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The interactions between state budget and political budget in Syria

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This memo aims to understand how the Syrian regime has used the state budget as a tool to reallocate resources for the benefit of warlords and crony capitalists. This mechanism plays multiple roles in Syria's contemporary political economy: on one hand, it is one of the means by which elites are given access to political funds in exchange for their loyalty (and other political services). At the same time, it represents one of the different ways in which the regime can replenish its political budget, which refers to the funds available for the ruler for discretionary spending on its elites to ensure their loyalty (de Waal, 2016). The memo analyzes the interactions between state budget and political budget from the perspective of an authoritarian bargain during the conflict in Syria. This approach assumes that repression is not sufficient for authoritarian regimes, including the Syrian one, to sustain control over their countries (Desai et al., 2009). Thus, in parallel to using coercive measures, they need to bargain with people and elites. Finally, the memo also investigates the modalities through which the elites have increasingly benefitted from public spending.

The analysis covers Syrian government controlled areas, which includes almost 70 percent of Syrian territory (Daher, 2020). During the last 50 years, the Syrian regime has developed relationships with a complex network of security and military entities to dominate (and penetrate) government and social institutions. These entities include the different security branches in addition to the 4th armed brigade and republican guards. They use, or are willing to use, coercion and illegitimate extensive power to protect their interests. These entities function independently and they monitor each other, but all are managed by the head of the regime who is the Syrian president. They are not accountable to but in fact are in control of the judicial system, the parliament, the executive government and its processes, including the design, approval and implementation of state budget (Mehchy et al., 2020). It is worth noting that security and military elites are not involved directly in business activities. They either enter into informal arrangements or partnerships with businesspersons, or seek to benefit from commercial networks and transactions through family connections (Haddad, 2012).

This study focuses on business elites and their formal access to the state budget.¹ These elites include crony capitalists and the newly emerged warlords during the conflict. However, they can only secure a monopoly over, or preferential access to budgeted state contracts and procurement if they share a significant part of the rents with the political elite (Haber, 2002). Thus, analyzing the dynamics of top businesspeople is important to understand other types of elites including the political elites. The research also argues that the elite dynamics and the abuse of public resources have come to pass with the supervision and active approval of the Syrian authorities.

State budget: a tool of the authoritarian bargain

The state budget in Syria has reflected a two-level bargain: regime-populace and regime-elite or intra-elite. The first one is a sort of social contract between the authority and the citizens under which the latter have traded political rights and freedom for economic benefits and public goods (Desai et al., 2009). The second level is the ongoing intra-elite political game in which the ruling group bargains with elites over how much access to resources they can have in return for their support (de Waal, 2016).

This memo argues that these two types of bargains have an inverse relationship in Syria. This means that when the allocated amount for public goods and services increases, the elites' access to government spending decreases, and vice versa. Within this context, the Syrian authority has tried to adjust the balance between these two types in a manner that sustains its stability and control over the country. The capability of the regime to govern this balance depends largely on its financial capacity, political stability, and efficacy of coercion. Indeed, the lack of resources and the existential threats towards the authority in Syria has minimized the spending on public goods for the benefit of the elites, who provide vital support to this authority, especially during the armed conflict. This is a basic dilemma facing transactional regimes under economic pressure.

The authority-populace bargain in Syria has been clearly reflected in the state budget since the Baath Party military coup in March 1963, though of course, it has changed over time. In its early days, the Party dominated the Syrian state and non-state institutions. It built its popularity by adopting Arab nationalism, fighting against Israeli occupation of Arab lands, and most importantly, by applying socialist policies (SCPR, 2013). Thus, at that time, the budget witnessed a surge in subsidies for health, education, basic goods in addition to the sharp increase in public employment. In parallel, the security spending was magnified and used to constrain basic freedoms, such as the freedom of expression (Khasham, 2016).

