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Syrian Investment Climate Assessment: Unlocking the Potential of the Private Sector

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Private Sector, Financial Sector and Infrastructure Group
Middle East and North Africa Region

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Currency equivalents
(As of January 31, 2005)

Currency unit: Syrian Pounds (SP)
Exchange rate: SP1 = US\$0.02

Weights and measures
The metric system is used throughout this report.

Fiscal year
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Acronyms and Abbreviations

ADR	<i>Alternative Dispute Resolution</i>
BDS	<i>Business Development Services</i>
BoP	<i>Balance of Payments</i>
CIS	<i>Commonwealth of Independent States</i>
CODB	<i>Cost of Doing Business</i>
EU	<i>European Union</i>
FIAS	<i>Foreign Investment Advisory Service</i>
FDI	<i>Foreign Direct Investment</i>
GAFI	<i>General Authority for Investment and Free Zones</i>
GCC	<i>Gulf Cooperation Council</i>
GDP	<i>Gross Domestic Product</i>
ICA	<i>Investment Climate Assessment</i>
IMF	<i>International Monetary Fund</i>
ILO	<i>International Labor Organization</i>
ISO	<i>International Organization for Standardization</i>
MNA	<i>Middle East North Africa</i>
NTB	<i>Non Tariff Barriers</i>
OECD	<i>Organization for Economic Cooperation and Development</i>
PE	<i>Public Enterprises</i>
ROSC	<i>Reports against Standards and Codes</i>
SEBC	<i>Syrian European Business Council</i>
SME	<i>Small and medium-sized enterprise</i>
SOE	<i>State-owned enterprise</i>
SP	<i>Syrian Pounds</i>
UAE	<i>United Arab Emirates</i>
UNIDO	<i>United Nations Industrial Development Organization</i>
WDR	<i>World Development Report</i>
WTO	<i>World Trade Organization</i>

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SYRIAN INVESTMENT CLIMATE ASSESSMENT: UNLOCKING THE POTENTIAL OF THE PRIVATE SECTOR

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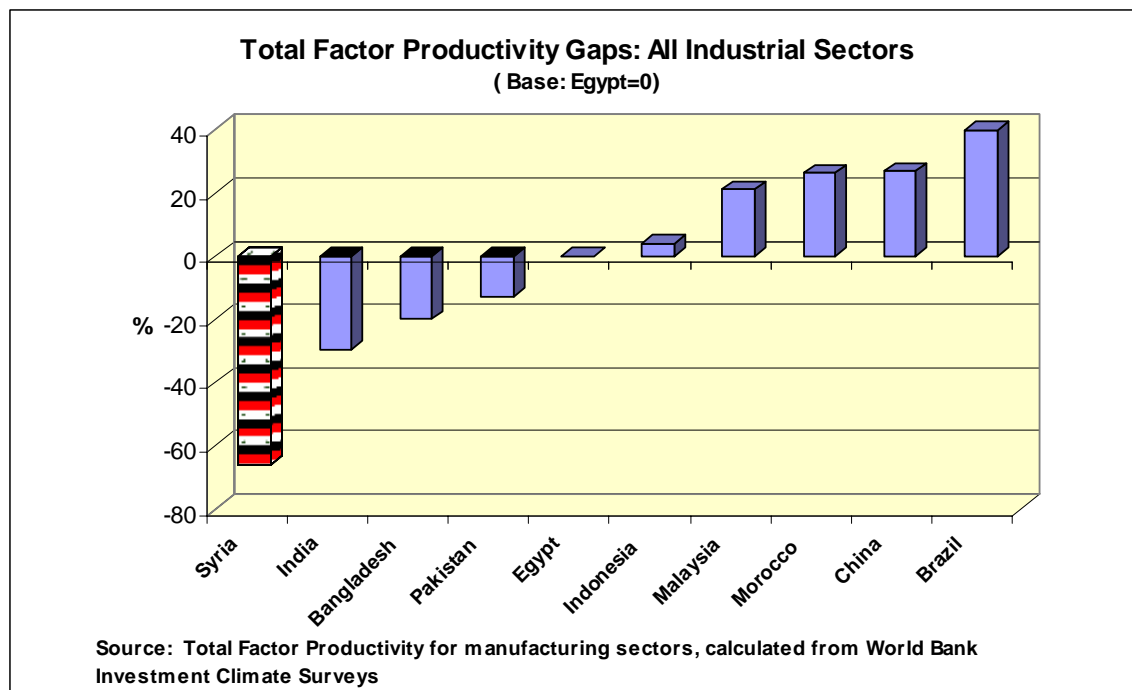
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EXECUTIVE SUMMARY

SYRIAN INVESTMENT CLIMATE ASSESSMENT: UNLOCKING THE POTENTIAL OF THE PRIVATE SECTOR

i. **The Growth, Employment and Productivity Challenges.** The core message of this report is that investment climate reform is urgently needed. Syria's investment climate benefits from a number of assets that give it enormous potential. They include a talented pool of entrepreneurs, strategic geography and natural resources, and a growing list of important reforms. Yet in spite of these assets, the Syrian economy is not achieving its productive potential. Productivity is low (Figure 1) and technological progress is limited. Syria's transition from a centrally-planned to a market economy has been far more gradual than in many other transition countries, leaving a long agenda of further policy and institutional changes.

Figure 1111: Factor Productivity Gaps: All Industrial Sectors (Base: Egypt =0)



ii. At the same time, economic liberalization is exposing the economy to new markets and new competition – an enormous opportunity but also a challenge unless firms become more productive. Syria's working-aged population is growing quickly, but the economy is not realizing the growth and investment needed to create jobs for them. Dwindling oil reserves create further pressure for Syria to initiate reforms to stimulate economic diversification over the next decade. Oil has provided around two thirds of export earnings and around half of government revenues in recent years. Agriculture has been providing around 30 percent of GDP and employment, yet fiscal concerns and trade liberalization puts

into question the sustainability of the substantial subsidies to agricultural inputs and outputs on which this sector has heavily relied.¹

iii. To meet the challenge of global competition and to raise incomes and employment of its people, Syria must raise its low level of productivity. Current productivity lags well behind many regional and international comparator countries, many of which host enterprises with which Syrian firms must increasingly compete in international and domestic markets (Figure 1). The problem does not seem to be a lack of entrepreneurial capacity, but rather of policy and institutional weaknesses that constrain economic performance. In fact, Syrian entrepreneurial talent is widely respected, and many Syrian entrepreneurs have succeeded better abroad, under more favorable investment climates. So what is needed to help Syrian enterprises to advance technologically and productively?

iv. Creating a Strong Investment Climate. The economic literature makes clear that economic growth, led by the private sector, is the primary vehicle by which employment and income expands. Productivity, in turn, plays a central role in economic growth. For example, a review of international experience found that over two thirds of country differences in national income can be accounted for by productivity, rather than the contribution of physical or human capital.² A growing body of experience shows that the growth of productivity and the overall economy is highly dependent on investment climate conditions.³ International opening to trade and investment integration is one part of this – Dollar and Kraay found that countries that integrated globally grew more than three and a half times the rate of countries that did not.⁴ The rules and institutions underpinning markets are also central. For example, Kaufmann and Kraay demonstrate that key conditions, including corruption, regulation and the rule of law, are strongly associated with economic growth.⁵ More recent work brings out a subtler point – it is the interaction of mutually reinforcing policies that yields growth. A recent review of the experience of 100 countries shows that the benefits of trade openness can only be realized with accompanying regulatory reform. These benefits are not realized in heavily regulated economies because: (a) resources are prevented from moving into the most productive sectors and to the most efficient firms within sectors”; and (b) “increased trade is more likely to occur in the wrong goods—i.e. goods where comparative advantage does not lie.”⁶

v. Thus, as Syria increasingly integrates with the global economy, the first priority of a strategy for development must be the creation of a good investment climate - one that sustains dynamic markets that encourage firms, both large and small, to increase productivity. Syria has clearly taken a number of steps towards improving conditions for private investment. These include: (a) beginning in 2001, Syria simplified and reduced some tariff rates; (b) in 2003, Syria cut the standard corporate tax rate on private companies to 25 percent; (c) the 2001 banking sector law allowed private entry, and four banks entered and started operation in 2004; and (iv) Syria has invested substantially in electric power generation.

¹ “Agricultural production has been expanded by means of substantial subsidies to both outputs and inputs. On the output side, production of key crops has been promoted by support prices well above world prices....” World Bank *Syrian Arab Republic Economic Review* (Washington, April, 2002). See also FAO, *Syrian Agriculture at the Crossroads* (Rome: FAO Agriculture Policy and Economic Development Series, 2003).

² E. Hall & Charles I. Jones, 1999. *Why Do Some Countries Produce So Much More Output Per Worker Than Others?*, The Quarterly Journal of Economics, MIT Press, vol. 114(1), pages 83-116.

³ “The first pillar of a strategy for development is the creation of a good investment climate - one that encourages firms, both large and small, to increase productivity. The private sector is not only the engine of aggregate growth, it is also the main provider of economic activity and opportunity for poor people.” Nicholas Stern, former Senior Vice President and Chief Economist, World Bank, 2002

⁴ Dollar and Kraay. *Trade, Growth and Poverty* (World Bank, June 2001)

⁵ Kaufmann and Kraay, *Growth without Governance*, *Economia*, Volume III, Number 1 (Fall 2002)

⁶ Bineswaree Bolaky and Caroline Freund *Trade, Regulations, and Growth* (World Bank: Policy Working Paper Series 3255, March 2004).

vi. Still, these reforms have yet to yield the hoped for benefits in terms of economic growth. This can largely be explained by the incompleteness of some reforms, the weak implementation of others, and the need for complementary policy and institutional reforms⁷ to allow private investment and resource allocation to respond where incentives have improved. Examples of this include:

- a. The 1991 opening of industry to private and foreign investment was not accompanied by an opening of trade, so private industry arose to meet domestic need under substantial protection. The efficiency gains hoped for through private investment were not realized due to the constraints on competition, as evidenced by low industrial productivity.
- b. The recent and substantial lowering of tariffs has not yielded its full impact on trade and investment in part because non-tariff barriers remain substantial.
- c. The benefits of a lower corporate tax rate were reportedly mitigated by the absence of accompanying reforms in tax administration. This is because a company's allowable expenses and total tax bill remain largely at the discretion of tax agents.
- d. The impact of opening banking to private participation has been muted by the lack of simultaneous institutional, regulatory and structural changes in the banking sector.
- e. Substantial investments in electricity generation were not matched by simultaneous improvements in distribution, meaning that service, as experienced by firms, remained unreliable in many locations.

The Investment Climate Assessment

vii. The purpose of this Investment Climate Assessment (ICA) is to:

- a. Provide the Syrian government, as well as business leaders, with a rigorous empirical analysis of the investment climate in Syria and the factors influencing firm-level productivity and competitiveness;
- b. Use this analysis to derive recommendations and options for priority measures to improve the investment climate and productivity, as well as ways in which the World Bank and others might further support these reforms.

viii. The ultimate objective is to provide an agenda of reforms that together will create a business-enabling environment conducive to accelerated private sector-led growth, thereby increasing Syrian national income and employment

ix. The World Bank Investment Climate Assessments (ICAs) provide a standardized way of measuring and comparing investment climate conditions in a country. They are a systematic instrument to “allow (a) better identification of the features of the investment climate that matter most for productivity and hence income growth, especially for poor men and women, (b) tracking of changes in the investment climate within a country, and (c) comparison of countries or regions within countries.”⁸

⁷ “First, market assessments of the internal consistency and sustainability of policies greatly influence the size and speed of the response to forward-looking decisions such as private investment and saving. Second, there appear to be close links between particular aspects of macroeconomic and structural reforms that are likely to be mutually supporting; hence the importance of a critical mass.” Erik C. Offerdal. *The Response of Investment and Growth to Adjustment Policies* (IMF: Finance and Development, June 1996) See also Roberto Zaghera et al, *Economic Growth in the 1990s – Learning from a Decade of Reforms*, World Bank 2005, which states, “Without realistic exchange rates, macroeconomic stability, infrastructure investment, the development of human capital and institutions which promote enforcement of contracts, actual gains from trade reform may fall far short of expectations.”

⁸ Private Sector Development Strategy – Directions for the World Bank Group, April 9, 2002.

x. The main focus of ICAs is on *microeconomic* and *structural dimensions* of a nation's business environment, viewed in an international perspective. To this end, ICAs look in detail at factors constraining the effective functioning of product markets, financial and non-financial factor markets, and infrastructure services, including in particular weaknesses in an economy's legal, regulatory and institutional framework. ICAs also provide the tools and analytical framework to identify reform priorities in a country's investment climate, by linking constraints to firm-level costs and productivity.

xi. Underpinning all ICAs is a standard core investment climate survey instrument, which allows the identification of existing conditions, the benchmarking of conditions to monitor changes over time, and the analysis of the impact of these conditions on firm-level performance. In Syria, the survey was conducted by a team at the University of Damascus with 552 Syrian industrial enterprises (see Table 1), in accordance with the standard methodology of the World Bank. The survey was completed in August 2004. It focused on private sector manufacturing firms, to facilitate uniform analysis and valid comparisons across countries. Manufacturing exports are typically seen as an important part of Syria's future economic development, and, typically, the experience of the manufacturing sector exposes all elements of the value chain, hence the results have broader relevance for the entire economy. Indeed, interviews conducted with service sector firms highlight similar constraints to those identified by respondents to the survey.

xii. The ICA integrates the analysis of the survey findings with other sources. This includes detailed discussions and focus groups involving members of the private sector, government officials and other experts, and a number of earlier or parallel studies, including:

- the World Bank "Doing Business 2005" indicators for Syria.
- other World Bank analytic work including the "Synoptic Note on Trade", "Syria: Integrating with Global Markets" and "Syrian Arab Republic: Economic Review".
- other analytic work carried out by the Syrian European Business Council, UNIDO, UNDP, and other Syrian and international experts

Table 1: ICA Survey Sample Structure

<i>Firm Size</i>		<i>Firm Activity</i>	
	<i>Sample</i>		<i>Sample</i>
Small <50	448	Chemicals	78
Medium 50<x<150	81	Food processing	103
Large 150+	25	Textiles	116
		Garments & Leather	117
		Wood & Paper	24
		Glass & Stone	44
<i>Market Orientation</i>			
	<i>Sample</i>	Metals	48
Exporter	245	Others	26
Non Exporter	307		
<i>Firm Ownership</i>		<i>Firm Location</i>	
	<i>Sample</i>		<i>Sample</i>
Domestic	545	Aleppo	231
Foreign	7	Damascus	70
State		Hama	40
Other		Homs	59
		Lattakia	40
		Ru Dam	120

xiii. These sources helped to deepen and balance the survey findings, providing the information by which to verify or challenge the private perceptions of enterprise managers and, where they are verified, to understand the underlying policy and institutional sources of their constraints.

Investment Climate Reform: The Key to Syria's Future

xiv. As a center of trade in the Middle East, Syria enjoys a rich history of private entrepreneurship. Beginning in the 1960s, Syria pursued a policy of central planning. In sectors such as agriculture, where there was continued private ownership, activity was highly influenced by government regulation, price controls, marketing boards, control of banking and distribution, and direct involvement in many other

aspects of input supply and product markets. Continuing through the 1980s -- like many other countries in the region and elsewhere in the developing world -- the Government pursued inward-oriented, import-substitution policies, protecting domestic industry from foreign competition. In 1991, a gradual process of opening began, which modestly accelerated in recent years. Today, the private sector is dominated by nearly 100,000 small and medium firms, with a very few large firms (see Table 1 on industrial firms). All together, in 2002, it had grown to produce 61 percent of GDP (up from 40 percent in 1980) and provides the great majority of employment. Industry is centered around two main locations: Aleppo and Damascus. There are important secondary cities in Homs, Hamma, and Latakia. Syria appears to present a tremendous potential for future growth.

xv. At least three of Syria's leading sectors face substantial challenges. The oil sector, which has accounted for over two thirds of Syria's export earnings, faces the challenge of dwindling oil supply, to the point where, in the next 10 years, Syria expects to become a net importer of oil. The agriculture sector faces the challenge of water supply, as well as a hard-to-sustain structure of subsidies and price controls. The industrial sector is confronting the challenge of low productivity (see Figure 1) and increasing competition as Syria liberalizes trade. In fact, the Syrian survey results (as well as earlier UNIDO studies) suggest Syrian private industrial productivity is one of the lowest in the region, although the productivity of public sector industries is even lower.

Constraints to Productivity and Investment

xvi. Syria's current weak productivity is a result of three sets of issues:

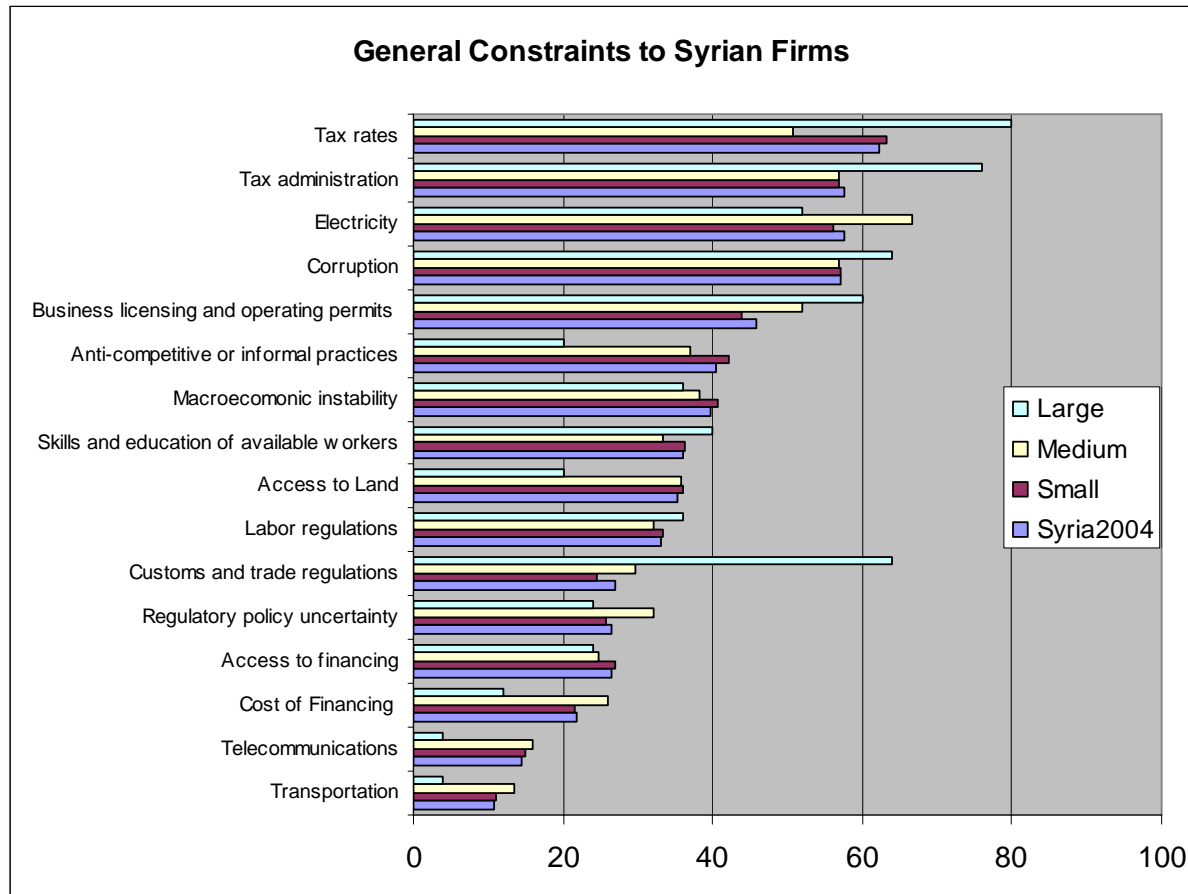
1. Limits to Opportunity: Market competition and private participation remains sharply constrained by:
 - a. Preferences given to state-owned enterprises
 - b. Restrictions on trade (tariff and non-tariff barriers)
 - c. Barriers to entry and investment
2. High and uncertain costs of doing business arising from:
 - a. Taxes and tax administration
 - b. Customs and trade facilitation
 - c. Bureaucratic discretion and regulatory procedures
 - d. An outdated legal framework for contracts, property rights
3. Factor Market Weaknesses in:
 - a. Labor markets – skills and flexibility
 - b. Financial services (and corporate governance)
 - c. Electric power and other infrastructure services
 - d. Technological factors

Each of these factors are discussed in the sections that follow.

xvii. The issues highlighted in the ICA were selected due to the importance given them by the senior managers of businesses themselves, by focus groups of foreign investors, and by experts interviewed for the ICA. The ICA was informed by a standardized survey of 560 private firms operating in Syria conducted by Damascus University in partnership with the World Bank, as well as focus group work, international indicators such as *Doing Business*, and a substantial body of other reports from organizations including the World Bank, EU and SEBC, UNIDO/UNDP, and FAO. While the constraints discussed here are mostly in the top 10 constraints most frequently identified by survey respondents as "major" or "very severe" (Figure 2), it is important to note that some issues came to the forefront due to the emphasis of a subgroup of investors. For example, the issues of taxes and tax administration, electricity, corruption, business licensing and permits, and unfair competition were each identified by

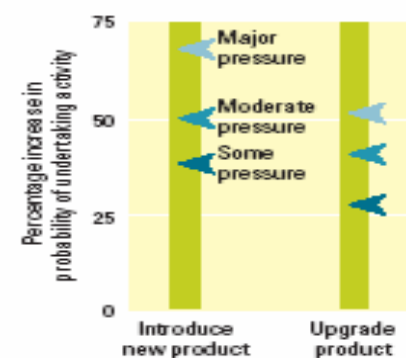
more than 40 percent of responding firms as “major” or “very severe” constraints. Customs and trade regulation emerged because it is the third most frequently identified constraint by large firms. Financial access and labor training and regulation issues were especially emphasized by firms with foreign investment and by foreign investors interviewed for the ICA.

Figure 2222: General Constraints to Syrian Firms



xviii. **Limited Opportunity.** Competition is the central driving force for enhancing productivity. Competition is the single most important disciplining force of market economies, converting individual profit-seeking into overall economic welfare. Without competitive pressure to narrow rents from commercial activities, consumers suffer from elevated prices and businesses entry and innovation is suppressed. Existing businesses become oriented towards protecting their excess profits rather than finding ways to produce at lower cost, improve their product or introduce new products. The WDR 2005 synthesizes the findings from surveys in 27 transition economies, showing that competitive pressure drives innovation in products, production processes and technology (Figure 3).

Figure 3 More competitive pressure, more innovation



Note: Percentage increase is relative to firms reporting no competitive pressure.
Source: World Bank Investment Climate Surveys/BEEPS II in 27 countries in Eastern Europe and Central Asia.

xix. Private participation can bring to bear resources, finance and creativity beyond the reach of most governments. In almost every productive economic realm, private-led economic activity has been found to be superior to state-led activity. When exposed to equal incentives and constraints, ownership should not matter. However, in reality, public entities are usually (and more intrinsically) the objects of protection, subsidies and political interference than are privately-owned firms. Of course, when private enterprises grow reliant on protection and subsidies, they too perform badly – the key factor is the absence of incentives to perform, innovate and reduce costs to consumers. Without the stimulus of competitive pressure, Syrian firms’ productivity, management, and innovation will remain low and their demand for better policies and institutions, worker skills and technology, external finance, and business services will remain low.

xx. In Syria, competition has been limited and substantial barriers to entry remain in many economic sectors. Some productive sectors remain reserved for the public sector, while others restrict certain types of foreign participation. Public sector monopolies control cement, sugar-refining, fertilizers, oil refining, mineral water, electricity, telecommunications, and insurance; remains dominant in banking. Elsewhere, inefficient State-owned Enterprises (SOEs) and public bodies play critical roles in many value chains – for example, through exclusive control of the procurement and sale of cotton and wheat, through the exclusive control of yarn-making and through the provision of infrastructure. Around 200 state-owned companies enjoy different levels of subsidy and protection. Beyond this, SOEs have exclusive right to import some goods, and for others, have the exclusive right to grant licenses for key imports.

xxi. Trade remains highly restricted by both tariff and nontariff barriers, and even the significant efforts at liberalization have left a web of protections, tariffs and exceptions that distort economic incentives and discourage competition. Tariff rates, while reduced from their historic highs, range from effective rates of 6 percent to 235 percent. Generally, lower rates apply to raw materials and intermediate goods than to finished goods. A complex web of exceptions and special rates, further complicated by GAFTA, mean that the tariff applied to a good continues to depend on who is importing it and from where it is being shipped, creating further distortions. Quantitative restrictions (QRs) add up to the equivalent of a 19 percent across-the-board tariff on all imports. There are goods that are forbidden outright. Some of these are forbidden for quite legitimate reasons of public interest, such as environmental, security and sanitary reasons. But in Syria the list is fairly expansive, and the criteria are not publicly known. Furthermore, Syria also bans the import of some final goods that compete with Syrian enterprises. And, as noted above, there are goods that only SOEs may import or over which they have exclusive license.

xxii. Finally, the process of business entry imposes constraints that can serve as barriers to new firms starting up and competing. The process of business registration is slow and expensive. Syria’s minimum capital requirement, when taken as a percentage of per capita GDP, is around six times the regional average for MENA countries (Table 2). With a stronger investment climate, including both market enabling conditions and facilitating institutions, investment and productivity will grow, firms can advance technologically and managerially, and workers will benefit.

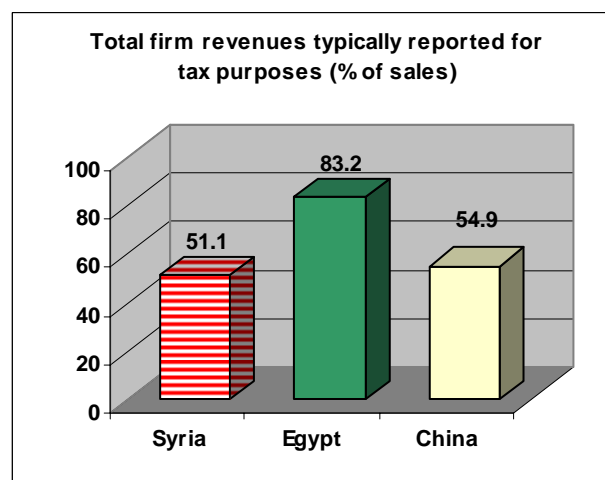
Table 2: Entry Procedures

	Syrian Arab Republic	Regional Average	OECD Average
Number of procedures	12	10	6
Time (days)	47	39	25
Cost (% of income per capita)	34.2	51.2	8.0
Min. capital (% of income per capita)	5,053.9	856.4	44.1

xxiii. **The High and Unpredictable Cost of Doing Business** A central factor constraining new investment and competitiveness is Syria's high and unpredictable costs to do business and to produce.

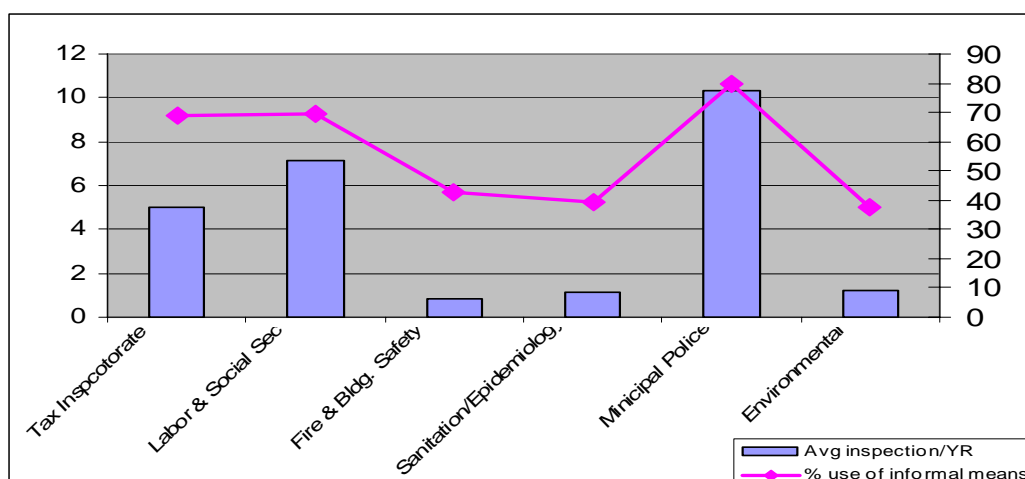
xxiv. Among the leading dimensions identified are taxes and tax administration. It became clear in the course of the study that tax rates themselves were not the main problem – rather the way they were assessed and administered and, to some extent, a proliferation of small taxes (such as the stamp tax) and costs (many informal) weigh upon firms. Corporate taxes as administered require extensive negotiation with tax officials and frequent informal payments. The average firm experiences 5 tax inspections or required meetings in a year, and roughly 70 percent reportedly involve requests for informal payments. Of course some of these payments are aimed at reducing tax liability, and, on average, survey respondents estimate that only 51 percent of income is reported for tax purposes (Figure 4). This means that stated rates and rules are less relevant than actual burden, and that all the money being collected may not end up in the treasury. Additional smaller taxes, like the stamp tax, make the effective tax burden higher than may be apparent, although the tendency to underreport income may counterbalance this.

Figure 4: Income reported for tax purposes



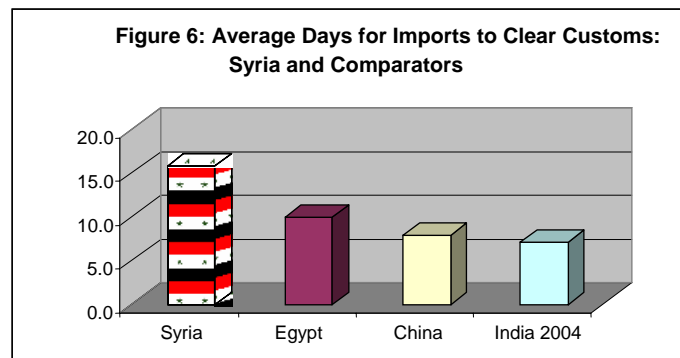
xxv. Overall, regulations and taxes, administered with substantial bureaucratic discretion, impose high and unpredictable costs on formal businesses, increasing the cost of transactions and making investment decisions riskier. For example, the typical Syrian business experiences around 25 inspections a year, consuming a substantial amount of the time and energy of enterprise managers (Figure 5). Typically over half of these encounters involve some expectation of informal payment, most frequently involving municipal police, labor and social security inspectors and tax inspection.

Figure 5: Incidence of Inspections and Informal Payments Requests



xxvi. The large amount of bureaucratic discretion and harassment contributes to a regulatory system that diverts a great deal of senior management time away from running the firm towards dealing with public officials. On average, Syrian senior managers spend 14.5 percent of their time dealing with regulation and officials, versus only 11.5 percent in China, 8.9 percent in Morocco, and 1.6 percent in Oman. This has a direct impact on productivity.

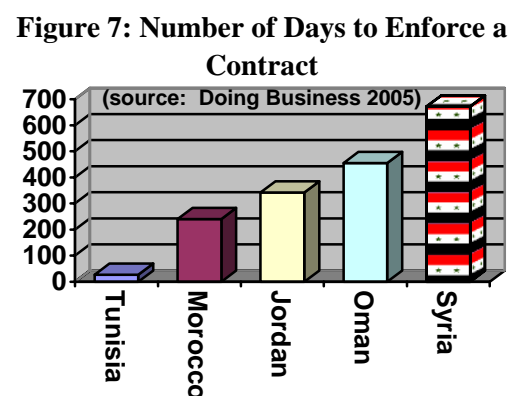
xxvii. Another area where regulations and state institutions create high transaction costs is in trade facilitation and regulation. On average, Syrian industrial firms in the survey report that imported goods take 15 days to clear customs and other trade regulatory procedures at the border, more than double the time required in many other countries (Figure 6). Furthermore, firms on average have experienced delays in their imports of over 30 days sometime in the last year, and delays of nearly 10 days in their exports. The trade policy report notes that:



Customs procedures and regulations constrain trade through a lack of consistency, a manual system for processing customs data, and inadequate dissemination of information on procedures and requirements. ...Currently, trade procedures in Syria require the processing of paper documents by several Ministries, banks, the port authority, and customs, as well as the usual professional organizations such as shipping agents and freight forwarders. ...Depending on the direction and status, up to 14 different declarations (and more than 50 signatures) are required.... Moreover, all import cargo is inspected, with the sample rate determined at the discretion of the customs inspector.⁹

xxviii. This means that firms must inventory, plan production cycles and design contracts around the long potential delay that may occur at the border.

xxix. Finally, the legal framework for doing business is incomplete and weakly enforced by the courts. It is hard to enforce contracts and collateral, and the average court case over debt took survey respondents 22 months to resolve. *Doing Business 2005* indicators suggest Syria has one of the slowest court systems in the region (Figure 7). Only 1 percent of respondents had resolved business conflicts using courts over the previous 3 years.



xxx. **Factor Market Weaknesses.** In factor markets, a number of weaknesses were observed that impede productivity. Although wages are not especially high, given low productivity and worker skills, labor is relatively expensive. Figures 8a and b present the example of the garment sector, where, like

⁹ World Bank. Syria: Harnessing Trade for Growth (December, 2004)

several other industrial sectors measured in the survey, low labor productivity makes the cost of labor input for each unit of output more expensive than in many other countries in the region and the world.

