

# **The Political Economy of Syria's Physical Fragmentation and Dependence**

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## **The Geneva Centre for Security Policy (GCSP)**

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Published in August 2021  
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## The Political Economy of Syria's Physical Fragmentation and Dependence

### Summary

- Syria's physical fragmentation and dependence on foreign powers and neighboring countries have created significant new dimensions of political economy in the country over the course of the conflict.
- Oligopolies controlling cross-border foreign trade and its financing in the fragmented areas of the country now play a major role, especially in the wake of the extensive disruption created by Lebanon's economic and financial crisis. Such oligopolies are closely connected with the controlling powers in these areas and with the countries that back them.
- Local warlords, linked to local combatants, control the internal crossing points still necessary for trade, the provision of basic goods and services, and humanitarian aid distribution. Local governance is directly associated with these warlords.
- Smuggling is unavoidable across the country's external borders and internal lines of separation, given the large differences in the prices of goods.
- In-kind humanitarian aid, a long-term undertaking, is distorting local markets where locally produced goods are sold. This discourages local production and undermines economic resilience, employment perspectives and the scope for recovery.
- The ongoing changes to the country's political economy could lead to further physical fragmentation and impede the emergence of political solutions to the conflict.

### Introduction

Most political economy analyses on present-day Syria tend to be based on pre-conflict perspectives and mechanisms. However, the country's economic reality has changed significantly after ten years of conflict. Syria is currently divided into three<sup>1</sup> areas of influence, where the supply chains for goods and services are differentiated and much less integrated than before. The resulting value chains have introduced new rent-seeking mechanisms that reflect local power structures, differentiated import channels resulting from the unilateral measures (sanctions), international aid and its recycling<sup>2</sup> in the economy, and the remaining and still necessary economic exchanges between the three areas of influence.

These new dimensions of political economy can be traced directly to the country's physical fragmentation and dependence and took shape over the course of the conflict. They have become increasingly entrenched, particularly since 2016, as ISIS lost control over large parts of the country and the conflict de-escalated in relative terms.

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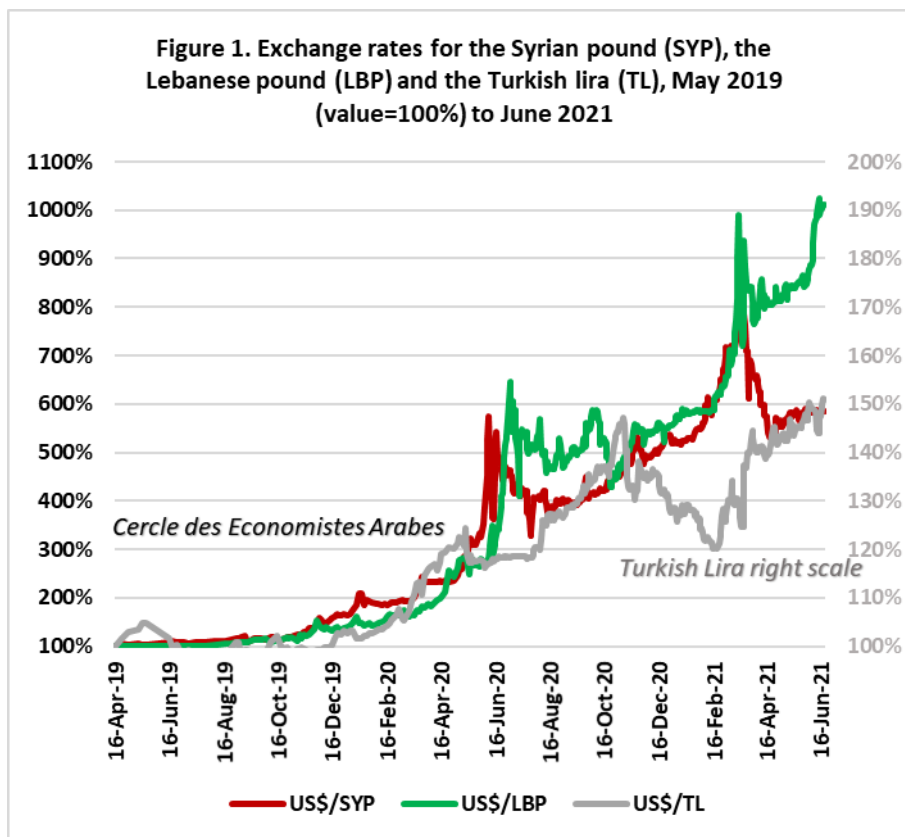
<sup>1</sup> One could argue that there are five areas, as the Idlib region is economically separate from the areas controlled directly by Turkey and the armed "opposition" factions loyal to it, and since the Syrian government does not have full authority over the Hauran region in the South.

