

**ANALYSIS OF REAL ACTIVITIES IN THE
SYRIAN ECONOMY: 1980 - 2010**

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**ANALYSIS OF REAL ACTIVITIES IN THE
SYRIAN ECONOMY: 1980 - 2010**

by

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TABLE OF CONTENTS

	Page
Acknowledgement	ii
Table of Contents	iii
List of Tables	viii
List of Figures	xi
List of Symbols and Abbreviations	xiii
Abstrak	xv
Abstract	xviii

CHAPTER 1 - INTRODUCTION

1.1 Introduction	1
1.2 Background of the Study	2
1.3 Problem Statement	5
1.4 Objectives of the Study	7
1.5 Research Questions	7
1.6 Significance of the Study	9
1.7 Scope of the Study	10
1.8 Organization of the Study	10

CHAPTER 2 - THE SYRIAN ECONOMY

2.1 Introduction	12
2.2 Overview of the Syrian Economy	12
2.3 Public Sector Investment	19
2.4 Private Sector Investment	22
2.5 Human Capital Development	27
2.6 Agriculture Sector	30
2.7 Industrial Sector	33
2.8 Oil Sector	37
2.9 Transport and Communication Sector	41
2.10 Foreign Trade	43
2.11 Trade Liberalization	52
2.12 Syrian Trade Agreements	57

2.12.1	The Great Arab Free Trade Area (GAFTA)	57
2.12.2	The Syria-European Union (EU) Association Agreement	59
2.12.3	Bilateral Trade Agreements	60
2.12.4	Free Trade Areas and Preferential Trade Agreements	60
2.12.5	Member of International Economic Organizations	62
2.13	Financial Liberalization	62
2.14	Exchange Rate Regime	65
2.15	Conclusion	68

CHAPTER 3 - LITERATURE REVIEW

3.1	Introduction	70
3.2	Review of Theoretical Literature	70
3.2.1	Economic Growth Theories	71
3.2.1.(a)	The Classical Growth Theory	71
3.2.1.(b)	The Neoclassical Growth Theory	73
3.2.1.(c)	The New Growth Theory	75
3.2.2	Theory of Export-led Growth	77
3.2.3	International Trade Theories	78
3.2.4	Investment Theories	81
3.2.5	Government Expenditure and Growth	84
3.2.6	Exchange Rate and Foreign Trade	85
3.3	Empirical Literature	86
3.3.1	Studies on the Determinants of Economic Growth	87
3.3.2	Studies on the Determination of Agricultural Production	96
3.3.3	Studies on the Determination of Industrial Production	98
3.3.4	Studies on the Determination of Public Sector Investment	99
3.3.5	Studies on the Determination of Private Sector Investment	101
3.3.6	Studies on the Determination of Exports	104
3.3.7	Studies on the Determination of Imports	107
3.4	Conclusion	110

CHAPTER 4 - METHODOLOGY

4.1	Introduction	113
4.2	The Empirical Model	113

4.2.1	The Economic Growth Model	114
4.2.2	The Agricultural Output Model	116
4.2.3	The Industrial Output Model	118
4.2.4	The Public Sector Investment Model	120
4.2.5	The Private Sector Investment Model	123
4.2.6	The Export Model	125
4.2.7	The Import Model	127
4.3	Data Sources	129
4.4	Estimation Procedures	131
4.4.1	Unit Root Test	133
4.4.2	The VAR Model	138
4.4.3	Cointegration Test	139
4.4.4	Granger Causality Test	143
4.4.5	The Vector Error Correction Model	144
4.4.6	Impulse Response Functions (IRF)	145
4.4.7	Variance Decomposition (VD) Analysis	146
4.5	Specification and Diagnostic Tests	147
4.5.1	Normality Test	147
4.5.2	Serial Correlation LM Test	148
4.5.3	Heteroskedasticity Test	150
4.5.4	Ramsey RESET Test	153
4.5.5	CUSUM Test	156
4.5.6	CUSUMSQ Test	157
4.5.7	Chow Breakpoint Test	156
4.6	Conclusion	158

CHAPTER 5 - EMPIRICAL RESULTS AND DISCUSSION

5.1	Introduction	160
5.2	The Economic Growth Model	160
5.2.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	161
5.2.2	Johansen Multivariate Cointegration Test Results	161
5.2.3	Residual and Stability Diagnostics Results	166
5.2.4	The Granger Causality Test Results	168
5.2.5	Impulse Response Functions (IRF) Results	170
5.2.6	Variance Decomposition (VD) Analysis	171

5.3	The Agricultural Output Model	174
5.3.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	174
5.3.2	Johansen Multivariate Cointegration Test Results	174
5.3.3	Residual and Stability Diagnostics Results	179
5.3.4	The Granger Causality Test Results	181
5.3.5	Impulse Response Functions (IRF) Results	183
5.3.6	Variance Decomposition (VD) Analysis	184
5.4	The Industrial Output Model	185
5.4.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	186
5.4.2	Johansen Multivariate Cointegration Test Results	186
5.4.3	Residual and Stability Diagnostics Results	192
5.4.4	The Granger Causality Test Results	193
5.4.5	Impulse Response Functions (IRF) Results	195
5.4.6	Variance Decomposition (VD) Analysis	196
5.5	The Public Sector Investment Model	198
5.5.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	198
5.5.2	Johansen Multivariate Cointegration Test Results	199
5.5.3	Residual and Stability Diagnostics Results	203
5.5.4	The Granger Causality Test Results	204
5.5.5	Impulse Response Functions (IRF) Results	206
5.5.6	Variance Decomposition (VD) Analysis	207
5.6	The Private Sector Investment Model	209
5.6.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	209
5.6.2	Johansen Multivariate Cointegration Test Results	210
5.6.3	Residual and Stability Diagnostics Results	214
5.6.4	The Granger Causality Test Results	215
5.6.5	Impulse Response Functions (IRF) Results	217
5.6.6	Variance Decomposition (VD) Analysis	219
5.7	The Export Model	220
5.7.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	220
5.7.2	Johansen Multivariate Cointegration Test Results	221
5.7.3	Residual and Stability Diagnostics Results	225
5.7.4	The Granger Causality Test Results	227
5.7.5	Impulse Response Functions (IRF) Results	229
5.7.6	Variance Decomposition (VD) Analysis	230

5.8	The Import Model	232
5.8.1	The Augmented Dickey-Fuller (ADF) Unit Root Test Results	232
5.8.2	Johansen Multivariate Cointegration Test Results	232
5.8.3	Residual and Stability Diagnostics Results	237
5.8.4	The Granger Causality Test Results	238
5.8.5	Impulse Response Functions (IRF) Results	241
5.8.6	Variance Decomposition (VD) Analysis	242
5.9	Conclusion	244
 CHAPTER 6 - CONCLUSION		
6.1	Introduction	249
6.2	Summary of the Results	250
6.2.1	Factors Affecting Economic Growth in Syria	250
6.2.2	Factors Affecting Agricultural and Industrial Sector Output ...	251
6.2.3	Factors Affecting Public and Private Sector Investments	252
6.2.4	Factors Affecting Exports and Imports	254
6.3	Highlights of the Important Finding of this Study	257
6.4	Policy Recommendations	259
6.5	Contributions of the Study	260
6.6	Limitations of the Study and Recommendations for Future Research ...	262
6.7	Concluding Remarks	262
 REFERENCES		264
 APPENDIX		
Appendix 1: The Data		298
Appendix 2: Vector Autoregression Estimates and Cointegration Test Results		304
Appendix 3: Stability Test Results		325
Appendix 4: Impulse Response Functions (IRF) Results		339
Appendix 5: The Map of Syria		346

