

Lebanon

Status Index (Democracy: 5.60 / Market economy: 5.82) 5.71		Management Index 4.16	
HDI	0.759	Population	3.5 mn
GDP per capita (\$, PPP)	5,074	Population growth¹	1.0 %
Unemployment rate	20-25 %*	Women in Parliament	2.3 %
UN Education Index	0.84	Poverty²	28 %
		Gini Index	0,435 (1997)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² CIA World Fact Book 2004. * Estimation, no official statistics available			

A. Executive summary

Since 2003, Lebanon has experienced a period of increasing confrontation with the Syrian occupying power, which culminated in late 2004 and early 2005 first in the resignation of Prime Minister Rafiq Hariri, then his assassination and finally in the resignation of the Karami government. Hundreds of thousands of Lebanese demonstrated on the streets either in support for or against a withdrawal of Syrian forces from Lebanon. However, the demonstrations of February and March 2005 are perhaps a sign of something else: the weariness of the Lebanese population of governments that do not really deserve the name; the desire to shape a sovereign future for the country, for reforms, and for more democracy; and the growing self-confidence of Lebanon's citizens.

The political setup, however, has not changed. The state and its institutions are still sectarian by nature, and their performance has not improved. The uneven distribution of wealth and political power has certainly not been leveled, and unresolved political conflicts – especially between President Lahud and Prime Minister Hariri - led to political paralysis throughout much of 2004. The escalation of this conflict into violence – including an attempted assassination of former Minister of Economics Marwan Hamadeh, the assassination of Hariri, and a series of car bombs in Beirut and its suburbs – is unfortunate proof of the lingering instability of the country and its system of political power-sharing.

In terms of economic development, there have not been any substantial structural changes. There were improvements in some areas, such as the first successful steps toward tax reform, which have eased the pressure on the government budget. However, the big issues for Lebanon remain the same. There has been no noticeable improvement in the huge wealth disparities, in the welfare system or the education system. Growing public awareness of the importance of protecting

natural resources has not been translated into consistent policies. In addition, two of the major constraints on economic development in Lebanon, corruption and the enormous public debt, remain largely unaddressed.

B. History and characteristics of transformation

Lebanon has been a parliamentary democracy based on a relatively strong rule of law, free press and civil consciousness since independence in 1941 (the first parliamentary elections were held in 1943). The country is a democracy by birth, but one that has always been seriously flawed. Although formally a consociational democracy with a constitution, a parliament and regular elections, real political power in Lebanon derives from the informal networks governed by the various sectarian elites.

Lebanon is a consociational (or sectarian) democracy based on agreed mutual political concessions among various religious communities. One of the central problems of the country is the question of distribution of power among the country's largest religious groups. This is because in Lebanon, 18 denominational communities, whether Muslim, Christian or Druze, coexist within a population of 3.4 million inhabitants on a mere 10,452 square kilometers of land and compete for resources, influence and cultural hegemony. Since 1932, only vague estimates have been made regarding the percentages that these denominations hold within the population as a whole. In fact, there are no concrete figures on the actual size of the population. This is because statistical proof of demographic shifts could quickly cast doubt on the electoral system of proportional representation, which has its roots in the unwritten National Pact of 1943. According to this system, seats in parliament were distributed between Christians and Muslims at a ratio of 6:5. This system also dictates that the office of president is always held by a Maronite Christian, that the post of prime minister be held by a Sunni Muslim, and that the speaker of parliament be a Shi'ite Muslim. The posts of deputy prime minister and deputy speaker are reserved for the Greek Orthodox. This proportional distribution of offices, which is based on demographic data from the 1930s, runs throughout Lebanon's entire public administration.

At the end of the civil war in 1989, it was agreed in peace negotiations in Ta'if, Saudi Arabia, that the distribution of power would be adjusted in favor of Muslims. The new 5:5 distribution of seats in parliament is somewhat closer to the demographic reality in Lebanon. No other major changes were made to the prewar system of proportional representation, except that much of the (Maronite) president's authority was shifted to the (Sunni) prime minister.

The persistently sectarian nature and behavior of Lebanon's institutions, and the ensuing low quality of its governance, will continue to define the context of Lebanon's development process.

There are other factors affecting the country as well. There is the economic and political legacy of Lebanon's 16-year civil war, as well as that of the long years of Israeli occupation of the south, which came to an end only in May 2000. There is also the continued conflict with Syria about the neighboring country's involvement in Lebanese affairs. In the years since the Taif accord (which ended the civil war), Lebanese foreign policy has been made in Damascus, as have been decisions about Lebanon's political leadership. Syria has not shied away from direct intervention if it believed its interests were threatened. The most recent example of this was the pressure Syria exerted on the Lebanese parliament in September 2004 to extend President Lahud's term in office for another three years – effectively circumventing the Lebanese constitution. It remains to be seen whether this problem will be solved with the withdrawal of Syrian military troops from Lebanon.

