Syrian Financial Sector Reform & Liberalization: Source of Modernization and Economic Growth[•]

Dr. Nasser Saidi[◙]

March 2002

1. Introduction

Syria has launched in the 1990's and early 2000's a series of important economic reforms, aiming at modernizing the Syrian economy, proceeding with an opening-up towards the rest of the world, and increasing its reliance on market forces and expanding the role of the private sector. The new policy measures are intended to reform existing rigidities in the administration and production regimes, combined with a complex regulatory environment.

The government introduced a number of measures to increase the role of the private sector, in particular in industry and foreign trade. Controls on prices, trade and foreign exchange were eased, and more emphasis placed on non-oil exports. The culmination of these measures was the introduction of law No. 10 of 1991 on encouraging investments in Syria, which facilitated foreign investment, led to some deregulation and offered private domestic and foreign investors tax and other incentives.

More recently, with the assumption of Dr. Bashar Al-Assad of the Presidency, a new wave of reforms and measures were enacted, mainly aiming at strengthening the banking and financial sector. These measures implemented in the post march 2000 period consisted in fiscal incentives (such as tax exemption up to 13 years) for some economic activities, allowing non-Syrians to own land and buildings, as well as retention of free exports proceeds.

The reforms are a courageous step. They require determined implementation by policy makers and by the executive and judicial branches of government, by its administration. Importantly, the regulatory environment needed to accompany these reforms has to be introduced. To modernize and renew economic growth and ensure sustained development, Syria faces a number of major internal as well as external challenges:

- Increase private sector participation in all aspects of economic activity, including infrastructure;
- Face up to the challenges emerging from the "information revolution" and the digital divide";
- Effect a strategic diversification away from dependence on oil and gas;

[•] Talk given at the Syrian Economic Society meeting held in Damascus, Syria on Tuesday 12 March 2002. The analysis and views expressed represent are the author's and should not be taken to represent official views or positions.

[◙] Former Minister of Economy & Trade and Minister of Industry, First Vice Governor of the Banque du Liban.

- Adapt to the challenge of globalization and increased opening-up of the Syrian economy and society. In particular Syria needs to implement deep reforms in view of the strategic choices made to implement Free Trade areas with a number of Arab countries, implement the Greater Arab Free Trade Area, proceed with the Association Agreement with the European Union, as well as enter into the WTO.

What is the role and why do we need a reform of the banking and financial sector? What is the impact of banks on productivity and long-term growth? The main thrust of my argument today is that the banking and financial sector has a critical and crucial role to play in ensuring the success of Syria's economic reform measures. Better functioning banks improve resource allocation, with positive repercussions for long-run economic growth. The evidence from economic history, from the experience of a large number of countries analyzed over the past 30 years of global change is that reform and liberalization of the banking and financial sectors is undeniably critical to the process of economic growth through its impacts on total factor productivity growth and technological change, and its symbiotic relationship with the development of the private sector. Financial sector reform reduces the vulnerability of the economy and its exposure to economic and non-economic shocks.

The financial sector promotes growth, and its reform is critical in allowing Syria to adapt to an international economy where technological developments in ICT are leading to finance without frontiers.

2. Main Macroeconomic Developments, 1990 – 2001

The Syrian economy performed relatively well over the period 1991-1995, with an average real growth rate of 7.2 %. However, it witnessed a slowdown starting 1996, with growth falling to 2.5% in 2000 and preliminary estimates indicating a further slowdown in 2001. A number of factors, internal and external as well as exogenous shocks contributed to this outcome.
The structure and vulnerabilities of the Syrian can be summarized in the following set of "stylized facts":

- Agriculture remains a major sector of the economy, with an average 30% share of GDP and about 28.5% of employment over the period 1995-2000. However, with only 25% of arable land irrigated, agricultural output remains subject to weather conditions and rainfall. Indeed, bad weather conditions in1997 and 1999, adversely affected crops and total agricultural GDP, contributing to and deepening the slowdown in aggregate economic activity.
- Export performance is dominated by oil and-increasingly- gas. Earnings from oil exports represented an average 60.9% of total exports on average over the period of 1991-1999, rising to 75.41% in 2000 as a result of the jump in oil prices. Whereas, proven natural gas reserves are equivalent to almost 100 years at current, relatively low, production levels, Syria faces the prospect of becoming a net oil importer by 2010, unless significant

new reserves of oil are discovered. Gas export markets will need to be developed in order to substitute for lower oil earnings.

