Evaluation of the economic and human costs of the sanctions by Arab countries on Syrian Arab Republic

The League of Arab States (LAS), who may soon be joined by Turkey imposed economic sanctions on Syria and – despite the non-participation of Lebanon[i] and Iraq, Syria's main trading partners – it will have far reaching economic and human development implications for Syria as well as for its neighbours. The sanctions involve:

- Cutting off transactions with the Syrian central bank
- Halting funding by Arab governments for projects in Syria
- A ban on senior Syrian officials travelling to other Arab countries
- A freeze on assets related to President Bashar al-Assad's government

Economic situation outlook prior to the sanctions:

The Syrian economic growth was projected to contract by 3.0 per cent in 2011 (5.5 per cent real growth in 2010). The negative impact of the disruptions to the economic activity were supposed to be partly offset by the partial implementation of planned public infrastructure projects and a resilient agricultural sector and private consumption.

Due to the social situation, the high oil prices and the oil production recovery of 2011 did not support the economy as expected. Export revenues amounting to more than 6 per cent of GDP, important loss of hard currencies due to massive foreign exchange interventions, restrictions on the current and capital accounts and pressures on economic growth were expected for 2011. The Syrian pound is depreciating, further trading with a significant premium reaching 10 per cent on a re-emerging parallel foreign exchange market.

Table 1:

GDP breakdown, forecast for 2011-2013, before and after sanctions

	Baseline scenario: before sanctions				Impact of sanctions	
	2010	**2011**	**2012**	**2013**	**2012**	**2013**
Private consumption	3.8	-3	-5	3.3	-5	3.3
Government consumption	5	7.2	5	-0.5	5	-0.5
Gross fixed investment	4.4	-2	-2	2	-6.9	2
Exports of goods & services	4	-4	-15	3	-34.5	3
Imports of goods & services	5.2	-3.2	-12	2.9	-27.8	2.9
Growth rate	3.2	-1.5	-3.2	2.1	-5.5	2.1
Poverty rate (lower)		12	13.7	12.4	14.8	13.5
Poverty rate (upper)		33	35.9	33.8	38.0	35.8
Employment change		-25,000	-53,000	35,000	-91,000	35,000

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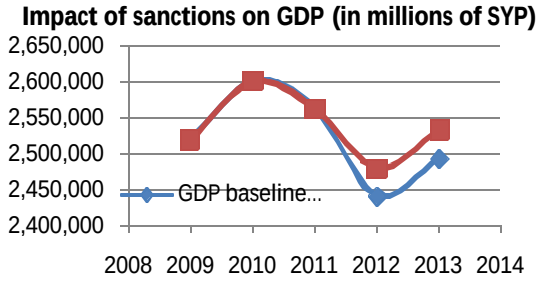

Finally, increased subsidizations were supposed to prevent a surge in inflation. Consumer price inflation was thus projected to reach 6 per cent in 2011 (4.4 per cent in 2010) but as at the expense of an increase of the fiscal deficit to an estimated 8 per cent of GDP.

Forecasts - Economic and human impact of the sanctions:

Using this baseline scenario, forecasts for GDP growth, employment and poverty have been made based on a number of hypotheses detailed above.

