw materials, resulting in turn from low-tech agricultural production methods. **On-farm investment for the development of modern farming is a necessary condition for agribusiness development in the processing and marketing sectors. Both imply each other, and none can progress without the other.**

These considerations suggest that an adequate framework and policies for investment in the farming sector (either on existing or new farms) should be regarded as a necessary complement of policies oriented to the industrial processing of agricultural products.

This is not the place to develop very detailed recommendations for this purpose. However, a few ideas are noted down, and additional technical assistance is foreseen in the attached Project Profiles.

9.6.1. Agricultural investments large and small

Modern export-oriented corporate farms. The design of the Investment Promotion Law is geared mainly to medium-size or large projects. The complexity of the administrative procedures, the minimum amount of about U$S 200,000 (ten million SP) foer eligibility, among other evidence, suggests so. This is fine for modern companies investing in high-return export crops such as fruit trees, greenhouse vegetables or aquaculture fishing. Creating **a large stratum of modern high-tech farms** of medium and large size may prove essential to ensure appropriate supplies of high quality products for export (either in primary or processed form), especially in the event of a trade agreement with the European Union. Syria is in a favourable position to become an **exporter of quality products to Europe**, chiefly raw and processed **fruit and vegetables**, and it should **attract specialised European firms** to invest in farm operations and processing units in Syria, bringing with them the necessary skills and technology. To those firms, adequate conditions should be offered within the provisions of Law No.10 conveniently adapted to the requirements of agricultural production. The Investment Council should revise its criteria to facilitate the approval of such projects.

Private investment in small farms. Not all agricultural investments are large, nor necessitate expensive high-tech investments, especially in a country like Syria where the average agricultural holding is about 8 Ha, and most farms are even smaller. A typical "large" investment for an 8 Ha farm, such as installing modern irrigation systems, could cost less than $20,000, i.e. one tenth of the minimum amount to apply for a Law No. 10 license. This small size notwithstanding, Syrian farms will need extensive investment in the coming years to cope with increasing water limitations and soil degradation, the necessity to improve product standards, and other shortcomings and opportunities.

Therefore, **adequate methods should be adopted for promotion of small-size investments at the farm level**, without increasing the unit cost of administratively processing the projects. For this purpose, among other things, **participation of the social or co-operative sector may prove essential**, as commented in the following section.

9.6.2. The role of the agricultural social sector

Existing agricultural co-operatives (and the related local-area unions in which they are grouped) are currently working mainly as the next-to-last echelon of the planning system and the next-to-final link in the chain of distribution of credit and inputs from the ACB. Moreover, they are concentrated (though not exclusively) on farmers growing strategic crops, since apparently other farmers tend to belong to Governorate-level Agricultural Chambers and not to rely so much on co-operatives (though many belong to both kinds of organisation). Additionally, co-operatives and unions (and to a lesser

degree Chambers) are widely perceived as semi-statal or para-statal entities, and not as autonomous associations of producers. Farmers that are members of the co-operative tend to see them as "they", not as "us".

Converting the existing co-operatives in working and autonomous channels for farm investment, marketing and access to support services is a very important task. It would involve, among other things, a more flexible approach to agricultural planning, and a real effort of devolution of autonomy to the co-operatives as **self-controlled farmer associations**. On this particular point more would be added in the next chapter under the heading of **decentralising the planning system**. Incorporating the Agricultural Chambers may be easier, but the Chambers are fewer, concentrated on main cities, and with lower membership. In the sector of farmers operating through the Chambers, especially those that are not members of co-operatives, the development of new operative associations of farmers at the ground level may be needed for the purposes outlined in the present section. The main form of these new associations may not be based on geographical proximity but on sectoral specialisation (thus, olive growers may tend to associate together, while their neighbours may belong to other organisations depending on their crops). A single farm may be associated to several organisations. **These ground-level associations are not meant to be massive: to be operative they should comprise ideally about 10-15 farmers, 50 at most.** Larger numbers become cumbersome, and detract from the face-to-face mutual trust that is essential to get farmers to co-operate with each other.

If farm-level investment projects are mediated by farmers associations, unit administrative costs may be substantially reduced. Other costs may also be lowered as inputs and equipment are purchased in volume. Moreover, the provision of technical assistance and other support services could also be more efficiently provided through some centralised channel covering a group of farmers. But for all these purposes the existing co-operatives and unions should also change their traditional ways as para-statal entities and start operating more often and more extensively (as permitted by the current legal regulations) as autonomous farmers organisations with productive functions such as the provision of support services, marketing, organisation of group credit and other related roles. As explained in the next section, they have also an important place in the development of adequate rural finance.

9.6.3. Rural finance

Investing requires savings and credit. But most small farmers in the developing world have no actual access to ordinary banking institutions. Bank branches are often scarce and far apart, bank procedures are difficult and complicated for ordinary smallholders, bank collateral requirements are usually too high for ordinary peasants. Thus in many countries a special branch of the financial system has been developed to deal with small-scale rural finance, operating mostly under **micro-finance** rules.

In Syria some of these restrictions are not so constraining. Bank branches, for instance, are relatively numerous: the ACB has 108 branches distributed across the country. However, banking regulations and procedures are indeed complicated for small farmers, and credit relatively scarce, especially credit outside the standard lines financing strategic crops. For these reasons, even in Syria rural finance may require the development of appropriate micro-finance facilities.

Rural micro-finance includes fomenting rural savings as well as enabling small farmers to get access to credit. There is an extensive experience on micro-finance, both rural and

urban, in many countries of the world. The most important is probably the well-known **Grameen Bank** of Bangladesh, created by Professor Mohammad Yunus. Similar institutions exist in many countries in Africa, and Latin America and the Far East.

The main instrument of rural credit used in micro-finance is the use of **group credit** based on the principle of **mutually guaranteeing repayment**, to replace insufficient farm collateral and enforce payment through **peer pressure**, as in fact practiced already by Syrian Agricultural Co-operatives. Rural savings may also be encouraged through adequate savings facilities. An adequate rural micro-credit programme would extend these facilities to all small peasants (not only those grouped in cooperatives) and make credit available even in very small scales and for all rural purposes (including not only farming but also small rural industries and petty commerce).

The **financial sustainability** of micro-finance institutions should be ensured through two basic mechanisms: **reducing banking costs**, and applying **sustainable interest rates.** Such institutions should adopt adequate banking techniques to reduce unit administrative costs. The main such techniques is group credit, but also reducing overhead costs in the micro-finance institution itself, and using appropriate means to collect and deliver payments.[60]

Regarding **interest rates**, it has been noticed that charging especially low rates is not advisable.[61] First, very low rates, below the minimum sustainable rate defined by the interest rate paid for funds plus adjustments for inflation, are not sustainable, requiring permanent replenishment from some outside source of funds (such as the government or some charitable institution). Second, if the micro-credits pay less interest than ordinary bank loans, smallholders are not encourage to "graduate" from micro-credit to become ordinary bank customers. Third, loans available at very low rates encourages deviating the funds towards other uses, such as depositing them at banks to obtain larger rates of interest, instead of investing them on the farm. Fourth, in spite of adequate banking techniques, small loans do carry somewhat higher unit administrative cost, thus precluding the application of very low interest rates that fail to cover costs of delivery. Fifth, farmers and other small borrowers ordinarily use some form of informal credit from traders, input suppliers or moneylenders, **that charge very high explicit or implicit interest rates.** Formal banks charge lower rates, but peasant have no access to formal banks anyway.

The fact that they are already paying high rates of interest leads to wondering how they can do so. In fact, when a small farmer or a poor tradesman receives a first injection of capital, it does not only obtain the normal returns for that capital. Accessing credit also allows them putting to full use other resources (land, labour, knowledge) that were idle for lack of sufficient capital. Therefore, the returns for the first injections of capital are usually higher than ordinary capital returns, thus allowing the investor to pay higher rates of interest, especially in the short and medium term. In the long run, when the capital/land and the capital/labour ratios have already increased, returns to additional capital start growing lower, converging towards ordinary rates of return to capital. Therefore,

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[60] The Grameen Bank of Bangladesh uses minimum central facilities, where few employees remain. Most bank agents are in the field, travelling to their allotted villages, paying loans and collecting payment on a weekly or monthly basis. These "barefoot bankers" cost a mere fraction of ordinary bank administrations.

[61] However, now the ACB charges reduced rates for loans to the co-operative sector including most small farmers. For loans below 50,000 SP the rate is 4.5% (lower than the 5.5% charged to the private sector) and above that amount the rate is 5.5% (private sector: 7.5%).

for long-term investments the rate should be lower than for short- and medium-term credit (medium term is here about 2-4 years, long term is 5 or longer).

The general recommendation for interest rates in micro-finance would be:

- Charge more interest than formal banks, but less than informal credit.
- Charge lower rates for long-term loans and higher for short and medium term loans.
- After several years of good standing, a customer should be upgraded to lower rates, and ultimately be sponsored by the micro-finance institution to become a normal customer in an ordinary bank.
- In any case, total interest revenue for the micro-finance institution should cover operating costs, the financial cost of funds, plus inflation.
- If the micro-finance institutions receive savings deposits, it should pay competitive interest to attract depositors. Donations should not be used to increase the operative costs but for enlarging the credit portfolio, and to subsidise lower long-term rates.
- Operating costs per loan should be kept low through inexpensive banking procedures, and group credit with mutual guarantee of repayment.

In the case of Syria no rural micro-finance institution exists, apart from traditional **ACB** credit channelled mostly through unions and co-operatives (although legally the ACB may lend to all kinds of farm producers). The only other likely candidate is the **Post Office Savings Fund** (**POSF**). This State institution accepts deposits from the public, but 90% of the funds were traditionally required to be lent to the Government at a rate of 8.75%. The remaining 10% was meant to be kept in liquid assets as reserves. However, on April 1999 the **POSF** started lending to the private sector. Since the Post Office has an established network of offices all around the country, it may be a useful starting point, but it needs important improvements to attract more funds and to become an active lender. It should specialise on lending to small projects in the farm and urban sectors, to become effectively a micro-finance institution. Also, the POSF should be allowed more managerial autonomy, and be permitted to receive outside donations or loans, in order to improve its operations, become more efficient, and be able to lower the rates and absorb part of its operating costs for long-term loans.

Also, **private micro-finance institutions** should be allowed to grow, in the form of Savings and Loans Co-operatives, or special private micro-financial entities, either for profit or not-for-profit, under adequate regulation and supervision. Regulatory oversight or supervision of micro-finance institutions is not equivalent to commercial banking supervision by the Central Bank, and requires that a specialised and flexible micro-finance supervision sector be established in the Central Bank, which should accomplish its mission according to the special needs of the micro-finance sector and using valuable experience accumulated in other countries.

The long experience of the Agricultural Co-operative Bank in dealing with co-operatives and unions for the purposes of the Agricultural Plan should be also used as a vehicle for financing rural investments, within or outside the requirements of the planning system. Unfortunately it concentrates on short-term financing for crops.[62] Lending to

[62] Of all credit extended by the ACB during 1999, a total of 10.2 billion SP, only 123.4 million SP, about 1.2%, was for long-term loans. Another 12.7% was for medium term credit, and the rest (85.1%) for short-term loans in cash and in kind. **Statistical Abstract 2000,** p. 486. In the case of the Industrial Bank,

co-operatives is a very efficient manner of grouping farmers, but the ACB should effectively extend its services also to other farmer associations applying for credit, and thus actually reach all small farmers, even those not producing strategic crops or not belonging to co-operatives, through group-credit schemes. The ACB is legally mandated to finance all producers, but it tends to concentrate on funding the unionised and cooperative sectors. Modernisation of the ACB, and development of improved techniques for processing investment credit applications should be introduced, and the Bank's access to loanable funds should be greatly expanded, for which undoubtedly much technical and financial assistance could be needed.

Other forms of rural financing may also be used. One of them is the establishment of **rotating funds** at village level, such as those created by the UNDP-sponsored ***Jabal el Hous*** Project. This project gives villagers the opportunity to access village-level rotating funds for credit **at no interest**. In essence, this approach consists of donating a certain amount of money to an organisation of peasants at the village level, to be used as a revolving fund only for agricultural or rural development initiatives, either individual or collective, and self-managed by the peasant organisation itself. The World Bank, who is generally opposed to create differentiated credit institutions for peasants, is nonetheless keen to finance operations consisting on the empowerment of villages through granting cash donations for constituting village rotating funds, that are meant for small investment needs at farm level.

Lending at no interest may be attractive to Syrian peasants, not only for economic but also for religious reasons. However, in that case the loans should have protection against inflation, in the form of product-related repayment (if the credit is for producing wheat, the payment may be expressed in the equivalent of a given amount of wheat). Peasants usually understand very well this concept of receiving the equivalent of 10 tonnes of wheat, and repaying the equivalent of one tonne of wheat one year later.

The problem with this rotating or revolving funds is that they are not very suitable for long-term credit and investment. If the revolving fund is used to extend 10-year loans, it will rotate very slowly, closing all possibility of further investment in the following years. Besides, if the funds are meant to provide for relatively large fixed investments, the resulting amount of donations to be made will soon exceed the capacity of any government. Funds obtained from financial institutions for credit operations are far more abundant than funds meant to be donated without any possibility of repayment. However, if the State of Syria is willing to transfer this "seed capital" to peasant groups, it may well be a way to empower the peasants to start a superior stage of their productive development, without requiring that the villagers enter financial operations completely alien to their cultural and religious tradition. It would be an adequate solution for poor and backward peasants with small individual needs, while modern credit or microfinance is reserved for slightly more developed farmers that are more suitable to banking credit. Of course, giving away money grants to organised groups of peasants

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that could finance small industrial micro-enterprises in the rural areas, the proportions are similar: off a total 2.0 billion SP in credit extended, only 19.5 million (2%) was long term, and 720 million (36%) was medium term, with the remaining 62% in short term operations. Notice that the entire lending capacity of the ACB is about U$S 200 million per year, and its entire outstanding portfolio amounts to 25.6 billion SP (about $513 million), an amount that (even if all of it could be devoted to investment) is well below the investment needs of the agricultural sector of Syria if it is to be modernised and expanded. The FAO Project GCP/SYR/006/ITA is carrying out a yet-unfinished study on agricultural credit, directed by FAO Consultant N. S. Parthasarathy with the participation of FAO Consultant K.S. Narasimhan, from which useful suggestions on the improvement of the credit system for Syrian agriculture may emerge.

should be done only with attached supervision of their investment activities, to avoid widespread deviation of the funds towards less productive goals.

9.6.4. Investing in the modernisation of irrigation systems

In Part II of this report, data and estimations were presented about the urgent need of modernising the existing irrigation system lest the further and necessary expansion of production in the coming years is compromised by insufficient water supplies for irrigation. This would put a dramatic end to the country much-sought food self-sufficiency, and impose large increases in food imports during the next decade and onwards.

To recall the main quantitative conclusions of that analysis, at an average cost of $2000 per hectare to install sprinklers or drip irrigation systems, modernising 1,275,000 Ha of irrigated land would cost about $2.4 billion. This is about five times the entire credit portfolio of the ACB, and 85 times its current annual delivery of long term and medium term loans. To that amount, at least 20%-30% should be added for other related on-farm investment in modernising the farms themselves, and related off-farm investments.

In other words, to achieve in five years the goal of total modernisation of irrigation **equipment** only, the farmers should have to invest about $500 million per year, plus other amounts for related on-farm investments excluding the irrigation equipment, and this should be financed through medium and long-term loans. With its present funds for medium and long term credit, the ACB would take 85 years to complete the financing of irrigation equipment, and more if other related investments are included. Even a much more modest goal of modernising **one half** of the systems in **ten years**, which would nonetheless fail to avoid some problems of water deficit along the way, would involve a total investment of about $1,200 million, or $120 million per year along an entire decade, which is also far above the existing availability of investment funds at the ACB.

Compulsory investment, as planned by the Government to ensure modernisation of the irrigation system, may have harmful consequences, especially because modern irrigation systems entail special skills on the part of farmers, and should be used as a basis for producing more valuable crops and to improve their marketing and processing. Those skills and farm-level changes are only achieved through self-motivation, economic incentives, training and extension, and complementary developments in support services, input supplies, processing facilities and more. Therefore it is strongly recommended that a system involving **water metering at farm level** and the application of **fines for overuse of water** be implemented along with the compulsory or voluntary **change in irrigation systems**. Also, it is recommended that extension activities be encouraged to improve farmers' capacity to use the new irrigation devices, changes in crop schedule, changes in grading and standards, etc. These changes would be best applied if a gradual liberalisation of the allocation of land and credit is also implemented, as recommended elsewhere on the matter of a more flexible planning system. This approach would allow farmers to use an increasing portion of their resources to grow more profitable crops, thus creating further incentives for farm investment and better farm practices.

9.7. Investment in support services

The modernisation of Syrian agriculture in the context of agribusiness development posits the need for an integrated development in agricultural production, processing of farm products, and **support services**. Presently, the Investment Promotion Law excludes in principle all investments in the service sectors, including agricultural support services. Though one article in the Law enables the Council to include projects from other

sectors, this is only a discretionary possibility that has been seldom used (only one service project, one in the field of tourism, has been ever approved). For agriculture, there are some approved projects for sorting, grading and processing fruit and vegetables, that could be said to be more a service than a manufacturing activity but have been approved as a manufacturing project anyway. Also, projects devoted to the production of certain farm inputs such as irrigation pipes lend also technical assistance to farms for the operation of drip irrigation systems. But these few examples are only exceptions, clearly showing that the field of agricultural support services has been generally absent from the process of investment sparkled by Law No.10. This in part is due to the scarcity of projects presented to the Council, but may also be a result of a lack of explicit mention of those services in the Law, and lack of explicit encouragement by the Council.

