

Peterson Institute for International Economics

The latest on Middle East economies: Syria, oil markets, and more

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[00:00:36.21] - Anjali V. Bhatt

Hi, and welcome to PIIE Insider Live. I'm Anjali Bhatt, Communications Manager and Research Fellow here at the Peterson Institute for International Economics. I often say that one of the best parts of my job is that I can just walk into the offices of some of the world's top economics experts and ask them questions. And then they answer. So with PIIE Insider Live, you're coming with me to ask those questions and hear those answers that you won't hear anywhere else. Today we're speaking with Adnan Mazarei, Nonresident Senior Fellow here at PIIE and a former Deputy Director at the International Monetary Fund. Before we start, if you're watching on Zoom, feel free to put your questions in the Q&A box. So, hi, Adnan. Thanks for joining us. Hello.

[00:01:14.18] - Adnan Mazarei

Thank you for having me on.

[00:01:15.26] - Anjali V. Bhatt

Okay. So as always, there's a lot going on in the Middle East. We'll start with Syria's economy and then we'll shift to Iran and other major oil producers and oil markets. So there was a civil war in Syria from 2011 to 2014 and further instability after that. After former President Bashar al-Assad was deposed in December of last year, a new government led by Ahmed al-Sharif was sworn in this March. So the toll over the last 15-ish years on the Syrian people and economy has been devastating. Just how bad is it?

[00:01:50.09] - Adnan Mazarei

The economy has been devastated. More important than anything else, 650,000 people died, 6 million people have been made refugees around the world, and about 7 million people have been internally displaced. The economy has shrunk to half of what it used to be. Uh, the

exchange rate fell from 47 to about 1,500. This passed on to inflation. It made people poorer. A new World Bank study says that two-thirds of the population is below the lower middle income poverty line. Now, as you said, there's a new government. We shouldn't have any illusions about some of their past, and the government doesn't have full control over the territory or its resources. And in recent days, even, we've seen some harsh clashes among various sectarian groups. But this is an important opportunity. It's like the Syrian reconstruction will actually be One of the only positive news that comes out of the Middle East. It'll be good not only for the Syrians, it will be good for countries in the region, Turkey, Lebanon, Jordan. And by allowing the refugees to settle back, it will take some pressures off a number of countries.

[00:03:28.21] - Anjali V. Bhatt

So this new government is very new, and as you said, this is a huge opportunity. It's also a huge task ahead of them. What does rebuilding the economy look like?

[00:03:41.05] - Adnan Mazarei

First and foremost, there are estimates of the dam reconstruction cost that range between \$250 and \$400 billion. The authorities are yet to articulate a fully clear economic strategy priorities for sectors. They're doing some things. They've put out a new budget. They're trying to redo their tax laws. But more important than anything else is the following: before the civil war, the economy of Syria wasn't doing badly, but it was highly state-controlled and tremendous amount of corruption. Okay. This is an opportunity to rebuild institutions and build trust, which is necessary not only to get the Syrian private sector involved, but also to build trust among others. There will be financing needs. Most of the financing will be met, certainly in the initial stages, by the Gulf Cooperation Council countries. Saudi Arabia just announced a \$4 billion package. Much could also come from Turkey, which has a very competent construction sector, and international organizations. There is also a need for, from the international community, creative financing in the sense of locating where the main constraints are in the value chains and trying to help, and try to help the risks associated with refurbishing those sectors.

[00:05:27.07] - Anjali V. Bhatt

So which sectors are those? I assume like electricity, construction. What, what else?

[00:05:34.23] - Adnan Mazarei

There's electricity, construction, irrigation, ports, ports, health institutions. Those are the main priorities. Okay.

[00:05:47.02] - Anjali V. Bhatt

So, I mean, they're going to need, you know, a lot of money to do this as well as the institutional support. But it seems now that the US and other countries have sort of approved of the new government, including lifting— the US has lifted sanctions via executive order. What were those sanctions? What does lifting them mean? What's sort of going on with the sanctions situation?

[00:06:11.05] - Adnan Mazarei

Syria has been under sanctions since 1979. The original sanctions were because Syria was considered a state sponsor of terrorism. Those sanctions were intensified in 2011 when the sanctions— when the civil war got worse. There were sanctions by the United States, Europe, but not the United Nations. Okay, the sanctions in the US were of two groups: ones that were imposed by presidential executive orders, and another one under the Caesar Act that was enacted by Congress in 2019 and renewed last year for another 5 years.

