Rebuilding Devastated Economies in the Middle East

Edited by
Leonard Binder

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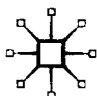

REBUILDING DEVASTATED ECONOMIES IN THE MIDDLE EAST

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1

Introduction

Global Perspectives and Regional Realities

Leonard Binder

Although it may seem that the profound changes that have transformed the Middle East occurred in response to the attacks of 9/11/2001, we can, with the aid of hindsight, discern the beginnings of a global and regional transformation in the coincidence of the eruption of the Kuwait War in 1990 and the winding down of the cold war. During the cold war, regional politics were dominated and equilibrated, if not frozen, by the coordination of American and Soviet policies. Major political transformations, such as the rise and fall of bureaucratic-authoritarian regimes (or Nasserist regimes), even when they occasioned economic crises, were not permitted to upset the status quo. Even the transformation of the petroleum industry, despite the sudden enrichment of some countries, was not permitted to alter the regional balance of power. There was a similar bilateral-bipolar coordination to prevent the frequent episodic recurrences of the Arab-Israeli War (1956, 1967, 1969, 1973, 1982, plus the 1987 Intifada) from spreading in space or extending in time. The Iranian Revolution of 1979 reaffirmed the defects of the Kemalist-Nasserist model and at the same time offered a premonitory indication of the political weaknesses of rentierism, but the full ideological and geopolitical consequences of that revolution were contained throughout the prolonged Iran-Iraq War. Both the prolongation of that war and its failure to produce any immediate change in the regional balance of power were products of the influence of the cold war.

With the end of the cold war, the global mechanism for the maintenance of regional equilibrium was dismantled, and it may have appeared to Saddam Hussein that there would be little incentive for the United States to expend the resources necessary to unilaterally maintain the regional status quo. In fact, the U.S. did not formally adopt the principle of maintaining the regional status quo in the post–cold war period until the adoption of the Department of Defense Planning Guidance report of 1992.[1] But since that time, the United States has been committed to a policy of preventing the emergence of a regional hegemon, while Saddam's policy was tacitly committed to seeking hegemonic domination of the Gulf region and its petroleum. It is now obvious that both our European allies in the cold war and the powers seeking to prevent the United States from asserting global hegemony (China, Russia, India) were and remain unsympathetic to the U.S. goal of preventing profound change in the Middle East.

While the crucial underlying factor in this emerging realignment of global forces remains petroleum, the situation has become greatly complicated by the rise of the neo-Salafi/neo-Wahhabi/Jihadi movements among the Sunnis (Kepel 2004: 152 ff.), and by the significant enhancement of Iran's strategic advantages as a consequence of the current U.S. involvement in Iraq. Nationalism, or what some social scientists call ethnonationalism, is not dead, it is merely dormant in the Arab Middle East. State-based nationalism has not succeeded in strengthening the legitimacy of statist authoritarian regimes, nor do contemporary Islamic ideologies strengthen the legitimacy of traditional monarchies, emirates, and shaykhdoms. Nor does close cooperation with the United States help either type of regime.

Faced with these challenges to its regional influence, it appears that the United States has adopted five lines of response, though with differential emphasis on each:

1 global realignment via direct pressure on the EU and ad hoc accommodation with Russia, China, and India;
2 redefinition of the war on terror as the assertion of an ideology of diffusing freedom and democracy globally (via force or otherwise) rather than a response to specific acts of violence;
3 regional realignment by supporting Middle East allies, sanctioning opponents, and, in the absence of alternatives, using preemptive military strikes to punish or overthrow recalcitrant regimes;
4 support Islamic moderates and the redefinition of Islam in terms of democracy, human rights, civil rights, and nonviolence;
5 develop a regional program linking economic assistance and the promotion of capitalism, democratization, and liberal versions of Islam within the framework of the Greater Middle East Initiative (GMEI) or Partnership.

The fifth response is of greatest relevance to the problem of rebuilding devastated economies in the Middle East, and it involves a more complex form of political and strategic thinking. The first and third responses call for restructuring the global and regional systems, respectively, and thus entail calculations of power and of strategic options. The second and fourth responses are simpler still because they are presented as moral imperatives to be obeyed regardless of cost. But the GMEI alternative alone is based on the projected convergence of several theoretical arguments.

The Greater Middle East Initiative

The central theme of GMEI is that democratic political development and the parallel development of a stable capitalist economy are mutually reinforcing processes. It is also argued that both may be gradually achieved by the reform and adaptation of undemocratic regimes and by enhancing the private sector or market-dominated economies. The adaptive process can be facilitated by means of foreign economic assistance, and authoritarian legitimacy can be transformed into democratic legitimacy without violence. When properly achieved, Middle Eastern autocracies will become integrated into the global capitalist system, property ownership will be diffused throughout these societies, and political power will be distributed in an egalitarian manner. Radical religious preachers expounding jihad and suicide attacks will have no appeal to ambitious and well-educated young men, women will enjoy equal rights, and personal security will be protected by civil society rather than by tribe, clan, sect, and family. Moreover, the promise of GMEI has been sustained by the recent trend toward the devolution of some traditional autocratic power to parliaments. A number of recent political studies have made much of such trends in Jordan, Morocco, Kuwait, Saudi Arabia, and Qatar, but critics have argued that such devolutions of symbolic power are meant to further protect the supralegal status of kings and amirs (Brynen et al. 1998; Diamond et al. 2003; Posusney and Angrist 2005).

Despite the obvious ideological stigmata linking the GMEI to the Bush administration, there is little evidence that it was ever considered a serious instrument for achieving a major foreign policy goal. The earliest reference to something called a "U.S.–Middle East Partnership Initiative" that I have been able to find is a State Department announcement dated December 12, 2002, that appeared on the homepage of the U.S. Embassy in Ankara; this announcement indicated that 97% of the funds allocated to the Partnership Initiative were already committed to Arab countries.[2] The partnership projects were not primarily dedicated to either political or economic reform except in the most general of terms.

The next word I have on the GMEI is from *al-Hayat*, February 13, 2004, which published a lengthy U.S. "working paper" intended to be presented at the Sea Island meeting of the Group of Eight (G-8) planned for June 2004.[3] That draft rehearsed the baleful findings of the UN Arab Human Development Reports of 2002 and 2003 and concluded that reform was absolutely necessary in order to avoid a disaster that would pose a grave threat to the national interests of the G-8 countries themselves. The working paper called upon the G-8 to agree on a joint program that would

> Promote democracy and good governance;
> Build a knowledge society; and
> Expand economic opportunities.

The theory behind the initiative was put in a single sentence:

> These reform priorities are the key to the region's development: democracy and good governance form the framework within which development takes [place?], well-educated individuals are agents of development, and enterprise is the engine of development.

Democracy was to be encouraged by holding free elections and by further developing civil society organizations (NGOs). The paper further noted that elections at various levels were being planned in Afghanistan, Algeria, Bahrain, Iran, Lebanon, Morocco, Qatar, Saudi Arabia, Tunisia, Turkey, and Yemen between 2004 and 2006.

Economic development was to be encouraged primarily by unleashing the region's "private sector potential" and by integrating the region's financial services into the global financial system. More generally, the paper declared that "[c]losing the Greater Middle East region's prosperity gap will require an economic transformation similar in magnitude to that undertaken by the formerly communist countries of Central and Eastern Europe."

Soon after the publication of the draft in *al-Hayat*, a chorus of objections was raised from a variety of directions. Zbigniew Brzezinski criticized the fact that the president had presented his initiative first at the American Enterprise Institute (in November 2003).[4] He wondered whether the premature imposition of democracy might bring Usama bin Laden to power in Saudi Arabia or Hamas in Palestine. He cited the suspicion that the initiative was simply a device to postpone an Israeli-Palestinian agreement until the Palestinians passed some sort of democracy test to be applied by Dick Cheney. Above all, he objected to the fact that the idea was being presented to the Arab states without first consulting with them, but he did

not note, as did many others, that the Bush "democracy initiative" indirectly threatened several Arab leaders who are considered reliable American allies.

Nevertheless, Tamara Cofman Wittes at the Saban Center wrote that "[t]he initiative is part of President Bush's 'forward strategy of freedom,' by which the expansion of political rights and political participation in the Muslim world is meant to combat the appeal of Islamist extremism."[5] In November 2003, with the mission in Iraq "accomplished," the president had said,

> Sixty years of Western Nations excusing and accommodating the lack of freedom in the Middle East did nothing to make us safe—because in the long run, stability cannot be purchased at the expense of liberty. As long as the Middle East remains a place where freedom does not flourish, it will remain a place of stagnation, resentment, and violence ready for export. [. . .] Therefore, the United States has adopted a new policy, a forward strategy of freedom in the Middle East.[6]

Wittes also takes seriously the administration's argument that the forward strategy of freedom is a response to a variety of civil society–based democratic initiatives that recently surfaced in the Arab world, of which the Alexandria Library Conference is the most celebrated. It is, nevertheless, important to bear in mind that the administration's justification for the invasion of Iraq included the assertion that democratization in Iraq would have a domino effect throughout the region.

