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The Political Economy of Postwar Reconstruction in Lebanon

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Abstract

This paper studies the postwar economic and political reconstruction in Lebanon. The paper shows that the 'reconstruction boom' was short-lived. The economy experienced a growth trap early in the reconstruction period, and entered a cyclical crisis in 1998 which resulted from an ill-designed fiscal-monetary policy mix. The expansionary fiscal policy resulting from the high resource demands – due to economic and political reconstruction and from the needs of addressing horizontal inequality codified in the peace agreement known as the Taef Accords – led to a fiscal crisis of the state. The monetary and central bank policy was finance-biased with emphasis on financial and exchange rate stability and foreign capital inflows. Such a mix led to a real interest rate shock in the postwar period that played a role in the onset of the cyclical downturn. The finance-biased policy led to the rise of a rentier economy leading to deindustrialization during this period. The rise of a growth-impeding political economic structure resulting from the Taef Accords also played a role in intensifying the economic crisis through exerting pressures on public resources and through the engendering of a political crisis that brought to an end the era of postwar reconstruction.

Keywords: conflict, civil war, post-conflict, institutions, social contract

JEL classification: D74, E52, O23, H56

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1 Introduction

The Lebanese civil war lasted more than 15 years from April 1975 to October 1990. In terms of its ranking amongst interstate and civil wars that the world has witnessed since the end of the Second World War, it was one of the major wars of the late twentieth century.[1] The consequences of the civil war were highly devastating to the functioning of the small open and liberal economy that Lebanon enjoyed before 1975. The effects of the war can be summarized in the following. First, the Lebanese economy's lost output was estimated at US$24 billion in 1986 (Saidi 1999). In 1990, the GDP per capita was less than one third of the GDP per capita in 1974 at the eve of the war. Second, the economy experienced a massive destruction of capital stock. It is estimated that the physical assets destroyed during the war are around US$25 billion (Gressani and Page 1999). Third, Lebanon suffered from the loss of human resources through war casualties and emigration. War related deaths are estimated at 131,000 (Uppsala Conflict Database) while emigration is put at around 500,000. Fourth, there was a deterioration of the infrastructure of the economy; mainly the electricity, telephone, water and road networks. Fifth, the negative productivity shock and the inflationary crisis of the 1980s led to massive redistribution of income and factor shares. The prewar wage share which reached 50-55 per cent was reduced to 15-25 per cent by the end of the war. Sixth, the war caused a weakening of state institutions including the military, security forces, administrative capacities and especially revenue generating capabilities and resource mobilization. Seventh, the war led to the destruction of communities through the massive displacement of population especially in Mount Lebanon and the South.

The hostilities ended in October 1990 with the implementation of the Taef Accords which redistributed political power amongst the different Lebanese sects and constituencies. The period between 1990 and 1992 was mainly a period of political reconstruction which included the reestablishment of Lebanese political, military, security and administrative capabilities. In 1992, a new government took power headed by Rafic Hariri, a Lebanese business man, which started a new era in postwar reconstruction. The government immediately set at devising an economic reconstruction plan aptly called 'Horizon 2000'. This ambitious plan consisted of an investment expenditures programme and corresponding macroeconomic targets from 1993 to 2007. In addition to the plan, the government undertook the task of macroeconomic and financial stabilization that aimed at controlling inflation and the recurrent currency crises which plagued the economy during the later phase of the civil war (post 1984) and during the early period of peace form 1990 to 1992. Financial and exchange rate stability were considered essential for the attraction of foreign capital for the reconstruction programme. The government and the central bank chose to use the exchange rate as a nominal anchor in the postwar stabilization period.[2] This duality of

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1 In comparison to seventy nine wars that Koubi (2005) studied, Lebanon's war indicators are consistently above the mean except for intensity. The indicators for Lebanon are: battle deaths (131,000), battle deaths per 100,000 (4366), duration of war (186 months), battle-deaths per month (705). The means for the indicators are 101839, 79.4, 63.72 and 6297.9 respectively for wars between 1960 and 1989.

2 The nominal exchange rate was chosen as an anchor in the postwar period (versus choosing money supply) because of high currency substitution and dollarization. The endogeneity of money supply relevant to the determination of the price level and output as a result of foreign currency deposits makes the control over money supply highly uncertain (Bhattacharya 2003).

postwar reconstruction and macroeconomic stabilization formed the basis of the policies of the successive Hariri governments until 1998. In addition to the plan and the set of policy initiatives, Rafic Hariri was seen as a symbol of the resurrection of Lebanon. The Hariri clout was so overwhelming that he projected an internal and external image of a country that is rising from the ashes: a kind of media generated 'Phoenix factor' that even won appraise from the president of the World Bank James Wolfensohn during his visit to Beirut in June 1997 despite internal criticisms at the plan and fiscal developments at the time (Corm 1998).

Postwar economy in Lebanon passed through four stages. The first phase (growth cycle) from 1992 to 1998 was the period of postwar reconstruction boom. The Hariri governments were able to sustain economic growth boosted by renewed confidence in the economy, high current and capital public expenditures and a stable macroeconomic environment. However, the boom was inherently unstable given high government deficits and the exchange rate based stabilization. The period ended with a recession in a typical Exchange Rate Based Stabilization (ERBS) boom and bust. The second phase (crisis I) came about as a result of the election of the army chief General Emile Lahoud to the presidency and the formation of a new government headed by Selim Hoss, an economist and veteran politician. The new government held anti-Hariri views especially on the direction of reconstruction and the state of public finances. The government formulated an austerity and stabilization plan that aimed at stopping the growth of public deficit and debt. The plan was never implemented and the economic crisis deepened given that there was a significant loss in confidence on the part of the consumers and investors. The government lost the parliamentary elections of 2000 that brought Rafic Hariri back to power in a landslide victory. The new phase in the economy of the postwar period (crisis II), despite the return of Hariri to power, signalled a further deepening of the crisis from a cyclical crisis to a more structural crisis. It was clear that by that time the reconstruction programme as envisaged by the Horizon 2000 plan was long considered to be over. The country was faced with a deepening structural crisis that threatened to undo most of the achievements of the postwar period. The economy was on the brink of deflation. The political crisis had three dimensions. First, cracks in the relationship between the different sects started brewing as a result of the fiscal crisis of the state and its inability to continue siphoning state resources to the various distributional channels that were established in the post 1992 period. By 2001, the internal political conflict was leading to economic crisis signalling the end of the Second Republic distributional system. The second dimension took a more nationalist and to a certain extent anti-Taef Accords. The period witnessed the beginning of a budding anti-Syrian national movement comprised of the Qornet Chehwan grouping of Christian political parties and figures established in April 2001, the Aounist Free Patriotic Movement and the left. This ushered in a new period of political crisis. The third dimension of the political crisis involved a continuous struggle for power between the President of the Republic Emile Lahoud and the all powerful prime minister Rafic Hariri. This power struggle impeded the proper functioning of the state institutions and most importantly the executive branch of government. The crisis threatened the economy with total collapse. The prime minister went for a foreign aid solution that would postpone the collapse of the economy and strengthen his position vis-à-vis the president. The Paris II meetings were held in November 2002 with an impressive show of support from major governments and international organizations. The Paris II agreement brought US$3.1 billion in pledges from international participants including France. This averted an impending financial crisis and led to the return of confidence and trust in the Lebanese economy producing a recovery period in 2003. However, the political crisis intensified, and ended in the assassination of Rafic Hariri and the withdrawal of Syrian troops in April 2005.

This paper argues that postwar reconstruction in Lebanon has failed to achieve its initial ambitious objectives. Unlike the post-conflict historical experiences of countries with an initial state of massive destruction of capital stock and physical assets, the Lebanese economy experienced what can be called a 'growth trap' early on in the reconstruction phase. The reconstruction boom lasted only up until 1998. The reasons for such a failure are multifaceted and reside in a badly designed fiscal policy, a finance-biased monetary and central bank policy and a political economic structure that was growth-impeding. Fiscal policy was driven by both political and economic reconstruction objectives and needs. This entailed huge government expenditures in the postwar period creating chronic budget deficits as a result of lagging revenues generated in part by a supply-side tax reform in 1993 that reduced income taxes. Monetary and central bank policy, on the other hand, had a sole objective of maintaining exchange rate stability, low inflation and capital inflows all deemed necessary for the success of the reconstruction process. This monetary-fiscal policy mix led to a finance-biased economy with high real interest rates which caused the end of the reconstruction boom phase by 1998. Moreover, this economic policy mishap was part of a larger political-economic structure that was established in the postwar period. A postwar political and distributive coalition was created in Lebanon that acted as a fetter on economic growth. The Taef Accords, being a grand scheme of consensus building amongst the sects in Lebanon, led to massive expenditures on state building, massive expenditures on addressing *horizontal inequities* amongst regions and sects and to political deadlock, foreign hegemony and sectarian conflict that caused in part the collapse of economic growth in the postwar period. In a sense, it can be said that costs of 'political reconstruction' played a role in the undoing of economic reconstruction.

