SUR/07/95

August 1, 2007

The Acting Chair's Summing Up
Syrian Arab Republic—2007 Article IV Consultation
Executive Board Meeting 07/67
July 30, 2007

Directors agreed with the thrust of the staff appraisal. They noted that macroeconomic adjustment and structural reforms have helped the Syrian economy engineer a strong rebound from the subpar growth of the previous half decade and maintain financial stability, despite the abrupt drop in oil proceeds, the deterioration in the regional environment, and the pressures stemming from the large inflow of refugees from Iraq. While the short-term outlook is encouraging, the challenges posed by the further depletion of oil reserves are daunting. Directors underscored that growth will need to be solidified, including by persevering with quality fiscal adjustment and the steadfast implementation of the reforms embedded in the ambitious tenth five-year development plan.

Directors commended the authorities for the sustained, timely and significant fiscal adjustment and welcomed the lowering of corporate income taxes. They agreed that introducing a VAT and phasing out petroleum price subsidies would provide the main pillars of the required fiscal adjustment. A broad-based VAT would have a strong revenue raising potential with only a limited impact on production and investment. Directors observed that phasing out petroleum price subsidies could generate significant efficiency gains and redress part of the social inequity in the existing policy. They recommended that the authorities accelerate the pace of tax administration reforms supporting the introduction of the VAT.

Directors commended the authorities for the significant progress toward exchange rate unification and current account convertibility. They stressed the need to enact a new foreign exchange law that would abrogate the existing complex set of foreign exchange laws and regulations and enshrine full current account convertibility, and a unified exchange rate. This would send a strong signal about the irreversibility of these reforms and the commitment of the authorities to re-entry into the global economy. Directors felt that although the level of the real exchange rate appears broadly appropriate, the impact of its recent strengthening on external competitiveness should be monitored carefully, particularly in light of the depletion of oil reserves and the large uncertainties about the level of the current account deficit and the sources of its financing.

Directors welcomed the tightening of credit policy, which helped tame inflationary pressures, despite the large demand shock from the influx of Iraqi refugees. They considered that the adoption of a bank law that would grant the central bank operational independence in monetary and exchange rate management would establish credibility in operating the new exchange rate regime and strengthen the monetary policy framework. This would need to be supported by the introduction of market-based instruments of monetary control, the centralization of official foreign exchange reserves at the central bank, and the establishment of the long-delayed government securities market. The process of licensing the foreign exchange bureaus and launching an interbank foreign exchange market should be accelerated.

With respect to financial sector reform, Directors were pleased with the fast-paced expansion of private banks. However, they were concerned about the emerging vulnerabilities and the remaining impediments. They urged the authorities to give priority to strengthening bank supervision capacity and to speed the process of state bank restructuring to stem further accumulation of bad debt and allow greater competition. Directors also noted the liberalization of the investment regime and the adoption of a modernized basic finance law.

Directors welcomed the steady progress made in trade liberalization, including the recent publication of the tariff schedule and the unified negative list of imports. They encouraged the authorities to further streamline the list of prohibited imports, abolish the system of industrial quotas, reduce the number of tariff bands, and eliminate nontariff barriers. Continuing to work on improving the business climate is essential to enhance the incentives of the private sector to invest and to turn the promise from the surge in investment approvals into a reality.

Directors agreed that an overarching prerequisite for the success of reforms in all areas is to strengthen domestic capacity. They encouraged the authorities to introduce a special fast-track scheme to attract highly skilled managers and to provide intensive training to newly hired young graduates, while continuing to work toward a far-reaching civil service reform.

Directors urged the authorities to improve the quality and timeliness of economic statistics, especially in the external and real sector. They recommended that priority be given to improving the balance of payments statistics to provide a sounder basis for macroeconomic management.

It is expected that the next Article IV consultation with the Syrian Arab Republic will be held on the standard 12-month cycle.