The power struggle between Lebanon and Syria ultimately led to Prime Minister Hariri's resignation in October 2004. He was accused by Syria of having used his excellent personal connections to bring about U.N. Security Council Resolution 1559 of September 2004, which demanded a full withdrawal of all Syrian forces from Lebanon. It is not surprising that many in Lebanon and in the international community blame Syria for the assassination of Hariri in downtown Beirut on February 14, 2005. This assassination managed to unite Lebanese across all sectarian boundaries in protest and ultimately led to the resignation of the Syrian-friendly Karami government. On February 28, 2005, following the first day of a highly controversial parliamentary debate over the course of investigation into Hariri's death, the then Prime Minister Umar Karami read out the following statement which was transmitted via loudspeaker to some 250,000 protesters gathered in Beirut's Martyrs' Square: "I announce the resignation of the government over which I had the honor of presiding so that it does not pose an obstacle [to the investigation into the killing]." (Karami had been forced out of government once before by public demonstrations in 1992.) In the following weeks, domestic and international pressure on Syria to abide by resolution 1559 and withdraw from the country intensified. And although most observers did not believe Syria would leave without a fight, the withdrawal of Syrian troops seems to have been completed.

As for economic transformation, Lebanon has a very long-standing tradition of a liberal economic system. Trade in particular was never subject to significant obstacles. Lebanon is now also seeking to recapture its former role as the region's financial hub. But the civil war did set the country back significantly in its development. At the end of the war, the state as the institution responsible for ensuring order, supplying public services and distributing resources had *de facto* ceased to exist, and hundreds of thousands of Lebanese – particularly members of the well-educated middle class – had left the country.

Although he was not even a member of parliament, self-made millionaire Rafiq Hariri was nominated prime minister in 1992, following the first post-war

elections. Hariri gave highest priority to rebuilding the country's infrastructure and stabilizing the Lebanese currency. The extremely rapid reconstruction – first of Beirut and in particular of the financial district in the old city - was largely funded by borrowing heavily, mostly from domestic banks. During this time, the nation's domestic and foreign debt ballooned fivefold and twenty-fold, respectively, while the government's uncompromising neo-liberal growth policy intensified social inequalities and concentrated income among a small percentage of the population. At the same time, however, policy-makers were able to cut inflation from more than 120 % to just 2–3 % at the end of the 1990s.

The infrastructure was returned to working order, garbage collection and mail delivery were up and running again, and the state's monopoly on the use of force was restored in most areas of the country. Control over the Israeli-occupied south was regained in May 2000. Hariri governed Lebanon with five successive cabinets, from 1992 until 1998 and again from 2000 until his resignation in October 2004.

Hariri's assassination dealt a blow to the country, for Hariri's international standing and even his private fortune were seen by many international lenders as Lebanon's only guarantee. Dealing with its massive debts will remain one of the pivotal challenges to Lebanon's economic development. Other challenges include the disentangling of private and public economic interests, the modernization of Lebanon's economic institutions and production facilities as well as countering growing inequalities.

C. Assessment

1. Democracy

Although still unstable after years of civil war, Lebanon has made progress toward reconstructing its democratic institutions. The democratic order of postwar Lebanon, like that of prewar Lebanon, is based on a system of proportional representation. This system has served to perpetuate the fragmentation of Lebanese society, public administration and politics along denominational lines. This system played a decisive role in Lebanon's civil war and is likely to remain a source of conflict in the future. Yet it is arguable that this balancing of the political interests of the various sects has helped to produce a relatively liberal political regime with a good measure of freedom in political, cultural and religious spheres and has also allowed for a relatively free press.

1.1. Stateness

The government's formal control of the entire territory of Lebanon was reestablished upon the withdrawal of Israeli occupation forces in southern Lebanon in May 2000. In practice, however, the government still does not control parts of the country: Non-Lebanese military and paramilitary forces retain significant influence over large parts of the country and, until recently, some 14,000 Syrian troops had been stationed in locations throughout the country. The government has also not attempted to disarm the Hezbollah, which controls some 20% of Lebanon's territory in the south and the Bekaa valley, and functions as a "state within a state." In addition, Palestinian groups, including armed factions, continue to freely operate in refugee camps.

The recent withdrawal of Syrian forces could grant Lebanon a realistic chance of regaining full sovereignty for the first time since the end of the civil war. It remains to be seen, however, if the country can also rid itself of Syrian intelligence forces and agents provocateurs, and find a democratic compromise with Hezbollah.

The definition of citizenship criteria in Lebanon is generally not contentious. However, there are an estimated 300,000 to 400,000 Palestinian refugees who have lived in Lebanon for decades but have been denied Lebanese citizenship. This in turn deprives them of basic rights such as the right to work or move freely about the country. In the past, Syria has also pressured Lebanon to naturalize the large number of foreign guest workers in the country, most of who come from Syria and did not obtain work permits.

State and religion are separated in principle, there is no state religion, and religious dogma does not have a significant influence on politics. However, all areas of the political system are marked by a denomination-based system of patronage. With the exception of rulings regarding marital status, the judiciary is secular. Questions regarding marital status are left to the Shariah courts or to church courts, depending on the religion of the individuals involved. There is no possibility of civil marriage, which is considered by many to be an impediment to marriages across sectarian divides. Contrary to Lebanon's constitution, civil status laws continue to discriminate against women on legal issues regarding marriage, divorce and custody of children.

Viable administrative structures exist and are comparatively functional, but administrative effectiveness is seriously hampered by patronage and corruption. Access to government resources is very unequal between regions, particularly since administrative posts are assigned according to the system of proportional representation. In formerly occupied southern Lebanon, Hezbollah has taken over many government functions including managing public services and utilities in the region.

