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ABBREVIATIONS USED IN THE TEXT

BoP	Balance of Payment
CBS	Central Bureau of Statistics
CPI	Consumer Price Index
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
ISMF	Institutional and Sector Modernisation Facility
KT	Kilotons
KWh	Kilowatt-hour
SPC	Syrian Petroleum Company
SETB	Syrian Economic Trends Bulletin
SITC	Standard International Trade Classification
SPC	State Planning Commission
SYP	Syrian Pound
US	United States
USD	United States Dollars

PREFACE

We are delighted to present the third issue of the Syrian Economic Trends Bulletin. Unfortunately, because of the delay in publishing the statistics by the official statistical agencies in Syria, we are not able to present a large size bulletin. We also regret that we have not received so far any contribution from Syrian Economists. Therefore, the third issue consists of three chapters and one appendix. The first chapter focuses on measuring the impact of subsidies on Syrian economy, all evidence indicates that the amount of subsidies significantly burdens the government budget. The second chapter presents the new National Accounts data and provides a comparison with previous version, as well as with SETB estimates: it seems that, despite the world crisis, growth is continuing its uprising trend, as was indicated in previous issues of the Bulletin. The final chapter is designed to assess the recent evolution of foreign trade in Syria, it shows that the trend of export and import diversification in Syrian foreign trade deepens. The appendix focuses on the recent flourishing informal market of “Mazout Coupons” which undermine the essence of the subsidy policy in Syria. All these texts constitute a basis for further discussion and we do hope that Syrian economists will react to the views expressed in the present issue.

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CHAPTER I

WHAT IS THE AMOUNT OF SUBSIDIES IN SYRIA?

Subsidies are everywhere in Syria : refined oil products are sold to the final consumer at a much lower price than crude oil; specific types of bread and sugar are officially sold “at a subsidised price”, farmers are subsidised, most notably cotton and wheat producers, and so on so forth. The resulting price distortions in those key sectors modify the whole set of relative prices, costs and profitability, and translate into inefficiencies in the allocation of resources, with manpower employed in sectors where output may be less valuable than the inputs used, and resources may be consumed in domestic activities instead of being exported. As a result, Syria might not have the appropriate type of specialisation and international trade it should have. Some kind of effective protection emerges, undermining the long term development of the country.

Still, a close look at the Syrian government budget hardly reveals any kind of expenditure on subsidies. Usually, one of the key problems with subsidies is that they put an extra weight on budget expenditure and may therefore contribute to an unsustainable deficit while strangling the contributing capacity of the economy at the same time. The Syrian subsidisation mechanism is all but transparent: even if reliable budget data was available, complex calculations would be necessary to determine how much each type of sector or firm receives directly or indirectly (under the form of implicit subsidies). Such calculations would help to figure out the degree of effective protection in the country. But budget data is not available: detailed figures on subsidies are not published, mostly because the activity of the Ministry of Finance does not comply with standard rules of public funds management; subsidies – as well as most other expenditure – are paid neither on a regular cash basis, nor on an accrual basis. They may be paid very irregularly and through a number of channels, for instance from a credit institution (which ultimately gets its money back at another period, unless it keeps piling up and turns into a batch of bad loans), from special in-budget or off-budget funds, or through the accumulation of business-to-business debt, or simply through cross-subsidisation within a single company, when losses in one of its activities are offset by profits in another activity.

Subsidies are thus often “implicit”, which does not mean that they do not exist: in principle, a profitable business with just a non-profitable activity should downsize that activity and re-direct its resources towards high return operations. In way, a firm that keeps a non-profitable activity going implicitly subsidises that activity while implicitly taxing other activities in the same amount. Both these implicit taxes and subsidies should be taken into account in order to measure the resulting loss of resources. It is however extremely difficult to determine the overall yearly amount of subsidies, which would be needed to build reliable national accounts and provide policy makers with good instruments of macroeconomic regulation.

The purpose of this paper is to produce a mere estimate of the amount of subsidies in Syria, along with a methodology to estimate them on a yearly basis. The key point in our estimation of subsidies is to consider that, once a company suffers a current loss (that is when its gross sales are less than its total current expenses), then it needs a subsidy. Of course, one may argue that such a firm may get a credit. This would be true for a start-up

business; however, we doubt that many large Syrian enterprises fit the description. Even if a current loss is financed by a credit, this credit will very likely turn into a “bad loan”, and will never be paid back. We consider that as an implicit subsidisation. In our view, the best way to measure subsidies in Syria is to determine the public sector’s current losses.

To that end, we use accounting documents produced by various trade organisations and companies, showing their costs, turnover and the resulting current loss or benefit on a yearly basis. Those documents, known as “monitoring reports”, are centred on the year 2006 but they also include some information on 2005 and 2007. The most interesting part of our methodology is to compare value figures in Syrian Pounds with volume figures in tons, cubic metres or whatever physical units, in order to get price comparisons. Of course, we are not able to determine precisely the amount of subsidies, because most of those organisations or companies are multi-product and cross-subsidisation within companies is widespread. But at least, one may get a rough idea of the burden of subsidies in Syria, with the purpose of integrating that estimate into the national accounts.

There are mainly three economic sectors in which subsidies play an important role in Syria: 1) the oil-gas-energy complex, including oil extraction, refining, oil products distribution, electricity and gas generation and distribution; 2) the agro-food complex, with cereals culture, flour milling, bread baking, bread, sugar and rice distribution; 3) the cotton growing and ginning industry. There is evidence that of these large sectors, the first one has taken the lead regarding the extent of subsidisation. That is why we concentrate the present paper on the fuel energy complex, leaving out the two other sectors for future research.

1) OVERVIEW OF THE FUEL-ENERGY COMPLEX

The fuel-energy complex comprises several stages of production: extraction is of course the first stage for both oil and gas. Two domestic companies are active here: the Syrian Petroleum Company (SPC) and the Gas Production Company. But oil production is shared with foreign companies, so that SPC represents 45% of the total turnover and production in 2006. Syrian output of oil is partly exported (41% in 2006, down from 48% in 2005 and declining to 39% in 2007), and partly refined in the two domestic refineries of Homs and Banyas. Refineries are supposed to process domestic crude exclusively, and there is no import of crude by Syria. They export a small share of their output (5% in 2006) and the bulk of refined oil products is either delivered to the Electricity Generation Company for purpose of producing electricity (29%), or delivered to the Mahrukat Company, mostly involved in the distribution of refined oil products. Mahrukat delivers oil products to final consumers, whether households, smaller distributors, final user industries or transport companies. But Mahrukat also imports rather large quantities of oil products (34% of its sales); by contrast, its exports are marginal (2% of sales), as are deliveries to electricity generation facilities (6%). On the side of the Gas Production Company, gas is either delivered to electric power mills, or made liquid and transferred to the Gas Distribution Company for sale to final users.

Electricity generation relies in Syria on three main sources of inputs: as was just said, the first source (60% of generated power) is fuel-oil, a refined oil product delivered either by refineries (the largest part) or by Mahrukat. The second source (27%) comes from gas delivered by the Gas Production Company. The third source (13%) is the Euphrates river dam. In surplus, the Electricity company imports and exports electricity in relatively

small amounts with neighbour countries. Next, there is a separation between generating activities and distribution. The Electricity Generating Company delivers its output to the Electricity Distribution Company, which in turn delivers it to final consumers (households, municipalities, industries etc).

Having presented the whole set of activities and firms of the fuel-energy complex, we may now take a closer look at each of the actors.

2) THE OIL-EXTRACTING COMPANIES

It is difficult to disentangle the SPC from foreign oil companies: there is scarce information about the volumes produced by the SPC. What we know is that in 2006, the gross output of the SPC was 188,033 million SYP, while the total gross output of the oil-extracting industry was 421,827 million SYP. We also know that the sales price applied to the volumes produced is the international price, whether the output is sold domestically or exported. For a total output of crude oil of 19,679 KT (kilotons), corresponding to 22,933 thousand cubic metres or 144.2 million barrels, we get an average price of 2925 SYP per barrel, or 58.50 USD per barrel. In 2006, the average price for Dubai oil quoted by British Petroleum was 61.50 USD per barrel, which more or less matches the Syrian average price.

For an output of 422 billion SYP, the oil-extracting sector (that is both the SPC and foreign companies) had 24 billion SYP worth of intermediate consumption, 17 billion SYP worth of capital depreciation, and approximately 20 billion SYP in wages (including foreign workers' wages). These figures leave the sector with a significant gross surplus of 341 billion SYP, and there is of course no need for subsidies here.

3) THE GAS PRODUCTION COMPANY

The same goes for gas-extraction, although prices are not as easy to read as for crude oil. The reference to world prices is more distant, as international trade remains limited by physical constraints on transport and storage. Up to 2006, the price of natural gas was billed at 1 SYP per cubic metre, and it jumped to 2.40 SYP in 2007; however, this hike did not prevent a decline in the value output of the company over the same year 2007, because one type of liquid gas saw its price decline from 30 to 9 SYP per kilo. There are various types of products in the sector ("clean gas" which is processed natural gas, household gas, liquid gas, sulphur, but let's note here that butane gas cylinders are produced by oil refineries) but the main company's top clients remain the independent Gas Distribution Company and the Electricity Generation Company. Different products have different prices but on average, for an output of approximately 5,500 million cubic metre, the value output of the sector (and thus of the gas production company) was 29,146 million SYP in 2006, leading to an average price of 5.30 SYP (or 11 US cents) per cubic metre. Liquid gas was sold at a price of approximately 30 SYP per kilo in 2006. On the costs side, there is very little: 507 million SYP worth of intermediate consumption, 1,171 million SYP worth of capital depreciation, and an unknown wage figure which may nevertheless be estimated between 0.5 and 1 billion SYP. The company is thus profitable (26.5 billion SYP) and no subsidies are needed.

4) REFINERIES

There are two important refineries in Syria, Homs and Banyas. These refineries purchase crude oil from the SPC at the international price and sell refined products at a price which is administratively set. Refined products are numerous and have different prices: butane, gasoline (benzin), diesel (mazout), naphtha, kerosene, were all priced between 32 and 36 SYP per kilo in 2007, while the international price for these products was 0.72 US dollar or 36 SYP per kilo (95.6 USD per barrel in the case of diesel); fuel oil, asphalt and other products were cheaper, around 18-20 SYP per kilo; lubricants were more expensive, at 74 SYP. The first category accounts for more than half of the total volume of refined products; the last one is very small (1%). The average price of all refined products was thus approximately 26 SYP per kilo in 2007, slightly higher than the price of crude oil, which stood at 25 SYP. Such a gap is not sufficient to ensure the profitability of refineries, especially taking into account that there are other inputs in use in the process of refining. Some of those inputs (such as “non material inputs”) have been included in the monitoring reports in 2007, so that the accounting frameworks are not totally comparable. In 2006, the average price of refined products stood at 20.8 SYP per kilo, whereas the price of crude was at 22.5; in 2005, those prices were respectively at 12.8 and 21.9. The situation has improved slightly in 2007 (the price of refined products is above the price of crude), however not enough to make the industry profitable.

Table 1.1
Costs and sales of refineries (million SYP)

	2005	2006	2007
Total sales of output	171,264	271,644	318,159
Intermediate consumption	241,167	290,508	357,787
of which: crude oil	238,292	261,157	293,659
Wages	2,700	2,721	2,711
Capital depreciation	605	648	700
Indirect taxes	22	24	23
Total costs	244,493	293,901	361,221
Losses = subsidy	73,229	22,257	43,062
Total refined products (kilotons)	13,388	13,026	12,136
Total crude oil consumed (KT)	10,882	11,607	11,762

Source: monitoring reports and estimates by the author

Table 1.1 shows that the subsidy to refineries has declined in 2006 with regard to 2005, only to bounce back in 2007. The first movement came over an administrative change in refined products prices (especially fuel-oil), which jumped by 60%, while the price of crude oil was increased by a lesser percentage. But in fact, as prices remained stable at the final consumers end, the change in the sale price of refined products has been offset by a transfer of subsidies from the refineries to the distribution company (see below). The second movement is due mostly to the incorporation of new cost items in the total “intermediate consumption”. Had these new costs been left out from the calculation of total costs, the subsidy to refining activities would have disappeared in 2007; however, these costs must be accounted for, and there should be something added to the results of years 2005 and 2006, rather than removed from 2007 results. What can be noted is that the amount of subsidies to refineries is in the range of 0.8 billion USD in 2007.

5) OIL PRODUCTS DISTRIBUTION COMPANY (MAHRUKAT)

Moving down the fuel-energy process from extraction to final uses, it seems that the first stages are profitable, whereas secondary stages (refining) need subsidisation. The following stage is the distribution of oil products. It is organised through a special company called Mahrukat which either buys fuels from refineries at the stated administrative price, or imports them at the international price, and then resells to consumers (households, businesses, smaller distributors) at a government-controlled price, lower than the administrative purchase price. Table 1.2 shows the balance of income and expenditure of Mahrukat.

Table 1.2
Costs and sales of Mahrukat (million SYP)

	2005	2006	2007
Total gross sales	102,277	153,745	182,452
(excluding discount)	480	600	714
(including secondary revenue)	65	75	85
Purchases for reselling	123,234	331,406	447,629
Intermediate inputs	2,548	3,121	3,670
Wages	1,160	1,351	1,342
Capital depreciation	264	308	339
Indirect taxes	16,602	20,750	15,067
Total costs	143,808	356,936	468,046
Losses = subsidy	41,531	203,191	285,594
Domestic purchases (KT)	5,669	8,682	9,678
Imported products (KT)	3,320	4,240	6,659
Exported products (KT)	70	223	92
Total domestic sales (KT)	8,914	12,383	16,544

Source: monitoring reports and estimates by the author.

Total domestic sales in kilotons may not add up to indicated components because of inventory changes

Several remarks should be made about the above figures:

1) There is an enormous jump of subsidies between 2005 and 2006, followed by another significant rise in 2007. As was already said in the refineries section, these movements are due to a change in the purchase price granted to refineries, against a background of unchanged sale prices; another explanation points to changes in the market covered by the company (for instance fuel-oil was not traded by Mahrukat in 2005). Comparing sale and purchase prices using value data and volumes shows that the average sale price (both domestic and exported sales) has been 11 SYP per kilo in 2005 and 2007, and 12 SYP in 2006. The average purchase price per kilo (both from refineries and from import) went up from 14 SYP in 2005 to 26 in 2006 and 27 in 2007. The (negative) price differential applied to volumes traded leads to subsidies of approximately 21 billion SYP in 2005, 167 billion SYP in 2006 and 265 billion SYP in 2007 (compared to actual figures of 41 billion, 203 billion and 285 billion). Where does this difference come from? The answer is given in the following point.

