



EUROPEAN
COUNCIL
ON FOREIGN
RELATIONS
ecfr.eu

POLICY
BRIEF

SYRIA'S WAR ECONOMY

Jihad Yazigi

SUMMARY

Three years into a conflict that is estimated to have killed at least 140,000 people from both sides, much of the Syrian economy lies in ruins. The regime of President Bashar al-Assad has succeeded in resisting full collapse in areas it controls – in part because of economic support from its external backers Iran and Russia. But above all in rebel-held areas, a war economy is emerging that is creating significant new economic networks and business activities that feed off the violence, chaos, and lawlessness gripping the country. This war economy – to which Western sanctions have inadvertently contributed – is creating incentives for some Syrians to prolong the conflict and making it harder to end it.

At the same time, the Syrian economy is fragmenting as the areas controlled by the regime and the opposition become increasingly disconnected from each other. The relative autonomy gained by local stakeholders is creating new interests and power centres that are likely to clash with any future central government should it want to reassert the level of control exerted by Damascus prior to the war. But the fragmentation of the economy could also be part of a solution to the crisis: a decentralised political system could be a way of appeasing the fears of all sides of the conflict and of guaranteeing them a say in their future.

Three years into a conflict that has killed at least 140,000 people, much of the Syrian economy lies in ruins. As the violence has expanded and sanctions have been imposed, assets and infrastructure have been destroyed, economic output has fallen, and investors have fled the country. Unemployment now exceeds 50 percent and half of the population lives below the poverty line. Food inflation is above 100 percent, the foreign exchange reserves painfully accumulated during the short oil boom of the 1990s are dwindling, and the budget deficit has exploded from less than 3 percent of GDP in 2010 to 33 percent.¹ The human development index (HDI) has fallen back to where it stood 37 years ago. It is estimated that even with an average annual growth rate of 5 percent it would take nearly 30 years to recover Syria's 2010 GDP value.²

This brief argues that, against this backdrop, a war economy is now entrenching itself across the country, particularly in opposition-controlled areas, creating significant new economic networks and business activities that feed off the violence gripping the country. This war economy is to some extent creating incentives for those now making money from the conflict to prolong it. Significant sectors of the economy now live and thrive off the conflict, creating a growing pool of individuals and groups that have no interest in seeing

¹ During the 1990s, Syria saw a boom in oil production that peaked at 600,000 barrels a day in 1996, enabling the government to accumulate foreign reserves. After that, production fell quickly to around 386,000 barrels a day in 2010.

² ESCWA, "Syrian Experts Urge Geneva II Parties to Seize Historic Opportunity", Beirut, 21 January 2014, available at http://www.escwa.un.org/information/pressescwaprint.asp?id_code=610.

the conflict end. At the same time, however, the Syrian economy is fragmenting as areas controlled by the regime and the opposition become increasingly disconnected from each other. As new interests and power centres emerge, it is increasingly difficult to imagine a return to the strong, centralised state that existed before the conflict. But this fragmentation could also be part of the solution to the conflict – in particular as a way of working towards a new national consensus from the bottom up.

Four stages of decline

Following the outbreak of nationwide conflict in 2011, the Syrian economy has declined in four stages. The first stage, which followed the immediate outbreak of the uprising, saw the rapid flight of tourists and a broad loss of domestic confidence, which led to an immediate fall in both consumption and investment. In May, only two months after the first protests, the country's nationwide average hotel occupancy rate fell and the number of investments licensed by the Syrian Investment Agency in the first half of 2011 dropped 43 percent compared to the same period in 2010.³ In response, the government quickly introduced public sector pay rises and reduced the price of subsidised heating oil.⁴ In September 2011, it banned all imports carrying a custom duty of more than five percent in a bid to make foreign currency savings of \$6 billion, but reversed the decision 12 days later following a general outcry from the business community.⁵

A second stage began in the autumn of 2011 with the imposition of Western, and most importantly European, sanctions on Syrian crude oil exports, signalling the economy's growing international isolation. The EU had been the biggest market for Syria's heavy type of crude oil – in 2010 it had bought around 90 percent of all Syrian oil exports, which represented 90 percent of the state's total foreign currency income. Thus the sanctions led to a dramatic fall in fiscal revenues. Other sanctions have complicated international transactions: state entities including the Central Bank, the Commercial Bank of Syria, and the Syrian Petroleum Company were blacklisted and the US Treasury banned the supply of any type of services to the Syrian banking sector, forcing Syrian banks to turn to non-dollar transactions. The EU and US also sanctioned a large number of Syrian individuals, including many of the country's most prominent businessmen.