- Similarly, earnings from oil represent a major source of government revenue and have a major impact on public finances. Oil revenues represented some 40% of total government revenue over the period 1990-2000, rising to 46% of total government revenues in 2000 and representing about 12.75% of GDP.
- Despite the onset of reform, the public sector –in terms of spending, production and total employment- plays a dominant role in the Syrian economy, generating about 30.9% of GDP in 2000, predominantly in industry, utilities, construction and banking and financial services. The private sector produced 69.1% of total GDP in 2000, of which about 29.3% originated from agriculture and the balance from manufacturing and services, mainly tourism.
- The main sources of growth in Syria are from factor accumulation-growth in labor and physical capital investment- with a virtual absence of productivity growth, which has represented the main source of growth during the past decade in the major industrialized countries. Technology and innovation, human capital accumulation, have not played a role in economic growth.
- Finally, whereas the average real growth rate in Syria was x% over the period 1990-2000 compared to y% in the MENA region, Syria's real GDP represented about 3.4% of the region's GDP, and GDP per capita was $1,238 compared with $1,979 for the MENA region in 1999. Syria has not been gaining relative to the average for the region.

Hence, despite a creditable growth performance, the structure of the Syrian economy remains predominantly agricultural, with an export concentration in crude oil and products and limited productivity growth. As a result, economic performance and income, exports, trade and the balance of payments, government revenue and public finances are vulnerable to two factors: weather/rainfall, and oil prices and production. Volatility the oil market and conditions, as well as the vagaries and uncertainties of weather and rainfall lead to instability of exports, public finances and in GDP.
In addition, regional security conditions and the lack of a settlement of the Arab-Israeli conflict have raised actual and perceived economic risk for the region, raised military expenditures and implied lower as well as more volatile external inflows and investment in the region, including to Syria. Indeed, the MENA region has the sad distinction of having the lowest level of per capita inflows and as a fraction of regional GDP of all regions in the world, attracting less than 3% of total flows to the developing countries.

3. Money and Banking, 1990-2001

What has been the role of the monetary and banking system in the economy? To what extent has it constrained growth and expansion? What have been the economic consequences of a "dormant" banking system and the absence of a modern payment system?

The main features of the monetary and banking system and their consequences are easily summarized.

- The level of **banking deepening** and penetration in Syria is low both by regional as well by international standards. There is only one bank branch per 52,000 people in Syria as compared to {…} on average in the MENA region, {…} in similar income countries, and about 5,600(?) in Lebanon. It is clear that Syria is under-banked and that a majority of households, a majority of the population does not have access to modern banking services. In addition, the bank branch network is highly concentrated around Damascus and Aleppo, implying that most rural households are un-banked. This creates a rural-urban divide, and lowers access and availability of bank services and credit to the poorer segments of the population.
- The level of **monetary and financial deepening** in Syria is low compared to the region and compared to countries with similar income levels. As the accompanying graph and tables show, the ratio of M1 to GDP averaged 36.6% in the period of 1995-1999 and reached 42.5% in 2000, while the M2/GDP ratio averaged 53.3% for the same period and 64.9% in 2000. Similarly, the per capita level of banking deposits is one of the lowest in the MENA region and in comparison to countries with similar income levels.
- Similarly, the **payment system and payment media have not evolved**. The use of currency banknotes dominates, with very limited use of non-cash media such as checks, credit and debit cards and electronic transfers. The share of currency in circulation in total money supply in Syria is one of the highest in the world: a clear indicator of severe banking and financial under-development.
- The banking sector is characterized by state-ownership of 7 specialized banks and by monopolistic practices. The industry is highly concentrated, with banking activities confined to traditional services and products, with a total absence of diversity in financial services and instruments. Indeed one bank, the Commercial Bank of Syria, has about 64% of all deposits and more than 71% of all credits.[1]
- **The economy does not rely on market signals for the purpose of credit allocation** and for guiding the saving and investment process: nominal interest rates have remained stable, unchanged since 1981. Given that inflation rates have been volatile over the period, the result has been volatile (and frequently negative) real interest rates, discouraging the development of bank-based saving and leading to the creation of informal, unregulated, credit markets. Combined with the absence of a developed banking system, volatile real interest rates the result was to induce the private sector to maintain high levels of cash