Figure 8: Value Added per worker and Ratio of Wages to Value Added (Garment)

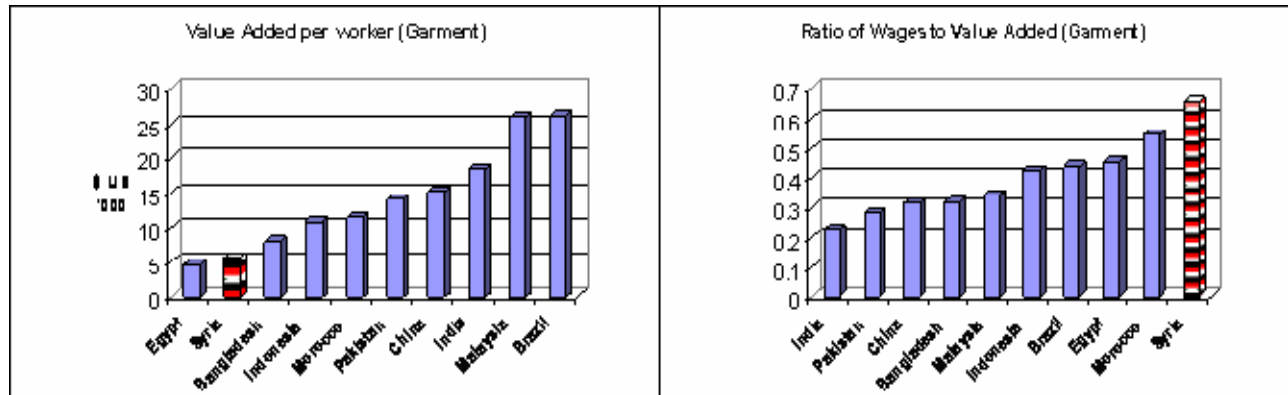
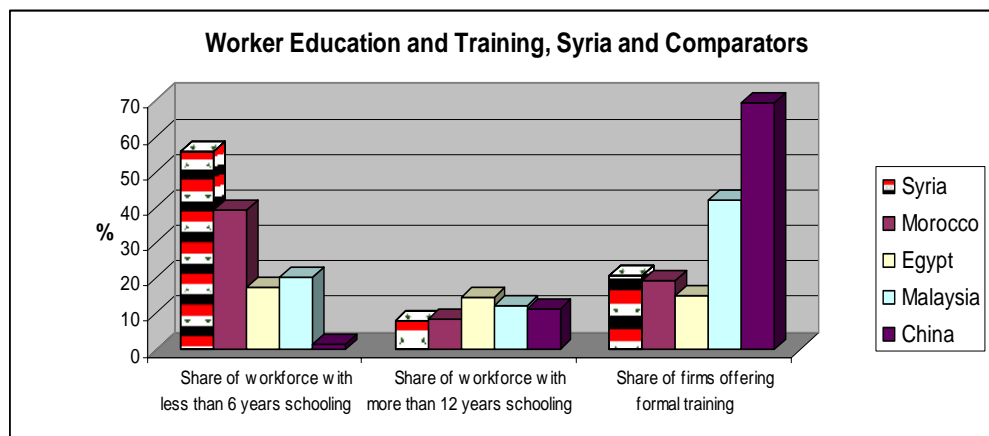
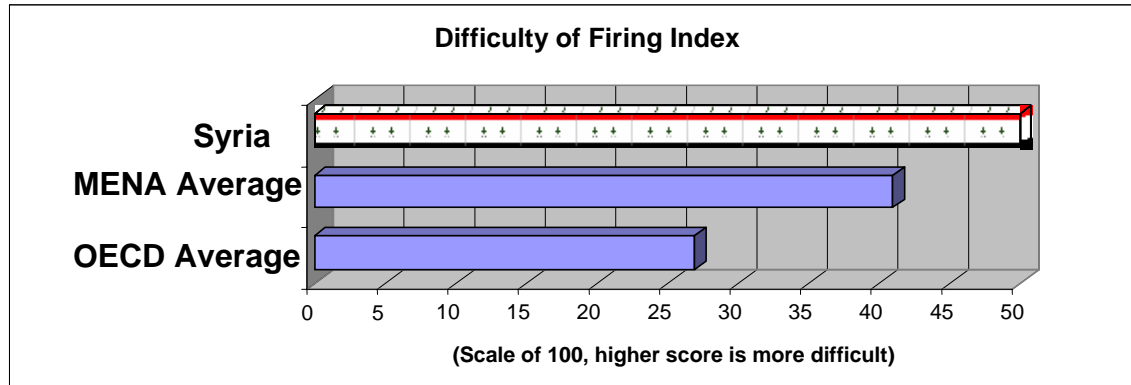


Figure 9: Worker Education and Training, Syria and Comparators



xxxi. Syrian workers have, on average, a lower level of education than in many other countries, and the rate of worker training does not compare well to East Asian firms, although it is slightly better than some other MENA countries (perhaps due to substantial public expenditure on vocational training) (Figure 9). Further, labor markets are somewhat inflexible. On the *Doing Business 2005* “difficulty of firing” index, Syria ranks behind the MENA average, which is itself considerably higher than in OECD countries (Figure 10). This may limit the ability of firms to adjust their labor force and skill mix in response to market conditions, and to motivate workers to perform well. The lack of a social safety net adds to the reluctance of employers to fire workers and the resistance of workers to shifting employment.

Figure 10: Difficulty of Firing Index



xxxii. Syrian firms obtain relatively little finance from its banking sector. In the survey, only 12 percent of the formal enterprises in the sample report having bank financing for working capital, and only 12 percent report having bank investment finance. Banks provide only 2 percent of working capital overall and 4 percent of total investment finance and 2 percent of working capital among surveyed firms (Figure 11). The average collateral required by banks is among the highest ever measured in ICA surveys, at 217 percent of the value of the loan it secures (Figure 12). There are few financial services offered beyond traditional lending.

Figure 11: Share of Finance from Banks, Syrian Enterprises and Comparators

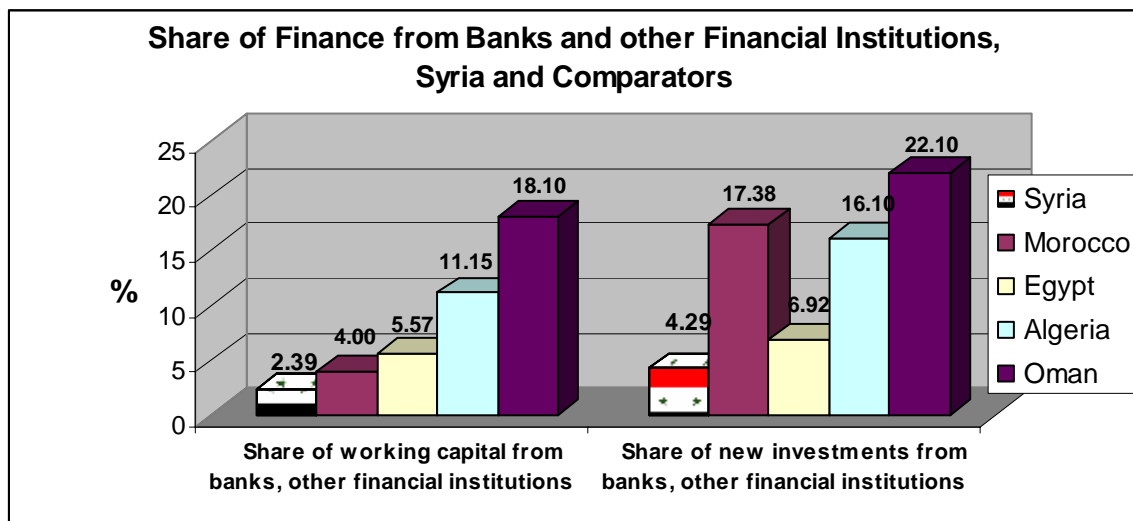
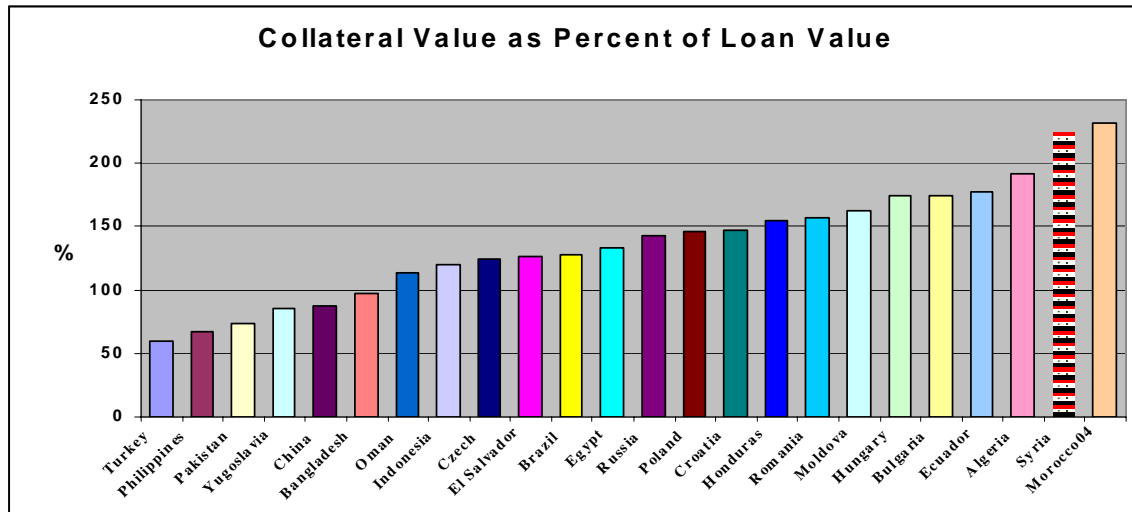
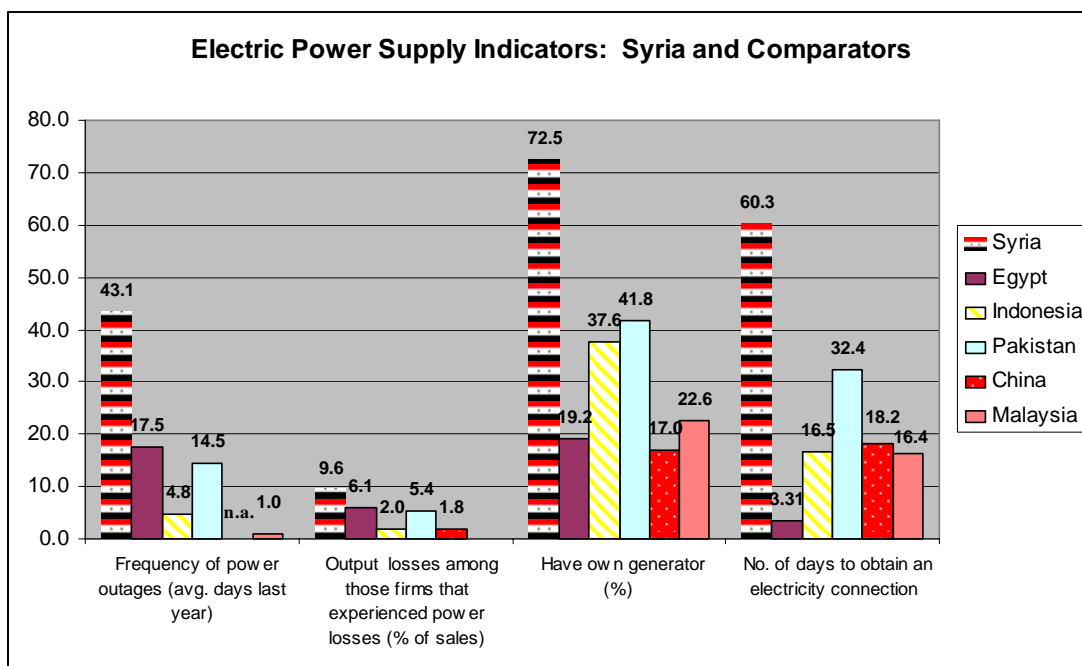


Figure 12: Collateral Value as Percent of Loan Value

xxxiii. Weak competition and heavy controls in the banking sector (which has only recently opened to private participation) diminish the availability of bank finance and raise its effective costs. This said, demand-side factors (including weak corporate governance) may be more important as a limit to the flow of bankable projects. A culture of secrecy, significant informality and weak accounting practices mean that relatively few firms can and are willing to come to banks (or equity financiers) with traditionally acceptable information and evidence of the financial soundness of the enterprise or its investment project. The slow functioning of the courts in adjudicating and enforcing collateral claims further undermines lending.

Figure 13: Electric Power Supply Indicators: Syria and Comparators

xxxiv. Electric power supply was the third most commonly identified constraint for surveyed Syrian firms. In spite of large public investments in power supply, in many locations electricity supply is unreliable. The overwhelming majority of firms supplement public power with self-provision, by buying generators. While the high rate of generator ownership may partly reflect the subsidized price of diesel fuel and conditions before recent investments in generators, that does not explain the large production losses attributed to power supply failures reported by Syrian firms (Figure 13). By location, firms in Aleppo and Rural Damascus are most likely to experience interruptions in power supply. Similarly, the majority of medium-sized and large firms own their own wells to supplement inadequate public water supply. In information and communication technology, Syria lags, ranking last in the region for its rate of internet connectivity and is 7th of 9 ranked countries in mobile phone density (Table 3). Mainline phones suffer from unreliability, with 50 phone faults per 100 lines, one of the highest rates in the region.¹⁰ At the same time, it appears that the levels of technology and quality control employed by Syrian firms are not very sophisticated. For example, only 7 percent of Syrian enterprises sampled report being ISO certified compared to 9 percent of Egyptian firms and 50 percent of Chinese firms.¹¹ UNIDO rates Syria as technologically well behind a number of other regional economies, including Jordan, Egypt and Tunisia. And the UNDP/UNIDO study of public sector industrial firms suggests that the level of technology in SOEs is even more behind. The recent World Bank trade policy study concludes that the primary way

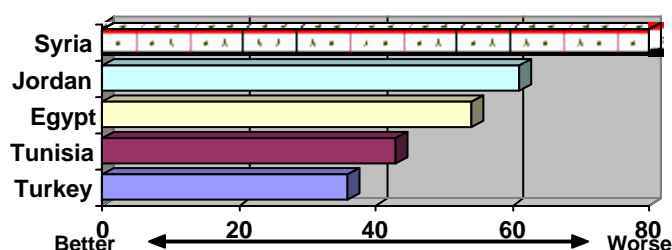
Table 3: Rate of Connectivity and Ranking

Country	Main tel. lines per 100 inhab.		Mobile lines per 100 inhab.		Payphones per 10000 inhab.		Internet subscribers per 10000 inhab.	
	2003	Ranking	2003	Ranking	2003	Ranking	2003	Ranking
Algeria	6.93	8	4.53	8	0.06	7	160	8
Libya	13.56	2	2.30	9	N/A	N/A	289	6
Morocco	4.05	9	24.44	1	3.02	3	265	7
Tunisia	11.77	5	19.72	4	3.33	2	637	3
Egypt	12.73	3	8.20	5	0.71	4	393	5
Jordan	11.36	6	23.54	2	0	8	833	2
Lebanon	19.88	1	23.43	3	0.25	5	1171	1
Syria	12.59	4	6.52	7	0.16	6	129	9
West Bank & Gaza	8.73	7	7.73	6	6.22	1	400	4
Europe	41	-	55.4	-	-	-	2373	-
World	18.76	-	21.91	-	-	-	1107	-

Sources: EMC, ITU, Arab Advisors, World Bank

xxxv. Syria will access **modern technology** in the short term is “through imports of goods and services that incorporate the technology, as well as the transfer of knowledge that comes with foreign direct investment.”¹² Yet, Syria has a relatively poor climate for FDI,

Figure 14: Ranking of Technological Structure



¹⁰ International Telecommunication Union, 2003

¹¹ The 2002 UNIDO UNDP study *Manufacturing Industry in Syria Industrial Development Strategy* found that “Syria has not paid enough attention to building a national technological base which is a precondition for industrial development....”

¹² World Bank. *Syria: Harnessing Trade for Growth* (Washington: December 2004, confidential draft)

significant trade barriers and weak protection of intellectual property. Therefore, flows of foreign investment, high technology goods and licensing agreement are not forthcoming to raise the level of technology.

xxxvi. **Recommendations for a Strategy to Compete.** To unlock the potential of the Syrian economy, Syria thus needs to focus on further opening opportunity to private investment and competition, lowering the level and variation in the costs of doing business, and improving the policies and institutions underlying factor markets. Before launching an economic transition program, it is worthwhile to look at the lessons of reform success in other countries.¹³ These include:

- The importance of up-front coordination among the diverse institutions and actors within Government on a reform strategy. Building a common vision among key implementers of the reform strategy will improve outcomes.
- Prior consultation with affected parties, and especially the business community, to increase awareness, agreement and ownership of the strategy and to improve its quality with their suggestions.
- Establishment of a sequenced strategy with a clear timeline. The main steps in the strategy should be established up front, and Government should commit to the timing. It is also useful to establish clear indicators when each measure has been implemented and had impact.
- Clear communication of the strategy and its components. Transparency is critical to avoiding misunderstandings and distortions regarding the strategy. Citizens, businesses and others should understand both the “what” and the “why” of the overall program and its major components.
- Periodically evaluate progress and revise the strategy. It is important to have timely information throughout the implementation process and its consequences, and to periodically take stock and adjust the strategy depending on how well different elements are working.
- Facilitate transition and protect the vulnerable. Clearly any fundamental economic change has winners and losers, at least in the short-term. Efforts should be made to smooth the transition and, especially, to protect the most vulnerable (for example, workers who may lose their jobs and their families), typically by enacting elements of a social safety net.
- Move forward on accompanying long-term policies and reforms. While a short-to-medium term strategy will focus on discrete actions placed in time, there remains an agenda of longer-term efforts that can be begun or maintained, such as:
 - Maintaining macro-economic stability and fiscal balance.
 - Comprehensive public administration reform
 - Judicial reform
 - Broader financial sector reform

xxxvii. While the ultimate elements of its strategy to unlock the potential of private-led growth are up to the Syrian Government to decide, the ICA analysis suggest a number of potential elements that merit priority attention. These include:

- To **open new opportunities for private sector growth, competition and innovation**, the following measures are central:
 1. The elimination of most state monopolies, allowing competitive pressure, and phasing out of remaining SOE subsidies and preferences (the treatment of “natural” monopolies such as power distribution is addressed below). At the same time, it is vital to assure that a redundancy program facilitates the transition of workers from state employment to new jobs through a severance package and retraining and job search support.

¹³ See, for example, Kikeri et al. “Lessons of Successful Reform Efforts...”

2. A deepening of trade liberalization, including the removal or tariffication of nontariff barriers – that is, converting prohibitions and restrictions into tariffs on the affected goods -- and a continued lowering of tariff barriers. Syria's GAFTA agreement and pending EU Association Agreement are highly encouraging, and deepening liberalization, with complementary reforms, would secure their benefit:

...[A]bolition of non-trade barriers ...would make the GAFTA and [the EU-Syria Association Agreement] agreements really effective. The trade pattern that would emerge is a strong increase of imports from Europe (including a large rise in investment goods) and a large increase in exports going to the GAFTA area.¹⁴

Box 1: Gains from Improving Trade Facilitation

Recent World Bank research has suggested that trade facilitation reform, as a complement to trade liberalization, brings enormous rewards. The study models countries that are members of the Asia Pacific Economic Cooperation (APEC), measuring their performance in four dimensions: 1) port efficiency; 2) customs environment; 3) regulatory environment; and 4) e-business usage. It suggests huge gains to improving trade facilitation in those countries that are below average. For APEC as a whole, it is estimated that a program to raise capacity "half-way" to the APEC average in all four dimensions among those countries below average would yield an increase in intra-APEC trade of about \$254 billion dollars average for APEC countries. This is about a 21 percent rise in total intra-APEC manufactures trade. About \$117 billion of the gain (and 10 percent of the increase in trade) comes from the improvement in port efficiency. About \$139 billion of the total gain comes from the improvements "at the border" in port efficiency and customs environment. An additional \$116 billion gain might come from improvements "inside the border" in regulatory harmonization and e-business usage.

Source: John S. Wilson Trade Facilitation WTO Rules and Capacity Building: What's at Stake? (World Bank Institute Development Outreach, July 2003.)

3. Complementary to this, attention must be paid to improving trade logistics (see below) and to complementary regulatory liberalization. Recent research on international experience with trade liberalization confirms that complementary reforms are essential to realizing growth following trade reform. Regulatory reform precedent or simultaneous to trade reform greatly enhances its impact. Without such mutually reinforcing policy changes, growth is not realized in heavily regulated economies because:
 - resources are prevented from moving into the most productive sectors and to the most efficient firms within sectors” and
 - “increased trade is more likely to occur in the wrong goods—i.e. goods where comparative advantage does not lie.”¹⁵
4. The removal of legal, regulatory and administrative barriers to business entry, including explicit and implicit restrictions on business start-up and investment. In order to encourage business entry and competition, Syria should continuously work to remove barriers from administrative and regulatory sources. Beyond removing explicit prohibitions, within business registration, a good first step would be to eliminate the minimum capital requirement, which imposes an expensive cost at entry. Syria's level of minimum capital is extremely high, but it is important to note that the World Bank Group's international data suggests that minimum capital requirements

¹⁴ World Bank. Syria: *Harnessing Trade for Growth*. Ibid.

¹⁵ Bineswaree Bolaky and Caroline Freund *Trade, Regulations, and Growth* (World Bank: Policy Working Paper Series 3255, March 2004). See also Roberto Zagher et al, *Economic Growth in the 1990s – Learning from a Decade of Reforms*, World Bank 2005, which states, “Without realistic exchange rates, macroeconomic stability, infrastructure investment, the development of human capital and institutions which promote enforcement of contracts, actual gains from trade reform may fall far short of expectations.”

are ineffective at their primary objective -- protecting creditors against insolvency. Clearly, government should specifically target reducing barriers for business entry including:

- the steps and time required for business registration
- the delay in licensing approvals
- the delays in land use and building approvals
- the waiting time for infrastructure services

Some of these can be achieved by streamlining the underlying bureaucratic processes, others may require more fundamental reform of the underlying agencies involved. For example, in infrastructure, this perhaps can only be addressed by fundamental reforms within each service sector, as is recommended elsewhere in this report, beginning with electricity.

5. In addition, the ICA advises the government to review the whole set of administrative hurdles to launching and operating an enterprise or new investment. A FIAS administrative barriers to investment study provides a useful framework for such a review.
- To **reduce transactions costs and improve predictability**, the following reforms are key:
 1. Reform of tax administration to rationalize incentives and sharply reduce discretion in enforcement, including:
 - a. the phasing out of tax holidays, exemptions and special treatment in favor of lower universal rates and uniform investment incentives such as accelerated depreciation or an investment tax credit;
 - b. the introduction of a tax procedures act to regulate the administration of taxes and establish clear procedures for enforcement, including the rights and responsibilities of the inspected, as well as the inspectors.
 - c. adoption of a system of risk-weighted, randomized inspection and audits, to improve their efficiency and fairness and reduce discretion.
 2. Improvement of customs administration to increase efficiency, speed processing and reduce uncertainty, by streamlining procedures, improving management of and incentives to customs officers, and computerizing the entry of customs data. Movement towards a “single-document” and “single window” system.¹⁶
 3. Finally, Syria should rationalize the enterprise inspection regime government-wide, establishing clear rules for frequency of routine inspections, permitted purpose of inspections, inspection procedures, and the rights and responsibilities of inspectors and inspected enterprises. This should be supported by longer term approaches towards civil service and public administrative reform, and towards rationalization of the regulatory process.
 - To **strengthen factor markets**, priorities include:
 1. **Labor market** measures to improve flexibility and skills. The identified constraint in laying off workers will affect Syrian firms’ ability to adjust to new incentives created by trade liberalization, and discourages formal employment. Syria should move to reduce rigidities in laying off workers for business or economic reasons, allowing employers to make decisions without prior third party approval. This would help to increase labor market efficiency. At the same time, measures

¹⁶ See World Bank. *Syria --Integrating with Global Markets: Trade Competitiveness and Logistics Assessment* (June 2004, mimeo)

should be taken to reduce the social costs of inevitable dislocations involved in labor market adjustments and overall economic reforms. In this regard, Syria should work to strengthen the social safety net for the unemployed (for public sector employees through severance packages, for all employees through social insurance).

Improving skills is in part, a long term program that involves the whole educational system. However, in the shorter-term, Syria must find ways to stimulate the development of the private market for training, one responsive to enterprise demand, if it wants a system that contributes to growth. Training policy should be designed to facilitate firms' investments in private training, rather than emphasizing public supply. If firms are insufficiently aware of the benefits of training or unable to finance it, some kind of tax incentive, such as a small training level refundable against private training expenses, may be appropriate.¹⁷

2. The **financial sector** is undergoing a gradual transition from large, state-run banks designed to serve the state sector to a combination of smaller private banks and reoriented state banks. The ICA notes that both supply and demand factors are important. Clearly the current state of corporate governance and financial standards sharply constraint projects that even a competitive, well-regulated banking sector would finance. Thus, the ICA encourages a public awareness initiative pursued through the accounting community, business associations (chambers), banks and the media that strengthens awareness of good corporate governance principles and benefits, and emphasizes the central role that good corporate governance plays in enhancing access to credit and equity finance.

While it is beyond the scope of this study to provide a complete diagnostic of the financial sector, continued encouragement of private bank entry, along with improved regulation, appear important to encourage competition and improved services to private enterprises. The legal and judicial basis for collateral recovery appears to merit further study and future strengthening, as collateral requirements now are very high and generally only immovable goods are accepted. And the establishment of a credit bureau, complying with global good practice principles, would clearly facilitate business credit, which is now impeded by the lack of reliable credit history information on potential borrowers. Good credit bureaus serve both banks and businesses, and provide positive and negative credit information. Care should be taken not to allow the credit bureau to become dominated by a few large banks, or it cannot serve as an equal and credible basis for expanded lending by newer banks.

The final recommendation on finance concerns the establishment of a legal basis for lease financing, which is generally regarded as a good alternative (or supplement) to traditional bank finance for capital goods, even in environments where traditional collateral enforcement can be difficult. A leasing law (as part of broader reforms to secured lending) can establish the framework for lease finance, in which the financier retains ownership of the equipment as collateral over the course of the lease.

3. With regard to **technology**, the recent World Bank trade policy study concludes that the primary way Syria will access modern technology in the short term is "through imports of goods and services that incorporate the technology, as well as the transfer of knowledge that comes with foreign direct investment." Aside from the general constraints to trade and foreign investment

¹⁷ See Hong Tan (2002) "Do Training Levies Work? Malaysia's HRDF and its Effects on Training and Firm-level Productivity", World Bank Working Paper, Washington D.C. and Hong Tan and Geeta Batra (1995) "Enterprise Training in Developing Countries: Overview of Incidence, Determinants, and Productivity Outcomes", Private Sector Development Department, Occasional Paper No. 9, Washington DC, World Bank.

noted elsewhere in the assessment, the most obvious failing in this regard is the absence of adequate protection of intellectual property rights (IPRs). This weakens incentives for innovation, licensing agreements and FDI involving proprietary technology. The legal basis for IPR protection exists, but enforcement has been slow. Therefore, Syria should review its legal framework for IPRs, to assure its completeness. It should work to strengthen enforcement, beginning with the training of law enforcement officials and judges and efforts to educate the public.

4. **Infrastructure services** also demand priority attention, beginning on a pilot basis with reform of the electric power sector. The ICA recommends corporatizing the public service and creating a regulatory structure that invites private participation in competitive segments. It is important to make appropriate provision for worker severance in restructuring sectors. Once this approach is established in power, it could be extended to other infrastructural sectors. Much like the electric power sector, reform of ports and shipping to rationalize management and incentives and to benefit from private participation would provide complementary stimulus for opening of markets and enhanced exports. The experience of Jordan suggests that telecom privatization is not only desirable, but can generate new employment.

The ICA notes the frustration of a number of investors with existing Syrian free zones (industrial estates). Given the need to improve their performance, the ICA recommends that the Government prepare for the competitive award of a private concession for management of its free zones (industrial estates) according to international practice principles. Private management and development can improve service quality and results accountability. At the same time, other elements of global best practice (described in Chapter 4) should be introduced in the management of these zones. In preparation for this reform, government could commission a review of existing arrangements and reform possibilities based on lessons of global good practice. Clearly, this new arrangement will require careful training of relevant officials in such skills as contract tender evaluation and supervision.

Box 2: Jordan - Engaging the Private Sector in Service Delivery

Jordan has actively engaged the private sector in many traditionally public services through its privatization program. Consumer benefits are being reaped from the privatization program and net employment has benefited as well.

- In telecom, competition came to Jordan's mobile telephone market through the sale of a 15 year cellular license to MobileCom. The Company launched commercial operations in September 2000 and built a network that achieves coverage for 98 percent of the population. MobileCom's arrival introduced competition to the Jordanian mobile telephone market and has contributed to unprecedented subscriber growth rates in Jordan. MobileCom expects to have approximately 700,000 subscribers by 2010.
- France Telecom took over the fixed line telephone service. The wait for a telephone line has been reduced from years to weeks, and phone rates, though still high according to international standards, have been reduced significantly.
- The Public Transport Corporation sale yielded a dramatic increase in bus frequency and ridership, which went from 60,000 to over 100,000. The fares have remained the same. Qualitatively, the buses are new, cleanly and less polluting. The commuting time for the average working person fell sharply, in some cases from two hours each way every day to under half an hour, allowing workers to seek jobs farther from home than they ever could before.
- Water supply in Jordan's cities was a very scarce commodity, delivered once or twice a week. Leakage and illegal connections left 55 percent of water usage unaccounted for. Broken meters and "private arrangements" resulted in inequitable access and cost sharing. Many households were forced to buy water from truck suppliers at much higher prices. Water is now flowing again on a more regular basis. Street flooding from water mains, once a common sight in Amman, is now less frequently seen.

Overall, Jordan's privatization authority estimates that its privatization has generated revenues so far of nearly 12 percent of gross domestic product (GDP), created more than 10,000 jobs, and provided major benefits to consumers.

Sources: World Bank, IFC and Jordanian Executive Privatization Commission

xxxviii. All of these reforms will need to be introduced in a sequenced strategy that is grounded in good information, prior consultation of affected parties, training of officials and professions involved, and clear communications with the public of the reform strategy and components. Such a strategy could be periodically revisited, in consultation with the affected business community, involved public agencies, and representatives of broader civil society. It is important for this strategy to be introduced from the outset, with a clear timeline and measures of progress. A matrix is provided at the end of chapter 4 that suggests a potential sequence and timing of reforms, identifies benefits and risks, and offers strategies to smooth implementation and reduce opposition.

xxxix. Along with the identified reform actions, there is an agenda of follow-up policy analytic work recommended to inform these reforms, including:

- a) A detailed examination at actual tax incidence and incentives, with recommendations for more effective ways of achieving policy and financing objectives.
- b) A detailed look at administrative barriers to investment and operation, with specific recommendations for streamlining procedures and improving administration.
- c) An in-depth study of the electric power sector, including the recommended route for restructuring and corporatization, the regulatory framework, etc.
- d) A sectoral study of the banking sector, its development and regulation as relates to private enterprise finance, including the development of non-loan financial instruments.

INTRODUCTION: WHY AN ICA?

Economic growth is the only sustainable mechanism for increasing society's standard of living. A good investment climate drives growth by encouraging investment and higher productivity." (World Bank, World Development Report 2005)

"The investment climate reflects the many location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand" World Bank World Development Report 2005

1. The purpose of this Investment Climate Assessment (ICA) (refer Box 1) is to:
 - a) Provide the Syrian government, as well as business leaders, with a rigorous empirical analysis of the investment climate in Syria and the factors influencing firm-level productivity and competitiveness;
 - b) To use this analysis to derive recommendations and options for priority measures to improve the investment climate and productivity, as well as ways in which the World Bank and others might further support these reforms.

Box 1: The Importance of the Investment Climate to Economic Growth --WDR 2005

The investment climate is central to growth and poverty reduction

Improving the opportunities and incentives for firms of all types to invest productively, create jobs, and expand should be a top priority for governments. It is not just about increasing the volume of investment but also spurring productivity improvements that are the keys to sustainable growth.

- The goal is to create a better investment climate for everyone. A good investment climate benefits society as a whole, not just firms. And it embraces all firms, not just large or politically connected firms.
- Expanding opportunities for young people is a pressing concern for developing countries, where 53 percent of people live on less than US\$2 a day, youths have more than double the average unemployment rate, and populations are growing rapidly.

Reducing unjustified costs is critical, but policy-related risks and barriers to competition also need to be tackled

All three matter for firms and thus for growth and poverty reduction.

- Costs associated with weak contract enforcement, inadequate infrastructure, crime, corruption, and regulation can amount to over

25 percent of sales—or more than three times what firms typically pay in taxes.

- Firms in developing countries rate policy uncertainty as their top concern. This and other sources of policy-related risk—such as insecure property rights, macroeconomic instability, and arbitrary regulation—chill incentives to invest. Improving policy predictability can increase the likelihood of new investment by over 30 percent.
- Barriers to competition benefit some firms but deny opportunities and increase costs to other firms and to consumers. They also weaken incentives for protected firms to innovate and improve their productivity. Increasing competitive pressure can increase the probability of firm innovation by more than 50 percent.

Progress requires more than changes to formal policies

Over 90 percent of firms claim gaps between formal rules and what happens in practice, and the informal economy accounts for more than half of output in many developing countries. Creating a better investment climate requires governments to bridge these gaps and to tackle deeper sources of policy failure that undermine a sound investment climate. This requires efforts:

- to restrain corruption and other forms of rent seeking that increase costs and distort policies;
- to build policy credibility to give firms the confidence to invest;
- to foster the public trust required to enable and sustain policy improvements; and
- to ensure policy responses are crafted to fit local conditions.

Investment climate improvements are a process, not an event

Government policies and behaviors influencing the investment climate cover a wide field. But everything does not have to be fixed at once, and perfection on even a single policy dimension is not required. Significant progress can be made by addressing important constraints facing firms in a way that gives them the confidence to invest—and by sustaining a process of ongoing improvements.

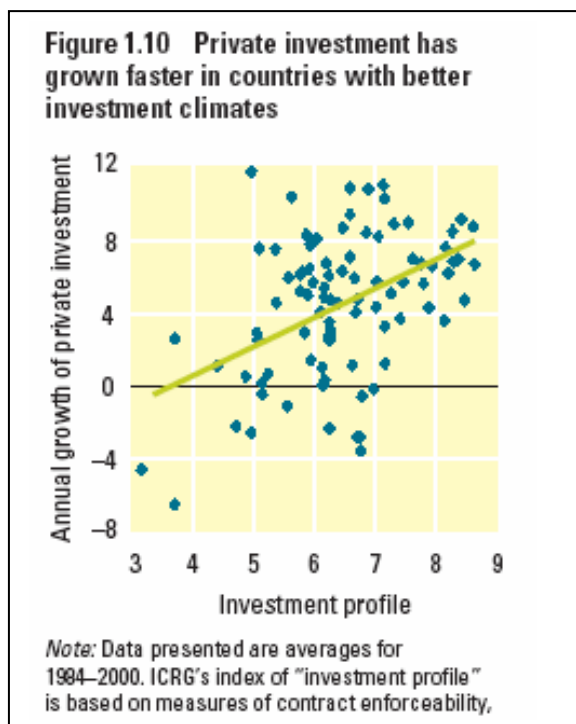
- Because constraints differ widely across and even within countries, priorities need to be assessed in each case. Reform processes benefit from effective public communication and other measures to build consensus and maintain momentum.

2. The ultimate objective is to provide an agenda of reforms that together will create a business-enabling environment conducive to accelerated private sector-led growth, thereby increasing Syrian national income and employment.

THE WORLD BANK'S ICA INITIATIVE

3. Work to improve the investment climate is as a key pillar of the World Bank's work to promote economic growth and poverty alleviation in developing countries.¹⁸ The 2005 World Development Report further reinforces the centrality of the investment climate to growth and poverty reduction. It points out the role of the investment climate, not only in affecting the quantity of investment, but in affecting its quality, in terms of productivity and economic contribution. It highlights the need in many countries to reduce policy-induced risks, costs and barriers to competition.

4. For Syria, the source of future growth and diversification must be a growing private sector. This requires more private sector investment, and it requires that investment to be more productive. The link between investment and growth is well understood by the Syrian authorities. But an additional lesson of international experience is that the quantity and quality of private investment is closely associated with the costs and quality of the investment climate. The chart above, from the 2005 WDR, shows that countries with a stronger investment climate generally experience a higher rate of investment.



5. Given the central importance of the investment climate to economic development, countries need a way to evaluate the quality of their investment climates and pinpoint aspects that may be constraining growth. The World Bank Investment Climate Assessments (ICAs) provide a standardized way of measuring and comparing investment climate conditions in a country. They are a systematic instrument to "allow i) better identification of the features of the investment climate that matter most for productivity and hence income growth, especially for poor men and women, ii) tracking of changes in the investment climate within a country, and iii) comparison of countries or regions within countries."¹⁹

6. The main focus of ICAs is on *microeconomic* and *structural dimensions* of a nation's business environment, viewed in an international perspective. To this end, ICAs look in detail at factors

¹⁸ "The central challenge in reaping greater benefits from globalization lies in improving the investment climate--that is, in providing sound regulation of industry, including the promotion of competition; in overcoming bureaucratic delay and inefficiency; in fighting corruption; and in improving the quality of infrastructure. While the investment climate is clearly important for large, formal sector firms, it is just as important -- if not more so -- for small and medium enterprises (SMEs), the informal sector, agricultural productivity, and the generation of off-farm employment. For these reasons, the investment climate itself is a key issue for poverty reduction." Nicholas Stern, Chief Economist, March 22, 2001.