By the end of 2011, the Central Bank had already used more than a third of its foreign currency reserves, which fell to \$14 billion by December 2011.⁶ The bank has not made public its balance sheet for the period since 2011 but foreign reserves are estimated to now stand at between \$2 and \$5 billion.⁷ However, at the beginning of 2013, the Assad government was able to get help from Iran to finance imports, including those of oil products. Thus the proclaimed objective of Western sanctions – to force the regime into accepting substantial political reform – has not been achieved. Very few, if any, of the blacklisted investors have switched to the opposition. In fact, many of the blacklisted investors are so closely tied to the regime, either out of business necessity or personal ties, that they have little interest in parting with it.

A third phase in the decline of the Syrian economy began in the summer of 2012 with the expansion of the conflict into Syria's two economic powerhouses, Damascus and Aleppo, which together had made up more than 50 percent of the country's manufacturing sector. The industrial base of these two cities, especially in Aleppo, was significantly affected by violence, stopping almost all manufacturing exports. This expansion of violence was part of a broader breakdown in law and order and growing reports of kidnappings and lootings, in particular in the Aleppo region. It led to an even greater large-scale emigration of the business community and middle class, much of which is now committing itself to extended periods in Turkey and other countries in the region.⁸

Finally, a fourth stage began in the spring of 2013 with the seizure by the opposition of the northeast of Syria, where most oil and grain resources are located. This development resulted in a split between the western part of the country (largely under government control) and the eastern part (under rebel control). The loss of the northeast forced the government to increase its dependence on imported petroleum products and thus on its international backers. In order to circumvent sanctions and fund these imports, Iran and, to a lesser extent, Russia provided credit facilities and even delivered oil with their own tankers. During this last stage, the Syrian pound also collapsed to over 300 per dollar, though it recovered to around 150 following the US decision not to launch military strikes on the country. Despite its decline in 2013, the Central Bank had successfully been adopting a carrot-and-stick approach to keep the currency afloat, such as pumping dollars into the market and regularly clamping down on moneychangers.

3 The Syria Report, "Investment Body Says Investment in H1 Down 43 Percent", 16 August 2011, available at <http://www.syria-report.com/news/economy/investment-body-says-investment-h1-down-43-percent>; The Syria Report, "Hotel Occupancy in Aleppo Close to 0%", 29 May 2011, available at <http://www.syria-report.com/news/tourism/hotel-occupancy-aleppo-close-0-report>.

4 The Syria Report, "Syrian President Announces Significant Increases in Benefits for Civil Servants", 28 March 2011, available at <http://www.syria-report.com/news/economy/syrian-president-announces-significant-increases-benefits-civil-servants>.

5 The Syria Report, "Decision to Reverse Import Ban Confirms Government Lacks Economic Strategy", 10 October 2011, available at <http://www.syria-report.com/news/economy/decision-reverse-import-ban-confirms-government-lacks-economic-strategy>.

6 Central Bank of Syria, "Monetary and Banking Statistics", December 2011, available at <http://www.banquecentrale.gov.sy/reports/MonetaryStats/Monetarystats-2011.pdf>.

7 Author interviews with bankers and economists, November–December 2013.

8 The Syria Report, "Syrians, Most Numerous Foreign Investors in Turkey", 27 January 2014, available at <http://www.syria-report.com/news/economy/syrians-most-numerous-foreign-investors-turkey>.

Resilience in regime-controlled areas

Despite the descent into conflict and the wide economic decline, most areas under regime control – with the exception of Aleppo and parts of Homs – continue to enjoy the provision of many basic state services such as water, electricity, education, and health services, and commodities such as bread, fruit and vegetables, gasoline, and heating oil. Even imported food products such as sugar and rice are accessible. This is particularly surprising given the wider conflict and in particular the economic burden for the regime of maintaining a large security force that could be as high as 240,000 men, including around 180,000 soldiers and 60,000 members of the paramilitary National Defence Force.⁹ Although salaries in the army and security forces as well as in the National Defence Force remain below \$100 per month, they still amount to a hefty total that is still being paid.¹⁰ In addition there is the cost of weapons purchases from abroad.

This resilience in regime-controlled areas can be explained by several factors. First, the fall in overall demand – a consequence of the decline in the purchasing power of the population and of economic activity and of a reduction by 15 percent in the population of the country – has made it easier for the government to continue supplying basic goods and services. Second, the decline in the value of the national currency has also increased the value of the sizable foreign currency holdings. Third, the government has taken measures such as increasing custom tariffs on imported cars in a bid to save foreign currencies – expenditure on car imports represented one of the main sources of currency demand. It also quickly reduced government spending on overheads such as office expenses or gasoline for cars used by civil servants and on investment, such as the construction of new schools, hospitals, roads, or water sewage systems, which had represented between a third and half of government spending.¹¹ Only strategic projects, such as work on a number of power plants, remain ongoing.

