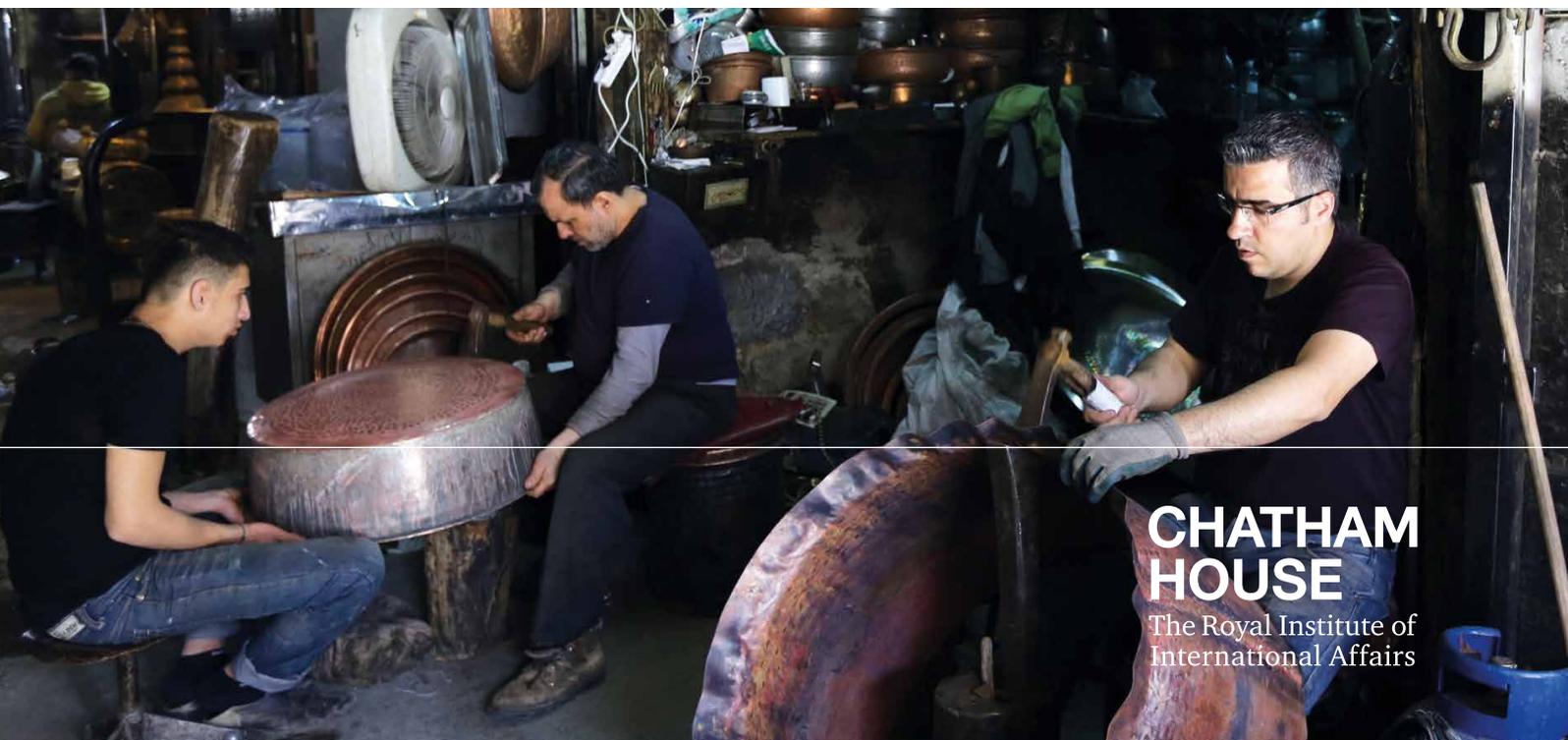


Research Paper

David Butter

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Salvaging Syria's Economy



**CHATHAM
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The Royal Institute of
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Summary

- Economic activity under the continuing conflict conditions in Syria has been reduced to the imperatives of survival. The central government remains the most important state-like actor, paying salaries and pensions to an estimated 2 million people, but most Syrians depend in some measure on aid and the war economy.
- In the continued absence of a political solution to the conflict, ensuring that refugees and people in need within Syria are given adequate humanitarian support, including education, training and possibilities of employment, should be the priority for the international community.
- The majority of Syrians still living in the country reside in areas under the control of President Bashar al-Assad's regime, which means that a significant portion of donor assistance goes through Damascus channels.
- Similarly, any meaningful post-conflict reconstruction programme will need to involve considerable external financial support to the Syrian government. Some of this could be forthcoming from Iran, Russia, the UN and, perhaps, China; but, for a genuine economic recovery to take hold, Western and Arab aid will be essential. While this provides leverage, the military intervention of Russia and the reluctance of Western powers to challenge Assad mean that his regime remains in a strong position to dictate terms for any reconstruction programme.
- If a political transition leaves the main elements of the regime in place, this would not amount to a credible settlement in the eyes of a significant portion of the Syrian population, both within the country and in exile. Such an arrangement would allow for some ramping up of UN aid efforts, but it would not provide a sufficient basis for planning a long-term reconstruction programme in which international financial institutions could play a substantive role.
- There is a risk that the West could become entangled in a web of political trade-offs in which economic aid is made conditional on concessions from Assad, while Assad seeks to make cooperation on the political settlement and in combating Islamic State of Iraq and Syria (ISIS) conditional on his receiving economic support. Western governments could come under increasing pressure to approve the channelling of reconstruction finance to the regime through multilateral agencies as a pragmatic means of providing humanitarian assistance and stemming the exodus of refugees.
- In the face of such pressures, Western powers should focus on setting clear benchmarks, including political inclusion and strict monitoring of ceasefires, before consenting to lift sanctions on the Syrian government. Provision of direct budgetary assistance to the Syrian government should be made contingent on a high degree of transparency in the management of the state's financial accounts.
- These conditions must also include the right to offer economic support to communities that have established their own autonomous institutions in the course of the struggle against the regime. Otherwise there is a risk that the pre-2011 state structures will be reassembled in some mutated form.

Introduction

It had occurred to me that ... the country was ... on the threshold of a great transformation, which first entailed degradation and regression in all areas of life. We were going back to square one in order to rebuild life from absolutely nothing.

*Samar Yazbek*¹

The conflict in Syria has had a shattering effect on the economy and society, and has broken the country into fragments. At the fifth anniversary of the uprising against the regime of President Bashar al-Assad, there is little sign of a resolution. More than 6 million Syrians, one-quarter of the population, have left the country, seeking refuge in neighbouring states or embarking on a perilous migration to Europe, and as the fighting continues many more are likely to follow. Despite the devastation, economic life continues, but reconstruction remains an elusive prospect. As of February 2016, the UN Office for the Coordination of Humanitarian Affairs (UN OCHA) estimated that there are 13.5 million people in need of humanitarian assistance in Syria.² This suggests that three in four Syrians within the country require some form of external aid in order to subsist. Under such circumstances, the task of putting the economy on a more or less sustainable footing poses a monumental challenge. Abdullah al-Dardari, the deputy executive secretary of the UN Economic and Social Commission for Western Asia (ESCWA), has said that \$180 billion of investment would be needed just to restore Syria's gross domestic product (GDP) to its pre-conflict level of \$60 billion.³

Parts of the pre-conflict national economy still function. Government salaries and pensions are paid; infrastructure operates, albeit at a considerably reduced level; farmers continue to produce food and cash crops, some of which are sold through state marketing channels; the Syrian pound remains the principal currency in circulation. In other respects, economic activity has reflected the course of the conflict, with the country breaking up into semi-autonomous zones. The movement of goods and people between these zones and over the borders to neighbouring states creates opportunities for middlemen to extract fees, forming the basis for a war economy. On the regime side this is a source of profits for militia bosses, security officials, business people and bureaucrats, while in rebel-controlled areas and in territory under the command of Islamic State of Iraq and Syria (ISIS), the proceeds go to financing military operations and enriching rebel leaders. A report published in mid-2015 by the London School of Economics provided valuable insights into the workings of the war economy in border areas in the south and north, as well as in eastern Ghouta, on the edge of Damascus.⁴ For the economy as a whole, these activities are the source of ruinous transaction costs.

The scale of the devastation wrought on Syria's economy and society means that recovery and reconstruction will pose enormous challenges, even in the unlikely event that a political settlement

¹ Yazbek, S. (2015), *The Crossing: My Journey to the Shattered Heart of Syria*, London: Rider Books, p. 72.

² UN OCHA (2016), Syrian Arab Republic: Crisis Overview, <http://www.unocha.org/syria> (accessed 24 Feb. 2016).

³ Al-Dardari, A. (2016), Channel 4 News, 4 Feb. 2016, <http://www.channel4.com/news/catch-up/display/playlistref/040216> (accessed 24 Feb. 2016).

⁴ Turkmani, R., Ali, A. A. K., Kaldor, M. and Bojjic-Dzelilovic, V. (2015), *Countering the logic of the war economy in Syria: Evidence from three local areas*, Research Paper, London: London School of Economics and Political Science, <http://www.securityintransition.org/wp-content/uploads/2015/08/Countering-war-economy-Syria2.pdf?> (accessed 24 Feb. 2016).

can be reached that offers stability and the prospect of good governance.⁵ Without such a settlement, the challenges will be even more daunting. Yet whatever the outcome of the political and military struggles, the operation of the Syrian economy – or of the various Syrian economies – will remain of critical importance to the country's remaining inhabitants, as well as to its neighbours and the wider world, which are faced with the prospect of absorbing more and more refugees.