1.2. Political participation

There is effective universal suffrage and the right to campaign for office. Elections are generally free, but ballot secrecy is insufficient. Some manipulation clearly occurs in the run-up to elections (especially as a result of Syrian pressure) including, for instance, in the redrawing of electoral districts, in the preparation of candidate lists, or even in direct influencing of voters. In addition, the right to campaign for office can in practice only be exercised by the wealthy. Women have the right to vote and are legally entitled to participate in the political process, but cultural barriers still remain. In 2004, women held only 3 of parliament's 128 seats. But there might be progress on this front: Karami's 2004 cabinet (following Hariri's resignation in October 2004) was the first Lebanese cabinet to ever include women (two out of thirty positions).

National elections for the legislature had been scheduled for 17th April 2005. Due to the recent political turmoil in the country, however, they were postponed (as of this writing, scheduled for May 2005) – not least because the status of relations between Lebanon and Syria was yet to be clarified.

The power of elected leaders to govern is effectively limited. Lebanese decision makers' attitudes toward Syria, for example, have often had a significant impact on their ability to enforce policy within Lebanon. A striking example of Syrian intervention in Lebanese politics was the parliament's decision in September 2004 to ignore the provisions of Lebanon's constitution and to extend Syrian-backed President Lahud's term in office by another three years. Some members of parliament (MPs) who had opposed the amendment reportedly received threatening phone calls and faxes. Four MPs resigned in protest after the decision, including former Minister of Economics Marwan Hamadeh, who later survived an assassination attempt on 1st October. Prime Minister Hariri also resigned from office in protest in October 2004. He was assassinated in downtown Beirut on 14th February, 2005.

Lebanon is a consociational democracy based on a delicate balance of the interests of the various sectarian communities. Lebanon's political system has been described as a "bazaar", where decisions can only be reached through a complex mechanism of negotiation and compromise. Throughout the past decade, there were many instances when the system appeared incapable of resolving conflicts and the interested parties turned to Damascus for help.

The constitution provides for freedom of association and assembly, but in practice these rights are not always guaranteed. The government does not usually interfere with organizations, but it has imposed a number of arbitrarily enforced restrictions and requirements concerning the notification process. The Ministry of Interior does not issue permits for demonstrations in an equitable manner, often times denying permission to opposition groups.

Freedom of speech and freedom of the press also exist in principle, but in practice they are limited, especially concerning Lebanese relations with Syria and the states of the Persian Gulf. Some journalists still face threats of detention, harassment or prosecution, and pressure is exerted on broadcasters and editors to practice self-censorship. Reporters sans Frontières report that the situation has deteriorated. The TV station MurrTV was closed down by the government in 2002 after the station covered the Metn regional elections and gave opposition politicians airtime. Despite these limitations, criticism of government policies and leading political figures continues on a daily basis in the Lebanese media. Many close observers of the Lebanese press believe that self-censorship on economic grounds poses the greatest danger to a free and fair media in the country. The Lebanese mass media is almost exclusively privately owned and because most media outlets are unable to cover their expenses through advertising alone, they often reflect the opinions of their financial benefactors. The situation is complicated further by the fact that many of Lebanon's media outlets are owned by political figures. FutureTV and Radio Orient, for example, belonged to former Prime Minister Rafiq Hariri. MurrTV, on the other hand, which was owned by the Murr family and was considered close to the anti-Syrian opposition, was closed down in December 2002.

1.3. Rule of law

While separation of powers is granted by the constitution and generally functional, the checks and balances in the political system are more often based on the sectarian balance of power than on the formal separation of legislative, executive and judiciary powers.

The constitution provides for an independent judiciary, however, cases involving the application of political pressure on judges continue to be reported. Influential politicians as well as Syrian and Lebanese intelligence officers frequently intervene on behalf of their supporters. Bureaucratic corruption also remains a problem. Some observers believe that the independence of the judiciary is being steadily eroded.

Corruption remains a significant problem in Lebanon and is widely debated by Lebanese society, including by the media. But the legal and political measures to combat corruption are generally seen as insufficient. There are no clearly defined procedures in place to deal with public complaints. Improper or corrupt behavior by holders of political office frequently goes unpunished, and the political system does not impose accountability in fiscal matters. In general, corruption is viewed as an inevitable part of patronage, so that it is often impossible to differentiate between the two.

Although civil liberties are guaranteed, infringements are not uncommon. The constitution provides the government with the ability to limit civil liberties in

order to safeguard post-war stability. This provision has been used, inter alia, to close down TV stations. Press and media freedom has been frequently restricted, including government censorship of broadcasts. Arbitrary arrests, use of force and even torture by the security forces have been reported. There are no restrictions with regard to practicing one's religion, and such discrimination is prohibited under the constitution.

1.4. Stability of democratic institutions

In principle, democratic institutions are functional and enjoy sufficient acceptance within Lebanese society. Administrative reform (including reduction of bureaucratic excesses, improvement in recruitment processes for civil servants, and better monitoring of public investments) is high on the government's agenda. However, the system of proportional representation and consociation frequently results in a loss of efficiency. Moreover, Syria's exertion of influence often limits the independence of Lebanese institutions.

Lebanon's democratic institutions are rooted in the self-conception of citizens as well as those wielding power in Lebanon. Even Hezbollah has publicly accepted the need for democratic pluralism and is making an effort to find its role within a democratic society. But the system of power distribution and compromise between the religious communities is extremely delicate. The Shiites resent the current system, which they believe does not grant them the privileges befitting their share of the Lebanese population. The Christian communities, on the other hand, fear losing their cultural, political and economic influence as a result of a rapidly growing Muslim majority. Alliances between sects and between the different economic strata of society serve to balance such interests. The current opposition movement, for example, is an alliance of the more affluent Maronites, Sunni and Druze. Although the sectarian affiliation of virtually everything in Lebanon and the ensuing system of patronage are also a constant source of critique, the need for democracy is never questioned by the Lebanese. Nevertheless, there is a certain level of ambivalence regarding institutions such as the constitutional council or constitutional calendars. The lack of control over the military intelligence services also presents a threat to Lebanese democracy.