LIST OF TABLES

		Page
Table 1.1	Objectives and research questions of the study	8
Table 2.1	Sectors' contribution to the gross domestic product (percentage share), 1980-2010 (at constant 2000 prices)	17
Table 2.2	The number of agricultural projects in Syria, its investment cost, and the number of job opportunities that has been created (1990 - 2009)	31
Table 2.3	The structure of Syrian exports by oil and non-oil exports 1980-2010	40
Table 2.4	Transport and communication sector in Syria	42
Table 2.5	Some of the free trade areas and preferential trade agreements of Syria	61
Table 2.6	Number of private and public banks in Syria, 1980-2010	63
Table 4.1	Variables and sources	130
Table 5.1	ADF unit root test results of the economic growth model	161
Table 5.2	Lag length selection from VAR estimates for the economic growth model	162
Table 5.3	Johansen cointegration test results of the economic growth model	162
Table 5.4	Cointegration equation normalized with respect to lnGDP	163
Table 5.5	Results of the statistical diagnostic tests on the VECM: Economic growth model	167
Table 5.6	Granger causality test results of the economic growth model	169
Table 5.7	Variance decomposition analysis of the economic growth model	172
Table 5.8	ADF unit root test results of the agricultural output model	174
Table 5.9	Lag length selection from VAR estimates for the agricultural output model	175
Table 5.10	Johansen cointegration test results of the agricultural output model	175

Table 5.11	Cointegration equation normalized with respect to $\ln AO$	176
Table 5.12	Results of the statistical diagnostic tests on the VECM: Agricultural output model	180
Table 5.13	Granger causality test results of the agricultural output model	182
Table 5.14	Variance decomposition analysis of the agricultural output model	185
Table 5.15	ADF unit root test results of the industrial output model	186
Table 5.16	Lag length selection from VAR estimates for the industrial output model	187
Table 5.17	Johansen cointegration test results of the industrial output model	187
Table 5.18	Cointegration equation normalized with respect to $\ln IO$	187
Table 5.19	Results of the statistical diagnostic tests on the VECM: Industrial output model	193
Table 5.20	Granger causality test results of the industrial output model	195
Table 5.21	Variance decomposition analysis of the industrial output model	197
Table 5.22	ADF unit root test results of the public sector investment model	198
Table 5.23	Lag length selection from VAR estimates for the public investment model	199
Table 5.24	Johansen cointegration test results of the public sector investment model	200
Table 5.25	Cointegration equation normalized with respect to $\ln GI$	200
Table 5.26	Results of the statistical diagnostic tests on the VECM: Public sector investment model	204
Table 5.27	Granger causality test results of the public sector investment model	205
Table 5.28	Variance decomposition analysis of the public sector investment model	208
Table 5.29	ADF unit root test results of the private sector investment model	209

Table 5.30	Lag length selection from VAR estimates for the private sector investment model	210
Table 5.31	Johansen cointegration test results of the private sector investment model	211
Table 5.32	Cointegration equation normalized with respect to lnPI	211
Table 5.33	Results of the statistical diagnostic tests on the VECM: Private sector investment model	215
Table 5.34	Granger causality test results of the private sector investment model	217
Table 5.35	Variance decomposition analysis of the private sector investment model	220
Table 5.36	ADF unit root test results of the export model	221
Table 5.37	Lag length selection from VAR estimates for the export model	222
Table 5.38	Johansen cointegration test results of the export model	222
Table 5.39	Cointegration equation normalized with respect to lnEXP	223
Table 5.40	Results of the statistical diagnostic tests on the VECM: Export model	226
Table 5.41	Granger causality test results of the export model	229
Table 5.42	Variance decomposition analysis of the export model	231
Table 5.43	ADF unit root test results of the import model	232
Table 5.44	Lag length selection from VAR estimates for the import model	233
Table 5.45	Johansen cointegration test results of the import model	233
Table 5.46	Cointegration equation normalized with respect to lnIMP	234
Table 5.47	Results of the statistical diagnostic tests on the VECM: Import model	238
Table 5.48	Granger causality test results of the import model	240
Table 5.49	Variance decomposition analysis of the import model	243
Table 6.1	Objectives, research questions, and results of the study	256

LIST OF FIGURES

	Page
Figure 2.1 GDP growth rate in Syria (annual %), 1980-2010	15
Figure 2.2 Economic freedom ratings for 2010 of ranked countries in the Arab world	18
Figure 2.3 Gross fixed capital formations (GFCF) of the public sector (SYP million), at constant 2000 prices, 1980-2010	22
Figure 2.4 Gross fixed capital formations (GFCF) of the private sector (SYP million), at constant 2000 prices, 1980-2010	25
Figure 2.5 Gross fixed capital formation (GFCF) by type of ownership, (annual %), 1980-2010	26
Figure 2.6 Government expenditure on education, at current prices, in millions of U.S. dollars, 1980-2010	29
Figure 2.7 Total public and private health expenditure per capita in USD, at current prices, 1995-2010	30
Figure 2.8 Agriculture sector output in Syria, at constant 2000 prices, in million Syrian pounds, 1980 - 2010	33
Figure 2.9 Mining & Manufacturing output in Syria, at constant 2000 prices, in million Syrian pounds, 1980-2010	37
Figure 2.10 Syrian crude oil production (thousand barrels per day), 1980-2010	39
Figure 2.11 Transport and communication sector's contribution to the GDP, (SYP million), at constant 2000 prices, in million Syrian pounds, 1980-2010	43
Figure 2.12 Syrian imports and exports, at current prices, in million Syrian pounds, 1980-2010	47
Figure 2.13 Syrian trade balance, at current prices, in million Syrian pounds, 1980-2010	50
Figure 2.14 The structure of Syrian exports by nature of exported items, 1980-2010	51
Figure 2.15 The structure of Syrian imports by nature of imported items, 1980-2010	51

Figure 2.16	Trade liberalization in Syria, (ratio of total trade to GDP in percent), 1980-2010	56
Figure 2.17	Foreign direct investment (FDI), at current prices, in thousands of U.S. dollars, 1980-2010	64
Figure 4.1	Procedure of analyses and tests	133
Figure 5.1	Generalized impulse response functions for the economic growth model	171
Figure 5.2	Generalized impulse response functions results of the agricultural output model	184
Figure 5.3	Generalized impulse response functions for the industrial output model	196
Figure 5.4	Generalized impulse response functions for the public sector investment model	207
Figure 5.5	Generalized impulse response functions for the private sector investment model	218
Figure 5.6	Generalized impulse response functions for the export model	230
Figure 5.7	Generalized impulse response functions for the import model	242

LIST OF SYMBOLS AND ABBREVIATIONS

ADF	Augmented Dickey-Fuller Unit Root Test
ANIMA	Anima Euro Mediterranean Network of Investment Promotion Agencies
ARCH	Autoregressive Conditional Heteroscedasticity Test
ARDL	Autoregressive Distributed Lag
BPG	Breusch-Pagan-Godfrey Test for Heteroscedasticity
CAEU	Council of Arab Economic Unity
CBS	Central Bureau of Statistics in Syria
CUSUM	Cumulative Sum
CUSUMSQ	Cumulative Sum of Squares
DF	Dickey-Fuller Unit Root Test
DSM	Damascus Stock Market
ERF	The Economic Research Forum
EU	European Union
FDI	Foreign Direct Investment
FRD	Federal Research Division
GAFTA	Greater Arab Free Trade Area
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formations
ICSID	International Centre for Settlement of Investment Disputes
IMF	International Monetary Fund
IRF	Impulse Response Functions
JB	Jarque-Bera Test for Normality
KPSS	Kwiatkowski, Phillips, Schmidt And Shin Test
MIGA	Multilateral Investment Guarantee Agency