¹⁹ Private Sector Development Strategy – Directions for the World Bank Group, April 9, 2002.

constraining the effective functioning of product markets, financial and non-financial factor markets, and infrastructure services, including in particular weaknesses in an economy's legal, regulatory and institutional framework. ICAs also provide the tools and analytical framework to identify reform priorities in a country's investment climate, by linking constraints to firm-level costs and productivity.

THE SURVEY

7. Underpinning all ICAs is a standard core investment climate survey instrument, which allows the identification of existing conditions, the benchmarking of conditions to monitor changes over time, and the analysis of the impact of these conditions on firm-level performance. ICAs further use a common structure and methodology to facilitate comparability between countries. They integrate survey data with other primary and secondary material to provide insights on the key, binding constraints in the investment climate and steps that would contribute to their amelioration. Parallel or supplemental studies often enrich survey data in detailing the underlying causes of high costs or other IC weaknesses.

8. In Syria, the survey entailed the design and implementation of an investment climate survey of 552 Syrian industrial enterprises (see Table 1), in accordance with the standard methodology of the World Bank. The survey was conducted by a team from Damascus University (Faculty of Economics) and completed in August 2004. The survey did not attempt to cover all sectors of the economy, particularly the service sector, and the micro enterprises (cut off size). The survey was for private sector manufacturing firms only. SOEs were not examined. The design facilitates uniform analysis and valid comparisons across countries. Nevertheless because the manufacturing sector exposes all elements of the value chain the results have broader relevance for the entire economy. Indeed interviews conducted with service sector firms highlight similar constraints to those identified by respondents to the survey. In other countries, ICA work that has included service sectors has suggested that service sector firms face the same general constraints as industrial sector firms.

Table 11: ICA Survey Sample Structure

<i>Firm Size</i>		<i>Firm Activity</i>	
	<i>Sample</i>		<i>Sample</i>
Small <50	448	Chemicals	78
Medium 50<x<150	81	Food processing	103
Large 150+	25	Textiles	116
		Garments & Leather	117
		Wood & Paper	24
		Glass & Stone	44
<i>Market Orientation</i>			
	<i>Sample</i>	Metals	48
Exporter	245	Others	26
Non Exporter	307		
<i>Firm Ownership</i>		<i>Firm Location</i>	
	<i>Sample</i>		<i>Sample</i>
Domestic	545	Aleppo	231
Foreign	7	Damascus	70
State		Hama	40
Other		Homs	59
		Lattakia	40
		Ru Dam	120

THE SYRIAN ICA

9. The analysis of the investment climate in Syria presented in this ICA benefited from the integration of an analysis of the survey findings with other sources. This includes detailed discussions and focus groups involving members of the private sector, government officials and other experts, and a number of earlier or parallel studies, including:

- The World Bank "Doing Business 2005" indicators for Syria.
- Other World Bank analytic work including the "Synoptic Note on Trade", "Syria: Integrating with Global Markets" and "Syrian Arab Republic: Economic Review".

- Other analytic work carried out by the Syrian European Business Council (SEBC), UNIDO, UNDP, and other Syrian and international experts

10. These sources helped to deepen and balance the survey findings, providing the information by which to verify or challenge the private perceptions of enterprise managers and, where they are verified, to understand the underlying policy and institutional sources of their constraints.

CHAPTER 1. INVESTMENT CLIMATE REFORM – THE KEY TO SYRIA’S FUTURE

We are also encouraging investment, especially in the private sector, which needs to take responsibility for creating jobs. This is one of the government’s main points of focus.

Syrian Prime Minister Mohammed Naji Ottri²⁰

11. This chapter provides the context for the investment climate assessment. It begins with including a very brief history of the evolution of the private sector and a discussion of its current structure. It then identifies the broad economic challenges confronting Syria today in terms of economic growth, employment and productivity. It analyzes survey data to show that Syrian productivity is critically low. Syrian productivity is clearly hobbled both by constraints in human capital and by the low level of technology employed by many Syrian firms. Yet the chapter argues that these factors and low productivity itself are primarily symptoms of the weak investment climate. Turning to the investment climate, the chapter notes both strengths and weaknesses. A key weakness is that individual reforms have not been complemented by supportive measures which together comprise a critical mass for the development of a more productive and competitive private sector. The priorities identified in the survey of Syrian private enterprises provide an initial agenda for attention. The leading issues identified in the survey, plus the issue of lack of external finance, are then organized into two categories of constraints, which form the basis for chapters 2 and 3: the high and unpredictable cost of doing business in Syria, and limits to opportunity. Resolving these two classes of constraints is critical to Syria’s future prosperity.

EVOLUTION OF THE PRIVATE SECTOR IN SYRIA

12. As a center of trade in the Middle East, Syria enjoys a rich history of private entrepreneurship. Historically, Syria was a major trading center and gateway, and the state provided support and security for the market.²¹ However, following many years of state planning and ownership of major productive activities, Syria is only gradually emerging today as a market-led economy.

13. Beginning in the 1960s, Syria pursued a policy of central planning. In sectors such as agriculture, where there was continued private ownership, activity was highly influenced by government regulation, price controls, marketing boards, control of banking and distribution, and direct involvement in many other aspects of input supply and product markets. Continuing through the 1980s -- like many other countries in the region and elsewhere in the developing world -- the Government pursued inward-oriented, import-substitution policies, protecting domestic industry from foreign competition. In 1991, a gradual process of opening began, which modestly accelerated in recent years.

²⁰ Quoted in Oxford Business Group, *Emerging Syria 2005*, (London: Oxford Business Group, 2004)

²¹ *Trade reached its peak in the 10th century with the growth of large cities, unrestricted by borders and abetted by new methods of organizing trade. With multiple trading routes – inland, caravan, sea and river – multinational competition was stiff (Arab, Iranian, Jewish and Indian traders). The states role was to reduce risks and give traders room to innovate.* World Bank. MENA Development Report: Trade, Investment and Development in the Middle East and North Africa – Engaging the World (Washington: The World Bank, 2003)

14. Today the private sector is dominated by many small firms, with a very few large firms (see table 1.1 on industrial firms). All together, in 2002 it had grown to produce 61% of GDP (up from 40% in 1980). Between 1992 and 1997, the private sector accounted for an estimated 51% of GDP, 72% of employment, 57% of gross capital formation, 69% of non-oil exports and 58% of imports.²² The most common form of corporate entity is the joint liability company -- essentially a formal partnership -- and most enterprises in Syria operate as family businesses. Other forms of companies (such as joint stock and limited liability) require a high level of capital. For that reason, joint stock companies and limited liability companies are not common. There are less than 20 registered joint stock companies in the country. Industries are centered around two main locations; Aleppo and Damascus. There are important secondary cities in Homs, Hamma, and Latakia. While available data is old, the approximately 100,000 formal firms in Syria appear to present a tremendous potential for future growth. The informal sector, while significant at an estimated 20% of GDP, is not as large as some comparator countries.

Table 1.1: Size of Product Units in the Private Industrial Sector by Type of Industry, 1998

Sector People	No. of	1-9	10-50	51-100	>101	Total
Agro-Food		87.22	12.43	0.27	0.08	15.44
Textile		91.7	7.93	0.24	0.13	19.22
Garments		94.19	5.69	0.08	0.04	43.24
Leather		95.68	4.21	0.11	0	11.72
Wood and wooden products*		98.63	1.22	0.08	0.07	5.31
Paper and paper based products		48.49	42.42	6.06	3.03	0.13
Chemical industries		73.06	24.8	1.6	0.54	1.51
Non metallic products		79.81	15.79	1.76	2.64	0.46
Non essential Ores		86.6	12.72	0	0.68	1.18
Machineries		82.83	15.94	0.92	0.31	1.32
Electrical instruments		89.92	10.08	0	0	0.48
Total		92.34	7.37	0.19	0.1	100

*Excluding Furniture.

Source: Central Bureau of Statistics, Industrial Survey for the Private Sector 1998, Damascus 2000

15. **The Oil Sector.** The oil sector remains administered and controlled by the state. Foreign Oil Companies can be invited to explore for oil, but must form a joint venture with the state-owned Syrian Petroleum Company (SPC) to actually produce oil. Oil income, which grew rapidly in the 1990s, today comprises over two thirds of Syria's export earnings and about half of government revenues. The forecasted depletion of net hydrocarbon reserves (i.e. including the sharp reduction of oil production and the rise of gas output) by 20 percent by 2015 could entail a deceleration of 0.5 percentage points of the annual real GDP growth rate, as well as a significant contraction of trade activity (exports to the EU in particular, the major importer of Syrian hydrocarbon products), and the need to increase the fiscal pressure on households to compensate for reduced government's oil-related revenue.

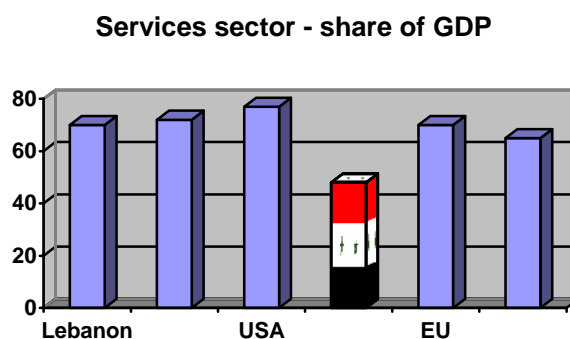
16. **Agriculture** provides up to 30 percent of employment and GDP, and is second to the oil sector as a source of export earnings, accounting for around half of non-oil exports. The agriculture sector has proved immensely important in absorbing the growing working-age population, as well as in meeting government goals for food self-sufficiency. Along with traditional exports, such as cotton, new export markets including wheat, fruits and vegetables, have emerged. However, the sustainability of agriculture

²² World Bank. *Syrian Arab Republic Economic Review* (Washington: World Bank, April, 2002) Confidential.

is unclear, given a complex web of subsidies, support activities, state engagement and state controls that make the true economic contribution of the sector unclear. Furthermore, there is a long-term shortage of water that puts future urban and industrial uses in competition with agricultural uses.²³ The FAO attributes the consistent role of agriculture in GDP to two factors: “[i] a result of both the slow developments of the [other sectors] (particularly the services sector) and [ii] the good progress in agricultural production, stimulated by domestic support, public investments and protection from international competition.”²⁴ Both fiscal concerns and growing trade liberalization put into question the sustainability of substantial subsidies to agricultural inputs and outputs.²⁵

17. **Industry.** Since its opening to private investment in 1991, the industrial sector has grown significantly, and now contributes roughly a quarter of GDP and employs some 14% of the workforce. However, manufacturing is still dominated by a combination of large state-owned firms and relatively small, private, family-owned firms. The state-owned role has shrunk to around 20% of sectoral GDP²⁶. The private sector thrived in supplying the domestic market under the import substitutions policies of the government, including the protection of high tariff and non-tariff barriers to imports. However, this sector will have to become increasingly outward-oriented and competitive in order to survive the reforms required by GAFI, and the anticipated EU Association agreement and WTO membership. As the subsequent sections detail, substantial improvements in the investment climate will be required for private industry to meet the competitive challenge of trade liberalization. There is a solid albeit small private industrial base to grow from.

Figure 1.1: Services sector – share of GDP



Dipak Dasgupta, Farrukh Iqbal, John Speakman and Jemal Zarrouk *Engaging with the World for The Gulf Cooperation Council (GCC) Economies* (World Bank, January 2005, Mimeo) and World Bank. *MENA Development Report: Unlocking the Employment Potential in the Middle East and North Africa: Toward a New Social Contract* (Washington: World Bank, 2005)

²³ The World Bank notes that the heavy subsidization of irrigation has led to unsustainable water use, with agriculture claiming up to 90% of overall supplies. World Bank *Syrian Arab Republic Economic Review* Ibid.

²⁴ See FAO, *Syrian Agriculture at the Crossroads* (Rome: FAO Agriculture Policy and Economic Development Series, 2003). Most of this paragraph derives from this source.

²⁵ “Agricultural production has been expanded by means of substantial subsidies to both outputs and inputs. On the output side, production of key crops has been promoted by support prices well above world prices....” World Bank *Syrian Arab Republic Economic Review* (Washington, April, 2002)

²⁶ This does not fully reflect the public sector’s continued importance in employment or capital investment, since some public industries have a negative value added and in some years, like 1998, the whole public manufacturing sector had negative value added. Syrian European Business Center. *The Potential Impact of the Syria-EU Agreement on the Syrian Economy* (Damascus: October, 2004)

18. Syria's **service sector** is quite undeveloped at present. There is considerable potential in many service sectors. There are two major dynamic service sectors at present; tourism and telecommunications. Tourism, where Syria in the period 1995-2002 was rated by the World Tourism Organization as the leading emerging tourism market in the Middle East, was disrupted by geopolitical events in the region, but continues to hold great potential.

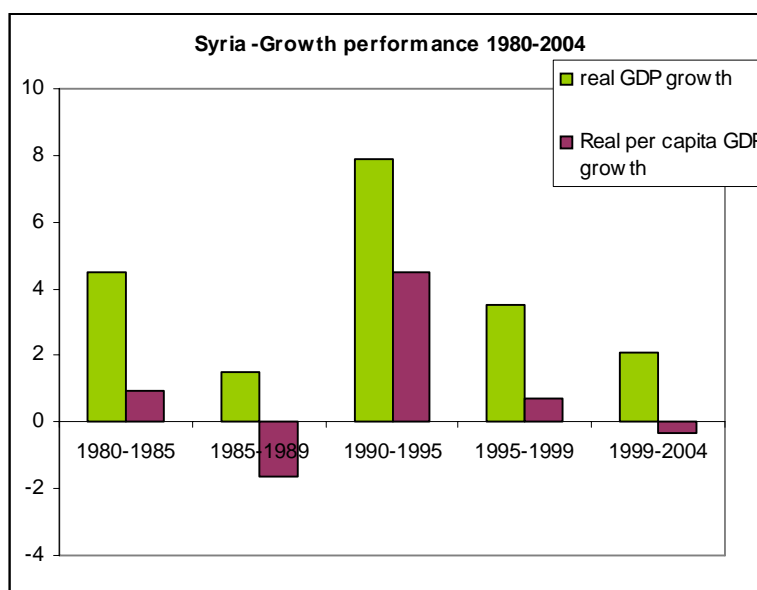
19. The telecommunications sector has also been growing rapidly. There are many other areas where there is significant potential; including financial services, health and education services, media and entertainment and construction.

THE GROWTH, EMPLOYMENT AND PRODUCTIVITY IMPERATIVES

20. Syria is a lower middle-income country (per capita income of US\$1160) that is growing slowly. Syria faces the same challenge as many other countries of the MENA region, of accelerating economic growth to employ its growing working-aged population and diversify its economy to reduce its vulnerability to shocks in the oil and agricultural sectors. After growing at an average of 4.4 percent in the second half of the nineties, real GDP growth dropped to an average of 2.4 percent between 2000 and 2003, mainly due to the continuous decline in oil production and exports since 1999²⁷. In 2003, weak GDP growth was due to a significant decrease in real export growth²⁸ reflecting, on the oil side, both a decline in domestic oil production and loss of Iraqi oil re-exports²⁹, and

on the non-oil side, the end of the Oil for Food Program exports to Iraq. Economic growth in 2004, by contrast was buoyed by high oil prices. Yet this income source is finite and diminishing. This emphasizes a salient feature of Syria's recent growth performance: its extreme volatility (Figure 1.2). Syria relies on volatile determinants such as the price of oil and the amount of rain (for agriculture) to sustain GDP growth³⁰ and these two sectors constitute almost 50% of Syria's GDP.

Figure 1.2: Syria Growth Performance 1980-2004



21. The ICA survey, consistent with GDP data, shows small declines in enterprise sales. Most firms surveyed had significant idle capacity, averaging 38% (see Figure 1.3, below). The story for the SOE sector is similar – a recent UNIDO study identified deterioration in every performance indicator they

²⁷ Syrian oil production is expected to continue its decline over the next several years, while consumption rises, leading to a net reduction in Syrian oil exports. If trend is confirmed, Syria could become a net oil importer within less than a decade. Gas production increases will offset only partially this decline.

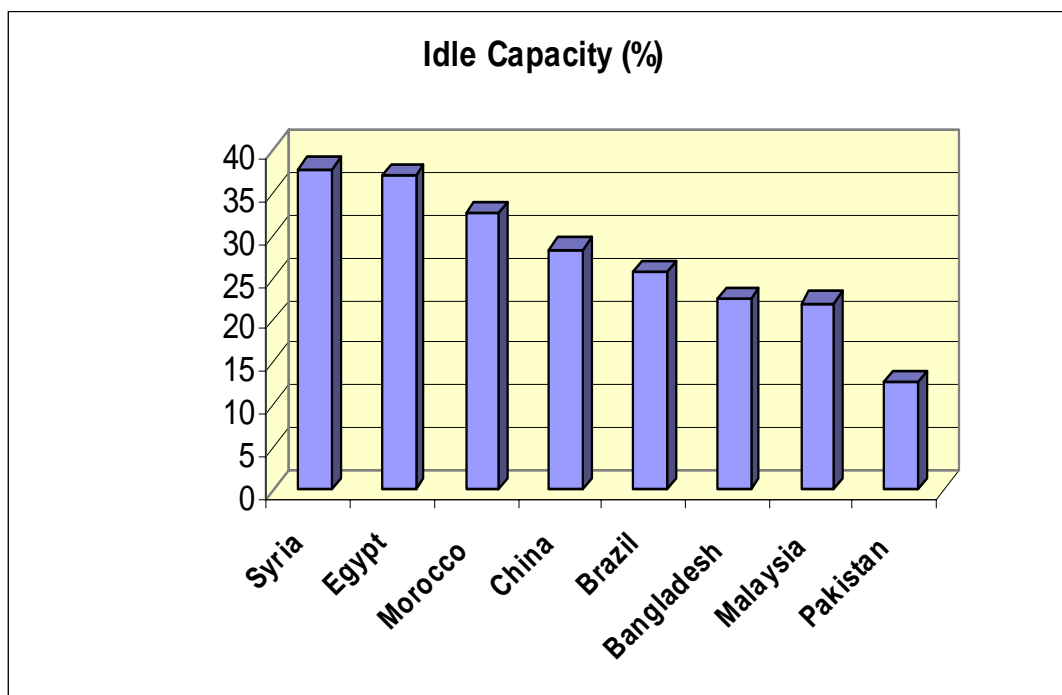
²⁸ Syria experienced sharp drop in exports to Iraq with the end of the OFFP and over 2003 non-oil exports declined from US\$2.4 billion to US\$2.0 billion.

²⁹ Syria received crude oil at subsidized rates from Iraq which it then re-exported at profit.

³⁰ Agriculture is dependent on rain fall which is highly variable in this region and the oil sector is subject both to the volatility of oil prices and declining reserves.

reviewed. Yet the SOE sector is totally dominant in infrastructure and finance, as well as occupying key parts of the manufacturing sector (approximately 40% of industrial sector GDP are SOEs) and controlling distribution and marketing of several key agricultural goods. The state sector has an official monopoly in television manufacture, beer, mineral water, mining salt and certain telecommunication equipment. SOEs also enjoy preferential treatment through budgetary and non budgetary support and access to finance.

Figure 1.3: Idle Capacity In Syrian Private Industrial Firms And Those In Comparator Countries (%)

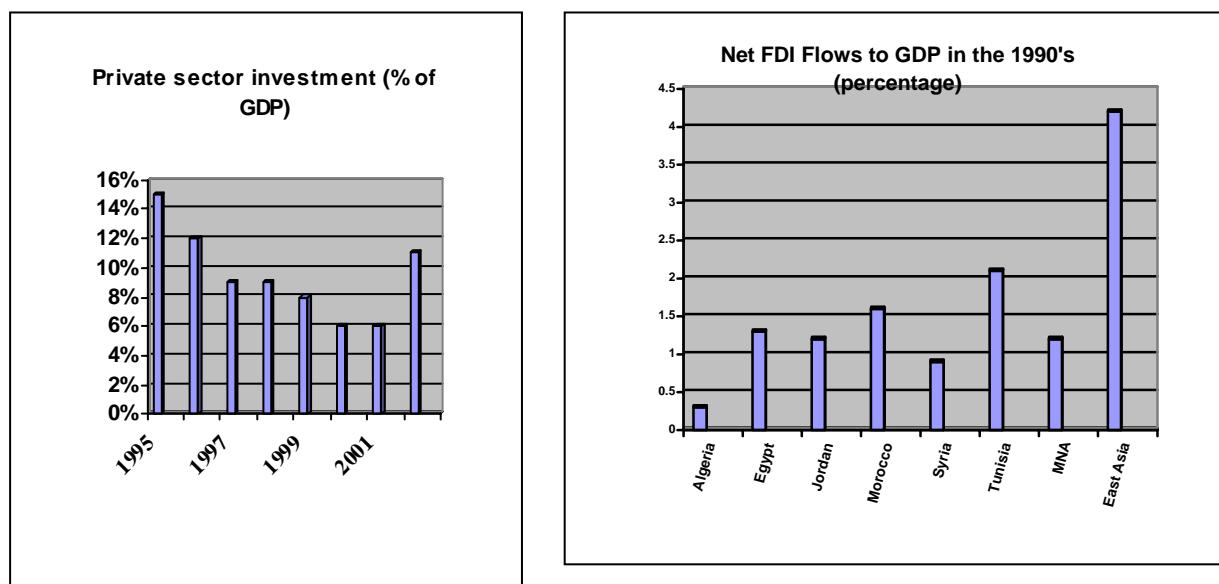


(Source: World Bank investment climate surveys)

22. Syria is losing world market shares in all categories of manufactured exports.³¹ In particular the share of medium and hi-tech exports in Syrian exports has gone from 28% in 1990 to only 1% in 2000. Syrian non-oil exports decreased from US\$2.4 billion in 2002 to US\$2 billion in 2003, as a consequence to the end of the Oil for Food program with Iraq and to the disturbances in the trade flows with that country. Recent preliminary statistics show a 13 percent decrease in non-oil exports in the first half of 2004 compared to the same period in 2003, which seem to confirm the loss of market share in Iraq, although transit activities with that country are still buoyant.

³¹ Source: U.N. Comtrade data and World Development Indicators 2005.

Figure 1.4: Private Sector Investment (% of GDP and Net FDI Flows to GDP in the 1990's)



23. Syria's overall growth performance is a cause of concern because it exacerbates the problems posed by high unemployment rates (15-20 percent) and a relative strong labor force growth which will lower real per capita GDP growth if there is no growth resumption. Syria's labor force is growing at a rapid rate of 4 percent per annum. The age cohort in the 15-20 years range is populated by an average of 450,000 people each year. The Government estimates there are 150,000 new entrants to the workforce each year, but if youth's labor participation remains at the current rate of 60%, 240,000 to 300,000 people will enter the labor market every year, representing about 5% of the labor force.

Table 1.2: Syria Labor Force

	Population (million)	Total Labor force (million) 2000	Labor force growth (% per annum) 2000-2010	Total labor force participation (% per annum) 2000
Syria	16	5	4.1	55.3

Source: ILO

24. In order to keep unemployment from increasing, job creation needs to grow at least at the same rate as the population.³² According to World Bank analysis, this would require Syria to grow at an annual rate of 6 percent to absorb these new entrants in the labor market³³. This dramatically higher growth rate will require a less gradual approach to investment climate reforms, to allow for a greatly expanded role for private competition and market-based growth.

25. There is ample evidence that, to date, Syria has not been terribly attractive for private investment. Both domestic and foreign investment rates are insufficient to generate the higher growth needed to meet

³² Technically, in order for the unemployment rate to not change, the percentage change in employment must equal the percentage change in the labor force, or $Urate_t = Urate_{t-1} \Rightarrow LF_t - LF_{t-1} / LF_{t-1} = \% \Delta LF = \% \Delta E = E_t - E_{t-1} / E_{t-1}$. This relationship is fairly transparent, but is proved in the Appendix.

³³ Syria experienced sharp drop in exports to Iraq with the end of the OFFP and over 2003 non-oil exports declined from US\$2.4 billion to 2.0 billion.

Syria's need for employment and higher incomes. Foreign investment (Figure 1.4) has been heavily concentrated in the energy sector, averaged below one percent of GDP in the 1990s, a little below the regional average and well below the rate in fast growing regions like East Asia. Total private investment in total has varied between 6 and 16%.

26. However, to achieve long-term growth and employment gains, investment alone will not address the problem. Syria must dramatically improve its productivity, the root of competitiveness. In spite of talented entrepreneurs, numerous national assets and a growing list of reforms, the Syrian economy is not achieving its productive potential. Productivity is low and technological progress is limited. Economic liberalization is exposing the economy to new markets and new competition – an enormous opportunity but also a challenge unless firms become more productive. Syria's working-aged population is growing quickly, but the economy is not realizing growth and investment needed to create jobs for them. Further looming, dwindling oil reserves mandate that Syria must launch urgent efforts to stimulate economic diversification over the next decade. Oil has provided around two thirds of export earnings and around half of government revenues in recent years. Agriculture has been providing around 30% of GDP and employment, yet fiscal concerns and trade liberalization put into question the sustainability of the substantial subsidies to agricultural inputs and outputs on which this sector has heavily relied.³⁴ Syria must raise its low level of productivity to meet the challenge of global competition and to raise incomes and employment. Currently, productivity lags well behind many regional and international comparator countries, many of which host enterprises with which Syrian firms must increasingly compete in international and domestic markets (Figure 1.5).³⁵ The central truth of the rapidly liberalizing environment is that Syrian firms must be competitive globally, or they will lose out both in export markets and at home. Data from Syrian enterprises collected in the survey suggests Syria ranks poorly compared to a number of countries, both in the MENA region and internationally³⁶. This low ranking is confirmed by earlier international comparisons.³⁷

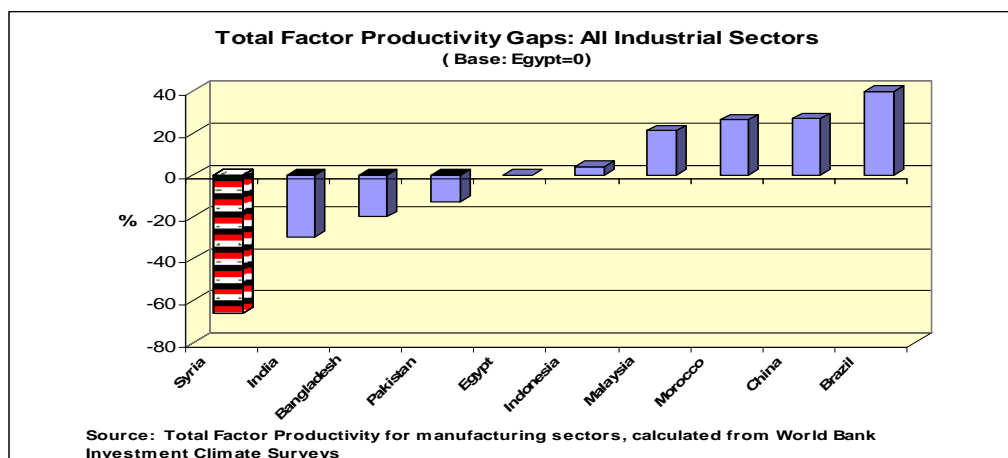
³⁴ "Agricultural production has been expanded by means of substantial subsidies to both outputs and inputs. On the output side, production of key crops has been promoted by support prices well above world prices...." World Bank *Syrian Arab Republic Economic Review* (Washington, April, 2002). See also See FAO, *Syrian Agriculture at the Crossroads* (Rome: FAO Agriculture Policy and Economic Development Series, 2003).

³⁵ ³⁵ For each country, value added was calculated based on survey data provided by firms. TFP was then estimated using a Cobb-Douglas production function in the following specification (TFP is the residual $\ln(Output) = \alpha + \beta_1 \ln(Material) + \beta_2 \ln(Labor) + \beta_3 \ln(Capital) + \sum_{i=1}^n \beta_i D_i + \varepsilon_i$

³⁶ While these data are subject to a number of potential sources of error, including underreporting of sales or labor, there is little reason to suspect more systematic bias in Syria than in several of the comparator countries, where the survey was conducted in a parallel manner..

³⁷ UNIDO estimates private sector productivity is about one –fifth of best practice.

Figure 1.5: Total Factor Productivity Gaps: All Industrial Sectors (Base: Egypt =0)



27. Labor productivity seems to be especially low, to the extent that relatively low wages cannot compensate for it. Instead, the cost of labor input for each unit of production in Syria is actually much higher than in a number of comparator countries. In garments, textiles, leather and food processing, a consistent trend is that the total cost of labor (i.e. wages) in a unit of output is higher in Syria than in a number of other countries like Morocco, Egypt and Pakistan.³⁸

28. Deeper analysis of the ICA revealed poor performance in key indicators of dynamism. This can be seen in terms of lack of external financing and limited financing options, low levels of capital investment, weak corporate governance (discussed in chapter 2), weak levels of worker educational attainment combined with little emphasis on training (also discussed in chapter 2), minimal research and development and low utilization of modern technologies. Yet observing the low level of technology utilization does not, of itself, account for **why** Syrian firms have been slow to adopt or innovate.

FACING THE PRODUCTIVITY CHALLENGE

29. Overall, the productivity problem does not seem to be a lack of entrepreneurial capacity, but rather of policy and institutional weaknesses that constrain economic incentives and performance. In fact, Syrian entrepreneurial talent is widely respected, and many Syrian entrepreneurs have succeeded better abroad, under more favorable investment climates. So what is needed to help Syrian enterprises to advance technologically and productively?

30. Improved productivity will come as a consequence of mutually reinforcing investment climate reforms. There are important lessons from recent detailed work on productivity by the World Bank and the McKinsey Global Institute:

- Levels of productivity are very much a function of the general institutional environment, not due to differences in labor or capital inputs. Therefore general work on productivity and technology will help drive productivity.
- High levels of informality in an economy can act as a major break on productivity growth.

³⁸ While other sectors were included in the survey, response rates were not high enough to make parallel comparisons.

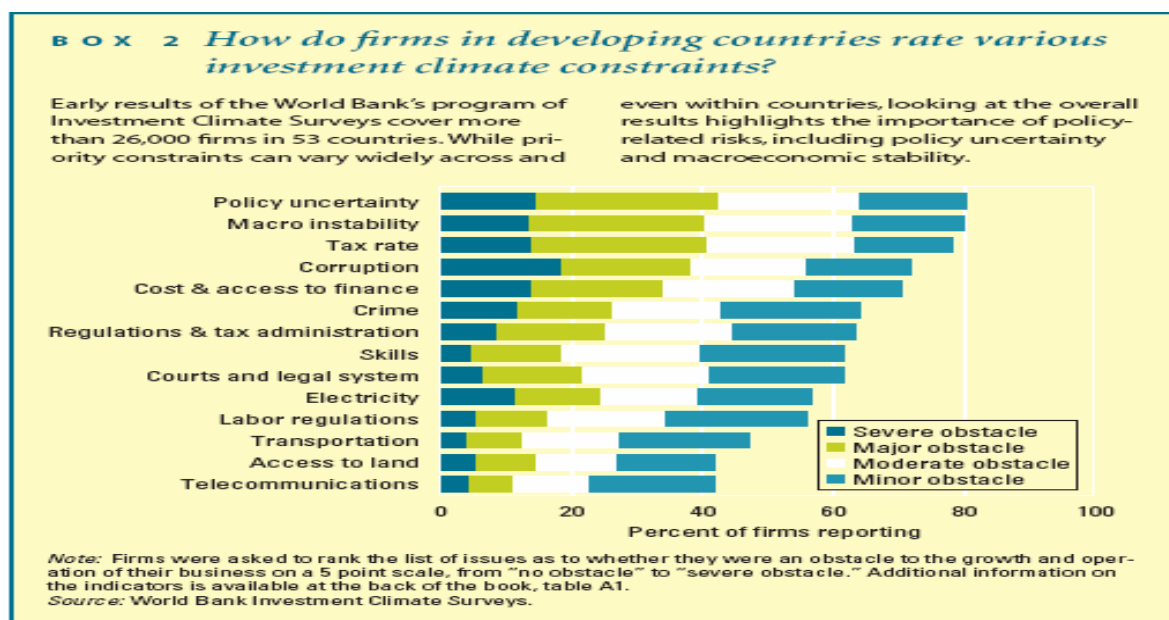
- The performance of some non-industrial sectors are critically important to productivity – for example the retail sector -- where industry interacts with the domestic market.³⁹

THE INVESTMENT CLIMATE TODAY

31. Syria offers a number of attractive features in its investment climate, beginning with its natural geographic advantage. It is a natural gateway between East and West, perched on the Mediterranean Sea. It has some fairly dynamic neighbors whose reforms are likely to benefit regional growth – Lebanon, Jordan and Turkey. Given the likely accession of Turkey to the EU, Syria will border the EU -- the largest single market in the World. Indeed taking advantage of this opportunity is one of the most important factors that will drive further economic liberalization and diversification.

32. Syria also enjoys a number of cultural and human assets. The country has wonderful artisanal, industrial and trading traditions and culture. Syrian businessmen are renowned, particularly by their neighbors for their acumen and hard work ethic. There is a good human resource base that helps Syria not only internally but drives a significant flow of remittance income from its diaspora, although remittances are less important for Syria than two of its neighbors – Jordan and Lebanon. Syrian remittances account for about 2.5% of GDP, while Jordan and Lebanon attracted the equivalent of 22.8% and 13.8% of GDP respectively in 2001. (Since a lot of remittances are suspected to take place informally, they may actually play a greater role in national income than official statistics suggest.)

Box 1.1: How do Firms in Developing Countries Rate Various Investment Climate Constraints?



33. In spite of regional geopolitical instability, Syria also offers a fair degree of domestic political and macroeconomic stability. The budget is roughly in balance, the exchange rate is stable, and for the present oil and agriculture sectors are helping maintain a continuous, if slow, level of growth. Indeed, unlike in many countries (Box 1.1), Syrian businessmen do not rate policy uncertainty, crime or macro

³⁹ See, for example, William W. Lewis, *The Power of Productivity: Wealth, Poverty, and the Threat to Global Stability* (The University of Chicago Press, 2004)

instability as leading problems (see the discussion later in this chapter).⁴⁰ And Syria has, in recent years, taken a number of steps to gradually open the economy and transform it from a state-directed, command economy to one that is more dynamic and market-led. Increased openness to private investment and reduced tariffs and tax rates are among the reforms that promise to encourage private investment and growth.

THE NEED FOR COMPLEMENTARY REFORMS

34. Yet these reforms have yet to yield the hoped for benefits in terms of economic growth. This can largely be explained by the incompleteness of some reforms, the weak implementation of others, and the need for complementary policy and institutional reforms to allow private investment and resource allocation to respond where incentives have improved (see chapter 4).

35. The Syrian economy remains mired in a slow process of transition from a command to a market system. In spite of the multiple economic reforms undertaken, many of the institutions and practices of the old system remain. Today, the economy still operates with considerable policy distortions, state controls and direct state ownership, and is characterized by relatively poor institutional and technological development compared to the other countries of the region.