Presently the private sector does not participate much in the supply of support services for farms, except marginally through para-statal institutions such as Agricultural Co-operatives, Unions and Chambers. Most such services are in principle provided by the State through the Extension department and other similar units at the Ministry of Agriculture, formally providing services in the fields of technical assistance to farms, animal health, pest control, and others. But most of those services are under-staffed, under-skilled and under-funded, lack complete coverage of the territory, cannot possibly supply even a fractional portion of the potential market for such services, and definitely do not provide an effective and efficient service for the nearly 700,000 farms existing in the country. Services such as adaptive agricultural research, agricultural extension, input supply, rural credit, technical and professional assistance in farm operation and management, marketing, market information, and many other should be available not only from the State, but from all sectors acting in a complementary form. This includes the social or co-operative sector, private professionals and private commercial enterprises. To be capable of serving for these and other similar purposes, the co-operatives and unions should have their functions and modes of operating well defined and reorganised. Their traditional role and the perception of them by farmers as para-statal institutions is not helpful for that purpose, and should be re-defined in the context of improving the conditions for investment and development in the agricultural sector.

9.8. Access to land and industrial zones

Several companies started under Law No.10 spent much time looking for a suitable location and subsequently entering lengthy negotiations and procedures to secure possession of that land from the State or from private owners. The land market in Syria is severely limited by various factors, including extensive State-owned real estate (especially in forests and steppes) for which no market exists, and precarious titulation of many private lands. Squatting abounds on State land, both urban and rural, and procedures for eviction as well as plans for definitive settlement of squatted-on areas are difficult and also lengthy. On the other hand, the actual annual payment for leasing State land (once the lease is accorded) may be extremely low. But the time spent looking for and securing access to land may prove too costly, and may be the deciding factor behind the decision to abandon or cancel a project before effectively starting construction. **The most immediate and efficient solution for this problem is to create industrial zones**. These areas would be provided with adequate energy supplies, access roads for heavy traffic, water supplies, adequate discharge for industrial waste without endangering the environment, telecommunications facilities, and easy access to land for businesses. All investment projects approved under Law No.10 should be given access to industrial zones, which should be established in various parts of the country. Administration of the zone should be autonomous and simple, as usual in this kind of zone in other countries.

9.9. Access to basic services

Various companies in the survey complained about not having access to electricity, water or telephony. No industrial zones exist in Syria, and thus new factories are built usually in isolation, far from residential areas and also far from other factories, with the consequent difficulties to get an extension of existing electricity, water or telephone networks. The cost of paying for an individual extension of the networks is usually prohibitive. The cost of self-generation of electricity, digging autonomous wells for water supply, and communicating through cellular or satellite telephones (if available) is also too high for most projects. Investing in basic services is an obligation of the State, and a basic requisite for an adequate investment environment. Even without a large restructuring of the macro environment in Syria, the State should provide **ready-made industrial zones**, with all the basic services, at least near the main cities of the country.

10. Improving the macro environment

10.1. Requisites of an adequate environment for investment

The precedent chapter dealt with improvements in the existing legal regime for private investment promotion, embodied mainly in Law No.10 of 1991. The present and subsequent chapters deal with systemic reform and the corresponding systemic policies to promote private investment and economic growth.

The macro environment comprises the **institutional** bases for a market economy, and adequate **economic** conditions that favour private economic activity. Also, it includes a State sector that accomplishes specific functions, essential for the existence of private investment as they are essential for the existence of society.

The basic institutional arrangements of a market economy are not the only arrangements possible. An economy without these institutional arrangements can also exist, and it may be considered by some people as morally or socially superior in various respects. Every country is sovereign, and entitled to adopt the economic system of its choice. But if a country chooses to have a market economy, the following are its institutional requirements.

10.2. Institutional conditions for private investment

This chapter deals with the basic **institutional** or **legal** arrangements that must prevail for a market economy to exist. When these institutional requirements are not met, or are met in a very imperfect or incomplete way, markets may not work properly. In particular, owners of capital may view that economy as a non-reliable place and consequently invest their wealth elsewhere.

10.2.1. Private property rights

Respect and enforcement of private property is one crucial ingredient of the institutional setting presiding over a market economy, and an essential element of an adequate environment for private investment. For private companies to compete with each other, they should have the **right to dispose** of their property, and **effective legal protection of their property rights**. This legal enforcement of private property is another necessary ingredient of a market economy.

Property rights extend also to **appropriable intangible assets**, such as trademarks, patented equipment or techniques of production, etc. Moreover, other kinds of investments and trade agreements are difficult to get unless full support is given to intellectual property rights. Thus, the legal enforcement of such rights becomes a central ingredient of a market economy if technological progress is to be achieved.

Limitations to private property exist for a variety of reasons. Some goods are kept outside the realm of private property for environmental reasons, or for the sake of national security, for instance. These limitations keep private agents from **possessing** certain things. There are also limitations to the **use** of private property, chiefly for the sake of not infringing on the rights of others (playing loud music on private audio equipment may unaccountably harm the private life of others; emitting noxious gasses or liquids from a factory may contaminate the environment or cause cancer to neighbours).

Property is supposed to be protected from arbitrary **confiscation**. However, in most countries there are constitutional clauses authorising the Legislative branch of government to declare some assets **expropriable for reasons of public utility**. Lawful expro-

priation is usually considered a legitimate right of the State, **provided there is adequate compensation** to the owners. Concern that property may be taken over by the State without adequate compensation would entail a general withdrawal of investors from the country. No private owner of capital would willingly keep its wealth in a country where such things may happen. Even if land (and to some extent existing man-made facilities) cannot be moved to other countries, new investments (equipment, improvements, technology, organisational and marketing know-how, etc.) will be re-directed to other countries.

The main reason to introduce limitations to private property are **market failures**, i.e. situations in which the operation of markets is not likely to allocate resources efficiently. For instance, markets often fail to prevent firms from causing environmental damage, and thus some kind of public policies are required. These policies may impose **forceful restrictions** (e.g. a prohibition of emitting a certain gas above certain maximum levels), or they may use a **tax** to penalise those that cause harmful effects (emitting noxious gas in that case is not forbidden, but taxable), or they may try to **create an efficient market** that solves the previous market failure (e.g. the issuance of tradable **pollution rights**, as proposed by market approaches to environmental protection). Of these three kinds of environmental policy, only the first is a direct limitation on the use of private property, and even in that case the limitations usually do not preclude the rightful use of the property in ways that are not harmful to the environment.

10.2.2. Economic freedom

Another fundamental feature of a market economy is **economic freedom.** It involves essentially three kinds of liberties:

- **Choice of economic activity**
- **Choice of suppliers**
- **Pricing the product**

The freedom to choose an economic activity is based on the idea that a person does not need to be especially permitted to exercise an economic activity: everyone may exercise any activity in complete freedom, with the obvious exception of criminal activities. All activities should be in principle permitted unless explicitly forbidden by law, and legal prohibition in this matter should be extremely limited. So producers may choose what and how to produce. Consumers may choose which goods they will buy. Sellers may choose which goods they will sell, and at which price they would offer their product. On all this economic freedoms, there should be clear legal rules and regulations of the public sector. The very idea of a market economy is that everyone is free to choose what to do, and even free to do nothing, but this does not preclude the existence of rules forbidding criminal activities, or regulations imposing limits on activities that may cause harm to the environment or to other people.

The choice of suppliers and the right to set the offered price is also usually considered part of basic economic freedoms. Without the possibility of choosing among possible suppliers, a company cannot minimise costs. Without the possibility of freely pricing the product, the company may not be able to maximise profit. Without minimising costs and maximising profits, all the advantages of private investment disappear.

Of course, no private company can fix the final price on its own. Prices are set in the market, by supply and demand. The freedom of setting an offer price does not mean that the price is unilaterally fixed by the seller. It is ultimately established in the market through supply and demand. Many producers compete for the same market, and all are

aware that reducing the price without endangering profitability is the only way to survive. The ultimate sovereign in the market is the consumer, who may choose what to purchase, and in what amount. From this consumer sovereignty stems all the force that binds the market together through the competition of many economic agents such as people and enterprises.

Plan, command and policy. Even in a market economy, the government has **plans** or **programs** reflecting the goals of the government or the will of the electorate. Such a plan would not operate by **command**, but through **policy.** Policies are courses of action taken by the government within its own sphere, not infringing upon the rights of any private agent, but in the expectation that they may **influence** people, **encouraging** them to engage in certain activities more than in others, but **not forcing** anyone to do so. Such plans based on policy instruments may contemplate specific goals, such as maximising economic growth or maintaining low inflation, but these goals are not achieved by command. Their fulfilment requires a keen knowledge of how markets respond, both at home and abroad, to changes in economic policy, and an efficient economic information system to monitor markets and measure the impact of policy decisions.

10.2.3. The rule of law

When a plurality of individuals engage in market activities, everyone must trust that the whole system works according to rules. When a contract is signed, the contract is to be respected by the parties involved, and any delinquent party should suffer a penalty. When a general rule is enacted by the State, that rule should operate in an impartial way, affecting everyone without unjustified privileges or arbitrary exceptions. The main dangers to be avoided are corruption and arbitrariness. Equality before the law, and protection from corrupt practices (especially from corrupt public servants) are necessary ingredients of a sustainable and predictable market economy.

The rule of law is a requirement of the market economy, not for moral but for **economic** reasons. In the short term, every individual agent may be interested in obtaining arbitrary benefits through special favours, but few outsiders (such as foreign investors) would be willing to join that economy if only the insiders get favours and benefits. In the end, some insiders may get rich but the economy as a whole falls into stagnation and decline, and most of the people become impoverished.[63] Two elements are crucial to ensure the rule of law: a **competent and independent judiciary**, and a high degree of **transparency in the conduct of public affairs**.

10.3. Roles of the State

The above requirements of fair and efficient courts of justice and transparent government point to certain characteristics of the public sector that are essential in a market economy. The State has **specific functions** that it must accomplish for the market

[63] Some economies in the Far East, like the Philippines under the dictatorship of Ferdinand Marcos, have been described as "crony capitalism", to indicate that most opportunities for profit were arbitrarily allocated by corrupt high officers among their friends or "cronies". The resulting system is highly unstable, creates little if any improvement in the standards of living of the people, is intrinsically linked to the continuity of a political regime, and consequently cannot last forever. Its weaknesses lead usually to economic disaster and the demise of the regime.

economy to work properly. Most of those essential functions of the State in a market economy are covered by the following list:

- **Enforce the law and provide legal security**
- **Ensure the provision of basic social services and public infrastructure**
- **Promoting equity in society**
- **Regulate certain private activities**
- **Provide a sound monetary system**
- **Promote competitiveness**

Brief comments on each of these essential functions are given below.

10.3.1. Law, order and legal security

A State has been defined (by Max Weber) as an organisation successfully claiming a monopoly for the **legitimate application of coercion** within a given territory. This implies two parallel obligations of the State: **to defend the territory and the population** from foreign military threats, and **to enforce the application of the law and the keeping of legal order** within its boundaries. Again, this does not give the Government a right to conduct arbitrary applications of force or coercion. For a market economy to operate, State-applied coercion should be always **in accordance to legal rules**, that in turn must be respectful of personal freedom and human fundamental rights.

Providing a legal framework for living in society, and ensuring that the legal framework is enforced in practice, is an essential and seemingly non-delegable function of government. It includes many things, high and low, from enforcing transit rules in the streets to catching and jailing criminals, from ensuring the legal equality of all before the law to making that all contracts are respected by the parties involved. A good judiciary system and a competent and honest civil service are important ingredients for this to be achieved.

10.3.2. Basic services and public infrastructure

The coverage of the concept of basic services may vary, but its "hard core" usually comprises education, health care, potable water, sanitation, and social security for old age. Additionally, it may comprise also other services such as electricity, postal and telecommunication services, protection of the environment, and more. These services (especially those in the "hard core") are called "basic" because usually the electorate and the Government firmly believe that access to such services should not be constrained by the purchasing power of the people, but be **universally provided**, at least in some basic form, free of charge or at a very low cost for the users. Thus, in some countries primary and perhaps secondary education is provided free, but university students may have to pay for their education. Also, access to basic health care is also often granted to all, and the State tries to ensure that water, sewage, electricity or telephone networks reach all the corners of the territory, including those that would not be profitable for a private company because of the scarcity of population or their low level of income.

If education or health care were provided by the market, only those with higher incomes would be able to educate their children or to get medical care in case of illness. If electricity and telephone networks were only extended to profitable areas, many small towns or rural areas would be deprived of the service. In some cases, the State ensures that the service is provided to all at no cost. In other cases, it only ensures that the

service is **available to all**, though everyone may have to pay for it (as is the case of postal services, electricity or telephones). Even in these latter cases, the State may be willing to ensure that a limited amount of the service is provided free, so that users only pay for the excess (for instance, a few cubic meters of water may be free for all families, but any excess charged).

Ensuring the provision of basic services does not necessarily mean that the State itself directly provides all the services. Some of the services may be **operated** by private companies **under State regulation and supervision**. The selection of the private operators is usually made in a competitive way, under close scrutiny by the concerned population who also monitor the efficiency of the service afterwards. However, this is a matter of public choice: many countries have an extensive public sector running most basic services, while others prefer to rely on private operators, and there is no clear rule suggesting a necessary superiority of one or the other arrangement.

Apart from ensuring the provision of basic services, the State is also in charge of building and keeping **basic infrastructure**, which includes public roads, bridges, railroads, airports, ports, urban public infrastructures such as public buildings or paved streets, etc. It also includes the infrastructure for providing basic services, such as electricity networks, power plants, schools, hospitals, water and sewage networks, etc. Also in this case, the fact that the infrastructures are under the responsibility of the State does not mean that the State necessarily has to build, maintain or operate them it directly: it may choose to hire private companies to do those jobs under public supervision.

The construction, maintenance and operation of basic infrastructure is often funded by the State, even in extremely market-oriented economies, because many of those infrastructures are not attractive for private investors but are nonetheless necessary to society. Private investors, if allowed, might build a road and levy a toll from all vehicles, but they would do so only in heavy-transit routes, not in isolated locations where few vehicles are expected to use the road. The necessity to pay the toll may hinder the fundamental right of everyone to go anywhere in his or her country of residence. Thus governments provide the roads, and even if they allow for a road to be maintained by a toll-taking private firm, they provide usually alternative routes for people not willing to pay the toll. Roads, as hospitals or public buildings, are not build with the purpose of obtaining a profit from the sell of their services, but for purposes of common utility. However, for reasons of efficiency and economy the Government may entrust the construction, maintenance or operation of some basic infrastructure to private companies, duly regulated and supervised by the State, and so happens in many countries.

10.3.3. Promoting equity in society

One fundamental mission of the State is ensuring that all people have access to a minimum of **satisfaction of basic needs**, and ensuring that the operation of markets does not create an **extremely unequal distribution of wealth and income.** Providing universal coverage of basic services such as water supplies, sanitation, education and basic health care is part of this obligation of the State. Imposing **progressive** taxes on income and wealth is a means to promote a redistribution of resources in favour of the poor and disadvantaged. Also, certain fundamental rights of workers (such a minimum wage, paid vacations, a pension system and others) should be legally protected.

Pursuing social justice, like promoting efficiency, can often not be carried to the extreme, for such objectives may collide with each other. An excessive preoccupation

with social objectives may endanger the country's competitiveness, as an excessive pursuit of efficiency may create an unjust and unequal social structure. In fact, a country should pursue social justice just **as far as it can afford without endangering its economic objectives**. As in a family, countries have budget constraints, and sometimes they cannot satisfy important needs unless they first get more income. As economic progress makes more social progress possible, further enhancements of social justice should be gradually enacted. Otherwise, economic growth would not occur, or would become socially unstable, and the end result may be worse.

10.3.4. Regulation of some specific private activities

For most economic activities no special regulation is needed. Most countries have basic legal rules, often embodied in a Civil Code, that provide the general regulations necessary for all the economic and non-economic transactions of society such as forming a company, making a contract, borrowing money, and so on. But in some cases a **specific regulation** is required.

An often cited case of public regulation is the **protection of the environment**. Another important case is the regulation of **private companies providing basic services**, especially when the nature of the service creates situations of **inevitable monopoly**. When one company gets the concession to provide a basic service in an area, the people has not usually the right to choose between several providers: there is only one supplier of that service in the area. Pricing the service cannot be left "to the market" because there is not a market but a single powerful vendor. In such instances, the pricing of the service and the establishment of its quality standards are effected by the State through direct regulations, usually preceded by consultations and negotiations with the company, the users and other relevant actors. All these cases concern situations of **market failures**, when the market does not exist or is not able to produce a satisfactory and efficient allocation of resources.

This legitimate and essential function of regulation may easily lead to **over-regulation**. A situation of over-regulation appears when legitimately regulated activities are the object of excessively detailed norms, that in practice make the service inefficient and costlier, discourage private investors from engaging in that activity, and ultimately cause more harm than good to the users. Also, over-regulation appears when the State regulates activities that should not be regulated. Rules that only protect particular interests at the cost of much inefficiency fall also under this heading.

Situation of over-regulation must be the object of a **deregulation** policy. However, deregulation does not mean that the State withdraws itself from a sector. Abolishing some restrictive and inefficient rules may imply that the State must engage in new kinds of regulation in the future. Deregulation means only repelling those **excessive** regulations that are not required by the market to operate efficiently, but rather cause it to operate in an inefficient manner.

10.3.5. A sound monetary system

The State must provide a solid and stable monetary system and monetary institutions. This requirement is not precisely about conducting a sound monetary policy. The day-to-day conduct of monetary policy is another matter. Before monetary policy can exist, money should exist, and money (at least in its primary form of coins and banknotes) is something created and maintained by the State. Since markets operate through money

transactions, ensuring that the monetary system has not any built-in tendency to the perpetual degradation or wide instability in the value of money is very important.