NAPC	National Agricultural Policy Center
OECD	Organization For Economic Cooperation And Development
OLS	Ordinary Least Squares
PP	Phillips-Perron Unit Root Test
RESET	Regression Specification Error Test
SDR	Ppecial Drawing Rights
SIA	Syrian Investment Agency
SIED	Syrian-Italian Economic Directory
SMET	Syrian Ministry of Economy And Trade
SMT	Syrian Ministry of Tourism
SPC	State Planning Commission
STE	Syrian Telecommunications Establishment
SYP	Syrian Pound
U.N	United Nations
UAR	United Arab Republic
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
USD	US Dollar
USDS	US Department of State
USEIA	United States Energy Information Administration
VAR	Vector Autoregression Model
VD	Variance Decomposition
VECM	Vector Error Correction Model
WB	World Bank
WTO	World Trade Organization

ANALISIS AKTIVITI SEBENAR DALAM EKONOMI SYRIA:

1980-2010

ABSTRAK

Kajian ini cuba untuk menyiasat penentu pertumbuhan keseluruhan dan sektor di Syria dari tahun 1980 hingga 2010. Selain itu, ia juga menyiasat pembolehubah yang memberi kesan kepada pelaburan sektor awam dan swasta dan perdagangan asing di negara ini. Isu utama dalam kajian ini ialah bagaimana untuk meningkatkan pertumbuhan keseluruhan sektor, pelaburan sektor awam dan swasta, dan perdagangan asing di Syria. Model VAR, ujian punca unit ADF, ujian kointegrasi Johansen, ujian sebab-akibat Granger, fungsi tindak balas impuls (IRF), dan analisis penguraian varians (VD) digunakan dalam kajian ini. Keputusan kajian ini menunjukkan bahawa KDNK Syria mempunyai hubungan yang positif dengan pelaburan sektor awam, pelaburan sektor swasta, eksport, harga minyak, dan pertumbuhan penduduk. Pelaburan awam mempunyai kesan terbesar terhadap KDNK. Output pertanian mempunyai hubungan yang positif dengan modal, eksport makanan, perbelanjaan penggunaan akhir dan tanah suai tani, tetapi mempunyai hubungan yang negatif dengan harga minyak. Tanah suai tani mempunyai kesan terbesar terhadap output pertanian. Output industri mempunyai hubungan yang positif dengan modal, eksport perkilangan, penduduk dan output pertanian, dan hubungan yang negatif dengan harga minyak. Output pertanian mempunyai kesan terbesar terhadap output industri. Pelaburan sektor awam mempunyai hubungan yang positif dengan harga minyak, pendapatan negara kasar, hutang luar negeri, dan bantuan asing, tetapi mempunyai hubungan yang negatif dengan pelaburan sektor swasta. Pendapatan dalam negara kasar dan harga minyak mempunyai kesan

terbesar terhadap pelaburan sektor awam. Pelaburan sektor swasta mempunyai hubungan yang positif dengan pelaburan sektor awam, keterbukaan perdagangan, KDNK per kapita, dan pengeluaran minyak. KDNK per kapita mempunyai kesan terbesar terhadap pelaburan sektor swasta. Eksport mempunyai hubungan yang positif dengan keterbukaan perdagangan, harga minyak, dan kemudahan komunikasi, tetapi mempunyai hubungan yang negatif dengan kadar pertukaran benar dan perbelanjaan penggunaan akhir. Kemudahan komunikasi mempunyai kesan terbesar terhadap eksport. Import mempunyai hubungan yang positif dengan KDNK per kapita, kadar pertukaran benar, keterbukaan perdagangan, pengeluaran minyak, dan modal. KDNK per kapita mempunyai kesan yang terbesar terhadap import. Tambahan pula, penemuan utama menunjukkan bahawa kedua-dua pelaburan sektor awam dan swasta mempunyai peranan penting dalam menyokong ekonomi Syria. Walau bagaimanapun, pelaburan sektor awam yang mendorong pelaburan sektor swasta dengan mewujudkan iklim pelaburan yang menarik, manakala pelaburan sektor swasta menyedapkan pelaburan sektor awam, yang dikaitkan dengan strategi kerajaan untuk menggerak ekonomi Syria daripada perancangan pusat kepada ekonomi pasaran sosial. Keterbukaan perdagangan, harga minyak, dan populasi juga memainkan peranan penting dalam menyokong ekonomi Syria. Keputusan kajian ini menyokong teori pertumbuhan neoklasik dan endogen, teori pelaburan, teori perdagangan antarabangsa, Hukum Wagner, teori pertumbuhan eksport (ELG), dan pendekatan keanjalan bagi perdagangan asing dan kadar pertukaran. Syor utama kajian ini adalah bahawa kerajaan Syria perlu bekerja lebih keras untuk meningkatkan ekonomi Syria dengan menambahbaik prestasi sektor awam, menggalakkan lebih banyak pelaburan sektor swasta, menaik taraf infrastruktur dan meningkatkan modal insan di negara ini. Ia juga perlu meningkatkan produktiviti

industri dan pertanian, dan meningkatkan kualiti dan daya saing produk Syria di pasaran tempatan dan global, di samping mengambil langkah-langkah liberalisasi perdagangan selanjutnya, yang boleh menggalakkan pelaburan dan membantu untuk mencapai ekonomi bidangan dengan penggunaan teknologi moden dalam proses pengeluaran. Akhir sekali, kerajaan Syria boleh terus membuka ekonominya untuk meningkatkan perdagangan asing dan mempelbagaikan eksportnya.

ANALYSIS OF REAL ACTIVITIES IN THE SYRIAN ECONOMY: 1980-2010

ABSTRACT

This study attempts to analyze the real activities in the Syrian economy through investigating the determinants of overall and sectoral growth, public and private sector investment and foreign trade in the country. The main issue in this study is how to improve overall and sectoral growth, public and private sector investment and foreign trade in Syria. The VAR model, ADF unit root test, Johansen cointegration test, Granger causality test, impulse response functions (IRF), and variance decomposition (VD) analysis are used in this study. The results of this study show that the GDP of Syria is positively related to public sector investment, private sector investment, exports, oil price, and population growth. Public investment has the biggest effect on the GDP. Agricultural output is positively related to capital, food exports, final consumption expenditure and arable land, but negatively related to oil price. Arable land has the largest effect on agricultural output. Industrial output is positively related to capital, manufactured exports, population and agricultural output, and negatively related to oil price. Agricultural output has the largest effect on industrial output. Public sector investment is positively related to oil price, gross domestic income, external debt, and foreign aid, but negatively related to private sector investment. Gross domestic income and oil price have the greatest effects on public sector investment. Private sector investment is positively related to public sector investment, trade openness, GDP per capita, and oil production. GDP per capita has the biggest effect on private sector investment. Exports are positively related to trade openness, oil price, and communication facilities, but negatively

related to the real exchange rate and final consumption expenditure. Communication facilities have the biggest effect on exports. Imports are positively related to GDP per capita, real exchange rate, trade openness, oil production, and capital. GDP per capita has the greatest effect on imports. Furthermore, the main findings show that both public and private sector investment have important roles in supporting the Syrian economy. However, public sector investment motivates private sector investment through creating an attractive investment climate, while private sector investment crowds out public sector investment in the country, which is associated with the government's strategy to move the Syrian economy from central planning to a social market economy. Trade openness, oil price and population also play an important role in supporting the Syrian economy. The results of this study support the neoclassical and endogenous growth theory, investment theories, international trade theories, Wagner's law, export-led growth (ELG) theory, and elasticity approach to foreign trade and exchange rate. The main recommendations of this study is that the Syrian government should work harder to improve the Syrian economy through improving the performance of the public sector, encouraging more private sector investment, upgrading infrastructure and improving the human capital in the country. It is also necessary to increase industrial and agricultural productivity, and enhance the quality and competitiveness of Syrian products in the local and global markets, in addition to undertaking further trade liberalization measures, which can encourage investment and help to achieve economies of scale with the usage of modern technology in the production process. Finally, the Syrian government can further open up the economy to increase foreign trade and diversify its exports.