1.5. Political and social integration

There is a relatively stable and moderate, yet fairly fragmented, party system. Sixteen parties ran in the 2000 elections. The system is marked by strong tendencies to focus on personalities and patronage as well as by a limited ability to form party platforms. Denominational alliances often cut across party lines. The main political parties include: Hizbullah (Shi'i), Amal (Shi'i), National Liberal Party (Christian), National Bloc (Christian), Kataeb Party (largest Christian party), Progressive Socialist Party (mainly Druze), Syria Social Nationalist Party,

Ba'ath Arab Socialist Party, the communists, as well as the Aounist Network (mainly Christian) and the Lebanese Forces Party (Christian), which have reappeared since withdrawal from Lebanon. The so-called Hariri List, under the leadership of Hariri's oldest son, plays perhaps the most important role in the current election season.

The denomination-based system of proportional representation often strengthens the position of religious leaders and hampers the development of a landscape of parties and interest groups that are able to transcend regional and religious boundaries. It remains to be seen whether the very recent success of the broad, but so far loosely knit, "opposition movement" can herald fundamental changes in this respect.

The Lebanese population's approval of democratic government is generally very strong. However, relatively low voter turnout at national elections could be a reflection of the population's discontentment with the paralyzing ubiquity of the system of proportional representation, patronage and the Syrian influence. Statistically, voter turnout was 40.5 % in the 2000 elections, but real voter turnout is probably higher as the statistical figures may be based on incorrect voter data.

Lebanese civil society is comparatively active and very highly organized. There is a strong network of autonomous, self-organized groups, associations and organizations, and there is a solid measure of trust within the population. There are some 1,300 registered civil organizations, including religious organizations, professional and industry associations, and environmental, advocacy and women's groups. These organizations frequently cross confessional lines and favor the establishment of a national Lebanese civil society. The sectarian organizations tend to take up functions typically expected of governments, particularly for social, environmental and educational services. However, the integration of non-governmental organizations (NGOs) and their umbrella organizations into the political decision-making and policy-making processes is still underdeveloped.

2. Market economy

There has been an overall moderate GDP growth of 2% to 3% and a stable inflation rate of below 3%. Shortcomings remain in the form of regional disparities in socioeconomic development and high rates of unemployment. The potential of the industrial and agricultural sectors is not being sufficiently exploited; in many areas there has been no consistent economic policy formulation. Chronic national budget and current account deficits also place severe limitations on the government's ability to make economic policy.

2.1. Level of socioeconomic development

Social exclusion is quantitatively and qualitatively severe and is to some degree structurally ingrained. The Gini Index of 1997, the most recent figure available, is estimated at 0.435. Coefficients above 0.40 are generally considered indicative of strong inequality. Other observations quite clearly indicate that the situation has not improved much since 1997. Reconstruction after the end of the civil war was primarily financed by domestic borrowing from private banks in the form of treasury bills. That is, the government pays interest on borrowing money from banks and individuals. Real interest rates have at times gone as high as 25%; in recent years, interest rates have hovered around 15%. Those who were able to save money in bank accounts could benefit from such high rates, but as of 1997, only 14% of Lebanese households had savings accounts. Given persistently high unemployment rates, suspected at between 20 and 25%, as well as the fact that about a third of the population lives in poverty, it is obvious that the level of inequality is still quite high and might even continue to worsen.

The structure of wealth distribution tends to follow that of sectarian communities. Although Shi'i communities are the most numerous, it is primarily the Sunni, Christian and Druze communities that own most of Lebanon's wealth. Accordingly, low levels of education, unemployment and poverty are primarily found among Shi'ites.

2.2. Organization of the market and competition

In principle, the basics of market-based competition are safeguarded. There is a deep-rooted consensus among policy-makers that the Lebanese economy should be based on the principles of *laissez-faire*. However, state intervention has taken place in the form of extensive government borrowing to finance the country's reconstruction, which has led to a crowding out of the private sector. In fact, since 2003, the proportion of public debt to commercial banks has risen slightly and remains at a level of around 46%. Free price formation and competition does work, although it is often limited by patronage-based social structures. The right to run a business or trade is not subject to any major limitations. But an inefficient bureaucracy, the lack of transparency in legislation and corruption do result in efficiency losses.

Although antitrust legislation is in place, monopolies and oligopolies are only occasionally regulated. The Lebanese business model has an inherent tendency to produce monopolies, but these are only rarely dissolved. WTO accession plans have recently spurred the formulation of more consistent antitrust laws. The late Prime Minister Hariri's intentions to push through far reaching privatization plans for the telecom sector have been jeopardized by President Lahoud's objections.

Foreign trade is mostly liberalized, with low tariffs and no fundamental state intervention in free trade. Implementation of the Greater Arab Free Trade Agreement (GAFTA), expected in January 2005, was expected to create pressure on the agricultural sector. The interim Association Agreement with the European Union, which entered into force in March 2004, as well as the government's ambitions to join the WTO, has pushed forward legislation for further liberalization. Successful efforts to implement tax reforms have allowed for tariff reductions as revenues from VAT have eased pressure on the government budget.