<sup>2</sup> The term recycling refers here to the population reselling the aid-related goods they receive to traders, who in turn resell these same goods again in the market.

Furthermore, all regions of Syria experienced an economic and financial crisis starting in mid-2019, in parallel with the ongoing Lebanese economic and financial crisis. This led to a collapse in the exchange rate of the Syrian pound that was similar in value terms to that of the Lebanese pound (figure 1). Inflation rose at unprecedented rates, further disrupting the economic mechanisms at play in the different areas of the country. The situation was exacerbated by the Covid-19 pandemic, which complicated people’s livelihoods even more.

### Financial and foreign-trade chains

The Syrian economy has become extremely dependent on migrant remittances and the flow of international aid, which together are estimated to surpass one-third of current GDP. The real value that reaches the recipients depends greatly on official mechanisms (such as the official exchange rate) and on the money traders’ channels stretching across the three areas of influence and in neighbouring countries.



Private-sector imports in government-held areas (GOS) were in large part financed by the Lebanese banking sector and channelled through the port of Beirut. They shrank<sup>3</sup> once these banks blocked foreign currency deposits, and decreased further following the Beirut port explosion on 4 August 2020. Imports to North-East Syria (NES) also declined, as the government sought to avoid depleting its foreign currency reserves, going so far as to stop its hard-currency purchases of the much-needed oil from NES. The same applies to North-West

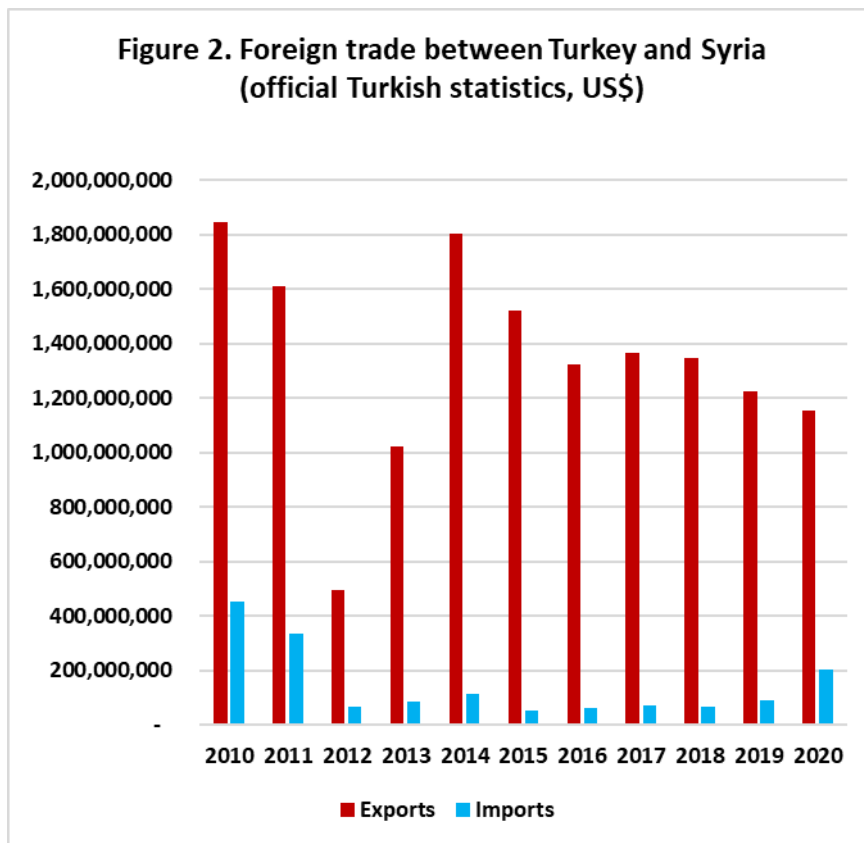
<sup>3</sup> As did exports through Beirut’s port and airport.