CHAPTER 1 - INTRODUCTION

1.1 Introduction

Syria is a middle-income developing country with a diversified economy. The agricultural and industrial (mining & manufacturing) sectors are the biggest contributors in terms of their percentage shares of the gross domestic product (GDP) in the country. Furthermore, achieving high levels of economic growth has been the primary focus of the Syrian government.

Since 1963, Syrian economic policy has undergone transformation towards the socialist direction, with highly centralized planning and under full public sector control. The central planning strategy was implemented by the state until the government formally adopted the social market economy as its main economic strategy in 2006 with the launching of the Tenth Syrian Five-Year Plan (2006-2010). Based on this new strategy, the government has worked to reduce central planning, encourage private investment, open up the economy to foreign investment, liberalize foreign trade, and diversify the country's exports. Hence, in order to understand the growth and development of the Syrian economy, it is necessary to analyze the real activities in the Syrian economy by investigating the main factors that affect Syrian economic growth, and examining the role of both public and private sector investment in the Syrian economic growth and the variables that affect them. In addition, it is also important to investigate the role of foreign trade in the Syrian economy and test the variables that affect the country's exports and imports.

However, there are only a limited number of empirical studies that have analyzed the real activities in the Syrian economy, and none of these studies have examined the role of the public and private sectors in economic growth. This thesis therefore attempts to fill this gap by investigating the main macroeconomic variables

that affect Syrian economy, and analysing their impact on its economic growth during the 1980-2010 period¹. Moreover, this thesis will focus on the role of the public and private sectors in the country's economic growth, and examine the variables that affect public and private investment. In addition, the foreign trade sector will be investigated in this study as it is an indicator of the opening up of the Syrian economy, and the variables that affect exports and imports will also be examined.

1.2 Background of the Study

Since Syria became independent from French occupation in 1946, agriculture has been the main sector in the Syrian economy and it has an important role in industrial development, because large landowners invested their profits derived from agriculture in creating industrial enterprises. Although the economy grew rapidly, there was little social equality and most of the countryside lacked the basic amenities such as electricity, education, and health care. In the 1950s, these poor circumstances had helped to raise political leaders who wanted a more powerful role of the government in the economy, more active government participation and state ownership in production.

After the union with Egypt in 1958, many laws were passed that gradually led to the socialization of the economy. By 1961 the state had gained control over the country's natural resources, and introduced land reform measures. The government also emphasized public sector investment, worked to nationalize the banking system, and decreed a wide range of nationalization measures. Syria's union with Egypt in

¹ Because of the lack and paucity of data for some variables before 1980 and after 2010, the study was confined to the period from 1980 until 2010 only.

the United Arab Republic (UAR) stayed until 28 September 1961. After achieving independence from the UAR, the Syrian government did not continue with the socialist transformation until March 1963, when the Baath Party became a major political force in Syria (Boris, 1987).

Since 1963, Syrian economic policy was transformed towards the socialist direction, with highly centralized planning and under full public sector control. The Baath Party adopted the policy of nationalization, and confiscated estates from large landowners and distributed some land to the peasants and landless farmers. Moreover, the state supported the agriculture sector, and it introduced many projects to improve infrastructure such as road expansion, and electricity and water supply to the countryside (Seifan, 2009). However, centralized planning and public sector control led to the high level of bureaucracy, the rise in corruption, and other problems that the public sector has to deal with.

The central planning strategy implemented by the state since 1963 was replaced by a new economic strategy when the government adopted the social market economy as its main economic strategy in the Tenth Syrian Five-Year Plan (2006-2010)². Based on this new direction of the Syrian economy, the government has worked to reform the economy by reducing the bureaucracy and interference of the state's institutions in production operations, and encouraging the private sector to invest in different activities. The government has also worked towards opening up the economy to foreign investment, liberalizing foreign trade, reducing the dependence on the oil sector and diversifying exports.

² The social market economy is a capitalist economic system that adopts the market economy, but it rejects the absolute capitalist form and revolutionary socialism. Furthermore, it works to make the public and private sectors work hand in hand to achieve the required economic growth and development in the country.

In general, from 1960 until today, the Syrian economy has undergone widespread structural changes, and experienced two boom stages. The first economic boom occurred in the second half of the 1970s, and the second boom in the first half of the 1990s. The Syrian economy has also achieved reasonable growth rates during the last decade (Seifan, 2009).

Notwithstanding the significant achievements of the Syrian economy in previous decades, it is still a developing economy and faces serious growth challenges, such as low levels of industrial and agricultural productivity, lack of modern management, technology, and industrial R&D, inadequate education, training and skills and also a poor industrial investment environment. These weaknesses are manifested in the low quality and quantity of Syrian products, which led to the decline in productivity and competitiveness of Syrian products in the global market. According to the Global Competitiveness Index 2009-2010, Syria was ranked 94th out of 133 countries (Schwab, 2009).

Oil is one of the most important energy sources in the country and Syrian crude oil has provided about 75% of Syrian energy needs at prices lower than world prices. Most of Syrian export earnings are derived from the export of primary commodities, where world prices are very volatile. Raw materials contributed about 68% of the average Syrian exports from 1980 to 2010. The high concentration of export of raw materials is a significant source of risk and instability for the Syrian economy, because the export of raw materials is affected by many factors that are beyond the control of the government. These factors include the production of raw materials, prices of raw materials in the global market and the rainy seasons that affect the production of agriculture products. Furthermore, the trade balance recorded deficits for most years during the period from 1980 to 2010. The trade account

recorded surpluses only from 1989 to 1991, due to the increase in the volume of special exports to Russia against previous debts, and from 2000 to 2003 due to the increase in oil prices (Ahamad, 2006).

Furthermore, despite the government's efforts to develop and reform the Syrian economy from a socialist central planning economy to a social market economy, the size of the private sector is still relatively small and it has only a limited role in the Syrian economy compared to the public sector. Most of the private sector companies are small, family-owned firms. In addition, due to the high protection accorded to local production activities, the quality of local products is low, because Syrian producers can make high profits in the local market without having to pay much attention to the quality of the products they produced. This has adversely affected the competitiveness of Syrian products in the global markets, especially after the opening up of the Syrian economy to foreign trade, which seems to have negative effects on the Syrian economy. On the other hand, there are also problems in the public sector that led to reduced investment activities. Some of these problems stemmed from corruption, bureaucracy and the low level of productivity in the public sector. Due to the relatively low quality and uncompetitiveness of public sector products vis-à-vis foreign products, this sector has incurred huge losses, especially after the liberalization of foreign trade and the opening up of the Syrian market to domestic and foreign investments.