Macro-economy

- *Reduction of 5% of total investment*: FDI represent 3.65% of GDP (e.g. 20% of the domestic investment in 2009). We suppose that the sanctions might lead to a total freeze of FDI inflows from Turkey and the Arab countries (excluding Lebanon and Iraq). Between 2006 and 2009 these inflows represented 25.5% of total FDI.
- *Additional decrease by 19.5% of Syrian exports and decrease by 15.8% of Syrian imports*: The Arab League and Turkey sanctions might lead to 80% decrease of Syrian trade with these partners. In 2009, Syrian trade with Turkey and the Arab countries (still excluding Lebanon and Iraq) represented 22.6% of its imports and 29% of its exports.
- *A contraction of the GDP growth by 5.5%* is expected as direct consequences of the trade and FDI drop (cf. Fig 1). The subsequent impact on the domestic demand, investment and employment might lead to a deepening of the recession to around -8%. The consumption of the private sector remains the main contributor to GDP growth at 2.3% in 2010, followed by exports (1.2%), imports (1.6%) and investment (0.8%). The fall of exports, imports and FDI will lead to a deepening of the recession to -5.5%.
- The reaction of the banking sector might aggravate the situation as several banks are already planning to sell their share in Syrian banks. This move will have long lasting consequences on the potential for economic growth, job creation and poverty reduction of Syria. Given that most of the Syrian banks are publicly registered the stock market will suffer.
- The Arab sanctions are expected to increase inflationary pressures, as substitutes to Arab imports from the Far East have higher shipping costs and custom duties. Even if Syrian trade businesses could find a leeway through Lebanon and Iraq- that are not abiding by the sanctions, business operating costs are expected to increase. This would result in higher consumer prices. Forecasts for the 2011 inflation expect it to amount to around 6-7 per cent in 2011 and crawling further higher in the following year.

Monetary and banking conditions

- Syria was adopting an expansionary monetary policy before the current crisis, in a context of low inflation (around 4 per cent in 2010[ii]). The banking sector was also expanding with deposit growth and healthy profitability ratios. Since the crisis aggravated, authorities tightened monetary policy and focused on defending the local currency. The Syrian pound is expected to come under stronger pressure,

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especially as the sources of the country's foreign exchange are increasingly used. During the last week of November, the value of the Syrian pound (SYP) to the US dollar fell to around 56, whereas in the official market the US dollar traded at SYP 50. The Euro traded between SYP 72 and SYP 76 in the black market, versus an official rate of SYP 67. These trends are unlikely to be reversed in the short term. The Central Bank of Syria is using its foreign reserves to stem currency depreciation on the black market. The Central Bank's reserves were ample pre-crisis, estimated at $18 billion. This should cover around 12 months of imports in principle, especially as imports decrease.

- Under such deteriorating monetary conditions, the impact started to be felt on the banking sector. For the first time since private banks started operations in 2004 in Syria, commercial banks' balance sheets contracted, as a result of a decline in deposits. The 12 leading market-listed commercial banks lost 21 per cent of their deposits during the first three quarters of 2011. These banks' loan portfolio went down 4 per cent over the same period.[iii] Bad loans provisioning is expected to increase. Most of the private commercial banks operating in Syria are Lebanese banks. Lebanon's Central Bank had just announced that - as results of recent stress tests on Syrian subsidiaries of Lebanese banks indicate - they were well capitalized and did not need to draw on their Lebanese parent operations.
- Profitability appears sound so far. The insignificant impact on profit margins is mainly due to a reduction in interest costs stemming from the deposits' decline. The impact on banking profitability could become more evident, as existing loans mature and new lending becomes limited. The public sector banks are expected to follow the same trends, yet they do not disclose updated figures.
- The private funds' outflow is going more into a growing cash-economy and less to banks in Lebanon, since, so far, Lebanese banking data showed a decline in deposits' growth in Lebanon. It is normal that the cash economy expands under crisis situations and heavy sanctions.
- The spillovers effects of the Arab sanctions on banking and monetary conditions in the region remain limited, unlike other sectors whereby the impact is more notable. The Syrian financial sector is most integrated with Lebanon, with around 10 per cent of Lebanese consolidated balance sheets coming from Syrian operations. However, Lebanon's banking conditions remain mainly driven by domestic factors and thus are not expected to be drastically affected.

Poverty

- *Increase of the number of people living under the national poverty line by 2.8 additional points and the upper poverty line by 5 additional points:* Around 12% of the population is currently living in poverty. It is extremely difficult to evaluate the impact the sanctions might have on poverty such as the consequences of disruption hospital and school functionality of electricity shortages in case Turkey cuts its electricity supplies to Syria which cover about 10 per cent of its electricity needs. Nevertheless, rising unemployment, the limited ability of Syrian migrant workers – especially working in the Gulf countries – and their families back home will be affected by the financial sanctions as their ability to transfer money will be limited. Worth noticing that in 2005, while Syria was enduring the US sanctions, 30% of the Syrian population was living in poverty and 11.4% live below the subsistence level.