Syria (NWS): its imports declined, as a large proportion of them were destined to be smuggled to government-held areas. This led to the emergence of new foreign-trade financing circuits.

Similarly, the role of conveying remittances to Syria shifted largely from Lebanon to Turkey, as well as to the Gulf countries, whose banks now dominate Syria’s private banking sector.

The prices of goods and services have risen dramatically in all parts of the country but at significantly different rates depending on the item in question and the area of influence. Throughout this time, exchange rates remained very close in all three areas. The move to use the Turkish lira in NWS has exacerbated inflation there.

It was not until March 2021 that the Syrian government managed to stabilize the exchange rate,<sup>4</sup> find a way to rein in the high inflation, and free itself from the ever-deteriorating situation in Lebanon and the exchange rate for the Lebanese pound. But this was accompanied by a major and unsustainable decline in consumer spending, the reduced availability – or outright disappearance – of many goods and services, and a sharp increase in poverty and extreme poverty in all areas of the country.



The country’s most powerful “warlords” are those who dominate the financial and foreign trade circuits described above. They have direct links with the ruling powers in each of the three areas of influence.

In NES, these warlords are involved in the informal exportation of oil, wheat, cumin and sheep, as well as in the importation of goods through the Semalka informal border crossing with the

<sup>4</sup> Following a period of stability between 2016 and mid-2019.

Iraqi Kurdish Regional Government (KRG). One Iraqi-Kurdish-Turkish-German company seems to dominate most of these imports, which come largely from Turkey but also from Iran. In NWS, exports are meagre. However, imports from Turkey to NWS exceed US\$ 1.3 billion per year, an amount similar to the pre-conflict level of all of Syria's imports from Turkey (figure 2).<sup>5</sup> The warlords of Azaz, Al-Bab and other cities north of Aleppo, with their Turkish licenses for imports through the Bab al-Salam border crossing, compete with those of Sarmada and other cities around Idlib who bring imports through the Bab al-Hawa border crossing, which is also used for humanitarian aid. That first group of warlords is directly linked with the different combat factions of Operation Euphrates Shield and Operation "Olive Branch" in Afrin; the latter group is directly connected with Hay'at Tahrir al-Sham (HTS, previously the Al Nusra Front).