Hafez Al-Assad, who ruled Syria between 1970 and 2000, also adopted this type of bargain by investing heavily in public goods and services, using a high level of repression at the same time. Yet, during the 1980s, the Syrian regime faced several challenges due to its involvement in the Lebanese civil war (1975-1991) and the internal armed conflict with the Muslim Brotherhood (SCPR, 2013). Further, Gulf countries withdrew their financial support to the regime due to Syrian support for Iran during the Iraq-Iranian war (1980-1988). These conflicts forced the regime to use more repression, and further increase its security budget. Financially constrained, Al-Assad also found it difficult to sustain existing subsidies. Consequently, the Syrian authority increased the prices of subsidized goods and services, and also increased the indirect taxes and fees; this resulted in the redistribution of wealth from working and middle classes to the influential economic networks. Dalilah (1999) estimated the annual sum of the increase in the indirect tax and the decrease in subsidies at less than 1 percent of the state budget in 1986, surging to 26 percent in 1997.

¹ The paper distinguishes between corruption and political budget. The latter is when the authority provides its business elites with legal access to benefit from state budget in return for specific services; whereas corruption is usually illegal access to the budget provided by officials for money. See also DE WAAL, A. 2016. Introduction to the Political Marketplace for Policymakers. *The Justice and Security Research Programme*, Policy Brief 1.

After Bashar Al-Assad was bestowed power in 2000, the public budget continued its shift towards less actual subsidies and more market-oriented economic policies. The result was an increase in crony capitalism, with concomitant increases in access for elites to state resources and assets, even as petty corruption continued unabated. The role of state was reduced in health, education, and basic goods, without giving more space for Syrians to express their ideas and opinions freely (SCPR, 2013). During the conflict, the Syrian authority lost a lot of its capability to use public resources as a bargaining tool with Syrian citizens. This was largely due to the lack of financial resources to sustain public goods, and the regime's total reliance on coercive measures to sustain its authority.

The first type of authoritarian bargain in Syria has therefore been substantially altered as there has been a substantial reduction in subsidies and a surge in fees and indirect taxes without any improvement in political freedom and rights. In fact, subsidies decreased from around 5 billion USD in 2012 to less than 200 million USD in 2020.² The conflict has worsened the situation and turned this type of bargain into mounting, exploitative, and oppressive practices by the Syrian authorities. In parallel, the elites have benefitted from public spending. They have managed to increasingly influence the formulation and the implementation of fiscal policies; they have also used the development spending in state budgets for their own benefits (Haddad, 2012).

The access of business elites to state budgets in Syria has taken two forms (though these may overlap in practice). The first one is through the corrupt relations between state officials and businesspeople (ICG, 2004), where the latter have bribed their ways to get government contracts through offers that do not meet requisite specifications and financial conditions. This usually involves relatively small amounts and is illegal by law. The second form is the legal access of business elites to public resources – better understood as legalized plunder. The Syrian authorities have approved and facilitated this access in return for these elites' support.

Since the beginning of 2000s, the second form has notably increased. Many formal contracts were signed between the government and crony capitalists, giving these cronies lucrative rent-opportunities such as a monopoly over the mobile telecommunication sector (Haddad, 2012). The rents of these contracts have allowed the elites to largely expand their business activities to include legal and traditional economic sectors such as construction, tourism, and internal trade. This has created a wide network of small and medium businesspersons, in almost all economic sectors, who benefit from the elites and work under their supervision. Through this network, the top businesspeople have managed to influence business dynamics inside the country, as required by the authority. From the regime's perspective, this will have minimized any potential collusion among businesspeople against its authority. Furthermore, the Syrian regime had considered these elites as financial reserves, should they be needed. Indeed, during the conflict, the majority of them have reciprocated with unlimited economic and military support. For their part, and in addition to purely pecuniary motivations, elite collusion with the regime appears to have been motivated by the fact that their own survival was deeply imbricated with the continued existence of the regime.

The dynamics of political budget

The war economy in Syria has created new and different sources for the political budget, which has been distributed by the regime and other newly emerged de facto powers to maintain the loyalty of their elites. These sources have included controlling border crossings and checkpoints, monopolizing internal trade, selling oil derivatives, and importing basic goods (Turkmani et al., 2015).

