Global Economic Crisis Boosts Utility of U.S. Sanctions on Syria

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Brief Analysis

On February 9, the Syrian minister of transportation announced that Washington had granted a license allowing Syria to purchase spare parts for two Boeing 747s that have been grounded for years. The announcement touched off intense speculation that the Obama administration would lift U.S. sanctions against Syria that have been in place since 2004. Even as Washington appears to be softening its stance with an eye toward engaging Damascus, sanctions remain an important tool to ensure that engagement achieves U.S. policy goals. Rather than dropping sanctions, Washington should recalibrate them to leverage the economic pressure on Damascus that has been exacerbated by the global economic crisis.

Syria's Economic Woes

Despite U.S. sanctions, the Syrian economy has performed relatively well in recent years. Fueled by high oil prices and increased investment from the Gulf, Syria has posted an average annual economic growth rate of about 5 percent over the past five years. There are, however, big problems: oil production -- proceeds from which account for 27 percent of state revenues -- has declined by 30 percent in the past five years. And Syrian industry -- accounting for 28 percent of the gross domestic product (GDP) -- is struggling to compete under a flood of imports resulting from Arab and Turkish free trade agreements. Likewise, unemployment hovers around 9 percent, and a record three-year drought has devastated the Syrian agricultural sector (23 percent of GDP).

Since the global economic crisis hit, Syria's economic situation has worsened. The collapse in oil prices forced the state to revise its budget oil price downward to $51 for light crude and $42 for heavy, resulting in a record budget deficit of $4.8 billion, or roughly 10 percent of its GDP. Syria is a net importer of oil, however, and the state earns revenue from exports while the cost of importing petroleum products (largely fuel oil) is borne by consumers. In the past, the government subsidized petroleum products, but it raised prices in 2008 to a point where the government now earns revenue from domestic fuel oil sales. Therefore, a reduction in oil prices still reduces government revenue. With Syrian crude averaging $38 and $32 for light and heavy respectively, the Economist Intelligence Unit now estimates the budget deficit will swell to $5.2 billion.

Although the state usually makes up for budget shortfalls by slashing investment spending -- a line item that accounts for 40 percent of the 2009 budget -- this tactic will be more difficult now. Syrians born in the 1980s and early 1990s, when the country was among the top twenty fastest growing populations in the world, are now flooding the job market. According to Syrian deputy prime minister for economic affairs Abdullah Dardari, Syria will need $14 billion of investment over the next two years to meet the 6-7 percent economic growth targets required to create enough jobs for the growing workforce.

A recent Syrian Economy Ministry report quoted by news agency AFP stated that the crisis would result in an estimated 30 percent drop in foreign investment, which totaled $875 million in 2007. The report also estimated that expatriate remittances, which amounted to $850 million last year, would fall while prices would rise. Last year, the International Monetary Fund estimated Syrian inflation at a record 15 percent, up from 5 percent in 2007.

Impact of Sanctions

The bad economic news explains Damascus's recent shift in focus from the need for Washington to mediate peace talks to a demand for Washington to drop U.S. sanctions. In an interview with Reuters news service this month, Dardari said that "to have normal relations between Syria and the United States, sanctions should be lifted. . . . This is going to be a very important part of any dialogue. . . ." His statements echo those of Sami Moubayed, a member of the U.S.-Syria Working Group (whose Syrian members were handpicked by the Bashar al-Asad regime to participate in Track II dialogue) who first linked lifting U.S. sanctions to dialogue with Syria just two days after the election of Barack Obama.

These statements represent a reversal of the regime's standard rhetoric on sanctions. When the Syrian Accountability and Lebanese Sovereignty Restoration Act (SALSA) was implemented in May 2004, Damascus bragged that the sanctions would have little effect due to historically small amounts of bilateral trade. Many Syria observers questioned the utility of U.S. sanctions over the last few years, as spiraling food commodity and oil prices drove the dollar amounts (but not volumes) of U.S.-Syrian trade to all-time highs.