When gold or silver were used as means of exchange and stores of value, governments could not print money. Precious metals were a product with a value depending on their cost of production and the demand for them, as every other product, and then the value of metallic money in terms of any other commodity was determined by the market. The only way of artificially cause gold or silver coins to depreciate was to mint them with a mixture of baser metals (and many kings and princes did so in the past, pursuing short-term gain and ultimately obtaining economic ruin).

Nowadays, money is only paper, and its value as a means of exchange or a store of value is only based on **trust**. That trust is essentially **trust in the monetary arrangements and practices of the State that issues the money**. For people to accept the money, and keep it as a safe store of value until they need to spend it, there should be a reasonable expectation that the value of money is stable. Not **absolutely** stable, for that is impossible, but **sufficiently stable** for economic calculations to be made without much risk of incurring grave losses.

Economics has already made clear the conditions for that kind of stability to occur. Prudent macroeconomic management and policies would avoid the danger of inflation on the one hand, and catastrophic depression and deflation on the other. But what are the **institutional conditions** that ensure (or make more likely) that macroeconomic management is indeed prudent?

The day-to-day conduct of government often faces urgent needs, and creates the desire to stretch the spending limits allowed by the budget. In such situations, the government ideally should reassign its resources, postponing inessential things to face the emergency. But some governments may simply take the easier way of issuing **additional money** and use it for **additional spending**. This can be done in several ways (issuing government debt and selling it to the Central Bank; lowering the rate of interest and then borrowing money from banks; directly ordering the Central Bank to print banknotes; and so on). Such expansionary measures, if used without restraint, usually spur inflation, which is the same than **degrading the value of money**, with deleterious effects on all economic activity, and primarily on savings and investment.

An independent monetary authority. The experience of countries with market economies has shown that the only way to minimise such dangers is to have monetary policy entrusted entirely to an **independent entity,** usually the Central Bank or its equivalent, committed only or chiefly to preserve the value of the domestic currency. This way, expanding or contracting the supply of money is still **within the public sector**, but **out of the control of the Government**. The Central Bank is **not** a part of the Government in the narrow sense. In many countries, the authorities of the Central Bank are appointed by the Congress or Parliament for relatively long periods after careful screening, and cannot be removed except by parliamentary impeachment.[64]

The Statute Law of the Central Bank, or an equivalent norm, usually stipulates that the conduct of monetary policy should **only** pursue the goal of **defending the value** of the domestic currency, or ensuring monetary **stability**. Defending the value of the currency

[64] Such is for instance the case of the Bank of England, the Bank of Japan, the Federal Reserve Board of Governors in the US, and the European Central Bank, and such was also the case of the Bundesbank in Germany before the European monetary unification that marked its demise.

means that the Bank should avoid the depreciation of the currency, but it may allow for monetary appreciation. Instead, the goal of ensuring stability commits the Bank to maintain the current value of the currency against other currencies, without significant depreciation or appreciation. Furthermore, in some countries the Statute Law of the Central Bank mandates that the Bank should pursue simultaneously two long-term goals: monetary stability and full employment.[65] This option leads the Bank to calibrate perpetually its policy, to maintain the economy in **the narrow path between increasing unemployment or increasing inflation**.

How exactly a Central Bank is organised, and what its objectives should be, are matters of debate. However, the point here is that practically all the developed market economies have an independent Central Bank, and a growing majority of emerging economies and economies in transition are adopting the idea. It is not a perfectly guaranteed system, since even Central Bank authorities may make mistakes or be sometimes pliable to political pressure, but experience has shown that it vastly increases the chances of having and preserving a sound monetary system, and therefore **good grounds for savings, investment and growth.**

10.4. Promoting competitiveness

Apart from concentrating in its essential functions such as enforcing law and order, providing basic services and sound monetary system, all examined before, creating a market economy implies abandoning many previous roles of the State, chiefly its activities in the production of goods and services for the market, and its direct control over production and marketing decisions. But it entails the emergence of **new roles** that become crucial for a market economy to work.

10.4.1. Quality and safety standards

One of them is the new attention that must be given to promoting the competitiveness of the economy. Among the functions related to this role is the **establishment and monitoring of quality standards**. Products oriented to international markets, in particular, must bear a **public guarantee of quality and safety**, especially regarding **food products** (and also medicines and others). Up to now, the legal standards applied in Syria (for imports) are extraordinarily high, much more so than standards in use in many developed countries, but this is chiefly **a non-tariff device to fend off imports** and thus protect some less-than-competitive domestic production. Few, if any, domestic producers comply with such stringent rules, which are only loosely enforced in the domestic market. This leaves producers at the mercy of the authorities, which could choose to apply the rules at any time. The rules themselves may often be deemed inapplicable in practice, by want of the technical requisites for applying them, or for their forbidding cost in the face of State-fixed prices and the limited purchasing power of the population. In many cases, strict enforcement of the rules will mean discontinuing domestic production.

This state of affairs should be modified. A **realistic set of quality and safety standards** should be established, in line with those in force in OECD countries, and **applied equally to imports and domestically produced goods and services, regardless of their destination for export or the domestic market.**

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[65] Such duality of goals exists most notably in the statute of the Federal Reserve System of the United States. The goal of full employment was introduced in the wake of the Great Depression of the 1930s.

10.4.2. Export and investment promotion

Another novel role for the public sector is enhancing competitiveness through the **promotion of exports** abroad, and also the **promotion of foreign investment,** to ensure the insertion of the country in the international economy and markets. This includes State support for direct promotion of the country's products (especially for enhancing their marketing image), entering agreements with foreign countries (e.g. the EU) and institutions such as the WTO, offering support for local businesses to make forays into foreign markets, taking steps to make the country more attractive for foreign capital, and reforming domestic policies to be in line with the requirements of such international relations. Several policy recommendations emerging from this study point to fulfil this role, including complete liberalisation of exports, engagement in trade agreements, and the expansion of the present Investment Office into an autonomous Syrian Agency for Private Investment.

10.4.3. Enhancing systemic competitiveness

A further crucial role of the State to enhance competitiveness is to improve the **systemic** competitiveness of the country. This concept differs from **microeconomic** competitiveness (which concerns the efficiency of an enterprise in producing a specific product) in that it concerns the **overhead cost** imposed on private costs by the **inefficiencies of the State apparatus** and the **low quality of public goods and services**.

Examples abound and could be multiplied at will. Poor roads increase transportation costs. Power shortages hamper the operation of factories. Complicated bureaucratical procedures use valuable time of managers and workers in unproductive ways (apart from wasting valuable budget resources of the State). Ill-conceived taxes distort productive decisions and lead to inefficient allocation of resources. Misaligned prices send the wrong signal to private firms, failing to lead to efficiency and competitiveness. Rationed systems for delivery of credit and foreign exchange also distort the conduct of business. Lack of expediency in public offices delays private decisions. Corruption in State agencies increases transaction costs and further contributes to inefficiency. An oversized State apparatus leads to exceedingly high taxation, which reduces profitability, deters investment and growth, and also artificially increases domestic costs of production (unless tax rebates for exports are enacted and effectively implemented).

The reform of the State to promote systemic competitiveness is a necessary ingredient of a process of transition from a centrally planned economy to a market-oriented one. In many countries, the public sector has accumulated a large number of inefficiencies over the years, has taken over activities that should have never fallen in its hands, has developed over-complicated procedures, and is plagued with duplications and inconsistencies between different areas of the bureaucracy. The administrative reform of the State apparatus is in such cases a first requirement to improve systemic competitiveness. It involves many aspects, such as: withdrawing the State from inessential activities that are better left to the private sector; simplifying the organisation of that apparatus and procedures required to deal with it; deregulating certain over-regulated activities to lighten both the burden on the private sector and the cost to the State of maintaining useless or counter-productive regulations; improving the efficiency of those sectors on which the State's activity should concentrate (such as education, health care, law and order, defence, basic services).

10.5. Economic conditions for private investment

The precedent sections contains a detailed exposition of all the **legal and institutional** requirements that are **necessary** for a market economy to exist, including general institutional prerequisites and essential functions of the State. They are necessary may not be **sufficient**, however. Without certain **social and economic** conditions, the institutional prerequisites may be present but the market economy will not work, or will not create sustainable growth. Those economic conditions concern certain key aspects of the economic system that do not depend on legal or institutional arrangements. They include chiefly the following:

- **Mobility of resources**
- **Adequate incentives**
- **Low overhead costs**
- **Predictability**

These elements describe an economic system that has in place the conditions that are conducive to a positive response of private capital in the form of investment, innovation and growth. These conditions are complementary to the basic institutional requisites analysed before.

The key primary element for growth in today's knowledge-driven economy is not natural resources but a sufficient supply of **human ingenuity and skills.** Any government that wants the prosperity of its country should devote the utmost efforts to promote this important asset. It involves providing a good education system, and promoting and rewarding creativity and innovation. However, this is a general requirement for developing countries and is only mentioned here in passing, since no particular policy recommendations can be readily drawn except the general precept of enhancing the education level and the creativity of the people.

The more immediately relevant economic conditions that should prevail are the three mentioned above. The economic resources accessible to the country should have economic **mobility**, i.e. they should be easily re-allocable, since growth would require that some of them are shifted from old uses to new uses. Third, the tax structure and other related economic policies should create a **right set of incentives**, not creating distortions but encouraging investment over superfluous consumption, efficiency and innovation over habit and underachievement, productive activities over idleness or speculation. Fourth, the global **overhead costs** of the country (costs incurred "off the gates of the factory", outside the control of the private company) should be kept as low as possible. Fifth, the economic and institutional situation should be **stable and predictable**. Some implications of these conditions are briefly revised below.

10.6. Mobility of resources

Growth cannot create resources from nothing. It can only re-arrange them in a more efficient way. For this to happen, resources must be mobile. Domestic resources must have to be re-assigned to new activities. Foreign resources must have to be brought into the country. Savers must meet investors. People that need land must be able to find people willing to sell land. People working in an inefficient line of production should be able to move to a more productive use of their talents. Without resource mobility, growth cannot occur.

The mobility of resources can be improved by removing **obstacles to mobility**. These obstacles are of various kinds:

- **trade barriers**
- **inadequate banking system**
- **foreign exchange restrictions**
- **lack of active capital markets**
- **restrictions to foreign investment**
- **rigidities in the labour market**
- **restrictions in the land market**
- **restrictions for accessing and exchanging information**

Removal of these and other similar rigidities and restrictions enables financial, physical, technological and human resources to circulate freely, thus facilitating a better allocation of resources and maximisation of productivity growth.

An **adequate banking system** is an essential component of a program to increase the mobility of resources. Without efficient banks no business can operate, and much less can it prosper and be competitive.

10.7. Adequate incentives

All activities have positive and negative qualities, and thus there are natural incentives for people and enterprises to engage in one or another of those activities. Governments create additional incentives (or disincentives) for private activity when they adopt rules, enact taxes or grant subsidies that affect the attractiveness and profitability of certain economic activities, or alter the relative value of resources or products. If a tax is applied to a good **A** but not to a good **B**, this action of the government makes **A** relatively more expensive than before, relative to **B**, and thus inevitable creates an incentive to consume more **B** and less **A**. This incentive can be conducive to more growth and more efficiency, or may lead to less growth and less efficiency, or perhaps it may be neutral. The adequacy of incentives to generate the desired results is an essential feature of a thriving market economy, because the activities of private agents can be influenced by the government mainly through the incentives implicit in economic policies. What counts is not the intention or wishes of the government, but the actual economic incentives created by its policies, and the kind of reaction that economic agents can be expected to have when confronted with such incentives.

Taxes and subsidies are the main forms available to the government to create incentives. However, it is easy to develop grave distortions by way of ill-conceived taxes or subsidies, that often achieve the opposite of what was intended.

10.7.1. Some basic ideas about taxes

The main instrument to set up an adequate set of incentives is an **efficient tax structure**. It should have several characteristics:

- **Simplicity**

There should be few taxes, that could be easily collected with little possibility of evasion on the part of taxpayers. This also avoids double or multiple taxation that occurs when many taxes are applied at different phases of the economic process, with possible "pyramiding" effects whereby taxes are applied on taxes.

- **Moderate distributive progressiveness**

A tax system is usually used to promote a more equitable distribution of wealth, income and welfare among the population. A progressive taxation system would concentrate taxation on the higher echelons of the income and wealth distribution, and use the proceeds to improve the living conditions and the economic prospects of the poorer sector of the population. This is done, for instance, through an income tax with increasing rates for successive income brackets (usually leaving the lowest bracket untaxed), or through taxes on wealth applicable only above a reasonable threshold.

However, an excessive preoccupation with progressive taxation would greatly reduce the incentives to increase wealth and income, and would deprive successful entrepreneurs and corporations of the margin necessary for further investments. In fact, it would tax more the successful (that earn more) than the failures (who earn less), which in effect rewards private inefficiency and hardly encourages the most efficient. Thus an adequate tax structure should be progressive, but only moderately so. The taxation of the highest incomes should be high enough to promote equity, but not so high as to leave little resources for further investment in the hands of entrepreneurs and corporations, and making economic success unattractive for the private sector.

- **Tax corporate fixed resources more than outcomes**

To encourage production, it is better that some corporate taxes fall on fixed resources and not exclusively on the variable product or income derived thereof. If a substantial part of the corporate tax burden is paid on fixed assets such as land or capital, the **relative** tax burden on income will diminish as production increases. This encourages private enterprises to increase production. This does not mean that income should not be taxed, but that some **part** of the tax burden should fall on assets. The corporate income tax should be complemented with a tax on productive corporate assets.

- **Tax consumption and idle assets, more than savings and investment**

Income devoted to the consumption of non-basic items and wealth maintained in the form of idle assets (especially luxury assets) are potential resources for investment and growth. Taxing them more than savings or investment should encourage people to put such resources to more productive uses, and would redirect some of their value, in the form of taxes, to be used for socially worthier purposes. The personal income tax should be complemented with a tax on personal assets such as real estate and cars. Money put in the bank should not be taxed since it is potentially usable for productive purposes when the bank lends that money to borrowers. For corporate profits, one device usually applied to reward investment and avoid incentives to consumption is applying taxes on **not invested income**, exempting income that is invested. For instance, a tax on corporate profit may fall only on distributed profits, while reinvested profits should be totally or partially exempt.

- **Moderate taxation**

Taxes come from production, but excessive taxes detract from the ability of economic agents to keep producing and expand production through investment. Taxes should not "kill the hen that lays the golden eggs", for then the golden eggs would come no more.

- **Collection efficiency**

A good tax should be easily collected. A complicated tax system is difficult to comply with, so simplicity makes for more efficient collection. Moderate taxation makes evasion less attractive, and thus also improves efficiency in collection. Additional gains in

efficiency come from methods of taxation that encourage **mutual control among taxpayers.** This is for instance the case with the Value Added Tax.

- **Avoid duplication and pyramiding**

Many indirect taxes have a **pyramiding** effect. If one tax is charged at one point in the processing or marketing chain, it is added to the cost of the product, so that further taxes in subsequent points apply also to the tax already paid. The taxpayers then pay a tax on the tax, which is not efficient. For instance, if one agricultural product pays a tax, raising its cost from 100 to 110, and then the processed product pays another 10% tax, this latter tax is paid on the value of 110, raising it to 121, then in effect applying a 10% tax on the tax already paid.

One appropriate way to tax expenditure in an efficient way is imposing a **Value Added Tax** (**VAT**). This tax applies a uniform percentage (usually between 6% and 15% in most countries) on all **sales**. At each stage of the economic chain, the charge is the same, but the seller (e.g. a manufacturer) can deduct the amount of VAT he has already paid for the inputs he purchased to make the product. Thus in fact he pays VAT only on the **additional value** (above the value of inputs) that was created at a particular stage, e.g. during manufacturing. This system avoids pyramiding and duplication of taxes along the processing and marketing chain.

One problem with VAT is the difficulties often encountered for its implementation when large sectors of economic activities work in an informal manner. Collection of VAT requires that economic transactions are done formally, exchanging legal bills or receipt documents, and this is not easily implemented with small-scale enterprises like those operated by semi-illiterate peasants, street vendors or small shopkeepers with little education. However, tax specialists have devised solutions to implement VAT in such an environment, and to create adequate control mechanisms to enforce the tax and gradually produce its generalisation to all relevant economic activity.

The VAT provides a useful means for control, since every taxpayer is interested in controlling that others pay the tax. For instance, a company must pay the VAT rate on all its sales, but deducting the VAT paid when it purchased its inputs. To make the deduction, it needs evidence that VAT was effectively paid for the inputs, and thus must ask its suppliers to provide that evidence (usually in the form of a standard bill documenting the payment of the tax). This generates a **chain of mutual checks** that greatly contributes to efficient tax collection, at little cost for the State, as is the experience of many countries where such a system exists. Implementing direct and adequate computerised control of the system, with **cross-checking** of existing evidence of income or wealth (such as bank account turnover, records of the acquisition of property such as houses or cars, and other similar sources), and submitting tax payers to **random direct checks**, with stiff **penalties (including jail) for offenders**, further improves the efficiency of the system.

10.7.2. An outline of an adequate tax structure

The previous chapter has outlined the necessity of tax reform, and the main characteristics that an efficient tax structure should have. They include simplicity, correct incentives, collection efficiency and social equitableness. The current tax structure in Syria has none of these virtues. An adequate tax structure satisfying those principles would consist of only **a few fundamental taxes**, such as the following:

Value added tax (VAT). Applied in each stage of the economic process, avoids duplication and creates little distortion. One single rate is applied, and it should not be

above 15%, possibly less (suggested value: 10%). Some articles (such as very basic food items, bread in the case of Syria) could be exempted for social reasons. A VAT rebate or exemption applies for exported goods.