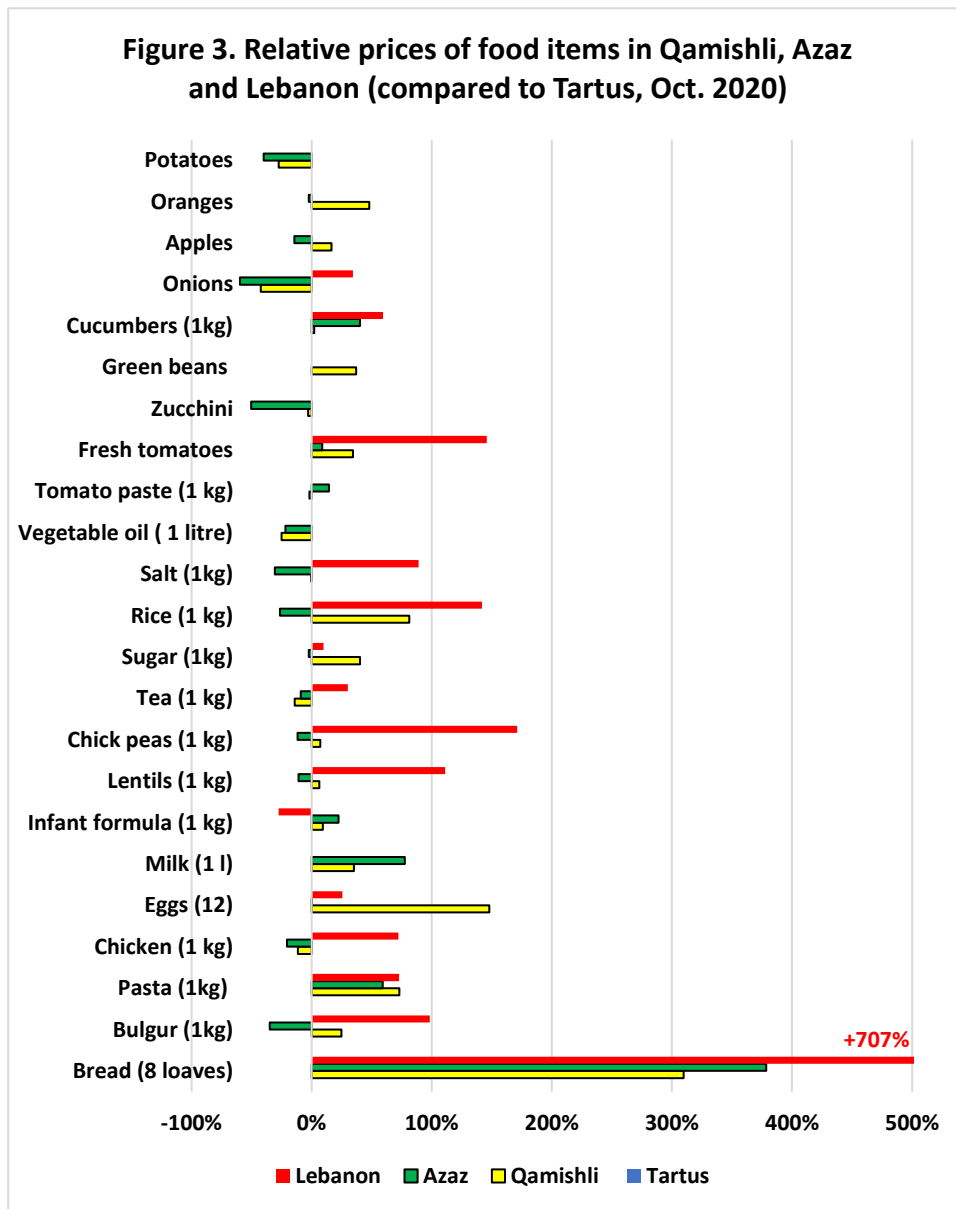
For the much larger population in GOS areas, the volume of imports from Turkey during the years of the conflict far exceeds that from Iran.<sup>6</sup> In these GOS areas, the volume of imports

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<sup>5</sup> See also **Trade without Religion between Turkey and Syria**; IFRI Editorial, [https://www.ifri.org/sites/default/files/atoms/files/aita\\_trade\\_without\\_religion\\_turkey\\_syria\\_2017.pdf](https://www.ifri.org/sites/default/files/atoms/files/aita_trade_without_religion_turkey_syria_2017.pdf).