But there is ample evidence that U.S. sanctions on Damascus are having an increasing impact. SALSA, which bans all U.S. exports to Syria (except food and medicine), has hit Syrian aviation particularly hard. State-owned Syrian Air could not obtain parts for its fleet of American-made Boeing jets or purchase new aircraft from Europe's Airbus, which uses substantial U.S. content in its planes. SALSA also complicated Syrian oil and gas production by denying companies operating in Syria the necessary U.S. technology to increase diminishing Syrian crude output. Indeed, in the summer of 2007, Damascus blamed electricity blackouts on the "knock-on effect" of U.S. sanctions; companies specializing in major high-tech projects shunned operations in Syria for fear of running afoul of U.S. law. (The only legal exceptions to the sanctions were "export licenses" for U.S. goods for certain humanitarian purposes to promote the exchange of information and to help maintain aviation safety. It was under this provision that a license was issued to repair the two Syrian Air 747s last week.)

At the same time, U.S. actions targeting the state-owned Commercial Bank of Syria (CBS) have exacerbated Damascus's financial woes by making it more difficult to repatriate critical oil revenues. The U.S. Department of Treasury's March 2006 designation of CBS -- the depository for the lion's share of Syria's estimated $18-20 billion in foreign currency reserves -- as a "primary money-laundering concern" under the USA Patriot Act led all U.S. and a number of European banks to close their correspondent accounts. In anticipation of the move, Damascus switched state foreign currency transactions from dollars to euros, and since oil, the regime's lifeline, is denominated in dollars, the switch complicates the regime's ability to fund itself. In addition, the designation scared businessmen away from the CBS and toward the country's new private-sector banks, which operate under less regime control, effectively reducing the amount of cash the regime could access.

Executive orders freezing the U.S. assets of Syrian officials have likewise made global banks and investors wary of doing business with Syrian officials and regime businessmen. Last May, two American executives of Gulfsands Petroleum -- a company contracted to boost Syrian crude output -- resigned, and the company moved its headquarters from the United States to London after one of the company's partners, business tycoon and President al-Asad's cousin Rami Makhlouf, was targeted by an Executive Order focusing on public corruption in Syria. Later, Washington successfully pressured the Turkish mobile provider Turkcell to put off its bid to buy Syriatel, another Makhlouf-owned business. The U.S. designation was hailed by Syria's business community, which views Makhlouf, according to a new International Crisis Group report, as "a symbol of crony capitalism, resented by many colleagues for having bullied them into forced partnerships or out of lucrative deals."

Smart Sanctions Key to Success

As the fiscal crisis unfolds in Syria, existing U.S. sanctions could have a powerful negative impact on the Syrian economy, prompting Damascus to reevaluate its policies -- on U.S. designated terrorist groups (Hamas, Islamic Jihad, and Hizballah), Lebanon, Iraq, and weapons of mass destruction -- to obtain relief. This kind of policy review could form the core of future Syrian-U.S. dialogue. To ensure U.S. leverage, Washington should recalibrate sanctions based on a clear understanding of Syria's fiscal problems and changing socioeconomic trends, rather than lift sanctions as Damascus suggests. The resulting "smart sanctions" should be a key element of a comprehensive U.S. strategy to put Damascus into dilemmas in which its choices will clearly signal whether Syria intends to continue fanning the flames of regional militancy or to play a productive role in reinvigorated regional peacemaking.

If these targeted sanctions are effective, Damascus will be forced to choose between continuing its policies and suffering the economic consequences, or concluding clear agreements with Washington to change its policies and gain American assistance to put Syria on the road to prosperity. U.S. sanctions contain sticks and carrots to lead Damascus down this path. In the weeks and months ahead, the challenge before the Obama administration will be to assess which sanctions have been most effective, and to link -- via a process of benchmarking -- the removal of sanctions to discernible and irreversible changes in Syrian policy.

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