[1] For a comprehensive survey of the banking system, see the paper by Dr. Hisham Bsat, …., AMF Paper No.2, Abu Dhabi November 2001.

liquidity outside the banking system and to rely on self-financing, or to seek banking services abroad, mainly in Lebanon.

- **The Syrian economy makes limited use of credit**, a major feature of modern economies. The ratio of total domestic credit to GDP, (DC/GDP), an important indicator of the availability of liquidity and the ability of businesses and individuals to obtain finance, averaged (…) over the period 1990-2000, standing at {…} in 2000. Again, these ratios are substantially below the average for the MENA countries or for countries with similar income level.
- **More important, is the low level of domestic credit to the private sector, as a share of total domestic credit and as a fraction of GDP, (23%) and 8.8% respectively in 2000.** Since end 1995, credit to the private sector has risen only by about LS13 billion, equivalent to less than 3 percent of money and quasi-money in 2000. Credit policy continues to be geared to the requirements of the public sector. In effect, credit is extended on an administrative basis to public enterprises and government, which capture 77% of domestic credit. In turn, credit is also highly concentrated in the hands of a few public enterprise borrowers, thereby crowding out the remaining public enterprises.[2]

Over the past thirty years, the monetary and banking system in Syria has not evolved in line with economic growth and development. Limited entry and the absence of competition have led to monopolistic practices, the absence of evolution of the payment system, a lack of introduction of modern banking products and services, high intermediation and interest rate spreads, greater concentration of credit and of credit risk, and a crowding out of the private sector.

In turn, the low levels of financial deepening, the crowding out of the private sector, the absence of capital and debt markets, the non-emergence of non-bank financial intermediaries[3], has implied a low level of domestic saving, and a misallocation of scarce resources leading to lower levels of economic growth. *The lack of banking and financial sector development has been a major impeding factor, leading to lower total factor productivity growth and lower economic growth*. International evidence shows that *financial sector liberalization has effects on economic growth and development that are of the same order of magnitude as the positive effects on economic growth of*

[2] For example, in 2000, about 91% of total outstanding credit to public enterprises was allocated to financing the subsidy-related deficit of the General Organization for Cereals Trade and Production, and for Cotton Ginning and Marketing

[3] For example, there is only one, state-owned, insurance company, established in 1952. Through its 24 branches, it carries out all forms of insurance from cars to life. Car and transport insurance constitute 73% of premiums. Insurance premia average annual growth was 13.4% and reached SL 3,268 million in 1996 about 1.7% of net deposits at banks.

increases in education and life expectancy (higher human capital), lower permanent size of government and lower population growth.[4]

4. Reform and Liberalization of the Banking and Financial Sector

Financial sector reform leads to economies that are more resilient, better able to withstand economic shocks and disturbances. Consider, as an example, the effects of lower oil prices in an economy dependent on oil exports as a major source of foreign exchange earnings and a major source of government revenue, as is the case in Syria and most of the Arab oil producing countries. A fall in oil prices implies a fall in export earnings, deterioration in the trade balance and in the balance of payments. In turn, the decline in net foreign assets in the banking system –in the absence of any offsetting policy action by the monetary authorities- implies a decline in money growth, tighter credit markets and lower rates of credit expansion. In parallel, the fall in export earnings directly impacts government revenue, resulting in higher budget deficits. Government reacts by cutting back on spending, in particular capital expenditure, delaying or cutting back on investment projects. The result is a decline in economic growth and reduced employment growth. Similarly, when oil prices rise the opposite adjustment operates. As a result fluctuations in oil prices generate a "boom and bust cycle" in the economy.