As was well reported, the GMEI proposal generated a split within the Arab League over whether to welcome the forward strategy of freedom or to ignore it. The split led to an embarrassing deferral of the Arab League Summit scheduled for March 29, 2004.[7] When it was held on May 22–23, 2004, a vaguely worded resolution supporting the continuation of responsible political reform was quite overshadowed by criticism of U.S. policies in Iraq and regarding the Israeli-Palestinian peace process. It is well known that Egypt, Saudi Arabia, and Syria strongly oppose the American initiative.

The ambivalence of the Arab League Summit toward the GMEI was echoed by the response of the G-8 Summit of June 2004 and the subsequent high-level U.S.-EU and NATO meetings. The G-8 response was to adopt a declaration titled "Partnership for Progress and a Common Future with the Region of the Broader Middle East and North Africa" (Perthes 2004: 85). The declaration allows for cooperation between the United States and the EU, but it leans more toward coordination between their respective approaches; it emphasizes treating each country on its own terms; it prefers taking small incremental steps; and it places greater

emphasis on the importance of solving the Arab-Israeli and Israeli-Palestinian conflicts.

Moreover, since June 2004, we have not heard much of the GMEI as attention turned to the U.S. elections, to the demise of Yasser Arafat, and to the elections in Iraq. Since then we have heard, and possibly come to believe, that the Iraqi elections have been a success—in the sense that they revealed the number of Iraqis willing to take a chance on ruling themselves without American protection to be larger than anticipated. It was hoped that the election turnout in Iraq signaled the culmination of a tipping process whereby at least the Shia and the Kurds have decided to isolate the insurgents and to support the emerging elected authorities. But the events in Iraq appear to be far more disappointing than have been the results of isolated, more or less fair, elections in other Middle East countries. But, then, the situation in Iraq is far more desperate than it was in Egypt or Jordan or Iran or Kuwait or Morocco.

This brief and confusing history suggests that the United States does not have a grand strategy for the development of Middle East economies other than the vague hope that democratization breeds private enterprise. To this point, far more attention has been paid to the problem of building a political regime capable of securing Iraq's oil production and export capacity, rather than to incentives for small cap entrepreneurship and the microfinancing of cottage industries. In the event, the Iraqi elections have not succeeded in reducing the American burden in Iraq, and there is little hope of establishing a centralized authority that can support itself. Clearly, the political side of the GMEI far outweighs the significance of the microeconomic perspectives that dominate the proposed economic reforms.

The Role of Middle East States

More generally, it appears that the developmental initiatives of the United States, the EU, the UN, and the Arab League will continue to be scattershot and uncoordinated, with each concentrating on their preferred countries and projects and none seeking responsibility for regional development. Of course, the regional powers themselves are divided over whether they want international actors to take such responsibility, with the weaker economies fearing domination and the stronger regional economies fearing contamination via migration and pressure to share the wealth. Both stronger and weaker economies are concerned that both regional and extra-regional powers may seek or maintain hegemonic relationships with some of the most vulnerable states, such as Lebanon, Jordan, Qatar, or Kuwait.

Because the international community is unlikely to act collectively to develop a comprehensive regional development policy, a great deal of the

responsibility for rebuilding devastated economies in the region will devolve onto the political and diplomatic skills of those who have seized or otherwise gained political authority in these countries. The rulers of Yemen, Sudan, Lebanon, Iraq, Afghanistan, and Palestine will themselves have to become the most valuable economic assets of their respective countries in order to elicit from the international community the resources necessary to rebuild their economies—but they are no more likely than the leaders of the wealthier states to do anything that will diminish their hold on power. The rulers of these states are well aware of the fact that economic devastation has been the consequence of civil strife, often aided and abetted by external influences, ideological, financial, and military. They know full well that some segment of their societies was willing and able, at whatever cost to themselves, to impose unbearable economic costs on their fellow citizens, to destroy the infrastructural unity of the country, and to replace markets with banditry. Consider, if you will, why some Iraqis compare Saddam's law and order favorably with the chaos prevailing in some parts of occupied Iraq.

At the same time, it remains quite clear that there can be no successful rebuilding of devastated economies, nor any reform of more robust economies, without some significant regime change. This contradiction frames the central dilemma of rebuilding devastated economies in the Middle East. Economic devastation occurs under conditions of partial or total state failure. The preconditions of economic rehabilitation include a government that can both maintain a minimum of order and execute economic policy in some economic spheres. Such governments are called upon not only to expand the scope of their own rule, but also to increase the size and heterogeneity of the ruling coalition. But even the most cautiously strategic expansion will, if successful, diminish the power of the original oligarchy to control the social and structural scope and pace of further openings. Given the type of regime that is likely to succeed in seizing power under the conditions of partial or complete state failure, to expect that "the last men standing" will defer to the logic of economic growth at the cost of diminishing their own power, and at the risk of losing everything, is at best problematic. We consider, therefore, that this political dilemma is one of the most—if not the most—challenging obstacle to the rebuilding of devastated economies in the Middle East.

When we examine the regimes in power in the seven cases that we have selected as examples of economic devastation, we see that they are a strange bunch. None of these regimes, except for the Palestinian state in waiting, has come into power via popular choice. None represents a consensual agreement that can provide the substrate for long-term compromise. In Lebanon, Afghanistan, and Iraq, the regime has been

sustained by a foreign force, so it has a kind of hybrid character. In Sudan, Algeria, Lebanon, Yemen, Afghanistan, and Iraq, the regime has little or no stable control over large parts of the national territory, though it is capable of inflicting considerable damage in those places. All of these states, or would-be states, are sustained by foreign financial sources or by the sale of petroleum, so all share the characteristics of rentierism. Many observers openly argue that none of these states enjoys the prerequisites of stable democracy, so that precipitous democratization may produce radical Islamic governments. Others, yet, warn that the continued suppression of popular political participation will lead to terrorism and the sort of anarchy that has already destroyed the economy.

All of these countries have experienced, or are experiencing, civil war or something like it. In some cases (e.g., Algeria), economic decline preceded the breakdown of state authority, but in all the cases, violence has deepened the economic crisis and has prevented economic recovery. State failure or frailty has opened the political arena to religious extremism that presents both political and ideological obstacles to economic recovery. It is, moreover, debatable whether economic recovery is a prerequisite for political recovery or vice versa—or whether both can be pursued simultaneously. All of these countries, except for Lebanon, have a tradition of centralized state control of the economy, albeit not very efficient. Algeria, Iraq, and Sudan can benefit to some extent from oil production, but it is clear that all will depend on external assistance—if they can convince the international community that they are worth the risk. But what strategies, guarantees, commitments, and collective arrangements should be adopted in order to bring back these devastated economies? There is little doubt that the structure of national economies, the ethnic division of power, the external sources of assistance, capital, and advice will all play a significant role in what now looms as a long and slow process. It appears that the indigenous economic obstacles to political stabilization may have received too little attention, whereas the effects of a generalized globalization are expected to impact, whether for good or for ill, on all peripheral economies in the same way. It would seem prudent to reexamine both sides of the development equation when considering how best to rebuild the devastated economies of the Middle East as part of a global effort to achieve regional peace.

Political Obstacles and Political Opportunities

This book is concerned with the obstacles encountered by states in the Middle East seeking to rebuild their national economies after those economies have been devastated by violent conflict, political upheaval,

and/or invasion. Some of the obstacles are the result of misguided ideological commitments to a particular theory of development. Others are the result of the imposition of conditions by lenders and donors. Still others have come about as the price of political compromise. In the next three chapters of this book, these obstacles are discussed in a general manner, focusing on distorted information regarding the nature of existing conditions, on the problems of illicit international transactions, and on the special problems of oil-exporting countries. In the following chapters, the development challenges of Lebanon, Algeria, Yemen, Sudan, Afghanistan, and Iraq are discussed.

The common factor among these cases is the application of violence destroying infrastructure, debilitating financial institutions, disrupting markets, eliminating credit transactions, causing runaway inflation, often inducing the invasion of foreign forces, producing shortages of essential commodities, and leading to the breakdown of legality and security. In response to these events, the international community is at first seized with the problem of saving lives and preventing the spread of chaos by delivering emergency assistance to the victims of such devastation. But before any rebuilding of economic institutions can take place, political, legal, and security institutions must be restored in some degree, and their restoration will often depend upon emergency material assistance and transnational institutional support. The development of markets for goods, services, food staples, capital, and credit, beyond local neighborhoods and smuggling arrangements, depends on first establishing elements of governance, legal order, and legitimate coercive organizations.

Thus, the rebuilding of a devastated economy, virtually by definition, takes place in a context of command rather than exchange. Allocation by command rather than by the market provides the recipient with either a positive or a negative rent, often benefiting supporters of the regime or penalizing its opponents. Usually, countries that have experienced this sort of economic devastation do not have the luxury of debating the respective merits of market-based versus government-based strategies of development. With globalization and the increasing involvement of the IMF and the World Bank in the determination of strategies of economic recovery, the provision of assistance is often conditioned on the acceptance of strategies based on the Washington Consensus of privatization-liberalization-deflation.

