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SUBJECT: Syria: Driving Toward Oil Self-Sufficiency

NESAM #86-20119

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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

24 July 1986

Syria: Driving Toward Oil Self-Sufficiency [redacted] 25X1

Summary

Syria is expected to begin pumping 50,000-60,000 barrels per day (b/d) at its new Thayyem field in eastern Syria in September when a new pipeline is completed. Development of the field is under the direction of a foreign firm, Pecten, which has promised President Assad it will produce 100,000 b/d by 1988. Syria intends to use its new oil domestically, initially reducing its dependence on imported oil by about 40 percent. It is not likely to achieve petroleum self-sufficiency without significant new finds. [redacted] 25X1

The new oil will only marginally strengthen Syria's economy, but Damascus will be less dependent on Iran for concessional oil shipments. Although Syria will still seek extensive support from all sides, Assad will have somewhat more latitude in his relations with Iran and Arab financial donors. In addition, potential economic benefits from as reconciliation with Iraq will diminish as oil import needs are reduced. [redacted] 25X1

A stronger domestic oil industry will not nearly overcome Syria's profound economic problems, which result from years of misdirected Ba'thist policies and burdensome military spending. Sluggish export trade will ensure Syria continues to run a current account deficit and suffer chronic foreign exchange shortages. Despite an invigorated energy sector, the Syrian

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This memorandum was prepared by [redacted] the Levant Branch, Arab-Israeli Division, Office of Near Eastern and South Asian Analysis. Information as of 24 July 1986 was used in its preparation. Questions and comments should be addressed to Chief, Arab-Israeli Division [redacted] 25X1 25X1 25X1

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[redacted]

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economy will remain basically weak and persistent downward pressures will likely add to Assad's problems. [redacted] 25X1

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The Role of Oil

Oil is central to Syria's economic health. Crude oil and products account for over 60 percent of Syrian exports. Syria, however, is a net importer of oil. According to the US Embassy in Damascus, the Syrian oil trade deficit was about $200 million in 1984 and probably larger in 1985, due to the high value of crude imports and declining volume of crude exports. Syria also exports 20,000 b/d of refined products, primarily low value fuel oil. [redacted] 25X1

Syrian refineries are designed to operate on a blend of domestic heavy crude and imported light crude, but operate more efficiently on straight imported light. Declining production of heavy crude from the older northeast fields--combined with erratic imports--makes Syria more vulnerable to external supply shocks. [redacted] 25X1

Exports are depressed due to lower prices and stagnant production. Revenues from oil exports fell from over $1.3 billion in 1980 to about $800 million in 1985. The official price for Syrian crude was steady through 1985 but fell dramatically in February after Damascus reluctantly introduced "netback" pricing, which ties the crude sales price to the value of refined product. If the increase in Thayyem production is unexpectedly delayed until 1987, we estimate this year's exports of crude could provide less than $400 million. [redacted] 25X1

The fall in exports for 1986 has been aggravated by the disruption in Iranian deliveries. [redacted] 25X1 Meanwhile, exports declined by at least 20,000 b/d--or $180 million--as the Syrians diverted export oil to domestic refineries to compensate for Iranian shortfalls. Supplies remain erratic this year, and may have further reduced Syrian exports below last year's 100,000 b/d level. [redacted] 25X1

Imports of crude oil and products represent a growing share of Damascus' hard currency imports. Falling oil prices and market disruption have a twofold effect on Syrian imports:

[redacted] 25X1

[redacted] 25X1

--Syria's primary supplier, Iran, suffers declining export income. As a result, Tehran has pressed Damascus for prompt payment and often suspended deliveries.