The paper is divided as follows. Section 2 discusses the economic recovery plan and the postwar record on economic growth and distributional developments. Section 3 overviews fiscal developments. Section 4 presents the role of the central bank in developing the finance-biased economy generated by state-central bank-commercial bank collusion. Section 5 discusses the political economy of 'political reconstruction' engendered by the Taef Accords. Section 6 presents concluding remarks that draw lessons from the Lebanese experience.

2 The economic recovery plan

The reconstruction programme went through different reincarnations between 1993 and 1995. Early in 1992, a National Emergency Reconstruction Plan (NERP) was quickly devised by the newly revived Council of Development and Reconstruction (CDR). The NERP was a short-term physical and social infrastructure rehabilitation plan with a cost of US$2.25 billion (Wetter 1999). The plan was then subsequently revised and expanded to become a full fledged long-term investment plan that included macroeconomic projections of GDP and GDP per capita growth, fiscal developments and internal and external financing needs. The plan was called Horizon 2000. The Horizon 2000 plan envisaged spending around US$18 billion on public and social infrastructure over a span of 13 years from 1995 to 2007. The sectoral composition of reconstruction investment was distributed are presented in Table 1.[3] Moreover the plan, based on historical data, assumed that public investment will be matched on a three to one basis by private investments in equipment and building structures. The plan projected that GDP growth over the period would average 8 per cent a year which would double GDP per capita by the end of 2007 (Alfazlaka 1995).[4] The plan is largely now forgotten and it had a life span of around four years that ended with the election of Emile Lahoud in 1998 and the exit of Hariri from government.

Table 1
Sectoral shares in the Horizon 2000 plan

Sector	Share (%)
Physical infrastructure (electricity, telecoms, roads, highways)	37
Social infrastructure (education, health, social affairs)	25
Public services (water, wastewater, public transport)	22
Productive sectors (irrigation, oil, airport, ports)	8
State apparatus (buildings, administration, information)	8

Source: Wetter (1999).

3 In addition to the massive economic reconstruction programme, the government had plans for the physical reconstruction of the Beirut Central District (BCD) and the rehabilitation of the Northern and Southern Suburbs of Beirut. The BCD was almost totally destroyed during the civil war and the suburbs (especially the Southern suburbs) were debilitated in terms of housing, infrastructure and social services due to years of neglect, war and internal migration. The reconstruction of the BCD was awarded to a private company *Solidere* which appropriated private lands and deeds. The cost was estimated at US$4.2 billion. The project is well underway and considered by many as the jewel of postwar reconstruction. The other two reconstruction projects were largely forgotten due to lack of funding and political disputes. The development of the Northern suburbs LINORD was a massive land reclamation and urban development project located on 2.4 million square meters with a total cost of US$550 million. The development of the Southern suburbs under the title Elyssar was envisaged as a massive development resident reallocation and infrastructure rehabilitation urban project. The company Elyssar was established but the project never saw the light of day. The project was seen at times as a threat to the influence of Hezbollah in the suburbs.

4 A back of the envelope calculation shows that the government was not widely off the margin in its prediction of 8 per cent real GDP growth. Public infrastructure has been shown to lead to increases in productivity. According to various studies reported by the World Bank (1994), the rate of return, as measured by the percentage increase in output as a result of 1 per cent change in infrastructure level, varies from 0.5-0.9 per cent depending on the country and type of project. Moreover, De Long and Summers (1992) estimated that every 1 percentage point increase in the equipment investment/GDP ratio is associated with an increase of about 0.20 to 0.35 percentage points in the growth rate of GDP per worker. Given these results, it is safe to assume that Lebanon will experience a tremendous growth in productivity over the years of the Horizon 2000 plan. The annual permanent investment boost to investment is almost 12 per cent of the GDP over the course of 13 years. If we assume that the social rate of return of this public investment is 30 per cent per year, which is less than the average of rates of returns of various public investment projects studied by the World Bank (1994), and that the rate of depreciation of public capital stock is 5 per cent then the increase in productivity per year as a result of the NERP over 13 years will be a 6 per cent permanent boost to annual output per year. According to De Long and Summers (1992), a 1 per cent permanent boost to equipment investment will result in a $(r + \delta)/\delta T$ per cent boost to the growth of output over a T-year period where r = annual rate of return and δ = depreciation rate.

During its lifetime, the plan initially met political opposition from the parliament. The Horizon 2000 plan which was presented to the parliament as part of the 1995 budget was sidelined to be approved on a project by project basis. Given the plan's composition as a series of projects rather than a comprehensive development or reconstruction plan, this political opposition did not dent the plan and it was overcome by Hariri through the formation of his second government in 1995. However, the main problems for the plan were fiscal. By 1996 and in response to a critical confidential World Bank report that criticized government finances and had gloomy future projections, the government reduced the total amount to be spent in the years 1993-2002 to US$7 billion in contrast to the initially estimated US$13 billion (Lebanon Report 1996). Despite such difficulties, the plan and the successive Hariri governments did actually spend massive amounts on reconstruction during the period 1993-98. By the end of 1998, CDR ongoing and completed projects totalled US$4.25 billion (Wetter 1999).[5] Moreover, the level of capital expenditures in 1992-98 was high. Table 2 presents capital expenditures for the period showing high levels compared to average capital expenditures in a sample of 25 industrial and developing countries in the period 1991-95 which was 3.7 per cent of GDP (Helbling 1999).

Table 2
Public capital expenditures (1993-98)

Year	Public capital expenditures (% of GDP)
1993	3.3
1994	9.3
1995	9.4
1996	8.5
1997	8.6

Source: Helbling (1999).

2.1 Economic growth

Given such an ambitious reconstruction plan and high levels of capital expenditures how did the Lebanese economy perform in the postwar period? The experiences of postwar reconstruction booms especially after conflicts that result in the destruction of capital stock and physical assets would predict that Lebanon should experience a similar boom. However, postwar growth in Lebanon was less than spectacular and the economy soon entered into a growth cycle and the long run record, measured over ten years, was dismal by postwar growth standards.

2.1.2 Postwar growth: historical experience

Postwar economic growth is usually driven by the bridging of the gap with prewar levels of GDP and GDP per capita. In the early postwar period, a postwar 'reconstruction boom' is expected and later growth performance depends on economic

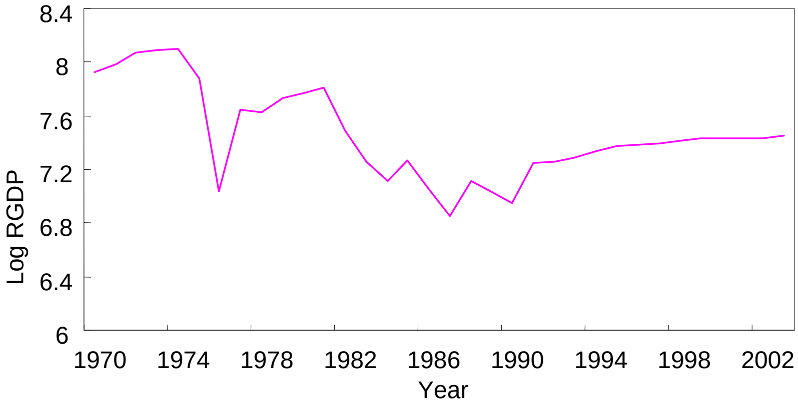
5 In addition, the momentum of future projects was still high. In the end of 1997, US$1.5 billion worth of projects were in preparation (Wetter 1999).