Income tax.[66] Income tax should be applied to incomes **above a reasonable threshold**, leaving most of the working population exempt. It should be paid by persons and corporations, but income received by persons from corporation profits (that have been already taxed at the corporation) should pay no income tax, to avoid double taxation of the same income. Very few income brackets should exist, with a moderate increase in the **marginal rate of taxation** at each successive bracket. The lowest bracket, with zero tax, should cover the income of most workers, clerks and small farmers and shopkeepers, so they pay no income tax at all. The top bracket should have a marginal effective tax not above 40%, in an economy that wishes to encourage rapid growth. To have an effective rate of 40%, the nominal income tax rate for the top bracket in Syria should be 30%, to which the War Effort Surcharge and local charges are added for a total of 39.90%. The boundaries of the brackets should be upgraded automatically each year, according to some simple mechanism publicly announced, such as the annual increase in the Consumer Price Index. **Saved or invested income should be partially or totally exempted.**

Fixed assets tax. This is a fixed percentage (not above 1%) of the **actual value** of major registrable assets possessed by families and corporations. Personal possessions **up to a certain limit** (say, U$S 100,000) are exempt. The tax is paid only on the excess of personal wealth above that limit. **Personal fixed assets tax** is paid on residential buildings, land, and cars. **Productive fixed assets tax** is paid on commercial or industrial buildings, equipment and vehicles other than cars. The personal fixed-assets tax should have a higher rate (suggested: 1%) than the corporate tax (suggested 0.5%), both calculated on the market value of the assets. This valuation should be initially based on actual market value, and subsequently updated to take into account improvements, depreciation and inflation. **No rebate or exemption for exports applies to these taxes.** The tax is paid for land, but trees and livestock may be exempt.

Custom import duties. A simple tariff with few relatively few categories should be adopted, with moderate percentages charged on the C.I.F. value of the imported merchandise, valued at the market exchange rate. All additional taxes or charges and surcharges applied to imported commodities should be eliminated, so that only one single tariff is applied. To encourage investment and to speed up technological progress, **all machinery and equipment should have a zero import duty**, including agricultural and industrial machinery, computing and telecommunications equipment, and heavy transportation vehicles. **Light utility vehicles and tourist cars should not be included in this category.**

No charges or taxes should be charged on exports: that would detract from the country's export competitiveness, and would imply expecting that foreigners ultimately

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[66] There is in Syria a corporate income tax on profits, another on wages and salaries, and another on personal income from movable capital (interest, dividends, etc.). Corporate profit is therefore taxed twice, at the corporate level and (if distributed) as personal (dividend) income from movable capital, which is a flat 9.75% (including 7.5% pure tax plus the War Effort Surcharge, or WES, which consists in a 30% increase of the pure tax). Income tax on wages and salaries has four brackets. Until recently, no bracked was exempted, starting with 5.75% for the bracket of 0-1000 SP per month, to 17.25% for monthly incomes over 4000 SP (WES included). Recently, the bracket from 0 to 1000 SP has been exempted. Corporate income tax ranges from 13.4% under 20000 SP per year, to 60.3% for yearly profits over one million SP (including WES and local administrative surtax).

pay taxes to the country, which is unrealistic. Most countries have no export tax at all, and Syria has recently abolished export taxes.[67] In fact many countries have export *subsidies*, though these are gradually diminishing by agreements before the WTO, and in general no more such subsidies could be adopted.

All other taxes should be eliminated, e.g. "**stamp duties**" and **specific taxes** for some **products** (such as agricultural products tax, etc) or for particular **transactions** (such as taxes on inheritance, on sales or transfers of real estate, etc).[68] One exception to this rule might be an allowance for some **specific taxes on harmful products** such as alcoholic beverages and tobacco products, to discourage their consumption.[69] Another exception could be **environmental taxes**, if taxation is used to discourage environmental damage. Some specific **non-basic** services provided by the State **on demand** may be charged a **price**, which is not considered a tax but a fee for recovering the cost of some activity the State is not obliged to perform. All basic services provided by the State should be free.[70]

10.7.3. Subsidies

Sometimes it is difficult to understand what is a subsidy. One farmer that is paid a price just covering his cost of production may look surprised if told that he is being subsidised. But in fact the notion of a subsidy has nothing to do with the farmer's cost of production, but with **the most efficient cost of production available**. The basic notion to understand subsidies is the notion of **opportunity costs.**

Whenever scarce means are used to achieve some economic goal, the means devoted to those goals are automatically **not devoted to other alternative goals.** To evaluate whether the means are being used efficiently, their present use should be compared to the **best other use** possible. If a person is working for 3000 SP a month, and is suddenly offered another job at a salary of 5000 SP, the opportunity cost of his old job is 5000 SP. To continue working in his old job, his is not working in the new job for 5000 SP,

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[67] Export taxes existed in Syria for a long time, but the last (on ginned cotton) was abolished in July 1999.

[68] Many such taxes exist in Syria: a charge of 21 SP per tonne of cement, 155 SP for consumer salt, 115 SP for industrial use salt, 0.15 SP (15 piastres) per kg of sugar, 15% on wholesale value of tobacco, 0.085 SP per litre of gasoline or kerosene, 14% on alcoholic beverages, 12.5% on electricity, an annual license fee of 195 to 390 SP per television set, an exit fee of 200 to 1600 SP (according to destination) for nationals travelling abroad, motor vehicle fees of various kinds (basic fee, special tax on diesel motors, tax on public transportation vehicles, annual car operation fee, drivers license fee). Import duties include a basic tariff (0 to 200%), plus an additional "unified tax" resulting from unification of several previous surcharges, plus WES, with ten resulting categories from 6% to 235%, plus a license fee ranging from 104 to 404 SP depending on the value to be imported. The duties are calculated on the value of imports converted into SP at one specified rate of exchange, that for a long time has been the official rate of 11.25 SP to the dollar, much below the market rate of 46 to 50 SP. This anomaly is being corrected in 2001. Notice that a tariff of 235% on 11.25 SP is roughly the same as a tariff of 53% on 50 SP, so the effective tariff is much lower than it nominally appears to be. **Therefore converging to WTO-Uruguay Round conditions or agreeing with the EU on the matter of tariffs may be less difficult than expected.**

[69] The current Syrian tax on alcoholic beverages (14% of retail price) and tobacco (15% of wholesale price) are below the levels of taxation existing in many Western countries for this kind of product.

[70] In the case of Syria, many specific taxes and fees charged for State services in the form of stamp duties or other similar payments, besides being often unnecessary and cumbersome, are generally out of date (they were originally set at a given monetary value in Syrian Pounds, and never or seldom updated), so that often the social cost of collecting them, and sometimes even the direct fiscal cost of collection, is above the amount collected.

and will be "losing" 2000 SP per month. His labour is paid 3000 SP, but the opportunity cost of his labour is in fact 5000 SP.

If a person visiting a shop is offered a commodity for 30 SP, but he knows the same commodity can be bought as easily in some other shop for 20 SP, then the opportunity cost of the commodity is 20 SP. If he informs the shop owner that he offers only 20 SP for the commodity, the shop owner may say that 20 SP is too little because his cost of production is 30 SP, and no discount is possible. But for the customer, buying at that shop for 30 SP would be a loss of money: the opportunity cost is 20 SP.

Suppose the shop owner finds someone (a rich man, or the government) that is willing to pay him 30 SP for that commodity. With that amount, he barely covers his costs. But in fact he is receiving a subsidy. **The subsidy is the difference between the price paid and the opportunity cost of the same commodity.** The indication that a subsidy is being paid is that **the purchaser could do better by purchasing elsewhere.**

Subsidies are necessary because life is not only economics. For **social reasons**, for instance, some sectors of the population are often given subsidies (they are paid more than the opportunity cost of the goods or services that they produce). For instance, one unemployed person (producing zero) may be paid a salary, which is a subsidy, because the economic value of the production is zero, and instead the unemployed is paid something. The payer could obtain a service for that money, and instead is obtaining nothing. At other times, the subsidy is to make some product affordable. Food may be expensive to produce, for instance, so the government often pays part of the cost of food so that poor people can afford to pay for the food. The people pay less than the opportunity cost of food, and this difference is called a subsidy. A subsidy to a producer does not consist in paying more than the cost of production incurred by that produced. **A subsidy to a producer consists in paying him more for a product that can be acquired for a cheaper price elsewhere.**

Considerable attention has been given in policy studies to the notion that subsidies, if its application is considered necessary, should create **as little distortions as possible**. Unfortunately, ordinary subsidies do not comply easily with this principle. One of the more frequent distortions regards **poor targeting**. Subsidies aimed at the poor may end in the pockets of rich people, for instance. One of the outstanding examples of this are certain agricultural subsidies in Europe that disproportionately benefit large landowners. Adequate and efficient subsidies should be better targeted to the appropriate sector of society that effectively needs the subsidy, ordinarily small producers and the poor.

Subsidies and price distortions. Another, and arguably more serious shortcoming of many subsidies is that they cause **price distortions**. This is the case with subsidies that operate through the payment of **higher prices to producers**, or through charging **lower prices to consumers** (the prices of wheat, flour and bread in Syria are examples of this). The goal of the subsidy is not the distortion of prices *per se*. The goal is to encourage producers to produce certain products in spite of their lack of profitability, by permitting producers to obtain a decent remuneration for their product, and at the same time allow consumers to pay for their daily bread less than its real cost. But with these noble intentions, a price distortion is created, which causes many problems.

This kind of subsidy via prices is, for instance, **poorly targeted**: big farmers are subsidised along with the small, and rich consumers along with the poor. Besides this, **distorted prices led people to make wrong decisions**, that may be harmful for the entire economy. For instance, a very high price paid for a product may led the producer

to a waste of resources, or to disregard other crops that are more efficient and socially more profitable. Finally, **distorted domestic prices distort international commerce.** For instance, the domestic price of wheat, flour and bread in Syria show large divergences from international levels, and may lead to failure to make agreements with foreign countries or to become a member of the WTO. Realigning prices is ultimately a necessity, but this does not mean eliminating or reducing the subsidy. So the problem is **how to realign prices without reducing the subsidy.**

10.7.4. Direct payments to producers

The advisable solution is to change the conduit of the subsidy: instead of subsidising the **product**, subsidise **people.** Instead of paying a higher price for wheat, pay the competitive price of wheat but make a **separate (de-coupled) direct payment to producers** to compensate them.[71] The price paid for wheat (apart from the direct payment to producers) would be in line with international prices. By the same token, instead of subsidising the price of flour and bread, **subsidise (if necessary) the income of the poor**, allowing them to afford bread. This could be done by rising minimum wages, or through monetary payments or, perhaps, through "**bread coupons**" that can be used as payment for bread. However, if the price adjustment for consumers is done gradually, and wages and other prices also adjust, the subsidy could be (under certain circumstances) gradually reduced. These income supplements may be **universal**, or alternatively they could be **targeted to poorer families**, which is preferable but has higher administrative costs.

Wheat and flour should be **priced competitively**, in line with international parity prices. Prices may also be made somewhat more flexible. In fact, if wheat and flour continue to be under heavy State intervention, it should be advisable to administer only the price of wheat and flour, letting the price of bread be fixed by the market.[72] The price of flour should reflect the cost of wheat and the cost of milling, but not the cost of maintaining the national stock. Maintaining the stock is a political necessity, and should be paid out of the budget. Then, increases in the cost of bread should be very moderate (raising its price to 10.50 or 11 SP/kg only), not implying serious social consequences. The reduction in the price of wheat to its parity level (which is about 7000-7500 SP/MT) should be done gradually, while implementing compensatory de-coupled direct payments to farmers.

Regarding the other strategic crops: the price of barley is already in line with international prices. The price of cotton is 30% above the parity price, and should be brought down gradually to parity levels. The price of sugar beets is the only one that is greatly above the parity price: reducing the area with sugar beets and resorting to sugar imports would imply a reduction in the retail price of sugar, and would free valuable land and water for other more profitable crops. In both cases (cotton and sugar beets) compensa-

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[71] This is actually the system ruling the Common Agricultural Policy of the European Union since the Mac Sharry reform of 1992. Prices were made to converge to international parity prices, and de-coupled payments per hectare of crop or per head of livestock were established, regardless of production, and subject to budgetary availability.

[72] In 1990, about 45% of the total supply of bread was produced by the private sector. In 1998 the proportion of private bread had risen to 62%, and is expected to continue growing since the State is not expanding its bread production, and demand is increasing along with population growth.

tory de-coupled payments to producers should be implemented gradually, as the prices is gradually reduced to international levels.

Implementing direct payments to producers is a complex affair, as the European experience since 1992 has shown abundantly. It is recommended that if that system is used in Syria, payments should be very simple and relatively homogeneous. The payment may have a fixed part and another dependent on the current product mix and the region. Irrigated areas should of course receive more than rain-fed areas. It is also advisable that the payments gave preferential support to small farmers. For instance, the first 10 Ha would receive 100% of the amount established per Ha, the next 40 Ha would receive 75% of the amount, and the excess over 50 Ha would receive only 50% of the amount. Since the basic payment per Ha is calculated to cover average cost of production, this would give relatively more income to small holders (whose cost is probably higher) and less to big holdings whose cost of production is probably lower.

If this system is calibrated with care, it would result in a reduction in the total fiscal cost, an encouragement to abandon the less profitable crops, a penalisation of inefficiency, and a penalisation of big farmers relative to small ones.

10.8. Low overhead costs

The private sector of production and distribution (factories, farms, shops, etc.) controls a large portion of costs of production, since the production of inputs and outputs occurs within its jurisdiction. Other costs are given, such as the cost of imported items, and little can be done in the country to modify them. But there are other costs that are imposed by factors existing "outside the gates of the factory", that impose an **overhead cost** on all products and transactions. All countries have an overhead cost, but some countries have a lower one. **Having lower overhead costs increases competitiveness**. There are various components of this overhead cost. The principal items are:

- **Inadequate infrastructure** (roads, ports, electricity) and **inefficient telecommunications services**, imposing added costs for production and distribution
- **Excessive bureaucratical complications** that delay the performance of production and distribution, and the consequent requirement of informal payments to get things done
- **Excessive taxation**, eating into the margin of profit of producers and distributors, encouraging tax fraud, and necessitating higher prices to cover such taxes
- **Rigidities in labour legislation** making hiring and firing more expensive and complicated, and thus discouraging the creation of new jobs.

The above list directly suggest the obvious steps to reduce overhead costs and make the country more competitive. The so-called **country cost** should be kept at a minimum to keep the country products competitive in the world market, and also to reduce the cost of living for domestic consumers, thus enhancing their standard of living.

10.9. Predictability

One important economic condition required to attract investments is that the overall economic situation is predictable. Two main factors contribute to this: a stable macroeconomic framework (especially after stability has been maintained for a number of years), and expectations that future political and social events will have no perturbing effects on the macroeconomic environment. The latter requires a basic social and politi-

cal consensus, so that alternation in power would not mean a radical departure from existing policy. A sound macroeconomic management steadily maintained for a long time would cover the first requirement. [73]

The absence of predictability makes investment too risky. Investors would demand a high expected rate of return to accept bringing capital into the country, or would require exceptional guarantees that may prove too heavy for the public budget. Creditors would apply higher rates of interest to any loans taken by the country's banks, or by the country's public or private sectors in international financial markets. The difference between those rates of interest and the rates charged to "predictable" countries is a measure of the so-called **country risk**. Country risk and country cost, the results of high overhead costs and low predictability, are the main factors affecting a country economic performance in the world economy.

[73] One example of that kind of consensus is exhibited by Chile. Reforms enacted by a military regime in the 1980s were maintained by the subsequent democratic governments led by Social Democrats and Christian Democrats through three successive presidential periods starting in 1989. The right-wing opposition is also keen to maintaining the same macroeconomic framework, that has already lasted for about two decades with only minor modifications.

11. Economic reform in Syria

Since 1981 Syria has taken steps to liberalise in a gradual manner what has been a highly centralised economy managed through a national planning system with heavy State intervention. This process of liberalisation took an important new impulse in 1991 with the Investment Law 10/91, and has been given renewed strength and a more accelerated pace lately, since the reforms to that Law contained in Decree 7/2000 and many decisions and policies adopted or announced since the inauguration in July 2000 of President Bashar Assad. It is important to understand the reasons and forces that lie behind this sustained effort of Syria to open its economy, and especially the reasons making that process to advance now at an accelerating pace. However, before going into those reasons it is convenient to discuss several debatable ideas about this process of economic liberalisation. These ideas try to explain why Syria is pursuing economic liberalisation, or attempt to warn about the dangers of such pursuit, but often they are devoid of solid grounds. The following is a brief discussion of the most salient of such "myths".

11.1. Dispelling some myths about economic liberalisation

External pressure and national sovereignty. It would be a profound mistake to believe that this process of economic reform is being imposed on Syria by deliberate external pressures coming from other countries or from international organisations. Syria has no compelling foreign debt problem, nor needs the financial support of international organisations that could impose conditions for their help. Syria is not suffering any acute emergency in the form of high inflation, unmanageable fiscal deficits, or a crisis in the balance of payments that could lead to an economic reform adopted under distress. Syria, in fact, is pursuing economic reform and liberalisation in an **autonomous** manner, as **a fully sovereign and independent country**, based on the Syrian Government's assessment of the needs of the Nation and the best means to promote its development and the welfare of the Syrian people.

Of course, if Syria wants to join some international organisation like the WTO it should have to accept the basic agreements and principles of that organisation, as every other country member has done. But no country is obliged to join the WTO or any other such organisation. If the Government of a country finds that joining the organisation may be against the country's interests, it may simply opt for not applying for membership.

However, there are significant processes taking place in the international scene that make of a turn towards liberalisation a wise option. These processes include from the demise of the Soviet bloc to the current technological revolution, from the increasing openness and globalisation of world financial markets to the changing shape of international trade. This external state of affairs does not *force* Syria to liberalise its economy, not *imposes* certain courses of action in a deliberate or explicit manner. But a careful analysis of the evolution of the international scene and the changing shape of the world economy makes certain economic reforms *highly advisable*, and they may even be considered *inevitable.* This does not involve any wilful or deliberate pressure from other nations or international organisations, but an **autonomous motivation** based on the assessment of **objective forces** operating at the level of the world economic and political system.