2) The second remark about table 1.2 is that there are both subsidies received by Mahrukat and taxes paid by this same organisation; how is that possible? First, let's note that the figures for taxes are quite high compared to the taxes paid either by the SPC or by refineries. This high level of taxes is the very reason why price differentials do not account for the total of subsidies received by Mahrukat. But it also indicates that among the numerous products traded by Mahrukat, there are some on which taxes may be levied and others on which subsidies are required. A detailed examination of Mahrukat monitoring report shows that gasoline (benzin) and lubricants do not need subsidies, unlike mazout, fuel-oil and kerosene. In 2006, benzin is bought at 25 SYP per litre from refineries and sold to consumers at 30 SYP. Mazout is sold at 7 SYP and bought from refineries at 24 SYP. In short, subsidies pertain to a limited number of products, but for which we observe a wide price differential (between purchase and sales price).

3) Third, domestic consumption has also increased in volume, due to relatively low prices: benzin consumption has increased by 20%, mazout consumption by 10% between 2005 and 2006. In 2007, benzin consumption again increased by 10%, mazout consumption by 8% and fuel consumption by 125%. Of course, purchase price increases are the major explanation for growing subsidies, but volume increases should not be forgotten.

6) GAS DISTRIBUTION COMPANY

Gas trade and distribution was formerly part of Mahrukat (or of the previously existing company Sadkop). It broke away from Mahrukat in 2004 and started working independently in 2005. It retains however the same principles of functioning as its mother company, that is purchasing gas from the Gas Production Company at a relatively high price, and reselling to final users at a low price, with both prices under government control.

The liquid gas was purchased domestically from the gas production company at 33 SYP per kilo in 2007, which amounts more or less to the "household gas" price appearing in the monitoring report of the Gas Production Company. The Gas Distribution Company also imported gas at a price of 34 SYP per kilo (459 KT were purchased domestically, while 371

Table 1.3
Costs and sales of the Gas Distribution Company
(mn SYP)

	2005	2006	2007
Total gross sales	9,525	10,700	11,733
(excluding discount)	241		
(including secondary revenue)	20		
Purchases for reselling	15,127	21,800	27,300
Intermediate inputs	433	500	550
Wages	250	250	250
Capital depreciation	0	0	0
Indirect taxes	0	0	0
Total costs	15,810	22,550	28,100
Losses = subsidy	6,285	11,850	16,367
Traded liquid gas (kilotons)			840

Source: monitoring reports and estimates by the author

KT were imported). Overall, the Company incurred a significant loss, which outweighed the value of sales in 2006 and 2007.

7) ELECTRIC POWER GENERATION AND DISTRIBUTION COMPANIES

An important client of both oil and gas industries is power plants. In Syria, power generation and distribution have been separated into one independent entity producing electricity on one hand, and fourteen regional distribution establishments, one for each mohafazat, on the other hand. However, every one of those fourteen public companies functions as a bilateral monopoly, since there is no competition between distribution outlets; exports and imports remain rather weak in this sector, and the generating company is still in charge of international trade. The electricity generation company buys fuel from refineries or from Mahrukat at government prices or buys gas from the gas production company, or directly receives electricity generated by the Euphrates river dam. It produces electricity and sells it to the distribution establishments at cost price. The distribution outlets re-sell electricity to final consumers at government price, which as a rule is less than the purchase price, making the deal even worse for those establishments that have to cover high power distribution expenses, since maintaining the whole network down to every home is a rather labour-consuming task (there is around 30,000 employees working in power distribution).

In order to have a benchmark for assessing the whole generation and distribution system, we refer to the year 2006, on which we have detailed data. Table 1.4 shows production costs and revenues of the generating part of the system.

The first line shows total power output in physical units (in million Kilowatt-hour) and in value (million SYP). The last column gives the resulting average price of one KWh sold to distribution outlets. The three following lines show the various types of fuels used in power

Table 1.4
Costs and sales of the Power Generation Company
(2006)

	Volume (mn KWh)	Value (mn SYP)	unit cost or price (SYP)
Total output of electricity	36,418	46,158	1.27
hydro-power (Euphrates)	931	2,807	0.71
produced with fuel-oil	20,848	36,440	1.75
produced with gas	11,639	8,405	0.72
Purchases from Euphrates co.		1,146	
Fuel-oil used (1-st col in KT)	4,462	27,643	6.20
Gas used (1-st col in MM3)	3,484	3,484	1.00
Taxes		58	
Wages		1,906	
Capital depreciation		6,516	
Other expenditure		6,899	
Total costs except fuels		15,379	0.42
Total costs incl. fuels		47,652	1.31
Losses = subsidy		1,494	

Source: monitoring reports and estimates by the author
Note: MM3 is for "millions of cubic metres"

plants and their respective electricity output in million KWh. Matching figures indicated in the second tab result from a calculation of the total cost of each type of fuel: this total cost includes the direct cost of the fuel itself (or of hydroelectricity) plus a share of other costs corresponding to the share of the type of plant in total power production. The direct cost of fuel is shown in the three following lines: for instance, it needs 4,462 KT of fuel oil to produce 20,848 million KWh, at a cost of 27,643 million SYP. But there are costs, other than direct, listed in the following lines (taxes, wages etc, amounting to 0.42 SYP per KWh) which should be added to each direct cost ; these indirect costs are attributed to each type of fuel in proportion to their respective share in output. Following up with the same example, the full cost of using fuel-oil is 36,440 million SYP.

The average price of one KWh is 1.27 SYP, whereas the average full cost of production is 1.31 SYP, with rather large differences between types of fuels: fuel-oil-generated electricity costs 1.75 SYP per KWh, while gas-generated electricity costs 0.72 SYP only. It is clear however that the low price of gas (1 SYP per 1 cubic metre in 2006) is responsible for this good performance. In 2007, with the price of natural clean gas rising to 2.40 SYP per cubic metre, the cost of one gas-generated kilowatt-hour would rise to 1.20 SYP. In the same way, with fuel-oil prices rising from 6 SYP per kilo in 2006 to 17.6 SYP in 2007, the cost of fuel-oil generated electricity would jump to 4.50 SYP per KWh. It is thus understandable that the total costs of the Electricity Generation Company should rise in 2007. From there, one of two things can happen: either subsidies to that company also rise (if sales prices to distribution establishments remain at the same level), or sale prices rise in order to maintain a balance between costs and sales.

Either way, the total subsidy to the consolidated “electricity system” comprising generation and distribution activities would remain the same. First, let’s get the big picture of costs, prices and subsidies by establishing the balance of electricity distribution outlets for the years 2005-2006.

Table 1.5
Costs and sales of Power Distribution Outlets
(2005-2006, million SYP)

	2005	2006
Total sales	36,603	42,392
Purchases for resale		42,547
Other inputs		1,572
Total intermediate consumption	42,328	44,119
Indirect Taxes	44	47
Wages	5,200	5,567
Capital depreciation	2,540	2,053
Total factors cost	50,112	51,787
Total loss = subsidy	13,509	9,395

Source: monitoring reports and estimates by the author

The main problem between power generation and distribution is losses in the network. Distribution outlets sell electricity which is really consumed by households, businesses or municipalities, whereas the output recorded by the generation company leaves out losses. There is an output of 36,418 million KWh in 2006, but total consumption amounts only to 22,934 million KWh, of which 55% goes to residential and commercial. The households’

price of electric power was 1.51 SYP per KWh, leading to an average price of 2.26 SYP per KWh for businesses and organisations. In 2007, there have been changes in the households' price, which may be estimated for the whole year at 1.67 SYP/KWh, and we will assume that the price charged to other final users remained at 2.26 SYP.

We are now able to approximate the subsidisation in the electric power system (both generation and distribution) for the year 2007. Table 1.6 calculates the total cost of electricity generation, which table 1.7 takes and uses to calculate the loss of electricity distribution establishments.

Table 1.6
Calculation of the full cost of electricity generation
in 2007

	Production		Fuel consumption		Direct cost of fuels		Indirect costs		Full cost of electricity generation mn SYP
	share (%)	mn KWh	unit input	total consum.	price of fuels	fuel cost mn SYP	indirect costs/unit	total in mn SYP	
Hydro	12	4,560	1	4,560	0.71	3,238			
Fuel-oil	58	22,040	0.214	4,717	17.6	83,011			
Gas	30	11,400	0.299	3,409	2.4	8,181			
TOTAL	100	38,000				94,430	0.42	15,960	110,390

Source: monitoring reports and estimates by the author

Total fuel consumption is in million KWh for hydro-electricity, in kilotons for fuel-oil and in million cubic metres for gas. Prices of fuels are in SYP per these same physical units

The base for Table 1.6 is production for domestic uses (38,000 million KWh). It is shared between the three basic production technologies according to previous year ratios. From there, fuel consumption is determined, which allows in turn (through 2007 prices) to determine the direct cost of fuels. Indirect costs are kept at the level of 2006, leading to the final result, the full cost of electricity generation. We can now integrate this production cost into the costs of electricity distribution.

Table 1.7
Balance of the electricity distribution outlets
for 2007

	Quantities in mn KWh	Prices in SYP/KWh	Values in mn SYP
Total power generation	38,800		
Losses in the network (35%)	14,100		
Total sales by distribution est.	24,700		47,807
To households (55%)	13,585	1.67	22,687
To others (45%)	11,115	2.26	25,120
Purchase for resale			110,390
Losses = subsidy			62,583

Source: monitoring reports and estimates by the author

Table 1.7 is the extension of Table 1.6: it takes for granted that the cost of electricity generation should be taken into account one way or another. We thus obtain a consolidated balance for the whole electricity system, showing that the total loss for the system should be within the range of 62 billion SYP in 2007, compared to 11 billion SYP in 2006, and 13 billion in 2005. This spectacular jump in the financial losses of the electricity system is mostly due to rising fuel-oil and gas prices. The problem is that these price rises have only partly improved the situation of refineries, which remain largely subsidised; the only positive impact is that the level of subsidisation of refineries is probably less than what it would have been without the price rise in fuel-oil, and that the gas production company has probably increased its profits.

8) PUTTING THINGS TOGETHER

Having reviewed each of the components of the fuel-energy complex, we may now draw a general balance sheet and measure the total amount of subsidisation supporting this sector. Table 1.8 shows all the subsidies we have detected in the previous paragraphs.

Table 1.8
Summary of subsidies
in the fuel-energy complex
(million SYP)

	2005	2006	2007
Oil refineries	73,229	22,257	43,062
Oil distribution (Mahrukat)	41,531	203,191	285,594
Gas Distribution Company	6,285	11,850	16,369
Electricity (generation & distribution)	13,509	10,889	62,583
Total fuel-energy subsidies	134,554	248,187	407,606
GDP at current prices	1,493,766	1,698,480	2,019,810
Share of FEC subsidies (% of GDP)	9.0	14.6	20.2

Source: estimates by the author

The total subsidies to the fuel-energy complex grew by 84% between 2005 and 2006, and again by 64% between 2006 and 2007. Over the same period of time, GDP (official data) rose in nominal terms by 13% and 19%. Accordingly, the burden of subsidies on the economy thus rose from 9% in 2005 to nearly 15% in 2006 and to 20% in 2007. These are extremely high figures by world standards. Of course, implicit taxes compensate partly implicit subsidies, so that the item “taxes net of subsidies” in the National Accounts might appear less negative than the figure obtained in Table 8. The distortions introduced by the price system in the Syrian economy are however huge, one of the most conspicuous being the image of citizens living close to the borders and transporting mazout in plastic bags to neighbour countries where – due to high taxes – prices are nearly 10 times higher than in Syria ; these undeclared but significant exports make it necessary to import more and more refined products at a high price in order to resell them at a low price, which in turn allows hidden re-exporting. Fortunately, the price reform introduced for mazout in April 2008 should begin to correct this behaviour. But other reforms are still pending : although the present paper does not deal with food products, a similar example might have been given with subsidised bread : at a certain point, the price of subsidised bread becomes so cheap that farmers buy bread to feed their cattle instead of industrial animal food.

In both examples above, low administered prices, which in principle seek to manage low inflation, paradoxically translate into higher inflation since consumers have more money to spend on products sold at a market price; in the same time, the real budget deficit grows and is financed by money emission. It is necessary to point that recent administrative price hikes on diesel fuel, electricity, water etc, do not even compensate for the general rise of the CPI: the April 2008 mazout price reform represents a rise of less than 30% whereas the CPI is growing at a rate of 20%; in one and a half year, the new price will have become lower in real terms than the old price. A permanent mechanism of revision of administered prices (for instance every quarter) should thus be introduced as soon as possible.

CHAPTER II

THE 2008 REVISION OF NATIONAL ACCOUNTS

At the end of November 2008, the Central Bureau of Statistics (CBS) released the final National Accounts figures for the year 2007. At the same time, it introduced significant changes in the 2005 and 2006 figures. The purpose of this Chapter is to update the presentation of National Accounts as compiled by the Central Bureau of Statistics for 2005-2007, and to compare the newly released figures with the ones that Syrian Economic Trends published in its second issue. As shown in the previous issues of SETB, the income method for calculating the nominal GDP is the most simple. Are the changes introduced by the CBS more consistent with our estimates?

National Accounts in Syria are limited to a calculation of the GDP according to the production method, with a distribution of the overall product by main end-uses. There are no accounts by institutional sectors, and research on building an input-output table is still in progress. However, some inconsistencies might be easily corrected. For instance, the first issue of SETB highlighted the fact that the construction sector, one of the fastest-growing sectors in Syria in recent years, had a contribution to GDP that was significantly understated. Table 2.1 shows that the construction sector had an added value of 45 billion SYP in 2006 according to the “old CBS data”, but the new figure for the same year is 62 billion SYP. This jump of + 50% with regard to 2005 goes in the right direction: there was a need for re-evaluating the contribution to GDP of this important sector of the Syrian economy. We may also note that the recently published figure for 2007 is 73 billion SYP, or a 18% rise of the sector, comparable to the overall growth rate of the nominal GDP ; this rise puts the share of the sector at 3.6% of the GDP, against 2.7% previously,

The Central Bureau of Statistics runs GDP accounts both in current and in constant prices. Estimates in constant prices are used in particular to measure the growth rate of the economy. For constant prices, the year 2000 is taken as a benchmark: all sales and purchases of productive units are priced at 2000 prices. As stated in SETB previous issues, adopting a system of base prices where fuel prices were very low may not be a good idea to get reliable estimates of growth. With those reservations in mind, we will review the presentation of GDP estimates in both systems of prices, before comparing the newly released figures with SETB estimates.