policy and structural change. The early period can be dubbed as a reconstruction-led boom while later periods may combine reconstruction residuals or the effect of structural reforms undertaken in the postwar period with the prime example being the German and Japanese miracles. A postwar reconstruction boom is usually transitory and can be explained by neoclassical growth theory. During wars, capital is destroyed and hence the economy starts off the postwar period with lower than capital-to-labour ratio than the long run equilibrium. Hence convergence necessitates that the economy grows at a higher rate than the equilibrium growth rate in a ‘closing the gap’ dynamics. Hence, this disequilibrium phenomenon leads to a postwar reconstruction boom that causes growth rates to reach prewar levels (Smolny 2000; Eichengreen 1995). Using such methodology, the period 1945-50 can be seen as the period of reconstruction in Europe. In this respect, rapid postwar growth not only bridges the gap with prewar output but also can be a source for asset and income redistribution policies that alleviate poverty, inequalities and provide the distributional basis of a new social contract (Addison and Murshed 2001). Moreover, Smolny (2000) has also shown that the economic conditions of growth, investment and increased demand in the reconstruction period had a positive effect on growth in the 1950-60 period in Europe. For example, in the postwar period in Europe, the reconstruction period formally ended in 1950 as the sigma convergence, the measure of dispersion between output per capita, between European economies to the prewar levels was achieved (UNECE 2000). In a study on Germany’s postwar growth and reconstruction Reichel (2002) has shown that the postwar economy in Germany experienced not only a reconstruction boom but a sustained economic growth that characterized what became to be known as the ‘economic miracle’ or *Wirstscahftswunde*r. The German economy in the 1950s and 1960s experienced above average growth rates which cannot be explained by the catching up dynamics which should have by the 1950s produced declining rates of growth. Two hypotheses emerge concerning the lasting effect of the reconstruction growth on the post-1950 period (Carlin 1996). First, rapid investment was caused by a disproportionality between physical and human capital stocks. Germany emerged from the war with high human to physical capital stocks which maintained higher than normal returns on investment even in the post-1950 period. The second hypothesis based on Olson (1982) distributional coalitions theory argues that the Second World War destroyed growth inhibiting coalitions. Moreover, institutional reform was instrumental in creating the right conditions for sustained economic growth. In terms of institutions, the Marshal plan and the currency reform of 1948 in Germany created the conditions for the postwar recovery to take hold. The currency reform had both distributional and productive impacts. The cancellation of enterprise and government debt led to a redistribution from holders of financial assets to the holders of real assets. In addition, the currency reform, led to the elimination of ‘repressed inflation’ – a phenomenon lasting from 1945-48 as result of the growth in non-market activities and the hoarding of goods and labour. The German economy then experienced a remarkable increase in the supply of labour and goods (Carlin 1996). The Japanese experience tells a similar story. The reconstruction phase in Japan lasted until 1954 when prewar GDP and GDP per capita levels were achieved. The subsequent growth in the 1950s and 1960s can be also attributed to the egalitarian and anti-monopolistic reforms implemented by the American occupation authorities (Ishi 1999).

2.1.2 Postwar growth in Lebanon

To get a picture of where the Lebanese economy stands today relative to the prewar period in terms of catching up with prewar output levels, Figure 1 shows the logged real GDP per capita for Lebanon from 1970 to 2003. It is striking that despite a return to economic growth in the postwar period after 1992, Lebanon is still lagging behind the per capita income reached before the war. In year 2003, GDP per capita was US$1715 in 1990 constant dollars compared with US$3308 at the eve of the war in 1974.

Figure 1
Log real GDP per capita in Lebanon (1970-2002)



Source: UNCDB.

In Table 3, the postwar growth rate of GDP and GDP per capita is shown for Lebanon. For comparison, available data from Germany are also presented. The growth performance in postwar Lebanon is dismal when compared with predictions by neoclassical growth theory and the performance of European postwar economies. In contrast, the growth slowdown in postwar continental European economies occurred in the early 1970s with the collapse of the Bretton Woods Agreements and the first oil shock (Ben-David and Papell 1998).

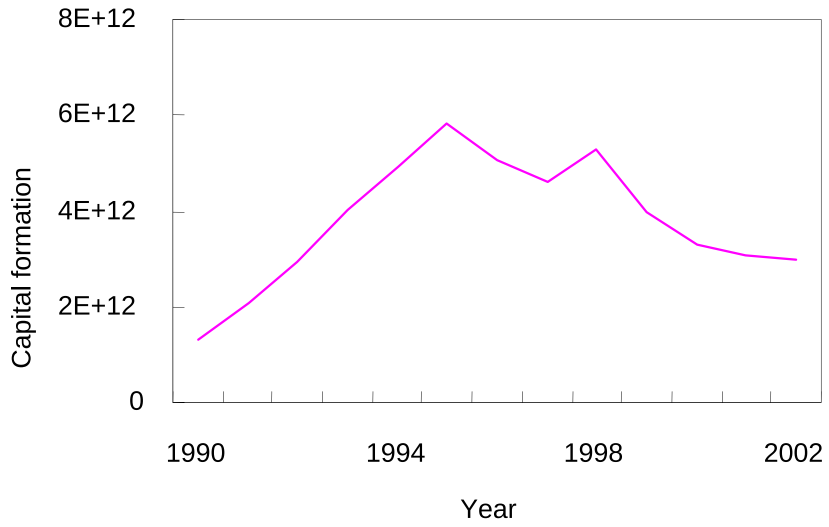
The postwar anemic growth was also accompanied by an investment and consumption slowdown during the period of crisis. The role of investment in postwar economics cannot be overemphasized. Many attribute the super growth of the European post-Second World War growth to the high levels of investment in the postwar period. In Lebanon, the record of postwar investment is dismal even when compared with economies that are in their normal state of affairs. The average annual growth of gross domestic investment was -5.5 per cent in the period 1993-2003 (World Bank Database). Figure 2 shows yearly gross capital formation in the postwar period. The failure of the Lebanese economy to experience high growth rates and the slump in capital formation in the reconstruction period rendered the prospects for long term growth less favourable. Figure 3 shows that private consumption experienced a slump in the post-1998 period. This growth cycle ended the postwar reconstruction boom.

Table 3
Economic growth in postwar Lebanon

Year	Lebanon (1992-2001) real GDP growth	Lebanon (1992-2001) RGDP per capita growth	Germany (income per capita growth)
1	4.5	1.5	
2	7	3.4	9.9
3	8	4.6	14.3
4	6.5	3.4	13.3
5	4	1.5	16.2
6	3.5	1.3	
7	3	1.1	
8	4	2.2	
9	2	0.25	
10	1.4	-0.27	

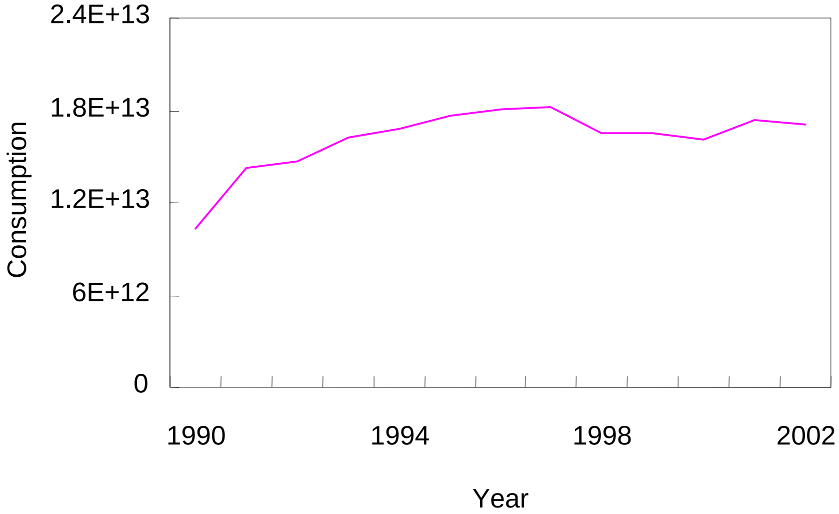
Source: For Lebanon GDP, UN estimates from UNCDB. For RGDP per capita for Lebanon, calculations by author from data on nominal per capita GDP and GDP deflator (UNCDB). For German income per capita, data from Reichel (2002).

Figure 2
Capital formation in postwar Lebanon (1990-2002)



Source: UNCDB.