Joseph Stiglitz describes the consequences for Russia of the application of this strategy in the form of "shock therapy" (2002: 133–65). The result was the creation of a "system of crony and mafia capitalism" that engaged in large-scale "asset stripping" of Soviet enterprises, and the wholesale transfer of liquid assets to foreign banking havens beyond the reach of the

slowly awakening Russian institutions. Stiglitz suggests that Yelstin was allied with the "oligarchs" who benefited from these policies; 10 years later, we find Putin using equally questionable methods of reestablishing state control if not formal ownership of some of these industrial and extractive enterprises. In the case of efforts to rebuild the much smaller Middle East economies, it seems reasonable to expect similar efforts to direct the allocation of economic rents to trusted allies—at least in the first desperate phases. Thereafter, the subsequent steps taken to rebuild devastated economies will either be shaped by or have to contend against the original phase of the allocation of rents, and attenuating the establishment of civility, legality, and public safety. Stiglitz refers to the product of such political and legal cultural arrangements as the "glue that holds society together" or "social capital" (161).

In his critique of globalization, Stiglitz describes the two major contending schools of economic development as those who "focused on how markets failed in developing countries and what governments could do to improve markets" and those who "saw government as the problem" and who believed that "free markets were the solution to the problems of developing countries" (13). The advocates of free markets, privatization, and liberalization see government intervention as a form of rent seeking, whereas those who advocate a government role in correcting market failures see the exploitation of market imperfections by private entrepreneurs and speculators as a form of rent seeking. Stiglitz comments, "in developing nations, markets are often absent, and when present, often work imperfectly. Information problems abound, and cultural mores may significantly affect economic behavior" (34).

There are some economists who would argue that everything that distorts free markets or takes place outside of the market is a form of rent—including everything political. But the sort of rent seeking discussed here should be differentiated from the practices of Middle Eastern rentier states, especially the oil-exporting states. Giacomo Luciani (1987: 63–82) distinguishes between "allocation" states and "production" states in the Arab world, identifying the former as rentier states and the latter as concerned with economic growth. From Stiglitz's point of view, both may be seen as dealing with rents, but the rentier state is distributing or redistributing rents (or wealth derived from extractive production) in order to maintain its popular political dominion, whereas the production state is engaged in the distribution of rents by means of distorting markets in a manner that will increase GDP or line the pockets of skillful bureaucrats and allied entrepreneurs who are supporters or members of the ruling regime or both. If everything political is rent, then both allocation and production states are rentier states. This, of course, is the view of some

economists, and it may be noted that political scientists who have become interested in the problem of rentier states may have been influenced by the once "hot" topic of the (relative) autonomy of the state (Binder 1988: 335). The point here is that definitions of the rentier state have been influenced by the dubious practice of reifying the state rather than identifying interested, strategic actors.

Lebanon

In the summer of 2006, a bloody and very costly asymmetric war broke out between Israel and Hizbullah—with the passive participation of Lebanon, Syria, and Iran, and the attenuated partisan involvement of the United States and many other players at the UN. At the present writing, a rather ambiguous cease-fire in place prevails in Lebanon while efforts are being made to assemble an international force that will support the Lebanese army's assertion of national sovereignty in the region between the Litani River and the Blue Line, or the Israeli border as recognized by the UN Security Council. Among other things, the UN Security Council Resolution 1701 calls for the disarmament of Hizbullah forces; the withdrawal of Israeli forces to the Blue Line; lifting the Israeli air, sea, and land blockade of Lebanon; and international cooperation in rebuilding Lebanon's infrastructure, its ruined villages, and the urban housing destroyed in South Beirut, Tyre, Sidon, and other cities. Some observers have written that the cost of repairing Lebanon's infrastructure will be about 2 billion dollars. Replacing or repairing destroyed housing will cost several hundred million dollars. Lost income to firms and private citizens will also be measured in the hundreds of millions of dollars.

The UN, the EU, and the Arab League, among other international organizations and agencies as well as individual states, have rallied to the cause of raising funds to assist the government of Lebanon in the rebuilding effort. What is less certain, however, is whether the political apparatus of the Lebanese state will be able to manage the rebuilding process in the face of the overwhelming domestic and regional political pressures that are already being applied. The *New York Times* reported on October 1, 2006 (1, 4), that "nearly $900 million in international pledges remain untapped by the Lebanese government," while that government strives to put in place "the trustworthy financial system needed . . . [to] provide a level of accountability and transparency unprecedented for Lebanon."

The Lebanese War of the summer of 2006 has been dubbed the first round of the war between Iran and the United States—an exaggeration that suggests the strategic importance of Lebanese territory (but not

necessarily the Lebanese state) in determining the balance of power in the Middle East. The ineffectualness of the Lebanese government is partly responsible for the outbreak of the conflict. Hizbullah did not deem it necessary to clear its provocative abduction of the Israeli soldiers with the Siniora government, though it had probably received a green light from Tehran. It has also been said that Israel received a green light for its air attacks from the United States, but both Iran and the United States have denied any such direct involvement. Prime Minister Siniora has tried to blame Hizbullah for the extensive destruction of infrastructure and housing, and he has denied Hizbullah's claim of victory, asserting that it was the Lebanese government that saved Hizbullah from defeat by successfully demanding a cease-fire. It is apparent that it will be impossible to insulate Lebanon from these global and regional political and military forces and permit it to rebuild both its cities and its financial and economic institutions.

The devastation of the Lebanese economy is not the result of misguided macroeconomic policy. Pre-1975 Lebanon, despite continuing domestic political strife over issues of fiscal and representational redistribution, benefited from a vibrant market economy that specialized in providing financial services linking the Arab Mashreq to the world. Domestic strife paved the way for external intervention involving Palestinian groups, Syria, Israel, and Iran, and produced 15 years of civil war followed by another 15 years of Syrian domination in the guise of implementing the fatally flawed Taif Accord of 1989. The fatal flaw of the Taif agreement was its refusal to confront the confessional issue as a dynamic demographic process requiring constant adjustment. Instead, Taif called for the eventual elimination of confessionalism and for a transitional compromise that exaggerated the number of Christians and Sunni Muslims and diminished the number of Shia. The Shii community, led by Hizbullah and generously subsidized by Iran, adopted a policy of supporting the Taif-based regime and Lebanese independence, at the same time seeking a revised confessional formula, a demographically representative second chamber, and redistributive rents from state coffers. Taif also legitimated continued Syrian occupation of Lebanon for a transition period to last until confessionalism was discarded; the Syrian regime took advantage of its dominant position to exact both private and public rents from Lebanon.

The assassination of Rafiq Hariri marked the high point of Syrian intervention, invoking a reaction from Christian and Sunni Lebanese nationalists (March 14, 2005, Cedar Revolution), which has been supported by the international community and has been respected, though not joined, by Hizbullah. Syria has been forced by the international community to withdraw its military forces from Lebanon, but it has not given up its claim

to sovereignty over Lebanon, and it appears likely to take advantage of the chaotic situation following the Israel-Hizbullah war to resume its violent campaign to regain control.

As we learn from this brief narrative, economic policy alone will not suffice to rebuild the Lebanese economy. Lebanon has much to contribute to the improvement of economic conditions in the region, but the realization of this potentiality depends upon both its insulation from the religious, ethnic, and territorial conflicts among its neighbors and its ability to adapt the allocation of power to the changing demography of confessionalism in a way that empowers the majority while protecting the minorities. In the foreseeable future, Shia are likely to constitute a majority of the population of Lebanon, whereupon the Shii community, under the leadership of Hizbullah, should become the major beneficiary of the eventual abolition of confessionalism as provided for in the Taif Accord. It seems unlikely that Iran will continue to subsidize the Lebanese Shia at the high levels currently prevailing. At that point in the future, even a rebuilt Lebanese economy will have to make difficult decisions between market-based policies and confessional rent seeking, between endogenous economic expansion and redistribution in the interest of social peace and equality.

Economic Growth in Ethnocratic States

In Afghanistan, Iraq, and Sudan, like Lebanon, ethnic and/or sectarian conflicts have emerged as major political causes of economic decline. As we have seen in the Lebanese case, liberal, educated, and Westernized observers have been inclined to reject ethnic and sectarian differences as valid and legitimate bases of determining political and economic distributive policies. In retrospect, however, we have learned that the Taliban movement was closely allied with traditional and tribal structures of Pashtun power, and that the problem of establishing a Taliban-free regime requires the reaffirmation of those structures of traditional power without the religious reinforcement. It is not merely a question of favoring Pashtuns as an atomized social aggregate. Pashtun rent seeking is structured in tribal, regional, and occupational patterns. The Afghan economy cannot produce revenues that will cover the cost of maintaining order by a combination of military force and the distribution of rents to tribal and religious authorities. So the major function of the Afghan state is to redistribute financial and military contributions from donor states.