1.3 Problem Statement

The Syrian economy is a developing economy and it relies on central planning. The government, however, has been working to develop and transform the economy from a centrally planned to a social market economy. This is accomplished by reducing

the intervention of the state in economic activities, developing the private sector, creating an attractive investment climate, and improving the different economic sectors, especially the main sectors such as industry and agriculture. But despite all these efforts, the Syrian economy is still a developing economy that encounters a lot of problems such as unstable economic growth, low levels of productivity, and deficits in the trade balance. Furthermore, the size of the private sector is small, while the public sector is weak and its performance is poor. The public sector has to deal with the high level of bureaucracy, the rise in corruption, and other problems. The Syrian economy depends mainly on crude oil and agricultural output, and both agriculture and mineral products are the main exports of the country. However, there are many factors that are beyond the control of the Syrian government such as oil price volatility, declining oil production since 1996, and seasons of drought and rain that affect agriculture output. All these factors may have an extensive impact on the Syrian economy.

Hence, in view of the importance of achieving economic growth in the country, and based on the Syrian government's strategy to develop the local economy, it is imperative to establish the forces that shape the Syrian economy, and analyze the real activities in the economy. Thus, the central issue in this study is how to improve the Syrian economy. Besides, the industrial and agricultural sectors are the main sectors in the Syrian economy, and foreign trade can also perform an important role in enhancing production and for achieving a higher level of economic growth and development. Moreover, in the light of the policy shift from a centrally planned economy to a social market economy, both public and private sectors investments too have important roles in the Syrian economy.

1.4 Objectives of the Study

The main objective of this study is to analyze the real activities in the Syrian economy, through investigating the determinants of overall and sectoral growth in Syria, as well as the determinants of public and private sector investment and foreign trade in the country. The specific objectives of this study are:

1. To determine the factors that affect economic growth.
2. To determine the factors that affect agricultural and industrial sector output.
3. To investigate the factors that affect public and private sector investments.
4. To examine the factors that affect exports and imports.

1.5 Research Questions

This study will provide the opportunity to answer the following questions:

1. What is the role of public and private sector investment, exports, oil price, and population growth in Syrian economic growth?
2. How does the agricultural sector output respond to changes in oil prices, capital, food exports, expenditure, and agricultural land?
3. How does the industrial sector output respond to changes in oil prices, capital, agricultural sector output, population growth, and manufactured exports?
4. How do changing oil prices, foreign aid, external debt, private sector investment, and gross domestic income affect public sector investment?
5. How do changing oil production, trade openness, public sector investment, and GDP per capita affect private sector investment?

6. What is the effect of oil price, trade openness, exchange rate, communication facilities, and expenditure on exports?
7. What is the impact of oil production, trade openness, exchange rate, investment, and GDP per capita on imports?

The following Table 1.1 shows how the research questions are related to the research objectives.

Table 1.1 Objectives and research questions of the study

Objectives of the study	Research questions
1. To determine the factors that affect economic growth.	1. What is the role of public and private sector investment, exports, oil price, and population growth in the Syrian economic growth?
2. To determine the factors that affect agricultural and industrial sector output.	2. How does agricultural sector output respond to the changes in oil prices, capital, food exports, expenditure, and agricultural land? 3. How does industrial sector output respond to the changes in oil prices, capital, agricultural output, population growth, and manufactured exports?
3. To investigate the factors that affect public and private sector investment.	4. How do changing oil prices, foreign aid, external debt, private sector investment, and gross domestic income affect public sector investment? 5. How do changing oil production, trade openness, public sector investment, and GDP per capita affect private sector investment?
4. To examine the factors that affect exports and imports.	6. What is the effect of oil price, trade openness, exchange rate, communication facilities, and expenditure on exports? 7. What is the impact of oil production, trade openness, exchange rate, investment, and GDP per capita on imports?

Source: Developed by the researcher

1.6 Significance of the Study

One of the most important topics in development economics is analyzing the real activities in the local economy, which may assist in achieving economic growth and development in the country. Syria is one of the developing countries that tries to achieve a higher level of economic growth. The recent Tenth Syrian Five-Year Plan (2006-2010) emphasized on pushing the Syrian economy towards a social market economy, encouraging private sector participation and giving it a bigger role in the Syrian economy, liberalizing foreign trade, and improving the agriculture and industry sectors. However, the public sector still serves a big role in the Syrian economy, and the Syrian economy still has many problems that need to be dealt with.

What are important to be investigated in this study are the determinants of Syrian economic growth, in addition to identifying a number of internal and external factors affecting industrial output, agricultural output, private investment, public investment and foreign trade. It is also crucial to understand the role of public and private sector investment as well as exports in the realization of the country's economic growth, because Syria is trying to move away from central planning to a market economy. This study is timely as it may assist Syrian policy makers in the near future to develop a comprehensive economic plan that takes into account the factors that affect Syrian economic growth, industrial output, agricultural output, foreign trade, as well as public and private sector investment in order to develop the domestic economy.

To the best knowledge of the researcher, there are very few empirical studies that have been undertaken in the past to investigate the determinants of economic growth, agricultural output, industrial output, public investment, private investment and foreign trade in Syria. El-Sakka and Al-Mutairi (2000) tested the relationship

between exports and economic growth in 16 Arab countries including Syria, and Berument and Ceylan (2005) and Berument et al. (2010) tested the relationship between oil price and economic growth of many countries including Syria. Therefore, this study will be one of the first empirical studies that will be able to shed light on the determinants of all the above mentioned macroeconomic variables. In addition, this study will be the first study to examine the effect of public and private sector investment on Syrian economic growth as well as how Syria is working towards the opening up of its economy.

1.7 Scope of the Study

This study will seek to analyze the real activities in the Syrian economy during the period from 1980 to 2010³, by testing the factors that affect GDP (such as gross fixed capital formation of the public sector, gross fixed capital formation of the private sector, oil price, exports, and population growth), as well as testing the factors that affect agricultural output, industrial output, public sector investment, private sector investment, exports, and imports in the country. The relevant annual data from 1980 and 2010 are obtained from the Central Bureau of Statistics in Syria (CBS), the World Bank (WB), and the United States Energy Information Administration (USEIA).

1.8 Organization of the Study

This study is divided into six chapters. Chapter 1 introduces the background of this study, followed by the problem statement, objectives, research questions,

³ The data are available until 2010 due to the war in Syria. Data are not reliable after 2010.

significance, and scope of the study. Chapter 2 reviews the Syrian economy. Chapter 3 presents a theoretical review of economic growth theories, international trade theories, and investment theories. Moreover, the Solow model, Wagner's Law, the elasticity approach, and the export-led growth theory will also be reviewed in this chapter. This chapter will also review the empirical studies that have investigated the determinants of economic growth, and the determinants of agricultural output, industrial output, public sector investment, private sector investment, exports, and imports. Chapter 4 presents the empirical models, definition of the dependent and independent variables, the data sources as well as the methodology and econometric tests to be applied in this study. Chapter 5 provides the empirical results and a discussion of the results. Finally, Chapter 6 gives a summary of the study, policy recommendations and the conclusion.

CHAPTER 2 - THE SYRIAN ECONOMY

2.1 Introduction

This chapter provides an overview of the Syrian economy and its main economic sectors such as the agriculture sector, industrial sector, oil sector, and transport and communication sectors. Public and private sector investment, human capital development, and foreign trade will also be reviewed in this chapter. Furthermore, trade liberalization, financial liberalization, exchange rate regime, and trade agreements with its major trading partners will also be discussed in this chapter.