36. As Syria moves towards an EU Association Agreement and WTO accession, it is vital to understand that the gains of trade are primarily realized by countries that undertake reforms beyond trade liberalization. A recent World Bank study of more than 100 countries shows that countries with excessive regulation do not grow following trade liberalization:

Excessive regulations restrict growth because resources are prevented from moving into the most productive sectors and to the most efficient firms within sectors. In addition, in highly regulated economies, increased trade is more likely to occur in the wrong goods—i.e. goods where comparative advantage does not lie....

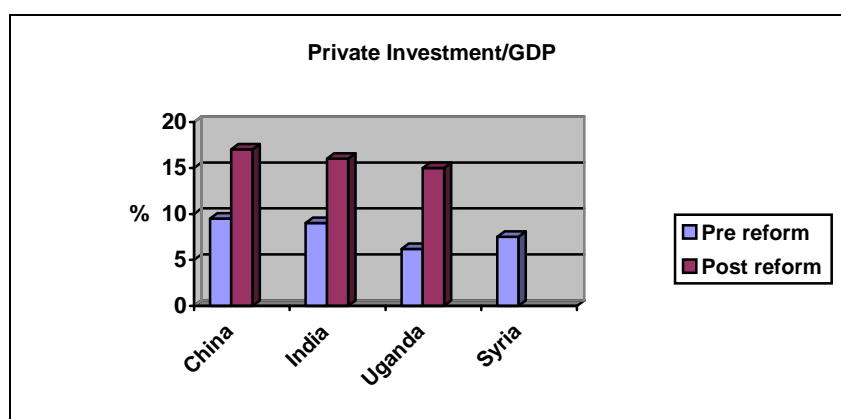
37. The implication is that countries like Syria that are opening to international trade must have “a strategy in place to improve their business climate” as they are reforming.⁴¹

38. The experience of a number of other reforming countries is encouraging about the potential for success. The chart below compares investment as a percentage of GDP in three countries before and after reform. Before reform, the investment rates in China, India and Uganda were similar to Syria’s. Yet by undertaking sustained and mutually complementary reforms, each country was able to realize higher investment and growth. The potential for Syria to grow from the current low rate is clear.

⁴⁰ Source: World Bank Investment Climate Surveys

⁴¹ Bineswaree Bolaky and Caroline Freund *Trade, Regulations, and Growth* World Bank Policy Working Paper Series 3255, March 2004

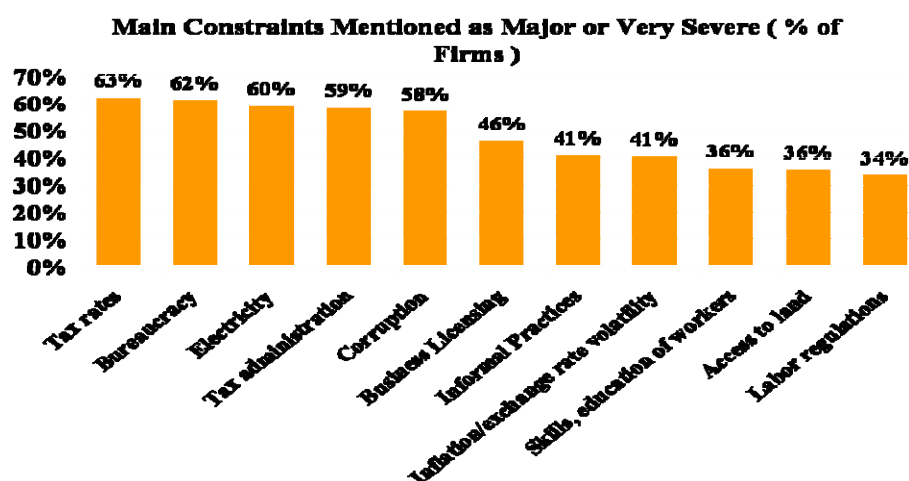
Figure 1.6: Private Investment/GDP



INVESTORS AND MANAGERS IDENTIFY A NUMBER OF INVESTMENT CLIMATE CONSTRAINTS

39. Investor priorities, balanced by other sources⁴², can help guide in identifying the most serious constraints imposed by the investment climate, hence the priorities for reform. The Syrian Investment Climate Survey conducted for this ICA identified the priorities, constraints, costs and performance of the senior managers of over 550 private enterprises operating in Syria.⁴³ These respondents identified their own priority constraints based on the development and day-to-day operation of their firms. The perceptions of these senior executives matter greatly because investors' perception directly influences their investment decisions. Their understanding of the risks and rewards of investing in Syria will directly affect the quantity and quality of investment realized.

Figure 1.7: Main Constraints Mentioned as Major or Very Severe (% of Firms)



⁴² Since businesses report their private perspective, it is always important to align survey results with other economic analysis of the factors identified. For example, while firms generally complain about taxes throughout the world, it is only by understanding actual tax burden and its distribution as administered that one can fully understand whether adjustments are needed.

⁴³ Annex 1 details the methodology of the survey.

40. The leading constraints to Syrian firms indicated by the ICA survey, where 80% of the samples were defined as SMEs, include:

- a) Tax rates were identified by 63% of firms as a “major” or “very severe” constraint to their operation and growth. Traditionally tax rates have been quite high in Syria, however, tax rates were lowered substantially around the time of the survey, and it is hard to know if responses fully reflected this. Chapter 2 analyzes this issue in greater detail, hypothesizing why tax burden may still be a concern for many firms in spite of reforms.
- b) Bureaucracy was identified by 62% of firms as a major or very severe constraint. The team heard numerous accounts of bureaucratic hostility to businesses, the exercise of bureaucratic discretion and corruption, and the high demands on managerial time, all of which contribute to an extremely difficult environment to do business. For example, the average firm could expect to spend more than 90 days a year in meetings with officials.
- c) Tax Administration was identified by 59% of firms as a major or very severe constraint. Discretionary and corrupt actions by bureaucrats create an important source of uncertainty for firms’ operating costs and profitability.
- d) Corruption was identified by 58% of firms as a major or very severe constraint. This is reportedly pervasive throughout the public sector.
- e) Business licensing was identified by 46% of firms as major or very severe. Licensing is a key blocking point for business entry, and often an impediment to access to land, infrastructure and other public services.
- f) Informal and unfair practices of competing firms were identified by 41% of firms as major or very severe. This is unsurprising given the significant degree of informality, but also a product of the market dominance (monopolization) by SOES and other powerful incumbents in certain product markets, dating from the period of import substitution.
- g) Inflation and Exchange Rate Volatility [Macroeconomic Uncertainty], identified by 41% of respondents as major or very severe, may reflect future concerns or difficulties encountered with the exchange rate policies in place. This constraint may also reflect geopolitical concerns, which are estimated by Government to have cost Syria 3% of GDP growth per year.
- h) Skills and education of workers, identified by 36% of responding firms as a major or very severe constraint, clearly reflects the very real problems of productivity experienced by firms. Syrian workers have, on average, a lower level of education than in many other countries.
- i) Access to Land, identified by 36% of firms as a major or very severe constraint, appears to reflect the high cost of land transfer, due to the structure of transaction taxes.
- j) Labor regulations, identified by 34% of firms, reflect the difficulty in firing workers for economic reasons.

41. Other constraints were identified by less than 1/3 of firms in the sample. In general, large firms reported being disproportionately constrained by regulations, most strikingly by customs and trade regulations, but small and medium firms were more likely to identify “bureaucracy” in general as a leading constraint.

42. The surprising omission from this list, a factor noted repeatedly in our interviews of key experts and counterparts, is the issue of finance. Generally, it is observed that SMEs have virtually no access to bank finance, and that high fixed fees and corruption make the total cost of credit unprofitable. Yet it is important to note that at least a dozen other factors were rated as more serious problem by this large sample of Syrian enterprises. Clearly, finance is neither cheap nor readily available to SMEs, and high fixed costs in the form of fees and informal payments for loans can more than double the cost of smaller loans compared to larger ones. The lack of real competition in the Banking sector and continued heavy state role (combined with weak enabling conditions) yield an unfavorable environment for SME lending. And, as noted in chapter 2, the general lack of reliable firm accounts and credit information further

exacerbates this problem. Yet many firms have learned to make do on self-finance and the liquidity of family and friends, which may help to explain why they do not identify external finance as a priority. As market conditions improve and competition grows more intense, financial sector weaknesses are likely to become more constraining.

43. What emerges overall from the survey and the other sources reviewed is a picture of a difficult investment climate that both imposes high costs and uncertainty, and restricts private sector entry and competitive dynamism in important ways. For this reason, the remainder of the assessment is organized into two broad categories:

- A. Chapter 2 looks at **limits to opportunity**, in terms of constraints to market competition and private investment and participation in the economy. Among the key factors it considers are:
 - a. restrictions on trade (tariff and non-tariff barriers)
 - b. barriers to entry and investment, and
 - c. explicit and implicit preferences given to state-owned enterprises.
- B. Chapter 3 identifies the features of the **high and unpredictable cost of doing business**. The features addressed are:
 - a. Tax policy and administration
 - b. Other Regulatory procedures, and
 - c. Bureaucratic discretion.
- C. Chapter 3 looks at **factor market weakness**, including:
 - a. labor market flexibility and labor skills
 - b. supply and demand factors in financial markets
 - c. provision of infrastructure services, and
 - d. use of and access to technology.

44. These are followed by a final chapter (Chapter 5) that offers options for a strategy to complete. It offers a detailed set of **recommendations for potential reforms to alleviate the critical constraints** identified and additional studies to probe more deeply into a few areas in search of appropriate solutions.

CHAPTER 2. LIMITED OPPORTUNITY

The more laws and restrictions there are, the poorer the people become.
Lao Tsu, 6th Century B.C., China

Ability is nothing without opportunity. Napoleon Bonaparte

45. Competition is the central driving force for enhancing productivity. Competition is the single most important disciplining force of market economies, converting individual profit-seeking into overall economic welfare. Without competitive pressure to narrow rents from commercial activities, consumers suffer from elevated prices and businesses entry and innovation is suppressed. Existing businesses become oriented towards protecting their excess profits rather than finding ways to produce at lower cost, improve their product or introduce new products. As noted in chapter 1, WDR 2005 reinforces the finding that competitive pressure drives innovation in products, production processes and technology.

46. Private participation can bring to bear resources, finance and creativity beyond the reach of most governments. In almost every productive economic realm, private-led economic activity has been found to be superior to state-led activity. When exposed to equal incentives and constraints, ownership should not matter. However, in reality, public entities are usually (and more intrinsically) the objects of protection, subsidies and political interference than are privately-owned firms. Of course, when private enterprises grow reliant on protection and subsidies, they too perform badly – the key factor is the absence of incentives to perform, innovate and reduce costs to consumers.

47. In Syria, competition has been limited and substantial barriers to entry remain in many economic sectors. Trade remains highly restricted by both tariff and nontariff barriers, and even the significant efforts at liberalization have left a web of protections, tariffs and exceptions that distort economic incentives and discourage competition. Some productive sectors remain reserved for the public sector, while others restrict certain types of foreign participation. Some 200 state enterprises continue to benefit from various levels of state support through explicit protection or subsidy.

RESTRICTIONS ON TRADE

48. **Tariff Barriers** Syria's principal imports include metal, machinery and transport equipment, which together account for 45 percent of merchandise imports, chemicals (10 percent), textiles (10 percent) and plastics (6 percent).⁴⁴ Seventeen percent of total imports consist of foodstuffs. In law, current tariff rates fall in 10 bands ranging from 0 to 200 percent. In practice, other duties and surcharges result in effective rates ranging from 6% to 235% and averaging 35 percent. (including other duties and surcharges. Current tariff rates on imports range from 6 to 235 percent in 10 tariff bands. The highest rate applies to certain vehicles, while tariffs in excess of 100 percent apply to certain agricultural goods and food products. In spite of these high weights, the total weighted average tariff is estimated to be only 8 percent, quite low by regional standards.⁴⁵ Yet the incentives introduced by tariffs are nonetheless distortionary – not only do they vary widely between goods, but some of the distinctions drawn between finished and unfinished goods are artificial, certain exceptions/exemptions are granted to some favored

⁴⁴ Most of the information in this section is derived from World Bank, *Syria: Harnessing Trade for Growth* Economic and Social Development Unit, Middle East Department, Middle East and North Africa Region, December 2004 (Confidential)

⁴⁵ Ibid.

enterprises. Furthermore, under the Gulf Area Free Trade Agreement (GAFTA), inter-GAFTA trade is subject to an 80% reduction on tariffs and will soon be tariff-free, meaning that like goods will be treated differently depending on country of origin.

49. **Non-tariff Barriers.** Syria also imposes two types of nontariff barriers to trade – quantitative restrictions (QRs) and technical barriers to trade. QRs prohibit the import of some goods and limit the right to import certain goods to certain government entities (especially SOEs). Prohibited goods include:

- A. Goods forbidden for environmental, security and sanitary reasons, although this list is not publicly available.
- B. Goods forbidden due to their negative impact on protected Syrian industries, including “flowers, animal products, forestry products, vegetable oils, sugar-based products, quarrying products, plastic and rubber products, leather and leather products, paper products, silk, textiles and clothing, craft products, glass products, electrical machinery and materials, etc.”⁴⁶
- C. Goods that can only be imported by public sector entities include “oil and oil-related products, alcohol and beers, arms, cotton, some cereal products, tobacco, pharmaceutical products, salt, black cement, fish, fruits, olive oils, TVs and TV components, aliments [food] for animals and phosphates.” There is an additional list of goods that can be imported with the payment of a commission to public entities that used to enjoy exclusive import rights, including cars and machinery, steel and steel products, wood, white cement, yarn for textiles, coffee, tea, rice, canned fish and meat, raw sugar, fertilizers, raw leather and paper.

50. The World Bank estimates that these and other quantitative restrictions are equivalent to a 19 percent increase in the price of imported goods. As noted in Chapter 2, inefficiencies in trade logistics (customs and technical control procedures, transport logistics and border and port crossings) are estimated to add a further 15 percent to the base price of imports.⁴⁷ The combined effect of nontariff barriers hurts poor Syrian consumers directly, constrains the industries in which Syrian private firms can participate, and reduces competitive pressure on protected firms, whether public or private.

EXPLICIT AND IMPLICIT PREFERENCES GIVEN TO STATE-OWNED ENTERPRISES

51. In spite of increased scope for private investment and direct competition in a number of cases, the playing field for competition between public and private sectors is far from fully open, and even where open, far from level. The private sector has been shrinking – for example, its role in manufacturing has dropped from 56% in 1991 to 37% in 1998.⁴⁸

Table 2.1: State Owned Enterprises, by Sector

SOEs in Key Sectors, 2001	No. of Companies	Production (Million SP)	Number of Employees
Textile Industries	27	13,300	28,415
Chemical Industries	13	9,000	11,396
Engineering Industries	13	7,600	7,292
Cement Industries	10	7,400	9,802
Food Industries	23	4,700	4,957
Sugar Industries	10	5,000	3,268
TOTAL	96	47,000	65,130

Source: UNIDO/UNDP *Industrial Public Sector Reform – Key Issues and Options* (2002)

⁴⁶ Ibid, p. 55

⁴⁷ Ibid. p. iii

⁴⁸ SEBC, op. cit. p. 35 citing the Central Statistical Office Industrial Census for 1998.

52. As an employer, its importance has shrunk from 46% of manufacturing workers to 39% over the same period. In invested capital, the public sector role has fallen from 67% to 31% in the nineties. Nonetheless, the public sector continues to enjoy a monopoly in cement, sugar-refining, fertilizers, oil refining, mineral water, electricity, telecommunications, oil and gas, and insurance; remains dominant in banking.⁴⁹ The public sector also controls parts of key value chains – including a monopoly on the procurement and sale of cotton (and cotton ginning and spinning, and yarn making) and wheat, critical inputs to the textile, garment and food processing sectors. State monopolies also provide most infrastructural services.

53. UNIDO reports that the public sector's productivity is extremely low and its profitability ranges between low and negative: "labour productivity in Public Sector companies is estimated to be 2 to 3 times lower than that of equivalent Syrian private sector companies, and up to 10 times lower than industrialized countries standards".⁵⁰ This is attributed to a variety of reasons, including (among many) inappropriate design, lack of investment in machinery and automation, poor management skills, suboptimal size, "social" obligations (presumably regarding employment generation) and bureaucratic paralysis. In all sectors, some 200 state-owned companies enjoy different levels of subsidy, protection and bureaucratic control. In addition, as noted above, many enjoy exclusive or privileged rights of import.

54. SOEs suffer from a high degree of external influence in virtually every aspect of their operations. Prices of outputs and inputs, staffing, and purchasing of imported raw materials and spare parts are all tightly controlled. There may be as many as 18 sponsoring, controlling or intervening bodies for a single enterprise. They also have very little market focus: marketing departments are a foreign concept, and (like most SOEs emerging from central planning regimes) they are highly production oriented.

55. The presence of these enterprises not only contributes to the fiscal burden on remaining enterprises, but also creates a tremendous drag on the economy through their monopoly privileges or privileged role in key supply chains. Their presence limits private investment both directly, through prohibitions, and indirectly, through unfair competition and crowding out. The current slow atrophy approach may, in the face of increasing liberal trade and competitive markets, drag a number of private enterprises down with the declining public sector. In considering the future direction for these enterprises, one clear goal should be to reduce their negative impact on private sector investment and growth.

BARRIERS TO ENTRY AND INVESTMENT

56. Aside from the areas where laws and regulations prohibit or discourage private investment, the procedures for starting a business in Syria clearly discourage entry. Doing Business 2005 reports that business registration involves more procedures and time than is the norm in the MENA region, which is already excessive by global standards (see Table 2.2). Fees to establish an enterprise, while not high by regional norms, are quite high in international comparison. More important, the effective minimum capital requirement is astronomical – more than 50 times per capita GDP.

⁴⁹ Syrian European Business Center *The Potential Impact of the Syria-EU Agreement on the Syrian Economy and Industry* (Damascus: SEBC, October 2004) p. 34

⁵⁰ UNIDO/UNDP Integrated Program for Syria *Industrial Public Sector Reform: Key Issues and Options* (December 2002)

Table 2.2: Entry Procedures

	Syrian Arab Republic	Regional Average	OECD Average
Number of procedures	12	10	6
Time (days)	47	39	25
Cost (% of income per capita)	34.2	51.2	8.0
Min.capital (% of income per capita)	5,053.9	856.4	44.1

57. Documentation of the steps required for registration show that a large part of the time delay in setting up a business arises from two steps: registration with the Ministry of Supply and Interior Trade and registration with the Tax Authority.

Figure 2.1: Starting a Business Graph – Syrian Arab Republic

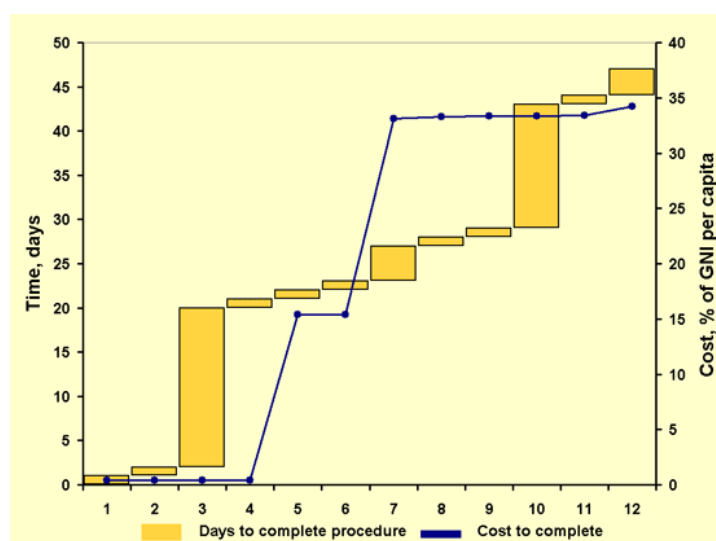


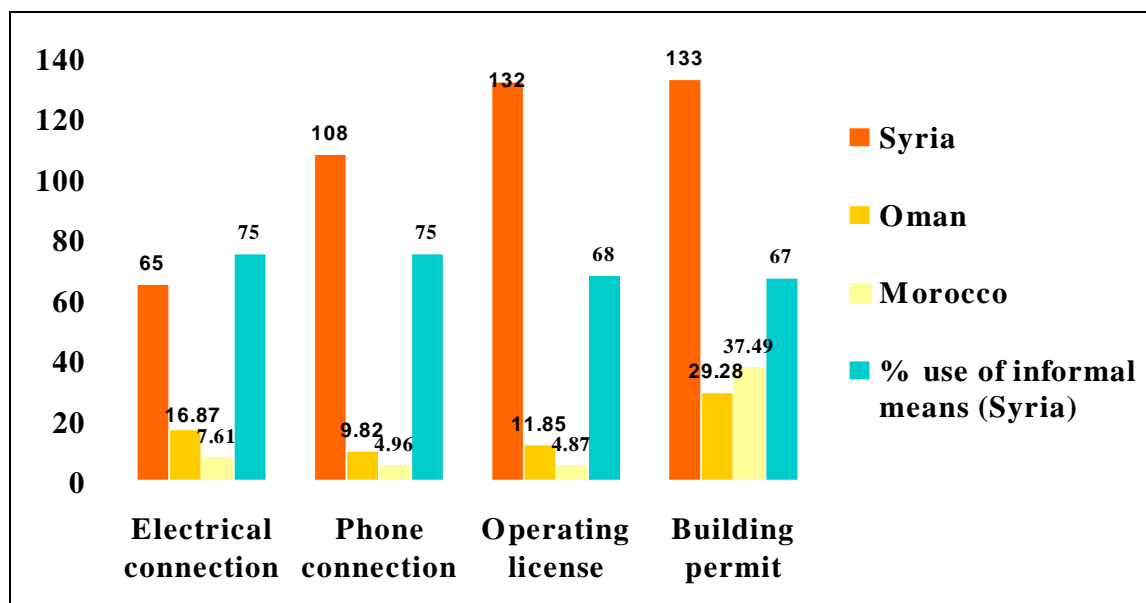
Table 2.3: Registration procedures - Syria

Nature of Procedure (2004)	Proc #	Duration (days)	US\$ Cost
Pick up forms of articles of incorporation	1	1	7.36
Deposit the initial capital in a bank	2	1	0
Register with the Ministry of Supply and Interior Trade	3	18	0
Register with the Court of First Instance	4	1	0
Pay the stamp tax	5	1	259.21
Notify the Tax & Financial department	6	1	0
Make payment to the Syrian Bar Association	7	4	309.02
Return to the Court to complete incorporation	8	1	3.06
Apply for commercial registration	9	1	1.47
Register for tax	10	14	0
Register with the Social Security Organization	11	1	0.59
Make a company seal	12	3	14.72
Totals:	12	47	\$595.43

58. **Business Licensing.** Licensing can be a legitimate government function to protect vital social interests such as public safety and health. However, it can also serve as a deterrent to business entry and a source of bureaucratic discretion. According to respondents in the survey, their most recent business license took an average of 132 days to be granted.⁵¹ This enormous delay and associated uncertainty invites corruption: 68% of responding firms report that an informal payment is required in association with getting an operating license. It also places Syrian businesses at a huge disadvantage when businesses in other countries routinely get their licenses within 30 days. It is potentially a significant barrier in delaying (hence discouraging) business entry, and imposes needless uncertainty on ongoing business concerns. Interestingly, it is a constraint that is perceived to increase in severity with firm size – 60% of large firms identify business licensing as a major or very severe obstacle, making it their fifth leading constraint.

⁵¹ In Egypt, another country where delays are substantial, the investment climate survey found that getting an operating license takes an average of around 115 days.

Figure 2.2: Delays in Obtaining Business Services, Syria and comparators and use of informal payments (Syria)



Source: World Bank investment climate surveys

59. **Other barriers to entry** Aside from operating licenses, a variety of bureaucratic approvals delay businesses and often require informal payments to facilitate. Firms report that it took them an average of 65 days to get an electrical connection, 108 days to get a telephone connection, and 133 days to get a building permit (Figure 2.2).

60. While land markets function relatively well for domestic investors, there remain some restrictions on the acquisition of land by foreigners. The law distinguishes between Arabs and non-Arabs: Arab nationals can freely buy and sell real estate, but non-Arabs cannot.

61. On the positive side, transfer of real estate seems to be a reasonably straight forward process. The Land Registry system, which is based on the French model, is well regarded. It is a public system and the legal aspects of transfer and registration are well understood. However, the land transfer tax, which can amount to as much as 40% of land's true market value, does inhibit land acquisition and motivates some informal transactions.

62. Building approvals are reportedly time consuming and difficult to obtain. And zoning rules can be hard to learn, changeable, and arbitrarily administered. Like many other areas of the Syrian administration, land zoning is very complicated. In interviews, businesses report consistent problems in establishing a clear right to operate. Some of these problems relate to disputes over whether the land is agricultural or industrial. Other problems relate to the interaction with the municipalities. An effective approach would be to integrate local economic development with the urban planning process. Right now, municipalities are not very motivated to encourage local industrial development. A common problem in many Arab countries is municipalities do not benefit in revenue terms from additional industrial investment, they get the costs to provide services but no revenue.

63. The exiting structure of investment incentives may serve as a disincentive to many investments, especially for foreign investors seeking equal treatment, transparency and predictability. Investment Law No. 10, as amended by Legislative Decree No. 7 establishes a number of incentives for some investments,

thus implicitly placing others at a disadvantage. Accelerated licensing and registration, waiver of certain regulations, capital and material import permits, a five year tax holiday, and privileged access to foreign exchange are all available to foreign investors judged by the Supreme Council for Investment as being “of special importance”⁵² but not to other foreign investors. Other industrial projects must be licensed under a separate law with different benefits – Decree No. 103 of 1952, which appears to have been interpreted to prohibit repatriation of foreign investment or earnings.⁵³ Economic logic and practical observation suggests that governments are ill-equipped to predict the true economic contribution of different activities, hence such actions simply create economic distortions (in the form of incentives to undertake otherwise unprofitable activities and no to undertake otherwise profitable ones) that reduce total investment and economic growth. But investors also report that the granting of these privileges can be slow and non-transparent. Another problem for start-up is that security clearances are required for the general manager and for all other persons who are likely to be involved in the management of the company, whether foreign or domestic. The purpose of such ex ante screening is unclear, but the process reportedly can take several months.

64. Finally, with regard to serviced industrial land, the government operates six duty free zones intended to promote foreign investment and trade. They are located in Aleppo; in Damascus; and at Damascus International Airport; in Adra (north of Damascus); in the ports of Latakia (intended mainly for storage of goods); near the border town of Dar'a (a joint venture between Syria and Jordan); and in Tartus. There are plans for creation of a free zone port in Tartus as well.⁵⁴ The Free Zones are controlled by the General Organization of Free Zones (GOFZ). Within the free zones, foreign-owned firms share the same benefits as Syrian enterprises, which include:

- No import licensing requirement for inputs and goods entering the zones. Importers need only present a manifest as documentation and for inspection purposes. Only military and other prohibited items are excluded. Any commodity permitted to be imported into Syria can be imported from free zone manufacturing facilities, but an import permit is required.
- No re-export regulations or restrictions are imposed except for military and internationally prohibited items.
- All goods entering and stored in the zones are exempt from local taxes and duties.
- All foreign exchange operations are free of applicable currency restrictions.
- Access to private banks operating in the free zone areas

65. These zones are supposed to provide enclaves free of many of the administrative difficulties encountered in the main economy. However, interviews suggest these many not be operated efficiently. There are lengthy delays and numerous bureaucratic hurdles for interested investors, that would certainly deter any time-sensitive investment. In addition, questions were raised about the completeness and quality of services.

66. Outside the zones, interview with a variety of investors suggest that bureaucratic attitudes in Syria deter business entry, perhaps as much as formal rules. There is a tendency on the part of officials to say no rather than yes. The example was given of an IFC investment which took six months to finalize because of the multitude of approvals and opinions that were required.

67. **Closing a business as an obstacle to entry.** Although it is often not recognized as such

⁵² Approved activities in agricultural products and processing, transportation, private and joint venture industrial projects, and other projects approved by the Supreme Council for Investment.

⁵³ The Oxford Business Group (in association with SEBC) *Emerging Syria 2005* op. cit. p. 158

⁵⁴ Information in this paragraph derive from United States Department of Commerce, *Syria Country Commercial Guide 2003*

difficulties in closing a firm inhibit investment. In any dynamic market economy, it is normal that a significant percentage of firms (for example, 10%) fail each year. If a prospective investor will have difficulty leaving the market, or can only leave under costly or punitive conditions, it deters the initial investment, increasing risk and reducing the expectation of return. In Syria, liquidation is extremely difficult. The Doing business indicators suggest that it takes over four years to close a bankrupt firm. While the formal cost is not high, the amount creditors can recover is only 29% of their debts, compared to 72% in OECD countries. In this regard, Syria is close to the MENA average, but the MENA average is very poor by international standards. Furthermore, as noted above, a further imposition to closing a business lies in laying off workers. Even in the face of financial hardship (or ruin), it is expensive and time consuming, when it is allowed.

Table 2.4: Closing Business

	Syrian Arab Republic	Regional Average	OECD Average
Time (years)	4.1	3.9	1.7
Cost (% of estate)	8	13.0	6.8
Recovery rate (cents on the dollar)	29.2	28.6	72.1

68. **Advertising.** Advertising is a critical way for companies to communicate to consumers, establish a reputation, differentiate their product, or simply enter a new market. In Syria, media regulations are inhibiting the use of this business tool. The recent World Bank External Affairs Department (EXT) mission found that there are strong, unique constraints to the firms' ability to advertising and to the development of the advertising industry arising from restrictions on and the use of Syrian media and government ownership of media. The advertising industry is poorly developed and there are few vehicles for advertising. Interviews suggest that this may impose a barrier to new products entering the marketplace and to the full development of the current marketplace. As one example, advertising expenditures per capita is about one tenth that of neighboring countries and only 2% of the level in many Western markets. The advertising industry in Syria is also unique in the world in that outdoor advertising is by far the leading form, capturing 50% of expenditures, instead of the mass media. Distortions in the advertising industry are mainly caused by taxation and regulation due to government ownership of the media and media purchasing house of the government. A related issue is the lack of trust in government owned media as source of information. For example, since advertisers can only use government newspapers, but these do not enjoy a strong readership or confidence among targeted consumers, newspapers are a weak vehicle for advertising. Constraints in these sectors are a hidden but strong impediment to investment and competition. Further research would be needed to provide a set of recommendations for reforms in terms of reforming the advertising industry and opening up the media market.

CHAPTER 3. THE HIGH AND UNPREDICTABLE COST OF DOING BUSINESS

“A good investment climate encourages firms to invest by removing unjustified costs, risks and barriers to competition” (WDR 2005)

69. A central factor constraining new investment and competitiveness is Syria’s high costs to do business and to produce. The costs imposed by Syria’s investment climate are simply too high and unpredictable in several key dimensions.

Table 3.1: Major Sources of High and Unpredictable Costs

Activity	Sources of High Cost, Unpredictability	Consequence
Production and Sales	<ul style="list-style-type: none"> • Unpredictable tax burden, some high fees, distorted incentives. • Export delays • High levels of informal payments • Management time for red tape • Weak enforcement of contracts • Weak competition in domestic market • Role of SOEs in key supply chains. 	<ul style="list-style-type: none"> • Businesses find it difficult to exploit otherwise profitable export and domestic markets as their costs are elevated and investment is riskier, while capabilities and efficiency remain low.
Raw materials and inputs	<ul style="list-style-type: none"> • High non tariff barriers for imported raw materials • Inefficient SOE sector provides some key inputs at poor quality 	<ul style="list-style-type: none"> • Raw materials are expensive and often of poor quality
Labor	<ul style="list-style-type: none"> • Laws make it difficult to fire workers • Weak skills and worker education and training limit productivity 	<ul style="list-style-type: none"> • Businesses avoid these laws which gives rise to informal payments
Energy Supply	<ul style="list-style-type: none"> • Unreliable electricity supply 	<ul style="list-style-type: none"> • Businesses buy own generators, adding dramatically to energy costs • Loss of output
Other Infrastructure Costs	<ul style="list-style-type: none"> • Transport and telecommunications infrastructure has important gaps in service and efficiency 	<ul style="list-style-type: none"> • Weak internet usage means e-business is not common • Poor ports infrastructure adds to costs.
Sales and Marketing Costs	<ul style="list-style-type: none"> • Virtually no marketing infrastructure, e.g. advertising agencies • Export market information is weak (particularly for SMEs) 	<ul style="list-style-type: none"> • This means firms have to internalize costs, which means they may not enter markets (export in particular)
Investment and Financing	<ul style="list-style-type: none"> • Financial sector does not provide services needed • Import of capital items is difficult • High cost of land transfer 	<ul style="list-style-type: none"> • Trade financing difficult and many firms limited to internal or family-based financing.
Innovation, research and development	<ul style="list-style-type: none"> • Weak protection of intellectual property rights limit incentives to innovate, licensing opportunities. • No specific encouragement of research and development 	<ul style="list-style-type: none"> • This expenditure which is crucial for technological advancement does not take place

70. Leading factors addressed in this chapter include:

- (i) Tax policy and administration
- (ii) Other Regulatory procedures (including trade and price regulations)
- (iii) Bureaucratic discretion

71. Table 3.1 summarizes how some of the major sources of high and unpredictable costs and other weaknesses in the investment climate constrain firms' ability to compete.

TAX POLICY AND TAX ADMINISTRATION

72. In investment climate surveys throughout the world, high taxes often rates as a leading constraint. Thus it is not so surprising to see Syrian firms identifying tax rates as a major or severe constraint (Figure 3.1 below). Yet tax effort from income taxes is remarkably low in Syria. Taxes on income and profits total only 4.2% of GDP. Oil has provided an important source of public revenue (although, as noted above, this source is finite and will decline over time), reducing the total amount of financing that must be raised through income taxes. So why do taxes top corporate concerns? Three explanations appear significant:

- First, respondents to the survey may have not fully experienced (or regarded as permanent) recent lowering of the corporate tax rate.
- Second, taxes as administered may be more burdensome than their apparent design would indicate. Indeed, if enforcement is simply more rigorous than before, some firms may end up paying more taxes in spite of lower rates. However, it is also a product of the way they are calculated and the exercise of bureaucratic discretion by tax officials.
- Third, companies may be responsible for other taxes and fees which together are more burdensome than marginal corporate tax rates would indicate.

73. Regarding the first explanation, the survey was administered in the first half of 2004, and some respondents may not yet have fully experienced the impact of a substantial lowering of corporate and income tax rates that transpired, as a result of the 2003 lowering of the standard corporate tax rate on private companies to 25%. Just prior to that, the top marginal tax rate for corporations was 58%. The personal tax rate is 17.25%, suggesting a substantial disincentive for private corporate activity and income in the tax structure.⁵⁵ The Government recently reduced marginal tax rates, and increased penalties for evasion. This reportedly has had a positive impact on tax collections, leading them to increase around 14% per year over the last three years.

74. A second reason may lie in the fact that taxes as enforced have not declined in proportion to the reduction of rates. First, more rigorous enforcement may mean that firms that were able to evade a portion of their tax responsibility are having a harder time. In the survey, businesses estimate that the typical firm like them reports an average of only 51% of its revenue for tax purposes. A lower tax rate applied to a higher percentage of income may actually increase the burden felt by firms. Also important, the way taxes are calculated makes effective taxes higher than the same marginal rates would impose in many other countries. For example, losses cannot be carried forward and income tax is assessed on total income before deductions.