It is also worth noting that, like Lebanon, Afghanistan does not fully control its own sovereign territory. In addition to significant areas where the writ of the government at Kabul is ignored, there have been times and

places where the neighboring states of Pakistan and Iran have intervened, exercised power, and developed political relationships. Both Pakistan and Iran continue to be extremely concerned about developments in Afghanistan and they are likely to find ways to intervene where and when their interests are threatened.

Much the same can be said about Iraq, where we have discovered that Iraqi *wataniyya* (territorial nationalism) was a thin veneer covering deep-seated and even violent emotional attachments to sectarian and ethnic loyalties. It is now apparent that sectarian antipathies have far exceeded Islamic radical ideologies of jihad as the major motive of the daily civic slaughter in Iraq. The ruling elite of Saddam's Iraq dwindled over time to a tribal fragment of a Baathi splinter of a regional segment of the minority Sunni sect. This very tightly controlled "ruling circle" monopolized rent seeking and reduced pressures to redistribute oil revenues by the application of ruthless repression by means of the Baath Party, the secret police, the Iraqi army, and other instruments of repression.

Iraq is blessed with enormous petroleum reserves and rich agricultural resources. It has also produced a large number of highly skilled and well-trained professionals, technicians, scientists, engineers, and managers capable of organizing and developing a modern economy. At times, the Iraqi economy has demonstrated a capacity for endogenous expansion based on the emergence of an embryonic bourgeoisie. So the potential for long-term self-sustained growth was there, but it remained unexploited as Saddam wasted Iraq's resources on ill-considered military adventures. The war with Iran dragged on from 1980 to 1988. The Kuwait War with the United States and its allies began in the summer of 1990 and ended in February 1991, only to be followed by the imposition of extremely burdensome sanctions that lasted until the American and allied invasion of Iraq in March 2003. From then until today, the Iraqi economy has consistently declined in productivity. Infrastructure for transportation, health services, communication, and electric power has consistently deteriorated. Security has broken down. Sectarian strife has steadily increased. Far from being able to rely on its own petroleum production to pay for American liberation services and to generate the capital necessary to rebuild its own economy, Iraq has been forced to rely on American handouts to maintain whatever semblance of authority the Iraqi government pretends to have.

As we have noted, the American-sponsored efforts to create a federated Iraqi democracy have exacerbated rather than mollified ethnic and sectarian conflict in Iraq. Kurds, Sunni Arabs, and Shii Arabs each demand their share of Iraq's oil wealth, but they cannot agree on a plan for sharing the power that will be responsible for running the petroleum installations profitably and then distributing the resultant revenues. No one seems to be

talking seriously about the structure of an integrated Iraqi economy, which might greatly increase the potential for economic growth in Iraq—a potential that would enhance the value of the contributions of each group and multiply the resultant payoffs to each group. Instead, each of the ethnic and sectarian groups places the greatest emphasis on securing its own share of available rents—thus setting the stage for a typical Prisoner's Dilemma outcome and a suboptimal equilibrium, blocking maximal endogenous growth.

Similarly, in Sudan we find a state apparatus, essentially bequeathed by British colonialism, holding sway over the Nilotic central region of the country and in the vicinity of the major cities, Khartoum and Omdurman. The political regime is a variant of the Kemalist-Nasserist military-bureaucratic-authoritarian type that has been so prevalent in the Middle East. But, as in all such cases, identification of the social, cultural, religious, ethnic, and clan origins of the ruling military and bureaucratic elites is crucial to understanding the politics of the country. In Sudan, these elites and the allied religious, parliamentary, and party elites, and civil society activists, including religious brotherhoods, are drawn from the high-status, Arabic-speaking population of the centrally administered regions. The populations of other regions, particularly Christian and pagan Equatoria and western Darfur, have been excluded from all authority and state distributions. A vicious civil war has persisted in the south almost continuously since independence until recently, and a virtual genocide is currently being carried out, however indirectly, in Darfur. The agreement ending the Equatoria secession includes provision for sharing oil revenues as well as guaranteeing measures of religious freedom for non-Muslims. The eruption of rebellion in Darfur was directly linked to the concessions made to the Equatorian peoples because the Muslim Furs demanded benefits similar to those being granted to the southern rebel communities.

Until recently, Sudan was an impoverished state, incapable of economic development and beset by political instability and frequent military seizures of power, as government after government failed to develop the means, or to display the political skills, to hold together a coalition broad enough to maintain power and stability. It was not unusual for military strongmen to seek alliances with traditional or modern religious movements to maintain power, but it was not until the discovery and exploitation of commercial quantities of petroleum that the regime of General Bashir has been able to get rid of his religious allies, buy off the Equatorial rebels, and mount a murderous repression of the Fur rebels while thumbing his nose at the pious protests of the guilt-ridden Western world. It is this government of Sudan that will set the political conditions for economic development in the country.

Petroleum-Exporting States

Our selection of cases includes three petroleum-exporting states: Algeria, Iraq, and Sudan. Petroleum may be a potent antidemocratic vaccine, but it has not prevented political upheaval and economic devastation. Algeria demonstrates the consequences of extreme price fluctuation on the stability of "rentier" states dependent upon a single extractive product. Algeria also demonstrates the consequences of setting too restrictive a limit on the beneficiaries of state-administered distributions of petrodollar income. Popular protest in urban Algeria took the form of demands for an Islamic regime, and after the suspension of elections that were about to be won by the Islamic coalition in 1992, a bloody civil war ensued and has lasted in some form and degree until very recently. Ironically, or maybe logically, $70 oil will restore stability and even economic growth in Algeria after the citizens of that long-suffering land have had the time and the perspective to consider the costs of no-compromise politics.

In Iraq, we have already noted the consequences of assuming that petroleum production and the flow of oil income are automatic and can be readily applied to any purpose. In fact, we have learned that oil pipelines are easy targets, that petroleum can be stolen, smuggled, and sold to support insurgent and terrorist operations. Rather than serving as a means of pacifying and stabilizing Iraq, its oil fuels instability and the fragmentation of political formations, militias, and resistance groups. Once again, ethnic and sectarian distrust have led to adoption of the principle of federalist division of territory, institutions, and resources; this principle is likely to be applied to petroleum as well, despite Sunni objections. Unsurprisingly, the division of petroleum resources and infrastructure is likely to lead to a suboptimal economic solution depriving Iraq of the full value of its petroleum wealth. Without oil income, it is doubtful that any future Iraqi central government will be able to unify the country and pursue a coherent foreign policy without external assistance—and the lowest cost external assistance usually comes from next door.

The military dictatorship in Sudan has been stabilized by the windfall of petroleum income at a time of peak prices. The regime has been able to consolidate its position and gain popular support by defying the Western powers who wish to prevent further bloodshed in Darfur. The regime has also been able to purchase more arms and assert greater control over larger areas of its sovereign domain. As petroleum income increases, Sudan may become transformed into a rentier state, capable of buying domestic tranquility, but for the proximate future, it may be expected that Sudan will redistribute its rents within a narrow circle of supporters rather than take chances on IMF and World Bank schemes for economic development.

All three of these petroleum-exporting states have populations exceeding 30 million, far too large to be satisfied by an egalitarian distribution of the proceeds from oil exports. Given the time and necessary political latitude, a prudent development policy, balancing poverty reduction and investment in infrastructure, might succeed in initiating a gradually accelerating process of endogenous growth—especially if current high oil prices continue. But in the absence of political patience, and under conditions of low-level insurgency, scattered acts of terror, and intensifying ethnic and sectarian conflict, the dominant but besieged political elite are hard pressed to shift resources needed for security to other purposes. The violent reaction of the Khartoum government to the demands of the Fur peoples to share in the distribution of Sudan's new oil wealth—as was guaranteed to the peoples of the south—is a case in point. The readiness of the dominant Shii factions of Iraq to exclude the Sunni population from a share of the country's oil wealth affirms the point. In Algeria, as well, the Bouteflika government has placed the greatest priority on suppressing the terrorist opposition before seriously considering readmitting the moderate religious movements to the political arena.

The current spike in the price of petroleum can reduce the pressure on repressive regimes where exclusion from sharing in extractive rents is not based on sectarian or ethnic differences as in Algeria. But in Iraq and Sudan, the "geopoliticization" of ethnic and sectarian differences has diminished any inclination to seek an inclusive compromise. Further barriers to expanding the number of recipients of oil rent shares have been put up as a consequence of Iranian influence in Iraq; similar influences may be at work in the Sudanese case.

Narrow-Based Regimes

Salih's Yemen, Saddam's Iraq, Bashar's Syria, Karzai's Afghanistan, Bashir's Sudan, all illustrate the rule of a type of extended affinity group (EAG elite)—more than a clan but less than an ethnic group; a sociological segment comprised of individuals with common regional, educational, occupational, cultural, religious, and ideological characteristics. These EAGs share characteristics that facilitate communication and collective action. Often enough, these characteristics have been acquired or enhanced during the processes of colonization, decolonization, and postcolonial adaptation of the colonial political and administrative experience.

It can be argued that the cost of collective action to achieve a given goal for a group of a given size will be less if the group is endowed with these characteristics when compared with the costs for a group not so endowed.