1) PRESENTATION IN CURRENT PRICES

The calculation of the GDP in current prices is not flawed with the limitations of constant prices estimates. The CBS begins by estimating the total output of each industry and then takes intermediate consumptions off that total in order to get the added value by sectors. Table 2.1 shows the difference between “old data” and “new data” for the years 2005 and 2006. The year 2004 underwent only very minor changes, and may be considered common ground to the old and new basis.

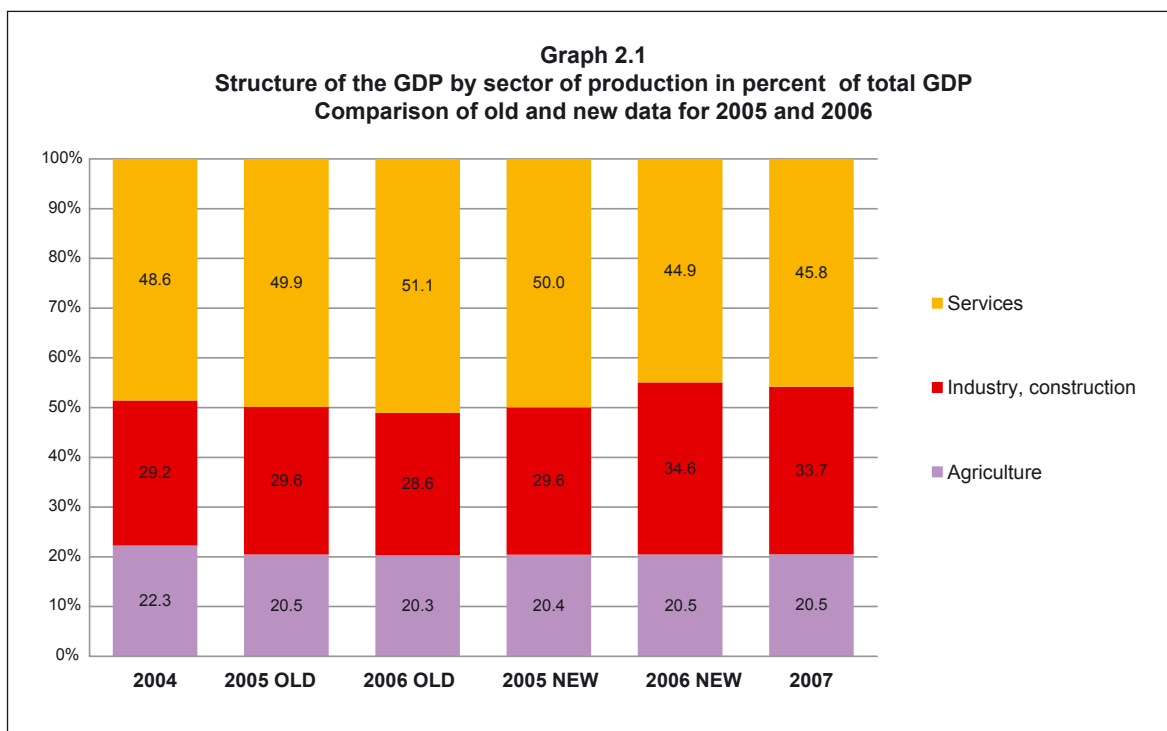
Table 2.1
GDP of Syria at market prices
by sectors of production and final uses,
in current prices, billion SYP

	2004	2005 OLD	2006 OLD	2005 NEW	2006 NEW	2007
Agriculture	281.2	305.3	347.4	305.3	347.4	413.9
Industry including mining	332	418.5	466.9	418.9	543.9	645.0
Construction	36.2	40.3	45.4	40.3	61.8	72.7
Trade	221.4	300.0	349.4	302.6	286.4	352.8
Transport & communications	141.6	160.8	192.5	160.8	182.2	201.2
Banking & insurance	53.3	74.0	103.4	74.0	84.4	112.3
Social and personal services	31.4	37.2	42.5	37.2	42.5	48.3
Government services	154	159.5	175.8	159.5	150.6	200.7
Non profit / non-govt services	0.7	0.8	0.9	0.8	0.9	0.9
Customs duties	22.6	22.9	17.2	22.9	32.9	18.8
Imputed bank services	-11.2	-28.5	-32.5	-28.5	-34.5	-46.8
TOTAL GDP	1263.2	1490.8	1708.9	1493.8	1698.5	2019.8
Final private consumption	810.0	993.1	1127.4	993.1	1122.7	1205.2
Final government consumptn.	197.9	206.6	218.8	206.6	194.9	248.3
Gross fixed capital formation	301.0	359.9	365.7	359.9	363.6	422.2
Public sector	141.3	167.2	188.4	167.2	188.4	178.3
Private sector	159.7	192.7	177.2	192.7	177.2	243.9
Machinery & equipment	153.9	187.2	188.5	187.2	192.8	221.2
Building & construction	147.1	172.7	177.2	172.7	170.8	201.0
Inventory change	-81.1	-98.3	-66.3	-95.3	-48.7	127.8
Export of goods & services	512.4	618.3	684.6	618.3	673.5	779.9
Import of goods & services	-477.2	-588.9	-621.4	-588.9	-607.6	-763.6
TOTAL GDP	1263.0	1490.7	1708.8	1493.7	1698.4	2019.8

Source: CBS Abstract. Differences in totals are due to rounding errors.

First, let's note that the changes in total GDP are relatively minor: 3 billion added in 2005, 10.4 billion subtracted in 2006. In principle, adding something in the first year and writing it off in the second year should lead to a decrease in the growth rate. In fact, we had a 14.6% growth in nominal terms with old data, down to 13.7% in new data. It remains to be seen whether this growth decline holds in constant prices.

Looking further into the causes of the overall change may be made easier by looking at percentage shares. Graph 2.1 shows the evolution of the sector structure of the GDP corresponding to Table 2.1. What does not appear on the graph is that – with old data – there was a constant increase of the share of services, from 42% of the GDP in 2000 to 51%. In 2006, on top of that, there was a constant decrease of the agriculture share, as well as of industry and construction. This has been reversed by the new data. The most significant change is a decline in the share of services from 51% to 45% in 2006 (figures for 2005 do not change very much). Over the same time frame, there is a rise of the share of industry and construction from 28.6% to 34.6%. Agriculture does not change significantly, and we've already said that construction share rose by 1%, which leaves manufacturing and mining industries with a gain of 5 percentage points. Unfortunately, we cannot go beyond this fact since the break-up by industries is not provided by the CBS National

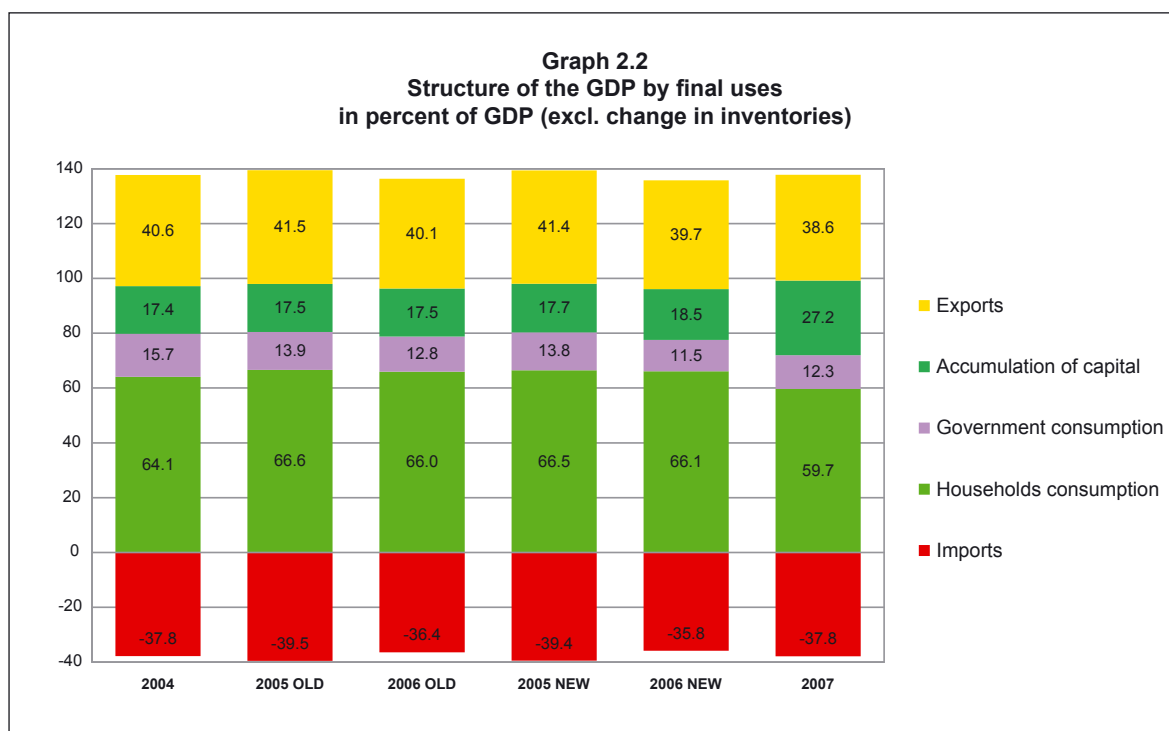


Source: CBS Abstract 2008

Accounts. It would be interesting to know whether the change was mostly due to mining (oil extraction) or to manufacturing.

Graph 2.2 shows the break-up of GDP by end-uses. The lengths of the bars do not add up to 100%, because imports are counted negatively: in 2006 with old data, for instance, the total of positive end-uses reaches 136.4%, as imports (-36.4%) should be deducted from that total. With new data, imports reach -35.8% of the total GDP, a figure which is not that different. What is really different between the two sets of data concerns investments (accumulation) and government expenditure. First, there is a substitution between the two categories of expenditure in 2006: in the new data, investment rises by 1 percentage point whereas government consumption declines by 1 percentage points.

But the most conspicuous changes take place in 2007: accumulation gains 9 percentage points with respect to 2006 new data, whereas government consumption gains nearly 1 percentage point. Where does this total difference of 10 percentage points come from? There is a reduction of exports by 1 percentage point while import “gains” 2 percentage points, which should be considered negatively and added to the export reduction. The 7 other percentage points gained by accumulation and government consumption come from a dramatic reduction in households consumption. Going back to Table 2.1, we see that households’ consumption went up by 7% from 2006 to 2007 in nominal terms, whereas total GDP rose by 19%. Investment rose 16%. But accumulation is the sum of investment and inventory change. That’s where things turned around in 2007: from a negative change of approximately 50 billion SYP in 2006 (Table 2.1, new data), we get a positive change of nearly 130 billion SYP in 2007. If one clusters inventory change together with investment, the “gross accumulation of capital” (fixed and circulating) increases by a huge 75% in 2007! Is such an increase possible, let alone credible? It is normal that inventory change may switch from negative to positive, or the other way around; but an increase in inventories accounting for 6% of the GDP is somewhat strange. The CBS would do well to comment such a rare phenomenon.



Source: CBS Abstract 2008

The largest share of end-uses is still household consumption (59.7% in 2007), followed by exports (38.6%) and imports (-37.8%). Gross accumulation of fixed capital represents 27.2%, and government consumption 12.3%. The picture that emerges from the 2007 data compared with new 2006 data is radically different from the one that we had in 2006 : if a 27% accumulation rate is really high by world standards, a households consumption share under 60% is really small by the same standards: with such ratios, Syria looks like China. But the external observer needs more details on the real content of these ratios in order to lend them some credibility.

2) PRESENTATION IN CONSTANT PRICES

Table 2.2 has the same structure as Table 2.1, but in prices from 2000. As was stated earlier, the use of 2000 prices may provide a distorted picture of the structural evolution of Syria. This is due to the spectacular change in oil prices during the period of observation, from 26 US dollar per barrel in 2000 to 61 in 2006 and 68 in 2007 (average yearly price at Dubai). However, the most interesting issues may arise from the observation of changes between the “old data” and the newly published ones for 2005 and 2006. Table 2.2 provides a picture of these changes in the GDP structure. (See table on the next page)

The most obvious change is in the 2005 growth rate, which jumped from 4.5% in the old data to 6.0% in the new data. This is quite a significant increase. The 2006 growth rate also increases, but by a mere 0.1 percentage point, from 5.1% to 5.2%. In 2007, the growth rate stands at 6.3%, a very good performance with regard to previous years: since 2000, only 2004 brought a better performance, with 6.7%.