On the other hand, a well functioning developed banking system and financial markets and with access to international financial markets, can mitigate the impact and effects of lower oil prices as well as their risks. If the decline in oil prices is temporary, the monetary authorities can offset the monetary and credit effects by injecting liquidity into the banking system and financial markets, and government can borrow and/or use the futures markets to hedge against adverse oil price changes. The result is lower volatility of economic activity and smaller fluctuations in economic growth, greater economic and financial stability and lower economic uncertainty.

Fundamentally, it is the authorities perception of the benefits of financial sector reform (FSR) for economic growth and development, the desire to reduce economic and financial risks and reduce private sector crowding out that ushered in a wave of reforms.

4.1 Recent legal and regulatory reforms.

In the past 2 years a number of important and long-awaited measures were taken to simplify the exchange rate system, reform the banking and financial sector, encourage private and foreign investment.

These measures included:

- The extension of the tax exemption period, for investments under Investment Law No. 10, for a total of up to 13 years
- Allowing non-Syrians to own land and buildings
- Allowing businesses to exchange foreign currency at the free market rate, the retention of all their foreign exchange export proceeds, and the opening of foreign currency deposits.

On the banking side, a series of major liberalization and reform policies were adopted. In June 2000, a **new law was enacted allowing foreign banks to set up in**

[4] [4] See the interesting results in G. Bekaert, H. Campbell and C. Lundblad, "***Does Financial Liberalization Spur Growth?"*** NBER Working Paper No. 8245, April 2001

the so-called "Free Zones". This encouraged a number of Lebanese banks to set up and provide services[5]. However, the geographical proximity of branches of all Lebanese based banks in the Bekaa and Tripoli, providing unrestricted access to all banking services, in addition to the expectation that more liberalization and opening would be forthcoming resulted in a wait and see attitude and response. Indeed, in April, 2001, a new law regulating the banking system, **Law No. 28** [6] came into effect, allowing the establishment of private banks would be permitted, either as private joint stock companies or as partnerships between the government (with a maximum stake of 25 percent) and the private sector. Importantly, it allowed for foreign participation and foreign banks, up to a maximum of 49% ownership. To provide additional incentives to utilize the banking system and its services, the authorities also passed a **Bank Secrecy Law**, which also came into effect in April 2001.

In addition, the authorities proposed a new **Law on Money and Credit and the Central Bank of Syria** (CBS), which is awaiting *Majlis Al-Shaab* approval. The new law would give the CBS a greater degree of independence in formulating and conducting monetary policy and would allow for the devolution of the basic monetary, credit, exchange rate, and prudential supervision functions to the Money and Credit Council (MCC) which would include representatives of the CBS and would be chaired by the Governor of the CBS. A law organizing the Capital Markets and an Anti-Money Laundering Act in line with the recommendations of the FATF would complement the draft legislation.

4.2 On the Need for Comprehensive Economic Reforms

Important as they are as a signal of the new economic strategy championed by President Bashar Al-Assad, the tax and banking reform and liberalization measures will have to be completed by reforms in other areas. Reform cannot be an isolated or sector-specific matter: it has to be comprehensive. Undertaking piece-meal or sector-specific reform may generate distortions and may lead to a "second best" outcome.
Economic reforms pose the issue of the size, activities and responsibilities of the state. Specifically, in Syria the public sector counts for –as we saw above- an important share of total production in all sectors of economic activity. Reform, liberalization and deregulation pose, in consequence, the role of the government and the state in production and economic activity and incentives. Importantly it is a well-functioning, non-distorted price system that has to be restored or introduced to create the appropriate set of incentives to consumers, investors and business. The politically difficult and strategic decision facing the authorities relates to the vision of the banking sector. In many developing countries the banking system was used to achieve social objectives. This policy has led to many under-performing loans and poor performance of banks due to the politicization of lending. In the years ahead, the authorities will have to set clear objectives and policies, separating between social and political objectives on the one hand, and on the other the development and maintenance of a healthy and efficient financial system.