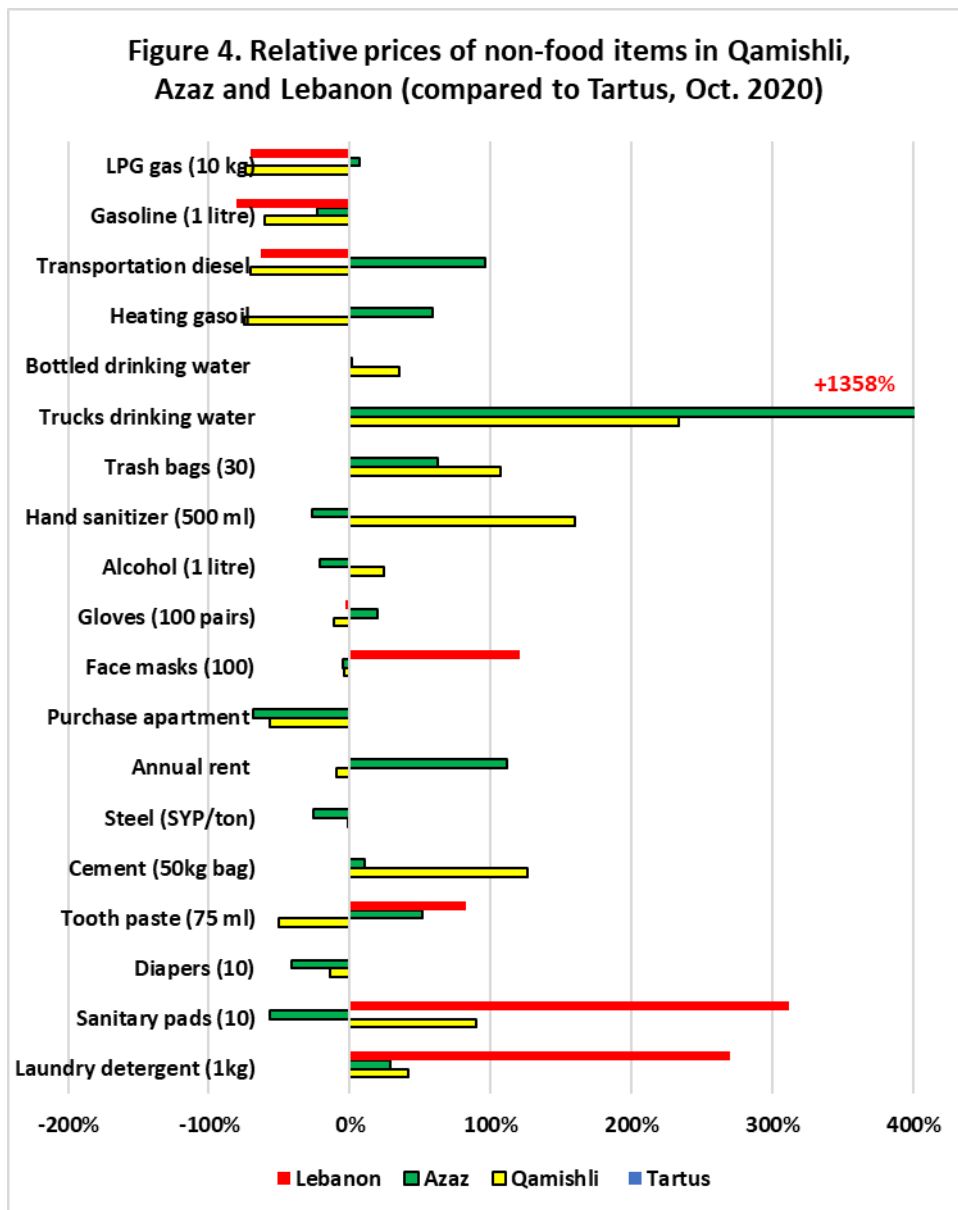
<sup>6</sup> Between US\$100 and US\$300 million, with a high in 2017, consisting mostly of oil, steel and machinery.

through the port of Beirut has dropped sharply since 2019. The Syrian ports of Latakia and Tartus, which experience very low regular maritime traffic, have taken up the slack, as have import routes through Turkey and NWS areas. Direct imports are concentrated in the hands of importers able to circumvent unilateral US and EU measures and over-compliance practices, in particular with regard to financial transactions.<sup>7</sup> It is worth noting that some wholesalers of imported goods are able to cover various parts of Syria thanks to their relationship with the different ruling powers and with all neighbouring countries.



<https://tradingeconomics.com/iran/exports/syria>.

<sup>7</sup> See **The Unintended Consequences of the US and European Unilateral Measures on Syria’s Economy and its Small and Medium Enterprises**; the Carter Center; [syria-unintended-consequences-aita-12-20.pdf](https://www.cartercenter.org/resources/policy-research/syria-unintended-consequences-aita-12-20.pdf) (cartercenter.org).



### Supply and value chains

Syria no longer enjoys food or medical security, even though a significant portion of the population has migrated abroad, and revenues and consumption levels have plunged.

Agricultural production is sharply down owing to the lack of fuel for irrigation and the challenge of importing the inputs needed by this sector (seeds, fertilizer, medicines, etc.), mainly as a result of the unilateral sanctions. Also, GOS services in support of agriculture have weakened significantly, and water levels on the Euphrates River have dropped as a result of upstream retention. Agriculture has become strongly dependent on rainfall, which could lead to a famine in case of drought, as is the case this year. The country has also become dependent on the in-kind food aid distributed in baskets in all areas of influence, in particular in IDP camps.