--According to press reports, periodic cutoffs this year have forced biweekly purchases of 50,000 b/d of light crude on the Mediterranean spot market. [redacted] 25X1

Syria probably pays for only a fraction of its oil deliveries from Iran, but must pay cash for spot market purchases. To compensate for Iranian shortfalls, Syria has turned to other sources. First quarter 1986 deliveries from Libya were about 2.5 million barrels--15 percent of import needs. These spot market purchases have almost exhausted Syrian foreign exchange reserves 25X1 and likely impressed on Assad his growing economic isolation. [redacted] 25X1

Syrian crude oil <u>production</u> has been stagnant for years, after peaking in 1976 at 200,000 b/d. Although it has granted several exploration and drilling concessions to foreign firms since 1974, these firms have failed to exploit successfully any major new fields--until Pecten's recent discoveries. The Syrian Petroleum Company (SPC) has relied on outmoded equipment and technical support, mostly Soviet, to operate its principal fields 25X1 at Suwaydiyah and Qaratshuk in the far northeast. [redacted] current Syrian oil production is 185,000 b/d, 25X1 including early production of at least 15,000 b/d from Thayyem, which is trucked to the Iraq-Syria pipeline for transport to Hims refinery. [redacted] 25X1

Domestic <u>consumption</u> of petroleum products has expanded rapidly over the past two decades, doubling since 1975. Current demand for petroleum products is about 190,000 b/d and growing over 10 percent annually. Military and industrial growth and price subsidies have fostered high consumption of several products, and government projections indicate total consumption of petroleum products will rise to 320,000 b/d by the turn of the century. [redacted] 25X1

Syria is only partly meeting current domestic demand for oil products. Liquid propane gas, primarily consumed in household uses, remains priced about 50 percent below cost and demand is booming. Electricity rates for domestic and commercial users also remain well below cost and account for much of the growth in fuel oil consumption. To curb consumption and relieve pressure on the budget, the government in late 1985 announced much-needed

[redacted] 25X1

[redacted] 25X1

price increases for most petroleum products to reflect actual costs. According to Embassy reporting, rationing of some oil products began in February and electricity is shut off in Damascus for three or more hours per day. [redacted] 25X1

Pecten Production Helps

The Pecten Syria Corporation--a consortium of Shell USA, Royal Dutch Shell, and Deminex of West Germany--is developing Thayyem and other finds and will divide the marketed production with the Syrian Government. According to Embassy reporting, Pecten had drilled 17 wells by last October and plans to complete 24 additional wells by October 1986 to meet their 1988 production goal of 100,000 b/d. Based on current reporting, we estimate production goals will be met on schedule. The benefits to Syria, however, will probably not meet Damascus' expectations. [redacted] 25X1

Syrian crude oil production is expected to increase substantially later this year. [redacted] 25X1 We expect the low gravity, low sulfur Thayyem crude will initially reduce imports about 40 percent and could eventually displace all oil imports if new discoveries allow Pecten production to increase above 140,000 b/d. [redacted] 25X1

Although production-sharing negotiations are still underway, the cost recovery and profit share for Syria's foreign partners will curtail Syria's financial return. [redacted] 25X1

Financial Gains Fall Short

We estimate during the cost recovery period, Syrian financial gains will be limited. Total oil exports may actually fall as Syria compensates Pecten for domestically-consumed Thayyem crude with Suwaydiyah crude on a value equivalent basis. While the current market prices for the two grades of crude are very close, light grades generally are higher priced. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Syria will likely remain a net importer at least until 1988. We estimate Pecten output will have to increase to over 75,000 b/d--including Syria's foreign partner's share--before Syrian oil trade comes into balance. If new discoveries allow production to increase to over 75,000 b/d, Syria and its partners will export part of the Thayyem crude [redacted] 25X1 The balance of Syria's oil import needs will likely be met by concessional deliveries from Iran. We estimate that the low level of initial output will extend Pecten's cost recovery period well over two years. After costs are recovered, Syrian export earnings on 75,000 b/d (at $15 per barrel) will increase by $100 million but will not significantly improve Syria's foreign payments position. [redacted] 25X1

Syria is holding Thayyem's early production as "credit" against future production. This policy has been a point of contention between Syria and its business partners and will likely add to Pecten's cost recovery period, thereby further postponing substantive financial returns to Syria. Embassy reporting indicates Pecten has previously limited production below potential to maintain leverage over the Syrians. [redacted] 25X1

Although occasional disputes have disrupted Damascus' relations with its foreign partners, Syria has been unusually accommodating toward Pecten. Damascus has twice adjusted Pecten's exchange rate for imports to lower, more realistic rates. [redacted] 25X1 We believe that Assad views Thayyem as one of the brightest hopes for Syria's economy [redacted] 25X1