[5] The BDL encouraged and provided the authorization for four banks (BLOM, Société Générale…) to establish themselves in the free zones.
[6] References… Al Jaride al Rasmiye

Comprehensive reform requires setting down a clear road map of intended reforms to inform the private sector, the public, as to the intended strategy.
There are five issues that are important in the specific context of the role of the state and financial sector reform. Briefly, these are:

1) ***The role of state in the financial sector and financial sector reform cannot be viewed in isolation from issues relating to the size and role of government and its involvement in economic activity and social life***. Economic reform must be viewed as a complex, interconnected policy package. Financial sector reform and deregulation aimed at increasing financial deepening should remove the subsidy schemes to public enterprises operating through the banking system and the administrative, non-market mechanism, allocation of credit. To be successful this requires, increased transparency in public sector operations, as well as fiscal and tax reforms aimed at removing existing tax distortions.

The authorities must also decide on continued ownership and management of state banks. The liberalization of the sector, the creation of private banks and entry of foreign banks will lead to increased competition, and a "level playing field" will have to be maintained. The link must also be broken between oil and gas revenue and the financial sector. This requires a structural diversification away from oil and gas towards other sectors and increasing the role of the private sector, and introducing other sources of revenue through reform of the tax system, to reduce dependence on oil revenues.

2) ***The timing and sequencing of reforms is important if not critical to the success of financial sector liberalisation and deregulation***. There has not been much public discussion of this important policy issue in Syria. Research and the lessons of economic reform successes (the reform process in the People's Republic of China (PRC)) and failures (most recently in Eastern Europe and the countries of the Former Soviet Union (FSU) and Russia in particular) suggest the following sequence of reforms: price and wage reform, fiscal and tax reforms, financial sector reform, trade reform, and finally, liberation of external payments and removal of capital controls.[7] Note that, domestic economic reforms should precede reform of the external sector. Policy makers must avoid domestic distortions or subsidies (in prices of goods and services or assets) creating the wrong incentives, giving the incorrect signal and attracting resources into a sector or an activity and exacerbating the distortion. Typically, "destabilizing capital flows" are the result of failing to ensure the removal of domestic distortions in the goods or capital markets, while allowing an opening up of the external sector. Policy makers must ensure that trade and capital flows are responding to "economic fundamentals", to the correct signals given by undistorted market prices and returns.

There is less theoretical and policy analysis consensus on whether reforms should be undertaken gradually or in a "big bang". Friction-less economies, with flexible institutions and well-informed agents would favour radical 'big bang' type policy

[7] See the discussion in Sebastian Edwards,

reforms. Some sectors of the economy necessitate a big bang approach while it is harmful for other sectors and a gradual approach would be recommended. A gradual implementation of reforms is appropriate for FSR in Syria, given the deep reforms and institutional changes required in the state-owned banks.

The public sector should take the lead in implementing reform. Government should put its own house in order prior to imposing reform or deregulation on the private sector. Typically, it is public sector intervention in the functioning of markets and economic activity that has created the distortions. Deregulation should, as a rule, lead with public sector companies and institutions, and encompass companies involved in production as well as financial intermediaries: various types of development banks, specialized credit and financial institutions owned or managed by government. The objective should be to create a level playing field, ensuring competitive conditions in the financial sector. Policy makers implementing deregulation will face opposition from a wide variety of special interest groups: public sector employees and regulators running the public sector financial institutions, the public enterprises benefiting from credit at below market rates, as well as the private sector interests and groups benefiting from 'cheap' finance and other benefits. Importance for fiscal policy and public debt management: public enterprises (including state-owned banks) are forced to accept market discipline (allocation of credit is done by the market at market interest rates).

3) ***Financial sector reform should imply adopting international standards and regulations****. What is critical is to invest in* ***financial system infrastructure****.* Financial infrastructure is the set of laws and prudential regulations and supervision of financial institutions; it includes a sound and efficient payment system, accounting policies and financial information disclosure, the framework governing financial transactions and the legal procedures to enforce them, the wide dissemination of financial and legal information, auditing. Financial infrastructure implies the set-up of market institutions and processes, the availability and use of financial instruments, the use of the price system, with flexible prices –interest rates and exchange rates- used to equilibrate markets. The accompanying graph shows the building blocks and the inter-connectedness of the various components of the financial infrastructure.