Following this assumption, we may conclude that for any fixed amount of revenue, whether from taxes or oil sales or geostrategic rents, an EAG elite, even when constrained to exclude all other groups from sharing in state revenues, has a better chance than other groups to establish and maintain a viable state.

However, over time, with changes in the price of oil or the geostrategic value provided by a great power rent payer or changes in the size of the population, or changes in the recruiting practices of the affinity group (all externalities, of course), the ruling elite may lose its ability to hold power unless it can bring about compensatory adjustments. It follows that ruling affinity group elites, acting rationally to retain power, should attempt to adapt to such changes either by further tightening the circle of beneficiaries of the state, as did Saddam Hussein, or by expanding the number of beneficiaries of state rents either at the elite (selected individuals) or the mass (ethnic and sectarian) level, as did Anwar al-Sadat in adopting the *infitah* (opening, apertura) policy.

If the margin of surplus repressive capacity is too thin, the affinity-based elite will be forced to tighten up the circle of successful rent seekers and apply those savings to increasing repressive violence, as was the case in every one of the countries we are considering (including Lebanon under Syrian domination). On the other hand, if oil prices increase sharply, or if more oil is discovered, or if bounteous quantities of foreign aid become available, or if emigrant remittances increase substantially, or if a worrisome foreign threat is removed (again, all externalities), then the option of opening the system may become available. Opening the system entails sharing power and that translates into diminishing the claim of each member of the affinity elite, as well as increasing the demand of the excluded groups for further opening. Opening the system also entails diminishing the ratio of command distribution to market-based distribution of wealth. Presumably, if the government is not seriously challenged by dissidents, economic growth should occur. It is at this point, it seems to me, that crucial decisions must be made about the strategies for further development. The choices are between maximizing antipoverty distributions that are likely to be immediately consumed, and setting aside funds for rebuilding infrastructure and subsidizing new entrepreneurial ventures.

This scenario does not yet bring us to the brink of democratization, but it is supposed to bring us to the brink of self-sustaining economic growth, which may be considered an optimistic harbinger of democratization if not an actual prerequisite. Our optimism may be somewhat dampened, however, when we try to understand what can be learned from the Egyptian case as one variant of this implicit game.

Lessons from Egypt's Experience

The Egyptian economy was not only devastated by violent conflict, but even before the Six-Day War, it was also more or less paralyzed as a consequence of the ambivalent application of postcolonial socialist and autarkic policies. After Nasser's death, the regime confronted dangerous challenges from its own left wing, from the suppressed religious opposition, from militant student groups, and from the Israeli occupying force. Sadat had to resist the pro-Moscow factions, wriggle out of dependence on the Soviet Union, confront Israel militarily in the Suez Canal zone, make serious overtures to the United States, and only then try to balance the distribution of political rents with the amount of repressive force needed to keep the regime afloat.

Sadat's infitah did open the Egyptian system in a limited fashion for a limited number of entrepreneurs—a clear case of the distribution of rents to a privileged group. The regime also provided the moderate elements of the Muslim Brotherhood with a tightly hedged opportunity to participate in the political arena. At the same time, state security kept the lid on all other parts of the society. The peace treaty with Israel was supposed to provide substantial side payments from the United States to cover the costs of acquiring additional political support, but it appears that Sadat underestimated the resources needed to maintain order. He was assassinated on October 6, 1981.

Hosni Mubarak persisted and even expanded the infitah policy of providing lucrative rents to a growing bourgeoisie, and that policy has paid off by fueling moderate economic growth and encouraging foreign investment. Continued American subsidies have also helped to maintain a slowly growing economy, but the regime still relies heavily on repressive force despite the parliamentary and electoral façade. Mubarak has, in fact, pursued a rational strategy, if we have properly characterized the Egyptian political game, although he may have become too cautious to make the necessary additional concessions that the game requires in order to maintain the (moving) equilibrium solution. If Mubarak has become too rigid, it may be because of American pressure to democratize, or because he believes that he needs more control to assure the succession of Gamal Mubarak, or, indeed, because the threat of radical Islamic revolution has increased. Whatever the reason, Mubarak sees little payoff in accommodating the liberal/moderate democratic reformers such as the Wasat group or members of the Ghad Party.

But, of course, Mubarak does not preside over a devastated economy. Nevertheless, much can be learned from examining the Egyptian trajectory since the seizure of power by the Free Officers in 1952 and the

decision to dissolve all political parties and establish the dictatorship of the Revolutionary Command Council under Gamal Abd al-Nasser. The crucial event that links most of our cases is the reestablishment of state authority after the violent events that disrupt normal economic activity. As we have seen, relatively tightly knit EAGs have an advantage in the scramble for power and they are able to provide a needed service. At the same time, it is important to note that the seizure and retention of power by a relatively small group in a chaotic situation will probably take all available resources, leaving little surplus after serving the needs of the new rulers and the maintenance of minimal order. Given the marginal restoration of order, the limited resources at their disposal, and the obvious priority of regime security, it is hopeless to expect such a regime to undertake rebuilding the infrastructure, supplying emergency assistance to the poor, or investing in growth-inducing projects. The debates over whether one should start with projects to build human capital or with projects that strengthen the market system are irrelevant in such circumstances. Rebuilding devastated economies must start with external grants aimed at providing some relief to ordinary citizens as well as investment funds that are intended to restore confidence in markets—as opposed to "feel-good" projects like the rebuilding of Beirut after the civil war. The major purpose of such grants during the first phase of rebuilding is to take the pressure off the new regime and encourage the formation of coalitions with groups that have been initially excluded from power and from rent seeking. It is true that during the first phase of rebuilding, much of these funds are going to be drawn off as rents to the EAG regime. Additional funds will go to subsidize food staples for the masses. An increasing portion will likely be allocated in the manner of Sadat's infitah to favored investors.

This scenario focuses attention on what appears to be the diversion of international financial assistance from its real purpose, but that construction misses the significance of establishing political order as a prerequisite of rebuilding devastated economies. At the same time, it is important to distinguish between the distribution of politically related rents when starting the rebuilding process, and the kind of routinized diversion of 10–25% of IMF loans by well-established regimes, some of which are even exporters of oil. "While no one knows how much of the bank's resources have been improperly diverted, informal estimates range from 10 percent to the 25 percent that Mr. Wolfowitz says went to corrupt cronies and family members of Indonesia's leadership in the 1990's."[8]

The key to rebuilding devastated economies is not the effective elimination of all partisan rent seeking. It is rather the strategic manipulation of the allocation of rents to balance the expansion of participation with the growth of the economy and the gradual enhancement of the role of private capital.

Notes

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4. Zbigniew Brzezinski, "How Not to Spread Democracy: Bush's Greater Middle East Initiative," *AxisofLogic.com*, Middle East, March 9, 2004, http://www.axisoflogic.com/cgi-bin/exec/view.pl?archive=124& num=5552& printer=1.
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7. Neil MacFarquhar, "Summit Collapse Leaves Arab Leaders in Disarray," *New York Times*, March 29, 2004, Late Edition Final, p. A1.
8. Steven R. Weisman, "Drive on Corruption Angers Some at World Bank," *New York Times*, September 14, 2006, pp. C1, C4.

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2

The "Uncanny" Writ Regional

New and Recurring Forms of Poverty and Inequality in the Arab World

Kiren Aziz Chaudhry

Introduction

It is common to note that by international standards, the region of the Middle East and North Africa (MENA) has relatively low levels of poverty and economic inequality (UNDP/RBAS 2002, 2003; Gardner 2003). Although this fact appears to belie the association commonly made between levels of social instability and economic deprivation, it also suggests that standard indicia of economic well-being might be poor predictors of broader social outcomes. Most importantly, it highlights the limits of comparisons conducted at a macroeconomic level: what does it mean to juxtapose a region that has had access to roughly 20,046 billion dollars in oil revenues between 1974 and 1996 and 784 billion dollars in aid from 1970 to 2003, with countries characterized by enduring and dramatic capital scarcities?

The main thrust of this chapter is to demonstrate that the key to understanding the substantive experience of inequality and poverty in the MENA region is concealed by aggregate measures. *Inequality and poverty take many different forms that are not comparable*. Rather, we must focus on the human consequences of extreme *economic instability* and volatility that

characterize the region. The sources of this instability, I show, are built into the region's resource structure, regional politics, and international interventions. The consequences of this economic instability can, I submit, be just as devastating, in terms of the lives people live, as long-term but stable poverty.