The change in the growth rate between old and new data corresponds to an increase of the GDP by 17 billion SYP for 2005. If we look at the breakup by sector, we see that all sectors kept the same value except two: industry and trade. Industry added value declines by 7

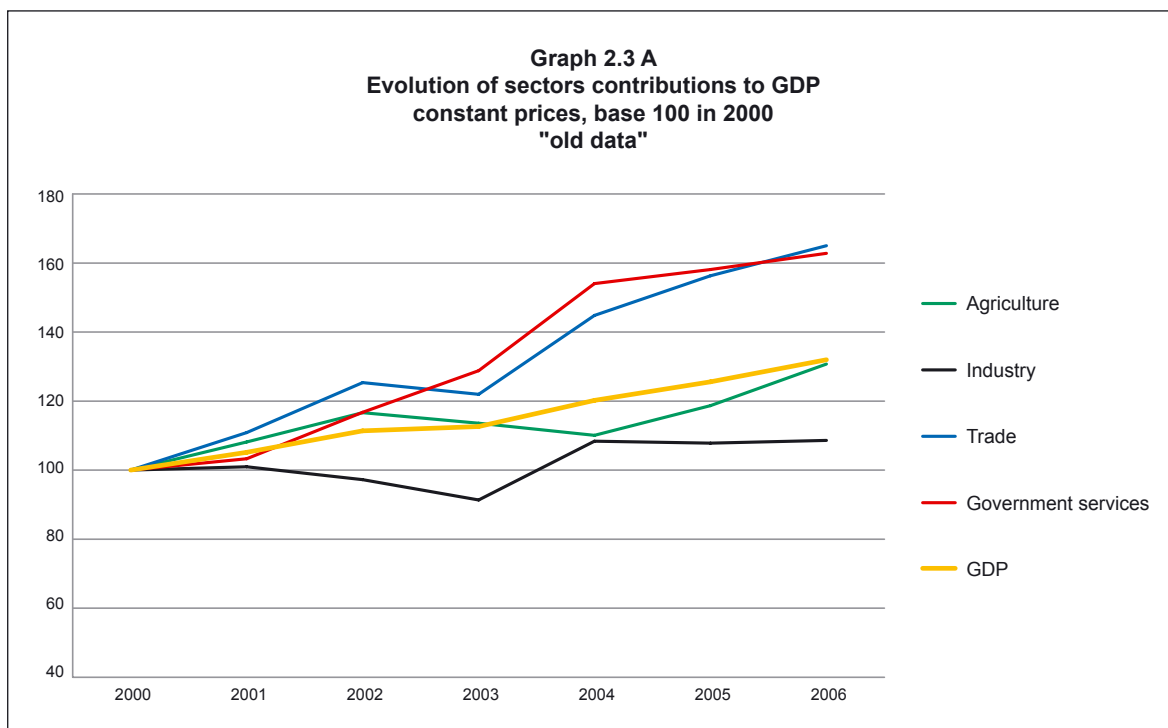
Table 2.2
GDP of Syria at market prices
by sectors of production and final uses,
in constant prices of 2000, billion SYP

	2004	2005 OLD	2006 OLD	2005 NEW	2006 NEW	2007
Agriculture	246.3	265.5	292.5	265.5	292.5	262.3
Industry including mining	295.4	293.8	295.9	286.5	288.1	296.3
Construction	32.5	36.4	39.7	36.4	50.6	55.1
Trade	194.6	210.1	221.8	233.9	222.2	262.8
Transport & communications	114.5	125.5	138.4	125.5	136.9	154.0
Banking & insurance	47.1	56.6	58.2	56.6	57.1	70.2
Social and personal services	27.6	31.3	35.6	31.3	35.6	39.6
Government services	117.7	120.8	124.4	120.8	128.7	165.8
Non profit / non-govt services	0.5	0.6	0.7	0.6	0.7	0.8
Customs duties	19.5	17.5	11.9	17.5	23.0	11.9
Imputed bank services	-9.6	-23.2	-26.5	-23.2	-24.1	-30.8
TOTAL GDP	1086.1	1134.9	1192.6	1151.4	1211.3	1288.0
Final private consumption	712.4	807.4	867.2	807.4	831.6	848.7
Final government consumptn.	156.1	159.1	161.3	159.1	161.6	199.6
Gross fixed capital formation	281.4	309.6	329.9	309.6	273.4	294.9
Public sector	135.8	146.7	164.9	146.7	129.7	136.4
Private sector	145.6	162.9	165.0	162.9	143.7	158.5
Machinery & equipment	147.7	161.3	203.1	160.7	136.5	142.9
Buildings & construction	133.7	148.3	126.8	148.9	136.9	152.0
Changes in inventories	-27	10.1	-166.6	26.7	-47.9	-2.3
Export of goods & services	381.1	375.4	528.5	375.4	452.6	459.0
Import of goods & services	-418.1	-526.8	-527.7	-526.8	-459.9	-512.0
TOTAL GDP	1085.9	1134.8	1192.6	1151.4	1211.4	1287.9
Growth rate of the GDP	6.7%	4.5%	5.1%	6.0%	5.2%	6.3%

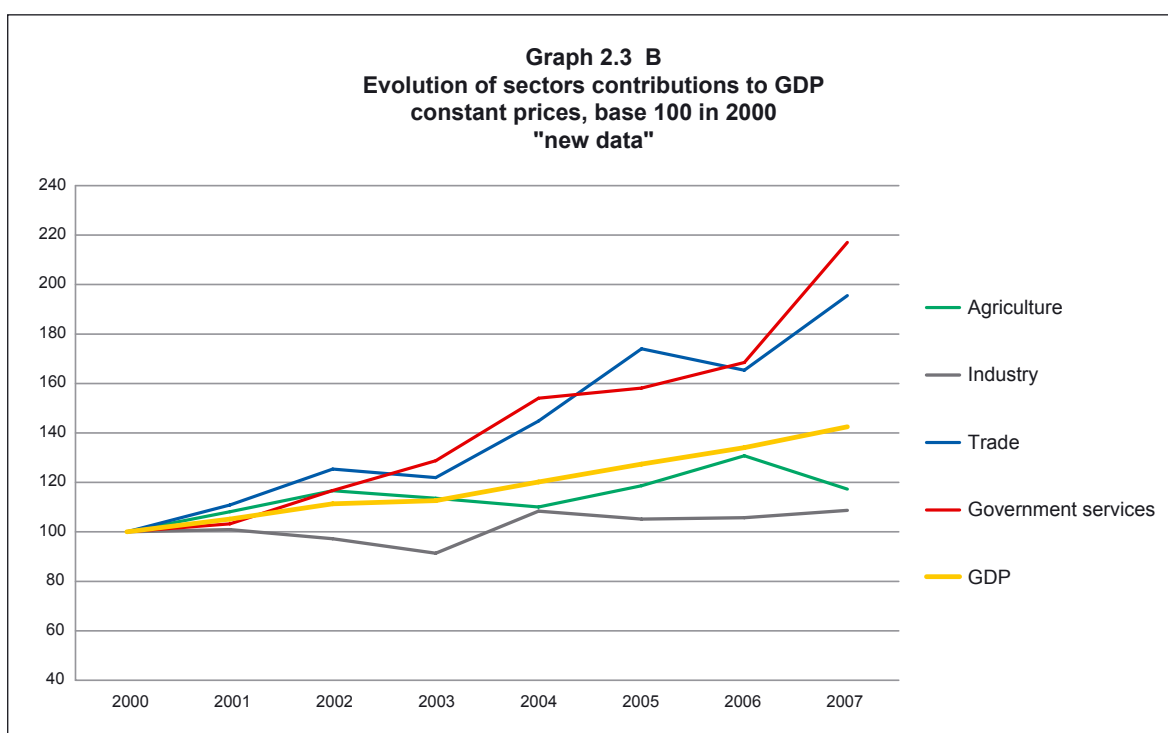
Source: CBS Abstract

billion SYP, whereas trade added value increases by 24 billion SYP. As for GDP uses, the only change lies in inventory change, which increases by 17 billion SYP, from +10.1 to +26.7, whereas in nominal terms, we had the figures -98.3 and -95.3. Despite this transformation from negative to positive, it seems rather logical that more trade accumulates more inventories. Trade is not limited to the small retail trade; it also includes the wholesale trade of Mahrukat for oil products and various General food product Establishments ; however, Mahrukat monitoring report states that this company accumulated inventories only up to 0.7 billion SYP in 2005. In 2006, it replenished its inventories by 6 billion SYP. As far as General food product Establishments are concerned, most of them show decreases of inventories in 2005 (whereas in 2006 there were some increases). In conclusion, there is a need to explain the nature of the 17 billion SYP inventory increase in 2005 in constant prices.

Moving on now to the year 2006, we see that the “new” GDP is 19 billion larger than the “old” one. The growth rate does not change significantly, because the 2005 figures have been increased by a similar proportion. The change in 2006 is more complex than the one in 2005. Five sectors, or components, show a change in their added value: industry (-8



Source: CBS Abstract 2007



Source: CBS Abstract 2008

billion SYP), construction (+11 billion SYP), government services (+4 billion SYP), customs duties (+11 billion SYP) and imputed bank services (-2 billion SYP). We already discussed the case of construction. Other sectors are difficult to comment because there is a lack of detailed information on what brought about those changes. It might be just a problem of re-allocation of some sub-activities that were attributed to one sector and then switched to another one; but many other causes are possible and explanations from the CBS would be a step in the right direction.

If we consider the uses side of the GDP in 2006, changes between “old” and “new” are even more striking. Households’ consumption loses 36 billion SYP, investment (gross fixed capital accumulation) loses 56 billion SYP, and inventory change gains 119 billion SYP. Export and import decline respectively by 76 and 68 billion SYP. Such changes are much more significant than for the year 2005. Moreover, it may be noted that customs duties are on the rise and imports are headed downward, both significantly. The dramatic move in inventory change might reflect a certain normalization of that indicator, since the old data showed a negative change of -166 billion SYP, definitely a non-credible figure (from what stock were they taken?), whereas with the new data it’s down to -48, which appears more reasonable.

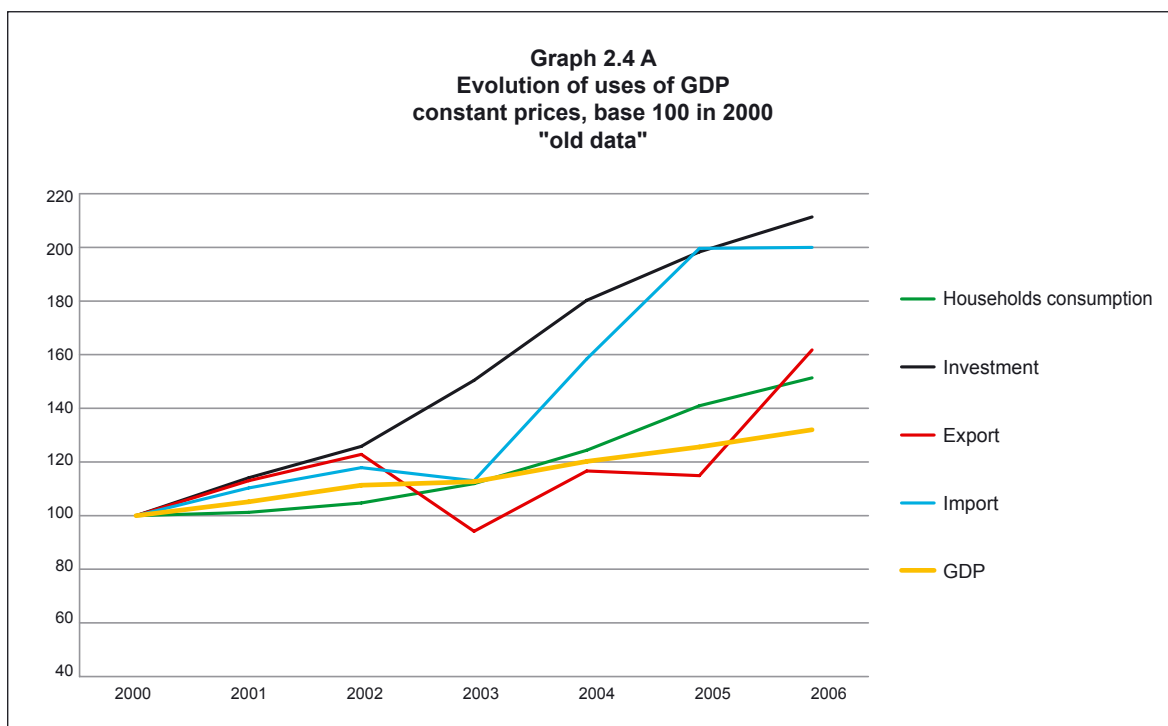
Graphs 2.3 A and B above (see previous page) show the evolution of some sectors’ added values over time (starting from the same basis 100 in 2000). The yellow curve in the middle represents the total real GDP. The first graph 2.3 A represents the “old data” evolution, whereas graph 2.3 B represents the “new data” evolution.

If we put the two graphs next to each other, we see that agriculture performance did not change over the 2000-2006 period; there was a drop in output in 2007, due to the bad weather conditions of that year. The trend of industry did not fluctuate very much either, although the curve of the new data runs a little below the old data one. As for trade, an important trend change took place in 2005 and 2006: with the new data, the sector suffers a significant crisis in 2006, which was not visible in the old dataset; however, this crisis is offset by a very significant growth of the sector in 2007. As far as government services are concerned, there is no change from 2000 to 2006, but the performance accelerates very significantly in 2007. What may have caused such a remarkable increase? Again, explanations are hard to come by: usually government services grow quite regularly, as they include vital public services such as education, health, police, army and administration. In conclusion, the most important trend change is in the trade sector.

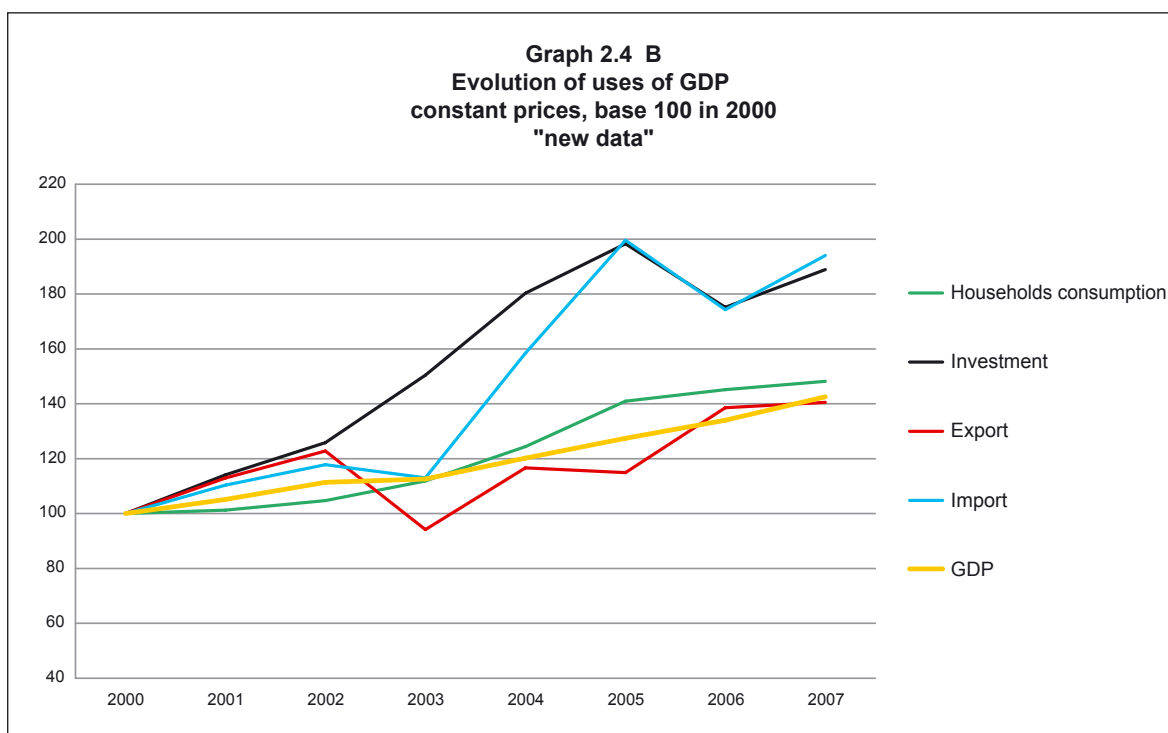
Graphs 2.4 A and 2.4 B below (*see next page*) feature the evolution of the GDP end-uses. Again, graph 2.4 A refers to the old data, and graph 2.4 B to the new data. In both cases, all components appear to be higher than the total GDP. This is because import is a negative component of end-uses, balancing all other positive components.