The objective should be to modernize banking and financial sector structure, laws and regulations.[8] International standards and norms include: (a) GAAP and International Accounting Standards; (b) BIS and Group of 30 recommendations for payment and settlement systems; the BIS Core Principles for Payment and Settlement Systems; (c) Prudential and supervisory banking norms and standards as recommended by the various BIS committees. In particular, a program should be put in place to ensure conformity with the BIS Core Principles for Banking systems.

Our experience in Lebanon in ensuring compliance with these principles has been beneficial in strengthening our bank system through an increase in capital requirements, higher liquidity, control of credit and operational risks, concentration of credit and exposure. There are at least three benefits from adopting international standards and criteria: (1) it leads to a harmonization of national regulatory systems with international systems, diminishing the risk of "regulatory arbitrage" and

[8] See the discussion in Makram Sader

distorting trade and financial flows; (2) by providing transparency and common "rules of the game", it serves to attract foreign investment in the domestic financial sector and access to the international capital markets; (3) it serves to disarm local lobbies fighting deregulation and financial sector reform, as policy makers can validly argue that the country must compete internationally and conform to international standards.

4) ***Institution Building, Market Supervision and Regulation***. Implementing economic and financial sector reform requires administrative reform, committed, dedicated policy makers and, is critical to the success of reform and modernization. The experience of many countries shows that years of backwardness, monopolistic practices, lack of competition, lack of a clear and transparent system of incentives and compensation is typically associated with inefficiency, waste and corruption. A comprehensive approach to financial sector reform in Syria should *focus* on attracting competent, productive and efficient regulators and policy-makers, providing them with immunity, and a set of incentives and compensation that should be in line with market compensation, in return for "good governance".[9] The policy makers and regulators should focus on developing the role and functions and/or establishing three major institutions.

- Central Bank/Monetary Authority. Increasingly the international trend is to define price stability or the achievement of low price inflation, with monetary and financial stability as the major objectives of the monetary authorities. This requires a central bank law that increases the powers and independence of the monetary authorities to diminish interference by government, but holds them accountable for achieving the objectives of monetary and financial stability. Financial sector reform is a necessary condition for the appropriate conduct of monetary policy: a developed, efficient banking and financial system allows the monetary authorities to use monetary tools and instruments to maintain price stability, improve economic performance and the economy's resilience and ability to withstand shocks and disturbances**.** The existing system does not allow the Central Bank of Syria to perform the functions of a modern central bank.
- Capital Market Authority (CMA). Management of the securities markets needs to be separated from their supervision and regulation. The Bourse de Damas along with the Bourse de Beirut are among the oldest established in the Mashreq. The Damascus Stock Exchange should be privately owned and managed to ensure, among other, international competitiveness and the introduction of new technology for trading, clearing and settlement of securities, and financial products. This will encourage the listing of both private and public companies, helping the Syrian economy attract

[9] Singapore's experience is illustrative o this point. Government ministers and executive, public officials are paid in line with market compensation to perform their duties beyond reproach. Singapore earns high marks for "good governance".

the equity capital and long-term finance it requires for investing in and developing its substantial natural resource base (oil, gas, water and mineral wealth), and providing infrastructure. The Beirut and Damascus stock exchanges should be linked up, with cross listing of companies, providing greater breadth, depth and liquidity to the markets.[10]

Capital market authorities should be instituted by a Capital Markets Law, run by independently appointed and mandated professionals, and endowed with independence to effectively supervise and regulate markets and participants. Notable progress in this direction has been achieved in Egypt, Jordan, Morocco and Tunisia. The existence of independent CMAs has allowed a renaissance of the stock exchanges in those countries, facilitated the process of economic liberalization, including privatization of public enterprises.

- An independent Banking Control Commission should be set-up under the same law providing for central bank independence. The objective is to develop and strengthen the prudential regulatory framework to ensure compliance with core banking principles, to maintain a safe and sound banking system, generating trust, leading to the process of financial deepening. Prudential supervision will play a critical role during the implementation of financial system reform. The new Syrian BCC will have the major task of ensuring that state owned banks comply with minimum standards and core banking principles, and maintain a level playing field between the competing private and state owned banks.