The banking system meets current international standards in terms of banking supervision, minimum reserve requirements, banking secrecy, etc. Lebanese banks also have a solid equity base, are profitable and liquid. The capital markets are open for both domestic and foreign capital and have thus far proven to be sufficiently immune to the effects of capital speculation. However, the government's heavy borrowing from the private banking sector has played a significant role in the profitability of Lebanese banks. The downside to this is that the private banking sector has been crowded out. Moreover, bank profitability is likely to come under pressure in the future as high-yield government papers reach maturity and international interest rates increase.

2.3. Stability of currency and prices

Inflation and foreign exchange policies are generally brought into concert with other goals of economic policy, and are institutionalized in a largely independent central bank. Since the end of the war, inflation has been under control. Since 2002, it has remained far below 3%. Lebanon's exchange rate policy is based on a managed float targeted to the US dollar and has generally maintained a stable exchange rate despite trends toward "dollarization". Reserves were brought up to around \$10 billion from around \$4 billion in 2002 and helped to stabilize the exchange rate. However, there remains a risk of foreign reserves depletion should confidence in the Lebanese pound suddenly drop. Moreover, as interest rate policy must respond to the conditions in the foreign exchange market, there is a tendency for trade-offs between exchange rate stability and the management of Lebanon's enormous public debt.

There are serious problems with setting objectives and achieving a consistent policy for stability. These problems are not due to a lack of political will but are instead due to the economic problems that resulted from the post-war reconstruction period. Lebanon's public debt-to-GDP ratio remained high at around 180%, but the government has reduced repayment costs by significantly reducing interest rates paid on treasury bills. Moreover, it managed to increase revenues as a result of successful tax reforms. Internal political struggles between the Hariri government and the pro-Syrian head of state have set limits, however, on privatization policies designed to lift the burden on the government budget.

2.4. Private property

Property rights and regulation regarding the acquisition of property are well defined for both citizens and foreigners. The private sector is traditionally seen as the pillar of the Lebanese economic model and enjoys a corresponding measure of legal protection. As part of its efforts to obtain WTO membership, Lebanon made additional refinements and adjustments to meet international standards. The corresponding legislation has not yet been adopted by parliament and might be further delayed due to current political uncertainty.

While private companies represent the backbone of the economy, there are still large state companies and strong market concentrations such as oligopolies. The Hariri government had begun to privatize state-owned enterprises and parts of the electricity, telecommunications and tobacco sector as well as national airlines and the lottery. However, these efforts have been severely undermined by President Lahoud and by the Syrian government's interest in maintaining a maximum of direct influence on the Lebanese economy. Attempts to impose existing antitrust laws with respect to private oligopolies are not considered a priority.

2.5. Welfare regime

Rudimentary measures to address social needs exist, but they are extremely segmented in terms of territory, social stratum and sector. The country cannot combat poverty systematically on its own and little has changed during the period of review. Lebanon's formal social safety nets are still poorly developed and do not sufficiently address the needs of the population. The risk of poverty is still high for significant portions of the population. About 40% of Lebanese do not have formal health insurance. Particularly the middle and lower classes are dependent on informal redistribution of resources within family or religious structures. Remittances from family members abroad continue to be an important substitution for formal social welfare support.

There are institutions to compensate for gross social differences, but they are limited in scope and quality and have shown little improvement during the period of review. In particular, social mobility exists primarily within sectarian boundaries, which implies clear limitations for some groups. Relative to Shiites, Christians tend to have better opportunities in absolute terms. Educational institutions are to a large extent privately organized and along sectarian lines. In terms of access to education, gender discrimination is rare: Women account for about half of all university students and play an active role in Lebanon's economic life. However, it is very rare for women to hold management positions. Religious institutions work to offset extreme social disparities.

2.6. Economic performance

In accordance with overall moderate GDP growth of 2-3% between 2001 and 2004, GDP per capita followed a moderate growth path, averaging nearly 2% since 2000. Prices are also stable with inflation oscillating between values of less than 2-3%. The key problem is Lebanon's enormous public debt. The government successfully lobbied the international donor community in 2002 and managed to transform a significant part of its expensive domestic debt into less costly foreign debt. Moreover, private banks agreed to buy a total of \$3.8 billion in two-year government securities at zero interest rates thus contributing significantly to the reduction of the government's debt burden.

Despite these initiatives, however, public debt has grown from about 150% of GDP in 2000 to more than 180% of GDP in 2003, and drains a significant share of state revenues towards debt servicing. Thus, unsurprisingly, the budget deficit remained at around 15% of GDP during the period of review. The trade deficit of around \$5-6 billion has remained constant, contributing to a negative current account equaling approximately 13% of GDP. The capital account could not fully compensate for this deficit and so financing out of reserves and with aid from international donors plays an important role.

Reliable statistics regarding levels of employment are not available. Estimates of unemployment range from 10 to 25%. However, taking into account anecdotal evidence, a value of around 20% seems to paint the correct picture. It is even more difficult to assess is the economy's growth potential. As it is heavily based on services, which are related to flows of trade and finance, Lebanon's economic performance largely hinges on international and regional economic developments. The government has not attempted to adopt a South Korea-like development strategy, but has instead relied on Lebanon's attractiveness as a liberal economy in an otherwise restricted region.