Figure 3
Private consumption in postwar Lebanon (1990-2002).



Source: UNCDB.

2.2 Distributional effects

Addison *et al*. (2004) discuss the importance of fiscal policy in post-conflict reconstruction in generating economic growth and alleviating distributional inequities and poverty. Although, the authors discuss specifically low-income countries that have experienced civil conflict in the 1990s, their discussion of the need to go beyond the traditional goals of fiscal policy in macroeconomic adjustment and stabilization and to direct resources towards the alleviation of poverty an inequality has relevance for the Lebanese context. The impact of the massive expenditures programme of Horizon 2000 on social welfare is very difficult to quantify. However, the possible benefits to the poor can be divided into two parts. First, the direct benefit that comes from the outlays on social sectors such as schooling and health which amounts to around 27 per cent of total investments. Second, the effect of reduction in costs of production both in the private sector and public sector as a result of investment in infrastructure (roads, electricity, water, etc.). Infrastructure investment has been shown to reduce the costs of providing services of electricity and water and other public utilities (World Bank 1994). This reduction will reflect itself in lower prices and/or in the reduction of deficits of public utilities which eventually will result, given appropriate fiscal policies, in the reallocation of resources towards useful social expenditures. Also of importance to the Lebanese case is the reduction of production costs in the private sector, as it is estimated that electricity and transportation costs form a major component of production costs in the Lebanese industry and given an oligopolistic industrial structures is usually passed on to consumers in mark-up pricing. Moreover, regional investment expenditures and current expenditures on health, education have a significant welfare impact. The reconstruction programme in Lebanon did attempt a form of redistribution but that was based on regional redistribution. This regional redistribution encoded under the necessity the achievement of 'balanced development' in the Taef Accords and hence in the new constitution of Lebanon, was reflected in the Horizon 2000 plan. Table 4 shows the regional distribution of public investment envisaged in the plan.

Table 4
Regional shares of investment in Horizon 2000 plan

Region	Beirut	Beirut Suburbs	South	North	Bekaa	Mount Lebanon
Horizon 2000	14	20	19	18	14	15

Source: UNDP (1997).

This type of regional redistribution was complemented with the creation of two main funds, the *Council of the South* which channeled development aid to the South of Lebanon and the *Displaced Fund* which was entrusted with the resource allocation for return of war refugees to their previous dwellings mainly in Mount Lebanon. Such redistributional mechanisms played a very important role in the rebuilding of the physical, political and social capacities of regions and the reintegration of the population and the legitimization of the postwar authority. However, regional and sectarian redistribution in the postwar period came at the expense of the distribution along income groups. The civil war as mentioned earlier had a severe negative distributional impact. The postwar economic strategy ignored such a distributional channel. This was reflected mainly in the tax structure that was built in the postwar period. The taxation structure was initially reformed in a typical supply side fashion which reduced income and profit marginal tax rates. The top marginal tax rate on profits was reduced from 50 per cent to 10 per cent. The top marginal tax rate on wages was reduced from 32 per cent to 10 per cent. The corporations tax rate became a flat 10 per cent. In addition, and as the fiscal crisis of the state intensified, indirect taxes became the main vehicle for state revenues. The continuous increase in indirect taxes (especially the gasoline tax) and the imposition of the value added tax (VAT) in 2001 have led to a tax system in postwar Lebanon that was highly regressive (Dibeh 2003a). Such a regressive tax system was seen as a major cause of the hardships faced by the majority of the population in the crisis period. The tax system was increasingly used for revenue generation with no regard to the distributional impact. Moreover, the intensification of the fiscal crisis of the state led to the abandonment of most of the social dimensions of the reconstruction plan. The state fiscal and economic functions were reduced by 1998 to revenue generation. In addition, contrary to many expectations, the state used the new assets generated by the reconstruction programme (electricity, fixed telephone, cellular network) to generate revenues. Consumer welfare considerations, an issue of concern for such utilities, were not even considered. In order to get a picture of the social welfare in postwar Lebanon, Table 5 presents relevant MDGs for the period. The MDGs were chosen based on the availability of data and their relevance to welfare implications (UNDP 2003).

Table 5
Selected MDG statistics for postwar Lebanon

Year	HDI	Gini	MDG-1 (%)	MDG-2	MDG-3	MDG-4	MDG-5	Below poverty line (%)
1990	0.673	0.55 (1960)						
1995	0.732	0.435 (1997)	6.3 (1997)	97.6	93	32 (1996)	91.1 (1997)	30 (1997)
2000	0.752			98.3	100	35	95.3	
2002	0.758							

MDG-1: poverty measure of percentage of people living with under US$1.3 per day. MDG-2: primary net enrolment rates. MDG-3: proportion of girls to boys in primary education. MDG-4: Under five mortality rate. MDG-5: proportion of students who have completed grade 5.

Sources: for MDG, UNDP (2003) and for HDI, UNDP (2004). For Gini for year 1960, WIDER World Income Inequality Database (WIID). For Gini for year 1998, Administration Centrale de La Statistique (1997) Conditions de Vie des Ménages en 1997, Republique Libanaise, Beirut.

3 Fiscal policy in the postwar period

Fiscal policy in the postwar period was driven by three factors. First, the economic reconstruction plan necessitated huge expenditures on infrastructure development. Second, the necessity of state building engendered huge expenditures on the military, security and administrative apparatus of the state. Third, the post-Taef Accord sectarian politics and the diffusion of the political power between the different sects as represented by the collective executive authority vested in the council of ministers has led to a massive distributive and rent seeking predatory activities by the representatives of the different sects in the postwar period. Demands on public resources and employment became the two main vehicles for such distributive politics. Prime Minister Hariri having crafted the Horizon 2000 plan understood the tremendous danger to his reconstruction effort of such huge claims on the public budget. However, the initial plan to conduct a fiscal adjustment failed. After an initial attempt at reducing the deficit in 1993, the government abandoned such an effort in 1994 and 1995. The deficit to GDP ratio, after an initial drop in 1993, went back its pre-1992 levels. This shows that the Hariri government was unable to implement fiscal adjustment. The government chose instead to rely on a restrictive monetary policy and substituted bond-financing of deficits for inflationary finance which was the norm in the 1980s. This resulted in a growth of government debt in the postwar period. A major component of public expenditures growth was the growth of the share of public wages as percentage of government expenditures. Table 6 shows the explosion of debt during the reconstruction period.

Table 6
Evolution of deficits and debt in postwar Lebanon

Year	Deficit/GDP	Debt/GDP
1993	9.01	34.4
1994	19.3	43.5
1995	15.6	51.3
1996	18.2	79.9
1997	23.6	96.6
1998	14.1	105.4
1999	14.4	120.0
2000	23.6	141.0

Source: Dibeh (2003a).

It is worth mentioning that postwar Lebanon registered one of the highest deficit to GDP and debt to GDP ratios in the world showing the intensity of the fiscal crisis of the state in the postwar period. This fiscal crisis of the state felt at the political level in 1998 put increasing pressures on the state to abandon its expansionary fiscal policy. The peace dividend was brought to an end as austerity measures were implemented during the Hoss government that lasted from 1998 to 2000.

In this respect, it can be said the question of the peace dividend in postwar Lebanon has a certain complexity to it. In all post conflict societies a peace dividend is generally expected by the population as the conflict dies down and military expenditures are reduced and the demands of the various sectors of the population are expected to be met (Addison and Ndikumana 2003). In postwar Lebanon, the peace dividend was coupled with high military expenditures and the growth of public debt. Public expenditures in Lebanon were high on both the military, health, education, the displaced and public wages. Table 7 shows the share of different sectors of public expenditures in selected years in the period up to 1998.[6] The military and security expenditures were mainly on wages and benefits. The percentage allocated to personnel expenditures rises as the regime takes hold and the early higher expenditures on physical installations and equipment level off.

6 The military and security forces also received sizeable pensions and retirement indemnities in the postwar period. For example, in the period 2001-03, the security and military personnel received around 70 per cent of all pensions and indemnities distributed by the government to public employees totalling for the three years approximately US$1.8 billion (II Monthly 2003).