Open or closed economy: a false choice. Another profound mistake would be the belief that Syria has a **choice** between remaining as a (relatively) closed economy, or opening itself to the forces of "globalisation". To open or to close is **not** the question. In fact, **openness and globalisation are already at play**. For example, in spite of restrict-

ions on foreign exchange, Syrian capital and savings go abroad all the time in enormous quantities, robbing the country of much-needed funds for investment and growth. This *de facto* liberalisation of capital flows already exists, but it largely operates as a unilateral flow of Syrian capital moving abroad, without much foreign capital coming into Syria. In other words, **there is no real choice: the economy is already *de facto* open to capital flows, and closing these flows is probably impossible. At the moment this *de facto* openness generates only a capital flight, and thus it goes mostly against Syrian interests. It should be turned to Syrian advantage. This involves adequate economic reforms to make Syria an attractive place to invest capital, thus keeping more Syrian savings at home, and moreover, attracting foreign capital to Syria**. The choice of remaining semi-closed, or to regress to complete closure, is in theory always possible, but at this stage is **probably not viable any more. Attempting to re-close the economy or to reduce the existing openness would mean generating more (illegal) capital outflow.**

Liberalisation and the role of the State. There exists the notion that liberalisation implies the virtual disappearance of the economic role of the State, and the related fear that this would entail economic chaos. Moving from a centrally planned economy to a market economy, even gradually, may certainly imply some turbulence and having to deal with undesirable (though normally temporary) side effects. But freeing market forces needs not entail economic chaos, nor the collapse of the productive system, nor the entire economy getting "out of control". The Syrian economy shows a remarkable degree of macroeconomic equilibrium, and this allows for a gradual process of reform that proceeds by steps and permits a gradual adaptation of the entire economic system to the conditions of the world market economy.

A *naïf* approach to liberalisation would call for a sudden removal of all controls and regulations. This would most likely entail a collapse of the existing economic structure before a new economic system is in place. The experience of painful and destructive economic transitions in some formerly socialist countries (chiefly the former Soviet Union) makes such an approach highly undesirable. Creating a market economy implies creating the **institutional and social prerequisites** of such an economy.

The first idea that should be understood in this respect is that a market economy requires **a very strong role of the State in economic affairs**. But the role of the State in a market economy is not to perform the production of goods and services, but a role centred on **regulation**. This regulatory role of the State concentrates in two specific areas: first, **enforcing the overall institutional setting** that permits the operation of markets (for example, guaranteeing private property, economic freedom and the rule of law); second, **regulatory interventions in some specific markets** where **public goods or services** are involved, or there is **market failures** of any kind, that prevent the markets from achieving a satisfactory allocation of resources. **The role of the State does not vanish, but it profoundly changes.**

Therefore, creating an adequate environment for private investment and gradually shifting from central planning to a market economy entails a full **reform of the State**, implying modifying the manner and ways in which the public sector operates, and sweeping changes in many kinds of legislation and regulations. This process of **institutional reform** is a necessary ingredient of the transition towards a market economy, and it should result not in a weak or non-existent State, but in **a strong, efficient and modern public sector that facilitates the operation of markets and takes care of the provision of public goods and services that are not easily provided by markets.**

Price liberalisation and monopoly pricing. It is very common in planned economies that the very idea of liberalising prices evokes two twin dangers: prices going chaotically up in runaway inflation, or prices been arbitrarily and unfairly rigged by monopolistic or monopsonistic corporations. In fact, the entire idea of a market economy is that this should not happen, and a good institutional basis for markets should prevent this to happen. Markets have ways to regulate themselves, if only the right institutions prevail and the right macroeconomic policies are in place.

In a country were few private economic actors are big enough as to determine market prices by themselves, as is the case in Syria, the fear of monopolistic price-fixing is not very realistic. Few goods are produced (or might be expected to be produced) by big or monopolistic private companies. Competition between many producers and suppliers should bring prices towards their equilibrium levels. Only in some specific sectors conditions of monopoly or near monopoly may exist, and **those** sectors **must be** regulated by the State. Such is the case in almost every capitalist country when such conditions prevail, especially in **basic services** when only one organisation is in charge of furnishing the service in a given geographical area (for instance, there is official regulation of the price of electricity or public transportation services in capitalist countries were the electricity network or public transportation are run by private companies). There is an extensive economic literature on the most efficient ways of establishing those regulations to ensure fair access of people to the services while ensuring the financial sustainability of the companies involved.

In other sectors besides public services (which tend to be "natural monopolies"), competition between domestic companies should self-regulate the market and establish an equilibrium price for every good or service involved. Besides, liberalising prices in a formerly closed economy normally involves also a **contemporary liberalisation of imports**, to allow foreign competitors to keep domestic producers from imposing excessive price burdens on consumers. Since price liberalisation should be gradual, **import liberalisation should also be gradual**, to avoid shocks against the existing productive structure when suddenly faced with foreign competition. In fact, many non-strategic sectors in Syria operate already in a free-market environment, whereby each company sets its own prices without significant government interference, and that has not caused any perceptible price-rigging or any tendency of prices to grow faster than average inflation.

Price liberalisation, relative prices and inflation. A parallel fear is that price liberalisation would entail runaway inflation. This not necessarily so. Market prices are not just the result of unilateral decisions by suppliers, but also the result of consumer behaviour. Consumers reduce their demand of items that have become relatively more expensive, and increase their demand of items that are relatively cheaper.

Certain items are, however, more substitutable than others, and this means that the cost of living **could** increase if the items whose price has risen are not easily substitutable (e.g. an increase in the price of bread could not be easily compensated in Syria, for bread is a basic food item not easily substitutable). In that case, the cost of maintaining the same standard of living would have risen, and attaining again the former standard of living would imply an increase in incomes and the supply of money, and that kind of price increase would thus originate inflation. A sudden and significant increase in the relative price of bread may entail a net loss of welfare for most of the population if money incomes do not increase in a matching proportion. However, its weight in total household expenditure and even in total food expenditure is quite low.

The fact that Syria has had a sound macroeconomic management during recent years, without any large imbalances in fiscal budgets or foreign trade, and without significant inflation, is a very important factor that would keep the economy from falling into an economic collapse or runaway inflation as the price system is liberalised, provided this price liberalisation proceeds wisely and by steps as hinted before, and that foreign trade is also gradually liberalised at the same time.

In the case of Syria, if a sound macroeconomic management is maintained and the process of liberalisation takes place in a gradual and integrated manner, proceeding along with a liberalisation of foreign trade, and if furthermore there are significant gains in productivity and efficiency and some compensation measures are enacted for changes in the relative price of basic subsistence goods, it is not expected that inflation should increase significantly. Such at least has been the experience of other countries undergoing strong changes in relative prices under a stable macroeconomic environment in recent years, such as several (formerly socialist) countries in Eastern Europe and the Baltic, as well as some (formerly very closed and over-regulated) Latin American economies such as Argentina after 1991 and Brazil after 1994.

The costs and benefits of economic reform. Sometimes the prospect of economic reform is rejected by appealing to the expected costs of such a reform, for instance an expected increase in unemployment or the expected closure of some factories or entire branches of production. These worries usually lead to postponing or directly rejecting the reform in question. Any decision to adopt reforms should certainly take carefully into account all the costs involved in the process. Some sectors of society would undoubtedly suffer reductions in their current standard of living (at least in the short term), there may be an increase in unemployment, and many other undesirable consequences. Sometimes these costs, however, are taken into account in a wrong fashion. The error comes usually from three sides: first, **short-term** effects are emphasised and **long-term** impacts of the reform are ignored or neglected; second, only the **costs** are considered, and not the **benefits**; third, the costs of **not** implementing the reforms are usually ignored.

Most of the costs of any process of social or economic change are short-term costs, and most of the benefits come later. Reforms, in other words, involve usually incurring short term costs in order to reap long-term benefits. They involve swallowing bitter medicine today to be cured of illness tomorrow. A myopic concentration in the short term would give undue relevance to the costs (that are concentrated in the short term) while disregarding the benefits (which mostly come at a later time). It is only human that immediate things are valued more than things expected for the future (we all balk at taking a bitter medicine or undergoing some painful surgery, forgetting the relief from illness that the drug or the surgery would cause after a certain time). But rejecting an economic reform for its short-term costs that may be as unwise as rejecting medical treatment because of the short-term pain involved.

Of course, a prudent economic planning would provide compensatory measures for the transition period, to make the short-term costs more bearable, just as doctors use anaesthetics and rehabilitation exercises to help patients tolerate a difficult treatment and recuperate from its undesirable side effects. For instance, if the reform may force some people to change employment, compensatory measures should cover as far as possible the subsistence of the affected workers while they are unemployed and should also cover the cost of their re-training for new jobs.

It is also frequent that a consideration of the **costs** of economic reform fails to consider the corresponding **benefits**. Costs may be painful, but they are incurred only because of the greater benefits expected. If the benefits are greater than the costs, the decision (in this case the decision to carry out an economic reform) makes sense and should be adopted. When all benefits are taken into account, the costs may be seen in another light, and may become justifiable and bearable, precisely because they are the means to achieve a greater benefit.

Finally, any valid consideration of costs and benefits should take as a reference the alternative of **not** performing the reform. Often the costs of doing nothing are far worse than the costs of implementing the reform (just as the cost of not taking a painful medicine may be a prolongation and perhaps an aggravation of the illness). For instance, not doing an economic reform to avoid an immediate increase in unemployment may cause a larger increase in unemployment later when the problems requiring reform become definitely unsustainable. In the case of Syria, failing to promote growth through private investment may mean a continuation of the economic stagnation of the last decades, a decline in income and consumption per capita, and thus ultimately more social costs than those of doing the reform immediately (with the added consideration that the reform would have to be done in the end anyway, when it cannot be postponed any longer, and probably under harsher conditions and with higher costs).

Exportable surpluses and the drive to access foreign markets. Sustained efforts towards food self-sufficiency have paid off in the 1990s by providing the country with some exportable surpluses of many agricultural commodities and related processed products. Some people in Syria believe that the drive to promote economic openness, competitiveness and private investment in agribusiness chains is mainly dictated by the need to place those exportable surpluses in the world market. According to this view, if only domestic production would not exceed demand, there would be no need of any change in the institutional framework of the economy, nor to promote exports.

This line of argumentation seems suspect on various counts. First, the surpluses have been deeply curtailed by the slowdown in agricultural growth in recent years (including a significant slump in 1999 due to adverse climatic conditions), forcing the country to run down its strategic-crop stockpiles accumulated in previous years. Second, the very existence of these surpluses depends on the use of natural resources to unsustainable extents: water availability from springs and from underground aquifers shows a tendency to decrease over time (apart from the short-term effect of the recent drought), and it also depends on the huge subsidies that support many of the products being produced above international cost. Any effort to open the economy and to align the price system with international levels may result in deep changes in output, including a reduction of those surpluses. Third, in spite of a tendency to decreasing demographic rates, population is still growing quite rapidly (an expected 2.5% per year in 2000-2010), and consequently domestic food demand will increase in the coming years, by that sole factor, to extents incompatible with the survival of the surpluses, and may pose problems of sustainability in view of the constraints on the supply of water for irrigation.

This latter constraint is very significant. Most of the increase in food supply in recent years has come from the expansion in irrigated areas, since rain-fed agriculture faced severe limitations to expand output (scarcity of fertile land, and the cost involved in reclaiming it by de-rocking) To maintain per capita food consumption at the level of 1995-2000, the country should increase food production by about 30% by the year 2010, and the demand for irrigated land would probably increase by more than 50%. It

seems that the existing supplies of water would not permit such increase unless profound transformations are effected in the technology of irrigation, which implies important levels of physical investment, both on-farm and off-farm, and a thorough change in farmers' agronomic and organisational abilities in order to apply and manage modern irrigation systems. This line of reasoning leads to the conclusion that food security should be pursued with more attention to efficiency. Otherwise, the mere fact of limited natural resources (land, water) and continuous population growth would defeat the very purpose of achieving self-sufficiency. The country seems to have reached the point in which this question becomes pressing, and must address the solution without further delay. In fact, opening up the economy to foreign markets and to the world economy, which entails transforming the economy from a centrally planned one into an economy more reliant on market forces, is the result of the perceived or expected exhaustion of the former system; it is not a result of its positive effects but a consequence of its limitations.

The road to foreign markets is a two-way road. Many Syrian officers have shown a keen interest in gaining an ability to export into foreign markets, but some of them are often seemingly unaware that any such access to international markets should be accompanied by increased ability of foreign producers to access the Syrian domestic market. This is especially so under commercial agreements with other countries, such as a possible agreement between Syria and the European Union: in exchange for granting Syrian products access to Europe, the EU would demand access to the Syrian market for various European products. Accessing foreign markets thus implies modernising production at home, not only to produce competitive exports, but also to compete with new imports in the domestic market. In the process of achieving a trade agreement, the parties involved may seek some degree of protection for sensitive products, but in the end the overall protection of the domestic economy should be significantly reduced. The drive to sell elsewhere is also a drive to be more efficient at home, and to withstand more foreign competition for domestic products.

Dispelled these erroneous ways of thinking about the process of economic liberalisation, the following section tries to identify the true motives and forces behind the move of Syria towards a market-based economic system.

11.2. Forces and motives for liberalisation

External conditions. As hinted before, worldwide economic and political events and processes are important factors in the situation facing Syria and in its move towards economic liberalisation. A profound and rapid **technological revolution** based in telecommunications and information is re-shaping the entire world economy. The very nature of the international economic scene changed radically around 1990 with the **demise of the Soviet economic and political system** and the related changes in Eastern Europe and other parts of the world. On the side of market economies, the international economic system shaped in Bretton Woods (1944), made of "insular" economies with limited international trade, fixed exchange rates and very restricted flows of capital across borders, collapsed in the 1970s and was gradually replaced by a system of much more open economies with **increasing and more liberalised trade**, **floating exchange rates and enormous flows of capital between countries**.

For a developing nation like Syria, a working relationship with this changing world certainly involves the necessity of economic reform, to make the domestic economy more suitable for integration into the world economy, in a manner conducive to economic development and increasing well-being for the population. That economic

reform must necessarily involve a liberalisation of the economic system, a more open economy, and a shift from a command regime to a market regime in many aspects of the national economic system.

Also, in the case of Syria, certain external development during the 1980s and 1990s probably prompted the government into starting a process of reform. For instance, large reductions in foreign aid in the late 1980s, and the macroeconomic imbalance thus created that precipitated a crisis in 1986 were probably behind the Decree No.10 of that year (fomenting joint-venture agricultural investments) and other contemporary reforms. Changing relations of Syria with the Arab world before and after the Gulf War evidently influenced aid flows and thus the motivation for reform. Increasing revenues from newly developed oil fields along with surges in aid flows in the early 1990s probably detracted from the urgency of attracting private investment and expanding non-traditional exports around the mid 1990s. New international economic developments (such as the financial crisis in the Far East and other parts of the world in 1997-98) and domestic drought problems prompted again for more rapid reform shortly before 2000. The need for closer political relations with the West after the collapse of Soviet socialism may have also played an important motivational role in the process of reform.

Domestic conditions. Apart from the above external conditioning causes of liberalisation, there are also internal motivations behind the move towards economic reform. The main one is ***economic stagnation*** and the prospect of ***economic decline***. Per capita GDP in Syria has had practically zero growth since 1980 up to 1999. After the decline in the 1980s, the recent growth experience in the 1990s has been too weak, and has not been able to reach levels higher than those of 1980. Expected future population growth may entail a **decrease** in per capita output unless something is done to correct the course of the economy. This is particularly true in the agricultural sector, where the effort to ensure self-sufficiency may be endangered by **acutely limited water supplies**, thus creating the necessity of a **rapid increase in agricultural productivity** in order to cope with **demographic pressure**. That increase in productivity could hardly be achieved and sustained without private (and foreign) investment and technology.

A related domestic factor is the continuing **capital flight** affecting Syria. As hinted before, hundreds of millions of dollars flee the country each year, severely affecting domestic investment and the growth potential of the economy. Trying to increase production and productivity while at the same time the economic system causes domestic private capital to escape the country, and dissuades foreign capital from coming to Syria in sufficient amounts, is a hopeless pursuit.

Attempts to forcefully repress this drain of resources by means of exchange controls and other means has proved useless: the drain continues unaffected. **Private capital cannot be mobilised by force or by command, but only attracted or repelled**. Such attraction or repulsion derive from the **institutional and economic environment** existing in the country. To keep Syrian capital to flee away, or to attract foreign capital into Syria, implies creating an adequate economic and institutional environment for private savings and investment, and such **investment-friendly environment** in turn implies the existence of a viable and sound market economy with its several essential attributes: **full support of private property, economic freedom, trust in the rule of law, efficient State services, and stable macroeconomic conditions.**

Part IV: Policy recommendations

12. Sequencing and organising reforms

12.1. Gradual, integrated and piecemeal reform

The Syrian Government is deeply concerned about the **pace** and **extent** of reforms encouraging private investment and the transition to a market economy. Regarding the pace, there is substantial consensus that the transition should be **gradual**. The mere fact that the country faces no immediate crisis (be it a collapse of the productive system, as in Russia after the demise of the Soviet system, or stagnation *cum* hyperinflation and high indebtedness, as in Latin America in the 1980s), shows that Syria is in no evident need of reforming everything in a hurry. The Government is seriously concerned about the possibility of unleashing the unwelcome effects of sudden change, such as unemployment increasing to levels that make social and political unrest inevitable. It also fears that sudden liberalisation of the price system may lead to uncontrollable inflation after decades of State management of wholesale and even retail prices. Thus reform has to be gradual, even if it is also recognised that the pace of reforms should accelerate, from the stately advancement of 1986-1998 to the more urgent rhythm perceived in 1999-2001.