2.7. Sustainability

Ecologically compatible growth receives only sporadic consideration and has almost no institutional framework. Since 2002, there have been virtually no political initiatives promoting environmentally sustainable growth. The most pressing problems Lebanon faces include deforestation, soil erosion, desertification, air pollution from traffic and waste disposal, as well as pollution of coastal waters through industrial effluent. The fact that Lebanon has signed numerous international treaties on protecting the environment reflects a growing public awareness. However, this awareness has not yet translated into consistent policies. Environmental legislation exists, but enforcement of that legislation is undermined by a lack of willingness due to political patronage, conflicts of interest and corruption.

There are institutions for education, training and research, and development, but they are very inconsistent and there are important deficits in research and development. During the period of study, no significant policy initiatives have been proposed. Since 1998, there is cost-free, mandatory schooling for all children up to the age of 12. The systems of secondary and postsecondary education are also well developed in quantitative terms (there are 15 universities). As a result, the illiteracy rate in Lebanon is the lowest in the Arab world and educational levels remain by far the highest in the region. However, because education is to a large extent privately organized and institutionalized along sectarian lines, it often misjudges labor market requirements. Similarly, a consistent policy for the promotion of research and development is not in place. Infrastructure is highly modern in and around Beirut, but there are severe shortcomings in other regions, such as in the Bekaa valley or southern Lebanon.

3. Management

The inability to address the fundamental political question sectarian power sharing, the system's sometimes apparent inability to resolve conflicts without outside help and the lack of accountability will remain the most serious obstacles to Lebanon's development. Not surprisingly, these problems have been paralleled by the lack of a coherent long-term policy focusing on qualitative national development and the public good. Instead, the public good has often been sacrificed for the private interests of influential members of Lebanese society. There have been no successful attempts to improve the quality of governance even though the electorate and international organizations such as the IMF consider this to be of utmost importance.

Profile of the Political System

Regime type:	<i>Democracy</i>	Electoral system disproportionality:	17.7
System of government:	<i>Parliamentary</i>	Latest parliamentary election:	03.09.2000
		Effective number of parties:	16
1. Head of State:	<i>Imil Jamil Lahhud</i>	Cabinet duration:	09/02-10/04
Head of Government:	<i>Rafiq Hariri</i>		
2. Head of State:	<i>Imil Jamil Lahhud</i>	Cabinet duration:	10/04-02/05
Head of Government:	<i>Umar Karami</i>		
		Number of ministries:	23
		Number of ministers:	30
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

3.1. Level of difficulty

Lebanon's medium level of economic and human development, relatively high level of education, liberal market structures, basic consensus on the country's democratic and economic development, cultural openness, and solid international relations, as well as the reconstruction of state and civil institutions, suggest that the preconditions for development are fair to good. In this sense, the level of difficulty must be considered relatively low.

However, Lebanon's extremely difficult geo-political situation must be recognized as a heavy burden. In southern Lebanon, national sovereignty and the state's monopoly of violence were reinstated in theory in 2000. However, in reality, the Shiite resistance movement Hezbollah is the de-facto power in this region. The Lebanese army does not even dare to venture into the southern suburbs of Beirut. Democratic freedoms are limited by the influence of Syrian interests. By relinquishing authority over their own affairs to Syria, the Lebanese government has also largely relinquished responsibility and accountability, important prerequisites for decision-making. The legacy of the civil war, which includes a large number of Lebanese refugees, crippling "brain drain", destroyed infrastructure and the massive debt that resulted from reconstruction, presents further impediments.

There is a very strong tradition of organization along sectarian lines, a tradition that survived throughout much of the civil war and has been able to sustain economic production and public services under the most crippling of circumstances. But civil society organizations that cuts across those borders remains weak.

Pronounced religious- and patronage-based structures, which cause losses of efficiency in administration and economic allocation, as well as corruption and social fragmentation, are problematic. Social fragmentation is intensified by large regional and social disparities. The fault lines of conflict run between the winners and the losers of reconstruction, between the proponents and opponents of Syria's presence in Lebanon, and between the old and new elites. Because these fault lines are in many instances congruent with sectarian affiliation, there is considerable potential for a breakdown in Lebanon's fragile political and societal consensus. The withdrawal of Syrian forces will prove to be a decisive point in Lebanon's path toward a sovereign and democratic state.

3.2. Steering capability

The Hariri government did pursue long-term aims in some policy areas, e.g. exchange rate stability and economic reconstruction. In most other areas, long-term development was more often sacrificed in favor of short-term political or

private benefits. In general, long-term strategies focusing on qualitative development do not exist.

All post war governments have sought to build democracy and a market economy, but their strategic aims were not always related to the country's situation and needs. Under Hariri, absolute priority was given to stable economic growth and to gaining the confidence of the private sector and foreign investors in Lebanon's economic recovery. Pressing concerns such as social inequity, poverty, poor urban and rural planning, the inequitable provision of public and welfare services, the waste of natural and public resources and corruption were largely neglected. Policies designed for economic growth have also been unbalanced and insufficient. For example, there has been no consistent program to develop and promote domestic industry or the agricultural sector. Banks have been the main beneficiaries of government policy and transfers.

The Hariri government's two central policies – focusing on GDP growth and a stable exchange rate – were in fact effectively implemented, but they did not bring the desired results. In many policy areas necessary for a sustainable development, consistent reform policies were either not formulated (e.g. to address social inequality, management of natural resources, fighting corruption) or were not effectively implemented and/or monitored (e.g. air quality protection, hazardous waste regulation). In cooperation with international institutions, some efforts have been made recently to improve public education. But in general, government failure on fiscal, monetary and structural reform policies has persisted.