Table 7
Shares of different sectors of public expenditures (in billions LP)

	1994	1995	1998
Military and security	900	1011	1216
Health	269	349	476
Education	530	702	957
Displaced fund	260	265	140
Public wages	1710	1869	2352
South Council	126	134	74

Sources: For military expenditures, II Monthly, August 2002. For health, education and public wages, Dibeh (2003a). For South Council and Displaced Fund, Ministry of Finance.

The percentage of expenditures on personnel rises from around 74 per cent in 1994 to a staggering 90 per cent in 2002 (II Monthly, August 2002). The expenditures/taxation system allowed for a non-sustainable social contract. The growth of debt, debt service and fiscal crisis of the state caused the diversion of resources away from reconstruction and social expenditures and caused high real interest rates that caused the cyclical downturn in 1998 (Dibeh 2003b).

4 Monetary policy and central banking

The role played by monetary policy and the central bank in the postwar period was all important in ending the reconstruction boom and in engendering a finance-biased rentier economy in the longer run. The monetary policy main objectives were financial stability and the maintenance of capital inflows. Financial stability was achieved through currency stability using the exchange rate as a nominal anchor in the postwar stabilization. The political economy of such a policy bias reveals the congruence of interests between the state and commercial banks in conducting such a policy. The central bank, as an institution that historically was subsumed to the interests of the banking sector, was instrumental in mediating between the interests of the state and the interest of commercial banks. In contrast to the experience of many central banks in civil wars (Addison *et al*. 2001), Lebanon's central bank maintained its status and functions throughout the civil war period. In this context, the role of the central bank of Lebanon in the postwar reconstruction period becomes an important element of the institutional nexus and the political economy of that period.[7] Its policy caused a

[7] The literature on the role of the central bank in economic development and the political economy of central banking can provide great insight into the role of such an institution in post-conflict reconstruction. In a recent paper, Epstein (2005) has argued that central banks have historically played an important role in the economic development of advanced capitalist economies mainly in the US, Britain, France and Germany. The recent consensus on central banks as inflation-fighters is not substantiated by the history of central banks. Moreover, in developing countries such as Mexico and Brazil, the central bank has played an allocative role in credit channelling towards sectors that are earmarked for growth hence playing an active role as an agent of economic development. Moreover, politics and institutions play a role in the determination of monetary policy and inflation-bias in both developed and developing countries. Epstein (1992) has shown that four factors: capital-labour

contradiction between stabilization and reconstruction and that contradiction was resolved at the expense of reconstruction. Nasser Saidi, vice governor of the BdL from 1993-2003, said clearly that

> Monetary policy should aim to control inflation through control of money growth. The Central Bank should not become a reconstruction or development bank. (Saidi 1999)

The central bank hence conducted an industrial policy of reviving and developing the banking sector. The banking sector emerged from the war largely unscathed despite the bank failures of the 1980s that mainly hit small banks speculating heavily in foreign exchange markets. The banking system, however, had very poor capital adequacy ratios. The policy of the central bank of high interest rates and its conduct of the Lebanese Treasury bills (T-bills) auction market allowed banks to make super profits in the period 1993-97 when the cumulative premium on Lebanese T-bills over foreign denominated Eurobonds reached around 54 per cent which to many was seen as the central bank's policy of propping up commercial banks with low adequacy ratios in an overcrowded banking sector (Hakim and Andary 1997).[8] This interest rate policy caused major shock to the economy as a result of the high level of real interest rates generated. The industrial sector suffered heavily. By 1997, it was obvious that high interest rates and real exchange rate appreciation were causing a loss of competitiveness and a drop in tradeable sector activity (Bolbol 1999).

The commercial banks and the state were two players in a sustainable game. This is not the first time that the banks played a political-economic role. During the civil war, commercial banks, by rolling-over debt during times where the probability of repayment was very low and currency depreciation wiped out asset values, held the political elite together (Henry 1987). The postwar game in the period 1993-98 was all profitable for the commercial banks. The probability of default was very low, the opportunity cost of capita was low for lack of other investment opportunities and the probability of

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relations, connections between industry and finance, the position of the economy with respect to the world economy and the position of the central bank relative to the state determine monetary policy in capitalist economies determine the policy-bias of the central bank. In countries where finance and industry are integrated, monetary policy is looser and more conducive to growth than in countries where finance and industry are separated. Maxfield (1998) argues that in developing countries the international dimension to the politics of central bank independence and currency values is significant. The international framework analyzes the impact of the need for international creditworthiness and balance of payments equilibrium on the domestic politics of the different sectoral groups and the government in relation to the degree of independence of the central bank. Discussing several cases of central bank independence in developing countries, Maxfield (1998) reaches the conclusion that the more the countries' need for capital inflows and foreign investment, the higher is the push by the financial sector and the government for an independent central bank.

8 One reason Hakim and Andary (1997) give for high interest rates during this period is the auction mechanism adopted by the central bank. The auction shielded the market from competition by foreign investors by committing to fulfill all foreign demand for T-bills regardless of size or interest rate even if such a demand exceeded the financing needs of the government.

depreciation was also very low.[9] It allowed commercial banks to transform the huge growth in deposits into lucrative, stable and relatively safe investments in Lebanese T-bills. Later starting in 1998, and as the specter of currency collapse loomed, commercial banks pressured the government to issue foreign currency denominated Eurobonds. This allowed commercial banks to adjust their balance sheets. The balance sheets were becoming too vulnerable for currency depreciation which would have caused a twin currency-banking crisis. The increase in Eurobond issue coincided with the entering of Lebanon into recession, new political regime and structural crisis. This policy did not constitute a refusal to finance the state, an act that would have caused the twin crisis. The optimal decision for the banks was to continue to finance the state but in foreign denominations. This special relationship between the banks and the state mediated by the central bank was instrumental in the prevention of state default or currency crisis. In an IMF study on the debt-generated financial vulnerabilities in emerging markets, IMF (2004) concluded that 'Lebanon has defied pessimistic predictions, including those of the Fund, and a debt crisis has been avoided. While investor confidence plays a role in any emerging market economy, in Lebanon it has become the linchpin of a unique symbiosis between the public-sector and the banking-sector balance sheets and how the authorities used this to overcome the near roll-over crisis of 2001-2002'.

The state-commercial bank collusion reached heightened levels during the Paris II negotiations with the declared commitment of commercial banks to buy US$2 billion of Eurobonds at zero coupon rates as the banks' contribution to the alleviation of the fiscal crisis of the state. In addition, the strong banking-central bank-state collusion made Lebanon immune to the emerging markets crisis in 1998. The spreads on the Eurobonds held steady. This was caused by the fact that the commercial banks of Lebanon were the largest holders of Eurobond issue by the government. Table 8 shows the evolution of Lebanese denominated and foreign denominated government bonds held by commercial banks.

Table 8
The evolution of government bonds held by commercial banks

Type	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 (Sept.)
T-bills in LP (billion)	4013	6825	7641	11480	12208	14788	17294	16828	13905	16213	13509	11293
Eurobonds (billion LP)	0	80	251	474	917	3008	4205	5675	8246	10309	9595	11075

Source: For years 1993-98, Nahas (2003). For years 1999-2004, Association of Banks in Lebanon Annual Report 2003-2004.

9 In Henry's iterated prisoner dilemma model, commercial banks would roll over debt if $p > \frac{r}{(1+i)(1-d)}$ where p = probability of repayment, r = discount rate (or opportunity cost of capital), i = interest rate on debt and d = expected depreciation rate. In the postwar period, p was high, r was low, i was high and d was low all factors that ensure the above inequality.

In this respect, one of the major outcomes of this state-central bank-commercial banks collusion was the extraordinarily stability of the Lebanese pound (LP) which hovered around 1500 since September 1993. The Lebanese pound has withstood severe pressures and predictions of an impending currency crisis. This political-economic nexus has defended a currency that otherwise would have been indefensible. Table 9 shows major episodes of intervention by the central bank in the defense of the currency.