Syria has also benefitted from its relative wealth in natural resources and its historically diverse economy. Good agricultural production during the three years of the uprising has played a major role in ensuring ongoing food supplies for the cities. The fact that most electricity production plants are powered with natural gas produced locally and extracted from fields located in regime-controlled areas has helped limit power outages. Local crude output ensured that supplies of most oil products were available across the country until the beginning of 2013.

At the same time, the government has clearly been propped up by significant financial support from its domestic and

international allies. Within Syria, businessmen whose interests are closely tied to the regime, in particular relatives of the Assad family such as Rami Makhlouf, considered the wealthiest and most powerful businessman in the country, have provided important backing. Makhlouf's wealth and control of key economic assets, such as the country's lucrative main mobile telecoms provider, have been mobilised in support of the regime. Fellow regime-supporting businessmen have also weighed in to support the regime's war effort, whether through direct financial aid or in-kind support. Mohammad Hamsho, the brother-in-law of Maher Al-Assad, Bashar Al-Assad's brother, who is active in various sectors including trade, metal manufacturing, and TV production, as well as Samir Hassan, the former agent of Nestlé in Syria, are both alleged to have made significant contributions in cash. As one local example among many, owners of transport companies have allegedly made their buses available for the troop movements.

This is not to say that the business community has collectively united behind the regime. On the contrary, many have pumped support into the opposition. In the summer of 2011, the chambers of commerce of Homs, Hama, and Deir-ez-Zor participated, more or less formally, in the strikes called for by opposition activists, while in Damascus some businessmen joined a strike in December of that year. Some of the most prominent figures of the business community have distanced themselves from the regime in order to avoid the backlash from international sanctions, in the process losing access to lucrative business deals and facing regime punishment, in the form of asset freezes or court actions under dubious charges.¹² Nonetheless, the regime's ability to secure the ongoing backing of significant parts of the business community has clearly bolstered its position. It is also worth noting that even financial support to the opposition will have helped the regime by feeding the wider economy.

The regime has also benefitted from external economic support. Tehran's support has been particularly substantial – and a shift in the relationship over previous years. In 2010, bilateral trade between the two countries stood at only \$316 million, according to Syrian official sources, well below the level of those countries now actively backing the opposition. The same year, trade levels stood at \$1.3 billion with Saudi Arabia, and \$2.3 billion with Turkey.¹³ Tellingly, in late 2010, the Syrian government announced the results of an international tender for the operation of a third mobile phone network in the country. Of the six companies that bid – France's Orange, Turkey's Turkcell, Qatar's Q-Tel, Saudi Arabia's Saudi Telecom, UAE's Etisalat, and Iran's Toseye Eatemad Mobin – the government only eliminated the Iranian company, which was rumoured to be associated with the Revolutionary Guards.¹⁴

⁹ "Syria's diminished security forces", AFP, 27 August 2013; Olivia Alabaster, "Pro-regime militias may oust Assad, threaten future state: report", the *Daily Star*, 13 December 2013, available at <http://dailystar.com.lb/News/Middle-East/2013/Dec-13/240910-pro-regime-militias-may-oust-assad-threaten-future-state-report.ashx#axzznLDdtgGF>.

¹⁰ Interview with families of conscripts, November–December 2013.

¹¹ Interview with civil servants, January 2012.

¹² The Syria Report, "Syrian Government Freezes Assets of Investor and Byblos Bank Director on Terrorism Charges", 19 February 2013, available at <http://www.syria-report.com/news/finance/syrian-government-freezes-assets-investor-and-byblos-bank-director-terrorism-charges>.

¹³ Central Bureau of Statistics, "Statistical Abstract," 2011, www.cbssyr.sy

¹⁴ The Syria Report, "Syria Shortlists 5 Telecom Firms for 3rd Mobile Phone License," 1 December 2010, <http://www.syria-report.com/news/telecoms-it/syria-shortlists-5-telecom-firms-3rd-mobile-phone-license>

However, as early as July 2011 reports surfaced that Iran was considering financial help of up to \$5.8 billion in the form of cash and oil supplies to the Assad regime. Then, in 2013, Iran granted two credit facilities worth a combined \$4.3 billion to Damascus. The first, worth \$1 billion, was intended to fund imports and the other, worth \$3.6 billion, was dedicated to the procurement of oil supplies.¹⁵ Two examples of the use of these credit lines were made public in December 2013. The Minister of Oil, Suleiman Al-Abbas, announced that three Iranian tankers were docking every month in Syrian ports, paid for by the oil credit line. The General Foreign Trade Organization, a state entity, also issued a tender for the purchase of food products to be paid through an Iranian bank.¹⁶