This commitment to gradual reform may be erroneously construed as a policy of **piecemeal reform**. This would mean reforming one aspect at a time. If the foreign exchange regime is thus reformed in one year, tax reform may be tackled on another, trade openness later, and so on. This is not in fact the right interpretation of the gradual character of reforms. All aspects of the economy are bound together, and influence each other. The economy cannot have one aspect reformed and others still in their original status, just like a person cannot have one foot in the first flour and the other foot in the third. The strain to the system would be too much, and the expected results (like getting to the top floor) may never materialise, or may come out in a very distorted way.

The international experience regarding the adaptation of developing economies to the conditions of the global economy shows that **transition needs to be a comprehensive and integrated process**, involving at once many aspects of the economic organisation. All these aspects should be made to work together, and to advance together, for the economy to integrate itself successfully into the world economy.

If reforms were independent of each other, the overall impact of a number of piecemeal reforms would be the sum of the impacts obtained by each. Failure to reform one aspect would not compromise the impact of reforms in other aspects of the economy. Thus, for instance, opening the banking system to the private sector would have a positive impact independently of any reform in the monetary system, the foreign exchange regime, or the judiciary system. But it is wrong to think so. Reforms do not work independently of each other. For instance, a reform of foreign investment policies would not be expected to have any large impact unless other reforms (say, in the banking system or monetary policy) are also carried out, for otherwise no significant foreign investment would come. More to the point of the present study, allowing for private investment will have none or a lesser impact if many aspects of economic life remain under the strict control of State planning, leaving no room for private decisions in allocating resources or determining prices, and if (for instance) the banking system remains in its current primitive and inefficient condition.

In fact, in many instances failing to apply related reforms simultaneously may cause **negative** results, and not merely an absence of results. One isolated reform while other related aspects remain unreformed would created a strain in the whole system, and

probably many unwelcome effects. For example, liberalising domestic prices without liberalising imports may cause an unwelcome increase in the cost of living, whilst the combination of the two may cause a decrease in the cost of living (if the initial prices were not subsidised and were thus above international levels due to inefficiencies in the domestic production sector). Contrary wise, liberalising imports without liberalising the administered-price system for domestic commodities would be a completely unworkable policy, and if applied would soon ruin domestic producers.

Besides the above general considerations it should be noticed that there are specific **interactions** between certain reforms. Reforming one specific policy A will affect the impact of another reform B, but may not have significant consequences for policy C. This leaves some room for certain "additive" or piecemeal reforms: policies A and B should be reformed together, but policy C may be left for some other time.

For instance, reforming the intellectual property rights regime may be important in a process of economic integration, to achieve foreign trade agreements with foreign countries, but may have little bearing on reforms aimed at making the bureaucratical apparatus of the State more efficient. Both trade integration and administrative reforms are important, but intellectual property rights reform may be related more to the first than to the second. Also, liberalising trade may not have a strong relationship with reforming the State, but it will have a very close relationship with liberalising foreign exchange and reforming the monetary system: without an adequate exchange regime, trade liberalisation may have less impact than expected. These specific policy links must be identified and studied, for they dictate the right sequence and combination of reforms.

The general conclusion that can be drawn from this kind of discussion is that **gradualness is not to be confused with a piecemeal approach**. These considerations lead to recommend an **integrated approach** to economic reform, and not only a sectoral or partial reform. Both at a macro and at a sectoral level, reforms should be combined in an integrated manner. Specific aspects of economic reform condition other aspects, and cannot be adopted in isolation. Economic reform, therefore, should be an **integrated and gradual progress.** It should involve proceeding **by incremental steps, but on many fronts at once**.

12.2. The extent of reform

Transforming the Syrian economy into a market economy poses the question of how far the reform should go. Even if gradual, reforms may be aimed at a complete economic turnaround, turning the country into a full-fledged market economy, or their goal may be conceived to be only a half-way system with more market elements but preserving much of the previous system. If the first option is chosen, the process of reform should be probably longer and much more wide-ranging. The half-way option would imply instead a careful definition of the shape desired for the final outcome, and a detailed evaluation of its consistency and viability.

Half-way options are often difficult to implement, because all aspects are interconnected, so that the desired final outcome for one sector may be compromised by the advance in other sectors. For instance, if Syria wanted to liberalise the economy but maintaining strict central planning for strategic crops, their processing and marketing, some problems may soon arise: subsidised prices for strategic products may displace competitive imports (such as pasta from Italy), causing foreign trade partners to complain of unfair competition and threatening to damage trade agreements.

If reforms advance gradually and in all fronts at once, at explained in the preceding section, the decision about how far to go needs not be taken in advance, thus greatly enhancing the ex ante acceptability of the reforms by all interested sectors. How far can (or should) the country go, in practice, is dictated mainly by two kinds of considerations:

I. **Internal considerations**. For social or political reasons, certain aspects of the economy may be left outside the liberalisation process.

II. **External considerations**. As open economies must compete with each other to attract capital and improve trade and investment, competition with other economies may impose going farther than originally planned.

Both involve costs, benefits and compromises. Leaving some aspect of the economy outside the process of reform means that the country as a whole is accepting a degree of inefficiency, for the sake of other considerations such as social cohesion or national defence. This has obviously some cost for the population as a whole or for particular sector in the population, so that all costs and benefits should carefully weighted.

In the end, the process of change and adaptation to new circumstances **never ends**. This is even more true in the case of the wide processes of change sweeping the world economy in our time. An economy starting its modernisation and integration in the world economy should not expect that the process of change would end any soon.

13. Improvements in the investment promotion regime

From the developments and discussions in the preceding chapters, the following specific **policy recommendations** arise for the improvement of the present investment promotion regime in Syria:

vii. Create and implement an autonomous Syrian Agency for Private Investment (SAPI) instead of the current Investment Office. The current Investment Council should become the Board of Directors of the SAPI. A body of representatives of the private sector should be appointed as an Advisory Council. A charge of up to 0.5% should be applied to all investments effectively accomplished by authorised projects, to cover the expenses of the Agency. The functions of the agency include not only processing tax exemptions and other legal benefits for private investment projects, but also promotion of investment opportunities in Syria; advice and consulting service for the development of investment projects; services of market information, finance sources and project databank; monitoring the development of investments; and other related functions.

viii. Simplify the application and authorisation process for investment projects under Law No.10. Previous and posterior approvals in the concerned Ministries should be eliminated, since the Ministers give their approval within the Investment Council. Other simplifications also should be introduced as explained in the text.

ix. Investors should be given legal access to foreign currency, especially for input procurement, profit remittances and capital repatriation in case of projects producing for the domestic market. Also, Syrian investors with capital in local currency should be given legal means of acquiring currency for importing equipment and inputs. If the foreign exchange regime is not directly liberalised, then at least it should be relaxed for authorised investment projects.

x. The current regime of time periods allotted for construction and for tax exemption should be replaced by a tax credit system, applicable to all investments made in the project at any time. After establishing a tax credit rate, for instance 40%, any investment would generate a tax credit equal to 40% of its value. Any income tax on profits obtained after that investment should be not paid but deducted from the tax credit, until the credit is exhausted. Further investments in the same projects generate additional tax credits. Also, reinvestment of profits should be income-tax exempt, and importation of equipment should be duty free at all times. Zero customs duties for capital goods as a general measure is recommended, but even in the absence of such a general policy, at least authorised projects should have the possibility of importing capital goods at no tariff, to foment incorporation of foreign capital and its embodied technology.

xi. Steps must be taken to simplify and made more clear and transparent the conditions to obtain State-owned land on lease or freehold for the purpose of building facilities for investment projects.

xii. Land for industrial investment projects should be pre-allocated in industrial zones near important cities, with provision of basic services (industrial-strength electricity, telephony, water, sanitation, roads or railways). Any project licensed under Law No.10 should be given easy access to industrial zones.

14. Improvements in the macro scenario

14.1. The main fronts of action

The above conceptual framework about the requirements of a market economy with high levels of investment and growth dictates what are the main aspects to be included in the process of reform:

A. Resource allocation policies
- **Taxes**
- **Trade**
- **Prices and subsidies**

B. Money and banking
- **Foreign exchange liberalisation and currency convertibility**
- **Banking reform**
- **Independence of monetary institutions and policy**
- **Development of capital markets**

C. Reduction of inefficiencies and overhead costs
- **Administrative reform of the public sector**
- **Improvements in basic infrastructures and services**

This chapter develops a number of practical recommendations about these various fronts of reform, on the understanding that all the reforms are to be implemented **gradually** but adopting them **on many fronts at once**, i.e. in an **integrated** and not in a piecemeal fashion.

14.2. Resource allocation policies

This section deals with various sorts of policies that have in common the capacity to affect the allocation of private resources. The include the tax structure, foreign trade policy, mechanisms related to price setting for various goods, and certain aspects specific to the agricultural sector: improvements in the planning system, and improvements in the regulations for irrigation water use.

14.2.1. Tax reform

Implement a thorough tax reform based on a few essential taxes, abolishing all the rest. The basic taxes should be: Value Added Tax; Income Tax for corporations and physical persons; Taxes on assets (productive or not); Customs Duties.

VAT. The suggested VAT tax should be 10%. VAT rebates for exports should be implemented.

Income tax. Income brackets for income taxes should be updated. The lowest bracket for corporate and individual income taxes might be 250,000 SP. The highest bracket might be applied above 50 million SP.[74] The brackets should be updated annually, based on the Consumer Price Index. The income tax rates should be increasing marginal rates. The lowest bracket should be tax exempt to protect small incomes. The lowest bracket of corporate income tax (up to 250,000 SP) should have a zero income tax. The highest

[74] Values of income brackets and suggested tax rates are only an indication of the order of magnitude recommended, and do not mean that something specific is behind any specific figure. Final design of the tax structure would surely adjust the figures.

marginal rate should be 30% (which becomes 39.90% when the War Effort Surcharge of 30% and the local administrative charge of 3% is added). Intermediate brackets should have rates from 10% to 25%. For instance, 10% for the 250,000 to 1m SP bracket, 20% for the 1m to 5m SP bracket, 25% for the 5m to 50m bracket, and 30% for the top bracket above 50m SP.

Individual income tax. Individuals should be taxed for their total income, not for specific categories of income such as wages or rents. Total income includes capital income (distributed profits, withdrawals from companies, shareholder dividends and interest), capital gains after the sale of assets, income from rental of real estate, salaries and wages, and income from independent work. The first income bracket should be exempt. Taxable income in subsequent brackets should be taxed at increasing rates. The top marginal rate for individual incomes should not exceed 30% (which becomes 39.90% when the War Effort Surcharge of 30% and the local administrative charge of 3% is added). The brackets may be the same as for corporate income tax. Distributed dividends that have been taxed at corporate level should not be taxed again as individual income: proof of corporate income tax been paid on the dividends creates the right to deduct dividend income from total income.

Taxes on assets. It is suggested that personal not-productive wealth above a certain amount (for instance, above the equivalent of U$S 100,000) be taxed at a rate in the order of 1%, and productive assets (stock shares, business facilities, heavy duty vehicles, machinery and equipment) at a lower rate such as 0.5%. Taxable items of personal non-productive wealth include residential dwellings, real estate, cars and other vehicles except heavy-duty means of transportation. Personal liquid assets held in bank accounts should not be taxable. Valuation of assets should be updated yearly based on market values and price indexes.

14.2.2. Foreign trade

Tariff. Establish a simple tariff system, with relatively few categories of goods. All quantitative or otherwise non-tariff restrictions should be converted into tariffs. The list of prohibited items should disappear, or include only dangerous items (such as weapons, illegal drugs or other similar items). The list of imports that can be done freely and the list of goods that can be imported with export proceedings only should be also cancelled. All importable items (i.e. all except those few that remain explicitly banned such as weapons or illegal drugs) should be included in the tariff, without using any other list. Items whose importation is not desired may be assigned a very high customs tariff. Initially, tariffs might be as high as desired, as long as quantitative or otherwise non-tariff restrictions are all converted into tariffs. The current "unified surcharge" should be integrated with the tariff, so that only one concept (the tariff) is applied. Duties should be computed on the dollar value of the imports at CIF level converted into domestic currency at the **market rate of exchange**. The maximum rate in the tariff should not exceed 50%, since under the current system the highest effective tax is about that level.[75] In the context of negotiations, the tariff structure would then gradually converge towards more amenable levels for trade agreements with other countries and for eventual membership in the WTO.

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[75] In the current system, the maximum rate (200%) plus the unified surcharges is 235%, but it is applied after converting the value of imported goods into domestic currency at the "official" rate of 11.25 SP per dollar. Since the market rate is about 50 SP per dollar, the **effective** maximum custom duty is in fact 53%.

Capital goods should have zero or very low customs duties (including productive machinery, special building materials for industrial facilities, computing and telecommunications equipment and software, heavy duty means of transportation, and spare parts for all the above categories). Family cars and light utility vehicles such as pickups and vans should **not** be included, though light utility vehicles may have a lower tariff than cars, for which probably the highest rate will be applied).

Export licenses should be abolished, and also most import licenses. Only import licenses for a few sensitive and very specific products may be retained. Anyone should be able to import or export, with the only requirement of going through the necessary banking and customs formalities. Any tax, charge or surcharge on exports should be abolished. Value Added Tax on items exported should be rebated.

Develop a serious and competitive system of grading and standards, applicable equally to imports, exports and domestic uses. Promote modern systems for ensuring quality such as ISO certifications and HACCP certification.

Continue negotiations for trade agreements with the European Union. The main policy objective should be to join the agreement as soon as possible, letting certain specific and sensitive points of disagreement to be adjusted later once the agreement has been signed and ratified. The political and commercial importance of actually reaching the agreement is much more important than any specific point of negotiation, and this kinds of agreement with the EU are not static arrangements: concessions not won at the time of signing the agreement may be negotiated afterwards, from the better position of a member of the partnership.

14.2.3. Prices and subsidies

Realign subsidised prices with international/border prices. In particular, realign producer prices of strategic crops at levels compatible with parity prices. Replace subsidies embodied in the price of strategic products with direct payments to producers. In particular, introduce direct payments to producers of strategic crops, pay competitive (parity) prices for those crops, market the derived products such as flour and bread also at competitive prices. If necessary, support consumers of basic food items through some suitable mechanism, though this is not deemed necessary with the current levels of subsidisation of the final products.[76]

Eliminate any requirement for private companies to request authorisation for changing the price of items that do not carry a fixed official price, or are not specifically regulated for some reason. Once controlled prices are realigned, gradually establish bands of permitted variation in the indicative or obligatory lists of prices, and proceed towards further liberalisation of prices and final abolition of official and indicative prices.

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[76] The implicit subsidy in the price of bread, according to Westlake estimates (**Strategic crops study**, op.cit) is about 2 SP/kg. For an average consumption of 1.5 kg of bread per day for a typical family, increasing the price of bread by 2 SP per kilo would involve an additional cost of 90 SP per month, hardly necessitating any wage increase or consumer subsidy. At the going wage rates for non-skilled workers that sum would represent less than 3% of the wage of one person (and there is usually more than one income source per household, so the impact per household would be probably about 1-2%). Consumer prices of sugar and other products are now close to the consumer parity price.

14.3. Money and banking

14.3.1. Foreign exchange and currency convertibility

The foreign exchange market should be fully legalised and gradually liberalised. The next step after the recent authorisation to convert domestic currency into foreign currency for personal purposes at the Commercial Bank should be a similar authorisation for private companies licensed under Law No.10, for legitimate operations such as import of equipment, repair parts and other inputs, profit remittances and capital repatriation. Next step is full authorisation to all banks to exchange currency. Dealing in foreign currency should be totally de-penalised.

As the general foreign exchange market develops, the special Export Proceedings Market should disappear. Alternatively, that market may be used as the basis for the new open foreign exchange market, by simple enlarging the right to operate in it.

The Central Bank would ensure that sufficient foreign currency reserves are held in the banking system to satisfy demand for foreign currency. Adjustments in the market rate of exchange may be achieved by Central Bank intervention (or not intervention) in the exchange market. A specific rule may impose that Central Bank intervention on behalf of the currency should never compromise more than a certain percentage (such as 20% over a period of six months) of international reserves. The Treasury should make additional contributions of foreign currency to enhance the reserve position of the Central Bank and thus contribute to currency stability. The long-term objective of that reserve-building activity should be to achieve that net international reserves of the Central Bank (foreign assets less foreign liabilities) are at least equal to the sum of domestic circulation plus deposits of banks and other liabilities of the Central Bank.

14.3.2. Banking regulation

Authorising private banks requires strict banking oversight by the Central Bank. For this purpose, rigorous **prudential rules** should be enacted, regarding minimum capital requirements, obligatory reserves, and rules for credit risk assessment at private and official banks. Application of the Basle Rules is recommended, though certain allowances should be made more strict (for instance, higher levels of minimum capital to establish a bank). Commercial banks should be required to report their day to day operations to the Central Bank, who should also regulate the way in which banks conduct credit operations. In particular, banks should not concentrate their credit in a limited number of debtors, should not engage in operations with high risk potential, and should be financially penalised for accepting deposits at rates much above the average of the banking system (for instance, accepting deposits at rates exceeding a certain margin over the average may not have deposit insurance).

14.3.3. Central Bank statute

The Central Bank should be given **autonomy** to conduct monetary policy with the sole objectives of defending the value of the national currency and promote long-term growth in production and employment. The main instruments for monetary policy should be the **discount rate**, the level of **obligatory reserves**, and direct **intervention in the foreign exchange market** within limits allowed in terms of percentage of net foreign assets. The Central Bank will have **strict limits for financing the Treasury** and for **rescuing troubled banks**. It could purchase State bonds only up to a certain maximum percentage of its foreign exchange reserves (for instance, up to a 20% of

reserves). It could lend money to solvent banks in case of transitory liquidity needs, but it cannot advance credit to insolvent banks, which should be let to close with due protection for small and medium depositors. Deposit insurance should be ensured for total deposits of up to a certain amount per depositor (e.g. the equivalent of $10,000 per depositor), but not to be paid by the Central Bank. Funds for deposit insurance will be held at a Deposit Insurance Fund formed by contributions from commercial banks, plus a contribution from the Treasury, plus a commitment of eventually providing fresh funds from the Central Bank up to a certain percentage of Central Bank net international reserves (again up to 20%).