The trend of households’ consumption changes slightly as it gets closer to the GDP trend in graph 2.4 B. Investment, which was growing steadily in graph 2.4 A, posted a strong decrease in 2006, as shown in graph 2.4 B. A closer look at investment on Table 2.2 shows that Gross Fixed Capital Formation may be split into two components, equipment and construction: comparing the old and the new data, we observe a huge contraction of the equipment component for the year 2006, partly offset by the growth of the construction component. Such a change is a step in the right direction, as it improves the reliability of National Accounts.

Switching now to trade, we may notice that in 2006, imports stabilised at a high level in graph 2.4 A, but decreased very significantly in graph 2.4 B. As for 2006 exports, their trend reached the level of 160 in graph A, but only 140 in graph B. As a result, the 2006 trade deficit is more or less at the same level in both datasets, much smaller than the huge gap that appeared in 2005. In 2007(graph 2.4 B), however, trade deficit again widens.



Source: CBS Abstract 2007



Source: CBS Abstract 2008

In conclusion, there are large discrepancies between 2007 ("old") and 2008 ("new") data. Some of them do correspond to necessary corrections of previous errors. Others are more difficult to explain, and the Central Bureau of Statistics should at least provide the data users with some explanations as to the numerous changes that have been introduced.

3) COMPARISONS WITH THE RECALCULATED GDP

We go on with the comparison of the old and the new GDP data with alternative GDP estimates provided by the Syrian Economic Trends Bulletins. We suggest that the reader refer to the first two issues of SETB in order to get the detailed methodology of calculation of the GDP in current prices, using the so-called “income method”. We also remind the reader that the estimates calculated with that method are very rough: a more detailed breakdown of each industry’s contribution is needed, based on more accurate data. In short, the results outlined below should be regarded as a mere order of magnitude rather than exact aggregates.

Table 2.3 draws the balance of all income components of the GDP.

	2004	2005	2006	2007
COMPENSATION OF EMPLOYEES				
Total compensation of employees	256.1	295.7	337.9	351.7
GROSS MIXED INCOME				
Self consumption in agriculture	32.3	34.8	36.2	38.6
Rentals of houses, including imputed	111.0	122.8	139.1	149.7
Small-scale business of self-employed	217.7	329.2	381.9	448.7
Total Gross Mixed Income	361.0	486.8	557.2	637.1
GROSS OPERATING SURPLUS				
Oil-related rent, gross	225.3	328.9	389.6	437.8
Gross surplus of the financial sector	44.7	67.5	97.5	121.0
Standard corporations total gross profit	388.5	449.0	525.5	551.5
Total Gross Operating Surplus	658.5	845.3	1012.6	1110.2
INDIRECT TAXES MINUS SUBSIDIES				
Net taxes on production and imports	-5.9	-103.7	-190.0	-199.4
TOTAL CALCULATED GDP	1269.8	1524.0	1717.7	1899.6
GDP in US dollars (billion USD)	25.4	30.5	34.4	38.8
GDP per capita in US dollars	1,417	1,668	1,835	2,022

Source: authors' calculation on the basis of CBS data

Let's note that there are four main types of income taken into account in the income method : employees' compensation (wages, social security contributions etc, representing 18.5% of GDP), gross mixed income (which includes the income earned by small private businesses, home rents, as well as the income earned by farmers working on their own plots, 33.5% of GDP), gross operating surplus (the profit of declared enterprises, including oil extracting companies, 58.4% of GDP), and net taxes on production and imports (taxes including customs duties minus subsidies, -10.5% of GDP). The calculation of nominal GDP is complemented with an original method of calculating the GDP deflator, in order to assess the real growth rate of the economy.

Table 2.4 below compares the total GDP obtained through the income method with the outstanding GDP presented by the CBS with its two variants, “old data” and “new data” (see Table 2.1). The results are very close for the first three years available (from 2004 to

2006) whether using the “old” or the “new” data. For the year 2007, however, the newly published figure of GDP is 6% higher than the one obtained using the income method.

Table 2.4
Comparison between calculated and official nominal GDPs

	2004	2005	2006	2007
TOTAL CALCULATED GDP (bn SYP)	1269.8	1524.0	1717.7	1899.6
OFFICIAL GDP OLD DATA (billion SYP)	1263.2	1490.8	1708.9	
OFFICIAL GDP NEW DATA (billion SYP)	1263.2	1493.8	1698.5	2019.8
Official GDP OLD in relation to calculated, %	99.5%	97.8%	99.5%	
Official GDP NEW in relation to calculated, %	99.5%	98.0%	98.9%	106.3%

Source: authors calculation on the basis of CBS data. Official GDP for 2007 is a provisional figure.

Table 2.5
Determination of the real GDP
and the real growth rate

	2004	2005	2006	2007
GDP calculated with Income Method				
Nominal GDP (current prices, bn SYP)	1269.8	1524.0	1717.7	1899.6
GDP Deflator, base 100 in 2000	115.0	128.4	136.9	143.2
GDP in constant prices, base 2000 (bn SYP)	1104.5	1187.4	1254.5	1326.5
GDP real growth rate (income method)		7.5%	5.7%	5.7%
Comparisons with CBS data				
Implicit GDP deflator (old data, 2000=100)	116.3	131.4	143.3	
Implicit GDP deflator (new data, 2000=100)	116.3	129.7	140.2	156.8
GDP in constant prices, old data (bn SYP)	1086.1	1134.9	1192.6	
GDP in constant prices, new data (bn SYP)	1086.1	1151.4	1211.3	1288.0
GDP real growth rate (old CBS data)	6.7%	4.5%	5.1%	
GDP real growth rate (new CBS data)	6.7%	6.0%	5.2%	6.3%

Source: authors calculation on the basis of CBS data.

However, that does not mean that growth figures match these nominal results. In order to measure growth, we have to deflate the nominal GDP with a specific price index that needs to be calculated. Unlike the CBS methodology, we calculate a deflator (one can describe it as a price index of the GDP) according to the methodology presented in the first issue of SETB. Based on several price indexes (CPI, wholesale prices, wages, import and export prices), we calculate deflators for each end-use component of the GDP. Those component deflators are eventually averaged according to the weight of each end-use component of nominal GDP for the previous year. Basic information and results are presented in Table 2.5.

CHAPTER III

FOREIGN ECONOMIC RELATIONS

This chapter assesses the recent evolutions of foreign economic relations. The first section presents a complete final version of the Balance of Payments issued by the Central Bank of Syria. The second section discusses the recent trends of Syrian trade in goods, broken up by countries. The commodity structure of foreign trade is studied in the third section.

SECTION 1 BALANCE OF PAYMENTS

The first paragraph describes the overall balance of payments as it is reported by the Central Bank of Syria; the second one presents the current account. Last, capital and financial accounts are briefly discussed.

1) THE OVERALL BALANCE FOR 2007 IS POSITIVE

As promised in the second of issue SETB, what we present here and in the following paragraphs is the complete and final table of the Balance of Payment (BoP) for the period 2003-2007. Tables 3.1-A and 3.1-B in the next pages show that, contrary to what happened in 2006, the overall balance recorded positive digits in 2007, leading to a 544 million dollars increase in net official reserves. The positive balance of the current account in 2006 (920 million dollars, see Table 3.1-A) declined by about half of its value in 2007, mainly because of the noticeable degradation in the trade balance (the imports increase outweighed the exports increase). The rising domestic demand on foreign products, along with the removal of trade restrictions and the appreciation of the Syrian pound against the US dollar, led to a huge deficit in the trade account balance. The remarkable increase in the service balance in 2007 softened this negative impact. In turn, the tourism and travel balance, which recorded an unprecedented positive surplus in 2007, outweighed the increasing deficit of the transport balance. Both the decrease in the income balance deficit and the increase in the current transfer surplus contributed to make the service balance positive. The capital account balance (see Table 3.1-B below) posted a surplus in 2007, owing to the increase in migrants' transfers. On the financial side (same Table 3.1-B), the marked decrease in net short-run loans along with the decrease in net long-run loans and the increase in net inflows of foreign direct investment (FDI), led to a significant decline in the deficit of the financial account balance.

2) CURRENT ACCOUNT BALANCE

As can be seen from table 3.1-A, unlike what happened in 2006, the imports of public and private sectors outweighed exports, leading to a trade deficit (-521 million dollars). Unsurprisingly, the oil balance of public sector continued posting a surplus, thanks to the hike in oil world prices through 2007, and in spite of the depletion of Syrian oil reserves; in the mean time, the non-oil balance continued accumulating a deficit, underscoring the failure

of state-owned companies in competing in the world market. Similarly, the private sector imported more than it exported in 2007, thus contributing to the trade balance deficit. The removal of trade restrictions, including reducing the tariffs to a next-to-zero rate for several groups of industrial products, along with generous import quotas, resulted in an import rise. Contrary to the trade balance, the service balance continued recording a surplus, which more than doubled in 2007; that is mainly due to the remarkable improvement in travel and tourism balance, as pointed by the World Tourism Organisation report which singled out 2007 as an exceptional year for the tourism industry in Syria. By contrast, the transport balance deficit remained on the rise. The improvement in the income balance came from the increase in net interests paid on foreign debts, with a surplus increasing from 275 to 446 million dollars, whereas the deficit of direct investment income slightly decreased from -1165 million dollars in 2006 to -1085 million dollars in 2007.

**Table 3.1 A: Balance of payments
Current account
2003-2007, million USD**

	2003	2004	2005	2006	2007
Current account balance	753	592	299	920	459
(in percentage of GDP)	3.47	2.43	1.07	2.75	1.07
Trade and Services balance	1071	642	411	1290	327
Trade balance	1332	264	-141	885	-521
Exports, f.o.b.	5762	7220	8600	10244	11765
Public sector	4566	3880	4360	4649	5060
of which: Oil	4111	3471	3851	4082	4398
of which: Non-oil	455	409	509	567	662
Private sector	1196	3340	4240	5595	6696
Imports, f.o.b..	-4430	-6957	-8741	-9359	-12277
Public sector	-1038	-1950	-2945	-3853	-5200
of which: Oil	-167	-972	-2100	-2500	-3784
of which: Non-oil	-871	-978	-845	-1353	-1417
Private sector	-3392	-5007	-5796	-5506	-7067
Services balance	-261	378	552	404	849
Receipts	1652	2613	2911	2924	3862
Of which :Travel and tourism	286	1150	1944	2025	2883
Of which: Transport	200	198	219	217	226
Payments	-1913	-2235	-2359	-2520	-3013
Of which :Travel and tourism	700	650	550	540	645
Of which: Transport	-605	-852	-1094	-1253	-1463
Income balance	-857	-729	-863	-935	-689
receipts	282	385	395	428	594
payments	-1139	-1114	-1258	-1363	-1283
current transfers(net)	539	679	751	565	821
Of which: workers remittances	530	689	761	610	831

Source: Balance of Payments, Central Bank of Syria

The current transfer surplus grew again in 2007 after its decline in 2006. Taking a close look at the data, we can see that the 2006 decline in net current transfers was caused by the increase in outflows of workers' remittances (from 2 in 2005 to 160 million dollars in 2006), not by the decrease in workers' remittances inflows. However, the workers' remittances

inflows increased more than the increase in outflows, leading to higher current net transfers (from 565 in 2006 to 821 million dollars in 2007).

3) CAPITAL AND FINANCIAL ACCOUNTS BALANCE

**Table 3.1 B: Balance of payments
Capital and financial accounts and overall balance
2003-2007, million USD**

	2003	2004	2005	2006	2007
Capital and financial account	-118	-79	-136	-1010	-234
Capital account	20	18	18	18	118
Migrants' transfers	-	18	18	18	118
Financial account	-138	-96	-154	-1028	-352
(in percentage of GDP)	-0.64	0.41	-0.58	-3.2	-0.82
Direct investment	160	275	508	613	898
Of which: oil - Gas project-related	90	150	151	125	126
currency and deposits	0	248	561	710	746
Long-term loans (net)	2	-187	-473	-414	-314
Receipts	224	215	138	86	256
Payments	-222	-402	-611	-500	-570
Short-term loans (net)	-300	100	250	-440	-250
Receipts	986	1600	1400	950	450
Payments	-1286	-1500	-1150	-1390	-700
Current and capital and financial account	635	513	163	-90	224
Errors and omissions	84	-334	365	-792	320
Overall balance	719	179	528	-882	544
(in percentage of GDP)	3.10	0.83	0.06	-2.10	1.27
Financing	-719	-179	-528	882	-544
Net change in reserves (increase= -)	-719	-179	-528	882	-544
Convertible	-719	-179	-528	882	-544
Central Bank	-672	-436	-1158	-647	-2066
Commercial Bank	-47	257	630	1529	1522
GDP in current prices (bn USD)	21.69	24.30	28.00	33.40	42.7

Source: Balance of Payments, Central Bank of Syria

As seen in Table 3.1-B, the 2007 increase in net migrants' transfers in (from 18 to 118 million dollars) led to an unprecedented increase in capital account surplus. Foreign direct Investment (FDI) kept riding up its rising trend in 2007, with both long and short-term debt payments outweighing the receipts, leading to a notable decrease in their negative balances. This resulted in a substantial improvement in the financial account balance, as its deficit declined from -1028 to -352 million dollars in 2007. To recap, it seems that the progress made in the service balance and the capital and financial account balances led to the remarkable improvement in the overall Syrian balance of payments, which turned from negative in 2006 into positive in 2007. Of course, this improvement resulted in an increase in foreign exchanges reserves, by 544 million dollars in 2007.