2.2 Overview of the Syrian Economy

Syria is a middle-income developing country with a diversified economy. The agriculture, mineral and manufacturing sectors accounted for more than 40% of the country's GDP (CBS, 2010).

The Syrian economy is mainly governed by central planning since 1963. However, the government has adopted the social market economy as its main economic strategy as spelt out in the Tenth Syrian Five-Year Plan (2006-2010), and it has reduced central planning gradually in line with the circumstances and the needs of economic development (SIED, 2011). Besides, it has been working to reform the economy, by opening up most sectors to private investment, opening up the economy to foreign direct investment, diversifying the economy, reducing the country's dependence on oil and agriculture, opening private banks, establishing a stock market, and consolidating all the multiple exchange rates (USDS, 2011). However, the Syrian economy is still facing serious growth challenges, such as poor performance of the public sector, declining oil production, unstable economic

growth, deficits in the trade balance, high level of bureaucracy, and corruption. Besides, the rate of investment, and the levels of industrial and agricultural productivity are low due to a centrally planned economy (USDS, 2011).

Figure 2.1 shows the annual GDP growth rate in Syria from 1980 to 2010. In the early 1980s, Syria faced an acute economic crisis due to the sharp fall in oil prices, the drop in export revenues, falling Arab financial assistances, decreasing Syrian worker remittances, depreciation of the Syrian pound, and the drought, which led to the sharp decline in the GDP growth from 11.9% in 1980 to -4.1% in 1984 (Boris, 1987). Not only that, in the late 1970s and early 1980s, the Muslim Brotherhood led an armed insurgency against the Syrian government, which affected negatively Syria's economic growth (McGowan, 1987)⁴. However, the GDP growth rate jumped to 6.11% in 1985, after a sudden increase in net FDI inflows from USD 50,000 in 1984 to USD 15,000,000 in 1985. The average GDP growth rate was about 3% during 1980-1985. In 1986 the GDP growth rate shrunk to -4.95% due to the fall in the oil price from USD 27.4 per barrel in 1985 to USD 14.2 per barrel in 1986. However, GDP growth recovered the following year, rising from 1.9% in 1987 to 13.27% in 1988 due to the expansion of crude oil production and increase in oil prices. But in 1989, the GDP growth contracted again to -8.95% following a reduction in agricultural production⁵. Then, the GDP growth rate bounced back to 7.9% in 1990 due to the rise in Syrian exports to the Soviet Union and Eastern European markets and the oil price increase from USD 17.9 in 1989 to USD 23 per barrel in 1990. The average GDP growth rate was about 1.8% during 1986-1990.

⁴ The Muslim Brotherhood is a religious and armed organization that is against the Syrian government, and it was responsible for many terrorist activities in Syria during the late 1970s and early 1980s.

⁵ The crop production index fell from 83% in 1988 to 52% in 1989.

During the first half of the 1990s, the returns of the state treasury increased attributable to Arab countries' assistances, Syrian workers' remittances, agriculture sector returns, private sector activities, and the higher returns from crude oil exports, with increased oil production during that period, which motivated the economic growth in the country (Kafri, 2004)⁶. The average GDP growth rate was 7.99% during the period 1991-1995. However, following the decline in oil production, decline in investment and increasing unemployment, the GDP growth slowed down, falling from 4.4% in 1996 to 1.8% in 1997 (Seifan, 2009)⁷. But in 1998, economic growth rallied to 6.3% after the increase in agriculture production, industrial output, FDI inflows and investment. While in 1999 the GDP growth slumped to -3.55% due to the drought and the decline in oil production and investment. In 2000, FDI inflows increased and the oil price rose to USD 28 per barrel in 2000 from USD 18 per barrel in 1999, which affected positively the country's economic growth. The average GDP growth rate was 2.35% between 1996 and 2000.

During the period 2001-2010, the average GDP growth rate was about 4.3%. The higher GDP growth compared to the second half of the 1990s was due to the rise in world oil prices and FDI. Furthermore, the government's strategy to open up the economy to foreign investment, upgrade productivity, increase private sector involvement in economic development, and modernize industries have boosted GDP growth (UNIDO, 2009). However, increasing inflows of Iraqi nationals into Syria after the American occupation of Iraq in 2003 was the main reason for rising

⁶ Exploration and production of oil were by service contracts awarded to foreign companies, which led to increased oil production from 194 thousand barrels per day in 1986 to about 600 thousand barrels per day in 1995, where 250 thousand barrels per day were for domestic consumption and the rest were exported (Kafri, 2004).

⁷ FDI declined from USD100 million in 1995 to USD 89 million in 1996, and USD 80 million in 1997. Private sector investment decreased from SYR 94,359 million in 1995, to SYR 87,570 million in 1996, and SYR 66,751 million in 1997.

inflationary pressures in the Syrian economy, which led to the decline in the economic growth in 2003 to 1.6% (El-Quqa et al., 2007). The GDP growth slowed to 3.2% in 2010 due to the fall in FDI, the drought, and decreasing returns from the oil sector after the decline in oil production.

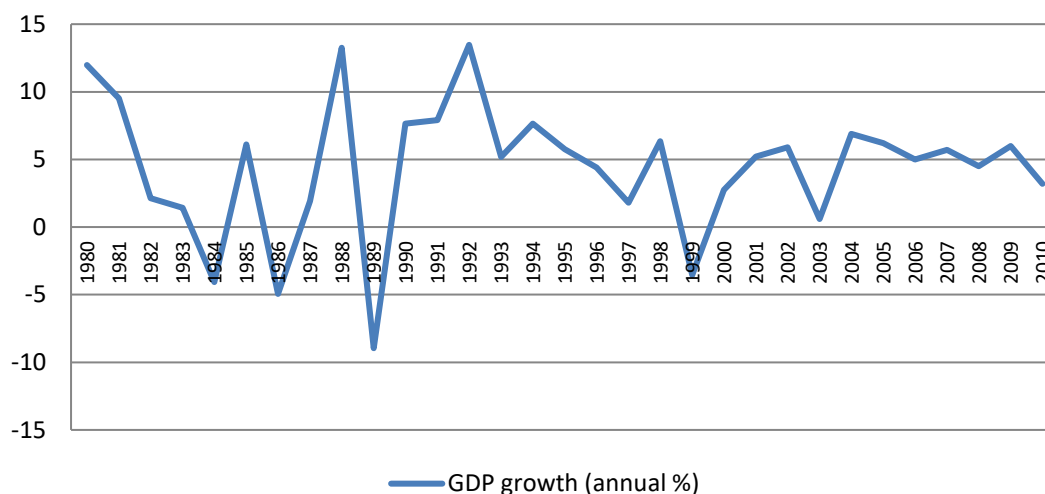


Figure 2.1 GDP growth rate in Syria (annual %), 1980-2010 (World Bank, 2011)

After taking a quick look at the history of Syrian economic growth from 1980 until 2010, we can see that fluctuations in the rate of economic growth are attributable to various factors such as public sector investment, private sector investment, foreign trade, population growth, oil price, assistance from the Arab oil countries and drought. However, Syria was able to achieve reasonable growth rates during the last decade, despite the global financial crisis and the tense political atmosphere in the region (Seifan, 2009).