[00:06:59.05] - Anjali V. Bhatt

So what did the Caesar Act do?

[00:07:02.18] - Adnan Mazarei

The Caesar Act was mainly directed against the supporters and associates of the Assad government. It includes asset freezes, trade restrictions, and also restraints on the financial sector. The new— the US administration, besides canceling the executive orders, but keeping the ones, the sanctions directed at associates of the Assad group. Have also really loosened up export sanctions. And the executive order, the most recent executive order, also imposed a 180-day cooling off with the Caesar Act. The Caesar Act is, as I said, passed by Congress, and it's up to Congress to extend it, cancel it, etc. Views differ in Congress on that. Some people would like to support the Trump administration policies by getting rid of it. But interestingly, this week, The House Financial Services Committee approved an amendment to toughen up the sanctions. Oh, this would toughen up the financial sanctions, money laundering. Of course, one committee passing this is not going to be enough. The draft has to go through three committees and other things to happen for it to become law, but it's a signal to the Syrian government that the issues of violation of the rights of the various sects and minorities is important.

[00:09:09.25]

And also there are some concern whether monies may be misused, etc. So This is one of those rare cases in these days where Congress is going against the administration.

[00:09:22.12] - Anjali V. Bhatt

Yeah. So we have the executive order passed by the Trump executive branch that tried to, yeah, cool down, you said, the Caesar Act a little bit. But then we also have at least one committee in Congress that wants to heat up the Caesar Act. Yeah, like you said, that is quite rare. So that'll be something that we will be watching here at the Peterson Institute. So besides US sanctions, who else had sanctions on Syria, and have they cooled those off as well?

[00:09:53.06] - Adnan Mazarei

Europe had sanctions, the United Kingdom had sanctions, and they are being cooled off, and some of them rescinded. There's a general view in Europe, the US, and other places that this new government in Syria despite its, the past of its people who run it, should be given a chance to move forward with rehabilitation and reconstruction.

[00:10:23.18] - Anjali V. Bhatt

So some of those sanctions are being lifted in general, which will make it at least a little bit easier for the new government to start that rebuilding process.

[00:10:32.09] - Adnan Mazarei

The removal of sanctions has allowed, will allow the financial sector in Syria to reconnect to the international banking system. The sanctions on the Central Bank of Syria have been lifted, and Syrian financial institutions will be allowed to use this SWIFT international messaging system.

[00:10:58.17] - Anjali V. Bhatt

So why is that? I know around a lot of the Russia stuff, SWIFT came up. Why is being connected to this banking messaging system important?

[00:11:07.27] - Adnan Mazarei

Essentially, SWIFT is the motherboard of the international banking system communication.

[00:11:15.06] - Anjali V. Bhatt

Wow.

[00:11:16.00] - Adnan Mazarei

There are attempts to have non-SWIFT platforms, but SWIFT is really a platform through which banks communicate with each other. So if you're not allowed to be on it, you get cut off.

[00:11:30.11] - Anjali V. Bhatt

Okay, so now their banks can interact with the rest of the world, I guess.

[00:11:34.16] - Adnan Mazarei

Yes. Yeah.

[00:11:35.18] - Anjali V. Bhatt

Okay. So you wrote in March that in addition to rebuilding the economy, part of doing that is that Syria needs a debt restructuring, and also that most of Syria's debt is owed mostly to Iran and Russia. What does that mean for restructuring debt, both for Syria and also sort of for sovereign debt restructuring processes?

[00:12:02.20] - Adnan Mazarei

Syria has a large external debt and it cannot repay it because it doesn't have the resources. The official sources in Syria place their external debt at about \$23 billion. That's 140% of GDP, which is a huge number. As you said, there are other sources of information putting the external debt as high as \$50 billion. So therefore, Syria will need a restructuring, but this restructuring would be quite difficult. First and foremost, the amounts are not clear, and who owes what to whom is not clear. So there needs to be an audit of that. Second, the most important point is that Again, as you mentioned, that this debt is mostly owed to Syria, excuse me, to Iran and Russia. These are debts that are in good part associated with the civil war and are military debt.