5. Some Thoughts on the Road Ahead

In the presence of such a distinguished and expert audience I hesitate to pronounce on appropriate economic strategies. I will venture some thoughts on the road ahead. Financial sector reform and liberalization can be the key to renewal of economic growth and modernization of the Syrian economy. It should be given priority on the agenda of policy-makers within a comprehensive economic reform package. Reform of the financial and banking sector is critical for several reasons:

1. Increased private sector participation in economic activity, including in the provision of infrastructure services, requires availability and access to finance. In this context, the authorities will need to consider the privatization (including private sector participation in the equity and management) of government owned banks. The regulatory, supervisory and information framework as well as the state banks will have to be prepared. Norms and regulations, accounting standards, information disclosure will have to be enforced on all banks in order to ensure a level playing field. International experience and empirical evidence show that there is a positive causal impact of financial development on real per capita growth and on productivity per capita growth. In particular,

[10] See the discussion in N. Saidi, "**Lebanon & Syria: Economic Relations, Challenges and Strategic Opportunities**", Beirut, December 1998.

increasing the share of private sector credit in total credit leads to higher GDP growth.[11]

2. A modern efficient, well-regulated, banking and financial system is a cornerstone for economic and technical innovation. Better functioning banks improve the allocation of economic resources and accelerate total factor productivity growth, leading to higher medium and long run economic growth. Further, the empirical evidence also suggests that -in addition to financial development- *financial liberalization* also increases economic growth.[12]
3. Syria needs to implement deep reforms in view of the strategic choices made to implement free trade area agreements with Lebanon and a number of Arab countries, implement the Greater Arab Free Trade Area, proceed with the Association Agreement with the European Union, as well as enter into the WTO. Adjustment and reform will require substantial investment by both the public and private sectors.

The international community should support Syria as it undertakes financial and economic reforms, within a comprehensive reform action plan. Such support is required both on a regional basis as well as on an international basis.

On a regional basis, Lebanon is the best suited to provide cooperation and support and has a comparative advantage in banking and financial services. Indeed, Lebanese banks have taken the initiative, and have established themselves in Syria. This opening up via the Lebanese banking system to foreign financial services, international banking and financial markets, will provide healthy competition and help introduce the required innovations in payment systems as well as banking and financial services, as well as being the main channel for closer economic integration between the two countries[13]

Internationally, apart from technical cooperation in reinforcing the capability of the monetary authorities, and on building up the supervisory and regulatory functions and institutions, the main focus should be on access to international finance and providing long term financial resources to Syria enabling it to: (a) finance the economic reform process, (b) develop its substantial natural resource base and (c) invest in information

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[11] See the review of the literature and evidence in Ross Levine, "***Financial Development and Economic Growth: Views and Agenda"*** in Journal of Economic Literature, June 1997, pp.688-726. T. Beck, R. Levine and N. Loayza have an interesting cross-country analysis and evidence on ***"Finance and the Sources of Growth"***, World Bank, working paper, 200.

[12] See the interesting results in G. Bekaert, H. Campbell and C. Lundblad, "***Does Financial Liberalization Spur Growth?"*** NBER Working Paper No. 8245, April 2001. The results show that equity market liberalizations, on average, lead to a one percent increase in annual real economic growth over a five-year period.

[13] I have developed these themes and called for closer integration in "***Lebanon & Syria: Economic Relations, Challenges and Strategic Opportunities***", 1998 and chapter 22 in N. Saidi, **Growth, Destruction and the Challenges of Reconstruction: Macroeconomic Essays on Lebanon**, published by the Lebanese Centre for Policy Studies, Beirut, December 1999.

and communication technologies (ICT) and basic infrastructure required to modernize the economy. In this connection, I wish to welcome and commend the recent initiative of the European Union Commission to establish a EuroMed Bank (EMB) as a subsidiary of the European Investment Bank. Beyond support to investment in infrastructure the EMB is expected to play an important role in supporting the private sector development in the region and actively enhance the partnership with the Mediterranean Countries. A similar initiative should be launched by the Arab countries in the form of an Arab Investment Bank for the Arab countries.

Syria has in President Dr. Bashar Al-Assad a young, ambitious, reforming and modernizing leader with a clear vision as to the country's future. He has set the road map for economic, banking and financial reform. The reform and liberalization strategy deserves regional and international support so that Syria can develop the full potential of its people and its economy.