SECTION 2 THE GEOGRAPHIC STRUCTURE OF GOODS TRADE

This section assesses the evolution of trade in Syria. First, it presents the evolution of exports and imports through 2000-2007, then it discusses the geographic structure of trade, and finally it presents the commodity structure of foreign trade.

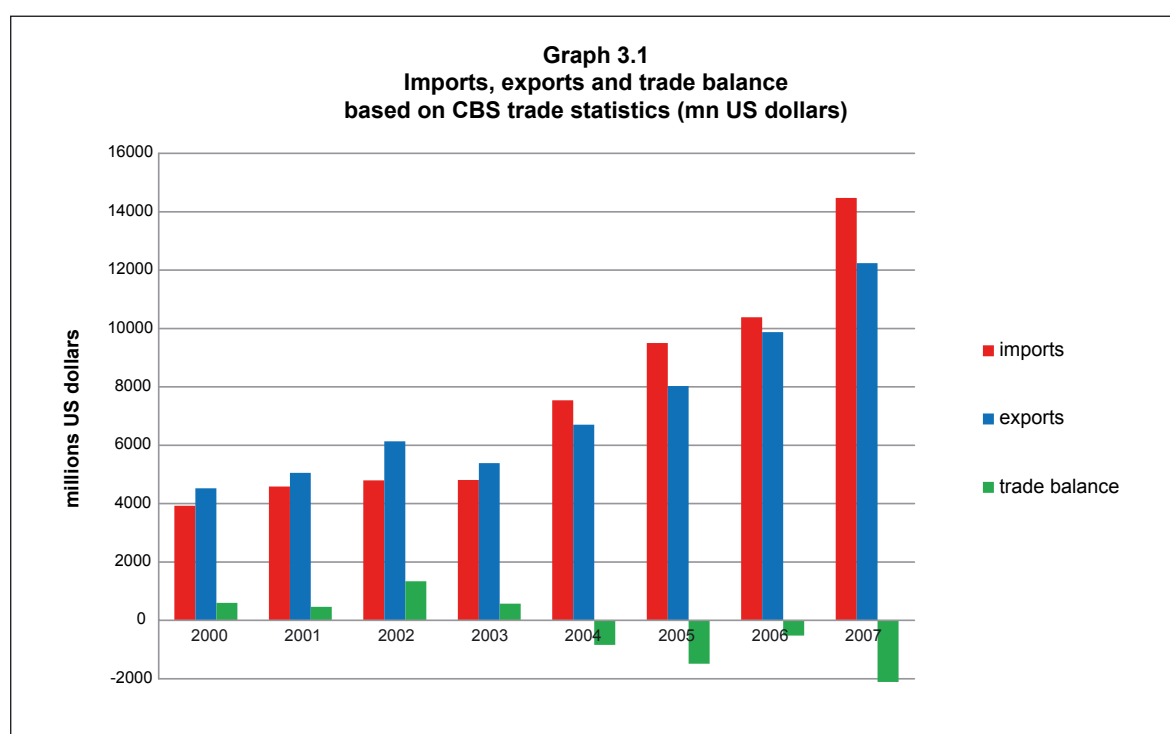
1) OPENING UP THE SYRIAN ECONOMY: AN ONGOING PROCESS

As part of its economic reforms program, the Syrian government went further in the removal of import restrictions and customs tariffs through 2006 and 2007. Table 3.2 shows that the share of foreign trade (measured as exports plus imports) to the GDP increased from 53% in 2002 to 63% in 2007.

Table 3.2
Syrian trade with the world
2002-2007

	2002	2003	2004	2005	2006	2007
Trade / GDP (%)	53	47	59	63	61	63
Imports yearly change (%)	4	0	57	26	9	39
Exports yearly change (%)	21	-12	25	20	23	24

Graph 3.1 shows the evolution of Syrian exports and imports through 2000-2007. It is clear that the size of trade deficit increased significantly in 2007 with regard to 2006. In 2007, imports grew at a much higher rate than exports (see table 3.2). This can be explained by several reasons: (a) the booming domestic demand on domestic and foreign products following the liberalization of the Syrian economy; (b) the real appreciation of



Source: Own calculation based on CBS Trade Statistics

the Syrian currency against the US dollar in 2007; (c) the continuation of foreign trade sector liberalization measures, including the removal of foreign trade constraints such as import quotas and reducing tariffs and non-tariffs barriers; (d) the loosening of foreign exchange rate rules and regulation, and the facilitation of trade financing by private and public banks.

2) THE GEOGRAPHIC DISTRIBUTION OF SYRIAN TRADE

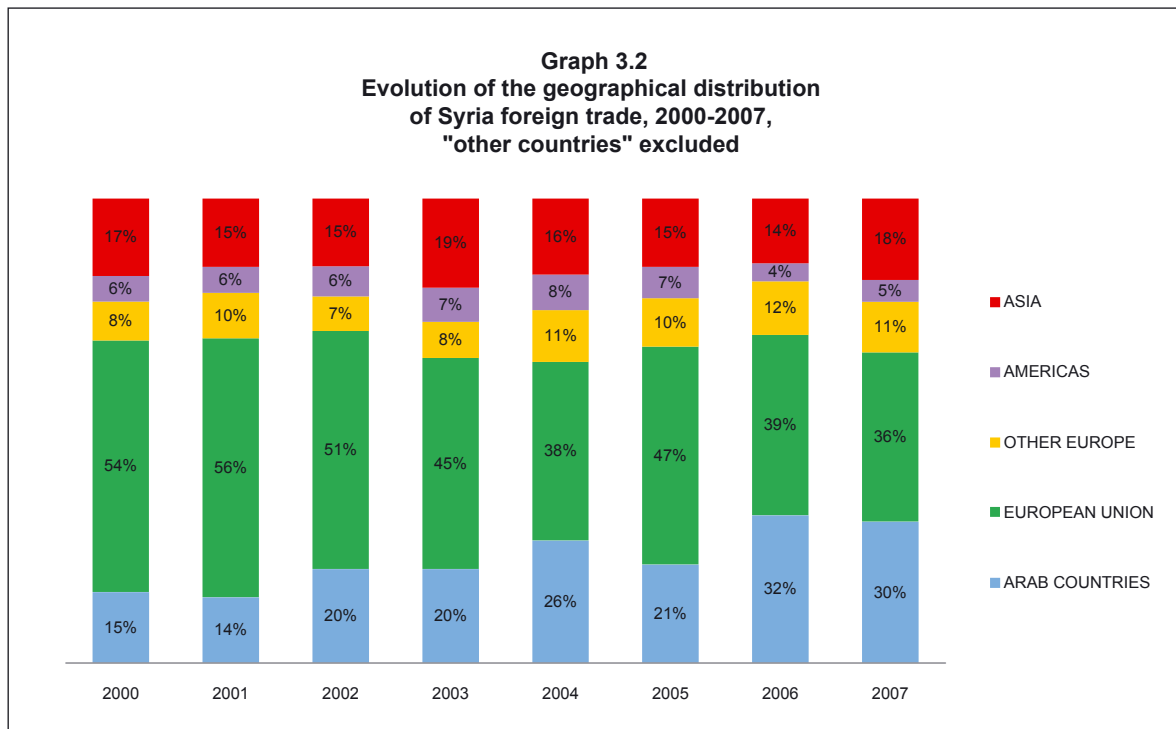
First, we present an updated picture of Syrian trade trends according to regions of the world, and then we take a different approach, breaking it up by major trade partners.

a) The regional structure of Trade

As stated in the first issue of this bulletin, the group of “other countries” has been left out from the scope of this study for clarity purposes.

1) Trade trends

Against all expectations, Graph 3.2 shows that the share of the European Union and Arab countries in Syrian foreign trade for the year 2007 declined, if by small margins.

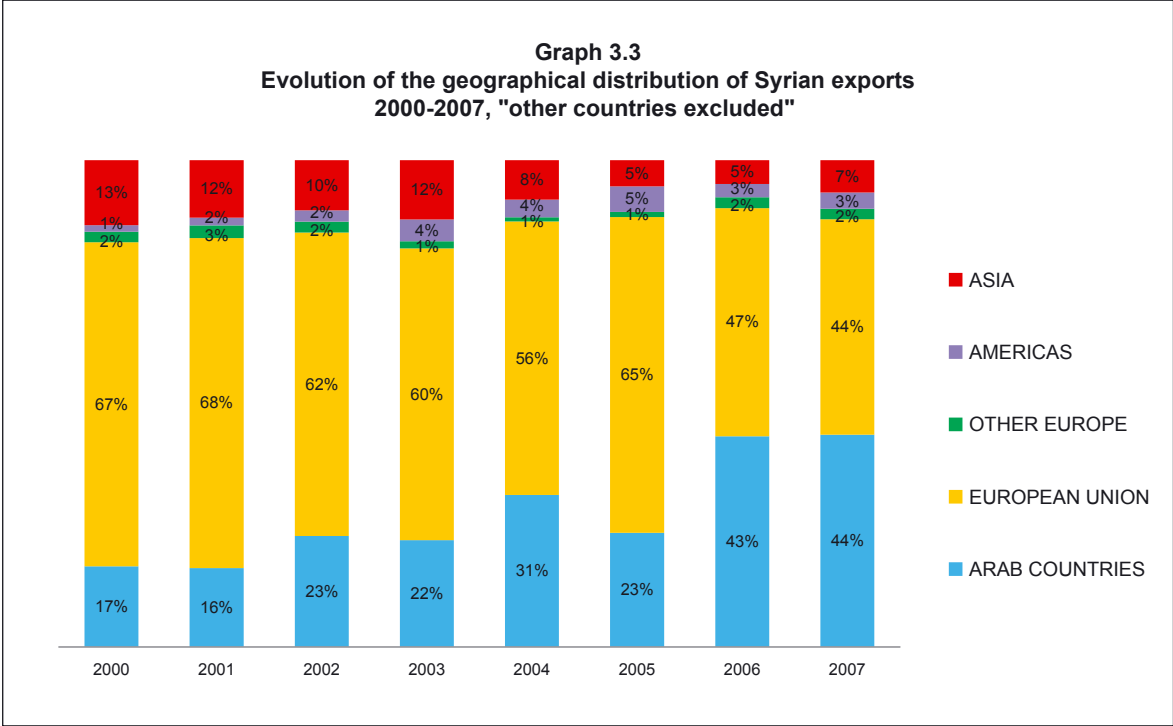


Source: Own calculation based on CBS Trade Statistics

This decline might suggest a shift of Syrian trade towards the booming Asian economies, as their markets become more attractive to Syrian exporters and as they provide low-cost quality products on the Syrian domestic market. Whether this change is permanent remains uncertain.

2) Export trends

Graph 3.3 shows the evolution of exports through 2000-2007. It shows that the European Union is losing ground to the Arab countries group as the major destination for Syrian exports; both have the same share in total Syrian exports in 2007 (44%). Also, it seems that Asia is benefiting from the European Union retreat, with a 2 points percentage increase in 2007.



Source: Own calculation based on CBS Trade Statistics

3) Import Trends

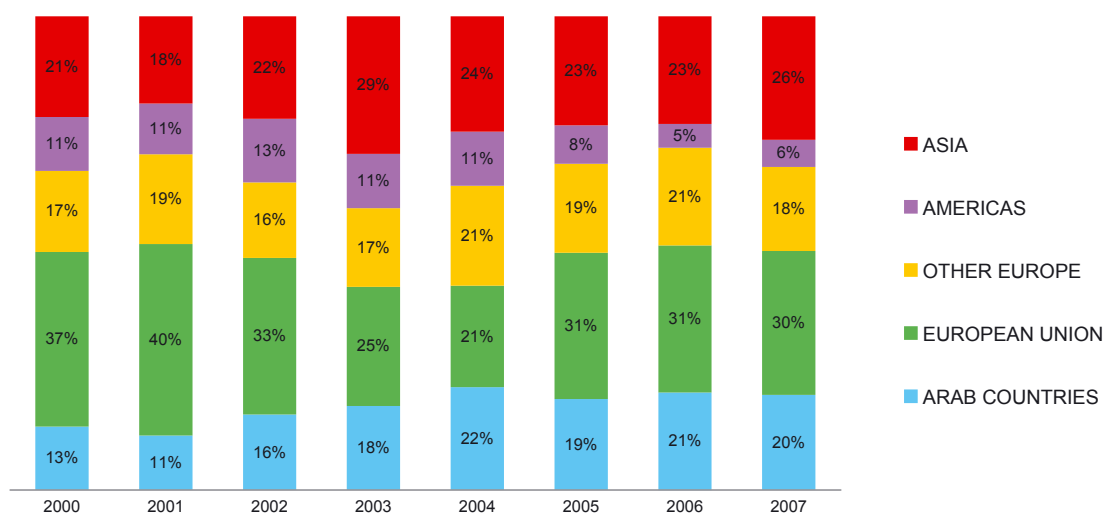
Without out factoring “other countries” in, it seems that Asia is the big winner among other regions of the world (graph 3.4) (See graph on the next page), as its share in total Syrian imports increased by 3% between 2006 and 2007, whereas the shares of Arab countries and of the European Union slightly decreased over the same period. By comparison, the Other Europe share decreased by 3%, while the Americas share increased by 1%.

To sum-up, Arab countries matched the European Union as Syria’s most important trading partner for exports in 2007. The EU is still the major source of Syrian imports, but Asian countries are quickly moving up to the first place. On a separate note, the group “Other Europe” attracts a significant share of imports (18%), making them much more diversified than for exports.

b) Trade by countries

In this section, we study the recent changes in Syrian trade with some of the country’s key partners. Next, we will study the trends in exports and imports through a selected group of key partners.