Putting aside, for the moment, the appalling quality of available economic data on the MENA region, an issue I take up in the next section, I make five basic claims in this chapter. First, extreme levels of economic instability and flux have defined the region since 1973. The Arab world's reliance on oil exports and the transmission of this volatility even to the nonoil exporters of the region have had deeply destabilizing effects on the social, political, and psychological fabric of these societies that go far beyond those captured by the literature on the "resource curse" or the Dutch Disease. If our concern with poverty and economic equality is a proxy for our interest in the quality of human life, surely economic *instability* and physical *insecurity* should figure in our calculations. There is a large body of literature, commonly associated with the moral economists, that stresses the primacy of stability as a human and social goal. Arguing against the classical Smithian view of man's innate propensity to accumulate, this literature highlights the violent outcomes of market forces, and the volatility created by the "price mechanism" or the "market" (Polanyi 1944; Sahlins 1972; Scott 1976, 1985; Thompson 1991). In a host of other literatures of vastly diverse origins, stability is associated with growth. Even conventional neoclassical accounts, not to mention the neoinstitutional economists (North 1990; Ensminger 1992), recognize the indispensability of stability in promoting investment, creating "trust," and securing the prerequisites for economic growth. Similarly, political economists seeking to explain the spectacular rise of the East Asian Newly Industrialized Countries argued that successful integration into international markets was facilitated by the institutional interventions of the "developmental state" (Johnson 1962, 1982, 2000; Evans 1979; Evans et al. 1985; Haggard and Chen 1987; Amsden 1989; Haggard 2000). Such institutional interventions and the patterns of economic behavior to which they give rise are highly vulnerable when subjected to particular kinds of market pressures for which they are singularly unprepared. Thus, the benefits of specific developmental strategies in one institutional arrangement can easily produce disastrous effects when parts of the institutional scaffolding of the "model" are removed, as was the case prior to the Asian financial crisis of 1996 (Wade 2000, 2004; Woodruff 2005).

Stable or even slowly rising levels of poverty and inequality, I suggest, are not nearly as disruptive as the cycles of boom and bust that have been the hallmark of the recent economic history of the Middle East. These

booms and busts, although directly connected to oil prices and exports, are not confined simply to oil exporters, but are transmitted to the region's labor exporters through lower levels of remittances or shifts in the composition of imported labor. This flux reinforces and feeds into a host of longstanding political conflicts that center on issues of citizenship, entitlement, and national belonging and can lead to violent conflict both within and between countries. Economic insecurity, in short, not only shapes economic behavior in dramatic ways, but it also reaches both up into the realm of high politics and down into the realm of the family and the individual psyche.

Second, social conditions have distinct political effects. *Most importantly, economic flux and insecurity undercut the formation of stable preferences necessary for political action and aggregation of interests. In short, they work against the formation of cross-regional religious and ethnic collaboration necessary for the creation of demands for universal political participation and democracy, and promote a politics of tribe, clan, family, sect.*

Third, a variety of political factors—local, regional, and international—have contributed to this resource-based instability. There have been numerous major wars in the region since the 1970s, not counting the Palestinian-Israeli conflict. In addition, international sanctions have created virtually unique externally imposed deprivation in a region that is, by all aggregate measures, "rich."

Fourth, aggregate data of the kind typically used when discussing MENA ignore large segments of the region's population and fail to capture the lived social and economic reality of the region's inhabitants. This claim, furthermore, applies to the majority of developing countries: the breadth and depth of the informal sector in the developing world open to question the utility and accuracy of macroeconomic data *in general*. There are basic structural imbalances in the region that prompt me to question the basis for celebrating the Arab world's affluence and higher levels of equality relative to other LDCs. As I show below, rising levels of unemployment, spectacularly high birth rates, and continued reliance on primary exports are only part of the problem. Underlying these are the much more fundamental issues of food security and the water crisis.

Finally, new forms of poverty and inequality are emerging in the Arab world that are, and will continue to be, deeply divisive and socially disorienting. These include the rapid feminization of labor in highly patriarchal societies where male unemployment is high and growing; new and unstable forms of export-oriented production; subnational differences in economic performance; the effects of post–9/11 restrictions on the flow of money and people across borders; new kinds of labor inflows; and the progressive retreat of the state from the provision of social services. The

decline in social services continues in tandem with relatively stable levels of government employment, but wages in the public sector have declined radically, pushing state employees into the ranks of the "working poor." As highly indebted Arab governments respond to World Bank and IMF demands for further "state shrinking," state employees will formally enter the ranks of the unemployed.

I begin with a brief discussion of the quality of data available through official state agencies as well as authoritative international developmental organizations like the Economic and Social Commission for Western Asia (ESCWA), the IMF, and International Bank for Reconstruction and Development (IBRD). I expose and challenge the extra-empirical ideological "work" that these data are often used to perform. Section two gives an overview of levels of poverty and inequality based on available aggregate data. In the third section I outline the various kinds of economic insecurity and flux that have characterized the post-1973 history of the region. Section four examines new forms of inequality and poverty, and section five examines international sanctions.

Why Don't We Know Anything?

In the 1970s and 1980s, when statism was the norm and all American academics were regarded as "spies," we became accustomed to scrambling for scraps of information about the Arab economies. This was the era when the population of the Gulf Cooperation Council (GCC) countries was a state secret and when cold war rivalries and regional military competition put a premium on secrecy in countries that functioned as regional proxies for the United States and the Soviet Union. Although the statistical data for the 1950s and 1960s were relatively robust, if tightly controlled by governments, the oil boom ushered in a new era of opacity. Motivated partly by politics and partly as a result of the atrophy of information-gathering agencies within Arab bureaucracies that were reorienting to manage capital inflows rather than monitor domestic economic activity, national elites were largely successful in creating a virtual void of economic and social information (Chaudhry 1991, 1993, 1997). Data on major labor-exporting countries such as Egypt, Jordan, and Yemen were similarly distorted with huge capital inflows entering the domestic economy entirely under the state's radar.

These issues have received attention commensurate with the frustration they evoked. The surprising (and equally frustrating) fact is that though economic liberalization, the end of the cold war, and the realignment of Arab countries resulted in the entry of international economic agencies into the very structure of the Arab state, there has been no noticeable improvement in publicly available economic data. With the exception of

countries such as Syria, Iraq, and Libya, which did not succumb to the directives of the IMF and the World Bank, it is entirely unclear why the reforms of the 1980s and early 1990s did not result in higher quality data and freer access to it in countries like Morocco, Jordan, Egypt, and Yemen. The same can be said of direct clients of the United States in the Gulf. It is a stranger fact, still, that almost *all* the online data sources on the MENA region are *suddenly* missing *any* data on Iraq.

One can only speculate about why this is so. I would like to suggest two possible reasons. First, even in cases where states have been direct clients of the host of institutions that manage and promote the Washington Consensus, there appears to be a tacit agreement between international institutions and governments to obfuscate and conceal. Where corrupt and unpopular governments are deemed to be important allies, a unity of interest emerges in secrecy, Saudi Arabia being the archetypal case. Even where detailed data exist, they are difficult to access. So, for example, Morocco and Jordan both did multiple household surveys in the 1990s, the results of which are apparently available to the World Bank but closed to public scrutiny. International agencies and Arab governments collude in what might politely be called "information management."

Second, as Wade (2004) suggests, the misrepresentation of economic realities by the authoritative institutions of international economic management is a result of some combination of technical incompetence, false assumptions, and a blatantly ideological project of justifying the neoliberal reforms of the past two decades. It is out of this proclivity that we are subjected to the analytical tack that dominates texts produced under the aegis of the World Bank, the IMF, and even the UN. International agencies have an interest in presenting a positive view of those countries in the region that are complying with their policy prescriptions.

As a result, we have a plethora of studies published by economists affiliated with the World Bank that focus on "selected" countries that permit them to deploy an image of economic health. "Analysis" rarely goes beyond the 1990 benchmark, when the effects of bank policies began to emerge in full force: they begin, in other words, from a crisis period. Blatantly contradictory "facts" thus come to be interpreted in the most positive way possible, and anomalies in the data are typically marked as being in need of "further investigation." Adams and Page of the World Bank, writing in the reputable journal *World Development*, for example, manage to strike a positive note while reporting that MENA has "one of the most equal income distributions in the world" when they conclude:

> [T]he MENA region has achieved all of this—low poverty with fairly equal income distribution—with very low rates of gross domestic product (GDP)

> growth. Between the 1980s and the 1990s, per capita GDP in the MENA region rose only by 4.3%. During the last 20 years, only one region of the world [Europe and Central Asia] recorded a lower rate of per capita GDP growth. This pattern of slow growth, reductions in inequality, increases in the income share of the poorest quintile, and a low and relatively stable poverty headcount index is unique to the MENA region. (Adams and Page 2003: 2029)

A miracle, indeed, especially since Adams and Page also note that "poverty in MENA has increased by about 17% over the past two decades" (2029).

It is not hard to see how statistical manipulations performed on partial data of dubious accuracy can yield these "unique" findings. Yet, it is less clear why one would take solace in noting that MENA, which had access to the largest capital inflows in the history of the developing world and very low population densities, should be congratulated when it compares favorably with countries like Bangladesh.

