

Focus on Syria Conference, 7 November 2007

Panel Session 1: TRANSFORMED BUSINESS ENVIRONMENT: INTERNATIONAL VIEWPOINT

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Introduction

At last year's conference a real sense that things were changing fast for the better

The choice of title for this session – transformed business environment – [not transforming, or potentially transformed] similarly suggests a sense of a real step change

What I'd like to do is to offer the views of a sceptical, non-partisan outsider on how far the economic - and so far as I can judge – the business environment is transformed and what might lie ahead. I'm conscious that many Syrians present will know more about this than I do; these remarks are partly designed to prompt a reaction from you and partly for the benefit of outsiders thinking about Syria for the first time.

I should make clear that I'm speaking in a personal capacity as an economist who has watched Syria and the region for a good many years. What I have to say does not represent the agreed view of the British Government for whom I work.

Progress to date

No economist – at least no Western economist - would dispute that up till a very few years ago Syria was one of the economic back markers even in a generally underperforming region:

- a back marker in providing an environment in which a competitive private sector could flourish; and thus
- a back marker in delivering prosperity to its people

The list of what was wrong with the environment was depressingly long. Much of it came down to what Syria inherited from a long period of highly centralised economic management which came close to the sort of central planning seen in central and Eastern Europe. But whereas Central European countries by and large threw off their failing systems in a big burst of reform in the 1990s, Syria remained saddled with much of its. Syrian businessmen and –women faced enormous obstacles

- in what they were allowed to do [SOEs monopolised some major sectors, had commanding positions in others, and enjoyed subsidies and other privileges; trade was severely restricted]
- in how easy the system made it for them to do even what they were allowed to do [regulations and taxes were complex and unpredictably administered; the legal framework was weak and poorly enforced]
- and in the quality of the inputs they had to work with [there was a relatively poorly educated workforce; the physical infrastructure, notably power supply, was inadequate; the financial infrastructure too was weak]

There was little real sense of strategic direction and little public debate about economic strategy. Although no-one doubted that given a chance many businessmen and –women were extremely entrepreneurial, as a result of all these failings investment was chronically weak, productivity was low, growth was weak and too dependent on oil. Many ordinary people were living in poverty.

So little was happening on the economic front that I used to find 5-6 years ago that people trying to accentuate the positive would talk in all seriousness about reforms that had happened a good many years ago

Now

If we fast-forward to the present, things have certainly changed.

The crucial change –seen from outside – is that there now a **political will** to shake things up and a coherent **medium to long term strategy** for doing so:

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- the President has said some impressively forthright things about the need for market-led reform. At least in broad terms he wants to see the right sort of change. In particular he seems clear that growth is the way to improve the lot of the poor, and that the economic system – and by implication elements of governance - needs to change accordingly [don't underestimate the political attractions of a more populist set of policies. cf Iran. – likely to end in tears] ;
- the Baath Party has voted for a Social Market Economy, which I am told is a remarkable ideological U-turn;
- Mr Dardari and a number of senior figures in government and the central bank have a clear understanding of the issues – not just the structural issues but the huge budgetary challenge which lies ahead - and what looks like a sensible strategy for change
- much of this is incorporated in the new 5 Year Plan

In this respect the comparison with Egypt is instructive [lots of rhetoric but no real progress for a long time until a group of senior reformist were installed, with at least the tacit backing of the President]. Although Syria is starting from further back I think there is now some of the same top-down drive.

This high level political commitment – as many of you know – started 2-3 years ago being translated into lots of individual practical steps. Now there is plenty to talk about by way of recent developments –so much in fact that an IMF economist told me recently that he was concerned at the ability of enterprises to digest so much change in such a short period. I'm sure we'll hear much more about this in the course of today, so let me just mention a handful of very recent examples:

- the exchange rate has been unified and – more recently – the peg changed from the \$ to the SDR
- there have been further reductions in the number of goods prohibited from import [with the promise of abolition by the end of this year]
- there is a new law on foreign investment
- a commitment to a Treasury Bill market has been made– important both for liquidity management and to help the banks diversify their assets
- water and electricity prices were increased a few weeks ago
- ... and of course last week there were politically high profile increases in domestic petrol prices. Interesting because Egypt has backed away from the same. When you see Syria moving faster than Egypt you know something special is happening

To anyone who remembers what it used to be like this is all quite startling. An economic system that was frozen for decades at last appears to be changing quite fast.

The effects on the ground are evident. Investment is picking up – to some extent in manufacturing and certainly in real estate, which is booming. There looks to be some momentum.