² Author's calculations based on state budgets in 2012 and 2020 announced by the Prime Ministry in Syria, and the annual average of the market exchange rate of Syrian Pound to US Dollar in the same years.

The Syrian regime has also given external actors access to public funds as a way of obtaining and ensuring their support. During the conflict, Iran and Russia have signed different agreements with the Syrian government, giving them significant influence over many vital public sectors and utilities such as mining and ports. For instance, in 2017, the Syrian government had signed a contract with a Russian private company called Stroytransgaz, through which the Russians monopolized the phosphate sector in the country for 50 years (Hatahet, 2019).

The elites' access to state budget has also been a way for the Syrian regime to finance its political budget. These elites, including traditional cronies and newly-emerged warlords (who made their fortunes initially from conflict-related activities such as smuggling, weapons trafficking, imposing taxes, and creating checkpoints and later diversified into other economic sectors), have monopolized the supply of basic goods within government controlled areas. They have managed to use their shadow companies outside Syria to overcome the impact of sanctions while importing some of these goods to Syria. Due to their excessive margins of profit, payments to these companies dominate public spending. In return, the elites have had to show loyalty to the Syrian regime. For instance, these elites have created and supported pro-regime armed groups in different Syrian regions, and they have crowded out businesspeople that were not supportive enough to the regime. It is worth noting that the space afforded to elites by the regime has fluctuated over time: business elites have had more space to operate (including by raising their own militia) when the regime was under threat, with their militia and operations being absorbed by force in more secure periods, or when these operations begin to threaten the regime's authority. The activities of Ayman Jabber, a businessman close to the regime prior to the war provide an excellent illustration. Although he managed to become extremely powerful in Syria's coastal regions, and even attracted some Russian support, the regime dismantled his militia within a day.

This part of political budget has become relatively more important despite the sharp deterioration in public resources. In 2011, the state budget was about 16.7 billion US dollars, dropping to less than 8.5 billion in 2015, and it reached its lowest level in the 2021 government proposed budget at 2.7 billion US dollars. The current public spending forms about 82 percent of the planned budget in 2021 compared to 54 percent in 2011 (Christou and Shaar, 2020). This 2021 spending includes about 17% wages and salaries for public workers³; whereas the main share of the remaining amount, estimated at 1.5 billion US dollars⁴, is expected to cover the supply of oil and wheat from internal and external sources.⁵ Many contracts to supply such goods are signed with business elites who make a substantial profit from these contracts with the approval of the Syrian authority. In other words, levels of political spending have remained relatively high even as the state budget has shrunk.

The supply of oil and oil derivatives is one example of how the government spending has become a source for financing the political budget in regime-controlled areas. The Syrian authority has covered its daily needs of oil and fuel from different sources. The first one has been imports from international markets, mainly from Iran and Russia (Shaar, 2019). The second source has been the oil produced in the north east Syria where the Self-Administration has been trading oil with the regime for water and electricity.⁶ The last source has been crude oil, extracted from areas under the control of the regime. For the first two sources, the Syrian authority has depended on influential

3 Author's calculations based on the total current spending and the total amount of wages and salaries announced by the Syrian government. See Enab Baladi article (in Arabic) "Al-Assad approved the state budget for the year 2021" available: <https://enabbaladi.net/archives/442391>

4 Author's estimation based on the current spending categories in previous years in addition to the announcements of many Syrian government ministers and officials.

5 The needed amount is expected to be higher, where the minister of oil announced in 2020 that Syria needs around 2.4 billion US dollars to cover its needs of oil and oil derivatives. See article (in Arabic) "the Minister of Oil: Syria needs to import 122 thousand barrels of crude oil per day". Available: <https://b2b-sy.com/news/1033348933/>

6 A report in Al-Sharq Al-awsat newspaper (2019): "The struggle on the Syrian Oil" (In Arabic). Available at: <https://bit.ly/2WUeQx9>

economic networks to provide the required quantity. They have used their shadow companies outside Syria to secure the needed oil for the Syrian government from external markets. Shadow companies are not new to the Syrian political economy, but they have proliferated during the conflict, primarily to help the regime avoid sanctions post-2011. These economic networks have also coordinated and negotiated with businesspeople and key persons in north east Syria to transport oil to the regime- controlled areas.