Graph 3.4
Evolution of geographical distribution of imports
2000-2007, "other countries excluded"



Source: Own calculation based on CBS Trade Statistics

1) Trade trends

Countries in table 3.3 can be clustered into three groups: the first group includes countries whose share in total Syrian trade declined over the 2005-2007 period (Italy, France,

Table 3.3
Major trade partners of Syria
("other countries" excluded)

		2002	2003	2004	2005	2006	2007
Italy	trade share %	23,3	22,7	14,9	16,6	13,2	14,6
	trade balance	1607.7	1583.2	916.3	1421.9	1586.2	1683.68
France	trade share %	9,9	10,2	11,2	9,9	6,1	6,4
	trade balance	650.6	649.1	799.4	831.0	689.2	981.9
Turkey	trade share %	6,6	7,8	6,3	4,6	3,8	4,6
	trade balance	258.0	130.4	60.6	-40.7	-13.1	32.8
Saudi Arabia	trade share %	7,1	5,8	6,5	5,4	7,4	8,0
	trade balance	343.9	127.8	23.6	23.0	460.0	384.9
Ukraine	trade share %	2,7	3,4	5,4	6,3	3,5	3,7
	trade balance	-217.4	-263.4	-487.4	-699.9	-421.9	-746.8
USA	trade share %	4,2	5,0	4,5	4,2	2,6	2,3
	trade balance	-179.1	-40.8	-106.1	44.3	-32.6	-39.1
China	trade share %	2,6	3,5	5,0	4,9	4,3	4,6
	trade balance	-248.5	-264.2	-424.6	-542.6	-611.2	-1139.7
Spain	trade share %	2,9	3,1	2,6	2,8	2,2	1,6
	trade balance	91.0	151.0	127.4	200.8	253.4	146.7
South Korea	trade share %	3,0	2,6	3,0	2,7	2,7	2,6
	trade balance	-234.1	-196.3	-250.1	-314.3	-407.3	-1370.3
Lebanon	trade share %	2,5	3,4	3,2	2,7	2,9	2,1
	trade balance	81.4	140.9	63.7	9.2	230.1	197.3
World	trade share	100	100	100	100	100	100

Source: Own calculation based on CBS Trade Statistics

Ukraine, USA, and Spain); the second group includes countries that saw their share grow over the same period (Saudi Arabia). Several countries present more or less the same pattern (Turkey, China, South Korea, and Lebanon).

2) Export trends

Factoring in “other countries”, Italy is still the first major destination of Syrian exports over the period 2006-2007, in spite of the noticeable decrease in its share, down to 24% in 2007. Another group of countries had a declining share in Syrian exports over the same time frame: France, Spain, Holland, USA, and UK. By contrast, countries such as Turkey, Iraq, and Lebanon enjoyed a slight improvement in their share. Saudi Arabia had a 5% increase, moving in range of France’s second spot.

		2002	2003	2004	2005	2006	2007
Italy	%	32,2	34,8	25,2	30,5	22,7	24,2
	Mn USD	1916.4	1786.0	1164.1	1684.3	1934.8	2672.2
France	%	13,5	15,1	20,0	17,9	10,2	11,7
	Mn USD	803.0	773.8	925.1	991.7	869.5	1295.5
Turkey	%	7,5	7,9	7,1	4,6	3,7	5,4
	Mn USD	448.1	404.8	330.3	253.7	317.89	591.24
Saudi Arabia	%	8,6	6,2	6,9	5,9	10,1	10,9
	Mn USD	512.1	318.8	319.6	323.9	863.5	1196.5
Spain	%	3,1	4,1	4,0	4,8	3,8	2,5
	Mn USD	184.6	211.0	184.0	267.9	321.1	274.0
Lebanon	%	2,7	4,2	3,9	3,0	4,4	3,3
	Mn USD	159.8	216.9	178.6	166.1	371.4	363.0
USA	%	1,9	3,9	3,5	4,8	2,4	2,5
	Mn USD	112.5	199.5	162.6	267.9	204.3	275.2
Iraq	%	1,2	1,6	10,0	4,5	7,4	5,7
	Mn USD	73.7	79.5	463.9	246.8	631.8	633.3
UK	%	2,4	2,2	1,9	4,1	5,0	1,0
	Mn USD	140.5	112.2	85.7	227.3	428.4	113.8
Holland	%	2,3	0,5	2,5	4,5	1,2	1,8
	Mn USD	137.4	26.8	113.7	246.9	102.8	194.3
Total Exports	%	100	100	100	100	100	100
	Mn USD	5951,7	5127,1	4624,2	5524,8	9873,0	12241,7

Source: Own calculation based on CBS Trade Statistics

In short, nearly half of all Syrian exports went to three countries in 2005-2007: Italy, France, and Saudi Arabia. Along with the trend of exports to other countries in the European Union and Arab countries, this supports the conclusion of a “gravity equation”: exports go to countries according to their market size (measured by their GDP) and according to distance (the nearer the country, the cheaper it is to ship goods). Europe and Arab countries are clearly the largest and the nearest markets for Syrian exports.

3) Import trends

Table 3.5 shows that Syrian imports are geographically more diversified than exports. 2007 brought about major changes, as Russia took the first place with a share of 10% of total Syrian imports. Ukraine lost its position as the main supplier of goods to the Syrian

Table 3.5
Major import partners
(“other countries” excluded)

		2002	2003	2004	2005	2006	2007
Ukraine	%	6,7	7,6	10,4	11,7	5,9	5,9
	Mn USD	240.8	278.2	499.2	719.8	516.6	833.3
China	%	6,9	7,8	9,2	9,0	7,7	8,1
	Mn USD	249.9	282.7	443.9	556.5	675.8	1149.1
Italy	%	8,6	5,6	5,1	4,2	4,0	7,0
	Mn USD	308.7	202.8	247.8	262.4	348.6	988.5
USA	%	8,1	6,6	5,6	3,6	2,7	2,2
	Mn USD	291.6	240.3	268.7	223.7	236.9	314.3
Turkey	%	5,3	7,5	5,6	4,8	3,8	4,0
	Mn USD	190.1	274.4	269.7	294.5	331.0	558.5
Saudi Arabia	%	4,7	5,2	6,1	4,9	4,6	5,8
	Mn USD	168.3	190.9	296.0	300.9	403.5	811.7
Russia	%	3,2	3,4	6,4	4,2	2,1	10,0
	Mn USD	115.2	122.4	307.8	260.4	181.8	1410.7
Japan	%	4,3	4,2	3,1	3,5	3,5	1,9
	Mn USD	155.5	153.5	147.5	218.6	310.2	264.4
France	%	4,2	3,4	2,6	2,6	2,1	2,2
	Mn USD	152.4	124.6	125.7	160.8	180.2	313.6
Egypt	%	2,6	2,6	3,7	4,0	6,2	4,5
	Mn USD	92.4	94.1	179.9	245.2	540.9	628.4
Total Imports	%	100	100	100	100	100	100
	Mn USD	3603.2	3637.6	4822.5	6178.5	10387.6	14472.7

Source: Own calculation based on CBS Trade Statistics.

market in 2004-2005 (its share fell from 11.7% of total imports in 2005, to 5.9% in 2007). China is still the runner-up, with 8.1%. The increase in Italy's share, from about 4% in 2005 to 7% in 2007, forced Saudi Arabia to go down to the fourth spot. Imports from Turkey, United States, Japan and France all declined through 2005-2007, while Egypt's share slightly increased.

Overall, the ten major suppliers of Syria captured about 50% of total Syrian imports in 2007. The concentration of Syrian exports is still an important issue that raises concern about exporters' competitiveness and their capability in finding ways into the world market. Of course, the competitiveness of Syrian exports is, somehow, related to their commodity structure, which the following section goes on to address.

SECTION 3 THE COMMODITY STRUCTURE OF FOREIGN TRADE

An assessment of Syrian foreign trade according to its commodity structure is presented in this section, through the evolution of exported and imported commodities as classified by SITC revision 3 (the last version of the Standard International Trade Classification).

1) SYRIAN COMMODITIES EXPORTS ACCORDING TO SIT CLASSIFICATION

Table 3.6 shows that there was a significant change in the level of concentration of Syrian exports during the period 2006-2007; although mineral fuels and lubricants were the major exports, there was a huge decline in their share of total exports, from about 75 in 2002 to 41% in 2007. Such a change cannot be, in any way, the result of the depletion in oil reserves and output decline, since oil prices more than offset output reductions particularly in 2007. This indicates a major breakthrough in the structure of Syrian commodity exports, which in turn reflects a change in the structure of Syrian output. Table 3.6 shows that there is a remarkable increase in the share of Manufactured Goods, from 4.6 in 2002 to 13.2% in 2007. It also shows the increase in the share of Chemicals and Related Products and Miscellaneous Manufactured Articles, from 1.2 and 4.7 in 2002 to 5.4% and 12.6% in 2007 respectively. Furthermore, the share of Machinery and Transport Equipments rose from 0.7 to 5% over the same time frame.

On the whole, it seems that Syria is headed towards the right direction with the diversification of its commodity exports, since oil's declining share in total exports is due to the expansion of other exports, in particular manufacturing products. Of course, this finding should not come as a surprise, as it reflects the persistent interests of the Syrian government in promoting the industrial sector by encouraging more private contributions, both domestic and foreign. We believe that the simplification of rules and regulation, particularly when it made investments in the industrial estate easier, resulted in more contribution from the industrial sector in the output growth and, in turn, in export densification. Nevertheless, there is still need for greater business efficiency, through the continuation of infrastructure

Table 3.6
Syrian commodities exports by product
("other commodities" excluded, 2002-2007, %)

	2002	2003	2004	2005	2006	2007
Food and Live Animals	14,3	12,7	13,1	10,3	16,1	17,4
Beverages and Tobacco	0,1	0,3	1,1	1,0	0,7	0,9
Crude Materials, Inedible Except Fuels	1,3	3,9	4,7	4,4	3,2	1,7
Mineral Fuels, Lubricants	74,3	71,3	67,6	68,8	43,4	41,1
Animal and Vegetable Oils	0,3	1,0	0,7	1,7	1,9	2,5
Chemicals and Related Products	1,2	1,0	1,7	3,0	5,3	5,4
Manufactured Goods	4,6	5,6	6,7	5,9	12,0	13,2
Machinery and Transport Equipments	0,7	0,6	1,1	1,5	5,1	5,0
Miscellaneous Manufactured Articles	4,7	3,6	3,5	3,6	12,4	12,6
Total Exports (except "others")	100	100	100	100	100	100
Commodities and Transactions not classified elsewhere	0,0	0,0	39,1	37,9	7,4	8,4

Source: Own calculation based on CBS Trade Statistics.

development and the production of high- quality government services, particularly in industrial estates; it is a vital challenge for the Syrian government and an important step in supporting the industrial sector and promoting its exports. (See table on the next page)

2) SYRIAN COMMODITIES IMPORTS ACCORDING TO SIT CLASSIFICATION

Table 3.7 shows that Syrian imports are more diversified than exports. However, it shows that there is a dramatic rise in the share of mineral fuels category, which increased from 3.2 % in 2002 to a spectacular 33% in 2007. This is explained by the rise in the value of refined fuels imports, which grew from 466 million US dollars in 2004, to 2,331 in 2005 and to 4,577 in 2007. Those rising imports are in turn due to the increase in refined oil prices on the world market. By contrast, the share of four categories of products, manufactured goods; machinery; chemicals; and food significantly declined through 2002-2007.

Table 3.7
Syrian commodities imports by product
(“other commodities” excluded)
(2002-2007, %)

	2002	2003	2004	2005	2006	2007
Food and Live Animals	15,2	15,6	14,0	11,4	10,9	10,1
Beverages and Tobacco	0,7	0,8	1,0	0,5	0,9	0,8
Crude Materials, Except Fuels	5,2	6,2	5,8	4,6	4,1	3,8
Mineral Fuels, Lubricants	3,2	3,6	7,4	25,7	27,5	33,0
Animal and Vegetable Oils	0,9	1,3	1,1	0,8	0,7	0,8
Chemicals and Related Products	15,2	14,9	15,0	12,3	11,4	11,4
Manufactured Goods	29,0	28,6	27,5	22,2	21,3	21,6
Machinery and Transport Equipments	27,9	26,3	25,5	20,6	21,5	17,2
Miscellaneous Manufactured Articles	2,6	2,6	2,9	2,0	1,8	1,3
Total Imports (except “others”)	100	100	100	100	100	100
Commodities and Transactions not classified elsewhere	0,3	0,2	19,0	4,3	1,4	0,0

Source: Own calculation based on CBS Trade Statistics

In conclusion, the pattern showing a greater diversification of Syrian exports is a noticeable shift in the country’s foreign trade commodity structure. This shift should be seen as an early signal of the change in the structure of the Syrian economy towards more industrialisation. If it goes on, it will offset the loss in oil revenues that the depletion of oil reserves and the drastic fall in oil prices on world markets caused recently. By contrast, Syria’s growing reliance on imported refined products, still highly subsidised compared to other countries, places a huge burden on trade and the balance of payments accounts, as well as on the government budget. The recent increase in fuel oil domestic prices that took place in April 2008 is expected to relieve this burden by rationalising the domestic consumption of oil-refined products. In addition, the signing of two contracts to build new refineries in Syria would help reduce the size of refined products imports, but will symmetrically reduce crude oil exports. Last, the recent drastic fall in world oil prices is expected to have positive impacts on the trade account balance and on the structure of Syrian commodity imports. We hope to assess the long-term consequences of this market trend in future issues of SETB.

APPENDIX

MICROECONOMICS OF MAZOUT COUPONS

In April 2008, the Syrian retail market of diesel fuel (mazout) witnessed an unprecedented change as part of the economic reform policy promoted by the five-year plan. For several years, up to March 2008, the retail price of mazout was on average 7 SYP per litre, or approximately 14 US cents. All consumers, including transport enterprises and households, were able to fill up their tanks or any other container at that price. Remarkably, there was never any shortage of mazout throughout the period when prices were so low. The major oil distribution company Mahrukat was responsible for meeting demand for refined products with an adequate supply. Table 1 show that Mahrukat has delivered growing quantities of the product (+9% in 2006, +8% in 2007). However, as the output of refineries was not sufficient, Mahrukat had to import increasing volumes from abroad: imports of mazout rose by 26% in 2007. Simultaneously, prices of refined products on the world market grew, together with the price of crude oil, with the result that that the value of mazout imports more than doubled between 2005 and 2007, reaching the enormous sum of 3 billion dollars.