Russia is also believed to be providing economic and financial support to Damascus, though the extent of this aid is less clear. One area of co-operation between the two countries has been an attempt to circumvent European and American sanctions, in particular on Syrian state banks and on the wider financial system. In December 2011, a few weeks after the announcement of these sanctions, the Central Bank of Syria opened several rouble accounts at Russian banks VTB, VEB, and Gazprombank.¹⁷ These accounts were used to deposit the assets that Syrian state banks had to withdraw from European institutions. In June 2012, the Syrian government also announced that it was finalising discussions with Russia to print money there.¹⁸ The Central Bank previously printed its bank notes in Austria.

In 2012, Russia and Syria also signed barter deals for the exchange of Syrian crude oil and Russian oil derivatives and other products. The extent of this trade, however, is estimated to have been limited and has now probably declined further given that the Syrian authorities have little to export after the loss of access to their oil resources.

Meanwhile, international humanitarian agencies – whose work Damascus has largely been restricted to regime-held areas, blocking for instance cross-border assistance moving into the opposition-held north – have also provided important financial assistance, which in addition to being critically important to recipients has helped unburden the government of some responsibilities. Over 2013, UN agencies and other organisations spent around \$1 billion on refugees and internally displaced persons. The UN requests for funds in 2014 is four times the level of 2013 and even if most of the aid requested does not come through, the government is likely to increasingly put the burden of shouldering the population's humanitarian needs on the UN and other aid organisations.

The emergence of the war economy

Provided they maintain their policy of reducing expenses to the bare minimum and continue receiving financial backing from domestic and international allies, the Syrian authorities seem able to continue paying salaries and ensuring the supply of basic commodities to their core constituency. But opposition-controlled areas, which now represent anywhere between 30 and 40 percent of the country, no longer possess functioning state services, although salaries to most civil servants continue to be paid. In these areas, electricity power is not supplied, consumer goods are lacking, formal economic activity has almost entirely ground to a halt, children are out of school and often not vaccinated, and poverty and hunger are becoming widespread. The desperate plight of the Palestinian camp of Yarmouk, starved of food and resources by a regime siege, highlights the situation of so many.

Above all, in the chaos of such opposition-controlled areas, a war economy has emerged that is influencing both the current evolution of the conflict and will also have a critical impact on the post-war period. As security has collapsed, an informal economy comprising looting, kidnapping, and smuggling has become an important source of income. Entirely new business networks, often illicit, are emerging and new groups and individuals are being empowered at the expense of the traditional business class. In Aleppo, for example, assets from hundreds of factories have been seized and resold elsewhere in the country or in southern Turkey. In Raqqa, when Jabhat Al-Nusra entered the city in February 2013, the most prominent spoils of war were the coffers of the regional branch of the Central Bank of Syria. Billions of Syrian pounds were alleged to have been seized and used for the group's war effort and its administration of the city. The north-eastern region, with its vast agricultural and energy resources, has now developed an economic life of its own with the development of a particularly buoyant oil trade and the enrichment of a new class of tribal and rebel leaders.

The expansion of the war economy in these areas has been particularly fuelled by the intra-rebel fight for lucrative resources such as border posts, oil fields, and grain storehouses. The fight for oil fields in the north-eastern region has been particularly bloody with Al-Qaeda linked groups, Arab tribes, Kurdish militias, and local brigades all battling for control. Jabhat Al-Nusra and the Islamic State of Iraq and Sham (ISIS), two Al-Qaeda affiliated groups, have been particularly efficient in managing their resources. They now control many of the larger oil fields around the Deir- ez-Zor areas, such as the Shadadi field,¹⁹ while smaller fields are under the control of local tribes; Saddam Al-Nuaimi, a warlord affiliated to the Free Syrian Army, for instance, controls wells in Bukamal near the Iraqi border.²⁰ The oil business has been so lucrative that a new market has been

¹⁵ The Syria Report, "Iran, Syria Sign Deal over new USD 3.6 Billion Credit Facility", 5 August 2013, available at <http://www.syria-report.com/news/oil-gas-mining/iran-syria-sign-deal-over-new-usd-36-billion-credit-facility>.

¹⁶ Maha El Dahan, "Syria issues second food tender using Iranian credit", Reuters, 24 December 2013, available at <http://www.reuters.com/article/2013/12/24/syria-flour-idUSL6NoK3oWC20131224>.

¹⁷ The Syria Report, "Central Bank Opens Accounts with Russian Banks – Report", 5 December 2011, available at <http://www.syria-report.com/news/finance/central-bank-opens-accounts-russian-banks-report>.