Table 2.1 shows the structure of GDP by sector from 1980 to 2010 (at constant 2000 prices). We can note that the agriculture sector, mining and manufacturing sector, and wholesale & retail trade sector are the main sectors of the Syrian economy, and they account for more than 60% of the total GDP. The

agriculture sector remained the biggest component of the GDP until 1990, followed by the wholesale & retail trade sector in the second place, and the mining and manufacturing sector in the third place. But since 1990, the mining and manufacturing sector has overtaken the agricultural sector to become the biggest component of the GDP, followed by the agricultural sector in the second place, and the wholesale & retail trade sector in the third place. And since 2008, the wholesale and retail trade sector has overtaken the agricultural sector to be in the second place, and the agricultural sector is in the third place. These changes in the structure of the GDP reflected the government's strategy and continuous efforts to improve industry and giving it a bigger role in the economy, and also to increase the role of the trade sector by opening up of the Syrian economy to the world markets.

Table 2.1 Sectors' contribution to the gross domestic product (percentage share), 1980-2010 (at constant 2000 prices)

Sectors	1980	1985	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Agriculture	29	24	25	23	24	23	26	23	25	25	26	25	23	23	24	20	18	19	16
Mining & manufacturing	15	17	26	28	31	34	33	33	30	29	26	24	27	25	24	23	23	23	24
Building & construction	7	8	3	3	3	3	3	3	3	3	3	4	4	4	4	4	4	4	4
Wholesale & retail trade	23	23	20	21	18	16	15	16	15	16	17	16	18	20	18	19	22	21	20
Transport & communication	7	9	10	11	11	11	11	12	13	13	13	14	11	11	11	12	12	12	13
Finance & insurance	5	3	3	4	3	3	3	4	4	3	3	4	4	4	5	5	5	5	5
Social & Personal services	3	3	2	2	1	2	2	2	2	2	3	3	3	3	3	3	4	4	4
Government services	11	13	11	8	8	7	7	7	8	8	9	10	11	10	11	13	12	13	14
Private nonprofit services	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Customs duties	0	0	0	0	0	0	0	0	0	0	0	0	2	2	2	2	2	1	1
(-) Value of financial intermediation services (FISIM)	0	0	0	0	0	0	0	0	0	0	0	0	1	2	2	2	2	2	2
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: Central Bureau of Statistics, 2011

In order to study the degree of openness of the Syrian economy to foreign trade and investment, it is imperative to take a look at some reports that reflect the economic standing of Syria relative to the world. According to the 2010 Index of Economic Freedom Report, Syria's economic freedom score was 49.4, making it the 145th freest economy in the 2010 Index (Miller and Holmes, 2010), while in 2009, Syria's economic freedom score was 51.3, and its economy was ranked the 141th freest in the 2009 Index (Miller and Holmes, 2009). Moreover, based on the 2012 Annual Report of the Economic Freedom of the Arab World, Syria's economic freedom score in 2010 was 6.2, being ranked 15th out of 17 countries (see Figure 2.2), while in 2009, Syria's economic freedom score was 6.1, and its economy was ranked 16th out of 17 countries (Al-Ismaily et al., 2012). Furthermore, according to the Global Competitiveness Index 2009-2010, Syria was ranked 94th out of 133 countries. This report also rated Syria at 13th position among 14 Arab countries (Algeria, Bahrain, Egypt, Jordan, Kuwait, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, and United Arab Emirates), only one position higher than Mauritania (Schwab, 2009).

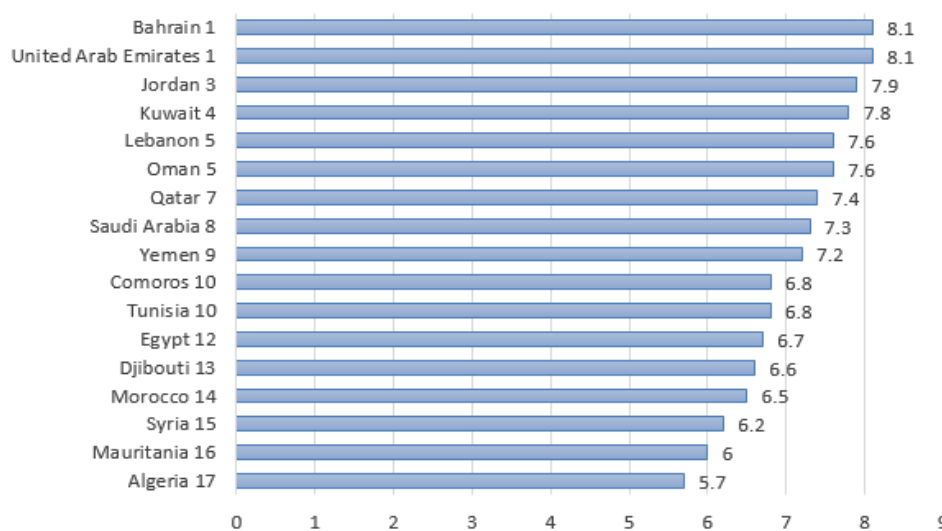


Figure 2.2 Economic freedom ratings for 2010 of ranked countries in the Arab world (Economic Freedom of the Arab World: 2010 Annual Report)

2.3 Public Sector Investment

When the Arab Socialist Baath party became the major political force in 1963, Syrian economic policy was transformed towards the socialist direction, with highly centralized planning and under full government control (Seifan, 2009). However, the government has worked to encourage the private sector to play a sizeable role in the Syrian economy and adopted the social market economy as its main economic strategy in the Tenth Syrian Five-Year Plan (2006-2010) (SIED, 2011).

Based on the socialist direction of the Syrian economy, the Baath Party worked to nationalize the manufacturing industries, mining industry, natural resources, insurance companies, banks, electric power plant, telecommunication companies, transportation companies, and the education system at all levels. Moreover, the state intervened in domestic trade, and it was responsible for pricing consumer goods and services. In addition, most international trade and domestic wholesale trade were controlled by the public sector (Seifan, 2009).

Under the state-controlled economy, the government offered free education to every child in the country, provided free health services to citizens, and expanded roads, and supplied electricity and water to the countryside areas. It also supported the agriculture sector by providing peasants with loans, fertilizer, seeds, pesticide, and agricultural machines that have helped to increase agriculture production. In addition, it introduced many projects to improve infrastructure (Seifan, 2009). All of that contributed to the increase in government expenditures, and led to a widening of the state's budget deficit. However, in spite of the economic crisis and the deficit in the state budget during the first half of the 1980s, the government increased its expenditures and public sector investment increased from SYP 91,367 million in 1980 to SYP 113,566 million in 1985. But in the second half of the 1980s, the

government took some actions to reduce the deficit in the state budget. The actions taken include decreasing government spending, encouraging the private sector to participate in tourism, agriculture and foreign trade, and giving up some of the government's monopolies to the private sector (Dagher, 2000). This led to the reduction in public sector investment from SYP 113,566 million in 1985 to SYP 42,515 million in 1990 (see Figure 2.3).

During the first half of the 1990s, public sector companies returned to produce goods and services after a break in the 1980s, and public services such as electricity, water, communications, transportation, education and health were upgraded. Besides, many employment opportunities have been created (Dagher, 2000). Not only that, the government has also improved the country's infrastructure, worked to raise the standard of living of the Syrian population, and continued its support policy of basic commodities such as bread, flour, sugar, rice, gas, construction materials and other materials. In addition, the government expanded free and semi-free health services, education and social care to its citizens (Sioufi, 2009). This led to the increase in government spending and public sector investment during the 1990s. Public sector investment increased from SYP 42,515 million in 1990 to SYP 99,331 million in 2000.