Supply chains for agricultural products have reorganized in view of the situation. Production and wholesale distribution networks are now concentrated around major oligopolies, replacing the complex networks that predated the conflict. Large differences in food prices can now be observed between the three areas of influence and with Lebanon (figure 3).<sup>8</sup> The lowest prices are generally found in NWS and the highest in NES, compared to GOS areas. In most cases, prices are much lower in Syria than in Lebanon.

Food prices are influenced by several mechanisms. For example, bread is highly subsidized in GOS areas, while it is lightly subsidized in NES by the Autonomous Administration of North and East Syria (AANES) and in NWS by INGOs. Also, other products are distributed as aid in food baskets by UN agencies and INGOs after being procured abroad, in most cases, even if they are locally produced. And as this distribution method has been in place for years, trade mechanisms for recycling items in the food baskets have developed at a significant scale and in all areas, and are managed by local warlords. The prices of recycled items are far below market prices. This undermines local production and further increases unemployment, thus harming people's livelihoods and their ability to sustain themselves. Similarly, the country's physical fragmentation and the resulting need to cross internal lines of separation and checkpoints manned by various militias have separated seasonal production from the cities, where the population is concentrated. Examples of this are the separation between Azaz (previously known for potato and chicken production), or Afrin (known for olive oil), and Aleppo, and the separation between NES and GOS areas for wheat. The prices of imported food items such as tea, rice and sugar are closer among the various areas of influence, as large importers manage to reach all areas by crossing internal lines of separation or setting up trading posts in neighbouring countries.

Fuel products are subsidized in GOS areas and distributed in very limited quantities through "smart cards", where people have to wait in lines to get their ration. However, most volumes are traded in the "free market", at prices generally much higher than in NES, NWS or Lebanon, which makes the smuggling of these products – by networks of warlords on all sides – highly profitable. This takes place not only between Lebanon and Syria, but also between NES and NWS, where for example Kurdish diesel is sold in HTS gas stations managed by their 'Watad'<sup>9</sup> oil company.

Drinking water and electricity are no longer provided as public services. Water distribution networks have deteriorated, and the quality of rationed deliveries is dubious. The provision of drinking water is viewed by belligerents as a tool of either coercion or negotiation. As a result, fresh water is distributed mostly via trucks operated by networks of local warlords who control the source – mostly wells. The same applies to electricity, which is also rationed. New "companies" have taken control of regional grids (such as AK Energy in northern Aleppo; it was founded by Turkish "investors" and Syrian local councils), and diesel generator providers have multiplied in neighbourhoods and small cities. Water and electricity prices are extremely differentiated in the various areas of influence, as they depend on the availability of freshwater

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<sup>8</sup> Price data were collected in October 2020 in the cities of Tartus, Qamishli and Azaz. See **The political economy and its social ramifications in three Syrian cities: Tartous, Qamishli, and Azaz**, Cercle des Economistes Arabes, <http://www.economistes-arabes.org/fr/wp-content/uploads/2021/06/Political-Economy-Report-English-F.pdf>.

<sup>9</sup> Oil from the Rmeilan field controlled by the Kurdish-dominated NES is smuggled to Idleb and distributed by 'Watad', the HTS oil company.

resources and of gasoil for generators. Basic necessities such as fuel products, electricity, fresh water, mobile phones and internet access are the foundation for major rent-seeking activities, which are dominated by providers directly linked to the ruling powers of each area of influence. These activities give rise to complex coercion tactics, negotiations and agreements between the parties across internal lines of separation and with the controlled population.