Obligatory bank reserves should be set at relatively high levels, such as 20% of deposits (with higher rates of obligatory reserve for checking and savings accounts and lower for time deposits or other medium- and long-term deposits). To reduce the cost of obligatory reserves and keep interest rates down, **obligatory reserves should be remunerated.** The obligatory reserves would be held by commercial banks at their accounts in the Central Bank, who would pay interest to the banks at a suitable rate. Commercial banks should be free to establish their own active and passive interest rates, though some regulatory instruments may be used to penalise high active rates.

14.3.4. Capital markets

After banking operations are improved and private banks are established with adequate banking oversight, introduce various financial instruments with free access for people and corporations. Accounts in foreign currency should be more freely allowed for people as well as for corporations. Once the above is in place, develop a market for public and private securities. Authorise private companies to issue negotiable debt instruments to be exchanged in that market.

Once the above is in place, implement the decision to create a stock market in Syria. Regulate stock operations and the issue of stock shares by corporations. Severely control insider trading, and regulate derivative trading and other destabilising practices. Also, permit residents to engage legally in operations with foreign capital markets.

14.4. Reduction of inefficiencies and overhead costs

14.4.1. Administrative reform of the public sector

A thorough reform of the public sector should eliminate redundant procedures, modernise operations, introduce computer-based information systems, reinforce training of State personnel, modernise rules for public service and the public servant career, and other relevant reforms.

14.4.2. More efficient basic infrastructures and services

Steps should be taken to improve the expansion and maintenance of basic infrastructure and services, if necessary by requiring the services of private firms for specific operations. Main priorities should be: modernisation of ports and logistic facilities for export; modernisation of tax collection and customs; modernisation of State banks; rapid expansion of telephone networks and Internet services, and improvements in power plants and electricity networks.

15. Specific recommendations for agricultural investment

15.1. Improve and decentralise agricultural planning

Introduce more initiative and innovation in the strategic-crop sector in a gradual manner, continuing and deepening the process of flexibilisation of agricultural planning that has been taking place in recent years. A growing percentage of available land, water, credit and inputs presently allocated to strategic crops should not be allocated by plan, but letting farmers decide on the best allocation of those funds. Start with 10% of the resources allocated in this manner, and gradually progress towards higher percentages.

15.2. Promote foreign investment in agricultural export products

Foreign capital and technology is needed to expand production of specific high-quality agricultural products, especially fruit and vegetables, for export to the European Union and other markets.

15.3. Develop improved rural finance

Improve and diversify sources and modes of financing agricultural activity and rural industry and marketing.

Promote rural micro-finance and the development of adequate banking techniques to reach small farmers through group credit at reasonable administrative costs with sustainable rates of interest and credit conditions.

Promote the gradual upgrade of small producers to the status of normal bank customers.

15.4. Promote marketing of agricultural products

Promote integration of farmers into vertical commodity chains for production, processing, domestic marketing and export of selected agricultural products

Improve administrative procedures for export, and logistic and port facilities, for rapid dispatch of perishable commodities to their destination by ship or air.

15.5. On-farm investment for modernisation of irrigation systems

Modernisation of irrigation systems in Syria involves shifting all gravity and flood systems to pressurised sprinklers and drip irrigation. **Metering water** is essential to create incentives for investing in the modernisation of systems. The form of payment for irrigation should consist of a **basic fee** for the use of irrigation water, plus **penalties of increasing value for exceeding allotted amounts of water.**

Secure funds for financing the conversion of 50% of irrigated lands to sprinklers and drip irrigation in ten years.[77] The cost is about $120 million per year, only for new irrigation equipment. Another $30-40 million per year are necessary for other related investments: improvements in off-farm irrigation infrastructure; technical assistance to

[77] The government has apparently decided to modernise the whole irrigated area in only four years. This involves a 30% in public irrigation schemes and the rest in private schemes (mostly wells). The recommendation of this report is more moderate, as it is limited to 50% in ten years. The goal set by the Government (100% in four years) may necessitate more funds than are currently available, and impose much strain on the implementing agencies. However, any efforts to accelerate the modernisation of the whole irrigated area are welcome and should be encouraged.

farms to modernise cultivation systems, change crop schedule, and learn to access new markets. Upgrading the equipment is only one step: upgrading the farms and the farmers should follow.

15.6. Create incentives for better use of irrigation

Incentives to economise irrigation water in public irrigation schemes should be established, starting with metering the water supplied to each farm. Each farmer would pay a **fixed fee** for the use of irrigation water **up to a certain amount** dependent on water supply. A system of **fines** for excess use of water above the allotted amount should be enacted. The fines would be an increasing function of the amount of excess.

16. Project profiles

16.1. Technical assistance to the Investment Office or Agency

Background. The Investment Office, dependent on the Office of the Prime Minister through the Office of the Deputy Prime Minister for Economic Affairs, is in charge of implementing the Investment Promotion Law (i.e. Law No.10 of 1991) and its by-laws and amendments (Decree No.7 of 1991 and Decree 7/2000). It process applications by investors, submits them to the Investment Council, acts as Secretary to the Investment Council, and monitors the subsequent implementation of the approved private investments.

Law No.10 grants private investments in selected fields a number of benefits, chiefly a right to import equipment duty free, income tax exemption for the first five years of operation (extensible to seven), the right to open a foreign currency account, and certain other advantages.

The Government intends to transform the Investment Office and Council into an autonomous Investment Promotion Agency, with wider duties. Apart from the above functions it would promote investment in Syria among foreign investors aborad, provide information about sources of capital and investment opportunities, provide technical assistance for the development of investment projects, keep a databank of investment projets in Syria and sources of investment capital abroad, provide marketing information, etc. The running costs of the Agency would be financed through a small charge on approved investments as they are implemented (suggested rate: 0.5%).

Objectives. To provide technical assistance and institutional strengthening to the Investment Office and its successor, the Syrian Agency for Private Investment (SAPI), during the transition to an autonomous Agency and during the first stages of its implementation.

In particular:

1. Assist in the creation of the autonomous Syrian Agency for Private Investment, contributing to its organisation and implementation.
2. Contribute to proposals for adjustments in the Investment Promotion legislation.
3. Assist the Office/Agency in the implementation of a sound information system about projects licensed under the Investment Promotion Law.
4. Assist the Office/Agency in the implementation of an effective monitoring and evaluation system for following up the development of investment projects authorised under the Investment Promotion legislation.
5. Assist the Office/Agency in the development of activities of investment promotion in Syria and abroad, including identification of investment opportunities, surveys of potential sources of risk capital and other forms of finance, participation of the Office/Agency and Syrian enterprises in international forums related to private investment in emerging markets, promotion of Syria as an adequate environment for private investment, etc.

6. Assist the Office/Agency in training activities for its officials, for officials in other related sections of the Government, and the private sector, in relation to siuch fields as preparation and evaluation of investment projects, international private finance, marketing, etc.

Activities. The project would provide local and international consultancy services, computer systems (equipment and software) and training.

Inputs and cost: The following preliminary assessment of costs has been prepared:

Local consultants: 50 person/months at U$S 2000 per month = U$S 100,000
International consultants: 12 person/months at a total unit cost of U$S 15,000 per month (including international travel and per diem in Syria), for a total of U$S U$S 180,000
Computer and telecommunications equipment: estimated cost U$S 250,000.
Training activities: U$S 200,000
Incremental operating costs of the project: U$S 30,000
Total resources needed: U$S 760,000

Duration: The duration of the project is established in 30 months.

Possible financing: Contributions from UNDP should be sought.

16.2. Technical assistance for developing rural finance

Background. The activities of the State-owned Agricultural Co-operative Bank (ACB) are the only financial activities available for rural areas of Syria. The ACB deals mainly with the centrally-planned financing of the production of strategic crops (wheat, barley, sugar beets, cotton and tobacco) and also with other crops, distributing group credit to small farmers through the extensive system of agricultural co-operatives and unions. Besides, the Post Office Savings Fund (POSF) has been recently enabled to extend loans to the public apart of taking deposits, and could also participate in a development of rural finance and micro-finance. Other (private or public) institutions or programs may also be developed for the same purpose.

The necessary development of new and improved agricultural activities, rural industry and microenterprises in the rural areas, and small-scale investments at farm level, such as productive endeavours following the adoption of modern irrigation systems, necessitate adequate micro-finance institutions with the requisite banking technology to finance small projects at reasonable administrative costs, possibly using group credit schemes with group members mutual guarantee (members of the group guaranteeing each other).

Objectives. To develop a feasible proposal for the development of an efficient system of rural finance, based as far as possible in existing institutional capabilities, to mobilise rural savings and finance rural economic initiatives of an individual or collective nature. To provide training experience for local financial officials/professionals regarding the working of rural micro-finance institutions.

Activities. The project would provide local and international consultancy services, and training abroad for local banking officials/professionals.

Inputs and cost. International consultant (3 months in 2-3 missions): U$S 45,000 (travel and per diem included)

National consultant: 6 month: U$S 12,000
Internal travel: U$S 2,000
Training: 5 short-term fellowships abroad. Total cost: U$S 30,000
Miscellaneous expenses: U$S 2,000
Total resources: U$S 91,000

Duration: 6 months

Possible financing: FAO TCP, IFAD Grant

16.3. Technical assistance on grading and standards for farm products

Background. Penetration of Syrian farm and agro-industry products in foreign markets necessitates an improved system of grading and standards. A unified scheme is needed for exports, imports and domestic uses, and adequate control systems to ensure compliance. The system should take account of the on-going negotiations with the European Union with a view to a trade agreement, and other international agreements and negotiations conducted by Syria, especially with other Arab countries.

Objectives. Provide technical assistance for unifying and developing a national system for grading and standards of agribusiness products.

Intervening Government areas: Ministry of Agriculture, Ministry of Industry, Ministry of Economy and Foreign Trade.

Organisation of the technical assistance: One of the Ministries would be in charge of Co-ordination of the project, and would provide administrative support, office space and other related facilities. A small co-ordinating committee with members from each Ministry would be created.

Activities: The project would provide international and local consultancy services, and would develop a proposed system of standards and grading for major agribusiness products (primary, intermediate or processed) involved in imports, exports and domestic use in Syria.

Inputs and cost.

International consultant: 3 months in 3 missions: U$S 45,000
National consultants: 3 consultants for 6 months each: U$S 36,000
Miscellaneous expenses: U$S 4,000
Total: U$S 85,000

Possible financing: FAO TCP

16.4. Long-term program for agricultural development

Background. The existing legislation for promotion of private investment (Law 10 of 1991 and Decree 7/2000) has been applied chiefly to industrial projects. In the case of the farm sector, the projects presented and approved so far are, largely, for processing agricultural products. Only a few include some agricultural activities related to the proposed processing.

However, developing the farm sector is urgent, both for domestic consumption and for export. This concerns both small-holders and corporate agriculture.

The national objective of self-sufficiency in strategic crops is endangered for continuing population growth in the face of limited land and water resources, thus necessitating improvements in the efficiency of land and water utilisation. This, in turn, requires farm-level investments of various sorts: modernisation of on-farm irrigation systems, land-levelling, soil conservation, land reclamation through de-rocking, diversification of production, etc. Other necessary farm-level and village-level investments concern post-harvest facilities for storage, cold storage, sorting, grading and primary processing of agricultural products. The average size of the farms involved is 8 Ha.

The foreseen enlargement of export opportunities to the European Union in the context of on-going negotiations for a Trade Agreement would imply also the necessity of medium-size and large-scale farm investments for high-tech production and marketing of exportable products, especially fruit and vegetables (fresh or processed).

Apart from this kind of investment, there is also a need of a thorough modernisation of agricultural production in the large mass of small holdings that make most of Syrian agriculture (only one quarter of agricultural land is held in farms over 100 Ha). There is an immediate need of converting existing flooding irrigation systems into pressurised drip irrigation or sprinklers, and this necessitates farm-level investments in equipment and infrastructure but also an improvement in crop schedules, technology and markets, calling for extensive developments in research, technical assistance, marketing facilities and other components. Soil degradation in various areas requires the adoption of soil conservation techniques, micro-basin management schemes and other improvements. Expected developments in the planning and pricing systems for strategic crops may motivate crop diversification, for which production and marketing technical assistance is also needed. These and other issues will require an intensification and enlargement of Government efforts to provide support for agricultural development in small farms, allowing small-holders to increase their productivity, to access new markets and to increase their income and standards of living.

Project GCP/SYR/006/ITA prepared a strategy document for agricultural development that should be taken as a starting point to carry out the more detailed technical assistance required by a thorough long-term program as envisaged in this proposal.

Objectives: The project would prepare a strategic outlook and identify several public investment and credit programs for developing a competitive, sustainable and efficient private agricultural production in Syria, for export and domestic consumption, in the context of the national objective of self-sufficiency in essential foodstuffs and in the context of the on-going process of trade liberalisation vis-a-vis the European Union as well as the on-going expansion of other foreign outlets for Syrian products. The project would also identify key areas for research, recommend more efficient systems to

provide support services (especially extension and technical assistance) to small farmers, and identify follow-up projects and sources of finance. The results of the project will be the basis for a pipeline of technical assistance and investment projects in small-scale agriculture in Syria.

Activities. The project would provide international and local experts in economics and agricultural science to assess and propose strategic choices and projects covering the following components:

- Micro-basin management and soil conservation
- Irrigation
- Crop development
- Livestock development
- Farm economics and farm management
- Farmers organisation for production and marketing
- Marketing in local and foreign markets

The expected output includes a strategy document and a number of identified projects (advanced profile level) for possible financing by international financial institutions. These results may be used to create a pipeline of investment and technical assistance projects for the following years.

Inputs and cost. The following inputs have been identified:
International consultants: one for each of the above components. Total: 14 person/months. Cost: U$S 210,000
National consultants: One or two for each component. Total: 9 consultants for 5 months each, or equivalent rearrangement. Total cost: U$S 90,000
Internal travel and field activities: U$S 30,000
Total: U$S 330,000

Duration: six months.
Possible source of financing: FAO TCP, FAO Investment Centre.

17. Annexes

17.1. Terms of reference

The following are the main aspects of the Terms of Reference for the International Consultant, defining the scope of the study.

Rationale:

The Project is assisting Syria in the formulation of a sustainable agricultural development strategy. Whatever the final configuration of that strategy, it is quite likely that the promotion of private investments will constitute a key element of the analytical framework of the strategy. It is in fact plausible to expect that a sustained and diffused process of private investment in the various phases of the commodity chains of the main sub-sectors would exert, directly and indirectly, positive impacts towards the enhancement of efficiency and the increase of competitiveness. More specifically, a sustained flow of private investments is a necessary condition for achieving two major policy objectives: a) sustain, in depth and pace, the process of adoption of new technologies in agriculture and agri-business; and b) remove the main post-harvest constraints through the creation of an articulated system of private enterprises in marketing and processing activities.

This recognition of the pivotal role of private investments has a major implication for the objectives to be pursued by the proposed study: in addition to the account and the assessment of the existing regulations specifically aimed at promoting private investments through various incentives, it appears necessary to extend the analysis to an overall account and assessment of the various components of the prevailing economic environment, because of their conditioning effects on the prospects for private economic activities.

Activities:

Under the direct supervision of the FAO Operations Service in the Near East (RNER) and the Technical supervision of the Policy Assistance Branch (RNEP) and the CTA, and in close collaboration with the Director of NAPC / National Project Director, Agricultural Economist and the National Task Force, the Consultant will prepare a detailed Policy study on the above subject.

In particular the consultant will:

- Provide a systematic account of private investment trends in the agribusiness sub-sectors, distinguishing between national and foreign investments, and pointing out the impacts of Decree 10 of 1986 and Law 10 of 1991.
- Identify key factors of the economic and business environment constraining market conduciveness to domestic and foreign investments, such as a) price policy, trade regulation and price determination mechanism; b) credit availability and access; c) access to foreign currency and international fund transferring regulations; d) fiscal regime; e) licensing and other regulations and administrative procedures constraining business operation; f) availability and access to market information, etc.
- Provide a systematic account of present regulatory regime, its impacts on organisation and functioning of the markets, and implications for business operations of existing and incumbent enterprises, for each of the key factors identified. For

example, in the case of prices and trade, provide a systematic account of existing regulations, analyse how do they influence domestic price determination mechanisms, and assess the implications of pricing strategies and investments' profitability for private companies.

- Ascertain the weight of public and private enterprises by agricultural commodity chains and by vertical articulation of the overall agribusiness system, and assess the effects of public presence on the degree of competitiveness of the sector and on entrance possibilities for private initiatives, pointing out activities characterised by potentially higher opportunities for private entrants.
- Assess the desirable extent of the State's direct involvement in production activities and identify, in an articulate way, the new functions to be assumed by the State in order to ensure an economic environment characterised by lower transaction costs, market failures correction, competitiveness and equitable economic opportunities.
- Identify and suggest practical policy recommendations for increasing opportunities for private investments in the various stages of the agricultural commodity chains within the existing economic and institutional framework. In particular, identify and suggest policy recommendations for improving the regulatory framework for new investments, with special reference to Law 10 of 1991, so as to enhance the ability to attract direct foreign investments vis-a- vis competing countries in the region.
- Identify and suggest recommendations for structural and institutional policy reforms, intervening in the key factors of the business environment identified and analysed above, needed for enlarging and strengthening opportunities for private investments, and for enhancing ability to attract foreign investments in a world market oriented economic and policy scenario.
- Provide a preliminary assessment of the expected impacts of the proposed policy actions, and an evaluation of benefits, risks and adjustment costs under alternative scenarios in terms of timing, sequencing and comprehensiveness of the policy reform process.
- Prepare project profiles for provision of technical assistance in key areas of encouraging private investments in agricultural production, processing and marketing be submitted to funding sources.
- Prepare a Technical report including the results of his/her study.