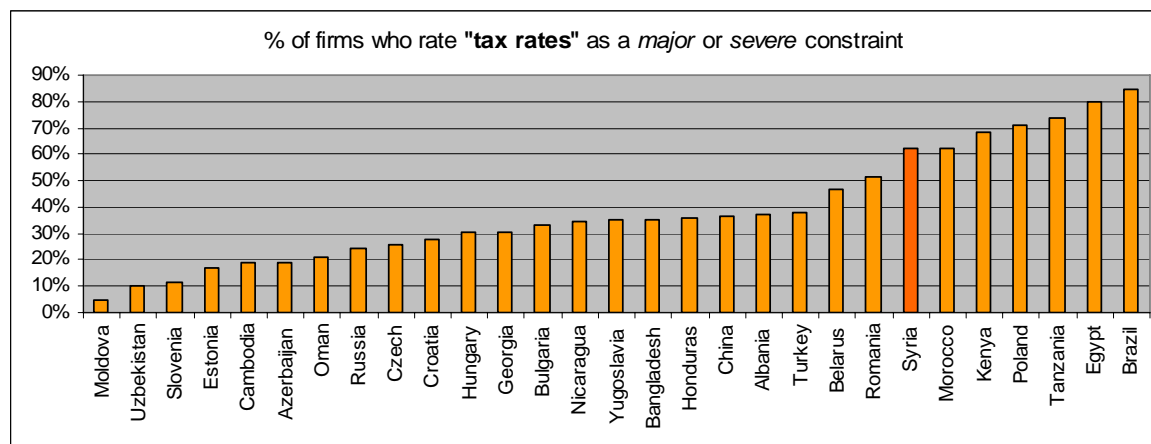
75. Equally important, serious problems remain on the administration side. Fully 58 % of Syrian businesses in the survey rated tax administration as a major or severe constraint. The payment of tax is described by knowledgeable observers as being negotiated every year between individual taxpayers and

⁵⁵ Rates include war effort surtaxes of 2.25% and 13% respectively.

the tax inspectors. The firms surveyed were inspected an average of 5 times for tax purposes, and in 70% of these cases they report that there was an expectation of informal payments, suggesting a high level of administrative discretion.

76. Tax agents reportedly assess taxes based on their estimate of the future income of the taxpayer. Yet many tax agents are ill-qualified to carry out this work according to the rules – many have little education or training. Generally, they are reliant on illicit income to supplement their official pay. And small firms may have significant working capital constraints in paying taxes on income not yet realized.

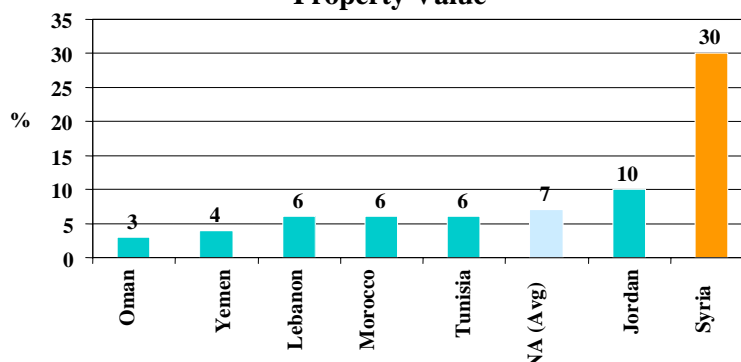
Figure 3.1: % of Firms who Rate “tax rates” as a Major or Severe Constraint



77. To many, the approach to tax administration appears arbitrary and based as much on an interest in extracting rent as one in the fair administration of taxes. The system creates difficulties for some people to pay the tax and strengthens incentives to evade by concealing income or bribing tax collectors. There are many perceived inequities in the tax system. The prevailing culture regarding taxes remains one of an adversarial relationship, where the legitimacy of administration is highly questioned. Hence, entrepreneurs are said to routinely keep two sets of books, to reduce their tax burden (a system that reduces the attractiveness of firms to external financiers, and especially to foreign investment). In countries where taxes are regarded as fair and impartially enforced, the payment of tax rests on the belief that the taxes are a necessary and legitimate contribution to enable government to meet economic and social needs of citizens. This belief does not appear to prevail yet in Syria.

78. Finally, in addition to taxes on income, there are a wide range of other fees and tax-like payments required of firms, some of which are quite high by international standards. The fee to register a property transaction is 30.4% of per capita GDP compared with an OECD average of 4.9%. The cost to register a business is 34.2% of GDP per capita compared with an OECD average of 8%. These other fees add dramatically to the cost of doing business. Taxes on inheritance and

Figure 3.2 Cost of Registering Property, as % of Property Value



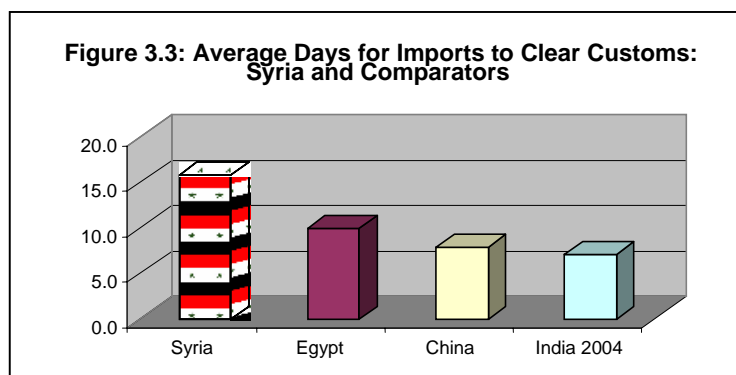
Source: Doing Business 2005

bequest are very high. Unless the heir is a son or a daughter of the deceased, the taxes due are almost 100% of the inheritance.⁵⁶ The only assets excluded from the assessment are the house where the heir resides and some bank deposits. Payment of this tax is very efficient because the burial of a deceased person cannot take place until the Ministry of Finance has issued a tax certificate confirming that all applicable taxes will be paid. Property tax is a minimum tax based on the value of property, but the rates were determined many decades ago when property values were low. If the tax was charged at the current value of the property many people would be unable to pay and would have to sell their land. This again creates leverage for evasion and negotiation, rather than the rational administration of taxes. Overall, the basic Tax Code, introduced in 1949 and amended several times since then, does not provide a modern and coherent incentive regime. The Code consists essentially of a number of separate taxes, and different tax rates apply to different sectors of the economy. While the ICA did not provide the basis for a complete analysis of the incentive effects of the current system and the specific needs for reform, this type of follow-up study is clearly needed.

79. In terms of incentives, aside from uneven application of taxes, Investment Law No.10 as amended by regulation No.7, while vital in creating a legal framework for private investment, also created a system of holidays and incentives that create an uneven playing field. Its tax incentives and holidays do not appear to have been effective for Syria, in terms of its overall investment rate. And, granting tax holidays to some investors adds to the perception of the tax system as being unequal and unfair. The international experience is very clear: tax incentive have very little impact on long-term investment. The reason is that the benefit is illusory for many legitimate international investors -- because they are required to pay taxes in their home country on the profits or income not taxed in Syria. There may be more efficient ways to help investors.

TRADE REGULATION: TARIFF AND NONTARIFF BARRIERS TO TRADE

80. The trade regime is a critical component of costs.⁵⁷ While customs and trade regulation were not among the leading constraints for all businesses, for large private businesses it is tied as the third leading constraint, after taxes and tax administration: 64% of large firms surveyed identified this as a major or very severe problem. In the IC survey (where the sample intentionally over-represents exporting firms) businesses report that, on



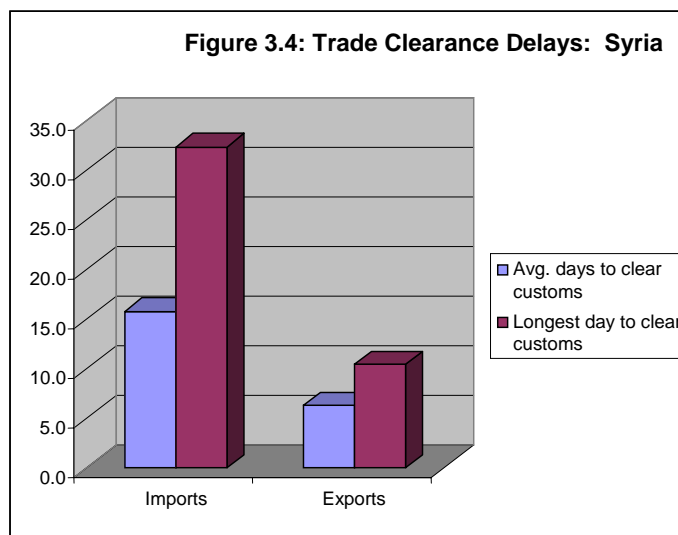
average, exports represent 19% of their sales and approximately 38% of their inputs are imported. Both import and export performance at the customs is poor, with substantial delays even to goods leaving the country. These delays critically limit the ability of Syrian-based firms to respond quickly to market demand, and add substantially to the transaction costs of trade and working capital costs of inventory. Comparing Syria to other countries we see that average import delays (15 days overall) are far in excess of the delays imposed by comparators (Figure 3.3). Furthermore, there is substantial uncertainty surrounding these averages that imposes additional costs. Firms have typically experienced exceptionally long delays to imports in the previous year, suggesting that they must inventory and plan production

⁵⁶ In an April 2005 mission, the World Bank learned that the inheritance tax has been substantially reformed.

⁵⁷ A separate, parallel World Bank report examines trade facilitation in great detail and discusses measures to strengthen and streamline procedures, as well as to build capacity and modernize.

cycles against the real possibility of delays in critical supplies of more than 30 days and delays in export shipments of 9 days (Figure 3.4). These are the average longest delays firms in the sample have experienced in the past year, and firms must plan against these “worst likely” delays when stocking inventory or agreeing to export delivery contracts. Overall, weak trade logistics (customs delays, technical control procedures, transport logistics and border and port crossing) impose a substantial nontariff barrier to trade, equivalent to 15 percent of the value of imports and exports.⁵⁸

81. While tariff rates have been reduced in recent years, they remain substantial in some product areas.⁵⁹ There are 10 bands that go up as high as 200%, although most inputs and intermediate goods are taxed in the bands below 30%. In addition, there are an increasing number of exceptions to tariffs that further complicates the regime and distorts incentives. For example, under the Gulf Area Free Trade Agreement (GAFTA) many goods from Gulf countries are duty free. Some of those may be re-exports from other countries from which the goods would have been subject to tariffs. Finally, certain enterprises have exemptions or special rates granted. The overall picture is one where effective tariff structure remains complex, and the potential for discretion in the determination of applicable tariff remains present.



82. There are significant non tariff barriers as well. A recent World Bank study on non-tariff barriers (NTBs) shows Syria’s trade restrictiveness to be very high. Comparing world and domestic prices of imports suggests that non-tariff barriers raise average prices of imported goods by 19 percent. The main non-tariff barriers are described in Chapter.

PRICE CONTROLS AND SUBSIDIES

83. Price ceilings exist on many goods and services, but in practice they are ineffective: actual market prices are below the official price ceilings. But this isn’t an argument for ignoring them. The fact that policymakers in Syria continue to believe in and use these controls is important, because there are some controls that do have an effect and do serious damage.

84. The main subsidies are in the energy and agriculture sectors. Transfers and subsidies in the budget account for 5.3 percent of GDP. Price distortions are particularly important in agriculture and help explain why Syria’s agriculture sector is the largest (relative to GDP) in the MNA region. This may also lead to misallocation of resources. For example, the diesel fuel subsidy has not only led to intensive investments in tubewells to irrigate agriculture, but has minimized the value placed on water conservation, which is essential to the long-term health of Syrian agriculture and to the availability of water for the growing urban population and economy. It also subsidizes diesel-powered generator use,

⁵⁸ World Bank. *Syria: Harnessing Trade for Growth* (Economic and Social Development Unit, Middle East and North Africa Region, December 2004)

⁵⁹ This subject is treated more extensively in the following chapter.

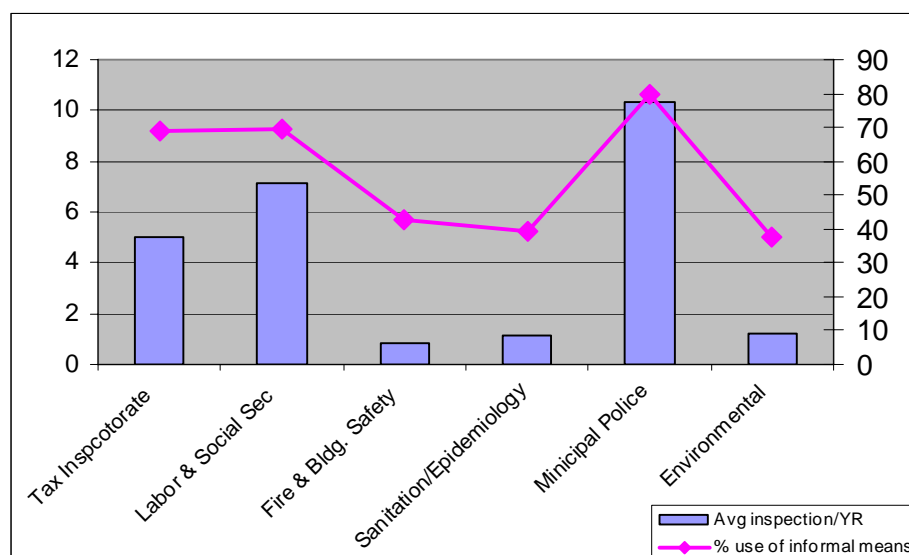
which may have both economic and environmental impacts.

Bureaucratic Discretion and Corruption

85. Regulations, many of which have not been fully reviewed with a market-driven economy in mind, tend to be excessively complex in Syria. Officials, often not sensitized to the importance and needs of private enterprises, can often impose additional hurdles through slow or discretionary implementation. The “Doing Business” indicators suggest that procedures for business registration, firing workers (see below) and other routine business activities are either inordinately slow or costly or both. Bureaucratic discretion imposes high and unpredictable costs on formal businesses, increasing the cost of transactions and making investment decisions riskier. Business inspections are frequent and intrusive.

86. For example, in the survey, the sampled Syrian enterprises report an average of 25 inspections a year, consuming a substantial amount of the time and energy of enterprise managers (Figure 3.5). A majority of these interactions involve the expectation of informal payment.

Figure 3.5: Enterprise Inspections - Frequency and Incidence of Requests for Informal Payments



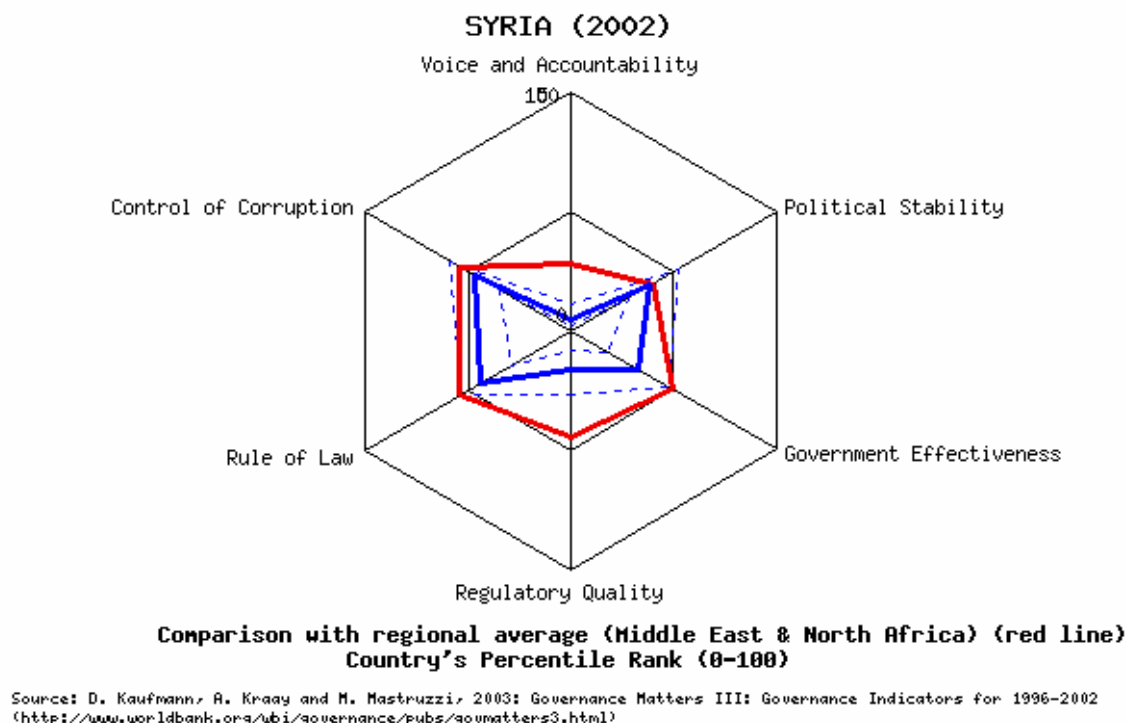
87. Furthermore, firms estimate that 70% of interactions with tax inspectors involve informal payment demands, 68% of labor inspections, almost 60% for fire and building inspections, and 80% of municipal police inspections do so. Responses also indicate that 75% of firms believe informal payments are needed for electricity connections, 75% for phone connections, 68% for operating licenses and 67% for building permits. In virtually all dealings with Government there is a significant incidence of informal payments. This is a significant cost for business, but it also means that government is not getting its rules and regulations enforced, and is likely losing substantial revenue.

88. These results also paint a picture of a highly distrustful, if sometimes collusive, relationship between government bureaucrats and businesses, where public officials often seek personal interest at the expense of economic and public interests. And the resulting gamesmanship has firms hiding income and workers from government. As noted above, firms estimate that there is substantial hiding of income from taxes. But they also reported hiding of wages and workers to escape labor regulation and taxes.

89. To a large extent, these problems are symptomatic of a broad need for public administrative reform and comprehensive regulatory reform. International governance indicators further confirm that

Syria, while in several dimensions near the MENA norm, is far from good practice broader governance concerns (Figure 3.6). Of particular note are the evaluations of regulatory quality, government effectiveness and accountability.

Figure 3.6: Syria (2002) Voice and Accountability (Syria is the innermost solid line)

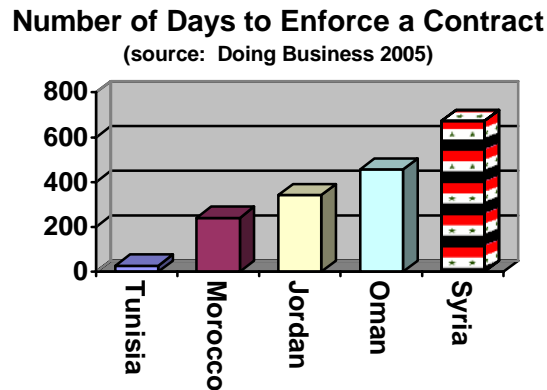


90. These are long-term but essential measures required to modernize the economy and the way the state regulates it. However, simplifying key regulatory procedures, making them as simple, easy, quick and transparent as possible, would provide an interim step that reduces discretion and uncertainty. Agency reforms aimed at points of high contact between businesses and public officials (such as tax and customs administration, business registration and licensing, labor inspection) might provide a targeted, if short term approach towards improving the economic impact of bureaucracy. In the long term, government must inculcate a more service-oriented in approach in public servants that recognizes the necessary contribution of business to economic growth while protecting essential public interests.

Conflict Resolution

91. **Judicial predictability.** One of the sources of predictability in developed market economies is that the legal system will support and enforce contracts and protect property rights. In Syria, although courts enjoy a tradition of being strong and independent, today there is very little confidence in the judiciary. In the survey, only 1% of business disputes over payments were resolved through the courts in the three prior years. For cases when the courts are used, respondents in our sample report it takes on average 22 months to resolve a dispute. Yet the Doing Business indicators paint a more pessimistic view of court processing of disputes: it takes 672 days to enforce a contract dispute regarding payments through the courts (Figure 3.7). Equally important is the issue of confidence: 79% of firms believe that the judicial system would not adequately enforce contractual or property rights.

Figure 3.7: Number of Days to Enforce a Contract



(Source: Doing Business 2005)

92. By most accounts, the court system today is slow, archaic and grossly overburdened. Interventions in the judicial process are not uncommon. Salaries are low, judges are poorly trained and the court infrastructure is weak. Businesspeople generally see no point in going to court, and fear that judges or court officials will be inappropriately influenced or “bought” by the other party. At the end of lengthy legal proceedings, the *Doing Business* indicators show that the cost of enforcing contracts is 34.3% of debt value, compared with the regional average of 17.9 and OECD average of 10.8. Arbitration exists through the Chambers of Commerce and another business organization, but is not common, and has no standing in law. Hence the courts routinely overturn such decisions on appeal.

93. The absence of effective contract enforcement mechanisms has serious consequences. A clear consequence is that firms are less willing to deal with new customers and suppliers, and fewer transactions take place. Firms tend to trade with recognized partners, making it difficult for new firms to obtain contracts or trade credit. Firms must rely either on reputation or prepayment to assure agreements with suppliers and customers. This reliance on personal relationships limits market dynamism as enforcement rests on the ability of the firm to punish its trading partner if it does not cooperate. In an investors’ conference in London in 2001, private investors identified the lack of an appropriate underlying legal framework to support commerce and the associated legal facilities (such as commercial courts) as the fundamental problem inhibiting private sector growth in Syria.⁶⁰

94. **“For every law there is an anti-law.”** In addition, the legal framework itself contributes to costs and uncertainty. In interviews, investors and experts tended to point to the contradictions, hence unpredictability of the legal framework. While some laws such as the Code du Commerce, the Civil Code and the Foreign Investment Law, and Law No. 10 are generally well regarded, on the whole, the legislative framework in Syria for investment was found to be wanting. The legal framework for markets is a mixture of the sufficient and the insufficient. The *Code du Commerce* of 1951 is the basic company law and is generally regarded as satisfactory. Several aspects of the legal framework are either outdated or incomplete. For example, the insurance law is out of date. There is no legal basis for arbitration. Legal protection for property rights is weak. Other laws are exceedingly complicated such as the tax laws. Some laws are poorly drafted, contradictory, fail to adequately cover their subject matter and are not well understood by those responsible for implementation.

⁶⁰ Euromoney Conference “Syria’s New Dawn” London, July 2001.

95. Generally, however, the content of the laws was reported to be less of a problem than its interpretation and application by public officials. This is a further manifestation of the phenomena described in section on bureaucracy above. Officials are reluctant to exchange information and tend to be secretive. The absence of transparency leads to distrust. Decisions can be contradictory and it there is often no agreement as to which laws and regulations apply in a particular situation. Some authorities are said ignore existing the law, issuing regulations one day and contradicting them the next.

96. Some reform work is already underway. A new anti-money laundering law was recently enacted. Drafts of a new company law and of a tax law, both of which have been under preparation for many years, are likely to be reviewed by the parliament in the near future. There has also been some improvement in the consultative process. The Chambers of Commerce and of Industry are regularly consulted on draft laws and some parts of the private sector are also consulted. Unfortunately, it is not clear to what extent the draft laws ultimately reflect those consultations. Once approved, laws are published in the Official Gazette which is readily available for a modest fee.

CHAPTER 4. FACTOR MARKETS

- “Countries face very different challenges and priorities as they move from resource-based to knowledge-based economies
- In low-income countries, the basic challenge is to get the basic factor markets: land; labor; capital working
- As countries advance the challenge is to make connections with international production systems by attracting sufficient flows of FDI.”

97. In factor markets, a number of weaknesses were observed that impede productivity. Individual constraints in labor, capital, infrastructure and technology markets together critically limit the progress of Syrian firms.

Weak Labor Skills and Flexibility

98. Wage rates are quite low by any regional comparison. Yet human capital limitations and restrictions on flexibility in labor markets appear to contribute to low productivity that makes the effective price of labor high. Figure 4.1 uses ICA survey data to demonstrate that in spite of relatively low wages, the effective cost of labor (the cost of labor to produce a dollar of output) is high in Syria. What factors explain this?

Figure 4.1: Labor productivity and unit labor costs in three sectors, Syria and Comparators

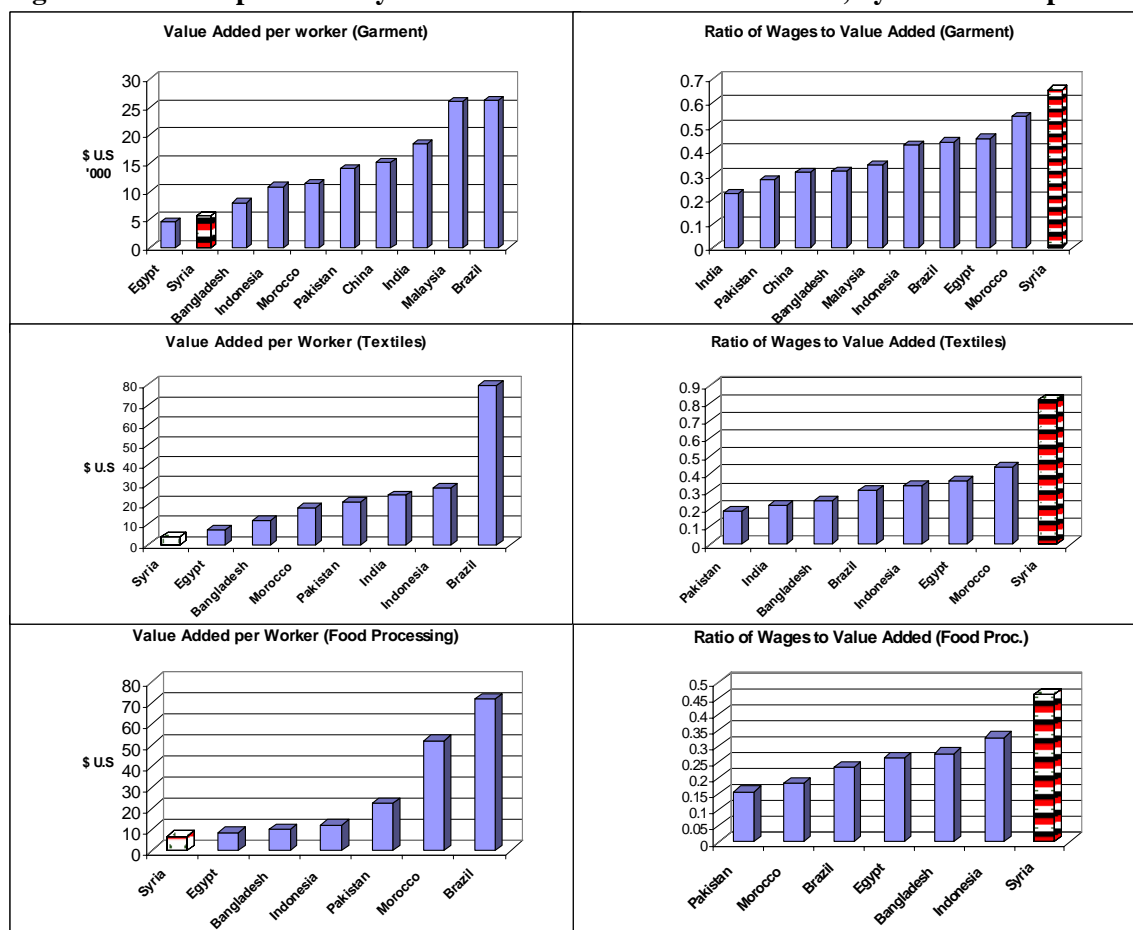
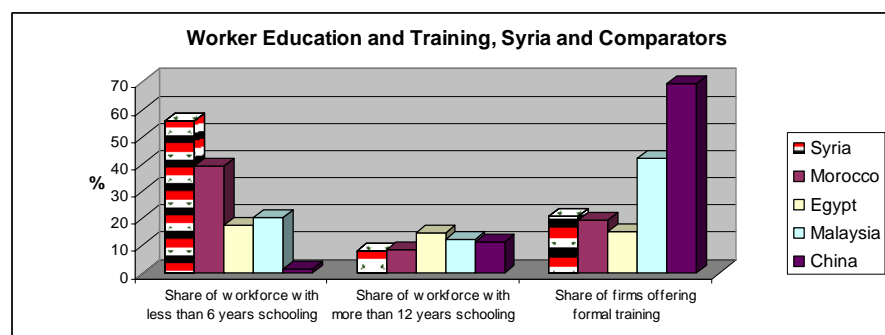


Figure 4.2: Worker Education and Training, Syria and Comparators



99. First, Syrian workers have, on average, a lower level of education than in many other countries. According to the ICA survey, the majority of workers in manufacturing have less than 6 years of schooling. Only around five percent have more than 12 years (Figure 4.2). Neither figure compares favorably to the figures for Morocco or Egypt, much less East Asian high growth countries like China and Malaysia. Thus, in spite of the fact that workforce skills do not generally alarm entrepreneurs, workers educated beyond the primary level are in short supply. International statistics on student enrollment confirm this fact (see Table 4.1). Foreign investors interviewed tend to perceive Syrian workers as having good basic skills but little capability beyond that. Unlike Lebanon and Jordan, where secondary school enrollment is around 80%, in Syria, the secondary school enrollment rate is less than half the level of the primary school enrollment rate, and the tertiary school enrollment rate is only 1/3 of that. A further observation from foreign investors interviewed was the lack of emphasis in the education system on foreign language skills. The issue is also evident in the area of business studies where tertiary enrollment in business studies, where Syria ranks considerably behind Lebanon and Jordan, with an enrollment rate of only one fifth of one percent.

Table 4.1: Comparative Student Enrollment

Net Student Enrollment Rates (%) 2001/2002	Syria	Lebanon	Jordan	Egypt
Primary	98%	90%	91%	90%
Secondary	43%	81%	80%	81
Tertiary	6% ^a	45% ^b	31% ^b	38 ^a
Business Studies	0.2%	0.4%	0.6%	

Sources: United Nations, *Human Development Report 2004*

^aUNESCO data for 1998/9 (most recent available)

^bUNESCO data for 2001/2002 (most recent available)

100. Large firms are almost three times as likely as small firms to employ workers with 12 or more years of education (Table 4.2). Furthermore, large firms are three-and-a-half times more likely to train their workers than small firms, and two-and-a-half times more likely to train their workers than are medium firms. This fact raises the possibility that, as in many countries internationally, SMEs may be under-investing in worker training.⁶¹

⁶¹ Geeta Batra and Andrew H. W. Stone. *Investment Climate, Capabilities and Firm Performance: Evidence from the World Business Environment Survey* (World Bank, Investment Climate Department, 2004, Mimeo)

Table 4.2: Education and Training of Industry Workforce

Training and Education	All Firms	Small	Medium	Large	Ex-porter	Non-Exporter	Domestic	Foreign
Share of workforce with less than 6 years schooling	55.8	58.0	49.8	34.0	52.3	59.1	56.1	15.7
Share of workforce with more than 12 years schooling	8.2	6.8	13.0	19.8	9.6	7.1	8.1	17.0
Share of skilled workers receiving training	47.8	49.2	42.2	38.1	47.3	50.4	50.4	18.0
Share of firms offering formal training	21.0	17.3	25.6	62.5	27.8	15.5	20.0	71.4

Source: World Bank Investment Climate Survey

101. The rate of worker training does not compare well to East Asian firms, although it is slightly better than some other MENA countries (perhaps due to substantial public expenditure on vocational training). However, the Government's extensive network for vocational training gives no evidence of contributing to worker productivity. Global best practice points to demand-driven systems of worker training, where any subsidy is used to enhance firms' purchasing power in the market place. A recent review of global evidence suggested that, outside of East Asia, only privately-provided training has a clear association with firm growth.

Table 4.3: Labor Force Composition

	Syria 2004	Small	Medium	Large	Exporter	Non-Exporter	Domestic	Foreign
Labor Force Composition								
Share of workers that are permanent	77.8	77.0	82.2	86.2	73.4	80.9	77.8	69.9
Female share of permanent workers	5.0	2.0	14.4	31.7	7.4	2.9	4.9	18.9
Female share of temporary workers	23.2	20.6	42.2	15.0	26.8	20.3	23.0	16.7

Source: World Bank Investment Climate Survey

102. Syria currently has a large network of publicly-operated vocational training schools but, according to a recent EU analysis, these are highly centralized and respond poorly to market needs. More important, the study finds no coherent system for retraining adult workers.⁶² Furthermore, the public sector institutes are underfunded: trainers are poorly paid and motivated.⁶³ In fact, international research findings strongly suggest that effective worker training must arise from the demand of private enterprises, not from public direction. Outside of East Asia, effective training is almost always delivered by private. A recent international study suggested that, except among the newly industrialized countries in East Asia,

⁶² : "If economic development is aspired to, much of the present labor-force (both workers and unemployed) should be retrained, taking part in a lifelong-learning program " European Training Foundation, *Focus on Innovative Practices in Teacher and Trainer Training in Syria* 2003, p. 16 <http://www.etf.eu.int/website.nsf/>

⁶³ "Low salaries and unattractive working conditions are de-motivating factors, which is why most trainers take on an extra job in the afternoon; this is naturally bound to produce a negative effect on their devotion to work and on the whole institution in general. The pay conditions in the private sector are better than those in the public sector and the government. Salaries for engineers and technicians who work as part-time trainers or on-the-job trainers in the private sector are three to four times greater than the salaries of those working as trainers for the government." Ibid.

only private external training is positively associated with enterprise growth.⁶⁴

103. Regulations further limit firm's ability to use labor productively. Syrian law imposes a number of hurdles in firing workers, in particular in its requirement for the government to approve individual dismissals. This makes it extremely difficult to legally fire workers for economic or business reasons. In the "Doing Business 2005" database, the difficulty of Firing Index is 50 compared with a regional average of 41 and an OECD average of 27 (where a hire number indicates greater difficulty). However, the rigidity in the formal law is widely circumvented. Many businesses in Syria employ considerable numbers of contract workers who are not covered by these laws. The end result of excessively rigid rules is a no win situation. The contract employee does not get any real protection from the regulation, and employers end up having to make informal payments to labor inspectors to circumvent excessively rigid regulations.

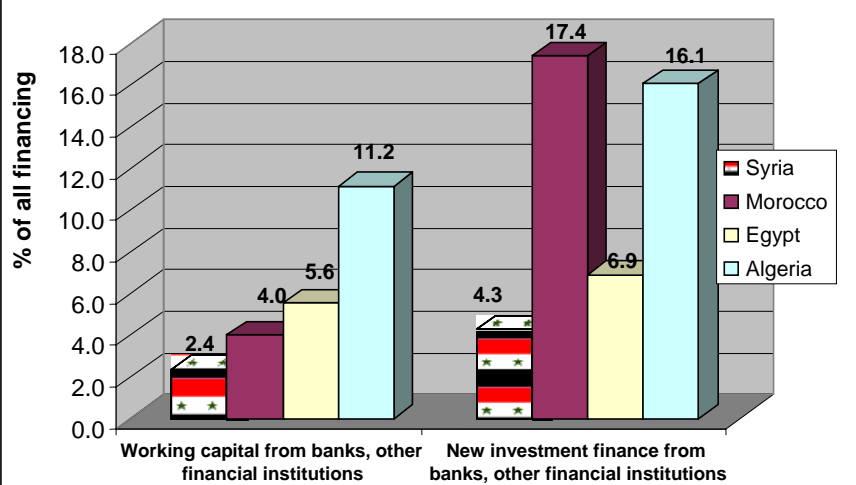
104. This marginalization may disproportionately affect women. Firms in the survey report that 23% of their labor force is temporary, but women are overrepresented in this temporary workforce. Women make up only 5% of the permanent workforce, but 23% of the temporary workforce. While traditional attitudes and practices may continue to make some employers hesitant to hiring women, rigid regulations have been proven internationally to inhibit the hiring of women and push them into informal employment.⁶⁵

Financial services

105. The most striking feature of the Syrian financial sector is how few private firms actually benefit from it. In a survey sample that over-represents exporters and more formal firms (who should be more likely to get formal finance), fully 88% of firms received no working capital from banks and 88% received no investment finance from banks.