The Syrian government has signed formal contracts with private companies and businesspeople. These contracts often include high profit margins for the elites. For example, in December 2020, the Minister of Internal Trade stated that the government is paying an average of 1000 Syrian Pounds for each liter of fuel.⁷ This meant an additional amount of 0.22 US dollar on each litre compared to the selling prices of fuel in Lebanon,⁸ which has been among the main channels of transporting fuel to Syria. With fuel consumption of 5.5 million litres per day,⁹ this additional amount has been estimated at around 400 million US dollars per year, which forms about 15 percent of the 2021 budget and is expected to feed into the political budget. It is worth noting that the additional cost could include high commissions for banks and intermediaries to use non-US financial channels. Yet, these commissions are paid illegally and in coordination with the warlords selected by the regime to conduct such transactions.

Today, Hussam Katerji is one of the warlords who are benefiting from state budgets through legal oil-related contracts with the government. He is a Parliament member in Damascus and he owns the Katerji Group with his brothers that has been involved in transporting oil from north east Syria to the oil refineries in regime-controlled areas (Cornish, 2019). His brother Baraa has had control over a Lebanese company that imports oil and fuel, mainly from Iran (Ibid). Moreover, early this year, President Assad approved the establishment of two private oil refineries that were owned by one of the Katerji companies, Arvada Petroleum.¹⁰ It is worth noting that in regime-controlled areas, there are only two public sector oil refineries.

In return, Katerji brothers have been always keen to show loyalty to the Syrian authority. For instance, they have established their own militia in the Deir-Ezzour governorate under the claim of protecting their investment in the area; yet, this militia has been managed under the supervision of the regime security agencies (Winter, 2019). They have also maintained good connections and financial relations with tribal leaders to facilitate their oil-related businesses and to keep these leaders under the regime's influence (Ibid). Finally, Katerji brothers have been among the main importers of the Iranian oil to Syria (Cornish, 2019). This shows that, in addition to the Syrian authority, Iran has been able to exercise a degree of control over Syrian public resources, including a part of public spending, and its allocation for political purposes.

Wheat supply is another example of how the regime has been reallocating public resources for the benefit of its cronies and warlords. Syria's wheat production sharply dropped from more than 4 million tons in 2010 to less than 2.2 million tons in 2019 (FAO, 2020). The drop in wheat yield and the fact that a large share of the wheat production in Syria is located outside the control of the regime, have forced the Syrian government to depend on its businesspeople to secure the needed quantity of wheat. In 2019, the director of the Syrian Public Establishment for Grain - responsible for purchasing, storing and marketing wheat- stated that the government had signed three contracts with the private sector to import 600 thousand tons of wheat at an average

7 Interview of the Minister of Internal Trade, Talal Barazi, with Alwatan newspaper (in Arabic). Available at: <https://alwatan.sy/archives/238939>

8 A report prepared by Kassiou newspaper on "looting subsidies and public support in Syria" (In Arabic). Available at: <https://kassiou.org/economic/item/66663-50>

9 Interview with the Minister of Oil, Ali Ghanem, with state TV (in Arabic). Available at: <https://www.facebook.com/mopmr.gov.sy/videos/683274285424359>

10 Enab Baladi article (2020): "Al-Assad approves establishment of two oil refineries". Available at: <http://bit.ly/2LdiwpN>

price of 275 US dollars per ton.¹¹ Thus, the Syrian government has been buying wheat for an additional 75 US dollars per ton, compared with the international cost and freight of wheat at 200 US Dollars per ton.¹² This has reaped a huge profit margin of 45 million US dollars diverted from public spending to fund business elites. It is likely that some of this spending has been recycled back into the regime's political budget.