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Labour Market

- *As a result of the crisis Syria's projected loss of 53,000 jobs in 2012 would increase due to the sanctions to 91,000 jobs:* The agricultural sector counting for 17% GDP and 16% workforce is traditionally a good shock absorber. Overall the estimated impact has to be analysed in the context of the already structurally deficient Syrian labour market[iv].

Flow of remittances

- According to the draft document of the sanctions, remittances sent home by Syrians working abroad will not be blocked. In 2010 around $750 million worth of remittances came from the Arab region. Due to very volatile and uncertain unfolding of the security situation it is very likely that only the remittances funding the basic consumption will be sent back to Syria and all those expatriates sending money with investment or savings purpose will be reluctant to do so. Additionally, assuming that an important amount of remittances goes to rural areas (outside Damascus), one can imagine the increasing popular discontent in the areas where the uprising originally started.

Foreign Direct Investment

- Arab League sanctions refer also to halting funding by Arab governments for projects in Syria. FDI inflows into Syria are forecast to shrink by 65 percent from 1.4 billion dollars in 2010 to around 500 million dollars in 2011[v]. Considering the current situation, it is very probable that this figure will go further down because- instability is one of the strongest disincentives for the FDI and will most probably cause many investors, both Arab and non-Arab to leave the country and close their operations. That, coupled with the trading embargo, blocking of the banking system etc. will lead to significant halts in production and employment, which will cause falling fiscal revenues. On the other hand, the investments from Russia and China are likely to persist despite the situation.
- According to Inter-Arab Investment Guarantee Corporation (IAIGC) report, inter-Arab FDI plunged by 76 percent in 2010 due to adverse political conditions in several countries and stood at 5.4 billion dollars. Data on FDI is majorly lacking for Syria but FDI Enterprise Survey Syria has conducted with UNCTAD and ESCWA, indicates that around 40 percent of the FDI stock in the country in 2008 was owned by Arab investors. UNCTAD data shows that FDI Inflows are becoming an important part of gross fixed capital formation in the Syrian economy (from around 3 percent in 2001 to around 18 percent in 2008).

Tourism

- Tourism in Syria is considered the country's second largest source of foreign currency income and it is viewed as strategically important industry for Syria's future economic growth. Tourism has accounted for 11 percent of Syria's GDP with revenues of more than 8 billion USD in 2010. The number of tourists visiting Syria during 2010 was 8.545 million (including 440,311 European tourists, 1,664,209 million Turks and 4.654.530 Arab tourists). As a consequence of the sanctions imposed by the Arab League and the EU tourism arrivals will plunge sharply. The sanctions will negatively and fundamentally affect the tourism sector mainly by banning nationals of LAS countries from travelling to Syria and asking those in Syria to leave immediately leading to cancellations in holiday bookings and hotel reservations. Even thought the religious tourism (e.g. to visit religious shrines) arrivals have not been

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banned; tourism in Syria is now at almost zero level.

Humanitarian impact

At this stage the situation is a human rights crisis and not a humanitarian crisis, nonetheless the existing displacement situation plays a role in the assessment:

- Displacements stemming from the violent response to the popular demonstrations starting in March 2011 see the majority of people returning to their homes once the military leaves[vi]. Considering the possibility of destruction of buildings and infrastructure together with the lack of (government) funds for rebuilding will prolong the periods of displacement.[vii] Almost three million people (out of a population of 21 million[viii] with an 8.4 per cent unemployment rate) are considered to be affected by the civil unrest beginning in March. To date, the bulk of the humanitarian response has been carried out by the Syrian Arab Red Crescent, and the Syrian people, but growing needs have led the Red Crescent to request additional support to feed 1.5 million people. UN agencies and national Governments are providing assistance to Syrian people in camps in Turkey[ix]. The inflow of refuges is likely to increase as soon as the sanctions take hold.

Other elements to take into account

The sanctions will have a number of spillover effects. For example, Syria is the 6th largest investor in Saudi Arabia, the second largest in Jordan. Another impact hard to evaluate but sizeable is the rise of transportation costs as Syria is one of the most active air space.