[00:13:12.02] - Anjali V. Bhatt

So the then-Assad government was borrowing money from Russia and Iran to like fund the military.

[00:13:18.24] - Adnan Mazarei

Exactly.

[00:13:19.03] - Anjali V. Bhatt

Yeah.

[00:13:19.23] - Adnan Mazarei

Now, the international community, as we've discussed, is increasingly willing to fund Syria's reconstruction, but they are not going to provide financing to Syria if it turns around and repays Iran and Russia. Now, in normal circumstances, a country that wants to restructure goes through the IMF. The IMF decides on an envelope of the resources the country has to repay that. And they go—

[00:13:52.23] - Anjali V. Bhatt

What does that mean?

[00:13:54.08] - Adnan Mazarei

It means that the country, they'll take stock of the economic situation and how much the economy will be doing in the next few years and how much they can pay. If that amount is very small, then the country needs to restructure its debt. Restructuring is done either by postponing payments or just taking it, giving it a cut. Now, the problem is going to be that Syria itself may claim, we're not going to pay these debts to Iran and Russia because those debts are odious. Odious debt is a well-known concept in international sovereign debt issues. It essentially means a despotic government that is not representative of people has borrowed money and spent the money not on the people. At the same time, those who lent it knew who was borrowing and for what purposes.

[00:14:58.17] - Anjali V. Bhatt

So it's just sort of bad faith all around.

[00:15:00.27] - Adnan Mazarei

Exactly. Yeah. The problem is, although it is intuitively clear, odious debt is not an accepted operation, legal and operational framework, and new different approaches will be needed. For example, Syria could use the same framework that was used in Iraq after the fall of Saddam.

[00:15:27.29] - Anjali V. Bhatt

What was that?

[00:15:29.01] - Adnan Mazarei

Essentially, they put aside this odious dead concept, but the international community under the auspices of the United Nations, with strong support from the US, got together the creditors and asked them to have a restructuring. The Paris Club of official creditors gave an 80% reduction, and others were supposed to do it on similar terms. So it was done. This required a lot of heavy political lifting from the international community. This could be done. There are other approaches that have been suggested. For example, the famous debt scholar Lee Buchheit has said there's another concept that could be used, and it's called war debt doctrine, which says that you decide when the war started, when it ended, and you try to cancel the debt that occurred, was accumulated during that period. But again, this will have to be worked into that international framework that I suggested.

[00:16:39.22] - Anjali V. Bhatt

I mean, I think especially in a situation with like Syria, determining that exact start and end date, we say, you know, 2011 to 2014 was the civil war, but there was definitely more than just that. That sounds very difficult to define in terms of how much debt was accumulated in a certain amount of time.

[00:16:58.15] - Adnan Mazarei

Absolutely. The start of the civil war gives it an intuitively appealing start. Also, in the early 2000s, Syria did get some debt write-offs from others, including Russia. So some of its previous debt was already forgiven. So much of this debt is from 2005 to 2011, but the bulk is from 2011 through 2013.

[00:17:26.03] - Anjali V. Bhatt

Is there, do you think there is political, international political support to do something like they did with Iraq? Is that some, is there interest in that?

[00:17:37.12] - Adnan Mazarei

There will probably be interest in that, but the Syrian government needs to build trust that it's handled, it's treating its own people properly. It's getting along with neighbors. It is improving its governance. So once debt relief is given, the new funds will not be diverted. And time will tell.

[00:18:09.14] - Anjali V. Bhatt

Oh, they've got a lot ahead of them. Turning to oil now, briefly, does Syria have oil?

[00:18:17.20] - Adnan Mazarei

Syria has oil. Before the civil war, its output was 400,000 barrels a day. Now it's about 90,000. And the oil is in the north in the Kurdish areas. So I don't think the central government has much control over the oil revenues. For example, they have a new budget, as I suggested, but it's not clear how much the oil revenues that are being assumed in that budget are.

[00:18:45.22] - Anjali V. Bhatt

Okay, so let's shift over now to the countries where oil is a very large part of their budget. So I guess, you know, the elephant in the room following the Israeli and US strikes on Iran, oil prices went up, spiked briefly, but then after that they went down even lower than they were before. Why? Okay.