Table 9
Central bank intervention in support of Lebanese Pound (1993-2005)

Period	Events	Central bank intervention
February 2005	Assassination of Rafic Hariri	Yes – Market
September 2004	Hariri resignation	Yes – Market (US$2 bn) between October and November
2001	- Increased dollarization rate - Long dollar speculative positions - IMF 2001 report calls for devaluation of the LP	Yes – Central bank bought directly T-bills issued by government denominated in LP
2001	High debt/structural crisis	Increased reserve requirements Market intervention (US$2 billion with US$1 bn in February-April 2001) Deposits solicited by Hariri form Arab governments totalling ~ US$1 billion) US$1 billion loan of which US$500 million went to boost central bank reserves.
1998	Government crisis	Central bank sent strong signals of no intent of devaluation
1997	- Speculative activity - First signs of uneasiness of markets given mounting deficit and debt - Hariri plan to raise taxes rejected by government in September	- Central bank market intervention ~ US$1.5 billion - Saudi deposit of US$600 million at the central bank
1995-96	Renewal for president Hrawi	Central bank increased yields on T-bills to 40%
1994 (end of year)	Hariri threat to resign	Central bank increased drastically interest rates

Source: Compiled by author from various sources and news bulletins.

In addition to the finance-biased policy of the central bank, capital inflows of various kinds (foreign capital flows, remittances and overseas development assistance (ODA)) further skewed Lebanon's postwar economy towards a finance-biased development. Such development caused the crowding-out of private investment and hence was instrumental in the failure of the Horizon 2000 plan which relied on a three to one ratio of private to public investments. ODA in postwar Lebanon was high when compared with ODA in post-conflict low-income states in sub-Saharan Africa when measured on a per capita basis but highly insignificant if measured in terms of GDP or reconstruction requirements (see Table 10). Moreover, the role of foreign aid was largely political in that it caused a national reliance on the rest of the world to prevent economic crisis and currency collapse (e.g. Paris II and foreign deposits at the central bank). In Lebanon actualized and promised foreign aid have played such a role in the postwar period. The Hariri governments always trumpeted the willingness of donors in the Arab world and elsewhere to provide Lebanon with financial assistance. Meetings held outside Lebanon with the purpose of aid provision were numerous which included the sums promised by Arab states during the Taef Accords signature, the Friends of Lebanon conference in Washington in 1997, the Paris I meeting and finally Paris II meetings in 2002. This was complemented by the willingness of friendly governments to purchase Eurobond issues such as Malaysia and the Gulf States and to deposit funds for the beefing up of foreign reserves at the central bank. Moreover, such foreign aid (and in many instances just promises of aid) had a significant impact on the fiscal stance of the government. This provided incentives for the postponing of reforms needed to avert the fiscal crisis of the state that developed. Such behaviour is in agreement with the role of ODA in affecting the fiscal stance of governments in the developing world and in post conflict societies studied by McGillivray and Morrissey (2004).

Emigrant remittances, on the other hand, have always played a role in the Lebanese economy through financing part of the chronic trade deficit and were a much larger inflow than foreign aid during the postwar period. The IMF estimates put the emigrant remittances at around US$2.5 billion averaged over the period 1993-2002 and Lebanon is the third highest country of remittances to GDP ratios (IMF 2005). These capital inflows, remittances, ODA and occasional Arab deposits reinforced the central bank's policy of financial and currency stability and helped in the creation of a nonproductive rentier economy. The rentier income from interest payments on deposits and T-bill subscriptions and bank profits plus ODA; remittances and foreign capital flows became a fetter in production as high real interest rates and real exchange rate appreciation suffocated the industrial sector. The process of deindustrialization in the postwar period was significant underlying a sort of Dutch disease phenomenon and shifted the economy towards commerce and the production of non-tradeables. The average annual rate of growth for industry in the postwar period form 1993-2003 was -0.4 per cent while for manufacturing it registered -1.8 per cent annually (World Bank Database).

Table 10
ODA in Postwar Lebanon

	Lebanon	Rwanda	Angola	Eritrea	Ethiopia	Mozambique
Per capita ODA (US$)	50	110 (1995)	27.9	40.8	10.6	61.3

Source: Lebanon: UNCDB. Rwanda: Ndikumana (2003). Others: Addison and Ndikumana (2003).

Table 11
Indicator of rentier income in Lebanon 1995-2000 (in billion LP)

	1995	1996	1997	1998	1999	2000
Banks' profits	286	487	655	758	658	556
Interest on T-bills	561	695	735	825	842	871
Total	847	1182	1390	1583	1500	1427
% of GDP	4.7	5.8	6.1	6.5	6.1	5.7

Source: For bank profits in 1995, Il Monthly March 2003. For 1996-2002, AUDI Bank Country and Market Update 2004.

To assess the importance of rentier income, an approximate calculation of the trend of such an income is presented. Rentier income is defined as commercial banks profits plus income derived from holding financial assets. Central banks can increase rentier income in the economy by raising real interest rates and lowering inflation (Epstein 2001) and in the 1980s and 1990s there has been a secular rise in the GDP share of rentier income in many industrialized countries (Epstein and Power 2003). Expansionary fiscal policy raised interest rates and increased the amount of interest payments from the government to rentiers. The insistence of the central bank on maintaining currency stability also maintained rentier income.[10] Table 11 shows the trend for an indicator of rentier income share for Lebanon for the years. Due to lack of proper national accounts in Lebanon, the approximate rentier income was calculated as equal to profits of commercial banks plus interest paid on T-bills held by the public. This of course grossly understates rentier income. However, the trend clearly shows an upward trend.[11]

The return on equity (ROE) of commercial reached very high levels in the period 1995-2000 compared to ROEs in the Middle East and in emerging markets. The asset to GDP ratio reached 332 per cent in 2003 compared with 101 per cent for the Middle East and 123 per cent for emerging markets (AUDI 2004). It is such super profits of the banking sector and the high rentier income share that formed the broad political-economic support for the policies conducted by the central bank that created a finance and services-biased economy.[12]

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10 Epstein and Power (2003) have shown that in many semi-industrialized countries such as Mexico and Turkey, financial crisis caused rentier income to decrease.

11 Although data is available for interest income for Lebanon for 1997 (National Income Accounts for Lebanon 1997, Ministry of Economy and Trade), a cross country comparison cannot be done because of different accounting, institutional and valuation methods in different countries and hence trend analysis signifies how such a variable moves through time in a given country (see Epstein *et al*. 2003).

12 Addison and Murshed (2001) have considered various possible outcomes for postwar economies in terms of the relative output of agriculture and services sectors. A relative price shift in favour of services can cause the economy to be S-biased and hence growth will be less likely to be poverty reducing.

5 Postwar political reconstruction: cooperation and conflict

The end of civil wars and postwar reconstruction is not limited to the economic sphere. Political and institutional change plays a crucial role in ending civil wars and in the modalities of postwar reconstruction. Hartzell (1999) studied negotiated settlements in 38 civil wars in the post-Second World War era and showed that the security dilemma presented by civil conflict necessitates power sharing institutions that solve such a problem through the use of coercive force, the distribution of political power and the distribution of resources.

Lebanon's Taef Accord, which ended the civil war in Lebanon, was a model example of such power sharing arrangements. The Taef Accords were signed in October 1989 in the Saudi resort city of Taef by Lebanese parliamentarians and the major warring factions. The Taef Accords provided the political and constitutional basis for a new post-conflict consensus between the different sects of Lebanon. It signalled the birth of what came to be known as the *Second Republic*. The necessities of political reconstruction and the redistributional content of the Taef Accords added a political economic dimension to the nexus of economic policies implemented in the postwar period and the finance-biased monetary and central bank policies. The fiscal crisis of the state intensified as a result of the military and security expenditures, demands by regions and sects for resources and the usage of public employment as a vehicle of social welfare.