Long-Term Growth Potential

Embassy reports on estimated reserves suggest Syria may--at best--become self-sufficient in crude oil and perhaps a nominal crude oil exporter. Pecten, however, has found oil in a third concession east of Thayyem that may allow substantially higher production by the early 1990s. Although [redacted] no indication of production above 100,000 b/d, Pecten's extensive investment and planned excess capacity suggest higher long term production is a realistic possibility. [redacted] 25X1 25X1

Syria still has high reserves in its northeastern fields and production could be maintained and even increased if Syria invested more in updating equipment and seismic studies. Syria's

[redacted] 25X1

[redacted] 25X1

northeast reservoirs are very complex, low density fields, and increased production will require advanced Western equipment and expertise. It is unlikely, however, that Damascus will allow greater Western involvement in its oil industry at this time. New development ventures are unlikely while world energy markets remain weak. [redacted] 25X1

Outlook and Implications

For the next one or two years, Damascus will remain dependent on its present suppliers, especially Iran, for concessional oil shipments. Syrian import needs over the medium-term are confirmed by the oil supply contract recently negotiated with Tehran for 100,000 b/d through March 1987. As Thayyem production is stepped up during 1987 and other finds are developed, Damascus will gradually grow less dependent on foreign suppliers. Syria doubtless will continue to demand high levels of aid from Iran and Arab countries, but Assad will have more room to maneuver. Moreover, Assad will have less incentive to reconcile with Iraq for secure oil supplies. [redacted] 25X1

Syria's foreign payments position will likely remain troubled, even as oil trade turns into a surplus. Non-oil exports--primarily cotton and phosphorous--are weak and declining, and foreign aid will probably continue to contract as the regional depression continues. Assad has consistently subordinated economic interests to political goals, but he may be inclined to take measures to increase Syria's share of the increased output from the new oilfields. If relations with Pecten in particular or the US in general turn sour, Syria could easily increase taxation on its foreign partners, demand renegotiation of the production-sharing contract, or even expropriate foreign assets. [redacted] 25X1

Increased oil wealth will help hide the structural problems in the Syrian economy and likely postpone necessary reforms. Syria's economic problems will not disappear, and the majority of the population probably will not feel any benefits from higher oil production. A marginally stronger economy will bolster Assad's determination to pursue high military expenditures, however, which are already an extreme burden on the economy. [redacted] 25X1 25X1

The prospects for increased US leverage over Damascus through greater involvement in the oil industry are poor. Although Pecten has a high stake in Syria, threats of sanctions and disinvestment are not likely to induce Assad to alter his

[redacted] 25X1

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policies. If Pecten withdrew operations in Syria, the impact on Damascus would be minimal. The Syrian Petroleum Company--possibly with Soviet, East European, or Arab assistance--could easily take over Pecten's operations with little disruption. In addition, West European oil firms, including Pecten's part-owners Royal Dutch Shell or Deminex, could offer Western expertise to keep production on schedule and continue exploration on new fields. 25X1

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[redacted] 25X1

APPENDIX #1

Iran: Syria's Import Lifeline

Syria's oil import requirement combined with its chronic foreign exchange shortages--estimated below $100 million in May--make it dependent on concessional oil shipments. Since Damascus broke relations with Iraq in 1982 and closed the 1.2 million b/d Kirkuk-Homs pipeline, Syria has relied primarily on Iran for crude oil deliveries to meet its growing demand. [redacted] 25X1

Syrian nonpayment of its debt and Iranian intransigence over selling below its official price have strained relations between them and resulted in periodic cut-offs of Iranian deliveries. Moreover, Syrian tankers loaded with Iranian oil have been targets of Iraqi attacks twice in 1986, further disrupting crucial imports. We estimate 1986 deliveries of Iranian oil at approximately 6.5 million barrels--only three ultra-large carriers. [redacted] 25X1

The oil link to Iran has been weak since the outset of the relationship in 1982. Deliveries have continued, albeit at progressively lower levels, despite Syria's consistently poor payment record.

--March 1982: Syria forms strategic alliance with Iran, and Tehran agrees to supply 180,000 b/d to Syria.

--April 1982: Syria closes the 1.2 million b/d Iraqi pipeline.