One of the central issues in external deliberations about the political future of Syria is the relationship between the 'state' and the 'regime'. Ever since the Geneva communiqué issued in June 2012, the starting point of a political settlement has been envisaged as a transitional governing body, which could include members of the present government along with opposition figures, and which would be created by mutual consent.⁶ The outline of a potential political settlement was presented again, with some modifications, at international meetings in Vienna on 30 October and 14 November 2015, retaining the stated commitment to the territorial and institutional integrity of the Syrian state.⁷ These proposals were endorsed in UN Security Council Resolution 2254, adopted unanimously on 18 December 2015. The settlement process was envisaged as starting with negotiations between representatives of the regime and the opposition about a transitional system of governance and a ceasefire to allow for a new constitution to be drawn up and for elections to be held within 18 months. There was an abortive effort to get these talks started in Geneva at the end of January 2016, but the UN suspended the process after the Assad regime launched a major offensive, backed by Russian air power, against rebel forces in the north and south of the country.

The international consensus on the need to preserve the institutional integrity of the Syrian state does not explicitly entail conferring legitimacy on the Assad regime, but it raises important questions about where the dividing line can be drawn between state functions and those of political interests that have dominated the state for decades. Armed opposition groups made their own effort to draw this line as part of their response to the UN's political initiative. The opposition groups made clear their continued insistence that neither Assad nor 'the pillars of his regime' can have 'a place or a role in the new Syria or the transitional phase', but they also called for 'the continuity of the service-providing State institutions', while demanding the dissolution of the security apparatus and 'the restructuring of the army and the judiciary'.⁸ In a later statement setting out terms for participation in negotiations, the opposition specified that Assad 'and his circle' must leave office at the start of the transitional period. The statement confirmed the opposition's commitment to the preservation of Syrian state institutions.⁹

This endorsement by the armed opposition groups of the principle that state institutions should continue to operate at a national level is important in countering the view that Syria's disintegration has become irreversible. However, it could be argued that such statements bear little relation to the reality of the armed groups' operations on the ground, and indeed that none of the main actors in the

⁵ An earlier research paper by this author attempted to quantify the impact of the crisis on the Syrian economy: Butter, D. (2015), *Syria's Economy: Picking up the Pieces*, Research Paper, London: Chatham House, https://www.chathamhouse.org/sites/files/chathamhouse/field/field_document/20150623SyriaEconomyButter.pdf.

⁶ Action Group for Syria (2012), 'Final Communiqué', 30 June 2012, <http://www.un.org/News/dh/infocus/Syria/FinalCommuniqueActionGroupforSyria.pdf> (accessed 24 Feb. 2016).

⁷ European External Action Service (2015), Joint Statement: Final declaration on the results on the Syria Talks in Vienna as agreed by participants, 30 October 2015, http://eeas.europa.eu/statements-eeas/2015/151030_06.htm (accessed 24 Feb. 2016).

⁸ An English translation of the text of the opposition groups' statement and the names of the signatories is included in Lund, A. (2015), 'Syrian Rebels Agree on Joint Approach to UN Peace Talks', Carnegie Endowment for International Peace, 18 September 2015, <http://carnegieendowment.org/syriaincrisis/?fa=61336> (accessed 24 Feb. 2016).

⁹ France Diplomatie (2015), 'Final Statement of the Conference of Syrian Revolution and Opposition Forces Riyadh', 10 December 2015, <http://www.diplomatie.gouv.fr/en/country-files/syria/events/article/final-statement-of-the-conference-of-syrian-revolution-and-opposition-forces> (accessed 24 Feb. 2016).

Syrian conflict are genuinely committed to the preservation of the nation state and its institutions. The regime has made a renewed effort, with the entry of Russia into the conflict since 30 September 2015, to reconquer rebel-held territory, an offensive that has resulted in further destruction of infrastructure in these areas and in further depopulation; the leaders of Syria's Kurds are focused on maximizing the autonomy of regions that they hold in the north and the northeast, and have taken advantage of Western military support to expand their areas of influence; ISIS has little regard for modern national borders; and the armed opposition groups are individually and collectively too small to lay credible claim to operating on a national level, particularly after the losses they have incurred following Russia's military intervention.

About this paper

This paper examines the Syrian economy from the dual perspectives of institutional survival and fragmentation. It asks what elements, if any, of the economy can continue to function on a national basis, and under what circumstances these sectors or activities can be supported by development agencies. The most important sectors in this respect are agriculture, which has assumed a much larger role in the economy since 2011 relative to other sectors that have suffered far greater damage, and government services. Other critical areas include energy, and safeguarding the property rights of households and businesses. The paper also assesses the prospects of parts of the economy that have only tenuous links to the Syrian state as a result of the country's fragmentation. The external contribution to Syria's current economic subsistence entails a division of labour, with Iran, Russia and UN agencies most heavily involved in regime-controlled areas, and Western and Arab governments and non-governmental organizations (NGOs) left to deal with refugees and people living in areas that are controlled by neither the regime nor ISIS. For any economic recovery to take place, these efforts would need to be pooled.

Any approach to charting a reconstruction strategy that could be put into effect during a transition to a political settlement will need to encompass ways to promote development in semi-autonomous parts of the country, alongside national initiatives. If the Assad regime succeeds in bolstering its position within Syria and in its international diplomacy, Western governments could come under increasing pressure to approve the channelling of reconstruction finance to the regime through multilateral agencies as a pragmatic means of providing humanitarian assistance and stemming the exodus of refugees. There is a risk that the West could become entangled in a web of political trade-offs: economic aid being made conditional on concessions from President Assad; and Assad making cooperation on the political settlement and in combating ISIS conditional on his receiving economic support, and on the European Union (EU) and the United States removing sanctions.

Institutional Survival

As the Syrian conflict has intensified and territorial divisions have become entrenched, the concept of a Syrian national economy is losing relevance. The central government continues to operate from Damascus, but its writ does not extend over more than half of the national territory, and it has lost control over most of its land border crossings, other than those with Lebanon. In some areas of policy the government has acknowledged the limits of its reach. For example, in February 2016 the Central Bureau of Statistics noted that it had dropped Raqqa, Deir ez-Zor and Idlib from the consumer price index that it compiles to show inflation by governorate.¹⁰ This split reflects the actual divisions between regime-held areas and areas controlled by the various rebel groups, Kurdish forces and ISIS. International aid agencies also implicitly recognize these divisions, with UN-affiliated agencies largely operating in coordination with government ministries and security authorities, and many NGOs working directly with local communities in rebel-held areas, or with ministries of the Syrian Interim Government, established by the Syrian National Coalition.¹¹

However, fragmentation is not the same as a formal break-up of the nation state. Most of the political actors and fighting groups in Syria still have some dealings with the Damascus government, and the political programmes of most groups other than ISIS are based on the presumption that Syria will continue to exist as a sovereign state. Within that state, there have been some fundamental changes in institutional structure. The previous system was based on strong centralized control exercised by the presidency, through numerous intelligence agencies, provincial governors and outposts of the Baath party. Ministers and senior figures in the civil service were either part of this structure or closely supervised by members of the security apparatus. Private businesses had some leeway to operate as long as they did not threaten the dominance of the groups with connections to the security state.

Many elements of the pre-conflict structure have survived within the core areas still under regime control. Changes have included the erosion of some of the influence of the Baath party, purges within the intelligence services (which have affected the fortunes of business people who had benefited from the patronage of some of the purged officials), and the growth of militias built up with Iranian support from the smuggling networks known as the *Shabiha*. The majority of households are still dependent on the state for part of their livelihood, in the form of salaries, pensions and subsidies, but this state role is in turn increasingly dependent on support from UN agencies that provide food, agricultural inputs, water, sanitation, education and health services in coordination with government ministries. Many Syrians supplement their meagre incomes through participation in the war economy, by moving goods, money and people between areas controlled by different armed groups; many more suffer the costs of the war economy through having to pay heavily marked-up prices for scarce basic necessities.

¹⁰ The most recent published consumer price index (CPI) data are for August 2015, available at <http://www.cbssyr.sy/CPI/cpi-month08-2015.htm>; CPI data for May 2015 are the last to include all 14 governorates.

¹¹ An example of the latter is the Syrian Recovery Trust Fund, a coalition of donors operating from Turkey and focusing on northern areas of Syria. Syria Recovery Trust Fund (2016), <http://www.srtfund.org/index.php> (accessed 24 Feb. 2016).

Depopulation and displacement

One of the most important changes to Syria's economic structure has been to the country's demographic make-up, in terms of both the fall in the total population and the shifts of population between governorates (see Table 1). At the start of 2011 the resident Syrian population was 20.8 million, according to the country's Central Bureau of Statistics. The total registered population, including Syrians living abroad, was 24.5 million. Of the total resident population, three-quarters lived in the region running from Damascus up to Homs, Hama, Aleppo and Idlib, and along the coast in Latakia and Tartous governorates. A further 3.6 million lived in the northern and eastern governorates of Hasaka, Raqqa and Deir ez-Zor, and 1.4 million in the southern governorates of Deraa, Sweida and Quneitra.¹²

Since 2011 there have been no government-issued population figures, but it is possible to make some broad demographic estimates based on UN data on refugees and internally displaced persons (IDPs). Between 2000 and 2010 the average net rate of population increase was 2.45 per cent, according to Syria's Central Bureau of Statistics. Applying that rate to the following five years, the resident population would have reached 23.5 million under stable conditions. By the beginning of March 2016, according to the office of the UN High Commissioner for Refugees (UNHCR), there were some 4.8 million Syrian registered refugees.¹³ The number of Syrians who had applied for asylum in Europe between April 2011 and December 2015 exceeded 897,000.¹⁴ Factoring in at least 250,000 deaths in the conflict and the probable exodus of more than two million Syrians not registered either as refugees or as asylum-seekers, the number of Syrians living within the country in early 2016 is likely to be between 15 million and 16 million.¹⁵ Any future military escalation will mean that the numbers of IDPs and refugees will increase.

Critically, the majority of Syrians still resident in the country live in areas under government control. These include Latakia, Tartous, Sweida, most of Damascus and Homs, and parts of Aleppo, Hama and Deraa. Yet it should be noted that people living in areas outside regime control still have residual links to the government, for example through trading across the front lines and drawing state salaries and pensions.