[00:19:11.07] - Adnan Mazarei

First and foremost, the oil market has not been tight recently. On the demand side, there has been some worries about the impact of the trade wars that have been started by the US on the global economy. Also, the International Energy Agency put out a report a while ago saying that the consumer countries have over time put in some mechanisms to deal with emergencies.

[00:19:44.22] - Anjali V. Bhatt

Like emergency oil price stuff or natural—

[00:19:47.28] - Adnan Mazarei

Disruptions especially.

[00:19:49.06] - Anjali V. Bhatt

Okay, oil disruptions.

[00:19:50.18] - Adnan Mazarei

Or even price spikes that will require some countries to lower their strategic reserves. For example, the United States has strategic oil reserves. The main show is on the supply side. First and foremost, in recent years, the share of OPEC in the global oil supply has come down because of the shale revolution in the US, increased production in places like Canada and the EU, Brazil. Secondly, right before these events between Iran and Israel, OPEC+ decided to increase output in part to keep prices low as a sign of goodwill to the Trump administration.

[00:20:43.11] - Anjali V. Bhatt

So that's OPEC, which is the oil and petroleum— no, oil-producing—

[00:20:48.22] - Adnan Mazarei

Organization of Petroleum Exporting.

[00:20:50.20] - Anjali V. Bhatt

I was close.

[00:20:51.17] - Adnan Mazarei

Plus means OPEC has 12 members. The plus is 10 more countries. Oh, well, mostly Russia.

[00:20:58.21] - Anjali V. Bhatt

Okay, so OPEC+ Russia already decided to keep oil prices low because the Trump administration wants lower oil prices.

[00:21:08.07] - Adnan Mazarei

Yes, their official explanation is we're trying to punish members who cheat on their quotas, but politics also entered in.

[00:21:18.19] - Anjali V. Bhatt

Okay, so they kept prices low before the strikes, right? Then the strikes happened.

[00:21:24.06] - Adnan Mazarei

The strikes happened. The big issue was whether Iran was going to close the Strait of Hormuz. The Strait of Hormuz is the place through which 30% of seaborne oil trade and 20% of liquefied natural gas trade go through. So a disruption of that trade would've led to much, much higher prices. But Iran selected not to do it. For the following reasons. First, it needs oil revenues. Second, its main consumer is one of its main allies, China. So it would've hurt China.

[00:22:07.01] - Anjali V. Bhatt

So if they had closed the strait, they wouldn't be able to sell to China. And since that's their biggest purchaser, that would really harm their revenues.

[00:22:15.10] - Adnan Mazarei

Exactly.

[00:22:15.26] - Anjali V. Bhatt

Okay.

[00:22:16.18] - Adnan Mazarei

Also, in past couple of years, Iran has been trying to rebuild bridges with the Gulf Cooperation Council countries. The closure of Hormuz would have disrupted that process. Furthermore, closure of Hormuz could have led to US military intervention and also others. So they decided not to do it. Of course, we shouldn't be complacent. If there are further attacks by Israel, on Iran. If the regime in Iran feels its survival is at stake, it may do so.

[00:22:59.13] - Anjali V. Bhatt

And then at that point, that would really be a big disruption to the oil market.

[00:23:02.10] - Adnan Mazarei

I mean, if that happens, the chances are low, but then that would be a big disruption.

[00:23:08.17] - Anjali V. Bhatt

I mean, I guess it would be a big disruption to a lot of things, not just oil. So moving west a little bit, I guess, and moving oil, but also shipping in general. This was the Suez Canal in the Red Sea, has the Houthis firing on commercial ships moving through that part of the world. How much has that changed shipping there? Is that just oil? Is it all shipping?

[00:23:38.01] - Adnan Mazarei

Trade going through the Suez Canal has fallen by 60 to 60, 70%.

[00:23:44.25] - Anjali V. Bhatt

Wow.

[00:23:47.00] - Adnan Mazarei

And a lot of the shipments that used to go through it now have to go through around Africa with increasing costs, including insurance costs. So it's hurt shipping and prices significantly. The party that has been hurt the most is Egypt, where its revenues from the Suez Canal were about \$10 billion. Now they've come down to close to 4, which is one of the reasons Egypt has come back to the IMF and others.

[00:24:28.20] - Anjali V. Bhatt

And is it just oil, or is it sort of everything going through there?

[00:24:32.25] - Adnan Mazarei

Everything.