The Arab Human Development Reports (AHDRs) of 2002 and 2003 represent a new interpretive twist to the approach taken by multinational agencies to development issues in the Arab world. While the AHDR 2004 openly questions the veracity of the American Occupation Authority's claim to be bringing democracy to the Arab Middle East, all three AHDRs (UNDP/RBAS) function within the ideological template of the Bush administration's rendition of the Washington Consensus. This is a version of neoliberalism that one could describe as a "Genesis Model of Development," in which economic growth is assumed to be the causal result of "democracy" established at gunpoint. The first two AHDRs, both of which I have reviewed in detail, can only be described as reflecting a "turn to fantasy." The reports, written almost exclusively by Arabs, are littered with quotations from famous Arab thinkers from various eras, presumably to buttress the impression that the values and prescriptions therein are indigenous to "Arab culture." The 2002 Report sets out to illuminate the "three deficits" in Arab society: knowledge, freedom, and women's empowerment. It lays out a general "strategy" for eliminating these "deficits." The 2003 Report focuses on the building of "an Arab knowledge society" on account of knowledge being "the most instrumental" of the original goals.

Although it would be difficult to take issue with the argument that educational reform is a pressing concern in the Arab world, as elsewhere, including California, the approach taken by the reports reflects a drift in thinking about development that avoids and obscures issues of resource allocation and income distribution. Moreover, as I show below, it simply is not true that women's participation in the work force is among the most pressing problems.

Just as the 1980s brought us the miracle of the market, and the "Velvet Revolution" that finally bestowed upon Russian women the gift of Levi jeans, the AHDRs mirror the ascendant discourse in Washington, which enshrines the conservative-revolutionary vision of democracy as being the cure for all human misery. The result is that the reports put forth grandiose and obviously unattainable goals that are patently "safe" from the perspective of contemporary Arab governments. Who, after all, can quibble with education as a goal? Who can deny that, whatever its true yield, the per capita expenditure of Arab states on education is the highest in the developing world? Ideologies deployed with the aim to demobilize often succeed simply by occupying public space. It thus matters little that the goal of creating the "knowledge society" advocated by AHDR 2003 is completely disconnected from any reality on the ground, for it refers to a self-sustaining transformation in original research and innovation that takes generations to achieve. Fantasy is comforting when the goal is avoiding the genuine problems in the Arab world—problems of corruption, deprivation, nepotism, and misallocation of resources.

More indicative of the "fantasy" approach, still, is the extent to which the reports reflect the triumph of the belief that something called "a free culture" is the key to a brighter developmental future. This assumption not only overturns several generations of social science research devoted to critically examining the notion of "culture" that is operative in the reports, but it also goes directly against the facts as any reasonable economist knows them: there is no relationship between freedom/culture and economic growth. According to the reports, scientific achievement rests on a knowledge-based society, which rests on culture. As I have argued elsewhere, the cultural auto-critique that became the dominant secular trope following the Great Disaster of the 1967 Defeat set the stage for the triumph of Islamist discourse (Chaudhry 1998: 35). The reports reflect this triumph, invoking religious injunctions for "seeking knowledge" that draw on no less contemporary a source than the reflections of the medieval Muslim scholar Ibn Battuta.

Like Alex Inkeles and David McLelland, the notorious 1960s champions of cultural engineering in the service of economic change, the authors of the second report are out to "fix" culture via knowledge and vice versa. To their credit, at least the feverish theorizing of Inkeles (1966) and McLelland (1966) was ultimately concerned with economic development. The reports, in contrast, use cultural marketing to promote a purely ideological agenda. This is a theme to which I return at the end of this chapter.

There are, obviously, historically grounded institutional reasons why governments in the Arab world are willing collaborators in the "turn to

fantasy" and the celebration of Arab economic achievements. It is a truism that most Arab governments are secretive. Economic information is politically sensitive for obvious reasons that are domestic, regional, and international. Corruption, militarization, economic stagnation, regional conflicts, and the exigencies of maintaining authoritarian control suggest that there are good explanations of elite behavior, but they are not particularly interesting or mysterious. Who needs that kind of publicity?

More interesting is the history of the shrinking institutional capacity of governments to collect economic information. In the preliberalization era, high levels of government intervention in the economy and direct state participation in production in countries such as Syria, Egypt, Algeria, and Iraq meant ready access to economic information, regulation, and taxation. As I have argued elsewhere, direct interventionism was often motivated by efforts to gain control of information and garner tools of economic statecraft that were illusive in the immediate postindependence era (Chaudhry 1993). In the so-called oil monarchies of the Gulf, information-gathering agencies atrophied along with the regulatory state starting immediately after the oil boom of the 1970s, as economic statecraft became possible through distributive policies. Later efforts to revive such institutions have floundered.

For the others, economic liberalization had a number of unintended consequences that undercut the state's access to economic data. The expansion of the informal economy, the freeing of international financial transactions and so forth, present formidable obstacles to information gathering, regulation, and taxation. Simply put, the portion of the economy that was visible using standard measurements started to shrink during the oil boom and then shrank in other ways following liberalization. Other factors, such as regional migration and informally remitted external earnings, added to the problem, particularly in aid-dependent countries where governments had a built-in interest in underestimating such flows. Thus, for example, official statistics on remittances in countries such as Jordan, Egypt, and Yemen bear absolutely no relationship to reality, despite the fact that labor constitutes their main "export commodity."

To summarize, then, I repeat the mantra with which we are so familiar: we know very little about poverty and inequality in the Arab world. Institutional infirmities, structural change, and the close connection between the exigencies of maintaining political power and secrecy are part of the story. In addition, through some alchemy of the political triumph of economic neoliberal thought, policies pursued under this doctrine, and the apparent collusion of governments and international agencies in highlighting positive developments, distributive questions are asked ever less frequently.

What We "Know": Increasing Poverty and Declining Living Standards

Real per capita income has declined rapidly in the Mashreq, to about half of what it was in 1980. In Saudi Arabia, the decline has been truly dramatic (figure 2.1). Moreover, figure 2.2, which contrasts GDP growth with growth in per capita income, shows that personal wealth has barely grown since the 1970s.

The proportion of Arabs living below the poverty line has grown remarkably in the era of liberalization, doubling in Algeria, and rising more than 6% in Jordan, Morocco, and Yemen in the 1990s. By the mid-late 1990s, the poverty head count in Algeria, Egypt, Morocco, Jordan, and Yemen was in the 20–26% range, with poverty concentrated in the rural areas (see table 2.1). These changes are not reflected in the Human Development Indicator (HDI) trends for the region, which show a steady,

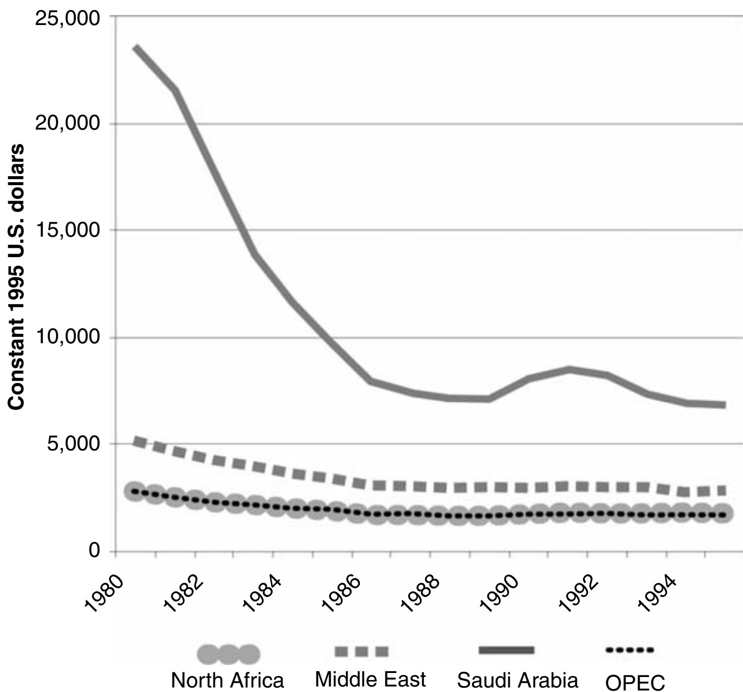

Figure 2.1 Decline in real per capita income in North Africa, the Middle East, Saudi Arabia, and OPEC, 1980–95

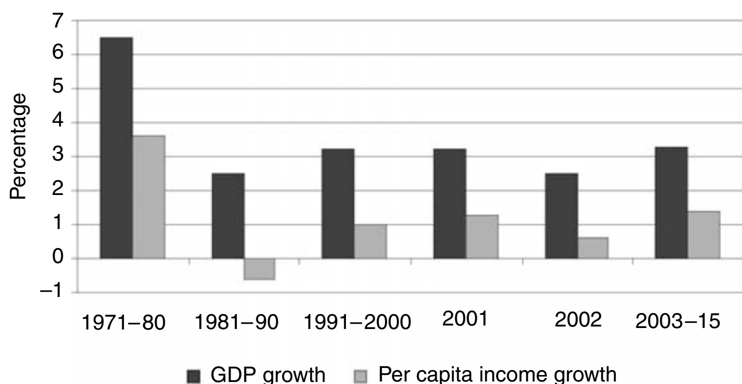

Figure 2.2 GDP growth versus per capita income growth in the MENA region

Table 2.1 Percentage of population below the poverty line, selected MENA countries

	Survey year	*Rural*	*Urban*	*National*	*Survey year*	*Rural*	*Urban*	*National*
Algeria	1988	16.6	7.3	12.2	1995	30.3	14.7	22.6
Egypt	1981	24.2	22.5	26.0	1997	29.1	23.1	26.5
Jordan	1987	23.7	16.6	18.7	1992	29.0	22.0	24.0
Morocco	1990–91	18.0	7.6	13.1	1998–99	27.2	12.0	19.0
Tunisia	1990	13.1	3.5	7.4	1995	13.9	3.6	7.6
Yemen	1992	19.2	18.6	19.1	1998	26.9	21.8	25.4

Sources: Algeria, Poverty Assessment, 1997; Jordan, Ministry of Social Development, 1987, 1992; Yemen, HBS, 1992, 1998; Morocco, Poverty Update, 2000; Egypt, Alleviating Poverty during Structural Adjustment, 1991; IFPRI, Profile of Egypt, 1997.

if small, improvement since 1990 (see figure 2.3). In regional comparative terms, the HDI is not anywhere near where it *should* be. Given the overall 17% rise in absolute poverty in MENA reported by the World Bank, one could only surmise that HDIs such as life expectancy are slow to change and gloss over shorter-term economic changes on the ground.