Significant numbers of people have migrated from rebel-held areas to relatively safe regime-held governorates such as Latakia, Tartous and the city of Damascus. The complexity of the movement of people within and between governorates can be gauged from Map 1, which traces the internal displacement of 1.2 million people between January and August 2015 – a period that witnessed heavy fighting between the regime and rebels in Idlib and Deraa governorates in particular, and conflicts between Kurdish forces and ISIS in Raqqa and Hasaka governorates.

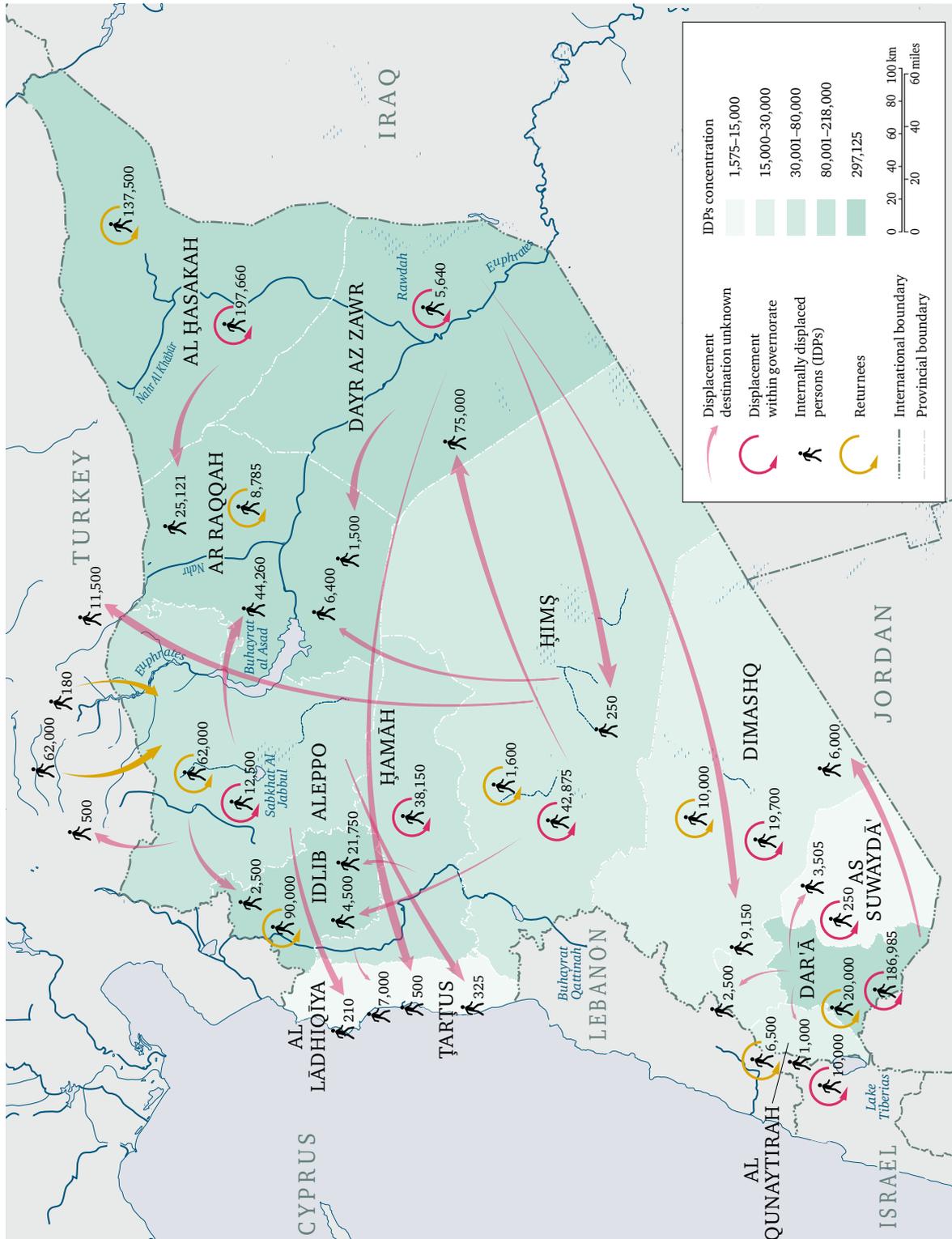
¹² Syrian Central Bureau of Statistics. General population data can be found at <http://www.cbssyr.sy/yearbook/2011/Data-Chapter2/TAB-1-2-2011.htm>; and population data including those living outside Syria at <http://www.cbssyr.sy/yearbook/2011/Data-Chapter2/TAB-1-2-2011.htm> (accessed 3 Mar. 2016).

¹³ UNHCR (2016) 'Syria Regional Refugee Response: Inter-agency Sharing Portal', <http://data.unhcr.org/syrianrefugees/regional.php> (accessed 8 Mar. 2016). The figure of 4.8 million includes 2.1 million Syrians registered by UNHCR in Egypt, Iraq, Jordan and Lebanon, 1.9 million Syrians registered by the government of Turkey, and more than 28,000 Syrian refugees registered in North Africa.

¹⁴ UNHCR (2016) 'Syria Regional Refugee Response: Inter-agency Sharing Portal, Europe: Syrian Asylum Applications', <http://data.unhcr.org/syrianrefugees/asylum.php> (accessed 8 Mar. 2016). The total of 897,645 is based on data for 37 European countries (i.e. including non-EU countries) that provide monthly information to UNHCR, and to the extent possible reflects first-time asylum applications.

¹⁵ For the purposes of this paper, a number of broad assumptions have been made about the distribution of a total resident population of between 15 million and 16 million: that the two coastal governorates of Latakia and Tartous have witnessed the biggest increases in population, mainly through internal migration, from 1.75 million in 2010 to about 3.2 million; that the population of central Damascus has remained stable, or declined marginally; and that in all of the other governorates the population is likely to have decreased, with the largest outflows coming from Rural Damascus, Aleppo and Idlib.

Map 1: Internal displacement in Syria (January–August 2015)



Source: Adapted from UN OCHA, <https://www.humanitarianresponse.info/en/node/111532>. The boundaries and names on this map do not imply endorsement or acceptance by Chatham House.

Table 1: Syrian population by governorate, 2010; and estimated change by 2016 (million)

	2010	2011–16
Damascus	1.7	Stable, or slight decline, as outward migration partly covered by inflow of IDPs
Rural Damascus	2.7	Heavily depleted, probably reduced to the low hundreds of thousands
Aleppo	4.7	Large-scale internal migration, mainly from E. Aleppo, and heavy external migration
Homs	1.8	Large exodus in 2012–14, both internally to coast and Damascus, and externally
Hama	1.6	Significant reduction in population
Latakia	1.0	Influx of population from other areas, but some outward migration from north
Tartous	0.75	Population likely to have more than doubled, as a result of internal migration
Idlib	1.5	Population reduced by at least one-third
Hasaka	1.5	Modest reduction as main population centres relatively secure
Deir ez-Zor	1.2	Heavily depleted as a result of fighting between ISIS and regime, coalition raids and ISIS oppression
Raqqa	0.92	Relatively stable during initial period of ISIS rule, but steady attrition from 2015 onwards
Deraa	1.0	Large-scale migration over the border to Jordan
Sweida	0.36	Relatively stable
Quneitra	0.08	Relatively stable
Total	20.8	15–16 million by early 2016

Note: These figures refer to the population actually living in Syria.

Sources: Syrian Central Bureau of Statistics; author's estimates.

Geography and living standards

The intensification of the conflict after the Russian intervention has led to an even starker contrast between living standards in different parts of the country. The regime has exploited the larger degree of control that it exerts over the distribution of aid as a means to tighten the squeeze on populations in isolated rebel-held areas; rebel forces also enforced sieges on a number of loyalist areas. In January 2016 the UN stated that it had identified 15 besieged areas, with a total of about 400,000 people at risk of malnutrition.¹⁶ Several NGOs cite higher figures – including Médecins Sans Frontières, which estimated in the same month that between 1.5 million and 2 million people were trapped by sieges imposed by the Syrian government or opposition groups.¹⁷ In a more mundane way, the government's own statistics reflect the regional disparities. The Central Bureau of Statistics continued to compile a consumer price index for all 14 governorates until (as confirmed in February 2016) it dropped Raqqa, Deir ez-Zor and Idlib with effect from June 2015. In the final 14-governorate index, showing the situation in May 2015, it was clear that most regime-held areas had been shielded from the worst effects of the crisis (see Table 2). The highest index levels and inflation rates were recorded in ISIS-controlled Raqqa and Deir ez-Zor. The lowest indices were in Latakia, Tartous and Damascus. Aleppo, which is split between the regime and rebels, had the lowest inflation rate in May 2015, but had the third highest index level, reflecting sharp price increases in previous periods of the conflict.

¹⁶ UN News Centre (2016), 'Syria: UN officials give first-hand accounts of 'horrible, terrible' desperation in besieged towns', 12 January 2016, <http://www.un.org/apps/news/story.asp?NewsID=52988#.VrsnpliLSM8> (accessed 24 Feb. 2016).

¹⁷ Doctors Without Borders (2016), 'Syria: Starvation Continues In Madaya', 29 January 2016, <http://www.doctorswithoutborders.org/article/syria-starvation-continues-madaya> (accessed 24 Feb. 2016).

Table 2: Consumer price index (CPI) and inflation rate, by governorate (May 2015)

	CPI	% increase from May 2014
Damascus	398.22	34.1
Rural Damascus	418.70	39.2
Aleppo	455.55	34.0
Homs	415.44	42.2
Hama	421.55	39.6
Latakia	377.41	42.3
Tartous	392.17	40.1
Idlib	423.80	45.4
Hasaka	416.31	36.8
Deir ez-Zor	518.33	61.9
Raqqqa	529.95	66.3
Deraa	430.77	45.6
Sweida	423.07	52.8
Quneitra	436.78	38.8
All governorates	430.21	39.7

Source: Syrian Central Bureau of Statistics.