[00:24:33.09] - Anjali V. Bhatt

Everything.

[00:24:33.27] - Adnan Mazarei

Everything.

[00:24:35.07] - Anjali V. Bhatt

Okay. Okay. So We, we have determined that oil trade is very important, um, and we don't want it to— we don't want, uh, those disruptions in it. But given that there are these major oil-producing countries that rely so much on, uh, oil for revenue, what are they doing, um, in response to sort of the push for decarbonization? How are the— is the green transition something that they care about? What is sort of that region of the world thinking about the green transition?

[00:25:12.18] - Adnan Mazarei

As you said, the oil producers of the Middle East are heavily, heavily reliant on oil for government revenues, for foreign exchange earnings. The problem is their levels of consumption are high and growing because of population growth. Another factor that has encouraged consumption of fossil fuels has been the heavy subsidies that have been given. They're trying to roll them back, but it's slow. Now, the countries of the Middle East, oil

producers, need to be really divided into two very different groups. One group is the Gulf Cooperation Countries, six countries, plus perhaps Algeria. These countries do, to different degrees, but certainly recognize and can read the writing on the wall with the energy transition. They have started to have new projects for solar and wind, but especially solar, and other things too. The countries that have gone the furthest are Saudi Arabia and the United Arab Emirates.

[00:26:27.11] - Anjali V. Bhatt

On green technology?

[00:26:29.11] - Adnan Mazarei

On movement Ford Green.

[00:26:30.15] - Anjali V. Bhatt

Okay.

[00:26:31.00] - Adnan Mazarei

Much needs to be done.

[00:26:32.05] - Anjali V. Bhatt

Yeah. Okay.

[00:26:34.01] - Adnan Mazarei

And the financing for these projects will be heavy in a world where foreign direct investment is coming down. Now, there's a second group of countries, oil producers, that are really in a bad shape. These include Libya, Iran, and Iraq. Each of them for its own reasons, has serious internal political problems and economic mismanagement. And energy transition is not at the forefront of their agenda, although these are parts of the world which are warming up the fastest. These are part of— parts of the world where water scarcity is very, very bad.

[00:27:25.22] - Anjali V. Bhatt

So you said briefly that, um, you know, funding, uh, funding these kinds of technologies, you know, solar, wind, etc., um, in the— at least in the countries that, you know, are open to it, um, FDI is going down. Say more about that.

[00:27:44.01] - Adnan Mazarei

FDI globally is weakening up a bit. Among the GCC countries, most of them are capital exporters. So although they need financing for FDI, through FDI, and also for technological technology transfers, they're financially okay because they have large balance sheets. The one that has become a net capital importer is Saudi Arabia and has been forced to cut back on some of his ambitious, uh, projects.

[00:28:25.04] - Anjali V. Bhatt

Okay, so we are almost at time. Wow, time flies. Um, so g— given everything that's happening in the world, you said, you know, that Syria might be one of the only sort of good stories to come out of the region. Um, what will you be looking for in the next 3 to 6-ish months.

[00:28:41.26] - Adnan Mazarei

Most of the issues are political, to be very blunt. This is the Middle East. The first issue that I'm looking at is to see if there's a ceasefire that brings an end to the tragic situation in Gaza and the Israeli hostages can go home. The second is if there is a resumption of the Israel-Iran clashes. Third, the evolution of the US tariff war and its implications for the region. It's creating a lot of clouds of war and people's decision-making is being affected. Fourth, developments in the US and international debt markets, bond markets, that may create some disruptions and cause flow interruptions to the countries in the Middle East.

[00:29:34.17] - Anjali V. Bhatt

Do we think that oil markets will sort of stay— barring any more major strikes, are oil markets probably going to stay relatively stable?

[00:29:45.28] - Adnan Mazarei

Yes.

[00:29:46.06] - Anjali V. Bhatt

Yeah.

[00:29:46.26] - Adnan Mazarei

Yes.

[00:29:47.03] - Anjali V. Bhatt

Okay. Well, that brings us right at time. Thank you so much for giving us an overview of a very complicated region. And thank you for joining us for this edition of PIIE Insider Live. What did you think? What do you want to see next? Let us know at meetings@PIIE.com. And if you're not already, subscribe to PIIE Insider, the newsletter, at PIIE.com/subscribe. Thanks for joining us, and we'll see you next time.