¹⁸ The Syria Report, "Central Bank Denies Printing Money to Finance Deficit", 18 June 2012, available at <http://www.syria-report.com/news/finance/central-bank-denies-printing-money-finance-deficit>.

¹⁹ Malik Al-Abdeh, "Rebels, Inc.", Foreign Policy, 21 November 2013, available at http://www.foreignpolicy.com/articles/2013/11/21/rebels_inc (hereafter, Al-Abdeh, "Rebels, Inc.")

²⁰ Al-Abdeh, "Rebels, Inc."

created near Manbij, close to the Turkish border,²¹ from where the oil is either exported to Turkey or resold to other parts of the country. ISIS also seized flourmills that produce enough flour to feed one million people a day and has used its monopoly over flour in the area to generate profits.²²

Another common source of business income for rebel brigades is the levying of transit fees at border crossings and checkpoints. Some 34 checkpoints, for instance, dot the 45km-long road between Aleppo and the Turkish border.²³ In Aleppo city, the Bustan Al-Qasr crossing linking opposition and regime-held area has been fought over by several brigades given the fees that can be levied on goods crossing it. At the Bab Al-Salam border post with Turkey, the Northern Storm Brigade and the Liwaa Al-Tawhid Brigade, who shared the control of the post, levied \$1,000 on every truck that passed through the crossing in August 2013.²⁴ Jabhat Al-Nusra reportedly capitalised on its control of areas crossed by pipelines to levy transit fees, which included allowing oil to keep flowing to government-held refineries in Homs and Banias.

Business opportunities are also arising from the battles themselves. During the six-month siege of the huge Wadi Al-Deif military base near Idlib, the Syria Martyrs' Brigade of Jamal Maarouf is believed to have deliberately extended the duration of the battle because it was an important source of generating revenue from external backers. As long as the siege was ongoing, the rebel commander continued to receive funds from Gulf donors to help him finish the battle. At the same time, the rebel commanders were alleged to be taking regime bribes to allow it to continue sending supplies to the men inside.²⁵

With the disappearance of the state in opposition-held territories, the central laws regulating business operations have also ceased to exist, providing new openings. Hence, while the import of used passenger cars is banned in Syria and a hefty duty fee of 50 percent is imposed on new vehicles, the northern region has seen a flow of used cars, mainly from Eastern Europe. In Bulgaria, Syrians have become the largest buyers of cheap used cars.

At the same time, elements of this war economy are also being seen in regime-controlled areas, where some form of centralised authority continues to apply. The growing regime reliance on local militias has forced the government to grant these militias increasing local leverage and autonomy, giving them the freedom to ransack and loot areas taken over from the opposition and, to a lesser extent,

areas under their direct control. In Lattakia, for example, Hilal Al-Assad, a relative of Assad, ruled the city for months and resorted to kidnappings to finance his operations.²⁶ In the city of Homs, as elsewhere in the country, a market for goods stolen from opposition areas has sprung up (named "Souk Al-Sunna, or the Sunnis' market, because opposition areas were mostly inhabited by Sunnis).²⁷

Western sanctions have inadvertently also contributed to the development of the war economy. Sanctions against state entities and prominent investors have forced the authorities to seek intermediaries for their international transactions, giving new individuals the opportunity to enrich themselves. The government will award a contract to one of these intermediaries, who will set up a company in Syria registered under a name that is not blacklisted or establish a front company in Lebanon. To further blur the details of the transactions, this company will then use a broker that will contract directly with the suppliers and a letter of credit to pay for the import will then be issued generally from a bank based outside Syria. At every one of these stages, fees are levied and new margins generated, leading to hefty profits for the middlemen and to an increase in the overall cost of the products. The sanctions are thereby enabling regime cronies to enrich themselves at the expense of state institutions, while increasing the price of basic commodities for the population. In other words, the sanctions are strengthening elements of the Syrian regime at the expenses of the state and its citizens.

These middlemen are now bringing in key goods required by the regime and population such as food products, but are also benefitting from the demand for new products and services, such as electric generators or the provision of private security services, not required prior to the conflict. Longstanding regime allies such as Makhlof and businessmen such as Ayman Jaber and Abdelqader Sabra have been identified as key profiteers.²⁸

The decline in the value of the Syrian pound has also offered new opportunities. The currency often fluctuates by more than ten percent in a single day, and these sudden changes are attributed to well-connected speculators close to the regime capitalising on the differential between the official and black market rates of the pound to make significant gains.²⁹ But trading in this highly speculative and profitable business remains dangerous. In October 2013, the Central Bank closed the foreign exchange company of Zouheir Sahloul, a Syrian currency trader often dubbed "the king"

21 Al-Abdeh, "Rebels, Inc."

22 "Manbij, a Success Story in the Liberated Areas", the *Syrian Observer*, 22 January 2014, available at <http://syrianobserver.com/Features/Features/Manbij+a+Success+Story+in+the+Liberated+Areas> (hereafter, "Manbij, a Success Story").