Government Reach

A central plank of the Assad regime's survival strategy has been to keep up the appearance that the government is continuing to function effectively despite the military conflict and the loss of territory to rebel forces and ISIS. The government draws up budgets, laws and regulations that are discussed by the parliament elected in May 2012 (for a four-year term) and signed off by President Assad. Government ministries responsible for sectors such as education, health and agriculture coordinate assistance programmes with UN agencies, supposedly covering most parts of the country. The Ministry of Internal Trade and Consumer Protection sets prices for commodities, even though few sales are actually conducted at these rates. The ministries of petroleum and electricity and affiliated state companies strive to maintain basic levels of energy provision.

The fiscal operations of the Syrian government continue to have a significant impact on the economic activity of the majority of the country's population, although the role of the unofficial economy has undoubtedly increased as a result of the conflict.

The fiscal operations of the Syrian government continue to have a significant impact on the economic activity of the majority of the country's population, although the role of the unofficial economy has undoubtedly increased as a result of the conflict. In the five years before 2011, government expenditure accounted for between 25 per cent and 28 per cent of GDP.¹⁸ Most of this consisted of current spending on wages and salaries, pensions, subsidies and defence, and about one-third was allocated to capital expenditure. Since the 2012 budget, the government has announced the annual estimated cost of subsidies, including explicit sums within the budget for basic foodstuffs and grants to companies, as well as a larger figure for implicit subsidies for fuel and electricity.

As set out in Table 3, based on the exchange rate applied by the government in announcing its budget plans before the start of each fiscal year (January–December), total planned expenditure has fallen in US dollar terms from \$24.3 billion in 2012 to \$7.9 billion allocated for 2016, when the rate applied was £S250:\$1 (the official central bank rate in October 2015). The 2015 budget spending target was equivalent to \$10.4 billion at the exchange rate of £S150:\$1 applied when it was announced. However, the government has since stated that a rate of £S200:\$1 should be applied; this would bring the total down to \$7.8 billion but also allow officials to disguise the extent of the real-term decline in government spending envisaged for 2016. Assuming further depreciation of the Syrian pound, the actual dollar equivalent of the government's spending target by the end of 2016 is likely to be only about \$6 billion, or one-quarter of what was allocated four years previously.

¹⁸ International Monetary Fund (2010), *Syrian Arab Republic: 2009 Article IV Consultation – Staff Report; and Public Information Notice*, International Monetary Fund Report, Washington, DC: IMF, p. 18, <http://www.imf.org/external/pubs/ft/scr/2010/cr1086.pdf> (accessed 24 Feb. 2016).

Table 3: Syrian government budget expenditure and subsidies, 2011–16

	Expenditure (£S bn)	Expenditure (US\$ bn)	Subsidies (budget and off-budget) (£Sbn)
2011	835	18.6	n/a
2012	1,326	24.3	376
2013	1,383	23.1	512
2014	1,390	13.9	615
2015	1,554	10.4	984
2016	1,980	7.9	1,050

Note: Exchange rates are based on those announced by the government at the time of budget publication. The rate of £S250:\$1 applied to the 2016 budget compares with the official commercial bank rate of £S336:\$1 in February 2016 and with the black market rate of £S400:\$1. Sources: Ministry of Finance; state media reports.

The most direct impact of the budget on ordinary Syrians is seen in the remuneration of state employees and pensioners. In September 2015 President Assad announced a flat-rate increase of £S2,500 (about \$10) per month for all government employees, members of the armed forces and staff of companies in which the state's stake is at least 75 per cent. It was the first increase in public-sector salaries since June 2013, when the government raised monthly salaries by 40 per cent for the first £S10,000 earned, 20 per cent for the next £S10,000, 10 per cent for the next £S10,000 and 5 per cent for salaries of £S30,000 and above. In the meantime, the official exchange rate has depreciated by 60 per cent and the consumer price index has risen by about 80 per cent.

According to *The Syria Report*, an independent newsletter covering the Syrian economy, the pay increase will apply to 1.5 million people.¹⁹ This is broadly consistent with the most recent official labour statistics, which showed 1.36 million government employees in 2010, in a total workforce of 5.1 million.²⁰ Two weeks after this announcement, the government announced a number of measures that would dilute any benefits from the salary increases. It said that the rate of income tax on state salaries would rise from 5 per cent to 10 per cent, although the threshold for paying tax has been raised to £S15,000 from £S10,000 per month. Another step that put further strain on household budgets was a 43 per cent increase in bread prices to £S50 per 1-kg bag (*rubta*), which typically contains eight loaves. There had already been two previous price increases, to £S35 in January 2015, and to £S25 from £S15 in July 2014. The government claims that the real cost of producing a bag of bread is £S183. The quality of bread has been impaired as more bran and husks have been mixed in with the flour. The government also announced an increase of £S200 in the price of a 10-kg canister of cooking gas, which now costs £S1,800.

The monthly salary and pension payments for most Syrians on the state payroll fall far short of what they would need to meet basic household expenses of about \$500 per month.

The monthly salary and pension payments for most Syrians on the state payroll fall far short of what they would need to meet basic household expenses of about \$500 per month. The gap is filled, according to circumstance, through corruption, participating in the informal economy or the war

¹⁹ *The Syria Report* (2015), 'Government Announces New Pay Rise for Civil Servants', 28 September 2015, <http://www.syria-report.com/news/economy/government-announces-new-pay-rise-civil-servants> (accessed 24 Feb. 2016; available by subscription).

²⁰ Syrian Central Bureau of Statistics (2010), 'Distribution of Employees (15 years and over) by Educational Status, Work Sector and Sex', <http://www.cbssyr.sy/yearbook/2011/Data-Chapter3/TAB-4-3-2011.htm> (accessed 24 Feb. 2016).

economy, or through resort to aid agencies, charities or relatives abroad. Another response to the steep decline in living standards is to leave the country. The resultant loss of human resources and talent is a drain on the economy, but has some benefits for the regime as it lowers the government's expenditure on salaries and subsidies. In the same way, the destruction of social infrastructure such as schools and hospitals in areas lost by the regime to rebel forces provides cost benefits to the government, as well as being a form of punishment for the civilian population that has the misfortune to live in these areas.

There is a yawning gap between the revenue that the government can realistically garner and its budgeted spending commitments, even taking into account the steep real-term decline in expenditure. The government announced that it would earn total revenue of £599.2 billion in 2015, but it did not provide any breakdown other than noting that most of the proceeds would come from oil, despite the fact that Syria no longer exports any oil. The revenue target set for 2016 was £1,359 billion, again with no explanation of how this would be achieved. Proceeds from taxation, customs and public-sector profits would amount to only a small fraction of the target. This means that the bulk of spending has to be financed through borrowing from the central bank and state-owned commercial banks, supplemented by aid from Iran. The government is also able to shift some of the burden of financing social programmes on to the shoulders of UN agencies. One of the conditions that Western donors could place on any future enhancement of aid to the Syrian government, whether through existing UN channels or through new multilateral or bilateral funding mechanisms, would be to insist on a much greater degree of transparency in government accounts, although it is questionable whether this is remotely feasible if most of the core structures of the Assad regime remain intact.

In the absence of a political settlement or a significant increase in external support, it is likely that both the financial situation of the government and the plight of the Syrians who depend on the state for their economic survival will continue to deteriorate. The Assad regime and its principal backers have sought to create a reality in which the survival of government institutions is synonymous with the survival of the regime. Excluded from this narrative is any possibility of the non-ISIS opposition being capable of providing an alternative means of safeguarding these institutions or of creating self-sustaining institutions of their own.

In a paper published by the Carnegie Middle East Center in July 2015, Kheder Khaddour argued strongly for international support to be stepped up for these opposition forces, including military protection of civilians and a heavy commitment to institution-building, as a means to undermine the regime's claim to be the sole effective guarantor of the integrity of the Syrian state.²¹ The Russian intervention has rendered the possibility of such empowerment of the opposition even less likely than it was before: dozens of hospitals, schools, markets and bakeries have been bombed in rebel areas,²² in what appears to be a strategy of depopulation. However, the regime's chances of reimposing central state control over all the areas that it has lost to the non-ISIS opposition since 2011, let alone of rolling back ISIS, are similarly slim. Moreover, Iran and Russia lack the economic resources to reconstitute the Syrian economy on their own. That task will need to be undertaken by a broad international coalition, which is unlikely to materialize unless a representative group of Syrians, and their state backers, can negotiate a way to end the rule of the Assad regime, or unless Western governments decide to provide economic support to the regime.

²¹ Khaddour, K. (2015), *The Assad Regime's Hold on the Syrian State*, Research Paper, Beirut: Carnegie Middle East Center, <http://carnegie-mec.org/2015/07/08/assad-regime-s-hold-on-syrian-state/id3k> (accessed 24 Feb. 2016).

²² Amnesty International (2015), 'Syria: 'Civilian Objects Were Not Damaged': Russia's Statements on Its Attacks in Syria Unmasked', <https://www.amnesty.org/en/documents/mde24/3113/2015/en/> (accessed 24 Feb. 2016).

Resource Depletion

Agriculture, oil and gas, phosphate mining and light industry were the mainstays of Syria's productive economy before the conflict, and the recovery of these sectors will need to be a central element in any sort of reconstruction effort. Agriculture accounted for almost one-fifth of national output in 2010, and since then its contribution has more than doubled in relative terms, despite a decline in the production of most crops and a sharp fall in livestock herds and poultry flocks. Oil output has dwindled, first as a result of sanctions and then as a direct result of the conflict; most oilfields are now in the hands of either ISIS or Kurdish groups. The government remains in control of natural gasfields to the west of Palmyra, which are linked to power stations outside Damascus and Homs, while ISIS controls other fields to the south of Raqqa and east of Palmyra that are linked by pipeline to power stations in northern and central Syria. Most fuel for domestic consumption comes from the Baniyas refinery, which processes crude oil supplied by Iran, or from small-scale refineries set up to process crude from fields in ISIS- or Kurd-controlled areas. Phosphate production has fallen sharply as a result of the capture by ISIS of the largest mines southwest of Palmyra. Industrial areas around Aleppo, Damascus and Homs have been heavily damaged in the conflict, and many factory owners have relocated to Tartous, on the coast, or to the area around Gaziantep in Turkey.