106. Syria's banking System was nationalized in 1963. After that, Syria's banking sector was comprised of a Central Bank and specialized sector banks. In 2001, law number 28 ended the state monopoly on banking services, allowing private banks to operate. Subsequent reforms have further eased regulations restricting private banking. The Commercial Bank of Syria is the main player, accounting for 80% of domestic banking assets. It has exclusivity in all foreign exchange transactions for businesses. There are four other state-owned specialized banks (Real Estate Bank, Agricultural Cooperative Bank, Industrial Development Bank, and Popular Credit Bank). These banks are burdened by over-staffing and, in general, poor quality of staffing. They operate under strict government controls including directed credit and controlled interest rates. Other areas of the financial sector remain

Figure 4.3: Enterprise Finance from Banks -- Syria and Comparators



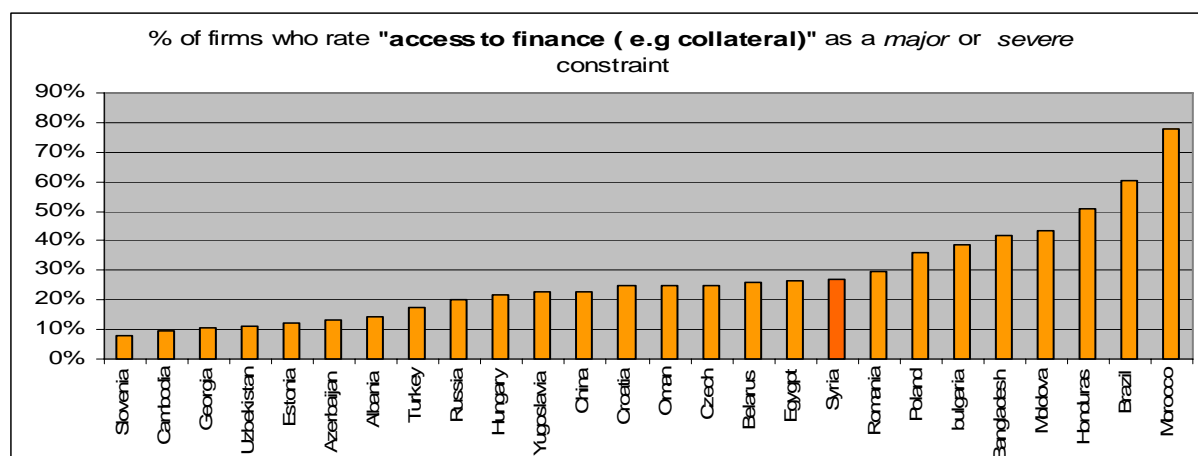
⁶⁴Geeta Batra and Andrew H. W. Stone *Investment Climate, Capabilities and Firm Performance: Evidence from the World Business Environment Survey* (World Bank: Investment Climate Department, January 2004, mimeo)

⁶⁵ World Bank. *Doing Business 2004*. (Washington, 2003)

underdeveloped- insurance, leasing, trade services, etc. Four private banks began operation in 2004, but they are thus far not a significant force in providing credit to private firms. Despite the recent liberalization of the banking sector, the Government remains the dominant player in virtually every aspect of financial services. Furthermore, since directed credit consumes much of the resources of state banks, only a fraction of assets can be allocated on an independent market basis with a profit orientation. Bank supervision is reportedly weak, although the Central Bank has recently announced a number of initiatives that may improve oversight. While a formal assessment of the financial sector has not been carried out, there are a number of areas that require strengthening. Payments processing is relatively slow. Syrian Banks do not have bankers trained in “cash flow” lending.

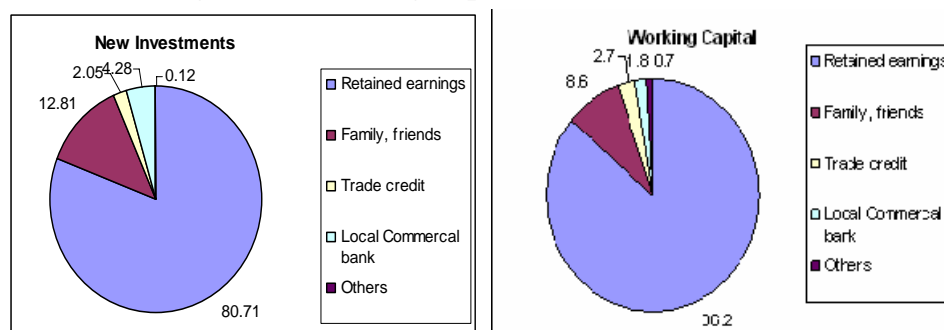
107. As noted above, the business community in large part makes very little use of formal bank finance (Figure 4.3). Although this pattern is common in MNA, the role of banks in private enterprise financing is unusually low in Syria. Larger, more creditworthy businesses are able to use a number of Syrian-owned banks based in Lebanon to meet a part of their financing financial needs.

Figure 4.4: % of Firms who Rate “access to Finance (e.g. collateral)” as a Major or Severe Constraint



108. Lending terms for the surveyed enterprises with credit do not appear favorable – although formal interest rates are not especially high, average collateral required is 217% of loan value. For large firms, collateral averages 160% of loan value, for medium firms 182%, and for small firms, collateral terms are most prohibitive – at 230% of loan value. Furthermore, large firms are less likely to have collateral required – only 60% of large firms with loans reported they were collateralized. Firms cannot leverage their assets for financing very well when collateral requirements are so high. This may in part be attributed to difficulties banks have in assessing risk, and in part to difficulties enforcing collateral, forcing them to discount its value (see below).

Figure 4.5: Working Capital and New Investments



109. However, financial markets are a function of both supply and demand and in Syria, it must be acknowledged that a number of factors contribute to weak effective demand for credit. One issue is to what extent Syrian firms demand bank credit, given alternative financing sources. Many Syrian firms are family owned, and family networks provide important access to non-bank financing. When Syrian firms are asked to identify their sources of finance, the leading category of external finance is “family and friends” – who provide nine percent of working capital and thirteen percent of investment capital (Figure 4.5).

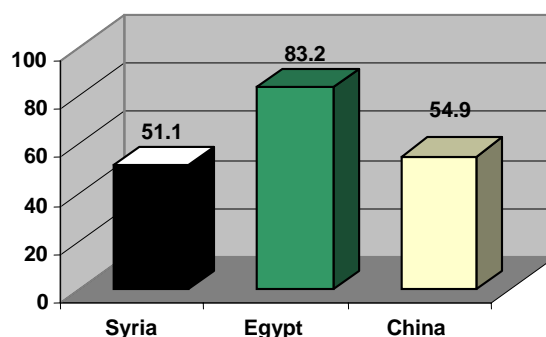
110. In addition, the development of bankable lending opportunity reflects, in part, a combination of corporate governance issues – lack of reliable and verifiable financial information – and the inability to use the judicial system to enforce contracts for repayment. First, poor accounting practices and weak corporate governance sharply constrain the number of “bankable” projects that would meet reasonable standards. For example, fewer Syrian firms keep audited accounts than in a number of other countries in the region (Table 4.4). And, as noted above, largely for tax purposes, many firms keep more than one set of books in order to conceal part of their income and/or payroll from authorities. The *Doing Business* Disclosure Index further confirms that Syrian business accounting practices are highly secretive, even by the standards of the MENA region.⁶⁶ Financial information is not offered and apparently not required to be fully disclosed. Anecdotal evidence from potential foreign investors suggests that lack of transparent and verifiable information is a key reason why they have not invested in Syria. It is reasonable to assume that banks and other local investors would be similarly reluctant to risk money without reliable information.

Table 4.4: Share of firms with audited Financial Statements

Egypt	81.5
Oman	77.3
Algeria	59.6
Syria	34.5

⁶⁶ . Indeed in carrying out the investment climate survey it was often very difficult to obtain needed financial information, due to deep distrust and fear that this could be revealed to tax authorities.

Figure 4.6: Total firm revenues typically reported for tax purposes (% of sales)



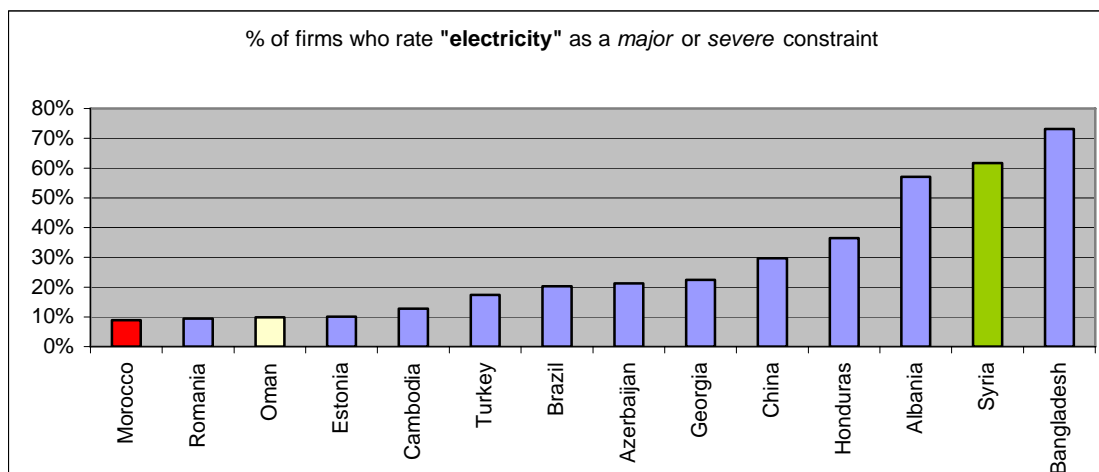
Box 4.1: Protecting Investors – Disclosure Index

The degree to which investors are protected through disclosure of ownership and financial information is measured below. The Disclosure Index captures seven ways of enhancing disclosure: information on family; indirect ownership; beneficial ownership; voting agreements between shareholders; audit committees reporting to the reporting to the board of directors; use of external auditors; and public availability of ownership and financial information to current and potential investors. The index varies between 0 and 7, with higher values indicating more disclosure. The Syrian Arab Republic has a score of **1**, compared with the regional average of **2.6** and OECD score of **5.6**.

Indicator	Syrian Arab Republic	Regional Average	OECD Average
Disclosure Index	1	2.6	5.6

111. Furthermore, Syria (like many other MENA countries) does not have a credit bureau, meaning that the history of a firm in meeting its financial obligations is not readily available. The lack of reliable information pressures lenders to rely on reputation or personal knowledge of borrowers, excluding less well-known enterprises (including recent start-ups) from consideration.

Figure 4.7: % of Firms that Rate “Electricity” as a major or severe constraint



Infrastructure: Unreliable Power Supply

112. The Government is the main provider of infrastructure services. It owns and operates all the main network industries (power, telecommunications, air services, airports, ports, rail etc). There is a single private provider of cellular services.

Figure 4.8: Electric Power Supply Indicators: Syria and Comparators

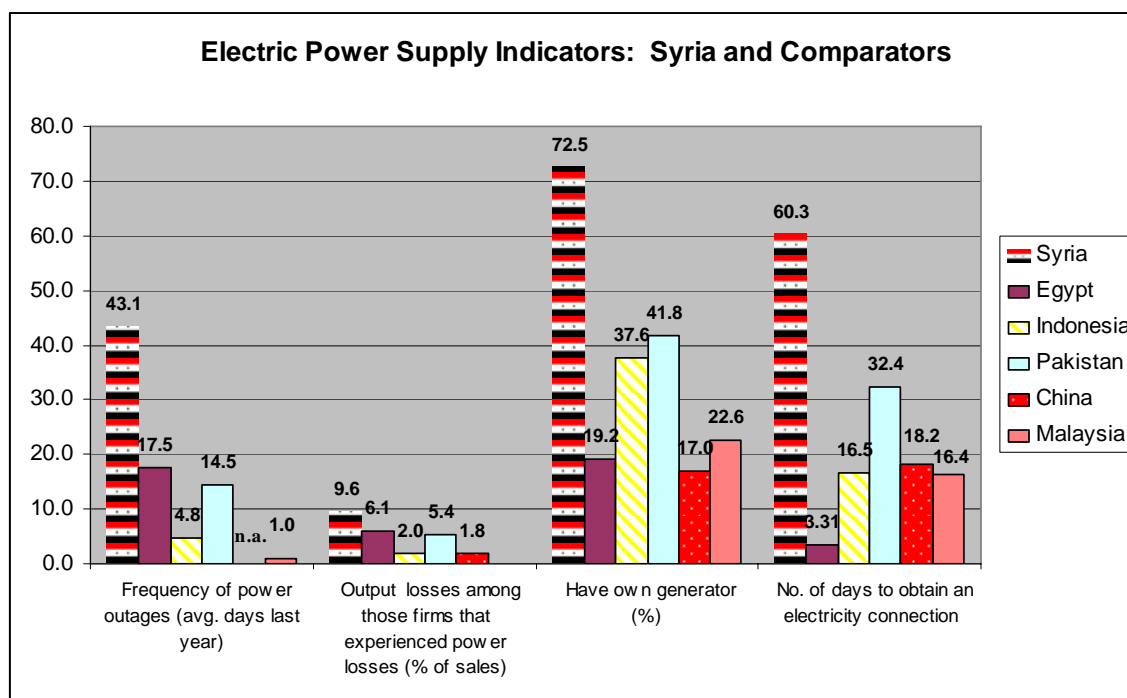
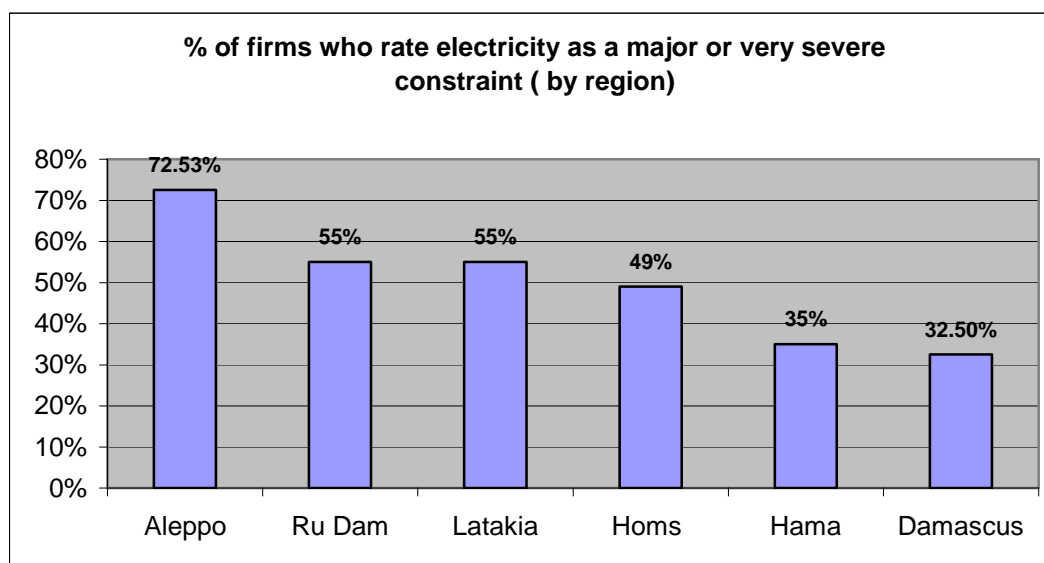


Figure 4.9: Percent of Firms that Rate Electricity as a Major or very Severe Constraint (by region)



113. The quality of these monopoly and predominantly state services varies between services, with electricity supply standing out as the most problematic. First, access to electricity is reportedly slow, taking an average of 60 days (Figure 4.8), which means yet another delay in starting a new business, hence a deterrent to entry. Once businesses are connected, many report their power supply to be unreliable. Electric power supply was rated by 58 percent of businesses as a major or severe constraint. Medium-sized firms are somewhat more constrained than either small or large firms. Firms report an average of 43 days of power outages per year, resulting in a loss of sales of nearly 10%. This is a major cost to Syrian businesses. The problem is particularly acute in the industrial heartland of Aleppo (see Figure 4.9). It is much less constraining to firms in Damascus.

114. To compensate for power supply weaknesses, a majority of industrial firms surveyed own generators. Fully 72% of responding enterprises reported owning a generator. While the incentive for generator use may be increase in Syria by the diesel fuel subsidy, for so many firms to make this investment suggests pervasive problems with reliability. Consistent with the considerable scale economies involved in generator use, small firms are less likely to own generators than large firms (Table 4.5).

Table 4.5	Small	Medium	Large
Have own generator (%)	69.0	85.2	96.0

Table 4.6: Regional Telecommunications Indicators

Country	Main tel. lines per 100 inhab.		Mobile lines per 100 inhab.		Payphones per 10000 inhab.		Internet subscribers per 10000 inhab.	
	2003	Ranking	2003	Ranking	2003	Ranking	2003	Ranking
Algeria	6.93	8	4.53	8	0.06	7	160	8
Libya	13.56	2	2.30	9	N/A	N/A	289	6
Morocco	4.05	9	24.44	1	3.02	3	265	7
Tunisia	11.77	5	19.72	4	3.33	2	637	3
Egypt	12.73	3	8.20	5	0.71	4	393	5
Jordan	11.36	6	23.54	2	0	8	833	2
Lebanon	19.88	1	23.43	3	0.25	5	1171	1
Syria	12.59	4	6.52	7	0.16	6	129	9
West Bank and Gaza	8.73	7	7.73	6	6.22	1	400	4
Europe	41	-	55.4	-	-	-	2373	-
World	18.76	-	21.91	-	-	-	1107	-

Sources: EMC, ITU, Arab Advisors, World Bank

115. While most Syrian businesses do not rate **telecommunications** as a significant problem, regional indicators suggest, and international investors stated in interviews, that services need substantial improvement. International indicators suggest that while Syria has an average number of fixed-line telephones for the region, it is far behind in mobile phones and dead last among measured countries in internet connections (Table 4.6). For example, a foreign investor focus group interviewed for the ICA reported that Syria essentially has no websites to contact, and no electronic procurement. The recently completed World Bank trade facilitation study highlights weak telecommunications as an important driver of logistic costs.

Table 4.7: Telecommunications Statistics (Syria)

Operator	12/99	12/2000	12/2001	12/2002	12/2003
Global Density (Fixed + Mobile subs. per 100 inhab)	9.95	11.34	11.36	14.68	19.11
Spacetel Syria	2,400	9,000	103,000	195,000	540,000
Syriatel	2,000	10,500	93,250	215,000	600,000
Total Mobile Subscribers	4,400	19,500	196,250	410,000	1,140,000
Total Mobile density (per 100 inhab.)	0.02	0.18	0.61	2.36	6.52
Fixed Subscribers	1,600,355	1,819,000	1,808,000	2,099,300	2,200,000
Fixed density (per 100 inhab.)	9.93	11.16	10.75	12.32	12.59
Public Payphones	1,377	2,549	2,844	2,844	2,844
Public Payphones density (per 1000 inhab.)	0.09	0.16	0.17	0.17	0.16
Internet subscribers	4,000	10,000	60,000	90,000	110,000
Internet subscriber density (per 1000 inhab.)	2.48	6.13	35.67	52.82	62.93

116. Even in mainline telephone service, indicators suggest that service leaves much to be desired. There is a long waiting list for telephones and firms often signed up years in advance of their anticipated need for an extra line. Furthermore, the rate of telephone faults, at 50 per 100 mainlines, stand out as one of the highest in the region.

Figure 4.10: Telecom Indicators, Syria and Comparators

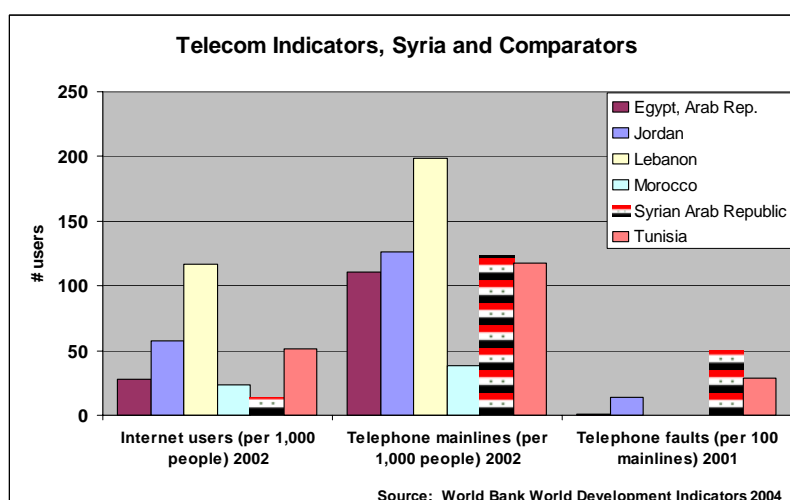
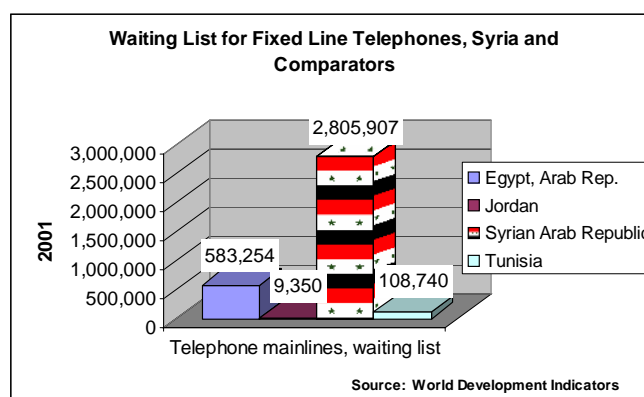


Figure 4.11: Waiting List for Fixed Line Telephones, Syria and Comparators



117. In **water**, which is a major long term development challenge for the country, a high number of industries - 38% report they have their own wells. However, 75% of large firms report owning wells and 53% of medium-sized firms, indicate that firms must invest substantially in self-provision of water. Perhaps as a consequence, water is not rated as a problem, unless it is the exercise of obtaining a connection. While large firms get their water connection in less than 12 days, medium-sized firms report waiting an average of over 90 days and small firms more than 70 days.

Table 4.8	Syria	Aleppo	Damascus	Hama	Homs	Lattakia	RuDam
Have own well (%)	38.7	37.1	21.4	42.5	37.3	42.5	50.0

118. Syrian firms do not identify **transport** as a leading problem, except for the small sub-sample of foreign firms – of whom 43% identified this as a major or very severe constraint. In fact, the recent World Bank study of trade facilitation and logistics suggests that “the basic transportation infrastructure continues to be operated by public monopolies” that yield both prices and levels of service less competitive. For example, at Syria’s ports, infrastructure is weak and technology is outdated -- there are

no ship-to-shore container gantry cranes in Syria.⁶⁷ The consequence is that Syria is not on the main trading routes and does not get as much benefit from proximity to the EU market as it should.

119. Internationally, the key means by which countries have strengthened infrastructure performance is to introduce sector reform that allows for competitive forces to be brought into play.⁶⁸ This has primarily been achieved through the engagement in the private sector in management of state-owned provision and/or direct service provision. Given the intention of the Syrian government to continue state ownership, there are still a variety of options that can strengthen management, improve incentives and bring private sector capacities to bear in improving services.

Technology

120. Syria's weak technological performance is both a symptom of weak competition and market dynamism, and a contributor to weak competitiveness. In a world where innovation becomes ever more important with shorter product life cycles, rising research and development, ease of outsourcing and off-shoring (making services tradable), reduced logistics costs and greater international production networking, technological capability is a key element of global integration. Indeed, globally, the most rapid manufactured export growth in recent decades has occurred in goods with higher technological content. Technological innovation is an important determinant of industrial productivity (hence competitiveness).⁶⁹

121. Yet the available indicators for Syrian firms suggest a low level of technological sophistication. In work by UNIDO (Figure 4.12), Syria appears to be far behind in its ranking of the technological structure of manufactured exports. Syria ranks 87th out of 88 countries in terms of technological sophistication of manufactured exports, and 75th out of 88 in UNIDO's index of competitive industrial performance.⁷⁰ The survey provides some indication of this. For example, the percentage of workforce that uses a computer is quite low. Parallel surveys suggest that 11% of workers in Syria use computers in their job, vs. 12% in Morocco, 27% in Oman and 33% in China. In the general population, 2002 data suggests that in Syria,

Figure 4.12: Ranking of Technological Structure

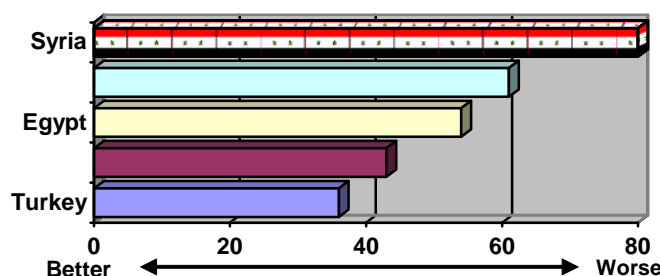


Figure 1.7. A higher number implies a lower ranking.
Source: UNIDO *Industrial Development Report*, 2002/2003

⁶⁷ "The performance at the ports of Latakia and Tartous combined with the added costs introduced by Shipco have discouraged shipping lines from upgrading services" World Bank, *Syria: Integrating with Global Markets – Trade Competitiveness and Logistics Assessment*. (April, 2004)

⁶⁸ "The most successful method for improving port performance over the past quarter century has been the introduction of private-sector management." Ibid.

⁶⁹ For example, recent World Bank work suggests the following key areas for future economic growth in global trade -- integrated circuits, the internet, miniaturization, modularization, life sciences, energy and multimedia. (Post Industrial East Asian City, presentation by Shahid Yusuf, DECRG, January 2005). The recent flagship report on closing the gap in education and technology confirmed, within the context of the growing international knowledge economy, the "interaction between technology and skill is critical in determining growth, productivity and the distribution of earnings." (World Bank Latin American and Caribbean Studies *Closing the Gap in Education and Technology* Washington, 2002)

⁷⁰ UNIDO, *Industrial Development Report*, 2002/2003 (United Nations, 2002)

19 people in 1000 have internet connections, compared to 81 per 1000 people in Lebanon and 38 in Jordan.

122. ISO certification provides another benchmark. If Syria is to compete internationally, its goods must be proven to meet international standards. Just over seven percent of Syrian industries surveyed reported having ISO or other internationally-recognized certification for their goods, a low level compared to many other countries. Only large private firms have a high rate of certification. In other MENA countries the average level across firms is also low -- in Egypt and Morocco, this level is nine percent, in Oman eleven percent. Yet in Pakistan this level is seventeen percent, and in China over half the surveyed firms had ISO certification.

Table 4.9: Firms with ISO Certification

	Syria 2004	Small	Medium	Large	Domestic	Foreign	Exporter	Non Exporter
Firms with ISO certification (%)	7.4	4.0	16.5	41.7	7.2	14.3	14.0	2.3

123. Technological sophistication is of course partly a reflection of relevant national systems of education, research and development, as well as the protection of intellectual property rights and related policies that facilitate licensing and foreign investment involving proprietary technology. Certainly technology policy is wanting, starting with the protection of intellectual property rights (see Chapter 2), which by most accounts is virtually absent in Syria. Yet technological advance is driven in large part by competitive pressure, and facilitated in large part by international openness. For example, the WDR 2005 found that the strength of competition was strongly associated with firms' likelihood to introduce new products, upgrade existing product lines and adopt new technology. Chapter 3 will discuss this issue and shows how the forces of competition remain inhibited in Syria today.

CHAPTER 5. POLICY RECOMMENDATIONS FOR A STRATEGY TO COMPETE

“Governments influence the investment climate through the impact of their policies and behaviors on the costs, risks and barriers to competition facing firms. Creating a better investment climate requires government to tackle all three.” (WDR 2005)

124. Syria has tremendous growth potential. Blessed with fertile land, natural resources, strategic location, capable entrepreneurs, historical treasures and a relatively stable macro economy, there is an exceptional foundation on which to build. In the context of continued macro-stability (which is crucial to maintain), the key is to remove the impediments in the investment climate that prevent market activities from creating growth and employment for a growing population. Thus, reform efforts need to be focused on lowering the level and variation in the costs of doing business, while strengthening incentives for productivity, and further opening the economy.

Box 5.1: Lessons of Adjustment: The Need for a Critical Mass of Reforms

Since the mid-1990s, development experts have observed that certain reforms are complementary to each other, and that the desired economic benefits will not be realized unless a cluster of reforms are achieved either simultaneously or sequentially.¹ Thus, hoped-for efficiency gains or investment response may not be realized with one major reform unless additional supportive measures are taken, and other binding constraints relieved. In Syria, examples of this may include:

- a. The 1991 opening of industry to private and foreign investment was not accompanied by an opening of trade, so private industry arose to meet domestic need under substantial protection. The efficiency gains hoped for through private investment were not realized due to the constraints on competition, as evidenced by low industrial productivity.
- b. The recent and substantial lowering of tariffs has not yielded its full impact on trade and investment in part because non-tariff barriers remain substantial.
- c. The benefits of a lower corporate tax rate were reportedly mitigated by the absence of accompanying reforms in tax administration. This is because a company's allowable expenses and total tax bill remain largely at the discretion of tax agents.
- d. The impact of opening banking to private participation has been muted by the lack of simultaneous institutional, regulatory and structural changes in the banking sector.
- e. Substantial investments in electricity generation were not matched by simultaneous improvements in distribution, meaning that service, as experienced by firms, remained unreliable in many locations.

¹ “First, market assessments of the internal consistency and sustainability of policies greatly influence the size and speed of the response to forward-looking decisions such as private investment and saving. Second,... there appear to be close links between particular aspects of macroeconomic and structural reforms that are likely to be mutually supporting; hence the importance of a critical mass.” Erik C. Offerdal *The Response of Investment and Growth to Adjustment Policies* (IMF: Finance and Development, June 1996)

Recommendations for a Strategy to Compete

125. To unlock the potential of the Syrian economy, Syria thus needs to focus on further opening opportunity to private investment and competition, lowering the level and variation in the costs of doing business, and improving the policies and institutions underlying factor markets. Before launching an economic transition program, it is worthwhile to look at the lessons of reform success in other countries.⁷¹

⁷¹ See, for example, Kikeri et al. “Lessons of Successful Reform Efforts...” (World Bank: 2005)

These include:

- The importance of up-front coordination among the diverse institutions and actors within Government on a reform strategy. Building a common vision among key implementers of the reform strategy will improve outcomes.
- Prior consultation with affected parties, and especially the business community, to increase awareness, agreement and ownership of the strategy and to improve its quality with their suggestions.
- Establishment of a sequenced strategy with a clear timeline. The main steps in the strategy should be established up front, and Government should commit to the timing. It is also useful to establish clear indicators to measure when each measure has been implemented and had impact.
- Clear communication of the strategy and its components. Transparency is critical to avoiding misunderstandings and distortions regarding the strategy. Citizens, businesses and others should understand both the “what” and the “why” of the overall program and its major components.
- Periodically evaluate progress and revise the strategy. It is important to have timely information throughout the implementation process and its consequences, and to periodically take stock and adjust the strategy depending on how well different elements are working.
- Facilitate transition and protect the vulnerable. Clearly any fundamental economic change has winners and losers, at least in the short-term. Efforts should be made to smooth the transition and, especially, to protect the most vulnerable (for example, workers who may lose their jobs and their families), typically by enacting elements of a social safety net.
- Move forward on accompanying long-term policies and reforms. While a short-to-medium term strategy will focus on discrete actions placed in time, there remains an agenda of longer-term efforts that can be begun or maintained, such as:
 - Maintaining macro-economic stability and fiscal balance.
 - Comprehensive public administration reform
 - Judicial reform
 - Broader financial sector reform

126. While the ultimate elements of its strategy to unlock the potential of private-led growth are up to the Syrian Government to decide, the ICA analysis suggests a number of potential elements that merit priority attention. These include:

127. All of these reforms will need to be introduced in a sequenced strategy that is grounded in good information, prior consultation of affected parties, training of officials and professions involved, and clear communications with the public of the reform strategy and components.

128. Such a strategy could be periodically revisited, in consultation with the affected business community, involved public agencies, and representatives of broader civil society. It is important for this strategy to be introduced from the outset, with a clear timeline and measures of progress. A matrix is provided at the end of this chapter that suggests a possible ordering of reforms, identifies benefits and risks, and offers strategies to smooth implementation and reduce opposition. Needless to say, some types of important reforms, such as comprehensive public administration reform and rationalization, are long-term, comprehensive programs that should be pursued in parallel. The strategy described here focuses on relatively discrete steps towards a better investment climate. This does not reduce their importance as part of an overarching and long-term reform strategy.

OPENING NEW OPPORTUNITIES FOR PRIVATE SECTOR GROWTH AND INNOVATION

Deepening of trade liberalization

129. Consistent with the recent trade policy report, the recommendation of the ICA is to continue opening the economy to trade. Syria's GAFTA agreement and pending EU Association Agreement are highly encouraging. Deepening reform involves both a continued lowering and simplification of tariff barriers to trade, and the "tariffication" of nontariff barriers:

130. *...[A]bolition of non-trade barriers ...would make the GAFTA and [EU-Syria Association Agreement] agreements really effective. The trade pattern that would emerge is a strong increase of imports from Europe (including a large rise in investment goods) and a large increase in exports going to the GAFTA area.*

131. Under such policies, investment and private manufacturing are predicted by the study to rapidly expand. However, the trade policy report notes that liberalization must be accompanied by other reforms, including "improving the environment for domestic investment, the abolition of preferential access to finance for public enterprises or specific economic sectors, the development of trade-related services, the improvement of trade logistics, and opening the service sector to greater competition." The trade policy paper and accompanying trade logistics paper provide a more detailed blueprint of trade-related reforms. Much like the electric power sector, reform of ports and shipping to rationalize management and incentives and to benefit from private participation would provide complementary stimulus for opening of markets and enhanced exports.

132. Beyond this agenda, recent research on international experience with trade liberalization confirms that complementary reforms are essential to realizing growth following trade reform. Regulatory reform precedent or simultaneous to trade reform greatly enhances its impact. Without such mutually reinforcing policy changes, growth is not realized in heavily regulated economies because:

- resources are prevented from moving into the most productive sectors and to the most efficient firms within sectors" and
- "increased trade is more likely to occur in the wrong goods—i.e. goods where comparative advantage does not lie."⁷²

133. Thus progress on trade reform makes the removal of other economic distortions all the more urgent.

Removal of explicit and implicit preferences for state-owned enterprises

134. The World Bank's global work on state-owned enterprise (SOE) reform has identified five preconditions for success, which are to:

- (i) operate with hard budget constraints,
- (ii) implement governance that is independent from Government,
- (iii) be free to use key factor markets – labor and capital -- on the same basis as the private sector,
- (iv) establish viability from both a cost and price perspective, and
- (v) compete with the private sector.

⁷²Bineswaree Bolaky and Caroline Freund *Trade, Regulations, and Growth* (World Bank: Policy Working Paper Series 3255, March 2004). See also Roberto Zaghera et al, *Economic Growth in the 1990s – Learning from a Decade of Reforms*, World Bank 2005, which states, "Without realistic exchange rates, macroeconomic stability, infrastructure investment, the development of human capital and institutions which promote enforcement of contracts, actual gains from trade reform may fall far short of expectations."

