Arab Reform Initiative

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Syria's Growing Economic Woes: Lebanon's Crisis, the Caesar Act and Now the Coronavirus

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Syrian people walk at one of Damascus main markets, January 2020. © EPA-EFE/YOUSSEF BADAWI

Three years after the regime retook the city of Aleppo, marking an important symbolic and material victory, the Syrian economy has still not recovered and few analysts expect any major reconstruction effort to take place any time soon. Among the government, businesses, and the population there is a growing recognition that economic difficulties are here to stay.

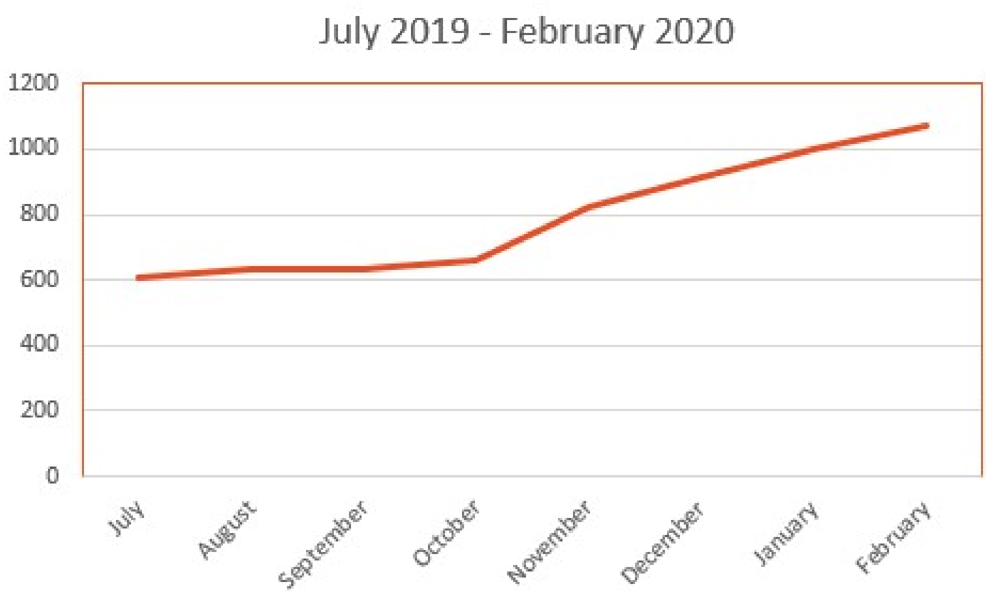
The already bleak economic prospects got worse in recent months with three new significant challenges: the Lebanese economic and financial crisis, the Caesar Act enacted by the U.S. Administration, and the spread of the coronavirus pandemic. The cumulative impact of these shocks remains to be seen. At a minimum, the continuation and increase of the humanitarian effort will be crucial. But given the strain the coronavirus is placing on major donor countries, this is not likely to happen, leaving Syria's already exhausted population at risk of further suffering.

Lebanon: Syria's gateway to the outside world closes

Lebanon, particularly its banking sector, had represented the Syrian economy's gateway to the outside world since at least the mid-1950s, and western sanctions imposed on Damascus after the onset of the uprising in March 2011 have only accentuated that role. Lebanon is where Syrian businessmen and individuals deposited their savings and bought their dollars, while its banks issued the letters of credit and other payment facilities Syrian traders needed to import goods into their domestic market.

The restrictions imposed by the Lebanese banking sector and the economic and financial crises faced by that small but dynamic neighbour have changed the rules of the game.

As soon as Lebanese banks started restricting the sale of dollars in August 2019 – even preventing depositors from withdrawing their savings in that currency – the price of the U.S. currency jumped in the Lebanese foreign exchange market followed by the Syrian one. As the Lebanese pound collapsed, the Syrian pound lost ground. At the end of July 2019, the cost of the dollar stood at SYP606 in the black market. It reached SYP635 at the end of August and increased steadily reaching SYP1,040 at the end of January 2020.



The price of the US dollar in the Syrian black market (in SYP)

This phenomenon is not new. In the mid-1980s the collapse of the Lebanese pound had the same impact on the Syrian currency.

Not only has the dollar become increasingly expensive to buy; the Lebanese banking sector can no longer process trade payments for Syrian importers. The deposits held in Lebanese banks by Syrian businesses are blocked, and the companies they set up in Lebanon to contract with foreign suppliers have become useless.

Wheat imports were the first to be affected by this new situation. At the end of 2019 and beginning of 2020, the government issued three tenders to bid for the import of around 600,000 tons of wheat but failed to sign any purchase contract because all the main wheat importers, who are business figures close to the regime, have their bank accounts in Lebanon.[1] The risk is not negligible: a shortage of wheat, and by extension of bread - a major food staple - threatens the food security of large segments of the Syrian population.

Beyond essential consumer goods, which are increasingly imported because of the widescale destruction of the economy, the import of raw materials and other production inputs is also affected. Shortages of these will not only have an impact on the production processes and the availability of goods in the market but will also negatively affect the jobs market.