Agriculture

The UN's Food and Agriculture Organization (FAO) and the World Food Programme (WFP) have jointly provided surveys of the state of agriculture, based on annual visits, the most recent in May 2015.²³ These reports set out the challenges that farmers face, including war damage to farmland and infrastructure, shortages of seed, fertilizer and animal feed, lack of fuel for farm machinery, disruptions to marketing and distribution networks, and the levying of taxes and transit fees by armed groups and regime-affiliated militias.

The 2015 cereals harvest was relatively good, reflecting favourable weather conditions, but production was still well below the long-term average. According to the May 2015 FAO/WFP report, wheat production was between 2.5 million and 2.8 million tonnes, most of which was harvested in the northern governorates of Hasaka, Raqqa, Aleppo and Idlib. In normal times the state cereal processing and marketing agency, Hoboob, procures about 75 per cent of the harvest. However, Hoboob's director, Majid al-Humeidan, said in August 2015 that the agency had only procured 412,000 tonnes in that harvest year.²⁴ The shortfall can be explained by a number of factors. Opposition groups in Idlib and Aleppo province have set up their own procurement networks, buying wheat from farmers at a price that is competitive with the government price of about \$220 per tonne, according to the FAO/WFP report. Some wheat is likely to have been smuggled over the border to Turkey or Iraq. ISIS has exerted control over agriculture in most of Raqqa and Deir ez-Zor governorates, and oversees the operation of flour mills in Manbij. In Hasaka, the high cost of transporting wheat to milling centres in

²³ Food and Agriculture Organization of the United Nations (2015), *Special Report: FAO/WFP Crop and Food Security Assessment Mission to the Syrian Arab Republic*, Rome: FAO, <http://www.fao.org/3/a-i4804e.pdf> (accessed 24 Feb. 2016).

²⁴ Shbat, A. (2015), 'Al-ḥubūb tatahafaz 'ala 'arqām wizārat az-zira'a ... al-'azma tukhfid 'intāj al-qamiḥ 10 'ad'āf' [Hoboob has reservations about Agriculture Ministry's wheat figures ... crisis has reduced wheat output tenfold], *Al-Watan*, 9 August 2015, <http://alwatan.sy/archives/14622> (accessed 24 Feb. 2016).

Homs and Damascus has led to a build-up of stocks, which are now estimated at more than 1.5 million tonnes; there have also been suggestions that this stockpiling was the result of a misguided effort by Kurdish political and military groups to maximize profits by holding back supplies in the expectation of securing higher prices at a later date.²⁵ The Ministry of Agriculture has expressed concern about the prospects for the 2015/16 cereals harvest, noting in January 2016 that only 538,000 hectares of the targeted 1.7 million hectares had been sown with wheat.²⁶

The FAO/WFP report includes an illustration of the comparative costs of delivering a tonne of wheat to Damascus from Hasaka and from the Black Sea. The original commodity cost is roughly similar, at between \$210 and \$220. The Black Sea wheat accrues costs of \$3 for quality control, \$45 for sea freight, \$13 for customs duty and \$20 for land transport, giving a final cost of about \$300 by the time it reaches Damascus. The cost of a tonne of Hasaka wheat in Damascus is about \$60 higher, \$52 being levied as a 25 per cent tax by armed groups, and with transport costs of \$96.

Olives have traditionally been the main cash crop in the northwestern governorates of Idlib, Aleppo, Hama, Latakia and Tartous. Syria has been one of the world's largest producers of olive oil, alternating with Tunisia in fourth and fifth place, behind Spain, Greece and Italy.²⁷ Before the conflict Syria produced on average about 1 million tonnes of olives a year, yielding up to 200,000 tonnes of olive oil.²⁸ According to FAO data, olive production slumped to 400,000 tonnes in the 2014/15 season, yielding only about 50,000 tonnes of olive oil. Farmers had to contend with 'peacock eye' disease, which afflicted trees in many areas, as well as poor weather conditions. Thousands of olive trees have also been cut down for firewood to make up for the lack of fuel supplies, and there have been frequent reports of orchards being burned down by army troops and regime militias as a form of collective punishment of communities hosting rebels. Prospects for the 2015/16 harvest are reported to be better, but the escalation of the fighting in northwestern Syria following the Russian intervention at the end of September 2015 casts doubt on how much of the crop will actually be picked, and on the volume of olive oil that will be produced.²⁹

Before the conflict between 180,000 and 200,000 hectares of land was devoted to cotton growing, mainly in Raqqa and Hasaka governorates. By 2015, according to FAO data, this had fallen to 43,000 hectares.

Other cash crops have suffered even more serious damage. Before the conflict between 180,000 and 200,000 hectares of land was devoted to cotton growing, mainly in Raqqa and Hasaka governorates. By 2015, according to FAO data, this had fallen to 43,000 hectares. Production has fallen from an annual average of about 650,000 tonnes to below 200,000 tonnes. The main issues facing farmers have been the difficulty in securing seeds and pesticides, and chronic labour shortages. There have been similar declines in the tobacco and sugar beet crops.

²⁵ Confidential observation from source with privileged information.

²⁶ Abdellatif, M. (2016), '31% faqaṭ nisbat tanfīth zirā'at al-qamiḥ ... wa su'ūbat ta'mīn mustalzamāt al-'intāj' [Wheat quota only 31% fulfilled ... problems securing production inputs], *Al-Watan*, 6 January 2016, <http://alwatan.sy/archives/35319> (accessed 24 Feb. 2016).

²⁷ International Olive Council (2015), 'World Olive Oil Figures', <http://www.internationaloliveoil.org/estaticos/view/131-world-olive-oil-figures> (accessed 24 Feb. 2016).

²⁸ According to government data, between 2006 and 2010 Syria produced on average 870,000 tonnes of olives per year, yielding 170,000 tonnes of olive oil per year. The deterioration in the oil yield since that point is likely to be war-related. Government figures for the historical data are available at <http://www.cbssy.sy/yearbook/2011/Data-Chapter4/TAB-26-4-2011.htm> (accessed Feb. 2016).

²⁹ Bacchi, U. (2015), 'Syria's olive warriors: Farmers defy civil war turmoil to lead global oil production resurgence', *International Business Times*, 14 October 2015, <http://www.ibtimes.co.uk/syrias-olive-warriors-farmers-defy-civil-war-turmoil-lead-global-oil-production-resurgence-1523941> (accessed 24 Feb. 2016).

Farmers incur an additional burden of taxation in the areas under ISIS control. A set of documents obtained by Aymenn Jawad al-Tamimi, a researcher attached to the Middle East Forum, and published in a blog on the Jihadology website, provides some valuable insights into this form of levy. According to the budget for Wilayat al-Khair, corresponding to most of Deir ez-Zor governorate and parts of Homs governorate for Rabi' al-Awal 1436 (23 December 2014 to 21 January 2015), the sum of \$300,000 was to be collected in *zakat*³⁰ from wheat farmers in the province that month, plus \$170,000 from barley farmers.³¹

There are measures that can be taken to support Syrian agriculture, even in the current circumstances. It is clear that farmers would benefit from supplies of critical inputs such as seed, fertilizer and fuel at affordable prices, backed up by reconstruction of damaged irrigation and drainage infrastructure. Many farmers have grown to depend on the government for technical advice and marketing structures, and aid agencies could play a role in enabling them to operate with greater independence. Some support can be channelled through the existing government administrative structures by UN agencies, but this is only feasible in areas of relatively little conflict, which may well be less in need of assistance than those that are outside government control. NGOs operating in rebel-held areas in the north and south of the country have an opportunity to work with local communities on small-scale initiatives to support agriculture, food processing and distribution, but this requires careful assessment of the likely impact on relations between civilians, including farmers and distributors, and the armed groups. Extending support to farmers in ISIS-controlled areas will be difficult to achieve without some sort of interaction with the group. ISIS would exert tight restrictions on supplies going into areas under its control, and probably levy taxes and fees. Fuel supplied by donors with the intention of helping farmers would be at risk of confiscation by ISIS, which could then resell it at a premium both within its own areas and across its borders. Payments to farmers or traders for produce grown in the ISIS zones would almost certainly be taxed by the group.

Humanitarian aid agencies have necessarily focused much of their efforts on providing food to people in need. They are aware of the risk that this could distort local markets and undermine the livelihoods of farmers. One way of mitigating this risk would be to try to increase the proportion of cash transfers³² to local communities, while providing financial support, training and technical assistance to farmers themselves and to marketing organizations. Agencies including the International Rescue Committee and the Danish Refugee Council are already directing part of their effort to supporting small-scale farms.³³ Such initiatives could make a valuable contribution to sustaining agriculture, but they cannot be a substitute for more substantial interventions to rebuild and adapt elements of the previous state-based support system for agriculture in Syria.

³⁰ One of the five pillars of Islam, *zakat* is a tax based on a proportion of net assets.

³¹ Zelin, A. Y. (2015), 'The Archivist: Unseen Islamic State Financial Accounts for Deir az-Zor Province', Jihadology, 5 October 2015, <http://jihadology.net/2015/10/05/the-archivist-unseen-islamic-state-financial-accounts-for-deir-az-zor-province/> (accessed 24 Feb. 2016).

³² Chatham House & Beechwood international (2015), Hawala and Humanitarian Aid Workshop Report (unpublished).

³³ Bailey, C. (2016), 'A different sort of aid for Syria', IRIN, 4 January 2016, <http://www.irinnews.org/report/102325/a-different-sort-of-aid-for-syria> (accessed 24 Feb. 2016).

Energy

The conflict has had a mixed impact on Syria's energy sector. Some of the elements of the national energy infrastructure, in particular the electricity and gas networks, have survived, albeit after sustaining heavy damage. The oil industry, by contrast, has been torn to pieces, with the main crude-producing areas in the east and northeast cut off from the refining areas to the west. Distribution of petroleum products has become one of the central activities of the war economy.