Assessment

The crucial questions are

- What are we to make of this?
- How far has Syria progressed?
- Has it really turned the corner?

To be realistic, I don't believe the backlog of problems I've just described can be cleared up rapidly. With the best will in the world

- a long and complex process of reform is required
 - not just a question of one-off legislative and regulatory changes which can be implemented from the centre, though these are an important element
 - a sensible transformation of state enterprises takes some years
 - the replacement of subsidies by a targeted social safety net is bound to take some years
 - transforming governance and the institutions of governance at all levels – from the grass roots administration of taxes and regulations and the grass roots operation of the legal system up to the efficient and honest operation of central government and the control of corruption – takes a good many years at best and will not happen at all without decisive political will
 - transforming the physical infrastructure and [especially the workforce] is for the longer term

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- and on top of this reform, substantial and potentially disruptive budgetary adjustment, including much further progress on subsidies and a broadening of the tax base, is needed
 - which incidentally is being given extra urgency by the surge in crude oil prices, by smuggling of subsidised products out of the country, and by the enormous extra burden of coping with Iraqi refugees, which Syria at present is having to do with relatively little help from outside

As if to illustrate the difficulties, despite all the recent progress Syria still scores pretty poorly on the World Bank's Ease of Doing Business ranking [137/178] and in the WEF's Global Competitiveness Index [84/128]. And in both cases relatively difficult governance problems loom large:

(1) in the Doing Business Rankings Syria's most acute problems emerge as

- enforcing contract [171/178],
- starting a business [169/178] and
- getting credit [158/178]

(2) in the Global Competitiveness rankings the three most problematic factors for doing business – by some margin – are

- inefficient government bureaucracy
- access to financing; and
- corruption

When you set all this and this sort of timescale needed for deep-seated change against the scale of poverty and unemployment [on the one hand] and the imminent budgetary crunch [on the other] it's easy to feel that those pushing through change have left it very late and are now in something of a race against time to avoid major budgetary problems, accelerating inflation, and worsening social problems. I think it's premature to say that the recent increase in investment will turn into a sustained boom.

However Syria is not exceptional in leaving it late. There are other cases where the will to change a stable but poorly functioning system is only really galvanised when the status quo becomes unsustainable

And on balance, despite this catalogue of challenges, I am not pessimistic. The changes happening are exciting and hold out serious prospects of real improvement.. It may be a good many years before Syria can aspire to be a *fully efficient* market economy delivering steadily growing prosperity to all its people, but when you look at the positives:

not just the longstanding but latent strengths like

- the skills and wealth of the Syrian business community; an industrial base which is by regional standards already pretty diversified; natural resources; its tourism potential; and the draw of Damascus

but the more recent developments

- the political will and the clear vision of the Government
- the enormous interest among Gulf private sectors in investing in Syria
- the change of mood on the ground in the light of recent reforms

it becomes quite plausible that **reforms and budgetary correction accompanied by strong foreign investment** will drive profound and far-reaching change in the next few years. There will be costs, and losers, but they will arguably not be on the scale of Central and Eastern Europe

Message

So -- with strong political commitment, stability, and a continued coherent strategy Syria might at last begin to realise its obvious potential, with sustained strong growth trickling down throughout society

Things to look out for in the next few years will include:

- further substantial reduction in energy subsidies – a critical part of the urgent task of containing the budget deficit

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- more focused action to address inequality and the needs of the poor, not just to compensate them for lower subsidies but to prevent the sort of strains which we see in other populous countries in the region. Following precedent of eg Morocco and potentially Egypt
- more action on a raft of microeconomic reforms, including uncharted territory like SOE restructuring and the elimination of monopolies, perhaps summarised in steady improvement in its international Syria's rankings; and in step with this
- a substantial increase in foreign investment, driving up productivity, spreading best practice, and stimulating ancillary domestic investment

This is not a foregone conclusion. Substantial obstacles to change remain.

I suspect that the business community – including foreign investors – will have a major role to play

- not just in catalysing all sorts of change through the process of foreign investment itself – which as we saw in CEE can be enormously powerful
- but – absolutely critically - in keeping up the pressure for reform.

This sort of conference shows an openness to ideas/readiness to listen among the sort of Ministers and officials who are advocating reform anyway. But there is a more difficult task of selling change to those in Syria who resist it and have the power to obstruct it, and in getting across the message to ordinary people that they and their children will benefit from far-reaching reform.

There is still a lot to play for