The problem with policy formulation and implementation in Lebanon is not one of a lack of ability to learn or analyze. It is rather a problem of political paralysis, which increased over 2003 – 2004 and culminated in a deadlock in government and Prime Minister Hariri's resignation in 2004.

3.3. Resource efficiency

“Waste,” as a euphemism for losses due to corruption and patronage, is one of the principal impediments to economic development in Lebanon – and there has been no noticeable recent improvement. For instance, official appointments are often politically motivated rather than based on ability or competence, and resources are often allocated based on the system of proportional representation instead of equality and need. Patronage and corruption are closely intertwined. It is estimated that between 20% and 30% of the money poured into reconstruction was illegally privatized in one way or another. There is also a persistent lack of demographic and socio-graphic data, which makes policy planning more difficult. Even the country's population is based on a vague estimate and ranges between 3.4 million and 4.5 million.

Administrative decentralization has been attempted but not achieved. The bureaucracy remains largely bloated and ineffective although there have apparently been successful attempts at reforming the value added tax and customs administration. Administrative reform (including implementing higher standards of recruitment, slimming down the civil service, and improving budget planning, execution and monitoring) remains high on the government's and the public's agenda. International donors such as the IMF and the European Union also pressure the government to implement reforms. The IMF has called for a fiscal responsibility law to be adopted to improve fiscal transparency.

The Lebanese political system, although designed for compromise, is often unable to resolve serious, especially inter-sectarian, conflict. Lebanon's political elites have in the past decade based their positions largely on their relationship with the power center of Syria and have often turned to Damascus for support. Hariri adopted an increasingly independent stance from Syria and tried to leverage international obligations, like those agreed to at the Paris II donor conference, to see through economic reform projects such as privatization of the telecommunications market. However, those efforts were blocked by the pro-Syrian forces in government, especially by President Emile Lahud. That power struggle led to a deadlock in 2003-2004 and eventually to Hariri's resignation.

Patronage networks and the ensuing corruption is part and parcel of the sectarian nature of Lebanon's institutions and political representation. Government expenditure has to a large extent become a mechanism of transferring money to the politically or economically privileged. Administrative and political office is often regarded as private and even hereditary property. Although civil groups, the political opposition and even the government view corruption as one of the fundamental problems facing the country, the fight against corruption has been largely ineffectual and unsuccessful. The necessary laws to fight corruption exist, but the bloated administration is scarcely willing to cooperate. Sentences are rarely handed down for corruption, and an existing law on the disclosure of government representatives' financial circumstances has still not been enforced.

3.4. Consensus-building

All major political actors in Lebanon agree in principle on building a market-based democracy, with even Hezbollah apparently having given up on their plans for a theocratic state. The major conflicts in Lebanon today circle around the question of the distribution of resources. Here, the government's role as an integrative, consensus-building power takes a back seat to the dynamics inherent in Lebanese society.

The emergence of a powerful, if loosely knit, trans-sectarian opposition movement following the assassination of former Prime Minister Hariri, is a new phenomenon in Lebanon. It remains to be seen whether it will give way to a new

political framework within which structural reforms can be achieved. The Lebanese version of a “constraint democracy” has been the result of the fragile sectarian power equilibrium that has been the country’s central characteristic since birth – further impeded by the Syrian occupation of Lebanon’s resources and political system. It is not yet clear what Syria’s future role in Lebanon will be or if the newly found Lebanese self-confidence will allow the country to tackle the instability and shortcomings of the sectarian system. It also remains to be seen whether the former resistance group Hezbollah, representing approximately one-third of the population, will emerge as a new veto power.

The political elites are aware of the need to modernize Lebanese society, but their scope for action is limited. They are themselves dependent on their patronage-based networks and supporter groups. The debilitating rivalry running through the Lebanese political system is largely due to this situation, with its ambiguous political structure and its unclear delineation of power and responsibilities. Syria’s dominant role in the post-war political order has so shaped politics in Beirut that authority is ultimately a function of a politician’s standing in Damascus. The poor personal relationship between Prime Minister Hariri and President Lahud did not help the situation during their term of office. Long before Hariri’s assassination, in mid-June 2004, there had been a rocket attack on his television station FutureTV. The fact that political conflicts in Lebanon can escalate into violence can be largely attributed to the intervention of certain non-state actors and interest groups, especially Syrian.

The development of social capital has certainly not been a priority for the government. It remains largely indifferent with respect to the role of civil engagement and solidarity – apart from the constant calls for “national unity and solidarity”. This situation is at least partly a consequence of the fact that civil organization and solidarity largely follow the lines of sectarian affiliation and therefore contribute to the political power struggles in the country. Many of the new post-war civil society groups recognize the need for cross-sectarian solidarity and organization, however, and are working to achieve this.

As with everything else in Lebanon, civil society organization often follows sectarian divisions and as such plays a role in political and cultural power struggles. For example, in Beirut alone there are some 300 registered family associations and 60 neighborhood associations. The government has adopted many of them into its patronage structure. At the other end of the scale, however, there are umbrella organizations such as the Lebanese NGO Forum or the Collective of Lebanese Voluntary NGOs that work to coordinate the efforts of humanitarian and social development NGOs in the country. They collaborate with state and international institutions, complement their activities and provide a civil forum for development. But in many policy areas, these efforts remain inadequate, as for example in the ecological arena, where NGOs are under-funded and ignored, and are unable to fill the large gaps left by inadequate public policy-making.

