“The uneven pattern of liberalisation in Syria’s key services sectors,” by Oxford Analytica

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SYRIA: Government controls services liberalisation

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Oxford Analytica Ltd

SUBJECT: The uneven pattern of liberalisation in Syria's key services sectors.

SIGNIFICANCE: The government's determination to cherry pick the type and timing of liberalisation is most obvious in the field of services. Telecommunications remains largely closed to foreign and private sector investors, while the banking sector has made more progress.

ANALYSIS: Syria's telecommunications sector remains largely closed despite the fact that a well-functioning telecommunications system is estimated to add up to two percentage points to GDP. It is also particularly important to the information technology (IT) sector, which is already significantly underdeveloped in Syria.

Telecommunications. The telecommunications sector needs extensive investment:

· Fixed line penetration is 18%, and, according to the International Telecommunications Union, internet penetration stood at 0.2% of the population in 2000 and increased to only 4.2% by September 2005.

· There are two GSM providers operating under 15-year Build Operate Transfer (BOT) contracts, which pay 40% of their income to Syrian Telecommunication Establishment (STE).

· A number of licences have been awarded to internet service providers (ISPs), but STE provides all other fixed-line communications.

While Syria's low national income would undoubtedly limit investor interest, sale of STE could still bring in much needed revenues. In developing economies the telecommunications sector typically attracts the lion's share of foreign capital and Syria offers significant room for growth in both the fixed-line and mobile sectors. GSM provider Syriatel, which currently enjoys dominant market share, has reported a significant increase in 2006 operations (thereby increasing revenues to STE). STE's revenues will also be boosted when it follows through on its decision to establish a subsidiary mobile operator by 2009. It is also a good time to sell STE following a record 30% increase in income in 2006, up from 39.34 billion Syrian pounds (0.76 billion dollars) in 2005 to 51.7 billion in 2006.

Financial sector. By contrast, some of the most significant reforms have taken place in the financial sector, as the government seeks to establish a well functioning financial system in order to support the domestic private sector

1. Banking. Since the ending of the state monopoly on banking, a few private banks have been set up. In addition to the specialised government banks, Syria's banking sector is now made up of private banks and banking branches in free zones. Private insurance companies were also established at the end of 2006 to compete with the one government-owned insurance company, so allowing for the growth of Syria's significantly underdeveloped insurance market.

> Further changes are underway: an amendment to the banking law is likely to be finalised that would allow for majority (likely to be up to 60%) foreign ownership of private banks. Stamp duty charges on private banks will also be removed and banks allowed to set their own interest rates. This will do much to bring the informal sector into the formal economy. The private sector has long by-passed banks due to high rates and fees on loans.
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> The informal sector will also be encouraged to join the banking sector due to a new programme being launched by Bank Audi Syria. The programme is aimed at increasing loans to small and medium enterprises. Hitherto the banking sector had ignored this sector of the economy.

o **Money transfers**. In its determination to support the contribution of the private sector to the formal economy, the government is also trying to regulate exchange and money remittance offices o The Money Exchange Law issued in March 2006 seeks to end a transfer route for the informal economy by obliging informal money changers to seek a licence.

o Exchange institutions were brought under the authority of the Council for Money and Credit which also controls the banking sector.

Syrians routinely circumvent capital controls by transferring currency illegally through unlicensed service providers. Capital transfers to Lebanese banks alone have been estimated at around 10 billion dollars. Currently, there are strict exchange regulations: the amount residents can take out is limited to 2,000 dollars and non-residents 5,000, and permission is needed to exceed these amounts. Ending illegal transfers will inevitably be a slow process but the government has set penalties for non-compliance, which will increase the chances of success.

2. Investment laws. The government also appears willing to offer a more stable legal and regulatory framework for investment. The EU is helping with legal advice and there is evidence that Syria is willing to crib investment laws from other countries with a legal system similarly based on the principles of civil law and Islamic law. This, combined with EU provision of personnel and training of Syrian judges and lawyers, will mean that a commercial code could be fully operational within two years.

Despite these developments, the entire financial sector desperately needs further reform:

o It is continually undermined by the poor state of Syria's telecommunications and IT industries. While the increased activity of foreign and private sector banks in the sector has meant improved IT capacity in these institutions, state-owned banks still do not have sufficient IT capacity to support modern banking methods.

o Record-keeping is poor in specialised governmental banks and regulations are poorly enforced.

o International accounting standards introduced as a matter of urgency if the formal private sector and the stock exchange are to attract investment.

o The insurance sector is undeveloped. The Bahrain-based Middle East and North Africa Financial Action Task Force has estimated that Syria holds less than 2% of the total insurance premiums in the Arab world, with insurance premiums amounting to less than 1% of GDP.

3. Stock exchange. After a 50-year hiatus, the Syrian bourse is expected to reopen by end-year with up to 50 companies seeking a listing. The government is aware that in the absence of privatisation, the stock exchange will lack depth, and so is seeking to encourage listings from other sources. Part of the capital of planned public-private sector joint ventures will be listed. The new tax laws also provide incentives for family businesses to seek a listing. In June, the Syrian Commission of Financial Markets and Securities (SCFMS), which is charged with supervising the establishment of the exchange, awarded preliminary licences to three new brokerage firms, bringing to six the total number of firms licensed to offer financial services on the exchange.

CONCLUSION: The government is committed to supporting the incorporation of the domestic private sector into the formal economy, and to its growth. In order to facilitate this, the financial system is undergoing constant reform. However, its determination to limit outside influence over liberalisation means that the telecommunications and information technology sectors remain in dire need of reform and investment and, as such, continue to constrain its efforts to reform and promote the financial sector.