Before 2011 fuel-smuggling was a well-established business line controlled by various state security agencies and prominent private business interests. It was based on buying up large amounts of fuel at the prevailing heavily subsidized prices and selling into neighbouring markets where prices had lower subsidies. The government has now phased out subsidies on most fuels, including *mazout* (domestic heating fuel), but well-connected traders exploit the limits on supply in order to profit from selling fuel within Syria at rates well above the official posted prices. Costs are further inflated for consumers by the charges levied by security forces and armed groups on fuel shipments between conflict zones.

Most of the fuel distributed in regime-held areas comes from the Baniyas refinery, which mainly processes crude imported from Iran, or from shipments of diesel delivered to Baniyas on tankers from Iran or the Black Sea. Regime-held areas also receive some liquefied petroleum gas (LPG) from plants controlled by ISIS. According to the Ministry of Petroleum, the Baniyas and Homs refineries processed the equivalent of about 98,000 barrels per day (b/d) of crude oil in 2015. Just under 10,000 b/d of this crude came from government-controlled fields, mainly in Homs governorate, with most of the remainder supplied by Iran.

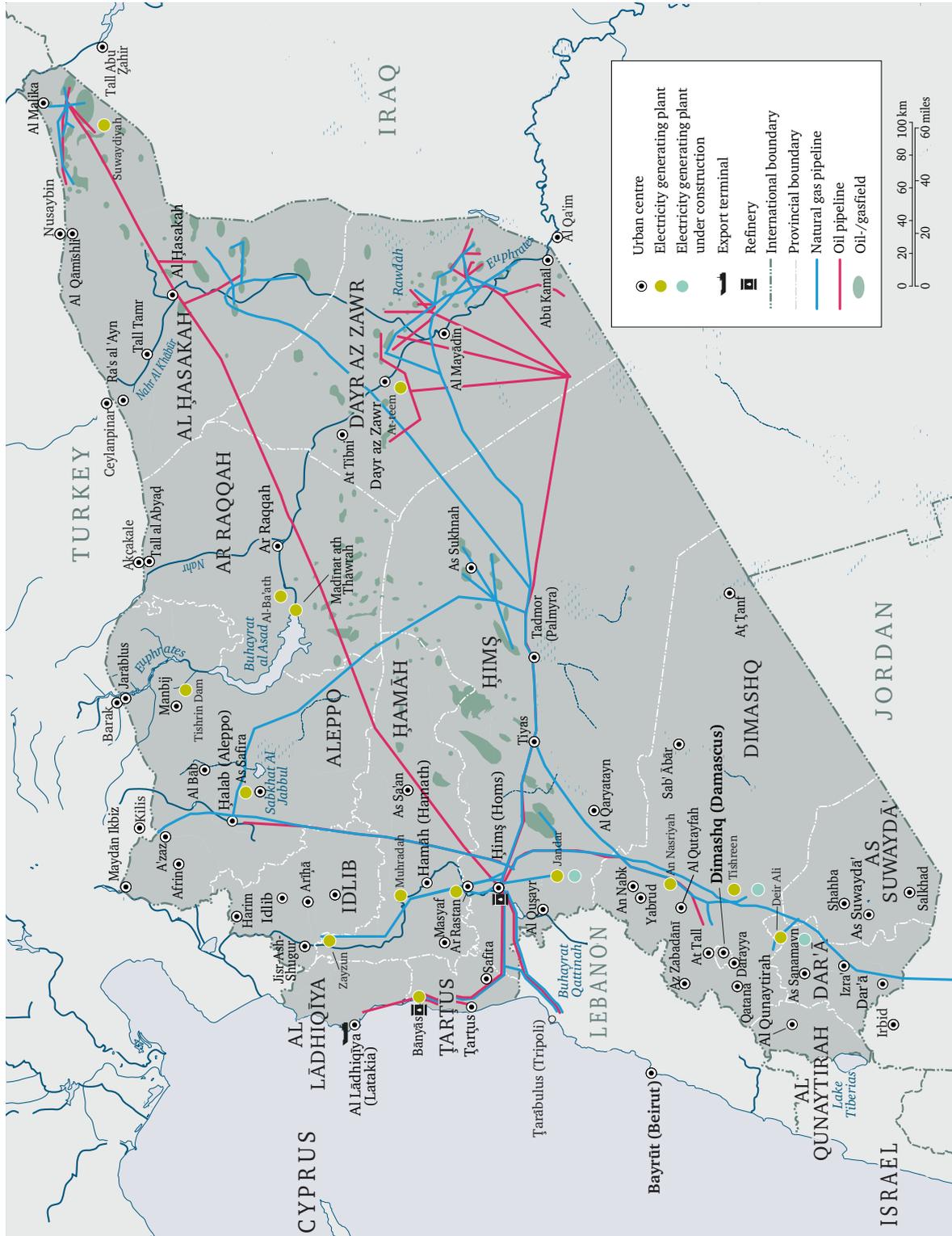
Rebel-held areas in the north depend mainly on fuel delivered by traders of petrol and diesel produced from oil sourced from ISIS-controlled wells in the Euphrates valley and in the southern part of Hasaka governorate. The products are of poor quality, but as a result of the lack of readily available alternative supplies they are priced at premium to international rates. Consumers in these areas are vulnerable to decisions by ISIS to restrict supplies (as occurred in June 2015), either in order to weaken rebel forces in the face of an ISIS push to seize more territory or because of problems in the ISIS supply chain. Since October 2015 there have also been supply problems as coalition airstrikes have for the first time targeted well-head facilities and road tanker fleets in ISIS-controlled areas. ISIS has also lost significant territory in southern Hasaka to the Kurdish People's Protection Units and the US-backed Syrian Democratic Forces (SDF). This includes the Tishreen oilfield, which was previously operated by China's Sinopec and which had the capacity to produce 10,000 b/d of crude oil.

The scale of the ISIS oil business is a matter of debate. In October 2015 the *Financial Times* published the findings of an investigation based on interviews with traders and engineers involved in the ISIS business, and concluded that well-head production was between 34,000 and 40,000 b/d, and that the oil was sold to traders at between \$20 and \$45 per barrel.³⁴ The principal sources of the oil were the Tanak and Omar fields, developed by Shell in the late 1980s and early 1990s. Tanak was reported to be producing 15,000–17,000 b/d for sale at \$40/barrel, and Omar 9,000–13,000 b/d for sale at \$45/barrel.³⁵ The report did not make clear when these output and price estimates applied, and it acknowledged that ISIS could have difficulty in sustaining production at these levels, given the technical challenges of operating fields that were already in steep decline in the late 2000s.

³⁴ Solomon, E., Chazan, G. and Jones, S. (2015), 'Isis Inc: how oil fuels the jihadi terrorists', *Financial Times*, 14 October 2015, <http://www.ft.com/cms/s/2/b8234932-719b-11e5-ad6d-f4ed76f0900a.html#axzz3pgZJVaai> (accessed 24 Feb. 2016).

³⁵ Solomon, E., Kwong, R. and Bernard, S. (2015), 'Inside Isis Inc: The journey of a barrel of oil', 11 December 2015, <http://ig.ft.com/sites/2015/isis-oil/> (accessed 24 Feb. 2016).

Map 2: Energy infrastructure in Syria



Sources: US Energy Information Administration; Syrian government *Statistical Abstract 2013*.
 The boundaries and names on this map do not imply endorsement or acceptance by Chatham House.

The prices cited for Tanak and Omar crude were also more or less in line with global prices, which suggests that traders and consumers would have a strong incentive to seek oil and petroleum products from other sources. Indeed, one of the central findings of the investigation was that most of the revenue obtained from the sale of oil and products originating from the ISIS-held wells was derived from sales within Syria and Iraq.

A different perspective on the ISIS oil business has come from the budget documents for Wilayat al-Khair noted above.³⁶ Of total budget revenue of \$8.44 million booked in Rabi' al-Awal 1436, about \$2 million came from 'oil wells' and \$342,000 came from gas. The ISIS accounts indicate that the largest source of oil revenue was the Albu-Kamal area, close to the Iraqi border, which could denote fields developed by Russia's Tatneft and China's Sinopec prior to 2011. The other areas that provided oil revenue were Al-Mayadeen, where Shell had previously operated, and the Badiya desert to the east of Homs, where Total, Croatia's INA and the state-owned Syrian Petroleum Company operated. Most of the gas revenue came from Badiya, suggesting that it came from operating the Conoco associated gas plant,³⁷ which supplies natural gas and LPG to regime-held areas. The revenue figures in these accounts suggest that the wells in Wilayat al-Khair would have been producing 5,000–10,000 b/d for sale at prices of between \$5 and \$10 per barrel. However, assuming these accounts are genuine, they are only a snapshot of ISIS financing, and additional oil revenue could be accrued in the accounts of other declared ISIS provinces, such as Al-Baraka (Hasaka) and Raqqa.

The other main area of oil operations is in the northern half of Hasaka governorate, which is largely controlled by the Kurdish People's Protection Units (YPG), and which is administered as an autonomous canton by the Kurdish Democratic Union Party (PYD). This region accounted for almost two-thirds of Syria's pre-conflict oil output, and is now thought to be producing about 40,000 b/d. Most of it is refined in the area for local distribution, but some is piped into the Kurdish region of Iraq for refining and onward sale.

One of the prerequisites for restoring Syria's oil production to a level at which it would enable the country to be more or less self-sufficient in petroleum products is to end ISIS control of the Euphrates valley oilfields. Another would be the resumption of flows through the pipeline from the fields in northern Hasaka via Raqqa to Homs.