Since 2000, the government has worked gradually to develop and reform the Syrian economy from socialist central planning to a social market economy. It focused on policy to reduce the budget deficit, changed its monetary and exchange rate policies, and passed a number of laws to encourage private sector investment and foreign investment (Brück et al., 2007). Moreover, the government has worked to reduce the bureaucracy and administrative obstacles, reform public sector industries, and improve the investment climate, by creating a stock market,

developing industries, and establishing industrial cities. In addition, the government has also developed many projects to motivate agricultural investment, and it has provided indirect support to the agricultural sector, in addition to creating the Agricultural Support Fund in 2008 (NAPC, 2008). Furthermore, the state has focused on social development and worked to upgrade the standard of living by expanding public investment in infrastructure besides education and health services (Dardari, 2008). The Tenth Syrian Five-Year Plan (2006-2010) also focused on increasing investments in infrastructure, besides human development and poverty reduction (Brück et al., 2007). In addition, the government has worked to increase domestic demand by raising the purchasing power of citizens through salary increases and creating new job opportunities. Public sector investment increased from SYP 99,331 million in 2000 to SYP 146,688 million in 2005 (see Figure 2.3).

During the second half of the 2000s, public sector investment declined continuously from SYP 146,688 million in 2005 to SYP 112,739 million in 2008, due to the government's giving up some of its economic activities to the private sector in support of the private sector and giving the latter a larger role in economic activities. In addition, there were some problems in the public sector that resulted in declining productivity, which led the public sector to reduce its investment activities. Some of these problems were the rising corruption, high level of bureaucracy, low level of productivity, and the low quality and competitiveness of its products vis-à-vis foreign products. The relatively poor quality and competitiveness of public sector products led to huge losses, especially after the liberalization of foreign trade and opening up of the Syrian markets to local and foreign investments.

However, after public sector investment had declined, the government realized that it cannot rely on the private sector alone to achieve economic growth.

The government then worked to solve the problems plaguing the public sector, re-organized and boost the sector, and increased its role in economic activities. At the same time, the government still focuses on the private sector and its role in economic growth. In addition to that, it still encourages the private sector to achieve the required economic development. Figure 2.3 shows that public sector investment increased from SYP 112,739 million in 2008 to SYP 144,153 million in 2010.

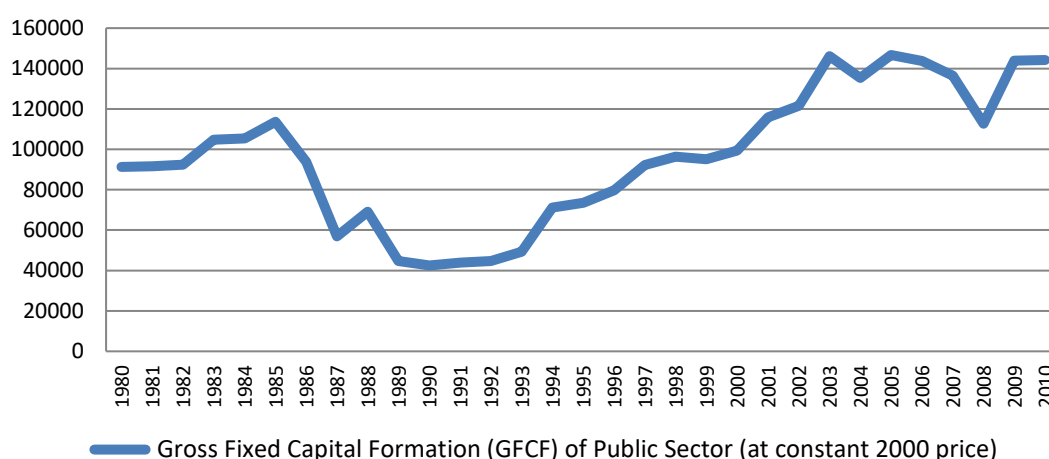


Figure 2.3 Gross fixed capital formations (GFCF) of the public sector (SYP million), at constant 2000 prices, 1980-2010 (Central Bureau of Statistics, 2011)

2.4 Private Sector Investment

In the wake of the economic crisis in the 1980s, which began to emerge from the beginning of the 1980s, Syria has adopted many measures to reduce the impact of the crisis by encouraging private sector activities and attracting foreign investment (Boris, 1987). Since the mid-1980s, the government has taken some actions to help the private sector to participate in tourism, agriculture and foreign trade. For instance, the government encouraged shared agricultural investment between the state and the private sector. Moreover, based on the principle of economic pluralism, the government handed over some of its monopolies to the private sector (Dagher,

2000). But in spite of the government's strategy to promote the private sector during this period, private sector investment dropped by almost half, from SYP 57,835 million in 1986 to SYP 28,977 million in 1988, due to the deficit in the state budget, and the decline in government expenditure and public sector investment⁸. However, after the increase in the private sector's exports to the Soviet Union and Eastern European States in the late 1980s, private sector investment increased to SYP 44,506 million and SYP 57,255 million in 1989 and 1990 respectively (see Figure 2.4). By the end of 1990, the share of the private sector in various economic activities had increased significantly to 98% in agriculture, 72% in transport, 62% in trade, 59% in the financial sector, 50% in construction and 37% in manufacturing (Perthes, 1992).

By the early 1990s, Syria had improved its relations with Europe and the USA, and started peace negotiations with Israel after the Madrid Peace Conference in November 1991. Moreover, the government continued to upgrade the country's infrastructure, and encouraged private sector and foreign investment in the country, by granting many incentives and exemptions to the private sector. This made Syria more attractive to foreign investors. Private sector investment increased from SYP 59,549 million in 1991 to SYP 94,359 million in 1995. However, after increasing the resources of the state treasury derived from oil and gas returns, Arab countries' assistances, and a successful agriculture policy, the government felt that additional economic reforms are not necessary, and that keeping the role of the private sector within the limits is considered adequate for the state. In addition to that, failure to achieve peace with Israel has increased the tendency for the state to keep its strong grip on the economy and society (Seifan, 2009). All of that led to the

⁸ Declining government expenditure and public sector investment have negative effects on the country's infrastructure. This also led to a decline in private sector investment.

decline in private investment during the second half of the 1990s from SYP 87,570 million in 1996 to SYP 56,761 million in 2000 (see Figure 2.4).

Since 2000, the government has been working to develop and reform the Syrian economy from a socialist central planning economy to a social market economy. To achieve this goal, a number of laws have been passed to encourage the private sector and foreign investment in the country (Brück et al., 2007). But the government did not disclose its new direction to a social market economy until it was adopted by the Baath Party Congress in 2005. It is worth noting that the Tenth Syrian Five-Year Plan launched in 2006 is based on the social market economy policy to reform the Syrian economy (Seifan, 2009). Moreover, the government aimed to open up the economy to foreign investment and to give the private sector a bigger role in the economic development of the country (UNIDO, 2009). Besides that, the state reduced its intervention in foreign trade, abandoned its monopoly on many goods and left them to the private sector, and passed a series of laws and legislative decrees to open the door to private sector investment and foreign investment to support the economy (Seifan, 2009). Furthermore, the achievements of the economic reform program in the first decade of the 21st century include the opening of private and Islamic banks, the establishment of the Damascus stock market (DSM), which opened its doors in March 2009, the setting up of private insurance companies, and the creation of industrial cities (UNIDO, 2009).

Moreover, the government has allowed the private sector to invest in higher education since 2001. Therefore, since 2001 all levels of education have been opened up to the private sector. In addition, it allowed the issuance of private newspapers and magazines, and the establishment of commercial radio stations. Furthermore, during this decade, the government worked to improve investment in the industrial