23 "Manbij, a Success Story".

24 Suhaib Anjarini, "Details Emerge on Syrian Rebels Responsible for Kidnappings", *Al-Monitor*, 22 August 2013, available at <http://www.al-monitor.com/pulse/tr/contents/articles/security/2013/08/syria-kidnapped-lebanese-brigade-azaz.html>.

25 Ruth Sherlock, "Syria dispatch: from band of brothers to princes of war", the *Daily Telegraph*, 30 November 2013, available at <http://www.telegraph.co.uk/news/worldnews/middleeast/syria/10485970/Syria-dispatch-from-band-of-brothers-to-princes-of-war.html>.

26 Interview with Lattakia-based activists, 15 December 2013. Hilal Al-Assad was killed on 23 March 2014 during battles in the Lattakia countryside.

27 Interview with Homs resident, November 2012.

28 Jonathan Saul, "Exclusive: Assad allies profit from Syria's lucrative food trade", *Reuters*, 14 November 2013, available at <http://www.reuters.com/article/2013/11/14/us-syria-food-idUSBRE9AD0U120131114>.

29 Author interviews with bankers, June-July 2013.

of the foreign currency market and credited with saving the Syrian currency in 2005 when the Hariri assassination and the withdrawal of the Syrian army from Lebanon incited a run on the pound.³⁰

The fragmentation of the Syrian economy

Alongside the development of new forms of business based on the conflict, a fragmentation of the Syrian economy is also taking place. The parts of Syria under the control of the government – almost all the main cities in addition to the coast and the Suweida governorate in the south – are often no longer connected with each other; Kurdish armed groups are partly in charge in the northeast and other pockets around Aleppo; the rest of the country is controlled by dozens of different opposition brigades. In the rebel-held north, much of the needs of the population – cars, oil products, some food items – are imported from Turkey. Oil extracted by rebel groups and farming products are also sold through Turkey.

In regions outside of government control, new institutions have been created to take charge of daily life. In the Ghouta suburbs of Damascus local councils manage the life of the inhabitants and ensure supplies of products and services. In the city of Manbij, a police force and a workers union have been established. In January 2014, de-facto Kurdish decentralisation was formalised with the creation by the Kurdish Democratic Union Party (PYD), the most powerful party on the ground, of local administrations to govern daily life in the three main areas under its control, around the city of Qamishli in the northeast and in two pockets north of Aleppo.³¹ In March 2014, the creation of the Higher Council for Local Administration (HCLA), a grouping of local administration groups was announced. While this grouping was only one of several similar groupings announced over the last two years, it confirmed the entrenchment of the decentralisation experience. In the statement announcing its creation, the HCLA said that it would work to move Syria “from a centralised dictatorship to decentralised freedom”.³²

The loss of the northeast to the opposition in the spring of 2013 was particularly sensitive for the government, given that the region contains all of the country's oil wealth and a large part of the grain and water resources. In response to its losses, the regime has sought to redirect economic resources to more secure areas of the country. The government has publicised new projects in the more stable coastal area and encouraged investors to relocate there. These projects have included a civilian airport in Tartous (despite there already being an airport in nearby Lattakia), several university faculties, a solid waste treatment plant and a tobacco-

processing centre.³³ A free trade zone in Lattakia has also been enlarged to accommodate new investors. In January 2013, the government received a loan from Tehran to build a 650MW power plant in the coastal area.³⁴ If these projects materialise, which is by no means certain, they will increase the attractiveness of the coastal area and provide the regime with the beginning of an alternative economic base to make up for losses elsewhere.

Coupled with these developments fostering growing decentralisation, opposition forces have also received important external backing aimed at strengthening their independence and hold over territories seized from the regime. This support has largely come in two forms: humanitarian aid aimed at alleviating the suffering of the population, provided by regional states, international organisations, Syrian expatriates, and private donors from across the Gulf region; and military aid, mainly provided by Gulf states, in particular Qatar and Saudi Arabia, as well as rich private funders from Kuwait and Saudi Arabia. As with all data on the opposition areas, measuring the size and allocation of these funds is challenging.