The depreciation of the currency also increases the cost of imported products and the rate of inflation and decreases the purchasing power of the population.

Among the other negative consequences of the Lebanese crisis is the sharp decrease in remittances sent into Syria. For decades, Syrian farmers and construction workers in Lebanon have numbered in the hundreds of thousands and contributed significantly to the remittance of dollars into the Syrian economy. The relative importance of these remittances increased during the conflict due to the rise in the number of Syrian refugees abroad and the drop in the other sources of foreign currencies, such as oil exports and tourism, as well as the overall shrinking of the Syrian economy. The crisis in Lebanon has already seen many of these Syrian workers lose their jobs, while those still working have seen their revenues, measured in dollars, drop. Because of the absence of official data, it is difficult to estimate the extent of these losses, but they are clearly substantial.

Finally, the psychological impact is significant. Lebanon represented a safety valve for many Syrians, and that is now gone. One direct impact is that Syrian investors, exposed to Lebanon's banking sector, will postpone their investment decisions, and wait to assess their losses.

Damascus may seek to capitalise on its reportedly close ties with the current government in Beirut to access some of its money blocked in the Lebanese banks, but its chances of success are slim. The Lebanese authorities have many more pressing priorities to deal with, and, despite all the speculations, the influence of Damascus in the Lebanese political scene is incomparable with what it was before the onset of the uprising in March 2011.

Some aspects of the Lebanese crisis may have some mildly positive consequences. The fall in the purchasing power of the Lebanese population may increase demand for Syrian products, which are cheaper than many of the products that Lebanon imports from elsewhere – imports represent a significant share of Lebanese consumption. Medical tourism will be another attractive option for the increasing number of Lebanese who are becoming poorer and would seek cheaper healthcare in neighbouring Syria.

The Caesar Act: meaningful long-term consequences

The Caesar sanctions bill that was signed into law late 2019 by the U.S. President will have significant medium and long-term consequences on the Syrian economy, but its shorter-term impact will be less meaningful.

After years of lobbying by various groups supporting the Syrian opposition and discussions and negotiations in the two houses of U.S. Congress, the law was finally approved as part of the annual National Defence Authorization Act in early December before being ratified by the president on 20 December 2019. The text is named after the codename given to a military photographer who defected from the Syrian regime in 2013 and leaked photos of thousands of detainees who were tortured to death in government prisons.

The Act adds to the long set of economic sanctions already imposed on Syria by the United States, the European Union and several other countries, including Switzerland, Canada, Japan, Turkey and countries in the Gulf. Because of the overlapping of many texts and different sanctions regimes, it is not always clear what the Caesar Act will effectively add that is not already there. Below are the main measures associated with the Act and their consequences.

Secondary sanctions

The main characteristic of the Caesar Act is that it imposes sanctions (called Secondary Sanctions) on institutions and individuals from countries other than the U.S. that conduct specific business activities with Syria. So, rather than targeting U.S. companies of individuals doing business in Syria, the text will go after companies from, say, Russia or China that do business with Syrian institutions that are under sanctions or/and operate in specific industries.

Before the Caesar Act, secondary sanctions on Syria already existed. Both Executive Orders 13582 of 17 August 2011 and 13608 of 1 May 2012, for instance, allow the U.S. President to sanction foreign persons, i.e., non-American individuals and institutions, that deal with Syrian entities that are under U.S. sanctions.

In practice, this measure has been seldom implemented. One case has been Russia's Tempbank, blacklisted in 2014 for providing millions of dollars to the Central Bank of Syria, and to Sytrol, the government's oil marketing company, both of which are under U.S. sanctions.

However, while the executive orders enable the U.S. President to act and sanction specific institutions and individuals, they do not oblige him to do so. The main characteristic of the Caesar Act is that it forces the U.S. president to impose certain secondary sanctions.

The Act specifically mentions the following actions:

- Sanctions on foreign persons who provide significant support to or engage in a significant transaction with the Syrian government or the military forces or contractors acting on behalf of Syria, Russia, or Iran.
- Sanctions on foreign persons that sell or provide:
    - significant goods, services, technology, or information that facilitates or expands the Syrian government's domestic petroleum production;
    - aircraft, parts, or related services used by military forces related to the Syrian government; or
    - construction or engineering services to the Syrian government.

The Act also requires the Department of the Treasury to determine whether the Central Bank of Syria is a financial institution of primary money laundering concern and, if so, impose one or more measures that go with that qualification under American law, including increased monitoring of its operations.

The sanctions to be imposed on foreign persons are a freeze on their assets located in the United States and, in the case of individuals, a ban on their entry into the U.S. The Act also allows the president to suspend some or all the sanctions under certain conditions, notably if the violence against civilians has ceased.

Targeted companies

The Caesar Act will likely see in the coming months an increase in the number of companies and individuals that are blacklisted by the U.S. administration because of their business activity in Syria. For instance, Mercury and Velada, two Russian companies which signed in September 2019 oil and gas exploration contracts, could be among these because they are contributing to expanding Syria's oil production.

Companies contributing to Syria's reconstruction, such as engineering and construction companies from Russia, Iran, the United Arab Emirates, China or Lebanon, could also be affected.