Tourism and investment to Lebanon might be impacted as well. A regional crisis is not unlikely.

The role of Syria's neighbours will be crucial. As during similar events, it is likely Syria will find options to bypass the sanctions. Iran seems to have offered Syria assistance in the form of 290,000 b/d of free oil over the next month. Lebanon could also offer an alternative route to trade in exchange of the payment of a small tax.

On the foreign aid side, upon Les Echos (French newspaper) Iran could to consider offering $5.8 billion in financial help, including a three-month loan worth $1.5 billion to be made available immediately.

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[i] Lebanon officials send out conflicting signals concerning the implementation of the sanctions: e.g. "Lebanon will enforce Arab League sanctions imposed on neighbouring Syria even though it did not back the punitive measures, Economy Minister Nicola Nahhas told AFP Wednesday" (http://www.dailystar.com.lb/News/Politics/2011/Nov-30/155622-lebanon-to-enforce-arab-syria-sanctions-minister.ashx#axzz1fNbsLqf9)

[ii] ESCWA's Social & Economic Survey

[iii] EIU 10 November 2011

[iv] 1) small improvements concerning the unemployment rate (see figure 1) and by the following in the last decadeiv, but significant yearly losses of jobs in agriculture, mostly for women (at a much higher rate than expected from the aggregate data on the reactivated rural-urban migration), while the job creation in urban areas, in particular in industry, services and tourism, are not able to cope with the increasing demand on the labour market (e.g. outside agriculture, 105,000 jobs were created yearly: 90,000 for men and 15,000 for women. Most of the urban women jobs created were by the public sector; but this was far from compensating the effect of women jobs losses in agriculture); 2) Gender disparity: During the period from 2001 to 2007 only a net average creation of 36,000 jobs yearly was achieved with men gaining 65,000 jobs per year and women losing 29,000 jobs; 3) Data for the 2008 LFS shows that, in net, 98,000 jobs have been lost in one year: men have lost 141,000 jobs while women have gained 43,000 jobs; the youngest being the major losers.

[v] October 2011, http://www.yourmiddleeast.com/news/arab-spring-sparks-sharp-fall-in-foreign-investment_1945

[vi] Internal displacement monitoring centre (11 November 2011): SYRIA - State policies and military actions continue to threaten further displacement http://reliefweb.int/sites/reliefweb.int/files/resources/syria-overview-nov2011.pdf

[vii] International humanitarian agencies were denied access and therefore no reliable figures on either temporary or longer term displacement in Syria are available, however: Internal displacement monitoring centre (11 November 2011): "Protesters have reported the destruction of their homes and farmland in military operations, particularly in Dara'a, Tel Kalakh and Jisr Al-Shughur. The entire 41,000 population of Jisr Al-Shughur reportedly fled in June in fear of military retaliation following the death of some 120 security personnel there. That month it was also estimated that about 70 per cent of the 100,000 population of Maarat al-Numaan had been displaced. Nearly all the Palestinian refugees in the camp of al-Ramel were displaced in August, and sought refuge in other cities such as Homs, or on the beach or elsewhere in Latakia. As with most displacements in 2011, camp residents returned within a week (HRW, July 2011). Syrians who have fled to Jordan, Lebanon and Turkey have confirmed such reports of temporary internal displacements." (p. 5)

[viii] This includes thousands who have fled the country, and many more who have sought refuge with family and friends away from their homes. The impact on the Syrian population will vary depending depending on which part of the population we are talking about (e.g. 2.4% Palestinian refugees, 1.8% non-citizen Kurds and 7.9% Iraqi immigrants). Source for the figures : Samir Aita (2009): Labour Markets Policies and Institutions, with a Focus on Inclusion, equal Opportunity and the Informal Economy - National Background Paper (The case of: SYRIA). Available: http://www.economistes-arabes.org/Cercle_des_economistes_arabes/Samir_Aita_files/Ilo-aita-summary.pdf

[ix] The Emergency Relief Coordinator's key messages on Syria dated 25 November 2011 (http://reliefweb.int/node/461481)

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