Among these elites was Samer Foz, a tycoon who has made a fortune during the conflict by benefitting from the war economy dynamics in Syria. He has had a wide range of businesses inside the country including pharmaceutical, cement, tourism, transportation, and media projects in addition to wheat trade and distribution to the Syrian government (Rasmussen and Osseiran, 2018). Part of his business in Syria has been based on formal contracts with the government, paid from state budgets to deliver basic goods such as wheat transactions (Ibid).

In return, Samer Foz has been providing the regime with an access to international market through his offshore company branches, headquartered in Moscow.¹³ This also reflects the deep connections with Russia, which is one of the main allies of the Syrian authority. Knowing that Foz has been placed under sanctions by the US¹⁴ and the EU countries¹⁵, one could envisage the illegal transnational networks through which he has maintained his businesses outside Syria. Furthermore, Samer Foz has funded the military security shield forces militia under the supervision of Air Force Intelligence Directorate - one of the Syrian authorities' core security institutions.¹⁶

The above two examples show how the regime has been financing a part of its political budget by using government spending. This has resulted in a reallocation of the already decreasing public resources from the majority of Syrians and into the pockets of the few business loyalists. The amount of political budget distributed by the Syrian authority towards these loyalists has depended on the services they have provided and their relations to external powers. However, the recent seizing of the businesses and properties of Rami Makhoul,¹⁷ who used to be the most important crony capitalist in Syria, indicates that the regime still has the capability to scale down or replace anyone among its elites. Although there is little evidence, it is likely that a combination of factors was responsible for Makhoul's loss of influence. These include the regime's desire to have direct access to his financial networks, its unwillingness to tolerate Makhoul's growing power and influence in coastal regions, and finally, the desire to signal to both internal players and external patrons that the regime remained dominant in the Syrian political arena. It is therefore worth underlining the fact that the Syrian authority is able to change, replace, or attack individuals within business elites, but at the same time it is in dire need of the business elites as whole. In other words, even as the regime remains reliant on business elites, it remains the pre-eminent player in the Syrian political market.

11 Interview of, Youssef Al-Kassem, the acting director of the Grain Establishment with Alwatan newspaper (in Arabic). Available at: <https://bit.ly/3n527B0>

12 A report prepared by Kassioun newspaper on "Unexplained 20 billion Syrian Pounds for wheat imports" (in Arabic). Available at: <https://kassioun.org/economic/item/61978-20-2019>

13 Pro-justice project, Samer Fawz profile. Available at: <https://businessmen.pro-justice.org/en/samer-fawz/>

14 ALJAZEERA (2019): "US imposes sanctions on Syrian mogul for supporting Assad". Available at: <https://www.aljazeera.com/news/2019/6/11/us-imposes-sanctions-on-syrian-mogul-for-supporting-assad>

15 European Council Implementing Decision 2019/87; Available at: <https://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=CELEX:32019D0087&from=EN>

16 Pro-justice project, Samer Fawz profile. Available at: <https://businessmen.pro-justice.org/en/samer-fawz/>

17 Reuters (2020): "Syrian government orders seizure of assets of Assad's cousin Makhoul". Available at: <https://www.reuters.com/article/us-syria-security-tycoon-idUSKBN22V11C>

Conclusion

In the 2000s, the Syrian regime began to shift public resources' away from government spending on basic goods and services towards the political budget. During the conflict, the Syrian authority accelerated this shift. The business elites have had increasing and legal access to state budgets through government procurement and contracts. This has further depleted already shrinking public resources and has amplified the influence of cronies and warlords. In return, the regime has expected these elites to play a vital role in sustaining its authority by supporting military activities and opening new financial channels with external markets. The constantly escalating cost of maintaining support from the elites has decreased the regime's bargaining power with its external patrons Iran and Russia, though internally it continues to control the means of coercion and state institutions. The primary outcome of this arrangement, however, has therefore been a move towards greater use of coercion by the regime. The more the Syrian authority reallocates resources for the benefit of the political budget, the less capable it is of establishing a social contract with its citizens. Consequently, the Syrian regime, and in dealing with the majority of Syrian people, has moved from 'the carrot and stick' ruling system to an approach reliant almost entirely on 'sticks'. This has left Syrians with neither political rights nor economic benefits.

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