135. Syrian SOEs are far from meeting these preconditions. The Syrian government has already served notice on many state-owned enterprises that their days of monopoly protection are over. This reform now needs to be extended, to remove remaining SOE monopoly protections and exclusive trade privileges, and open the economy more fully to private investment, with a very few exceptions for reasons of national security. Subsidies should be made transparent and budgets hardened, with a phasing out of budgetary support. Opening entry to the private sector and opening SOE procurement and sales to private competition will increase economic efficiency both overall and within the public sector. It will greatly expand the scope for competitive incentives, which induce firms (public or private) to reduce costs and innovate.

136. Allowing independent and separate SOE operation with private competition may well be the way forward. Such arrangements need not be constructed as privatizations but as capitalizations, whereby the Government does not sell shares but invites the private sector to subscribe for new capital. In Jordan where the Government has retained stakes in some of its large industrial enterprises it partially privatized, the residual stakes have become very valuable.

Box 5.2: Lessons of Transition: A critical mass of dynamic enterprises

For transition economies in Eastern Europe, moving from an economy dominated by large, state-owned enterprises to private and predominantly smaller enterprises was not always a smooth process. Simply having a small number of highly productive small enterprises is not enough. New enterprises have to grow into active economic competitors for resources with SOEs before they can rapidly generate growth and employment: “In many CIS countries where growth remained low until the end of the decade, the share of employment in small enterprises hovered around 20 percent. In fast-growing Central Europe, in contrast, that share reached 50 percent.” There appears to be a threshold—of around 40 percent for the shares of private small enterprises in employment and value added—below which economies do not take off in terms of growth.

Source: Pradeep K. Mitra and Marcelo Selowsky *Lessons from a Decade of Transition in Eastern Europe and the former Soviet Union* Finance and Development (June 2002, Volume 39, Number 2)

137. Clearly, one potential impact of these reforms will be to force some SOEs to reduce or change the composition of their workforce. In this regard, the prior implementation of provisions to mitigate the social consequences of labor force adjustment is vital. A severance system should be designed to ensure a reasonable incentive for workers to leave public employment. And some social insurance measures – unemployment benefits and retraining and reemployment assistance, are central to assuring flexibility of the labor force.

Removing administrative and regulatory barriers to entry

138. In order to encourage business entry and competition, Syria should continuously work to remove barriers from administrative and regulatory sources. Within business registration, a good first step would be to eliminate the minimum capital requirement, which imposes an expensive cost at entry. Syria’s level of minimum capital is extremely high, but it is important to note that the World Bank Group’s international data suggests that minimum capital requirements are ineffective at their primary objective -- protecting creditors against insolvency.⁷³ Clearly, government should specifically target reducing

⁷³ Background research to Doing Business 2004 showed no relationship between minimum capital requirements and their objective – protection of creditors. The report observed, “If capital requirements were commensurate with risks of creditors, shouldn’t they differ across sectors? When in-kind contributions become acceptable, as they are

barriers for business entry including:

- the steps and time required for business registration
- the delay in licensing approvals
- the delays in land use and building approvals.
- the waiting time for infrastructure services

139. Some of these can be achieved by streamlining the underlying bureaucratic processes, others may require more fundamental reform of the underlying agencies involved. For example, in infrastructure, this perhaps can only be addressed by fundamental reforms within each service sector, as is recommended elsewhere in this report, beginning with electricity.

140. In addition, the ICA advises the government to review the whole set of administrative hurdles to launching and operating an enterprise or new investment. The FIAS administrative barriers to investment study provides a useful framework for such a review. Updating the preliminary FIAS work would be helpful in guiding the next round of reforms.

REDUCING TRANSACTIONS COSTS AND IMPROVING PREDICTABILITY

Reform tax rates, administration and inspections to rationalize incentives

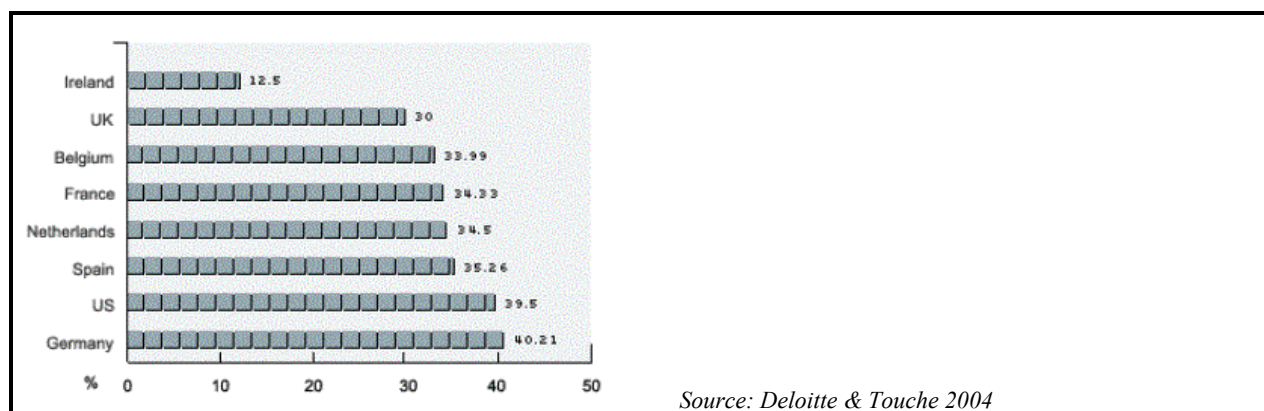
141. The principle for an efficient tax system that encourages investment is low rates, few exceptions, and broad investment incentives available automatically and equally to all. The principle for efficient administration is to sharply reduce opportunities for discretion, apply a standard formula to inspections and audits, and impose a framework to guide tax administration and clarify the rules for taxpayers. The role of the tax authority should evolve into a body dedicated to facilitating tax compliance, thus reducing the sometimes collusive and often antagonistic gamesmanship between taxpayers and tax agents.

142. In service of these objectives, the ICA supports three measures to reform taxation. **First**, with careful preparation and sufficient publicity, the government should completely phase out tax holidays and existing exemptions and any special treatment. This system should be replaced, in a revenue neutral manner, with lower universal rates and uniform investment incentives, such as accelerated depreciation or an investment tax credit. This would reduce economic distortions, while encouraging broad-based investment and efficient economic growth. It takes government out of the business of deciding which investments are beneficial to the economy on a case-by-case basis, and increases the ability of private investors to respond to the new incentives created by trade liberalization.

Box 5.3: The Irish Corporate Tax System

Ireland's corporate tax system is considered one of the most straightforward and friendly to investment. Ireland imposes a standard tax on corporate income from trading of 12.5%, perhaps the lowest in any high income country (see graphic). On qualified manufacturing firms, the rate is 10%. For passive income (interest and dividends) a 25% rate applies. To encourage investment, there is a capital allowance ("write-down") of 12.5% per year allowed on plant machinery and vehicles and 4% on industrial buildings and hotels. In addition, firms selling goods with a turnover of greater than €51,000 and service firms with a turnover of greater than €25,500 are subject to a VAT of 21% on many goods, and 13.5% on others. Exports and financial, insurance, educational, training, medical, optical, and dental and passenger transport services are VAT exempt.

in almost all countries, what is the actual value of minimum capital in the event of insolvency?" Doing Business 2004. (Washington: World Bank, 2003) p. 26.



143. **Second**, Syria should enact a Tax Procedures Act to regulate the administration of taxes to improve the consistency, transparency and accountability of tax administration. Such an act would establish clear procedures for enforcement, which currently is subject to substantial uncertainty and discretion. It would establish clear rules under which tax officials would operate, both for assessing and collecting taxes and for subsequent inspection and auditing. It would clearly define the rights and responsibilities of both taxpayers and tax officials. It would also clearly define key concepts in the tax code.⁷⁴ It should also create a clear system of accountability for tax officials, including meaningful checks and clear penalties for malfeasance. This should be counterbalanced by merit-based incentives for good performance. In drafting such an act, the Government can clearly benefit from EU and IMF expertise and technical assistance. Clearly, the affected business community and accounting profession should be consulted. Officials must be trained and the public educated to facilitate compliance on both sides.

144. **Third**, Syria should reduce the discretion and increase the fairness of tax inspections by adopting a system of risk-weighted, randomized inspections and audits. Currently, inspections are carried out arbitrarily, without regard to either the cost imposed on firms or the revenue likely accrued to the state. In this model, firms are randomly selected for inspection according to a probability influenced by their characteristics, in particular, the risk of evasion within their sectoral and size type and the potential for loss of revenue. This approach can be used to sharply reduce the number of inspections and audits, while increasing the probability of discovering fraud and error, thus increasing public revenue. May permit petty evasion. In discussions with EU experts, it became clear both its experts and those of the IMF can assist in such efforts to strengthen and modernize tax administration.

145. In addition, Syria should improve customs administration to increase efficiency, speed processing and reduce uncertainty, by streamlining procedures, improving management of and incentives to customs officers, and computerizing the entry of customs data. It should move towards a “single-document” and “single window” system.⁷⁵ This would be one key part of a broader approach to facilitating trade, including other regulation, port efficiency, and e-business approaches, all of which could contribute to export growth.

146. **Finally**, Syria could rationalize the enterprise inspection regime government-wide, introducing administrative procedural controls on non-tax inspections as well. This could be done by establishing some clear rules governing inspections either by decree or law. These rules would specify the permitted

⁷⁴ One tax expert pointed out that even such fundamental terms as “turnover” are not defined in law.

⁷⁵ See World Bank. *Syria --Integrating with Global Markets: Trade Competitiveness and Logistics Assessment* (June 2004, mimeo)

frequency of inspection, purpose of inspections, inspection procedures, and the rights and responsibilities of inspectors and the inspected enterprises. Such controls would reduce discretion and improve regulatory enforcement. For businesses, it would reduce operating costs and enhance predictability, since enforcement would more closely coincide with the written rules for all enterprises. Inspection reform sends investors a strong signal and a visible signal of Government's commitment to change. To prepare for this work, it is suggested that a careful inventory of current inspections and the rules and procedures governing them is developed, led by an inter-ministerial task force. This could be linked to broader work on administrative barriers and begin to build capacity for more institutionalized and continuous regulatory reform. The World Bank and FIAS can provide successful models from other countries. As with other reforms, it is important to clearly communicate its provisions, purpose and benefits of reform to agency officials, businesses and the public. This should be further supported by longer term approaches towards civil service and public administrative reform, and towards rationalization of the regulatory process.

Box 5.4: Gains from Improving Trade Facilitation

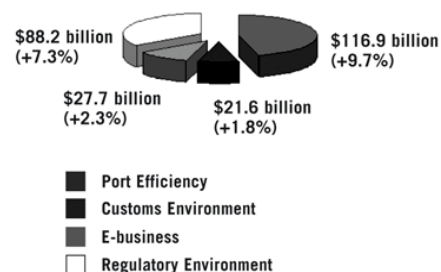
Recent World Bank research has suggested that trade facilitation reform, as a complement to trade liberalization, brings enormous rewards. The study models countries that are members of the Asia Pacific Economic Cooperation (APEC), measuring their performance in four dimensions: 1) port efficiency; 2) customs environment; 3) regulatory environment; and 4) e-business usage. It suggests huge gains to improving trade facilitation in those countries that are below average. For APEC as a whole, it is estimated that a program to raise capacity "half-way" to the APEC average in all four dimensions among those countries below average would yield an increase in intra-APEC trade of about \$254 billion dollars. average for APEC countries. This is about a 21 percent rise in total intra-APEC manufactures trade. About \$117 billion of the gain (and 10 percent of the increase in trade) comes from the improvement in port efficiency.

About \$139 billion of the total gain comes from the improvements "at the border" in port efficiency and customs environment. An additional \$116 billion gain might come from improvements "inside the border" in regulatory harmonization and e-business usage.

Source: John S. Wilson *Trade Facilitation, WTO Rules, and Capacity Building: What's at Stake?* (World Bank Institute Development Outreach, July 2003)

OVERVIEW OF SIMULATION

BRING BELOW-AVERAGE COUNTRIES
HALF-WAY UP TO THE GLOBAL AVERAGE



Source: Wilson, Mann, Otsuki 2003

Strengthen factor markets

147. Improvements in the performance of individual factor markets together contribute to overall productivity gains. Keys options include:

Labor market measures to improve flexibility and skills. The ICA points to inflexibility in laying off workers as a substantial impediment affecting Syrian firms' ability to adjust to new incentives created by trade liberalization. In fact, far from protecting workers, excessive labor regulation in fact suppresses formal employment and encourages informal employment that can marginalize vulnerable workers.⁷⁶ Syria should move to reduce rigidities in laying off workers for business or economic reasons, allowing employers to make decisions without prior third party approval. This would help to increase labor market efficiency and encourages labor mobility to higher value sectors. At the same time, measures should be taken to reduce the social costs of inevitable dislocations involved in labor market adjustments and overall economic reforms. In this regard,

⁷⁶ World Bank. *Doing Business in 2004: Understanding Regulation* (Washington, World Bank, 2003)

Syria should work to strengthen the social safety net for the unemployed (for public sector employees through severance packages, for all employees through social insurance) and to adopt training policies that facilitate worker retraining and encourage employers to invest in it.

148. **Improving worker skills** is in part, a long term program that involves the whole educational system. For both technology and training-based improvements in firm capabilities, the education of the workforce is centrally important to the ability of firms to make use of new technology, adopt improved management and quality control, and reap the benefits of training. However, in the shorter-term, Syria must find ways to develop the private market for training that is responsive to enterprise demand, if it wants to develop a system that contributes to growth.

Box 5.5: Labor Reform and Infrastructure Reform: Aligning Objectives

Labor reform is a key component of infrastructure reform as their objectives are often aligned, with a major emphasis on efficiency improvements. Although the introduction of private participation in infrastructure has resulted in **labor cuts**, many of them are derived from other factors, such as technological change or competition. Some sectors have benefited from increased dynamism and have expanded their workforce, and private participation can also bring substantial benefits to workers, through higher pay, and job creation resulting from expansion. Any labor reform should start with a **careful analysis** of existing and future staffing requirements, as early as possible in the process. Governments need to carry out some **restructuring** and cannot leave reforms to the private operator. Because such reforms may be costly and difficult, private operators may be reluctant to take on labor liabilities and are not well-placed to consider the social impact of reform and establish an appropriate safety net.

Labor reform programs should comprise of a mix of options, with “soft options” such as the enforcement of existing workplace regulation or internal restructuring and “harder” measures, such as early retirement and voluntary departures. Soft options are seldom sufficient, especially when there is over-staffing and difficult labor relations. The design and implementation of **severance payments** is one of the most challenging areas. Recommendations are given on defining severance levels, targeting inefficient areas in the program, avoiding “adverse selection” and financing. **“Active” labor market programs**, providing retraining and alternative employment for severed workers, and can complement voluntary retirement schemes, although they have had mixed results and their cost-effectiveness should be carefully reviewed. The cost of past obligations or future commitments of an existing **pension scheme** are commonly among the most significant considerations in determining potential investors’ willingness to participate in a transaction. When possible, pension reforms should be framed in the context of broader pension reforms in the country.

Engaging with stakeholders, particularly employees and labor unions, is a critical factor for successful reforms and should be based on a thorough stakeholder analysis, to map stakeholders based on their influence and importance. Forms of engagement, ranging from communication to consultation, negotiation and cooperation, should be defined based on this analysis. **Monitoring** the impact of labor reforms is key to learning from previous experiences and to redesigning labor programs half way through, if scope for improvement is found.

Source: Excerpted from The World Bank and PPIAF, *Labor Issues in Infrastructure Reform: A Toolkit* (World Bank: 2004) <http://rru.worldbank.org/Toolkits/Labor/Download.aspx>

149. Training policy should be designed to facilitate firms’ investments in private training, rather than emphasizing public supply. If firms are insufficiently aware of the benefits of training or unable to finance it, some kind of tax incentive, such as a small training level refundable against private training expenses, may be appropriate.⁷⁷

⁷⁷ See Hong Tan (2002) “Do Training Levies Work? Malaysia’s HRDF and its Effects on Training and Firm-level Productivity”, World Bank Working Paper, Washington D.C. and Hong Tan and Geeta Batra (1995) “Enterprise Training in Developing Countries: Overview of Incidence, Determinants, and Productivity Outcomes”, Private Sector Development Department, Occasional Paper No. 9, Washington DC, World Bank.

150. The **financial sector** is undergoing a gradual transition from large, state-run banks designed to serve the state sector to a combination of smaller private banks and reoriented state banks. The ICA notes that both supply and demand factors are important. Clearly the current state of corporate governance and financial standards sharply constraint projects that even a competitive, well-regulated banking sector would finance. Thus the ICA encourages a public awareness initiative pursued through the accounting community, business associations (chambers), banks and the media that strengthens awareness of good corporate governance principles and benefits, and emphasizes the central role that good corporate governance plays in enhancing access to credit and equity finance.

151. While it is beyond the scope of this study to provide a complete diagnostic of the financial sector, continued encouragement of **private bank entry**, along with improved regulation, appear important to encourage competition and improved services to private enterprises. The **legal and judicial basis for collateral recovery** appears to merit further study and future strengthening, as collateral requirements now are very high and generally only immovable goods are accepted. And the establishment of a **credit bureau**, complying with global good practice principles, would clearly facilitate business credit, which is now impeded by the lack of reliable credit history information on potential borrowers. Good credit bureaus serve both banks and businesses, and provide positive and negative credit information. Care should be taken not to allow the credit bureau to become dominated by a few large banks, or it cannot serve as an equal and credible basis for expanded lending by newer banks.

152. The final recommendation on finance concerns the establishment of a legal basis for **lease financing**, which is generally regarded as a good alternative (or supplement) to traditional bank finance for capital goods, even in environments where traditional collateral enforcement can be difficult. A leasing law (as part of broader reforms to secured lending) can establish the framework for lease finance, in which the financier retains ownership of the equipment as collateral over the course of the lease.

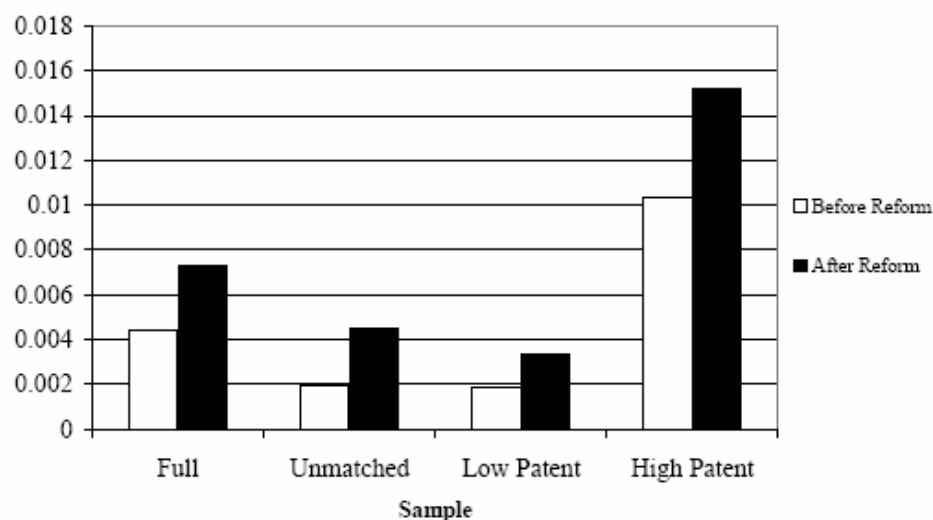
153. With regard to **technology**, the recent World Bank trade policy study concludes that the primary way Syria will access modern technology in the short term is “through imports of goods and services that incorporate the technology, as well as the transfer of knowledge that comes with foreign direct investment.” Aside from the general constraints to trade and foreign investment noted elsewhere in the assessment, the most obvious failing in this regard is the absence of adequate protection of intellectual property rights (IPRs) (box 5.x). This weakens incentives for innovation, licensing agreements and FID involving proprietary technology. The legal basis for IPR protection exists, but enforcement has been law. Therefore, Syria should review its legal framework for IPRs, to assure its completeness. It should work to strengthen enforcement, beginning with the training of law enforcement officials and judges and efforts to educate the public

Box 5.6: Protecting Intellectual Property Rights (IPR)

The view that IPR reform results in an increase in technology transfer among U.S. multinationals is strengthened by the fact that R&D spending by affiliates – traditionally viewed as a complement to technology imports from the parent – increases after IPR reform. Examination of international trends in patent applications also suggests that at least one component of the observable increase in licensing flows is associated with the introduction of new technology in the wake of patent reform. Both the level and rate of change of nonresident patenting increase in the post-reform period. Consistent with earlier work, the results indicate no corresponding reaction in resident patent filings. Interviews with practitioners confirm that the strength of the local IPR regime is one of the critical factors reviewed by U.S.-based multinationals in determining the scope and level of local affiliate operations. Collectively, our results provide evidence that improvements in IPR result in real increases in technology transfers by multinational enterprises.

Box Figure 1

Figure 1: Aggregate royalty payments/aggregate sales. The clear bars indicate the average annual aggregate royalty payment to sales ratio for various samples of affiliates in reforming countries before reforms occur. Averages are calculated as the mean of annual ratios in each country over all years in the pre-reform period. The shaded bars depict average ratios for the year of and years following reform. The first two bars are for the full sample, the next two for affiliates of parents that cannot be matched to the NBER patent database, the third pair of bars are for the sample of affiliates of parents that do not make extensive use of patents in the U.S., and the final pair are for affiliates in the high patent use sample.



154. **Infrastructure services** also demand priority attention, beginning on a pilot basis with **reform of the electric power sector**. The ICA survey results make it clear that reliability of electricity supply continues to impose a severe problem for industry (and other commercial establishments), in spite of substantial investments in generation. Planned investments in transmission and distribution should normally contribute to improved supplies. However, the current institutional set up has few incentives to improve service delivery and it is likely to be difficult to keep pace with growing demand without introducing more fundamental sectoral reforms. The Government has already recognized this in part by separating generation from transmission and distribution. Consideration should be given to separate policy making from operations. It is recommended to move towards corporatizing and commercializing the power sector, establishing a clear, autonomous management structure, hard budget constraints, and, if necessary a transparent subsidy system.. It may be advisable, as other countries have done, to further separate transmission from distribution. To ensure adequate funding to each corporate entity, government may also need to adjust tariffs and transfers.

155. Establishing commercially oriented corporations would help to improve accountability and efficiency of electricity service delivery. In parallel, it is recommended that Government should work to establish a regulatory framework and agency for the power sector that would govern these corporations and establish a basis for private participation in competitive market segments. It will be vital to draw from international experience in the design of this new regulatory structure, and to recruit and train strong and independent regulators. These steps would lay the groundwork for improving services, and to open opportunities for private participation in appropriate segments. Public education and efforts targeted at affected industries and electric sector employees will be important to marshalling support for these reforms. This type of reform may confront capacity limitations in implementation. All of these steps should be understood in the context of a long-term sectoral strategy to improve service delivery.

156. Once this approach is established in power, it could be extended to other infrastructural sectors. Much like the electric power sector, **reform of ports and shipping** to rationalize management and

incentives and to benefit from private participation would provide complementary stimulus for opening of markets and enhanced exports

157. It should be noted that Syria's one experience in opening up infrastructure to private provision has been somewhat successful. One reason why perceptions of Syria's telecommunication system are quite positive is because of the recent introduction of a private sector cellular operator which has led to a dramatic increase in telephone density. Liberalization of the telecommunication sector has generally been a success story wherever it has been undertaken in the world. Additional employment in the telecommunication sector in Jordan as a result of their liberalization exceeds 10,000 people (box 5.7). Liberalization of the education and financial sectors could have similar benefits. This argues for further opening up of this sector to additional entrants, and the potential replicability of this approach in competitive segments of other sectors, such as port services and shipping.

158. In preparing for liberalization of a sector, there are several prerequisites that need to be established:

- An effective regulatory capability to protect consumers from monopoly abuses;
- A capacity to manage and implement liberalization;
- SOE reform to maximize competition within the sector, e.g. separating electricity distribution from generation; and
- Cost-based pricing for services.

Box 5.7: Jordan - Engaging the Private Sector in Service Delivery

Jordan has actively engaged the private sector in many traditionally public services through its privatization program. Consumer benefits are being reaped from the privatization program and net employment has benefited as well.

- In telecom, competition came to Jordan's mobile telephone market through the sale of a 15 year cellular license to MobileCom. The Company launched commercial operations in September 2000 and built a network that achieves coverage for 98 percent of the population. MobileCom's arrival introduced competition to the Jordanian mobile telephone market and has contributed to unprecedented subscriber growth rates in Jordan. MobileCom expects to have approximately 700,000 subscribers by 2010.
- France Telecom took over the fixed line telephone service. The wait for a telephone line has been reduced from years to weeks, and phone rates, though still high according to international standards, have been reduced significantly.
- The Public Transport Corporation sale yielded a dramatic increase in bus frequency and ridership, which went from 60,000 to over 100,000. The fares have remained the same. Qualitatively, the buses are new, cleanly and less polluting. The commuting time for the average working person fell sharply, in some cases from two hours each way every day to under half an hour, allowing workers to seek jobs farther from home than they ever could before.
- Water supply in Jordan's cities was a very scarce commodity, delivered once or twice a week. Leakage and illegal connections left 55 percent of water usage unaccounted for. Broken meters and "private arrangements" resulted in inequitable access and cost sharing. Many households were forced to buy water from truck suppliers at much higher prices. Water is now flowing again on a more regular basis. Street flooding from water mains, once a common sight in Amman, is now less frequently seen.

Overall, Jordan's privatization authorities estimates that its privatization has generated revenues so far of nearly 12 percent of gross domestic product (GDP), created more than 10,000 jobs, and provided major benefits to consumers.

Sources: World Bank, IFC and Jordanian Executive Privatization Commission

159. The ICA notes the frustration of a number of investors with existing Syrian free zones (**industrial estates**). Given the need to improve their performance, the ICA recommends that the Government prepare for the competitive award of a private concession for management of its free zones (industrial estates) according to international practice principles. Private management and development can improve service quality and results accountability. At the same time, other elements of global best practice (box 5.8) should be introduced in the management of these zones. In preparation for this reform, government could commission a review of existing arrangements and reform possibilities based on lessons of global good practice. Clearly, this new arrangement will require careful training of relevant officials in such skills as contract tender evaluation and supervision.

Reform of Free Zones (Industrial Estates)

Box 5.8: Special Economic Zones

A recent FIAS review of international experience with special economic zones (SEZ's) found that around 80% of SEZ's globally are unsuccessful. It identified 6 factors that typically contribute to their failure, listed below:

1. Public sector development of zones

- Physical development is not phased; facilities are subsidized or over-designed facilities; public sector allocates poor locations away from business and urban centers (due to "growth pole" concept and political rationales), resulting in high public expenditures; government support is inconsistent.

2. Uncompetitive policies

- Lack of appropriate incentives for private zone development with an over-reliance on tax holidays; lack of incentives for private zone development and services; rigid eligibility requirements; poor labor policies and labor relations, suppression of unions; cumbersome legal and regulatory framework; competition on the basis of incentives rather than facilitation and services; lack of autonomy, flexibility and focus of zone authorities; poor backward and/or forward linkages with supplier companies and customers; and high levels of administrative barriers within the zones.

3. Bureaucratic procedures and controls

- Complex investment approval procedure; cumbersome customs procedures; and excessive Monitoring and reporting requirements.

4. Market access

- Lack of preferential access to regional and global markets; small market size.

5. Inadequate institutional structure

- Too many agencies involved in regulation; lack of authority and funding in key regulatory body.

6. Lack of an integrated development approach

- Failure to provide off-site infrastructure; lack of public-private partnerships; poor backward and forward linkages with supplier companies and customers in national and international economy; failure to use existing infrastructural facilities; mismatched regulatory authority capabilities and requirements; low net exports due to low local value-added.

Conversely, the zones that succeeded were found to have 9 key features:

1. Clear zone designation and development criteria
2. Public-private partnership approaches for zone development
3. Top-level, integrated support of government (e.g. Jordan, UAE)
4. Streamlined legal and regulatory framework
5. Competition on the basis of facilitation and services rather than incentives
6. Zone authority is autonomous, flexible, and focused on regulation
7. Minimization of public expenditures by locating zones carefully/use existing facilities
8. Largely private sector-led; lead role for one developer
9. Regulatory authority capabilities are built-up over time.

Source: Gokhan Akinci: "Special economic zones" (Washington: FIAS, 2005)

Additional Studies

160. Along with the identified reform actions, there is an agenda of follow-up analytical work required to inform policymakers about the details of needed reforms and their sequencing. These studies could include:

- a) A detailed look at actual tax incidence and incentives, including the incidence of smaller fees and taxes (e.g. the “stamp tax”) with recommendations for more effective ways of achieving policy and financing objectives.
- b) A detailed update review of administrative barriers to investment and operation, with specific recommendations for streamlining procedures and improving administration.
- c) An in-depth study of the electric power sector, including the recommended route for restructuring and corporatization, the regulatory framework, etc.
- d) A sectoral study of the banking sector, its development and regulation as relates to private enterprise finance, and the potential for development of non-loan financial instruments.⁷⁸

161. The World Bank Group can assist government in identifying resources in support of those reforms it decides to adopt, either through direct work or by reference to the many development partners such as the EU (and SEBC), IMF and PEP-MENA with capacity to assist.

⁷⁸ In mid-2004, the Ministry of Finance commissioned a consulting firm to conduct a study on the reform and restructuring of the domestic banking sector. The outcome of this study is not known.

Action Plan for Investment Climate Policy

Timing	Actions	Main benefits & costs	Pre-requisites and risk mitigation
2 months after adoption of the plan	Announce publicly Plan for Investment Climate Reform at major national/ international event. Conduct public awareness campaign. Establish clear targets and monitoring mechanism	Clearly establishes coherent vision for improving key conditions of investment climate to encourage growth and employment. Risk of negative reaction of affected interests benefiting from status quo.	Clearly establish political commitment to reform in key ministries. Ensure inter-ministerial coordination. Clear explanation to business community and public of plan design and rationale based on consultation, public information, and consensus formation. Informed by Five Year Plan, SPC and MoET work, ICA, WB Trade Policy and Trade facilitation studies, EU/SEBC Accession studies, UNIDO studies, etc.
3 months	Eliminate minimum capital requirements for enterprise registration	Reduces financial needs for formal business start up and encourages formality. Potential perception that it increases risk of fraud.	First step in reform of business registration. Educate business, financial community as to benefits and international experience.
	Establish the legal basis for lease financing	Provides legal basis for new source of nonblank financing with self-enforcing characteristics.	Effort to consult and educate business and financial (e.g. commercial banking) communities and legal community on provisions of the new law.
	Rationalize enterprise inspection regime, with clear regulation of frequency of inspection, permitted purpose of inspections, inspection procedures, and the rights and responsibilities of inspectors and the inspected enterprises.	Reduces operating costs and enhances predictability for all enterprises. Reduces opportunities for discretion. Strong signal of Government's commitment to reform. Likely resistance of some agencies conducting inspections. Possible public perception of laxity towards business.	Base system on inventory of inspection regime followed up by inter-ministerial review of inspections. Link to broader work on administrative barriers and regulatory reform. Look to successful models in other countries. Clearly communicate provisions, purpose and benefits of reform to agency officials, businesses and the public.
6 months	Adopt new company law and ensure that related legislation is reviewed and modernized as needed for a complete commercial law framework.	Encourages investment and trade by completing the legal framework for modern market economy, corporations, financing and business transactions. Builds basis for better corporate governance.	Consult international best practice and make appropriate adaptations for Syrian legal traditions, institutions. Carefully consult business and legal communities, then educate broadly on final provisions.
	Establish legal basis for arbitration and mediation mechanisms for commercial dispute resolution managed by business organizations	Institutionalizes existing arbitration services and new ones, currently not recognized by courts. Reduces cost of/delays in business conflict resolution, hence contracting, encourages FDI. Potential for judicial resistance if seen as threatening prerogatives.	Carefully consult regional and successful international experience (e.g. Egypt) for good models. Consult business and legal communities on design and implementation.

Timing	Actions	Main benefits & costs	Pre-requisites and risk mitigation
	Review and streamline business registration and licensing procedures	Encourages business entry, increased dynamism and job growth. Potential resistance from agencies administering current system, or incumbents threatened by new entry.	Commission study of administrative barriers to investment and design of streamlined system for and reducing costs of registration and licensing, while protecting public health, safety and the environment. Consult business community on design of new procedures.
	Continue electric power sector restructuring by separating generation, transmission and distribution in preparation for corporatization.	Lays groundwork for improving services, establishing regulatory framework, and eventual public-private partnerships in service delivery. Increases transparency of costs, subsidies and operating efficiency.	Consult international good practice. Educate industry users, public and sector employees and officials on intentions and impact of sectoral reform. Declare medium term sectoral strategy and timing of subsequent steps.
9 months	Issue private concession for management of free zones (industrial estates) according to international practice principles.	Encourages job creation through new investments and expansion of existing businesses. May improve service quality and results accountability. Presents some challenges of concession tender, supervision.	Commission review of existing arrangements and reform possibilities based on lessons of global good practice to design concessions. Carefully train relevant officials in contract tender evaluation and supervision.
	Implementation of trade action plan, including the removal or tariffication of non-tariff barriers, simplification of tariff structure, and continued lowering of tariff barriers.	Increases potential gains to consumers and businesses of trade agreements. Reduces economic distortions and bureaucratic discretion. Will reduce protection of some industries, forcing them to become more competitive. Will require some economic adjustments.	Carefully educate public and business community of benefits of trade, including consumer benefits of access to less expensive goods. Consult affected parties and seek means to mitigate impact on or partly compensate those harmed without compromising simplified system.
	Introduce new law on intellectual property rights protection	Creates stronger incentive for innovation, licensing agreements and FDI involving proprietary technology. Potential resistance from producers and consumers who benefit from patent, copyright and trademark violations.	Train judiciary and law enforcement on provisions of law and educate public on its value. Consult affected members of private sector.
	Establish credit bureau through public-private partnership	Creates basis for expanded commercial lending, trade credit and new financial instruments. Increases importance of responsible borrowing. Potential resistance from those interested in secrecy.	Draw on design principles of international good practice. Carefully consult business and financial communities in design. Credit bureau should serve both banks and businesses, and provide both positive and negative credit information. Limit control by large banks.