--April 1983: Supply contract amended to 120,000 b/d supplied at $2.50 below official price with 20,000 b/d free for military. Almost $1 billion in oil debts forgiven.

--May 1984: Contract renewed at same terms, and Syria's $993 million oil debt rescheduled on generous terms.

--May 1985: Contract renewed again, possibly further delayed debt payment.

[redacted] 25X1

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--August 1985: Iranian deliveries halted for four months.

--December 1985: Syrian Prime Minister signs accord in Tehran to resume shipments. Iranians agree to partial payment in barter.

--May 1986: Annual negotiations on supply contract cut off. Contract expires, but deliveries continue.

--June 1986: Iranian Deputy Foreign Minister Besharati in Damascus on eve of scheduled Syria-Iraq ministerial meeting. Iran probably promise to resume steady oil shipments.

--July 1986: Syrian delegation in Tehran signs six month contract commencing October 1986 for 100,000 b/d. [redacted] 25X1

[redacted] 25X1

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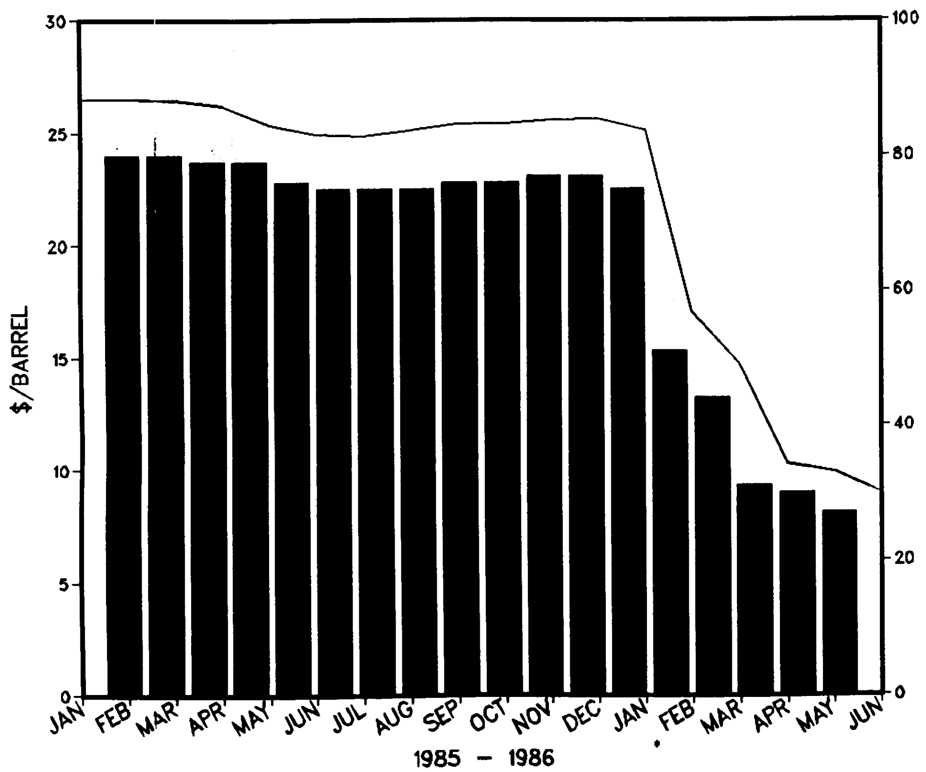
SYRIAN CRUDE OIL SALES PRICE
AND EXPORT REVENUES