The importance of donations from private charities in the Gulf, channelled through informal networks, complicates the task. Contrary to the government side, where private donations have remained limited, large Gulf-based networks have poured hundreds of millions of dollars into opposition groups. In Kuwait alone, the aid has reached the hundreds of millions of dollars, although these amounts may not necessarily all be originating from the country.³⁵ Relatively lax terror-financing regulations have encouraged many donors from other Gulf countries to channel their funds through the country. Beyond financing the armed struggle, this money has been used to fund a wide selection of projects in opposition areas, such as hospitals, water wells, or bakeries.

Even as fragmentation deepens and the central government's hold over the country grows ever weaker, some economic interaction between the areas controlled by the regime and the rebels has continued. In Aleppo, after the Sharia Authority, which manages civilian life in opposition areas, threatened to cut water supplies to government-held areas if electricity outages were not discontinued, a “water-for-electricity” deal was agreed by the two sides. In Idlib, rebel groups owning wheat stocks reportedly struck a deal with local government officials who controlled a flour milling plant. In April 2013, reports emerged that Jabhat Al-Nusra had struck a deal with the government to supply it with oil after it took over several oil fields in Deir-ez-Zor. These economic linkages may represent one of the very few

³⁰ The Syria Report, “Central Bank Clamps Down on Money Changers, Targets Sahloul,” 7 October 2013, available at <http://www.syria-report.com/news/finance/central-bank-clamps-down-money-changers-targets-sahloul>.

³¹ The Syria Report, “Syrian Kurds Grow Increasingly Assertive, Form Local Councils”, 27 January 2014, available at <http://www.syria-report.com/news/economy/syrian-kurds-grow-increasingly-assertive-form-local-councils> (hereafter, The Syria Report, “Syrian Kurds Grow Increasingly Assertive”).

³² The Syria Report, “Syrian Kurds Grow Increasingly Assertive”.

³³ Mohammad Hussein, “Ijraat li-Ihdath Matar Madani fi Tartous”, *Al-Thawra*, 2 April 2014.

³⁴ The Syria Report, “Iranian Credit Line to go to Power Sector”, 21 January 2013, available at <http://www.syria-report.com/news/economy/iranian-credit-line-go-power-sector>.

³⁵ Elizabeth Dickinson, “The Syrian War's Private Donors Lose Faith”, *The New Yorker*, 15 January 2014, available at <http://www.newyorker.com/online/blogs/newsdesk/2014/01/the-syrian-wars-private-donors-lose-faith.html>.

tangible means of exerting mutual compromises out of the warring parties.

Even so, the relative autonomy gained by local stakeholders is clearly creating strong interests and localised power centres that are likely to clash with any future central government should it want to reassert the level of control exerted by Damascus prior to the war. Control of natural resources, such as oil and water, or over access to border posts and ports, will likely be a major source of ongoing competition. More broadly, the relationship between the different regions and the capital, the respective dependency of the one towards the other, the level of autonomy granted to local powers and the future of the institutions created during the war will all be sources of ongoing friction given that newly empowered groups and regions are unlikely to willingly cede what they have gained.

Towards a solution

Three years after the Syrian uprising began there is no end to the conflict in sight. An uprising that began as a call for a fairer, freer, and more dignified life has been transformed into a prolonged civil war. As it has developed, both regime and rebel sides have taken advantage of the shifting dynamics to ensure their ongoing ability to mobilise resources behind their fight. A growing number of individuals and groups on both sides of the divide are now reaping significant material benefit from the ongoing conflict, which gives them a powerful incentive to prolong the fight from which they are profiting. Many rebel brigades are now believed to focus entirely on their business operations, and have effectively given up the fight against the regime. For these, and many other individuals and groups on both sides of the divide, the ongoing war is now cementing lucrative new money-making opportunities.

At the same time, the control of the central state has been fatally weakened and new forces and actors have seized control across the country. These new power centres have been particularly empowered by access to and control over key economic resources, such as oil in the northeast or border crossings along the Turkish border, which have provided economic independence, helping to cement local holds on power.

Europe's most important tool over the course of this conflict has been the imposition of sanctions. Although it has a significant financial impact on the regime's revenue streams, it has not produced the desired political impact. The sanctions, which were initially supposed to coerce the regime into accepting the demands of its population, have broadly failed in their political goals. Meanwhile, they have contributed in their own way to the war economy by strengthening new supply networks to bypass them. The sanctions have also given the Assad regime a scapegoat for the public cost of the conflict; had a humanitarian impact by limiting supplies and increasing the cost of imported foods,

medicines, and other products such as equipment for waste treatment plants; and have served to tighten the regime's dependence on external actors, particularly Iran.