3.5. International cooperation

The political leadership makes well focused use of international aid for the needs of transformation and demonstrates its ability to utilize international assistance for its domestic policy agenda. Lebanon cooperates intensively with bilateral and international donors. In certain policy areas, such as environmental or social development policy, international supporters lament the lack of a coherent government strategy and often cooperate with NGOs.

The international community recognized the Hariri government's reform efforts and thus viewed the government as reliable and predictable. Lebanon's successful implementation of measures to combat money-laundering activities as well as its cooperation in fighting terrorism have bolstered international confidence in Lebanon. However, the IMF has explicitly criticized the lack of necessary data, as this makes consultative cooperation difficult. The IMF constantly presses for reforms to improve accountability, fiscal responsibility and transparency. The EU has also criticized shortcomings on human rights issues. Lebanon is currently in negotiations for WTO membership and the country's efforts in this regard have been evaluated positively. The association agreement with the EU entered into force in March 2004.

Lebanon's cooperative relations with its immediate neighbors are complex. Lebanon's integration into the regional system of states has been stable and successful on the whole. Lebanon is a strong supporter of regional peace and integration, however, Lebanon's relationship with Israel remains tense. Partly due to the US pressure, the conflict between Lebanon and Syrian also escalated, leading to the resignation of Lebanon's pro-Syrian government and the unexpected withdrawal of Syrian troops from the country within a matter of months. All Lebanese actors, including the anti-Syrian opposition, however, know that Lebanon's survival cannot be envisaged independent of its relationship with Syria.

4. Trend of development

4.1. Democratic development

Stateness, political participation and the rule of law have remained at their former levels of quality. There have been no significant changes yet, but this might change quickly in view of the current unpredictable political situation in Lebanon and the withdrawal of Syrian troops. At the time of this writing, the security situation has not improved.

The level of consolidation of democracy has not changed yet, but current dynamics make future developments largely unpredictable. The political opposition, whose supporters camped for weeks on Beirut's Martyrs' Square to

compel the pro-Syrian Karami government to resign, is composed of Christians and Druze plus a large part of the Sunni community. It is an opposition movement formed out of the more affluent, western-oriented parts of society. Indeed, in Lebanon the week-long demonstrations are sometimes referred to as the “Gucci Revolution.” The future of the country will depend on the opposition movement’s ability to integrate the Shiites, who represent about one third of the population, and the Hezbollah into any newly emerging government. If the Shiites feel they are in danger of being marginalized once again, a new civil war is conceivable. It is also an open question whether this new opposition movement will be able to mobilize political power or sufficient political pressure to achieve its aims.

But there is reason for a more optimistic outlook: Hezbollah staged an impressive demonstration of pro-Syrian, mostly Shiite supporters on 8th March to hammer home its message that the so-called opposition movement does not represent all of Lebanon. But it was notable that, although the demonstration was staged after Syria announced it would withdraw its troops, demonstrators were heard saying “Thank you Syria” and were seen waving Lebanese flags. Leaders across the sectarian divides know there cannot be a stable and sovereign Lebanon without a broad consensus that encompasses all the relevant groups. Hezbollah might well prove to be the pivotal power at this historical turning point: Will they seek to be part of a national consensus and become a full parliamentary force – or will they choose to isolate themselves under Syrian protection and block any new developments in Lebanon?

4.2. Market economy development

The country’s overall development as measured by the Human Development Index (HDI) changed from 0.752 in 2000 to 0.758 in 2002. This difference can be viewed as insignificant. Moreover, it is not likely that a more recent estimation would yield notably different results.

The institutional framework has not changed significantly. More precisely, the institutional framework has been stuck in gridlock caused by the political rivalries of late Prime Minister Hariri and President Lahoud.

Overall economic development has improved both qualitatively and quantitatively. GDP has constantly improved since the negative growth of 2000; growth rates since 2002 have exceeded 2%. Quantitatively, GDP grew from \$16.4 billion and was projected to reach \$19.5 billion in 2004.

D. Strategic perspective

The assassination of former Prime Minister Hariri, who was credited as the driving force behind Lebanon’s reconstruction after the devastating civil war, has cast a large cloud over the country as it grapples with a deepening economic crisis. At the time of this writing, Lebanon has no functioning government; only

an interim government led by Najib Mikati and slated to continue until the results of the new elections – the first after the Syrian withdrawal – are clear. The elections began on May 29, 2005 in Beirut and were scheduled to continue over the following four Sundays in the other electoral districts. The hope is that the future government will finally be able to lead Lebanon into a truly sovereign and prosperous future. So far, however, it seems that Lebanon's old elites, who are again fighting it out among themselves, have not been able to develop answers to the new challenges and the expectations of the young generation.

The major challenge the country is facing on the democratic front is to maintain the plurality and freedom of a multi-religious society while resolving the twin issues of an unstable political power equilibrium and poor governance.

As to the development of Lebanon's market economy, the key strategic challenges that must be overcome in the medium term include improving the institutional efficiency of public administration, improving accountability, stepping up the fight against corruption, reducing the national debt, further stabilizing the state's revenue base, reducing social inequalities and poverty, maximizing the resources of the industrial and agricultural sectors, and developing answers to pressing questions of sustainability.