*NETBACK PRICING INTRODUCED

OFFICIAL PRICE, SUWAYDIYAH–24

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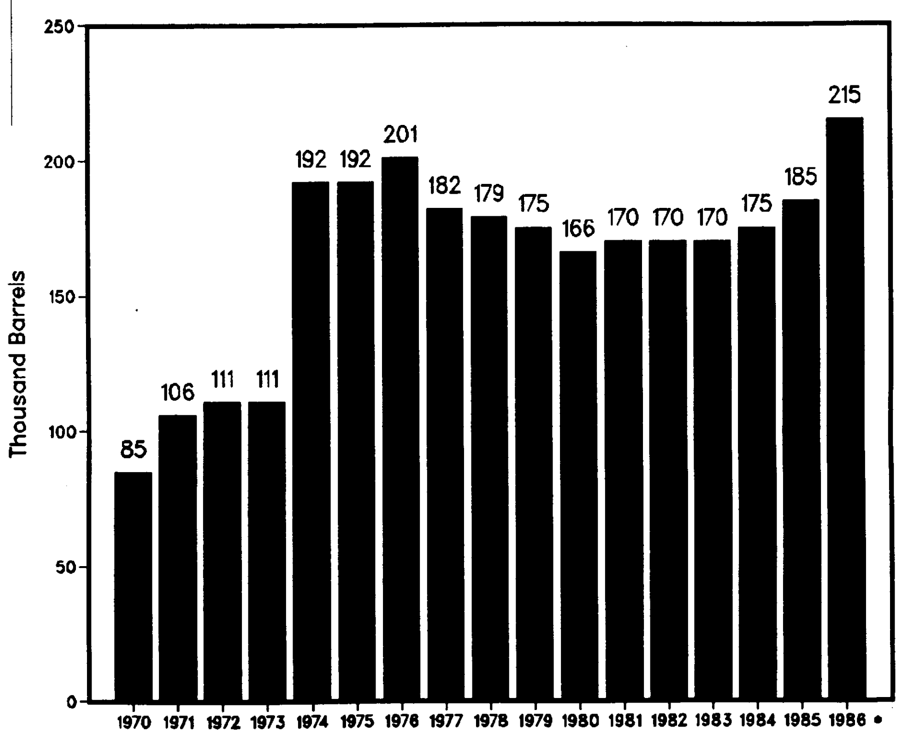
SYRIA: CRUDE OIL PRODUCTION



* PROJECTED

Year–End Daily Output

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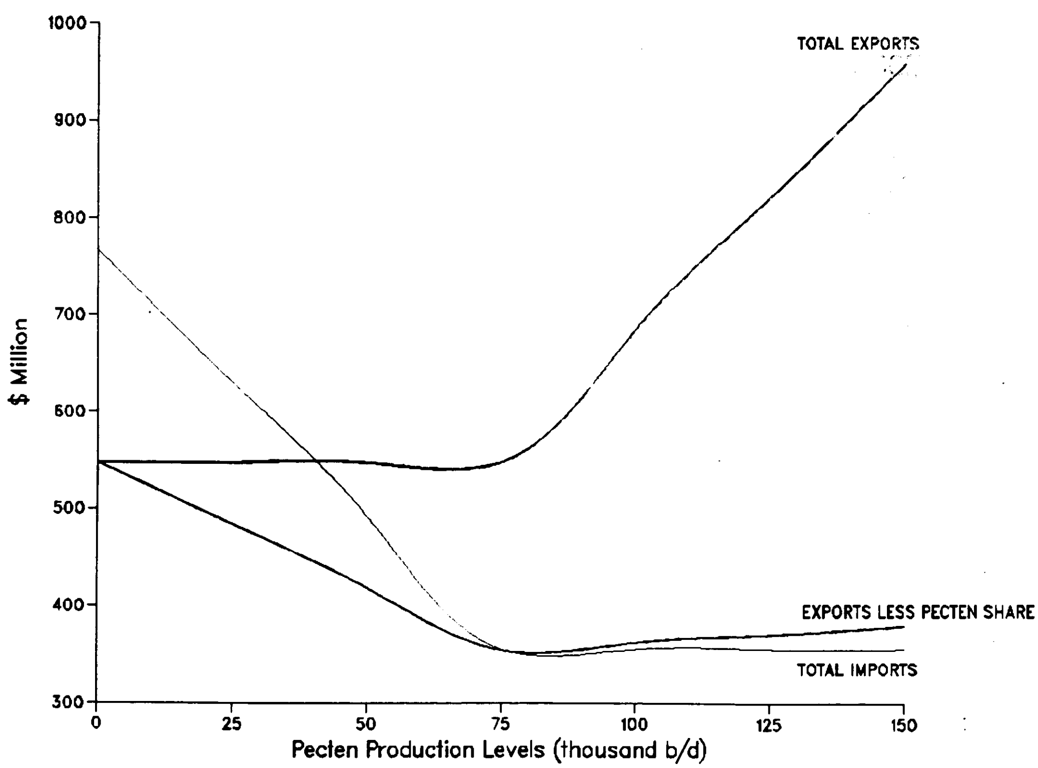
SYRIA: PROJECTED CRUDE OIL TRADE UNDER PECTEN PRODUCTION SCENARIOS