One of the prerequisites for restoring Syria's oil production to a level at which it would enable the country to be more or less self-sufficient in petroleum products is to end ISIS control of the Euphrates valley oilfields. Another would be the resumption of flows through the pipeline from the fields in northern Hasaka via Raqqa to Homs. Any future agreement on the national distribution of resources would probably have to include provision for the construction of refineries in both Deir ez-Zor and Hasaka governorates in order to address long-standing grievances of the local populations, and to give these communities a worthwhile stake in the industry. Ramping up production in the main northern Hasaka fields, Sweidiyeh and Rumailan, should not present any legal complications as they were operated by the state-owned Syrian Petroleum Company. However, there would be legal issues to resolve in relation to fields that were developed and operated in joint ventures with international oil companies. Most of these companies suspended operations in compliance with EU sanctions imposed in late 2011,

³⁶ Zelin (2015), 'The Archivist' (accessed 24 Feb. 2016).

³⁷ The facility is known by the name of the US company that built it in the early 2000s.

but they retain contractual rights. The UK-registered Gulfsands Petroleum, which was producing about 25,000 b/d from Block 26 in northern Hasaka, has stated that it plans to continue adherence to its licence terms, within the constraints of the EU sanctions, and that it intends to 'maintain readiness to return to conducting operations as soon as circumstances allow'.³⁸ However, Gulfsands is something of a special case, as Syria was one of its most important areas of operation, and in view of the minority stake held by Al Mashrek Global Invest, part of the business interests of Rami Makhoul, a maternal cousin of President Assad.³⁹ It is not clear whether companies such as Shell, for which Syria represented only a small fraction of its global business, would be interested in returning to the country under any circumstances. Moreover, the production infrastructure in the fields previously operated by Shell and Total has sustained considerable damage as a result of the shift in policy by the US-led coalition since October 2015 to bombing well-head facilities in order to impair the ISIS oil business.

If the territorial divisions of Syria persist, production of oil and gas is likely to decline, as the government, ISIS and the PYD will find it increasingly difficult to maintain processing equipment and pipelines, and the reservoirs will show the effects of the way in which they have been treated over the past five years. The government will continue to depend on imports of crude and petroleum products through Baniyas port to meet demand for gasoline, *mazout* and fuel oil, and other areas will have to devise ways of meeting their needs either by smuggling from government-controlled areas or through their own imports. Some of the fuel supplies for the non-government areas could take the form of aid shipments, although this would be likely to give rise to smuggling operations. Natural gas production will continue to decline, resulting in increased use of fuel oil for electricity generation.

Repairing power stations and electricity transmission and distribution networks will be an essential part of any reconstruction effort. According to the Syrian government, effective generating capacity in the second half of 2015 had fallen to about 2,000 MW, compared with 7,900 MW in 2013 and a pre-conflict total of about 9,700 MW. Most of the operating capacity is clustered around Damascus, and linked by pipeline to gasfields in central Syria.

According to Mohammed al-Abdallah, the head of the Public Establishment for Electricity Generation, the supply of natural gas for power stations had fallen in early January 2016 to 8–8.5 million cubic metres per day (m³/d) as a result of repeated sabotage attacks on the 36-inch Arab Gas Pipeline and 18-inch Al-Furat Pipeline.⁴⁰ Abdallah stated that the country's gas-based power stations needed 18 million m³/d in order to operate at full capacity. According to the Ministry of Petroleum, natural gas production averaged 14.4 million m³/d in 2015 (5.3 billion m³ in total), compared with 15.5 million m³/d in 2014, but government officials acknowledge that production has been well below this level for the past few months.⁴¹

Abdallah said that Syria's thermal power stations generated 18.8 billion kWh of electricity in 2015, of which 8.2 billion kWh came from the steam turbine units at Tishreen (Damascus), Mhardeh, Baniyas and Al-Zara, 8.5 billion kWh from combined-cycle units at Deir Ali and Nasiriya (both outside

³⁸ Gulfsands Petroleum (2014), *Annual Report and Accounts 2014*, http://www.gulfsands.com/wp-content/uploads/2015/11/2014AR_GPX_Mc7zdn.pdf (accessed 24 Feb. 2016).

³⁹ As of May 2015, Mashrek was listed as owning 5.74 per cent, according to the Gulfsands *Annual Report and Accounts 2014* (p. 32: http://www.gulfsands.com/wp-content/uploads/2015/11/2014AR_GPX_Mc7zdn.pdf). Following a major restructuring in January 2016, Mashrek has since diluted its shareholdings and thus no longer appears on the list of shareholders. Gulfsands advised the author that shareholders owning less than 3 per cent are not required to disclose their holdings.

⁴⁰ Shbat, A. (2016), 'Kilfat naql ton al-fiyul irtafaat min nutf lira ila 3,000 lira ... arqam al-kahraba: 56% inkhifadh al-intaj khilal al-azma' [Cost of transporting a tonne of fuel oil has risen from £50.5 to £3,000 ... Electricity Ministry figures: 56% fall in generation during the crisis], *Al-Watan*, 20 January 2016, <http://alwatan.sy/archives/37458> (accessed 24 Feb. 2016).

⁴¹ *The Syria Report* (2016), 'Iran Supplies Stabilise Syria', 26 January 2016, <http://www.syria-report.com/news/oil-gas-mining/iran-supplies-stabilise-syria%E2%80%99s-oil-market> (accessed 24 Feb. 2016).

Damascus), as well as Zeizoun, Jandar and Tishreen, and 2.1 billion kWh from gas turbines at Tishreen, Sweidiyeh, Baniyas and Thayyem. He did not mention Aleppo.⁴²

In 2014 ISIS took control of a number of large power stations, including the Tishreen and Tabqa hydroelectric plants and a 1,000-MW thermal plant at Safira, southeast of Aleppo. The two large hydroelectric plants have continued to generate electricity for the northern region of the national grid since falling under ISIS control, but their output has been constrained by the low level of water in the Euphrates and by the poor state of repair of the Tabqa plant, which was built in 1970s. At the end of 2015 a YPG-led force launched an offensive aimed at wresting control of the Tishreen plant from ISIS, and in early 2016 regime forces claimed to be on the point of capturing the Aleppo power station from ISIS.

The Aleppo power station has been supplied with natural gas from the Twinan treatment plant, southwest of Raqqa. This is part of the North Middle Area gas project undertaken by Russia's Stroytransgaz and its local partner Hesco. During the latter stages of the plant's construction it fell under the control of ISIS. The first phase of production started in late 2014. The plant was operated by staff of the government's Syrian Gas Company under ISIS supervision, and part of its output was sent by pipeline to the Aleppo power station, with the remainder transported to the national grid. ISIS took the 500 b/d of condensate that was produced along with the raw natural gas. It also controls the Conoco associated gas plant in Deir ez-Zor governorate and the Jbeissa plant in Hasaka, both of which supply gas to regime-operated power stations.⁴³

If ISIS manages to hold on to its main areas of operation in Syria for the next few years, energy deals between it and the regime are likely to persist. These mainly take the form of service exchanges rather than involving cash payments. This could complicate Western companies' involvement in the reconstruction of energy infrastructure in the context of any kind of truce accompanying steps towards a political settlement, as it is likely that ISIS will continue to be proscribed as a terrorist organization. There is also a risk that ISIS could react to the increased military pressure being brought to bear on it by both the US-led coalition and regime forces by sabotaging or destroying the energy infrastructure that it controls.

Under any scenario, rebuilding integrated energy infrastructure will be a long and costly process. In the meantime, the fragmentation of Syria offers opportunities for investment in small-scale energy projects aimed at local communities. Such investments are already part of the war economy, taking the form of diesel generators that have been widely deployed to provide back-up during power cuts or to compensate for the destruction of power infrastructure altogether. One of the challenges that will face civic authorities during any transition to reconstruction will be to regulate such operations, and ultimately squeeze them out of business by restoring cheaper electricity services. This could include schemes for investing in renewable energy, with development agencies providing finance for setting up solar or wind power plants, as well as for the creation of local distribution ventures that could draw on donor funds to bridge the difference between the relatively high initial production costs and a subsidized system of tariffs for consumers.

⁴² Shbat (2016), 'Kilfat naql ton al-fiyul irtafaat min nush lira ila 3,000 lira ...'.

⁴³ Jbeissa was captured by the SDF and the YPG in February 2016.

Property Rights and Finance

The destruction wrought by the armed conflict and the mass displacement of people have left a huge problem with regard to assessing future claims on property rights – a fundamental aspect of a properly functioning economy and society. The government has sought to pre-empt such claims in some areas of Damascus and Homs by enabling the creation of private real-estate companies that will be entitled to supersede existing property rights. Many of the records of land and property ownership have been lost or destroyed in areas taken from the government by opposition forces and subsequently subjected to heavy bombardment.

President Assad said in a speech to parliament in July 2014 that reconstruction should not be delayed until the end of the political crisis. He indicated that the government was already taking steps on the policy and regulatory fronts to enable reconstruction to start.

President Assad said in a speech to parliament in July 2014 that reconstruction should not be delayed until the end of the political crisis. He indicated that the government was already taking steps on the policy and regulatory fronts to enable reconstruction to start. He cited the example of Kafr Souseh, a district in southwest Damascus where a holding company has been set up to undertake reconstruction, with owners of property rights given shares in relation to the value of their assets. The scheme – which has some parallels with the Solidere redevelopment of downtown Beirut – is based on a decree (No. 66) adopted in September 2012. At the time, it was criticized on the grounds that it appeared to be geared towards expropriating unlicensed buildings that housed opponents of the regime, whereas nearby loyalist areas were not affected. Assad said that shares in the new holding company would be handed out in the next few months, and that construction work would start in 2015. He suggested that it could be a model for reconstruction projects elsewhere in the country. One potential target for such a scheme is the devastated Old City of Homs.⁴⁴

Building regulations have been widely ignored during the conflict, which has provided opportunities for developers in relatively secure areas. The government continues to maintain the semblance of applying building codes and fees. An example of its approach, however, is legislation enacted in November 2015 that allows exemptions from building licences and fees to owners of property that is deemed to have been damaged by 'terrorist actions', provided that it is in a generally secure area and that the owner does not expand or materially change the property.⁴⁵

Syrian private businesses with strong regime connections have started to position themselves to take a leading role in construction projects in areas that have been devastated by the conflict. In December 2015 the government approved the establishment of a metals and steel council, the functions of which will include regulating steel production and trade. The council's chairman is Mohammed

⁴⁴ See <http://www.unhcr.org/emergency/5051e8cd6-56b85ba2c.html> for UNHCR videos of local efforts to rebuild parts of Baba Amr in Homs.