The war has destroyed the hegemonistic role of the Maronites who in the prewar period held the all powerful presidency and army leadership under their control. The Taef Accords stripped power from the Maronites and redistributed it to the other sects through transferring the executive powers of the Maronite president to the collective institution of the council of ministers. The council was supposed to be the political space where the sects and to a minor effect political parties play out their cooperation and conflicts. However, such an arrangement or new form of consociational democracy was not self-propelled as Syrian hegemony in postwar Lebanon has played a role in the mediation and prevention of conflict between the different sects. Wantchekon (2000) gives Syrian hegemony the role of enforcement mechanism for the power sharing agreement between the sectarian elites that ended political instability and such mechanism ensured stability despite the unfairness of the Taef Accord to the Maronites.[13] The postwar political arrangement represented a form of tackling the

[13] As in many countries that have experienced civil conflict, the signing of the Taef Accords in 1989 did not bring an instantaneous end to the civil war in Lebanon, with an intra-Christian confrontation between the supporters and opponents of the Accords. General Michel Aoun, the Lebanese army commander, declared his opposition to the Accords knowing that they legitimized Syrian hegemony in Lebanon. In what was described as 'conflict among former allies' (Atlas and Licklider 1999), forces led by Aoun attacked the Christian militia, the Lebanese Forces, and the fighting ended in a ceasefire in May 1990. The Aoun rebellion against the pro-Syrian government, the Taef Accords and Christian militias ended in October 1990 when Syrian forces attacked his positions and he was ousted and exiled to France. In the period between October 1990 and May 1991 all militias, except Hezbollah, handed over their arms to the central government and Lebanon emerged as a unified nation and embarked on political reconstruction. The role of the Syrian regime in bringing about the end of the civil war was paramount and crucial for the political reconstruction process. In a similar role to that played later by the United Nations, NATO, the US and the European Union in bringing an end to civil conflicts in Europe, Asia and Africa, the Syrians used coercion and incentive structures for the Lebanese to end the war. Winslow (1996) argues that the suppression of the Aoun rebellion signaled to all militias the willingness of the Syrians to physically oppress all opposition to the Taef Accords.

problem of *horizontal inequality* that have been a major source of conflict since independence in 1943 and played a major role in the eruption of the civil war. It can also be seen as the 'social contract' that ended the war which is considered a necessary requisite for the success of reconstruction in post-conflict societies (Addison and Murshed 2001). The reallocation of political power towards greater representation especially for the previously marginalized Shiite population was one of the major achievements of the Taef Accords and the Second Republic.[14]

The Second Republic reinforced sectarian divisions by focusing reform on power sharing and redistribution rather than the formation of a secular democratic system (Rigby 2000; Ofeish 1999; Hudson 1999). The political settlement of the postwar period not only reflected the outcome of the civil war where Syria and its mainly Muslim allies gained the upper hand but also reflected the outcome of shifting demographics and even economic wealth distribution. The influx of capital from the Gulf mainly through Sunni channels was already shifting the sectarian distribution of commercial bank ownership in the 1980s. Henry (1987) provides evidence that shows that while in 1974, Christians controlled 62 per cent of the total capital of the top 15 banks while Muslims controlled 18 per cent, by 1982 the ownership structure has changed to 32 per cent Christian versus 33 per cent for Muslims. Although there is no evidence on ownership shares by the end of the civil war and during the reconstruction period, it is highly probable that such a trend continued. Moreover, the incursion of Muslims into traditionally held wealth spaces held by Christians was also extended to the commercial and service sector. In 2002, the law of exclusive dealerships, a hallmark of Lebanese capitalism since the prewar period, was up for scrapping by the parliament. Christian merchants who dominated the commanding heights of the import sector opposed such a move which prompted a much controversial response by the leading intellectual on the Hariri side to lambaste such opposition accusing them of ignoring sectarian wealth distribution shifts that has occurred. The sectarian distribution of state funds that took outright and open channels included the Shiite dominated Council of the South, the Druze-dominated fund for the Displaced and the Sunni-dominated Greater Beirut Public Works Council which was later disbanded under the Lahoud regime and its functions relegated to the CDR.[15] The amounts disbursed in the period 1993 to 2004 reached around US$850 million for the Council of the South and around US$1.2 billion for the Displaced Fund.

The reconstruction was successful in rebuilding the political and fairly democratic institutions in the postwar period. This can be considered one of the major achievements of the reconstruction era. The state apparatus, army and security forces were unified under one leadership. The prewar parliament was beefed up by appointees and first postwar elections were held in 1992. Such achievements, sometimes overlooked by some observers, overcame very quickly the divisions of the prolonged civil war which witnessed increased fractionalization of the Lebanese society. This achievement must be

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14 The question of horizontal inequality among different groups in culturally diverse societies has been largely neglected in the development literature. Stewart (2000) considers that horizontal inequality should be as important as vertical inequality in the design of development policies because such multidimensional inequality that encompasses economic, political and social differentiation have severe consequences on individual and social welfare.

15 Even the CDR was seen by many as dominated by Sunnis (Hudson 1999). The CDR was, until the Hoss government came to power in 1998, a haven for Hariri loyalists.

contrasted to many countries in Africa (Somalia, Sierra Leone), Asia (Afghanistan) and Europe (Bosnia) which witnessed instability, failed states and widespread security breakdowns in the post-conflict period.[16] Lebanon, in this respect, was successful in building the authority of the state in a relatively short period of time. The first president in the post-Taef period, Elias Hrawi, did put the maintenance of law and order in the top of his administration's priorities (Rashchka 1993).[17] The unification of the armed forces under one leadership was considered the first and most important step in the emergence of post-conflict Lebanon. Early on, the US government, as one of the protagonists of the Taef Accords, did recognize this fact. Edward Djerdjian, Undersecretary of State at the time, told the American Task force on Lebanon in 1993 that

> The Lebanese leadership regards the Lebanese Armed Forces (LAF) as a key instrument for national reconciliation. The LAF has disarmed most of the militias which plagued the land. It has successfully eliminated the confessionalism which formerly divided its ranks, an example the Lebanese nation could well take to heart. Most significantly, the LAF has worked to extend the authority of the central government throughout Lebanon's territory. An institution of national scope, the LAF, under the able leadership of Gen. Emile Lahoud, is rightfully earning the respect of the Lebanese people.
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> US Department of State Dispatch, Washington DC: 18 October 1993, 4(42): 736.

The choice between the accumulation of physical and social capital and between military expenditures defines the tradeoff embodied in fiscal policy for a narrow-based regime in a multiethnic or religious society and incentive structures may push the regime to choose a pure security seeking state that causes social capital depletion (Ndikumana 2004). However, the imposition of security is also a form of public good that the poor also demand in post conflict societies (Addison and Murshed 2001). The post-Taef political regime did build upon the unification of the security forces and the regain of the authority of the central government. There were three parliamentary elections held in Lebanon in the postwar period in 1992, 1996 and 2000.[18] The first

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16 For Bieber (2000), the composition of Lebanon as a multireligious state versus Bosnian and former Yugoslavia as a multinational state helps explain the rise of a Lebanese identity in the post conflict period while nationalist tendencies preclude a national identity for Bosnia. Despite the signing of the Dayton Agreements, Bosnia failed to produce self-propelling institutional growth and development and remains dependent on foreign aid (Cowen and Coyne 2005).

17 The challenges of the reconstruction of what was dubbed 'collapsed states' became a major policy objective of the international community in the 1990s in response to major outbreaks of civil conflict and wars during this period (Ottaway 2002). The experience of building the post-conflict states in Africa, Cambodia, Kosovo and Bosnia lend Ottaway (2002) to consider the challenges of state and institutions building as an integral part of the reconstruction programmes. Yannis (2002) emphasizes the role of the state as an authority to impose public order in post-conflict societies.

18 One major element of postwar conflict was the parliamentary electoral laws. The division of the districts and the non-proportional representation encoded into the three laws for the elections in 1992, 1996 and 2000 ensured that the overwhelming majority will be won by pro-Syrian political parties and figures. The main opposition to such laws came from the Christian camp that claimed that such divisions that parted away with smaller districts adopted before the war misrepresented the Christians

parliamentary elections merely two years after the end of the war were marred with a widespread Maronite Christian boycott of the elections and to a certain extent Sunni Muslim skepticism and indifference causing a 30 per cent electoral turnout, the lowest in Lebanese history (Salem 1997). However, the elections of 1996 brought back the majority of the Maronites into the electoral system as a more pragmatic and conciliatory towards the Syrian political class emerged amongst them. The 1996 elections consolidated the Taef regime (Hudson 1999). Moreover, the Sunnis revived politically by prime minister Rafic Hariri four-year tenure in office joined in with full force. However, the 1996 elections saw heavy handed Syrian interference in designing the electoral law, forming candidates' list and even forming a coalition to downsize the increasingly defiant Hezbollah (Usher 1997). The 2000 elections redrew the political landscape and set the stage for the political gridlock and crisis that ensued. The elections swept Rafic Hariri back into the office of prime minister. His sweeping election victory in Beirut came against the direct involvement of the Syrian regime in designing electoral districts with the major purpose of preventing an all out victory for Hariri against his Sunni adversaries in Beirut (Norton 2000).