Real estate and housing construction have emerged as another source of rent-seeking in all areas of control owing to the widespread destruction of housing during the conflict, a still-growing population, an unprecedented acceleration in rural-urban migration, and the large numbers of IDPs. Warlords seize real properties and violate people's house, land and property (HLP) rights<sup>10</sup> (Law No. 10 of 2018 designed for part of downtown Damascus, together with the Afrin cases, are the most visible examples). After establishing an "industry" based on recycling rubble, oligopolies took control of the importation and sale of construction materials (cement, steel, etc.). Housing development became a major investment opportunity for the warlords, while real estate proved most effective at protecting financial savings from devaluation. At the same time, price differentials increased substantially both among urban neighbourhoods (for example, between those with good and poor "public services", or between those that host INGOs and international organizations and those that do not) and between cities and their surroundings (insulating cities from IDP camps).

These general conditions – sanctions, an energy shortage, unstable prices, and high revenues from rent-seeking activities – have impeded industrial production and investment.

### **Smuggling and illegal activities**

Trading activities qualified as "smuggling" have spread not only across borders, in particular with Lebanon, but also – and primarily – across the lines separating the various areas of influence. Informal crossing points have been active throughout the conflict, taking advantage of large price differentials. There are also formal crossing points, such as in Raqqa between NES and GOS areas. Smuggling is a necessity for NES, which needs to turn oil products and large agriculture crops into financial revenues in order to cover the high cost of the Autonomous Administration of North and East Syria (AANES). Such smuggling also accounts for a significant share of the NWS economy, which enjoys easier access to imports from Turkey.

Smuggling is also linked to illegal activities, such as the production of the stimulant Captagon and other products or drugs. All areas of influence are involved in such high rent-seeking activities, whether this concerns importing the necessary inputs or selling the final products.

Under current conditions, these illegal activities are expected to continue or even expand as the formal economy deteriorates.

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<sup>10</sup> See **Urban Recovery Framework for Post-Conflict Housing in Syria. A first physical, social and economic approach**; Cercle des Economistes Arabes & Common Space Initiative, <http://www.economistes-arabes.org/fr/urban-recovery-framework-for-post-conflict-housing-in-syria/>.

## Political economy and resolving the conflict

It is difficult to imagine how the Syrian conflict could be resolved through a political process alone that does not directly involve the combating forces in Syria – namely the Syrian army and its associated militias linked to the power system in Damascus, the Syrian Democratic Forces (SDF) and their Democratic Union Party (PYD) power system, as well as the “opposition” factions and their respective backers, i.e. Iran and Russia, the USA and Turkey. Similarly, it is difficult to imagine such a solution without addressing the political economy that has emerged and that now underpins these forces’ power, the warlords’ chaos-inducing advantages gained from the country’s physical fragmentation, the hidden or open bargains between these warlords and other powers, and the deterioration of Syrians’ living conditions to unbearable levels.

The current situation, where the country’s physical fragmentation has reached relative stability, could persist for a long time at the people’s expense. However, several factors could reignite the conflict: growing competition over resources and rent-seeking activities, even within each area of influence; the ongoing decline in much-needed international aid; and the further deterioration of the situation expected in Lebanon and its consequences for Syria.

At this stage, several questions are worth addressing from a political economy standpoint as part of the effort to bolster people’s resilience and set the stage for conflict resolution and recovery:

- Can international aid be expected to remain in place for the coming years? If so, will aid distribution continue to be differentiated by area of influence? Can it continue to flow if the already high rates of poverty increase further?
- Can the distribution of in-kind aid continue without assessing the impact of its recycling on local production and employment?
- Can humanitarian border crossings be treated separately from the internal lines of separation between areas of influence? And should the issue of the free circulation of products and individuals across these lines be addressed by the international community?
- Can the unilateral measures (sanctions) applied by the US and the EU to state institutions and foreign trade and transactions continue in their present form, knowing that they are entrenching the country’s physical fragmentation and encouraging unofficial rent- and power-seeking mechanisms?
- Can the “decentralization” envisioned as a key element of a political solution be addressed without analyzing the role of local and regional warlords in local and regional governance? How does the idea of “free” local elections fit with this scenario? Could a political solution for Syria be based on the Lebanese model of power-sharing between warlords?
- What sort of political order comprising governance, economics and political economy – at both the central state and regional levels – could be envisioned for each of the areas of influence, and what would such a political order mean for warlords and the backing countries? And how could it safeguard people’s livelihoods and resilience, end the present fragmentation and form the basis for a recovery?