Timing	Actions	Main benefits & costs	Pre-requisites and risk mitigation
	Establish severance payment system for SOE employees. Consider options for establishment of unemployment mitigation measures for private sector.	Mitigates risks of social consequences from economic transition to a market-based economy and reduces resistance to economically valuable reforms. Increases labor mobility and flexibility. Potential objection of Finance to short-term costs.	Develop detailed financial plan with experts and calculate potential costs and benefits. Educate labor and private leaders as to advantages of economic adjustment. Also, risks of long-term unemployment can be mitigated by new training policies in accordance with international principles of good practice.
12 months	Enact Tax Procedures Act, regulating administration of taxes.	Establishes clear procedures for enforcement. Rights and responsibilities of payers and assessors/collectors of taxes. Establishes clear definitions and rules for tax assessment and auditing, accountability for tax officials. May encounter opposition from those benefiting from current system.	Benefit from EU and IMF expertise in preparing act. Carefully consult accounting and business community. Up-front training of officials and public education of taxpaying public will increase compliance. Take accompanying measures to make taxpaying easier, more transparent.
	Reduce discretion of tax officials by setting risk-weighted randomized system of inspection and audit.	Reduces number of inspections and audits, increases probability of discovering fraud, increases public revenue. May permit petty evasion.	Benefit from EU, IMF and other international expertise on tax inspection procedures. Consult accounting and business communities.
	Reduce rigidities in laying off workers for business or economic reasons.	Increases efficiency of labor use and encourages labor mobility to higher value sectors. Invites opposition of labor groups.	Educate public, workers on economic benefits, costs of existing system. Strengthen social safety net and training policies to facilitate worker adjustment and minimize social costs.
	Remove SOE monopolies and exclusive trade privileges, with exception of areas of national security.	Increases economic efficiency and expands scope for competitive incentive for cost reductions and innovation. Often encounters opposition from workers, management and related Ministries.	Educate public and workers on economic benefits. Assure transitional assistance to workers whose employment is affected.
	Corporatize each segment of the power sector and ensure adequate funding through government transfers or tariff adjustment. Establish a regulatory agency for the power sector	Lays groundwork for improving services, and private participation in appropriate segments. May confront capacity limitations in implementation.	Consult international good practice. Intensely train regulators and ensure independence. Continue to educate industry users, public and sectoral employees on intentions and impact of sectoral reform. Declare long term sectoral strategy and timing of subsequent steps.
	Create policy framework for private-led training. Re-allocate vocational training funds to appropriately structured business subsidies for worker training. Allow private entry.	Increases worker productivity and wages. Reorients training towards business needs, economic demand. Increases responsiveness of training to business demands. Potential transitional problems in supply of training.	Phase in approach. Allow public and private facilities to compete, coexist to minimize dislocation and transition costs.

Timing	Actions	Main benefits & costs	Pre-requisites and risk mitigation
	Streamline legal procedures for recovery of collateral	Increases security of loans, hence improves supply and terms of commercial lending. Requires implementation by judiciary and enforcement mechanism.	Increase judicial training and implement as part of longer-term strategy to strengthen judiciary.
	Investment Symposium to review progress of IC Action Plan and outline 2 nd year plan.	Allows stocktaking and midcourse correction, plus renewed impetus for 2 nd year actions. Danger of insufficient progress or information.	Present data on reform progress and impacts. Present 4 studies to better inform consultations: 1) tax incentives 2) administrative barriers to investment 3) corporate governance 4) infrastructure service delivery – sectoral reform.
18 months	Create an industry structure and regulatory agencies to allow private participation in competitive segments of other key infrastructure sectors, beginning with telecom and ports.	Lays groundwork for improving services and for public-private partnerships in service delivery Increases transparency of costs, subsidies and operating efficiency.	Consult international good practice. Educate industry users, public and sector employees and officials on intentions and impact of sectoral reform. Declare medium term sectoral strategy and timing of subsequent steps.
24 months to 36 months	Establish VAT	Increases automaticity of tax system and incentives for tax compliance. Diversifies government revenue and increases efficiency of revenue collection. Potential implementation problems.	Extensive upfront consultations and public education campaign. Train officials. Assure efficiency of rebate system. Can phase in beginning with larger businesses.
	Complete phase out of tax holidays and exemptions and any special treatment and replacement with lower universal rates and uniform investment incentives, such as accelerated depreciation over investment tax credit	Reduces economic distortions, encourages investment and efficient economic growth. Increases ability of economy to respond to trade liberalization. May encounter opposition from those benefiting from existing tax structure. Potential problems of implementation.	Conduct in revenue neutral manner. Honor existing benefits within original time bounds. Educate business community as to benefits in terms of lower rates, automatic incentives and increase equity of treatment. Train tax officials in new rules.

ANNEX 1: SYRIA AT A GLANCE

Syrian Arab Republic at a glance

9/29/04

	Syrian Arab Republic	M. East & North Africa	Lower-middle-income		
POVERTY and SOCIAL					
2003					
Population, mid-year (<i>millions</i>)	17.4	312	2,655		
GNI per capita (<i>Atlas method, US\$</i>)	1,160	2,210	1,480		
GNI (<i>Atlas method, US\$ billions</i>)	20.2	689	3,934		
Average annual growth, 1997-03					
Population (%)	2.4	1.9	0.9		
Labor force (%)	4.0	2.9	1.2		
Most recent estimate (latest year available, 1997-03)					
Poverty (% of population below national poverty line)	..	..	..
Urban population (% of total population)	50	58	50		
Life expectancy at birth (years)	70	69	69		
Infant mortality (<i>per 1,000 live births</i>)	23	44	32		
Child malnutrition (% of children under 5)	7	..	11		
Access to an improved water source (% of population)	80	88	81		
Illiteracy (% of population age 15+)	17	31	10		
Gross primary enrollment (% of school-age population)	112	96	112		
Male	115	100	113		
Female	108	92	111		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1983	1993	2002	2003	
GDP (<i>US\$ billions</i>)	17.6	13.7	20.0	21.5	
Gross domestic investment/GDP	25.3	26.0	22.6	23.6	
Exports of goods and services/GDP	13.5	27.9	43.1	40.2	
Gross domestic savings/GDP	11.7	12.9	32.5	30.9	
Gross national savings/GDP	14.6	10.5	30.2	29.1	
Current account balance/GDP	-12.2	-4.7	7.2	-2.2	
Interest payments/GDP	0.4	0.5	0.2	0.3	
Total debt/GDP	49.1	147.3	107.6	100.3	
Total debt service/exports	13.3	4.8	2.9	4.1	
Present value of debt/GDP	106.3	..	
Present value of debt/exports	237.0	..	
	1983-93	1993-03	2002	2003	2003-07
(<i>average annual growth</i>)					
GDP	3.5	3.1	3.2	2.5	3.9
GDP per capita	0.2	0.4	0.8	0.2	1.5
Exports of goods and services	11.6	12.4	2.1	5.8	-5.3

Development diamond*

Life expectancy

GNI per capita

Gross primary enrollment

Access to improved water source

Syrian Arab Republic

Lower-middle-income group

Economic ratios*

Trade

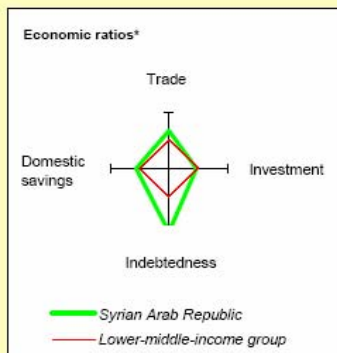
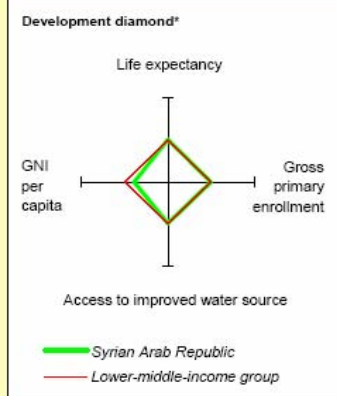
Domestic savings

Investment

Indebtedness

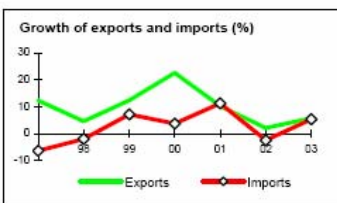
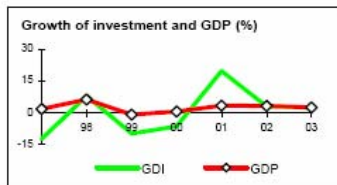
Syrian Arab Republic

Lower-middle-income group



STRUCTURE of the ECONOMY

	1983	1993	2002	2003
(% of GDP)				
Agriculture	21.2	29.0	23.5	23.5
Industry	22.7	18.1	29.3	28.6
Manufacturing	..	13.8	26.1	25.5
Services	56.2	52.9	47.1	48.0
Private consumption	66.3	73.5	56.3	58.5
General government consumption	22.0	13.6	11.2	10.7
Imports of goods and services	27.2	40.9	33.2	33.0
	1983-93	1993-03	2002	2003
(average annual growth)				
Agriculture	2.3	3.1	2.7	0.4
Industry	10.2	7.0	2.7	0.9
Manufacturing	..	7.9	2.7	0.9
Services	2.6	1.5	3.8	4.6
Private consumption	5.3	0.1	0.3	4.2
General government consumption	-2.6	-0.4	-0.2	3.9
Gross domestic investment	-3.3	-0.3	3.0	2.5
Imports of goods and services	2.0	4.7	-2.4	5.4



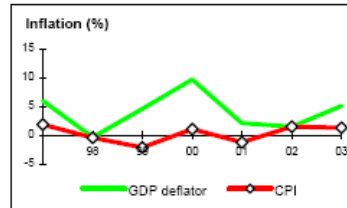
Note: 2003 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Syrian Arab Republic

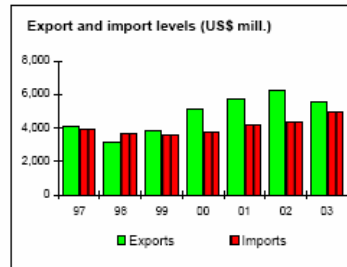
PRICES and GOVERNMENT FINANCE

	1983	1993	2002	2003
Domestic prices				
(% change)				
Consumer prices	6.1	13.2	1.5	1.3
Implicit GDP deflator	5.0	5.9	1.5	5.1
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	..	27.9	24.8
Current budget balance	..	9.0	9.6	9.2
Overall surplus/deficit	-9.0	-5.3	-3.2	-3.1



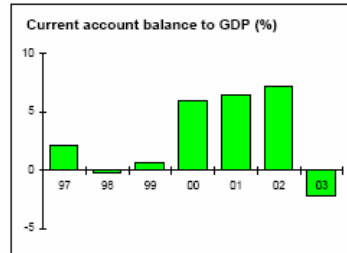
TRADE

	1983	1993	2002	2003
(US\$ millions)				
Total exports (fob)	1,920	3,150	6,297	5,593
Mineral fuels and lubricants	1,332	1,953	4,279	..
Food and live animals	..	..	982	..
Manufactures	..	..	241	263
Total imports (cif)	..	..	4,364	5,001
Food	..	..	664	..
Fuel and energy	1,357	115	167	..
Capital goods	..	..	2,271	2,369
Export price index (1995=100)	13	89	108	115
Import price index (1995=100)	13	89	111	115
Terms of trade (1995=100)	102	100	98	100



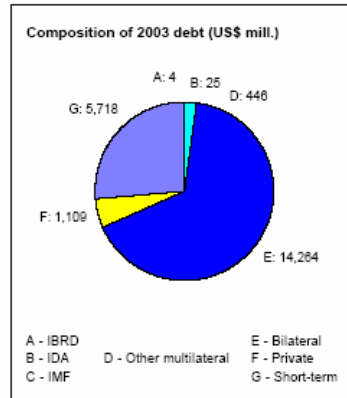
BALANCE of PAYMENTS

	1983	1993	2002	2003
(US\$ millions)				
Exports of goods and services	2,477	4,734	8,227	6,601
Imports of goods and services	4,878	4,741	6,341	6,956
Resource balance	-2,400	-7	1,886	-354
Net income	255	-632	-925	-610
Net current transfers	0	0	479	487
Current account balance	-2,146	-639	1,440	-477
Financing items (net)	2,000	1,202	433	931
Changes in net reserves	145	-563	-1,873	-453
Memo:				
Reserves including gold (US\$ millions)	..	..	3,968	4,450
Conversion rate (DEC, local/US\$)	4.2	30.2	50.1	50.1



EXTERNAL DEBT and RESOURCE FLOWS

	1983	1993	2002	2003
(US\$ millions)				
Total debt outstanding and disbursed	8,634	20,178	21,466	21,566
IBRD	287	419	11	4
IDA	47	44	27	25
Total debt service	384	247	258	320
IBRD	41	39	15	8
IDA	1	0	2	2
Composition of net resource flows				
Official grants	730	46	71	..
Official creditors	2,438	160	-108	-161
Private creditors	-7	-7	-1	-4
Foreign direct investment	0	109	225	..
Portfolio equity	0	0	0	..
World Bank program				
Commitments	0	0	0	0
Disbursements	53	0	0	0
Principal repayments	22	19	8	9
Net flows	32	-19	-8	-9
Interest payments	20	20	9	1
Net transfers	12	-39	-17	-10



ANNEX 2: SURVEY AND FOCUS GROUP METHODOLOGY

The Syrian Investment Climate Survey

1. The Syrian Investment Climate Survey was based on the core survey instrument (the PICS) of the World Bank with some minor modifications to suit Syria. The survey of enterprises is intended to determine the leading problems enterprises encounter in starting and operating a business—and, if the business fails, in exiting. The survey captures firms' experience in a range of areas—financing, governance, regulation, tax policy, labor relations, conflict resolution, infrastructure services, supplies and marketing, technology and training. These are areas where difficulties can add substantially to the costs or risks of doing business. The survey attempts to quantify the costs or constraints imposed on private enterprises by different aspects of the investment climate. Using a standard methodology, the assessment then compares the survey findings with those in similar countries to evaluate how the country's private sector is faring and how well it can compete. It also permits the identification of systematic differences in how costs and constraints are experienced by firms of different size, sectoral, ownership and locational characteristics. Finally, the survey uses basic financial questions about the firm as well as questions about the workforce to permit calculations of total and partial factor productivity, key measures of firm performance.

The findings of the survey, combined with relevant information from other sources, provide a practical basis for identifying the most important areas for reform aimed at improving the investment climate.

2. The Investment Climate Survey used a stratified random sample which encompassed 560 firms from the industrial sector in 6 locations (Mouhafadhats): Aleppo, Damascus Hama, Homs, Latakia, and Rural Damascus. It included a large number of SMEs and a small number of large private enterprises which, as noted in the text, are relatively rare in Syria. It significantly over-sampled exporters. Sectorally, the sample was composed mostly of manufacturing firms in diverse sectors, with the largest concentration in food processing, textiles and garments and leather. The sample frame was drawn within strata, using a statistically valid sample selection technique, from databases maintained by the Federation of the Chamber of Commerce and local Chambers of Industry. The Survey was conducted by the Damascus University Faculty of Economics and Commerce.

Table 1: ICA Survey Sample Structure

<i>Firm Size</i>		<i>Firm Activity</i>	
	<i>Sample</i>		<i>Sample</i>
Small <50	448	Chemicals	78
Medium 50<x<150	81	Food processing	103
Large 150+	25	Textiles	116
		Garments&Leather	117
		Wood&Paper	24
		Glass&Stone	44
<i>Market Orientation</i>		Metals	48
	<i>Sample</i>	Others	26
Exporter	245		
Non Exporter	307		
<i>Firm Ownership</i>		<i>Firm Location</i>	
	<i>Sample</i>		<i>Sample</i>
Domestic	545	Aleppo	231
Foreign	7	Damascus	70
State		Hama	40
Other		Homs	59
		Lattakia	40
		Ru Dam	120

3. Recent investment climate surveys have been carried out in a largely parallel fashion in countries including Algeria, Morocco, Syria, Egypt, Oman, China, India, Poland, and Pakistan. This report uses data from these surveys to benchmark Syria against some of these countries for which comparable survey data are available. While the selection of comparators is largely a matter of judgment and data availability, international benchmarking against economies at similar levels of development, or those whose development path Syria can aspire to, helps in

inferring what is feasible—or vital—to achieve in pursuing economic policy and institutional reform. The survey work is complemented by a policy review of the regulatory and institutional environments in order to define a concrete action plan to improve the investment climate.

Workshop and Focus Groups

4. A workshop with relevant Government officials, academicians, private sector representatives and key counterparts reviewed the principal findings of the ICA in December 2005⁷⁹. Their comments confirmed the general validity of the findings, and helped to define the general thrust of recommendations that are contained in this report. These and other discussion also helped to identify several issues for further investigation and follow up, as reflected in Chapter 4 of this report.

5. In addition to the survey, focus group discussions were held with groups of businesspersons the survey did not cover. These groups represented artisans, women and Lebanese businesses that had investment in Syria. They were interviewed in a less structured and more qualitative format than the structured survey.

⁷⁹ Damascus University, December 12, 2004

ANNEX 3: PRODUCTIVITY GAP ANALYSIS METHODOLOGY

6. This annex describes how data from the Syrian “productivity and investment climate survey” (PICS) was used to analyze and compare Syrian productivity with data derived from parallel investment climate surveys in other countries.

7. **Productivity and Investment Climate Dataset and its Purpose.** The PICS productivity dataset brings together survey data on firm-level performance by combining and processing key productivity questions from World Bank investment climate surveys carried out in different countries in recent years. Its main purpose is to support comparative productivity analysis. Rather than being a comprehensive gathering of Survey questions, this database builds upon a few key questions by harmonizing questions across surveys from a “productivity” perspective. The dataset also contains a group of “derived concepts” so that the user can work directly with central variables like labor productivity, capital intensity, unit labor cost, and others. The dataset permits the identification of these derived variables for groups of firms, for example by sector, size characteristic or country of origin.

8. **Structure of the Dataset.** The dataset assigns common variable names (e.g. Sales, Fuels, etc) to common questions across surveys and the information was stacked producing one column for each variable spanning all firms and countries in the sample. At this stage, no outliers were removed. All “value” questions were converted to dollars, either using nominal exchange rate values⁸⁰ or a purchasing power parity (PPP) conversion. The productivity gap calculations presented in the ICA are based on PPP values. Sectoral breakdowns were harmonized across countries to maximize the number of comparable sectors. Missing observations in the dataset indicate that a certain variable was not available in the respective survey. This problem directly affects value-added calculations.

9. **Estimating Productivity Gaps Across Countries.** The calculation of productivity gaps was based on the estimation of a production function pooled across countries (Bangladesh, Brazil, China, Egypt, India, Indonesia, Malaysia, Morocco, Pakistan and Syria). One equation pooled data across sectors, while separate equations analyzed the productivity for three key sectors with the largest number of valid observations (Garments, Textiles and Food Processing). In each, ordinary least squares was used to fit an augmented Cobb-Douglas equation. The specification used was:

$$\ln(\text{Sales}_i) = \text{constant} + \beta_m \ln(\text{Material}_i) + \beta_l \ln(\text{Labor}_i) + \beta_c \ln(\text{Capital}_i) \\ + \text{SectorDummies} + \text{CountryDummies} + \varepsilon_i$$

10. Where i indexes the firm, n the country where the firm is located, and J denotes the number of countries. Egypt was chosen as the basis for a country dummy.

11. Productivity gaps expressed in relative percentage terms were retrieved from the estimated coefficients on the country dummies as follows: Productivity Gap for country $n = [\exp(n\beta) - 1] * 100$, for any country n other than Egypt.

⁸⁰ Using IMF [International Financial Statistics](#) and World Bank [World Development Indicators](#).

ANNEX 4: STANDARD TABLES

Table 1: Sample Structure⁸¹			
Firm Size		Firm Activity	
	Sample		Sample
Small <50	448	Chemicals	78
Medium 50<x<150	81	Food processing	103
Large 150+	25	Textiles	116
		Garments & Leather	117
		Wood & Paper	24
Market Orientation		Glass & Stone	44
	Sample	Metals	48
Exporter	245	Others	26
Non Exporter	307		
Firm Ownership		Firm Location	
	Sample		Sample
Domestic	545	Aleppo	231
Foreign	7	Damascus	70
State	0	Hama	40
Other		Homs	59
		Lattakia	40
		Rural Damascus	120

⁸¹ Because some firms are not identified, not all categories sum to the same number.

Table 2: Globalizations of Markets and Inputs

	Syria2004	Small	Medium	Large	Foreign	Domestic	Exporter	Non- Exporter	Low Capacity	High Capacity
Percent of Sales:										
Sold Domestically	80.9	83.3	74.6	59.6	43.6	81.5	57.4	99.6	81.6	80.4
Exported Directly	12.7	10.8	18.6	24.6	43.6	12.2	28.3	0.3	11.4	15.3
Exported Indirectly	6.4	5.9	6.8	15.8	12.9	6.3	14.3	0.1	7.1	4.4
Percent of Inputs/Supplies:										
From Dom. Sources	61.7	63.1	60.3	35.6	31.7	62.1	56.6	65.9	64.1	59.6
Imported Directly	21.9	19.2	28.1	54.0	63.3	21.3	28.3	16.7	18.5	28.9
Imported Indirectly	16.4	17.6	11.5	10.4	5.0	16.6	15.0	17.4	17.4	11.4

Table 4: Respondents Evaluation of General Constraints to Operation

Syria 2004	Small	Medium	Large	Exporter	Non- Exporter	Domestic	Foreign	Low Capacity	High Capacity
14.5	15.0	16.0	4.0	13.9	14.7	14.7		14.4	13.4
57.5	56.0	66.7	52.0	55.1	59.9	57.8	28.6	59.7	54.3
10.9	10.9	13.6	4.0	13.9	8.1	10.3	42.9	11.5	11.3
35.4	35.9	35.8	20.0	33.5	36.8	35.0	42.9	34.7	37.6
62.3	63.2	50.6	80.0	58.8	65.1	62.2	57.1	60.6	65.6
57.7	56.9	56.8	76.0	59.6	56.4	56.9	85.7	57.4	58.1
27.0	24.6	29.6	64.0	38.8	17.9	27.0	14.3	24.1	31.7
33.0	33.3	32.1	36.0	38.4	28.7	33.0	42.9	32.1	34.9
36.1	36.4	33.3	40.0	37.1	35.5	36.0	42.9	37.4	33.3
45.9	43.8	51.9	60.0	49.0	43.6	46.1	57.1	44.7	47.8
26.4	27.0	24.7	24.0	27.3	25.7	25.9	57.1	26.2	24.2

Table 5A: Infrastructure Indicators

	Syria	Egypt	Indonesia	Pakistan	China	Malaysia	Aleppo	Damascus	Hama	Homs	Lattakia	RuDam
Frequency of power outages (avg. days last year)	43.1	17.5	4.8	14.5		1.0	49.7	34.7	17.4	40.3	29.1	46.4
Output losses among those firms that experienced power losses (% of sales)	9.6	6.1	2.0	5.4	1.8		0.0	7.3	6.4	12.9	21.3	8.0
Have own generator (%)	72.5	19.2	37.6	41.8	17.0	22.6	71.9	65.7	57.5	64.4	70.0	87.5
No. of days to obtain an electricity connection	60.3	3.31	16.5	32.4	18.2	16.4	42.9	73.1	85.5	50.5	63.8	77.4
Have own well (%)	38.7	17.12	N/A	43.8	21.1	5.7	37.1	21.4	42.5	37.3	42.5	50.0
Production lost in shipment (%)	2.4	1.3	N/A			0.5	1.0	3.2	1.8	3.9	7.7	2.0
No. of days to obtain a telephone connection	57.2	3.81	29.5	25.3	12.5	11.9	48.3	83.4	44.8	78.1	39.6	62.7
No. of days to obtain a water connection	68.5	3.31	42.3			13.1	75.2	85.9	57.5	37.2	7.3	83.1
Share of Exports/Sales	19.1	8.65	28.6	15.1	25.9	36.8	21.3	20.2	22.8	5.3	12.1	22.0

Table5B: Infrastructure Indicators									
	Small	Medium	Large	Domestic	Foreign	Exporter	Non-Exporter	Low Capacity	High Capacity
Frequency of power outages (avg. days last year)	39.0	56.0	76.4	42.8	80.8	47.2	40.5	44.5	42.2
Output losses among those firms that experienced power losses (% of sales)	9.6	5.0	15.0	9.4	12.5	9.3	9.7	9.3	10.4
Have own generator (%)	69.0	85.2	96.0	72.7	71.4	77.6	67.8	71.8	74.7
Have own well (%)	34.2	53.1	75.0	38.7	42.9	40.4	36.7	38.1	40.9
Production lost in shipment (%)	2.7	0.2	3.8	2.5	1.6	2.1	2.7	2.8	2.2
No. of days to obtain a telephone connection	52.8	80.9	45.7	58.4	2.0	50.9	64.8	67.3	39.2
No. of days to obtain an electricity connection	54.6	82.7	28.8	61.6	2.5	61.6	61.2	56.4	77.1
No. of days to obtain a water connection	70.6	91.6	11.5	69.1	0.0	100.2	49.2	62.7	92.3
Share of Exports/Sales	16.7	25.4	40.4	18.5	56.4	42.6	0.4	18.4	19.6

Table 6: Sources of Finance

	All Enterprises	Small	Medium	Large	Exporter	Non-Exporter	Domestic	Foreign	Low Capacity	High Capacity
<i>Share of working capital from:</i>										
Retained earnings	86.2	85.9	87.9	81.6	84.6	87.6	86.3	95.0	86.0	85.2
Banks, other financial institutions	2.4	2.0	4.2	4.2	3.4	1.6	2.3	0.0	1.9	3.8
Trade credit	2.7	3.0	1.3	2.6	1.4	3.8	2.7	0.0	4.1	0.3
Equity										
Informal sources										
All other	8.8	9.1	6.7	11.6	10.6	7.0	8.6	5.0	8.0	10.8
<i>Financing of new investments from:</i>	All Enterprises	Small	Medium	Large						
Retained earnings	80.7	79.3	91.7	77.0	85.6	76.4	80.5	83.3	80.0	79.5
Banks, other financial institutions	4.3	4.6	4.4	0.0	4.1	3.9	4.4	0.0	4.1	5.3
Trade credit	2.1	1.8	2.2	6.0	1.6	2.5	2.1	0.0	2.7	1.0
Equity										
Informal sources										
All other	12.9	14.3	1.8	17.0	8.8	17.2	13.0	16.7	13.2	14.2

Table 7: Financial Sector Indicators

	All Enterprises	Small	Medium	Large	Foreign	Domestic	Exporter	Non- Exporter	Low Capacity	High Capacity
Share with overdraft or line of credit	19.1	17.0	28.8	23.8		19.6	25.8	14.3	19.4	21.5
Percent of credit that is currently unused	31.7	27.9	40.0	55.0		31.7	40.9	16.9	34.4	26.5
Share with a loan from a bank or financial institution	12.7	12.1	17.3	12.0		12.8	14.3	11.4	13.5	11.8
<i>For the most recent loan or overdraft:</i>										
(a) Share that require collateral	75.5	77.1	73.7	60.0		76.1	77.8	72.9	79.3	68.8
(b) Average value of collateral required (as % of the loan)	217.3	229.9	182.5	160.0		217.3	226.3	208.2	215.7	226.0
(c) Average interest rate on loan										
(d) Average duration of the loan										
Share of your total borrowing denominated in foreign currency	4.3	4.4	5.6	0.0	0.0	4.4	3.8	4.8	3.5	6.0
Share of long-term (1 year or more) liabilities in total liabilities	14.2	13.2	56.5	50.0	25.0	13.8	10.2	16.0	14.3	15.1
Share of short-term liabilities in total liabilities	33.5	33.7	43.5	50.0	27.4	33.7	21.9	36.5	32.8	34.9
Share of equity and retained earnings in total liabilities	52.3	53.2	0.0	0.0	47.6	52.4	67.9	47.5	52.9	50.0

Table 8: Financial Sector--Auditing, Transactions and Property Rights

	Syria2003	Small	Medium	Large	Exporter	Non-Exporter	Domestic	Foreign	Low Capacity	High Capacity
Share of firms with audited financial statements	34.5	30.6	49.4	52.0	42.0	27.9	34.2	42.9	31.8	42.4
<i>Days to clear through your financial institution</i>										
(a) a check	3.3	3.4	1.8	5.7	2.7	3.7	3.4	0.7	3.4	3.4
(b) a domestic currency wire	1.5	1.6	1.0	0.0	2.0	1.2	1.6	0.0	1.5	1.8
(c) a foreign currency wire	2.1	1.5	12.3	0.0	4.0	0.7	2.1	2.7	1.8	3.5
<i>Share of land that is:</i>										
(a) owned	84.1	83.0	84.6	100.0	85.1	82.8	84.0	85.7	81.3	88.1
(b) leased or rented	14.3	15.5	11.8	0.0	13.6	15.2	14.3	14.3	16.6	11.2
(c) average length of lease/rental	36.1	31.8	62.7		41.2	30.1	37.0		38.8	32.6
<i>Share of buildings that are:</i>										
(a) owned	85.6	83.5	91.8	100.0	87.0	84.0	85.4	100.0	83.0	89.5
(b) leased or rented	14.1	16.2	7.9	0.0	12.6	15.6	14.3	0.0	16.5	10.4
(c) average length of lease/rental	25.8	25.6	30.0		28.9	23.1	26.4		24.0	28.2

Table9: Regulatory Burden and Administrative Delays by Countries

	Syria2003	Small	Medium	Large	Domestic	Foreign	Exporter	Non-Exporter	Low Capacity	High Capacity
Senior management's time spent dealing with regulations (%)	13.0	12.6	15.5	13.0	13.0	13.7	14.6	11.9	12.8	13.8
Total firm revenues typically reported for tax purposes (% of sales)	51.1	52.1	21.4	57.0	51.7	32.0	48.3	52.5	51.0	52.0
Inspections:										
(a) Total days spent in inspections or required meetings with officials	24.9	25.5	22.3	24.4	24.9	26.7	25.5	24.6	25.9	24.3
Imports:										
Avg. days to clear customs	15.8	15.1	16.5	18.8	15.9	10.5	16.4	15.1	16.3	15.3
Longest day to clear customs	32.4	33.8	29.1	30.1	31.9	60.0	33.9	29.6	36.5	25.6
Exports:										
Avg. days to clear customs	6.3	6.5	5.6	7.4	6.3	2.6	6.0	7.4	5.9	6.9
Longest day to clear customs	10.4	10.4	9.7	12.6	10.2	7.0	9.8	13.1	10.7	10.1

Table10: Governance--Uncertainty and Corruption

	All Enterprises	Small	Medium	Large	Exporter	Non-Exporter	Domestic	Foreign	Low Capacity	High Capacity
<i>Uncertainty:</i>										
Share of profits reinvested in the firm	52.9	52.0	56.6	56.1	52.0	53.4	53.1	26.4	47.7	59.7
Percent of payment disputes resolved in the courts	1.4	0.9	2.6	1.2	1.7	1.3	1.5	0.0	1.5	1.2
Planning horizon for investments (months)	10.1	9.2	30.0	10.7	9.0	10.7	10.1	9.0	9.7	7.6
<i>Corruption:</i>										
<i>Percentage of firms saying gift/payment required for:</i>										
(a) a mainline telephone connection	75.7	74.1	80.0	86.7	78.8	73.1	75.8	80.0	72.7	81.2
(b) an electrical connection	75.3	75.6	70.4	81.8	80.4	70.8	75.1	100.0	77.3	74.0
(c) a construction permit	67.5	67.0	63.2	100.0	75.4	60.0	66.4	100.0	67.7	67.3
(d) an import license	66.9	62.9	75.0	66.7	67.1	65.5	66.4	66.7	61.6	73.7
(e) an operating license	67.7	64.8	84.6	100.0	75.5	63.8	67.5	100.0	66.2	74.5
Revenue reported by typical establishment for tax purposes (%)	51.1	52.1	21.4	57.0	48.3	52.5	51.7	32.0	51.0	52.0

Table11: Technology Indicators in International Comparison										
	All Enterprises	Small	Medium	Large	Domestic	Foreign	Exporter	Non-Exporter	Low Capacity	High Capacity
Firms with ISO certification (%)	7.4	4.0	16.5	41.7	7.2	14.3	14.0	2.3	6.5	8.1
Form of Technology Innovations										
(a) Firms that developed a major new product line (%)	42.0	37.1	57.5	80.0	42.0	42.9	52.5	32.7	37.2	51.1
(b) Firms that upgraded an existing product line (%)	45.9	43.7	50.6	72.0	45.3	57.1	55.4	37.5	42.4	53.8
(c) Firms that introduced new technology that substantially changed the way the main product is produced (%)	33.2	28.9	45.7	68.0	32.6	42.9	42.6	25.0	28.9	40.9
(d) Firms that discontinued at least one product line (%)	21.4	20.5	22.2	36.0	21.3	42.9	25.4	18.3	22.0	20.4
(e) Firms that agreed a new joint venture with foreign partner (%)	3.8	3.5	2.5	16.0	3.6	28.6	6.3	2.0	3.9	3.9
(f) Firms that obtained a new licensing agreement (%)	5.7	5.5	6.2	8.0	5.8	0.0	6.3	5.0	4.8	6.6
Form of Technology Acquisition (% of firms rating as 1st, 2nd and 3rd most important)										
(a) Embodied in new machinery or equipment	66.5	65.5	70.8	68.2	66.7	50.0	71.0	61.9	63.0	72.5
(b) Hiring key personnel	14.8	11.6	23.1	31.8	14.5	0.0	17.5	10.7	12.8	17.6
(c) Licensing or turnkey operations from international sources	5.6	6.4	3.1	0.0	5.5	16.7	7.1	3.6	5.7	5.3
(d) Licensing or turnkey operations from domestic sources	3.1	4.1	0.0	0.0	3.2	0.0	2.2	4.2	2.4	3.8
(e) Developed or adapted within the establishment locally	27.7	25.8	32.3	36.4	28.4	16.7	27.3	28.0	28.4	25.2
(f) Transferred from parent company	3.4	4.5	0.0	0.0	3.2	16.7	2.7	3.6	2.4	4.6
(g) All other	72.9	69.7	81.5	86.4	72.2	83.3	79.2	65.5	71.6	74.8

Table 12: Labor and Training in International Comparison and by Firm Characteristic

	All Enterprises	Small	Medium	Large	Exporter	Non-Exporter	Domestic	Foreign	Low Capacity	High Capacity
<i>Labor Composition</i>										
Share of workers that are permanent	77.8	77.0	82.2	86.2	73.4	80.9	77.8	69.9	77.1	77.8
Share of permanent workers that are female	5.0	2.0	14.4	31.7	7.4	2.9	4.9	18.9	4.2	5.1
Share of temporary workers that are female	23.2	20.6	42.2	15.0	26.8	20.3	23.0	16.7	18.0	35.7
Share of perm. skilled wkrs. that are foreign nationals	1.1	1.1	0.8	0.8	0.6	1.5	1.1	2.0	1.6	0.0
<i>Labor Turnover</i>										
New employees as a share of total	20.0	20.0	21.2	18.0	21.1	19.5	20.3	5.6	18.4	23.0
Employees that left as share of total	10.1	10.7	7.3	7.2	9.8	10.4	10.2	4.4	9.7	11.3
Avg. time to fill a skilled techn. vacancy (weeks)	6.7	6.9	6.5	3.0	10.2	5.0	6.7	8.0	6.6	8.0
Avg. time to fill a prod/service wkr. vacancy (weeks)	2.7	2.7	3.8	1.7	3.2	2.4	2.7	0.5	2.5	2.7
Desired level of workforce as % of current level	125.3	124.2	140.3	119.4	133.0	120.2	125.7	107.8	130.0	119.7
<i>Training and Education</i>										
Share of workforce with less than 6 years schooling	55.8	58.0	49.8	34.0	52.3	59.1	56.1	15.7	56.3	56.1
Share of workforce with more than 12 years schooling	8.2	6.8	13.0	19.8	9.6	7.1	8.1	17.0	7.4	9.1
Share of skilled workers receiving training	47.8	49.2	42.2	38.1	47.3	50.4	50.4	18.0	50.3	41.7
Share of firms offering formal training	21.0	17.3	25.6	62.5	27.8	15.5	20.0	71.4	19.7	20.9

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