⁴⁵ Tharwa Online (2015), 'Ar-ra'is al-'asad yuṣḍir qānūnan b' i' fā' mālikī al- iḡarāt al-mutaḍarira natijat al- a' mā' al- irhābiyya min rusūm rikha al-binā' bima fihā ar-rusūm al-mudāfa ' ilayh'ā'ā [President Assad issues a law exempting owners of properties damaged as a result of terrorist actions from building licence fees, including those for extensions], 23 November 2015, <http://www.thawraonline.sy/index.php/news-list/local-news/87830-2015-11-23-09-06-50> (accessed 24 Feb. 2016).

Hamsho, the owner of one of Syria's largest steel mills, who has close connections with the Assad family. Steel producers are said to be making use of scrap metal gathered from areas that have been recovered by the regime from rebel forces, and that have been largely depopulated as a result of heavy bombardments by the regime.⁴⁶

In early 2016 parliament approved a law on public-private partnerships, aimed at enabling the private sector to make a greater contribution to reconstruction. Legislation was also adopted that set up a new regulatory agency for small and medium-sized enterprises (SMEs). Initiatives of this sort appear to be geared in part towards providing channels for international development agencies to direct funds to projects engaging the Syrian private sector, rather than being confined to providing humanitarian aid. Agencies could be receptive to doing this, but there would be a risk of becoming drawn in to schemes serving core interests of the Assad regime. In the areas not controlled by the regime, development agencies are also looking for ways to support SMEs, but in these instances they encounter difficulties in monitoring the use of any funds provided, as well as in establishing a robust legal framework for such ventures to operate.

Another important constituency in any kind of post-conflict land-grab is the non-Syrian forces that have come to play an increasingly important part in the regime's military operations. These include members of Iran's Islamic Revolutionary Guards Corps, which controls considerable economic interests in its home country, and which could be attracted by the business opportunities in Syria's abandoned urban and industrial areas.

⁴⁶ *The Syria Report* (2015), 'Mohammad Hamsho Leads Newly-established Syrian Metals Council', 22 December 2015, <http://www.syria-report.com/news/manufacturing/mohammad-hamsho-leads-newly-established-syrian-metals-council> (accessed 24 Feb. 2016).

Prospects: Dependency and Decentralization

The decline in Syria's agriculture and energy sectors means that the country will be increasingly dependent on outside assistance for ensuring the supply of its most basic needs. Further support will be needed for virtually every other aspect of economic activity and social service provision. Whatever the outcome of the military conflict and of any political settlement (or partial settlement), there will be a degree of decentralization as a result of the fracturing of the previous state structure and the emergence of autonomous regional and local organizations, including the Kurd-dominated Rojava, ISIS and the local administrations in rebel-held areas.

The main burden of supporting the Syrian government has fallen on the shoulders of Iran, Russia and the UN. For Iran and Russia, this will entail financial costs through continuing military aid and the supply of basic commodities on generous credit terms, but it also presents opportunities to build up long-term commercial relationships and investments. Iranian companies are already involved in supplying electrical parts and equipment, revamping pharmaceutical factories and investing in real estate, and Russian companies are poised to invest in a wide range of ventures in the coastal region, including a Russian import–export 'village' in Latakia.⁴⁷ Russian companies are also involved in maintaining oil and gas production facilities, although at the end of September 2015 Soyuzneftegaz announced that it was pulling out of an offshore exploration contract that it had signed in December 2013.⁴⁸ For UN agencies, support for the Syrian government will take the form of continuing to provide humanitarian aid to fill the huge gaps left by the government's lack of resources.

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Without a credible political settlement, there is unlikely to be any substantive role for institutions such as the World Bank, the International Monetary Fund or the European Bank for Reconstruction and Development, or indeed for Western governments on a bilateral basis. Following the Russian intervention, there may be a chance for an accommodation among the West, Russia, Iran and some Arab governments on a form of political transition that would leave the main elements of the Assad regime in place, but this would not amount to a credible settlement in the eyes of a significant portion of the Syrian population, both within the country and in exile. Such a deal would allow for some ramping up of UN aid efforts, but it would not provide a sufficient basis for planning a long-term reconstruction programme.

⁴⁷ *The Syria Report* (2015), 'Russia Says Planning Economic Projects in Latakia', 14 September 2015, <http://www.syria-report.com/news/economy/russia-says-planning-economic-projects-latakia> (accessed 24 Feb. 2016).

⁴⁸ Shurmina, N. and Lyrchikova, A. (2015), 'Russia's Soyuzneftegaz drops plans for offshore oil and gas exploration in Syria', Reuters, 30 September 2015, <http://uk.reuters.com/article/2015/09/30/us-russia-syria-oil-idUKKCN0RU02V20150930> (accessed 24 Feb. 2016).

The territorial gains made by opposition forces in the north and south of the country in the first half of 2015 provided an opportunity for local administrations to develop their services with the support of NGOs. These efforts were frequently undermined by the predatory activities of opposition armed groups, but they nevertheless prompted some aid agencies to try to move away from mere distribution of assistance to working with local communities to develop agriculture and services such as water and wastewater. The feasibility of such projects has been put at risk by the Russian intervention, which has included heavy bombardments of civilian facilities such as hospitals and schools in areas held by rebel groups. This will lead to further reductions in the population of areas outside regime control, and a swelling of the refugee population.

The prospects for economic development in the areas run by the PYD-led Rojava administration are more promising, provided they continue to enjoy a measure of protection by the US-led anti-ISIS coalition. However, for Rojava to flourish it would require a measure of cooperation from the Turkish government. This is unlikely to be forthcoming, given the extent of the Turkish authorities' hostility to the PYD and its armed wings, the YPG, the Women's Protection Units (YPJ) and the Asayish police force. The Turkish government has no desire to see Kurds on its side of the border seeking to emulate the autonomous model of the Rojava administration.

The other main player in the Syrian economy is ISIS, which has created an elaborate governing system for the relatively sparsely populated but geographically extensive territory that it controls in Syria and Iraq. By early 2016 its dominion in Iraq and Syria had been reduced as a result of attacks by the US-led coalition and by Iraqi, Kurdish and Syrian opposition forces on the ground. The ISIS oil business has been badly affected by the coalition decision to start attacking well-head facilities from October 2015, and the capacity of ISIS to raise revenue from other sources has been increasingly challenged by resource constraints: there are limits to the amount of tax it can generate from local farmers, businesses and households when many of their own sources of income have been compromised.

Within Syria, most of the territory lost by ISIS during 2015 was taken over by Kurdish forces or by the SDF, a Kurd-dominated group set up with US backing and including fighters from local Arab tribes. If ISIS is pushed out of its main strongholds in northern and eastern Syria it is unlikely to be replaced by a single coherent governing organization. Kurdish forces would stake a claim to territory that they deem vital to the integrity of areas with a significant Kurdish population, but any attempt to extend their control to other areas would meet stiff resistance. Elsewhere, there are likely to be confrontations between established opposition groups and local groups looking to set up their own governing structures. The government can also be expected to stake its claim to fill any vacuum left by an ISIS retreat.

The US-led coalition is another significant interested party, given that its intervention in Syria has been dedicated primarily to defeating ISIS. At the very least, the coalition could seek to ensure that civilians receive some protection in areas from which ISIS has been driven out.

If some sort of equilibrium can be established between the various areas of influence within Syria in the context of a transition to a political settlement, there will be scope for negotiations about economic relationships between these zones and the creation of a new state structure in which the aspirations for civil society to be fully engaged in local governance can be realized. Such a benign outcome seems improbable, given the brutal nature of the Syrian conflict and the high stakes that Iran and Russia have invested in ensuring the survival of an authoritarian central state. Western governments are already implicated to some degree in helping the Assad regime to remain in power, as a result of the imperatives of getting humanitarian aid to the people who desperately need it.

The moment for Western military intervention against the regime has long passed, and European governments have come to assess the Syrian conflict from the perspective of both the threat of ISIS terrorism and the reality of mass refugee inflows. Measures that could help to improve economic conditions in Syria are an important element in any strategy for tackling either. If this entails dealing with the core Assad regime as a means of bolstering the ability of the Syrian government and private sector to produce and deliver goods and services, Western governments should insist on the imposition of closely monitored ceasefires and on transparency in government financial operations, as well as on their right to provide equivalent or even greater resources to areas that have developed institutions that are autonomous from the central state.

The military advances that the Assad regime has made in early 2016, thanks largely to the support of Russian air power and diverse militias financed and commanded by Iran, make it highly unlikely that that Western and Arab donors will be in any position to impose conditions on the provision of aid to the central Syrian state. The Assad regime, with financial and material support from Iran, Russia and UN agencies, remains able to cater to the basic needs of the rump population in the areas under its control. This still leaves the majority of Syrians dependent on other forms of support to meet such needs. The least that the international community can do is ensure that refugees and people in need within Syria are adequately supplied with humanitarian support, including education, training and possibilities of employment.

About the Author

David Butter is an associate fellow in the Middle East and North Africa Programme at Chatham House. He has worked extensively on Middle East political, economic and business affairs since the late 1970s, first as a reporter in Beirut for Interpress news agency, and later, in 1984–2002, as a reporter and ultimately editor of *Middle East Economic Digest* (MEED). In 2002 he moved to the Economist Intelligence Unit, where he became regional director for the Middle East and North Africa. He is currently working on consultancy and freelance journalism assignments on Middle East topics.

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The Royal Institute of International Affairs
Chatham House
10 St James's Square, London SW1Y 4LE
T +44 (0)20 7957 5700 F +44 (0)20 7957 5710
contact@chathamhouse.org www.chathamhouse.org

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