Table 1
Production, imports and sales of mazout
(volume, value and unit price)
2005-2007

	2005	2006	2007
Output of refineries (kilotons, KT)	3,714	4,155	3,895
Domestic purchases by Mahrukat (KT)	3,697	4,080	3,907
Value of domestic purchases (mn SYP)	33,042	117,308	128,889
Price of domestic purchases (SYP / kilo)	8.94	28.75	32.99
Imports by Mahrukat (KT)	3,167	3,424	4,319
Value of imports (mn SYP)	71,885	98,573	146,100
Price of imports (SYP / kilo)	22.70	28.79	33.83
Exports by Mahrukat (KT)	8	8	7
Value of exports (mn SYP)	197	267	265
Domestic sales by Mahrukat (KT)	6,851	7,479	8,094
Value of domestic sales (mn SYP)	57,035	62,260	67,370
Price of domestic sales (SYP / kilo)	8.32	8.32	8.32
Price of domestic sales (SYP / litre)	6.98	6.98	6.98

Source: Monitoring reports of Mahrukat and Homs and Banyas refineries

By examining the balance of sales and expenses on mazout in 2007, it is apparent that Mahrukat lost 207 billion SYP (equivalent to more than 4 billion dollars) by selling the product at a low price and buying it at the market price. This also represented more than half the total fuel-energy subsidies in Syria (see Chapter 1). Finally, the government decided to stop squandering resources and introduced a reform at the beginning of 2008 which took effect in April 2008.

The idea behind the new scheme was to limit consumption by raising prices, without adversely affecting the poorest part of the population. It was decided to give every family

a quota of consumption amounting to 1,000 litres per year at one price, and to sell the product above this quota at a higher price. The quota itself is not free of charge: consumers have to pay 9 SYP per litre, a price 28% higher than the previous price of 7 SYP, but still very low relative to international conditions, where diesel fuel costs the equivalent of 30 SYP per litre (average international price in 2007 is 95.6 USD per barrel). Beyond the quota, consumers would pay 25 SYP per litre, still 20% less than international price, but still a significant increase in comparison to the previous price.

The mechanism of this dual price system relies on the issuing of coupons, in the form of an anonymous booklet which any family may obtain from the local administration or from the place of work by presenting the family book. A stamp is put on the family book once the coupon booklet has been received, ensuring that a household may receive only one coupon booklet. These coupon booklets are free of charge and they grant the holders the right to obtain from any petrol station or fuel distributor 1,000 litres of diesel-fuel (or a fraction of that total amount) at a price of 9 SYP per litre instead of 25 SYP. The retailer removes the corresponding number of coupons from the booklet as a counterpart to the fuel sold at reduced price. Every family needing mazout either for car use, for central heating purposes, or for activating a pump or any agricultural tractor or machinery, is thus still able to get 1,000 litres at a very low price (although somewhat more expensive than before). If the family needs more, then it will have to pay the “full price” of 25 SYP. That last price, which is called by Syrians “market price”, is in fact a fixed price, at which it is possible to buy any quantity of mazout ; notice that even this high price remains subsidised since Mahrukāt bought domestic mazout at 33 SYP per kilo and imported it at 34 SYP in 2007 (27.5 or 28.5 SYP per litre). As far as transport or other enterprises are concerned, they are already obliged to pay the price of 25 SYP.

A few months after the introduction of the reformed system, a new kind of trade appeared in many places: people began to trade coupons on the street. In June, coupons were traded at 10-13 SYP; in November, one was able to find coupons at 8 or 9 SYP. What is the rationale behind this “black market” of coupons? Notice that this trade is not really “black” (meaning illegal) since no law or regulation forbids it. We call it “black” because it resembles black markets found elsewhere in the world. A better expression might be “informal market”.

In order to understand how the market for coupons functions, it is necessary to distinguish between several kinds of mazout consumers or coupon users. First, there are large consumers of diesel-fuel such as transport enterprises (bus or lorry companies). For them, the system of coupons does not apply. Their yearly consumption already represents several thousands of litres and they are not willing to spend time collecting coupon booklets to economise on fuel. The solution to the price increase for them is thus twofold: one solution might be to raise the price of their services. For instance, a bus company running the Damascus – Lattakia line has raised its prices from 320 to 500 SYP (return fare) in order to cover the higher costs of fuel. Of course, the actual supplementary cost of the fuel is much less than this amount; clearly, the company has exploited the opportunity to raise its prices and enhance its profitability. Some inflation is thus an expected consequence of the mazout price reform. A second solution would be to economise on diesel-fuel by making production more efficient. This solution depends on competition: if there were real competition between bus companies running the Damascus-Lattakia line, then the company which performs better might try to reduce its fuel consumption (for instance by substituting new low-consumption buses for old ones), improving its service, and justifying

higher prices by higher quality. In principle, the aim of the price increase is, by whatever means possible, to reduce fuel consumption through the pressure of competition.

What is the demand corresponding to “large clients”? Using the number of buses and lorries registered in Syria and estimating the yearly distance they cover, as well as their average consumption of fuel per kilometre, leads to the a very rough estimation that approximately half of the total mazout sold by Mahrukat went to transport enterprises in 2007. The remaining amount (4,000 kilotons or 4,800 million litres) was demanded by households for various purposes. In order to satisfy the entire household demand, 4 million coupon booklets should be distributed at the price of 9 SYP per litre, if consumption remains constant in 2008. Since there are only 3.5 million households in Syria, and certainly not all of them get a booklet, a share of the demand will have to be addressed at the higher price (25 SYP) at which mazout is distributed by gas stations. However, total consumption should decrease because of higher prices and even if fuel demand is very rigid in relation to prices, enterprise demand should definitely decline.

How large is the price elasticity of diesel-fuel demand? Studies in the United States or Britain show that, over a year, a 10% rise in the price of gasoline is translated into a 2.5% reduction of demand. In Syria, there might be less elasticity (the demand might be more rigid). Supposing that the elasticity of demand to prices is - 0.1, this means that a 10% increase in prices is translated into a 1% reduction of demand. The price increase for mazout – passing from 7 SYP to 25 SYP – is +257%. The resulting reduction of consumption might thus be in the range of 25%. If, before the price change, enterprise demand was 4,000 kilotons, then after the price change, it might pass to 3,000 kilotons. As for households, if the price increase is from 7 to 9 SYP (+ 28%), the reduction of demand might be in the range of 3%: consumption would decrease by 120 kilotons. The total demand for mazout to be supplied by Mahrukat would thus pass from 8,000 KT to 6,880 KT for a full year.

Turning to households, three categories can be identified. A first category contains households with a consumption of more than 1,000 litres per year: Families which consume more than 1,000 litres of mazout per year do so through, for example, central heating for a large house, extensive use of diesel cars, farming activity etc; informal export to neighbour countries should not be neglected either. A second category of households consume less than 1,000 litres per year. A third category of households does not consume diesel-fuel at all. A reasonable hypothesis is that the second category of households does not take part in the black market of coupons. Rather, it is thought that this informal market brings together the first and the third categories of households.

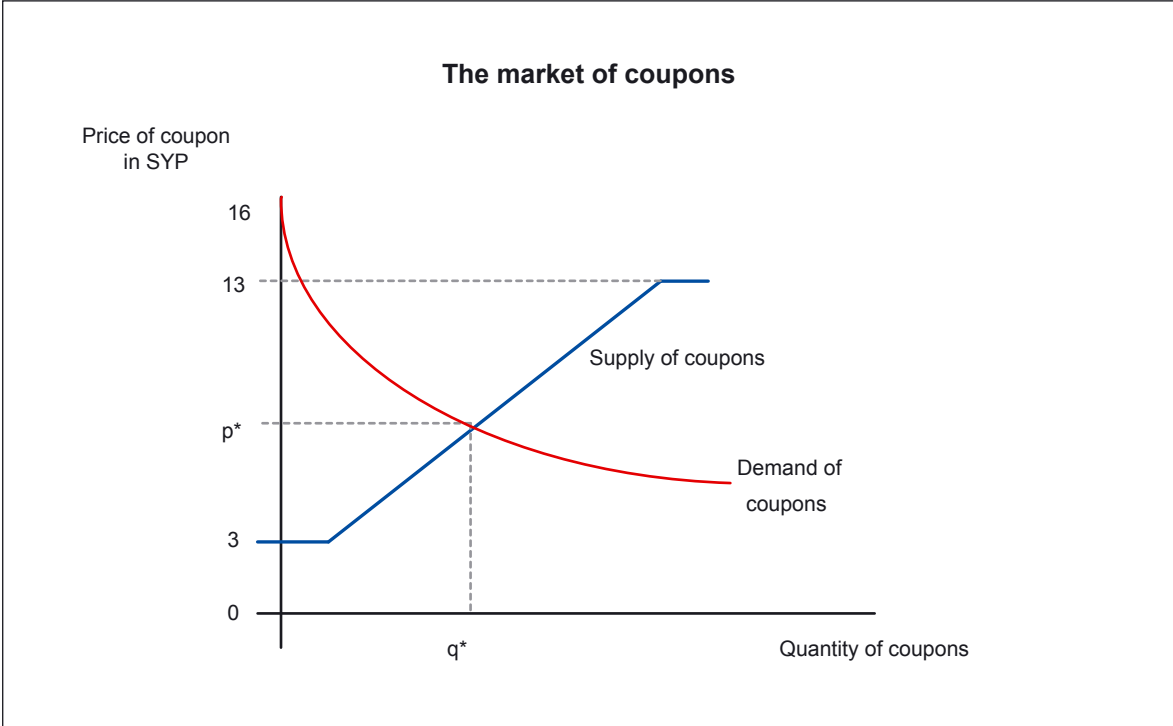
Families who do not consume mazout at all still reserve their right to receive their free coupon booklet, and ultimately to sell it elsewhere. Families who consume large amounts of mazout are interested in getting more coupons once they have used up their own booklets. Both groups may find a common interest in trading coupons: at what price will coupons be traded?

The price of coupons (per litre) is bounded by two theoretical limits: buying mazout directly at the petrol station results in a cost of 25 SYP (without coupons) – and in practice no mazout consumer would agree to pay more than 16 SYP for a coupon. The total price of 9 SYP mazout plus coupon should not exceed 25 SYP. On the other hand, as coupons are received free of charge, their price might decline as low as zero. However, these limits are only theoretical. In practice, if a coupon costs 16 SYP and the total cost of one litre

reaches 25 SYP (16 + 9), there would be no incentive for the mazout buyer to avoid direct purchases. In order for the coupon deal to motivate the buyer, this buyer should save at least 3 SYP per litre; thus the price of the coupon should not be more than 13 SYP (so that the total cost of mazout reaches 22 SYP instead of 25). On the other hand, the coupon seller will not give the coupons free of charge: going to the local administration to obtain the coupon booklet and finding a client, is time consuming, and no one would do such an operation for less than 3 SYP per litre (which results in the sale of the entire booklet for 3,000 SYP or 60 dollars). Thus, in practice, the price of the coupon may vary between 3 SYP and 13 SYP.

Of course, coupon sellers would like to sell their coupons for 13 SYP, and coupon buyers would prefer to pay 3 SYP. One may imagine a simple solution to the problem of price determination: as both the buyer and the seller gain something in the exchange, the idea might arise that they should gain an equivalent amount. In that case, the price of the coupon would be established at the average of 8 SYP: the coupon seller gains 8 SYP and the coupon buyer also gains 8 SYP (he should have paid 25 SYP but will pay 9 + 8 = 17 SYP per litre, meaning that he will save 25 - 17 = 8 SYP).

Another solution relies on supply and demand of coupons. Let us consider first the case of the coupon seller. If the market price of the coupon is less than 3 SYP, no one will ever sell a coupon. Once the price rises higher than 3 SYP, some sellers will appear; and of course they will become more numerous when the market price of the coupon increases further. When the price reaches 13 SYP (its limit) coupon supply may grow until all potential sellers receive their coupon booklet. The supply curve of coupons is illustrated in the graph below. Let us now consider the case of coupon buyers: their demand for mazout depends on the price; it is possible to draw from this a demand for coupons, which depends on the price of the coupon. This is represented as a declining curve: the lower the price of coupon (or of mazout), the larger the quantity demanded.



In the coupon market on the street, buyers and sellers meet. This meeting is represented in the graph by the intersection of the supply and demand curves. If the market functions in a transparent way, the confrontation of supply and demand will determine an equilibrium price p^* and a corresponding quantity of traded coupons q^* . At present, it seems that p^* is equal to 9 SYP, but this price may vary because of speculation. For instance, if it is expected that the price will increase in the coming weeks, coupon sellers will stop selling (the supply curve will move to the left) and, if the buyers demand remains stable, the price will go up. This speculation effect might be the explanation of the fluctuations observed in the coupon price.

Unsurprisingly, the “mazout coupons” informal trading system has been associated with many cases of fraud and the use of falsified coupon booklets. We may expect that these phenomena have caused losses to the government budget and distorted the essence of the new subsidy scheme. Several booklets were stolen, many were misused, some were falsified, and many others were black-marketed. This raises the following questions: is the mazout coupons system the best, and does it ensure the optimal allocation of government subsidy? Or does it need reconsideration?

Some economists propose to replace the coupons system by a direct allocation of cash, in order to avoid misuses of coupons. What amount of money would be equivalent to the coupon system? With the coupon system, a subsidy of 16 SYP per litre (25 minus 9) is given to Mahrukat for all mazout sold according to quotas. If 3 million households (out of a total of 3.5 million households in Syria) take and use or sell their coupon booklet, this represents an amount of $16 * 1,000 * 3$ million SYP or 48 billion SYP. This is only the cost of the coupons system, which is a part of the total mazout subsidy. Another part of the total mazout subsidy is the loss incurred by selling the product at 25 SYP, whereas the real cost is 33-34 SYP per kilo or 28 SYP per litre. This price differential generates a loss of 29 billion SYP which should also be covered by a subsidy. In total, the mazout subsidy is still 77 billion SYP (for a full year) after the introduction of the coupon system. The idea of transferring that subsidy from Mahrukat to households would imply that each Syrian household would receive a yearly lump sum cash of 22,000 SYP (440 dollars) *, and the price of mazout would be fixed at 28 SYP per litre, which would allow Mahrukat to balance its accounts. Of course, many households would reduce their consumption of mazout and use the subsidy to purchase food, clothes or other goods or services.

Such a system presents some advantages as it establishes “true prices” and allows rational decision-making by households and enterprises. But it also has some shortcomings as it may trigger undesired inflation. Would it be more convenient to both the Syrian government and Syrian families to adopt this system compared to the coupons one? This is an open question for discussion and for further research in forthcoming issues of Syrian Economic Trend Bulletins.

* Of course, it would be possible to distribute the subsidy according to the number of persons in the family, or according to the number of “consumption units” (counting for instance 1 for adults and 0.7 for children).