The number of foreign companies active in Syria is very small, and Iranian companies, as well as some Russian ones, may be insensitive to the threat of sanctions because they either operate in an environment that is already heavily sanctioned, such as in Iran, or because they do not have and do not plan to have operations with western, including U.S., companies.

Others are already taking precautions. For instance, the fact that Mercury and Velada are unheard of is likely because these companies operate as fronts for other more important Russian interests that are trying to protect themselves from the wrath of the American administration.

Short and long-term consequences

In the short term, it is important not to overestimate the impact the Caesar Act can have on the Syrian economy, which is already largely affected by various other factors, including existing western sanctions. The number of foreign companies operating in Syria is very low, and nothing in the political, legal or business environment currently encourages much foreign interest.

The passing of the Act has seen no specific bouts of panic in Damascus, including no specific impact on the value of the Syrian pound, although most currency traders had already factored in the passing of the law. In the coming months, the impact of the financial crisis in Lebanon will likely be more significant on the

Syrian economy than the Caesar Act.

In the medium and long terms, however, the situation is different. The fact that the text specifically targets the construction sector will be particularly harmful to any effort, however limited, to kickstart reconstruction activities in Syria.

Some Emirati companies probably hoped that the recent warming of relations between Damascus and Abu Dhabi would translate into better opportunities for them, and bilateral visits had been conducted by businessmen from the two countries.[2] Lebanese construction companies could also have hoped to benefit from some reconstruction effort, however small. Many of these will now have to reconsider their plans. Similarly, it is likely that Chinese interest in Syria's economy, which is already not particularly high, will weaken further.

Therefore, while its short-term effects will be limited, the Caesar Act is an additional deterrent to any interest in the Syrian economy by foreign companies and institutions and as such it kills the limited remaining prospects for a large-scale reconstruction of the country.

The dramatic potential consequences of the Coronavirus pandemic

On 22 March, the Syrian government announced the first case of coronavirus in the country and a ban on public transport as it stepped up its lockdown procedures which included the closure of schools, restaurants and various public institutions.

What is particularly worrying in the case of Syria is the dismal state of the country's healthcare system which has been battered by nine years of conflict and particularly targeted by the regime and Russia's air force. According to some estimates, up to 50 per cent of the country's public hospitals are out of service. There is also a shortage of medical equipment and medicines, while health personnel are lacking as a result of migration.

Another serious risk stems from the very high population density in refugee and IDP camps as well as in Syria's urban centres as a result of the vast destruction of towns and cities, due to overwhelming regime bombings. This has drastically reduced the number of housing units and increased the average number of people living in every home. The lack of proper sanitation systems in many areas is also a source of concern.

As in other countries, the economic and social consequences of the pandemic are likely to be dramatic.

By mid-March, the prices of medical supplies had already increased significantly and despite the government asking state-owned and private sector companies to increase their production of medical devices and products, they are unlikely to meet the needs.

Overall economic demand, which is already low, will weaken further. Almost all business sectors will be affected, particularly retail trade, transport and tourism; and the absence of tourists will also close one of the rare sources of foreign currency revenues. Meanwhile, the limited government resources will have to be reallocated to the health sector and to mitigating the impact of the pandemic rather than to other essential services.

Even before the first positive case was officially recorded, the Syrian pound had resumed its depreciation compared to the dollar, reflecting the nervousness that has already gripped the country. Between 1 and 18 March, the dollar gained 10 per cent in the black market and was traded at SYP1,175 compared with SYP1,070 on 1 March.

A grim outlook for the Syrian economy and society

The near future looks extremely grim for Syrian society and economy.

The consequences of the crisis Lebanon have probably not been entirely felt yet and will be particularly severe. For now, the Syrian economy does not have an obvious alternative to access US dollars and imports.

As to the coronavirus, the government has not yet provided any estimate of the impact of the pandemic on the economy or the health safety of Syrians, but as things stand the picture looks very worrying. A very large number of Syrians are potentially at risk and the healthcare system seems unfit to meet the challenges that the pandemic will impose.

The exhaustion of the population is extreme, and the levels of poverty, frustration and desperation will likely grow and deepen. While the regime was able to count on Russia and Iran for military aid, its allies can do little to really help it on the economic front.

Some expect these difficulties to generate unrest, eventually leading to wider protests, but this is highly speculative and, in any case, unlikely to have meaningful political consequences on the regime.

In these conditions, Syria's population will remain highly dependent on international humanitarian effort. Given the pressure the Coronavirus is putting on the finances of major donor countries, the future of international aid is itself under question.

Only time will tell if the regime will feel the need to offer concessions to ease its economic isolation. But if the past is any indication, the regime is unlikely to be moved by its people's suffering.

Endnotes

1. The Syria Report, “Government Fails Again to Award Wheat Import Contract”, 4 March 2020, https://www.syria-report.com/news/food-agriculture/government-fails-again-award-wheat-import-contract

2. The Syria Report, “Business Event Boosts Syrian Regime Ties with UAE”, 22 January 2019, https://www.syria-report.com/news/b2b/business-event-boosts-syrian-regime-ties-uae

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