The addressing of the inequalities of sectarian access to political and administrative spaces was also accompanied by a regional investment and expenditures policies that aimed at some form of 'balanced development'. However, such sectarian power reallocation created distributive coalitions that impeded economic growth. In a sense the Taef Accords created a reverse Olson-effect in that the war destroyed the coalitions that were conducive to economic growth in the prewar period and replaced them with growth impeding coalitions (Olson 1982). Olson has argued that one of the main reasons for rapid economic growth in postwar periods is that wars devastate growth impeding political arrangements. A prime example of that is again the Weimar republic in Germany. Distributional conflict can have a negative impact on growth rates in postwar reconstruction periods. In Germany the weak growth rates experienced in the aftermath of the First World War during the Weimar republic were attributed to the profit squeeze generated by class conflict. This conflict led to low growth rates and investment rates when compared with both the prewar period and the post-Second World War reconstruction period.[19] One interesting aspect of postwar political economy in Lebanon was the success of the state in destroying the threat to economic growth and stability that would have come from the labour movement and class struggle. After initial tensions during the early period of reconstruction, the state completely neutralized the labour unions by 1997. Wage rigidity was an important element of postwar reconstruction. Although labour market data is very lacking in Lebanon, the minimum wage freeze since 1996, unprecedented in the history of Lebanese wage dynamics, and the systematic attack on labour unions by the continuous

in all areas of Lebanon where they were in a clear minority. This contention regarding political representation formed one of the main contested terrains between the sects and led to a general state of latent conflict. Such latent conflict has even a deeper origin in the Christian belief that despite all formal arrangements such as equal parliamentary representation, collective leadership in the council of ministers and equal division of top administrative posts, the political power in the postwar period was mainly held by the Muslims (Perthes 1997).

19 In a recent cross-sectional study of determinants of economic growth in postwar contexts in 79 wars, Koubi (2005) has found an indirect evidence for Olson's theory. The intensity and duration of war was found to be positively correlated with economic growth, evidence consistent with neoclassical growth theory and with Olson's theory that intense and long wars destroy entrenched coalitions.

policy of the marginalization and division of the General Federation of Labour, once an all too powerful political an economy player in Lebanon. The ministry of labour which has control over labour union licensing, foreign labour permits and resolution of labour disputes was allocated throughout the postwar period to one of the most pro-Syrian parties, the Baath party and the National Syrian Social Party. Both parties used their sphere of influence to severely weaken the labour movement, resist calls for control of Syrian labour in Lebanon and profit tremendously from the influx of foreign labour into Lebanon through corruption and siphoning of funds. In an unprecedented policy, the successive Hariri governments starting in 1995 gave the army a continuous standing order to suppress of trade union strikes and demonstrations (Baroudi 1998). The trade unions activity reached a peak in 1995-96 with the unions declaring a general strike in 1996 in their attempt to raise minimum wages and halt the continuing rise in indirect taxes. However, the government responded with a heavy-handed approach sending in the army to break demonstrations and imposed a curfew in one instance another precedent in the history of labour unrest in Lebanon. The increases in wages were seen as a threat to the stabilization and reconstruction plans of the postwar period. The labour demands were coming in a period where it was obvious to the Hariri government that the financial and resource burdens of reconstruction were weighing heavily on government finances. Such anti-labour measures were also seen as a form of 'socialization of parts of the reconstruction costs' (Perthes 1997). In 1997, the government engineered a split in the General Federation of Labour and since then the unions have been marginalized. As evidence of such marginalization, the government has frozen the minimum wage in Lebanon since 1996 and many indirect taxation measures with severe distributional effects were passed in the post 1997 period.

The distributional conflict hence was played in the *sectarian space*. The mechanisms of such conflict were transformed from initial cooperation to conflict played. Initially, the necessity of the construction of the state and the transition from the *First Republic* to the *Second Republic* in which power is diffused led to the enormous expenditures on public employment, security apparatus and sectarian targeting. This cooperative phase lasted until around 2001. The second phase, witnessed simmering conflict between the sects and the beginning of the end for the Second Republic as the fiscal crisis of the state intensified and it was apparent to everybody that the postwar model cannot be sustained for a long period. It is in this period that the sectarian conflict over the Taef Accords and Syrian troop presence intensified which ended with the assassination of Rafic Hariri and the withdrawal of Syrian troops in 2005.

6 Concluding remarks

Reconstruction and development plans and programmes are difficult and complex tasks whose success is doubtful even in more coherent post-conflict societies. For example, the failure of the African National Congress-inspired Reconstruction and Development Plan is a prime example of the complexity of planning economy paths given growth and distribution tradeoffs (Blumenfeld 1997). Many lessons from the Lebanese experience can guide post-conflict reconstruction in middle to upper-middle income countries which experience massive destruction of physical assets. First, the reconstruction boom must be complemented with policy reforms and state intervention that would transform such a boom into a more sustainable post-reconstruction economic growth. The complementarities between reconstruction and the establishment of a developmental state are crucial to the success of reconstruction. The reconstruction process necessitates state intervention in the setting of national priorities and control of key sectors. This was the experience of post-Second World War reconstruction in Europe and Japan (Van Raemdonck and Diehl 1989). In this respect, postwar reconstruction planning must be a part of a national development plan with clear macroeconomic and sectoral objectives. In the Lebanese experience, reconstruction as planned by the CDR was considered as a collection of projects proposed to the council of ministers without social return or cost benefit analysis or impact on economic growth and development.[20] Infrastructure expenditures on large projects produced inefficient results as a result of such ad hoc approach to planning public investment projects. The airport, the fixed telephone line system and electricity infrastructures are prime examples of such excess capacity projects.[21]

Second, the success of economic reconstruction and the generation of sustained economic growth would allow the state to embark on a process of asset and income redistribution. Such redistribution must address the inequalities generated by the years of conflict or to ameliorate inequalities that led to the conflict in the first place. Such an addressing of horizontal inequities was attempted in Lebanon with some success but it came at the expense of vertical inequities that were largely ignored or even solidified. However, the growth and cyclical crisis that erupted very early on in the postwar era stifled the opportunities for income and asset redistribution with severe and damaging political consequences.

Third, political economy of policy making has a significant impact on the reconstruction process. The Lebanese experience shows that economic policy making and institutions can create conditions that end the reconstruction boom and even more importantly stifle long run economic growth. The right fiscal-monetary policy mix, exchange rate policy and interest rate policy are crucial for the success of reconstruction. In Lebanon, such elements of economic policy caused a finance-biased economy, a growth cycle and deindustrialization.

Fourth, in multiethnic or multi-confessional societies, political formulas for cooperation and the alignment of confessional interests with national political interests and economic reconstruction needs must be done. Such an alignment would make reconstruction a process which promotes national objectives and dissipates inter-confessional rent seeking and grabbing activities. The power of the state must be utilized to create growth-enhancing distributive coalitions. The lack of national involvement in the reconstruction in Lebanon was apparent in all areas related to the reconstruction process. In the BCD reconstruction, for example, the middle class and citizens did not participate in the development process which involved massive transfer

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20 A similar process was followed by the Ministry of Planning in Angola (Aguilar 2003)

21 The airport capacity is 6 million passengers per year which costs around US$600 million. The passenger numbers in 2004 reached only 3 million. The fixed line system capital expenditures planned 1.7 million lines (with 1.3 million installed in 2002) for a total investment of US$775 million. However, the number of subscribers in 2003 reached only 656,000 (II Monthly, January 2004). The electricity sector has an installed capacity of 2300 Megawatts at a cost of US$1.8 billion. The mismatch between production capacity and transmission capacity caused actual production to be 1350 megawatts in 2001, while actual power needs are between 1400-1650 megawatts, causing power shortages, blackouts and the purchase of electricity from Syria (II Monthly, May 2002).

of property rights from around 100,000 claimants to the private company *Solidere* that produced widespread protests (Stewart 1996). These asset transfers coupled with the rise of the rentier economy and the confessional contest for different project parcels led to an atmosphere of discontent that considered the reconstruction process as a grand scheme of contested exchange. In the end, the fiscal crisis of the state ended the material basis for such rent seeking activities and provided the economic basis for the political conflict that intensified in the post-2000 period.

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