Price: $15/barrel

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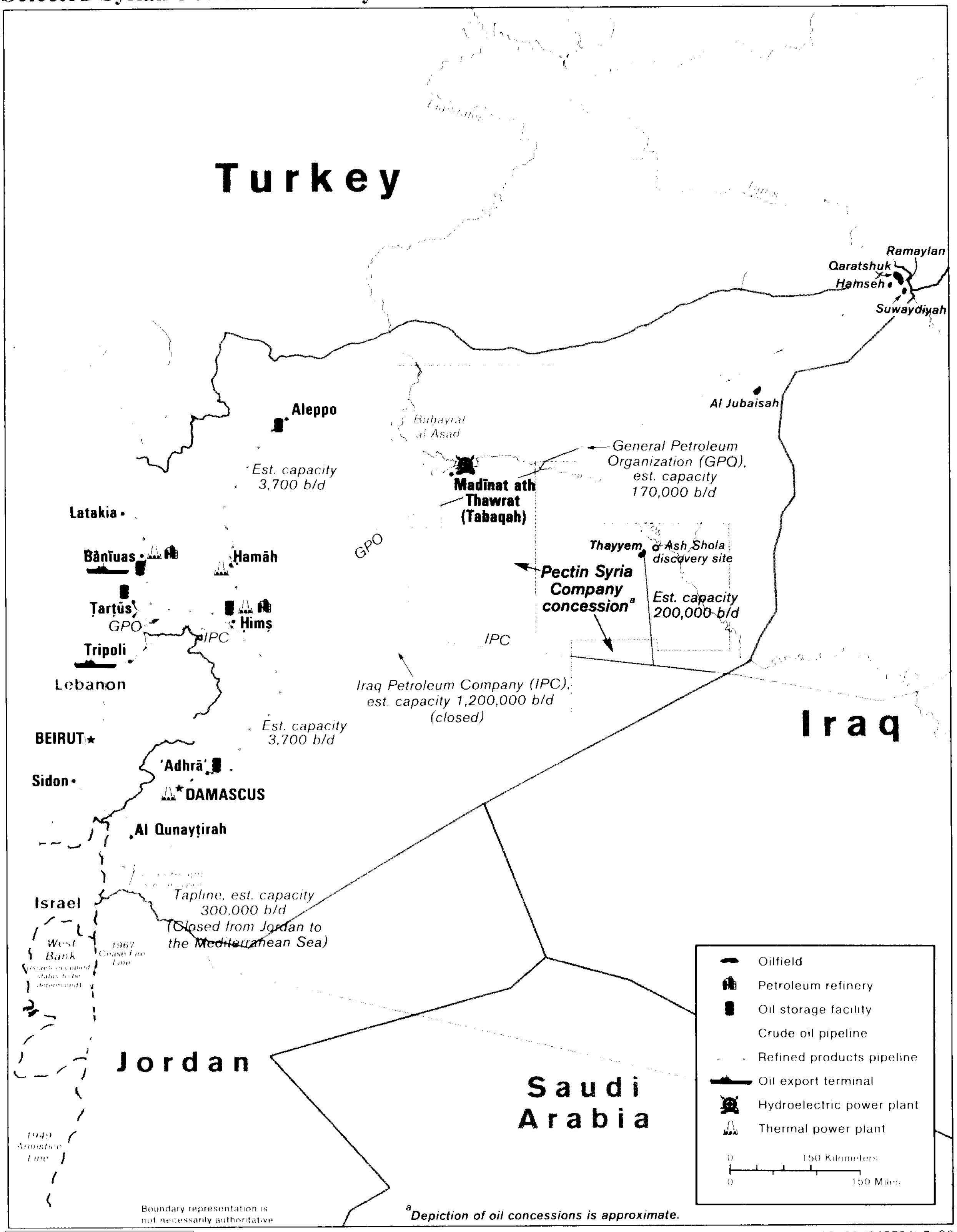
Selected Syrian Petroleum Activity



[a]Depiction of oil concessions is approximate.

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