To accomplish the above tasks, the consultant shall undertake two missions to Syria.

In the first mission of three weeks duration in Syria, the consultant will:

- Undertake field visits and conduct interviews with concerned parties to have a preliminary understanding of the financial and fiscal sustainability of the agricultural policy regime in Syria;
- Prepare a plan of work and develop a detailed scheme of analysis;
- Provide detailed account of the data and information required for the successful completion of the suggested study and appropriate methodologies for its collection and preliminary processing;
- Propose a time schedule for data collection and analysis;

- Train members of the task force on data collection and processing;
- Supervise initial stages of data collection and provide on-time guidance; and
- Prepare a report in English on his preliminary findings and indications on the main areas of concern he / she plans to address in the second mission and an annotated outline of the final study-report, and submit to the FAO Operation Service in Cairo.

In the second mission of five weeks duration in Syria, the consultant will:

- Review and validate the data collected by the task force, identify gaps and take necessary action for quickly filling these gaps;
- Organise and implement a short training session for the project trainees to illustrate the methodology employed in this study, and highlight its main findings;
- Give a seminar at the end of the assignment for senior Government officials of MAAR, other relevant institutions and parastatals, concerned political and professional organisations, concerned agents in the private sector and representatives of the donor community, to present and discuss the results of the study.
- Prepare while in Syria, a draft technical report in English (with an executive summary) including the main findings, conclusions and policy recommendations on the opportunities, constraints and possible policy options for Encouraging Private Investments in Agricultural Production, Processing and Marketing in Syria and submit it to FAO for clearance; and
- Provide a brief evaluation of the support provided by each member of the task force, excluding the trainees.
- The Consultant will finalise the report, including FAO comments, and submit it to FAO, both as hard copy and on diskette, within two weeks from receiving those comments.

17.2. Guidelines for interviews with private companies

The interviews are to be conducted by two persons, in the manner of a conversation. The object is, first, to obtain basic information about the company: name, ownership, activity, date of establishment, amount of capital invested, number of workers employed, etc. Second, to review the various aspects of the company's operation to detect problems and suggestions about the existing Syrian regime for private investment and related economic conditions. The subjects in these guidelines are not to be interpreted as literal questions but as topics to be discussed during the conversation.

Basic and historical information about the company: year started, size, employment, etc. Under which Law the firm was licensed. If did not apply for Law N0.10, reasons why. Current size and capacity of the company

Process of establishing the firm under Law No.10 (1991), if applicable

Reasons for applying (or for not applying). Were they rejected? Withdrawn? Why?

Time elapsed for each step in the procedure (from application to getting started). Ministries involved. Problems encountered. Suggestions for modification of procedure. Knowledge and evaluation of modifications enacted by Decree 7/2000 (1999)

Inputs

Source of raw materials (state firm, intermediaries, farmers, etc)
Quality, homogeneity of raw materials. Problems to achieve improved quality and more homogeneity.
Is the supply of raw material stable, in terms of amount and quality? Reasons for variation.
Price of raw materials. Stability of the price. Price/quality relationship
Timeliness of procurement
Amount obtained as compared with processing capacity and demand
Other inputs used (cans, packaging materials, chemical products, etc)
Proportion of imports on total inputs used for production
Competitiveness of inputs compared to alternatives in quality, price, timeliness, etc

Access to foreign currency (for imports, profit remittances, etc.).

Access to credit
Bank credit in Syria
Foreign bank credit
Commercial credit (with suppliers and customers)
Other informal sources of credit (family relations, etc)

Marketing
Marketing chain for the firm's products
Problems related to the intervention of intermediaries between the firm and the local or foreign markets
Effects of government pricing system. Regulations regarding increasing or decreasing prices. Regulations regarding the price of new products, and the pricing of different qualities or different variations of the same product. How companies deal with changes in costs of production: modifying prices, modifying the product, etc.
Problems related to storage
Problems related to packaging
Transport problems (availability, cost)
Tariff and non-tariff barriers for entry into other markets
Standards for food products (and other agribusiness products) set by the Syrian government, for domestic and foreign markets. Are they complied with? What is the cost of complying? Are they enforced?
International standards (such as ISO): does the company have an ISO certification? Has the company problems with standards to access export markets? Has the company HACCP quality control?

Access to foreign market information
Standards
Regulations
Demand and export opportunities
Costs and prices
International and regional agreements
Information on tariff and non tariff barriers
E-commerce
Information technology
Production technology

Taxes and subsidies
Import duties
Taxes on profit

Export taxes
Capital tax (on equipment)
Sales tax
Subsidies on raw materials
Rate of exchange applicable for imported inputs and equipment
Rate of exchange applicable for exports
Foreign subsidies affecting competitiveness

Production

Destination of production (% domestic, % export)
Limitations on export competitiveness: cost of domestic inputs, cost of imported inputs, rate of exchange, quality, lack of homogeneity, etc)
% Utilisation of capacity
Plans to reduce or expand capacity, or to diversify production
Effects of price ceilings on quality of product. Problems with export market derived from this.
Competitiveness of product compared with local and foreign competitors, regarding price, quality, variety

17.3. List of agribusiness companies visited

Name	Activity	Location
Mansour	Fish farming	Al Ghab
Al Muttaheda	Olive oil	Aleppo
Azzahra	Wheat milling	Aleppo
Tala	Canned food	Damascus
Hana/Masamiri	Dairy products	Damascus
Daghmash	Frozen food	Damascus
Al Reef	Frozen Vegetables	Damascus
Mouneh	Frozen vegetables	Damascus
MAIS	Irrigation equipment	Damascus
Tlas	Packing mushrooms and vegetables	Damascus
Fiorella	Pasta	Damascus
Al Sabouni	Grain milling + milling machines	Hama
Al Hiloo	Chicken farming	Homs
Sadro	Margarine	Homs
Firzat	Vegetable oil + animal feed	Homs
Anbouba	Vegetable oil + animal feed	Homs
Hamad Alsabah	Sheep farming	Kanaker
Ogarit	Fruit juice and concentrate	Lattakia
Al Mutawaset	Olive oil	Lattakia
Al Rahi	Olive oil	Lattakia
Joud	Soft drinks	Lattakia
Al Sabah	Olives and sheep	Raqqa
Al Jabal Al Akhdar	Fruit juice	Sweida
Fresh Mountain	Fruit juice	Sweida

17.4. Statistical tables

Estimation of the size of the labour force

Published information from the recent Multiple Purpose Survey and population projection statistics allow for an updated estimation of the size of the labour force in Syria, based on the rates of labour participation by gender and age. These estimates have been used to assess the relative importance of the new jobs created by private investment projects.

Estimated population and labour force by age and gender, 2000

Age in years	Population (in thousands)			Labour participation rates (%)		Labour force (in thousands)		
	TOTAL	Male	Female	Male	Female	TOTAL	Male	Female
< 1	391	191	200					
1-4	1,673	814	859					
5-9	2,228	1,085	1,143					
10-14	2,326	1,141	1,185	7.3%	4.4%	135.4	83.3	52.1
15-19	2,195	1,077	1,118	43.4%	13.9%	622.8	467.4	155.4
20-24	1,526	758	768	69.9%	19.9%	682.7	529.8	152.8
25-29	1,198	606	592	89.9%	21.3%	670.9	544.8	126.1
30-34	986	494	492	96.5%	21.9%	584.5	476.7	107.7
35-39	848	439	409	98.7%	21.2%	520.0	433.3	86.7
40-44	710	359	351	96.1%	16.6%	403.3	345.0	58.3
45-49	571	271	300	97.3%	16.1%	311.7	263.7	48.0
50-54	522	255	267	92.5%	11.8%	267.4	235.9	31.5
55-59	335	160	175	87.4%	9.2%	155.9	139.8	16.1
60-64	311	136	175	68.7%	6.7%	105.2	93.4	11.7
65+	500	191	309	49.4%	3.8%	106.1	94.4	11.7
TOTAL	**16,320**	**7,977**	**8,343**			**4,565.8**	**3,707.5**	**858.3**

Participation rates as measured in the 1999 Multiple Purpose Survey. Data taken from Central Bureau of Statistics, **Statistical Abstract 2000**, pp.65 and 81. Notice that the population data at p.65 of the **Abstract** are erroneously captioned as population in 1999, whereas the figures are for 2000 (see the same source, p.64). Labour force estimates have been directly derived from population and labour participation figures. It is assumed that labour participation rates have not changed significantly between 1999 and 2000.

Gross Domestic Product, total and per capita

In the text of this report some summarised information is given on GDP and per capita GDP in some selected years of the 1963-1999 period. Here is the more detailed series including individual years of the last decade, and including also agricultural GDP.

Data from the most recent series of national accounts include data in real terms at 1995 prices, and include all years of the 1990s but only selected years (those ending in 0 and 5 since 1970, plus the year 1963) for the period before 1990. Individual years in the 1980s are also available, but from a previous series whose values at current prices do not agree exactly with the new series, and its real values are at 1985 prices. Chaining the two overlapping series has proved difficult, and thus only the newest series is used.

It should be taken into account that official figures may understate the real level of economic activity in Syria, as in other countries, because of the existence of an underground or undeclared amount of production and income in many sectors of the economy. The size of this undeclared production is a matter of debate, but many indications suggest that it is relatively large in the case of Syria. It concerns mainly **non-agricultural** sectors of activity, since much of the agricultural sector is directly measured at field level, and marketed through formal (mostly State-owned) channels.

Aggregate supply and demand:
GDP, consumption and investment, 1963-1999
(million Syrian Pound, at constant 1995 prices)

Period	GDP	Population (000)	GDP per capita (SP)	Private consumption	Per capita private consumption (SP)	Private investment	Public consumption & investment	Net foreign trade (*)	Aggregate domestic demand
1963	130,960	4,992	26,234	111,339	22,303	12,475	25,595	-18,449	149,409
1970	143,106	6,305	22,697	118,065	18,726	9,931	44,130	-29,020	172,126
1975	259,971	7,380	35,226	200,113	27,116	24,539	52,528	-74,984	277,180
1980	372,992	8,704	42,853	285,517	32,803	50,042	159,460	-122,027	495,019
1985	419,536	10,267	40,863	295,733	28,804	53,337	105,215	-122,436	454,285
1990	389,469	12,116	32,145	319,888	26,402	53,045	105,709	-89,173	478,642
1995	570,975	14,285	39,970	378,823	26,519	87,420	76,709	-39,381	542,952
1999	663,688	15,891	41,765	399,424	25,135	61,456	169,295	33,513	630,175

(*) Net foreign trade in goods and non-financial services ("Net external transactions" in Syrian National Accounts). Based on Central Bureau of Statistics, **Statistical Abstract 2000**, pp. 518-519 and 528-529. GDP is Gross Domestic Product at Market Prices, at constant 1995 prices. Public expenditure is the sum of public consumption and public investment. Aggregate domestic demand is GDP minus net external transactions, and is also the sum of all consumption and investment, public and private.

Annual rates of growth, 1963-1999

Period	GDP	Population	GDP per capita	Private consumption	Per capita private consumption	Private investment	Public consumption & investment	Aggregate domestic demand
1963-70	1.28%	3.39%	-2.05%	0.84%	-2.47%	-3.21%	8.09%	2.04%
1970-75	12.68%	3.20%	9.19%	11.13%	7.69%	19.83%	3.55%	10.00%
1975-80	7.49%	3.36%	4.00%	7.37%	3.88%	15.32%	24.87%	12.30%
1980-85	2.38%	3.36%	-0.95%	0.71%	-2.57%	1.28%	-7.98%	-1.70%
1985-90	-1.48%	3.37%	-4.69%	1.58%	-1.73%	-0.11%	0.09%	1.05%
1990-95	7.95%	3.35%	4.45%	3.44%	0.09%	10.51%	-6.21%	2.55%
1995-99	3.83%	2.70%	1.10%	1.33%	-1.33%	-8.43%	21.88%	3.79%
1963-80	6.35%	3.32%	2.93%	5.70%	2.30%	8.51%	11.36%	7.30%
1980-99	3.08%	3.22%	-0.14%	1.78%	-1.39%	1.09%	0.32%	1.28%
1963-99	4.61%	3.27%	1.30%	3.61%	0.33%	4.53%	5.39%	4.08%

Rates of growth are not applicable to net foreign trade.

GDP (total and agricultural) per capita at 1995 prices, 1963-1999

	Syrian Pounds at constant 1995 prices		US Dollars at constant 1995 prices	
Year	**GDP per capita**	**GDP agric per capita**	**GDP per capita**	**GDP agric per capita**
1963	26,234	12,330	570	268
1970	22,697	8,171	493	178
1975	35,226	11,272	766	245
1980	42,853	13,284	932	289
1985	40,863	11,033	888	240
1990	32,145	9,965	699	217
1991	33,542	10,733	729	233
1992	36,800	12,512	800	272
1993	37,448	11,983	814	261
1994	39,176	12,536	852	273
1995	39,970	12,790	869	278
1996	41,779	13,787	908	300
1997	41,693	12,925	906	281
1998	43,682	14,852	950	323
1999	41,765	12,530	908	272

Source: Central Bureau of Statistics, **Statistical Abstract 2000**, pp.527-529. Agricultural per capita GDP estimated, based on total GDP per capita and the share of agriculture. Converted to dollars at the rate of 46 S.P. per dollar.

Private production of selected processed food products, 1990-98

Products	**Units**	**1990**	**1994**	**1995**	**1998**
Cereal processing					
Bread	000 MT	n.a.	n.a.	864	1095
Biscuits	MT	10494	8960	8265	8605
Macaroni	MT	6711	6662	4270	5387
Beer	000 litres	0	0	0	0
Edible oils					
Olive oil	MT	85893	99895	84852	145000
Vegetable oil	MT	0	0	272	22625
Dairy					
Pasteurised milk	MT	n.a.	n.a.	1614	1383
Chocolate	MT	4729	6617	5547	5654
Beverages					
Mineral water	000 bottles	0	0	0	0
Arak	000 litres	n.a.	n.a.	710	575
Wine	000 litres	0	0	0	0
Other alc.bev.	000 litres	n.a.	n.a.	1207	750
Soft drinks	000 litres	n.a.	n.a.	48812	82824
Fruit juices	000 litres	n.a.		4060	9296
Canned food	MT	1008	3954	3419	7660

Source: Central Bureau of Statistics, **Statistical Abstract (1995 and 2000),** statistics for the industrial sector provided by the Ministry of Industry.

Total (public and private) production of selected processed food products, 1990-98

Products	Units	1990	1994	1995	1998
Cereal processing					
Bread	000 MT	n.a.	n.a.	1531	1753
Biscuits	MT	16169	14692	14041	11462
Macaroni	MT	9006	9005	6460	6303
Beer	000 litres	9870	10243	10243	9744
Edible oils					
Olive oil	MT	85893	99895	84852	145000
Vegetable oil	MT	26175	28217	33707	64389
Dairy					
Pasteurised milk	MT	13055	15783	15433	14111
Chocolate	MT	4729	6617	5936	5855
Beverages					
Mineral water	000 bottles	11670	19047	19629	25116
Arak	000 litres	n.a.	n.a.	3537	3400
Wine	000 litres	349	256	249	218
Other alc.bev.	000 litres	n.a.	n.a.	1307	783
Soft drinks	000 litres	n.a.	n.a.	54480	88837
Fruit juices	000 litres	n.a.	n.a.	4060	9296
Canned food	MT	13764	18152	18149	18633

Source: Central Bureau of Statistics, **Statistical Abstract (1995 and 2000),** statistics for the industrial sector provided by the Ministry of Industry.

Annual average growth rate of production of selected food products, 1990-98

	Annual growth rate of total production (private and public sector)			Annual growth rate of production by the private sector		
Products	**1990-94**	**1994-98**	**1995-98**	**1990-94**	**1994-98**	**1995-98**
Cereal processing						
Bread	n.a.	n.a.	4.62%	n.a.	n.a.	8.22%
Biscuits	-2.37%	-6.02%	-6.54%	-3.87%	-2.00%	1.35%
Macaroni	0.00%	-8.53%	-0.82%	-0.18%	-10.52%	8.05%
Beer	n.a.	-1.24%	-1.65%	0.00%	0.00%	0.00%
Edible oils						
Olive oil	3.85%	9.76%	19.56%	3.85%	-4.00%	19.56%
Vegetable oil	1.90%	22.91%	24.08%	n.a.	n.a.	336.52%
Dairy						
Pasteurised milk	4.86%	-2.76%	-2.94%	n.a.	n.a.	-5.02%
Chocolate	n.a.	-3.01%	-0.46%	8.76%	-4.31%	0.64%
Beverages						
Mineral water	13.03%	7.16%	8.56%	0.00%	0.00%	0.00%
Arak	n.a.	n.a.	-1.31%	n.a.	n.a.	-6.79%
Wine	-7.45%	-3.94%	-4.34%	0.00%	0.00%	0.00%
Other alc. bev.	n.a.	n.a.	-15.70%	n.a.	n.a.	-14.67%
Soft drinks	n.a.	n.a.	17.70%	n.a.	n.a.	19.27%
Fruit juices	n.a.	n.a.	128.97%	n.a.	n.a.	31.80%
Canned food	7.16%	0.66%	0.88%	40.73%	-3.57%	30.85%

Based on data from the Ministry of Industry, taken from the **Statistical Abstract** of 1995 and 2000. There might be some non-comparability between production estimates up to 1994 and since 1995. For that reason, growth rates for 1990-94 and 1995-98 are more reliable than those for 1994-98.