In partial recognition of some of these effects, the EU decided in the spring of 2013 to partially lift its ban on Syria's oil exports to allow for the export of crude from regions under the control of the opposition. This relaxation of sanctions was intended to generate new sources of revenues – and local sustainability – in opposition-controlled areas. In practice, however, the measure had little impact because one of the conditions for lifting the ban was that the proceeds would go to the National Coalition, the opposition grouping recognised by Western countries, but which has little meaningful leverage with the fighting groups that control the fields.

Europe now needs to more carefully consider the implication of sanctions. While the measures imposed have already had an impact that is irreversible, European states must resist falling back on the default measure of imposing new sanctions for lack of other alternatives, when it wants to make a further stand against the Assad regime and its supporters. Given the urgently deteriorating humanitarian catastrophe, Europeans should also constantly reassess the impact of sanctions. While there are obvious risks that regime cronies may benefit from loopholes, this should not impede a "liberal" application of the sanctions regime on humanitarian grounds. In particular, a reduction in procedures with regards to trade and banking transactions to speed up supplies of medicines and food should be considered.

Meanwhile, although the civil war is fundamentally a struggle for political power, Europeans need to take into account the emergence of powerful economic interests when it comes to thinking about what it will take to draw the fighting to an end. In particular, the fragmentation of the Syrian economy makes it increasingly difficult to envisage the reconstitution of the pre-uprising central Syrian state. The new forces created by the emergent war economy are almost certain to powerfully resist attempts to rebuild central control over Syria and will likely only support a settlement based on a large degree of local political and economic autonomy. Although many Europeans would prefer to re-establish a strong central state, they should consider a transition premised on a decentralised state.

Given the growing strength of localised actors, European policymakers need to do more therefore to empower the capacity of local councils across the country. These efforts are already starting to take place, and should be actively pursued. Efforts should not be geared only towards humanitarian aid but focus rather on providing the means for the self-sustainability of these regions for as long as a broader new political dispensation remains elusive. A more decentralised political system could even be part of the solution to the Syrian conflict, providing a means of working towards a new national consensus from the bottom up.

About the author

Jihad Yazigi is a Visiting Fellow at the European Council on Foreign Relations. He is the founder and editor of The Syria Report, an online bulletin covering Syrian economic affairs. He has written extensively on the Syrian economy and has provided research, advisory and consultancy services to regional and international organizations.

Acknowledgements

I would like to express my gratitude to the various individuals and activists that have given their time and knowledge to improve my understanding of the situation in Syria. My gratitude also goes to Julien Barnes-Dacey and Daniel Levy whose input and advice have been invaluable in the course of my work on this paper.

ECFR extends its thanks to the governments of Norway and Sweden for their ongoing support of ECFR's Middle East and North Africa programme.

ABOUT ECFR

The **European Council on Foreign Relations** (ECFR) is the first pan-European think-tank. Launched in October 2007, its objective is to conduct research and promote informed debate across Europe on the development of coherent, effective and values-based European foreign policy.

ECFR has developed a strategy with three distinctive elements that define its activities:

- **A pan-European Council.** ECFR has brought together a distinguished Council of over two hundred Members – politicians, decision makers, thinkers and business people from the EU's member states and candidate countries – which meets once a year as a full body. Through geographical and thematic task forces, members provide ECFR staff with advice and feedback on policy ideas and help with ECFR's activities within their own countries. The Council is chaired by Martti Ahtisaari, Joschka Fischer and Mabel van Oranje.
- **A physical presence in the main EU member states.** ECFR, uniquely among European think-tanks, has offices in Berlin, London, Madrid, Paris, Rome, Sofia and Warsaw. Our offices are platforms for research, debate, advocacy and communications.
- **A distinctive research and policy development process.** ECFR has brought together a team of distinguished researchers and practitioners from all over Europe to advance its objectives through innovative projects with a pan-European focus. ECFR's activities include primary research, publication of policy reports, private meetings and public debates, 'friends of ECFR' gatherings in EU capitals and outreach to strategic media outlets.

ECFR is a registered charity funded by the Open Society Foundations and other generous foundations, individuals and corporate entities. These donors allow us to publish our ideas and advocate for a values-based EU foreign policy. ECFR works in partnership with other think tanks and organisations but does not make grants to individuals or institutions.

www.ecfr.eu

The European Council on Foreign Relations does not take collective positions. This paper, like all publications of the European Council on Foreign Relations, represents only the views of its authors.

Copyright of this publication is held by the European Council on Foreign Relations. You may not copy, reproduce, republish or circulate in any way the content from this publication except for your own personal and non-commercial use. Any other use requires the prior written permission of the European Council on Foreign Relations

© ECFR April 2014.

ISBN: 978-1-906538-97-2

Published by the European Council on Foreign Relations (ECFR),
35 Old Queen Street, London,
SW1H 9JA, United Kingdom

london@ecfr.eu