Most Arab countries have experienced a sharp decline in real wages since the 1980s, with public sector wages in the temporal lead (ERF 1996). In the most extreme case, Egypt, 1992 public sector wages were only 50% of their 1982 levels. Algeria did even worse, with public sector wages declining by 16% per annum between 1989 and 1992 (Ali and Elbadawi 2000).

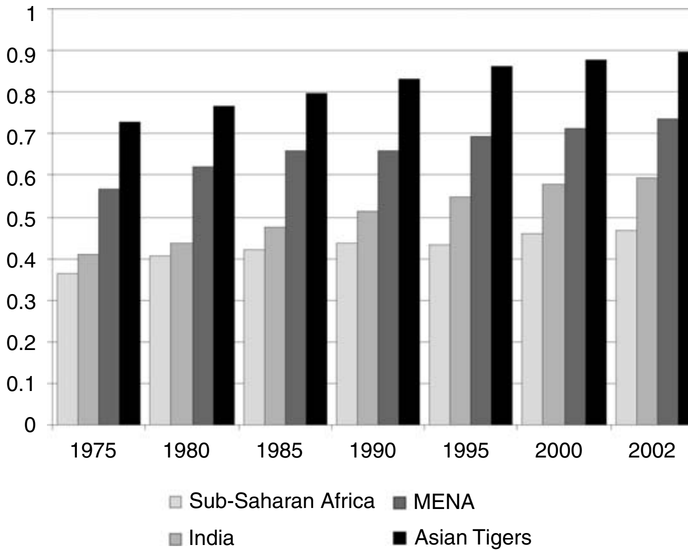

Figure 2.3 Average HDI score by region, 1975–2002

Rates of unemployment in non-GCC countries are among the highest in the world (see figure 2.4). Poverty, like joblessness, is concentrated among the young (ERF 2002) (see figure 2.5). There have been marked spikes in informal urban employment, ranging from 30–35% in Egypt to 35–45% in Yemen, 37% in Morocco, and 33% in Jordan (Ali and Elbadawi 2000). Underemployment and the practice of taking many different, insecure jobs on a temporary basis are on the rise, although these trends are notoriously difficult to quantify with any accuracy.

Institutional mechanisms for labor to represent its interests have disappeared with the implementation of new labor laws. Countries that continue to have liberal labor laws on the books are often the biggest violators of workers' rights: Saudi Arabia, for example, has perhaps the most protective labor laws in the world. According to the authoritative institutions of international economic management, the elimination of all progressive labor laws would solve the unemployment problem. In fact, even if one were to accept the logic of this neoliberal economic idea, it would have no impact since huge chunks of the labor force are already functioning in the informal economy and working for day wages far below officially mandated ones. Gestures toward political liberalization have been highly effective as a method of obscuring responsibility for

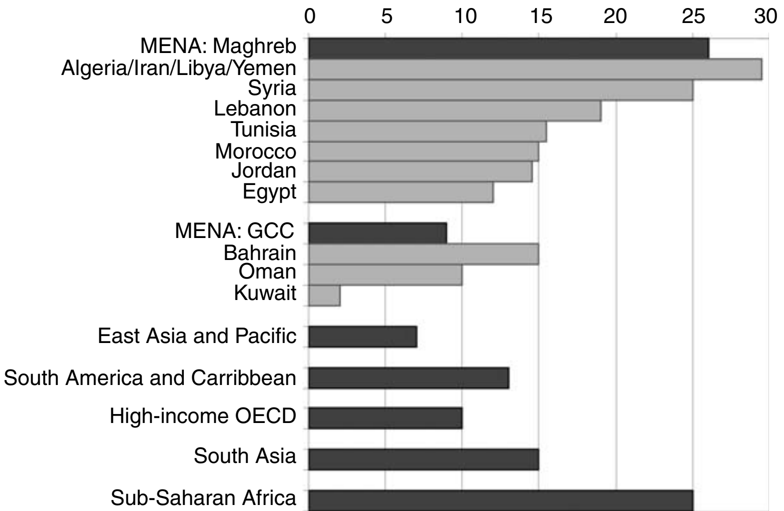

Figure 2.4 Unemployment, 1999

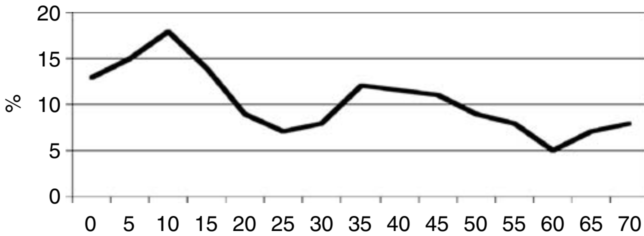

Figure 2.5 Poverty rates by age, Jordan, 1997

economic outcomes; in fact, economic policy is strangely absent from parliamentary agendas, not to mention the formal public space. There are, however, some limits: As Ali and Elbadawi (respectively of the UN and the World Bank) point out, one must always be wary that the poor, when pushed to the limit, might force distributive policies upon governments, thereby derailing the speeding locomotive of economic liberalization (Ali and Elbadawi 2000).

As mainstream economists never tire of repeating, the Gini coefficients for the region depict higher levels of equality than elsewhere in the developing world. Yet, as a measure of inequality, the Gini has little

relationship to absolute levels of poverty or economic decline. Thus, as figures for sub-Saharan Africa suggest, a country can be dirt poor and have a respectable Gini coefficient. This is basically what is happening in the Arab world. This is why it is not reasonable to celebrate the fact that the composite Gini for the Arab world is lower than that of Latin America, especially since over the period in question (the 1980s and 1990s) the only region to have lower growth rates than MENA were the successor states of the USSR.

In assessing the real lived experiences of human beings in the Arab world, I want to argue for a stronger focus on three underlying structural factors that are almost completely ignored in the literature, but that, in my estimation, pose the most important long-term challenges for the Arab world. First, there are two basic resource deficits in the region that, unlike the "freedom" deficit identified by the AHDRs, are real, long-term, and deadly: food and water. The region has an absolute and growing water scarcity and imports an inordinately large proportion of the food it consumes. Efforts to revive agriculture in countries such as Algeria and Iraq in the mid-1980s foundered for a variety of reasons. Others, such as Yemen and Somalia, have agricultural sectors that almost exclusively use female labor and have moved from food production to narcotics. Although the GCC countries, having depleted their aquifers with the wheat bonanzas of the 1970s, were able to invest in desalination plants for potable water, poorer countries do not have the same option. For at least the last two decades, water—even drinking water—has become the most scarce commodity in the region.

Second, though much has been made of the "demographic gift" bestowed on the Arab world following three decades of the highest growth rates in the world, to this writer, the gift looks more like a population bomb. The assumption, reflected in the literature of the UN-IMF-IBRD trio and parroted by their intellectual progeny in the Economic Research Forum in Cairo, that the relatively large number of employment-age citizens and the relatively small number of dependent retirees is a recipe for a Rostowian "take off" is nonsensical. With rates of joblessness growing rapidly and little hope for employment-generating investments in sight, it is difficult to imagine how a large number of poorly educated and completely unskilled youth who have no acquaintance with the disciplinary strictures of the work ethic can be presented as a favorable phenomenon.

Post-1973 Economic Insecurity and Flux

As I argued above, an aspect of economic life in the Arab world that deserves much more attention than it has gotten is the inordinately high levels of volatility and flux that characterize the region's economies.

Consider, for starters, figure 2.6, which shows GDP percentage change from the previous year for 15 MENA countries, against the same trend for the world. The boom and bust patterns we see here are not, as economists are wont to call them, "business cycles," but rather the result of oil export dependence, intra-Arab political conflicts, and war. Figure 2.7 shows the same trend for selected examples worldwide. It counters the notion that figure 2.6 is a false measure of volatility, as it includes aggregate world data.

We need not recount here the peaks and valleys of oil prices: they are well known. But since memory tends to be selective, let us recall the other source of instability and consider how war maps onto the booms and busts

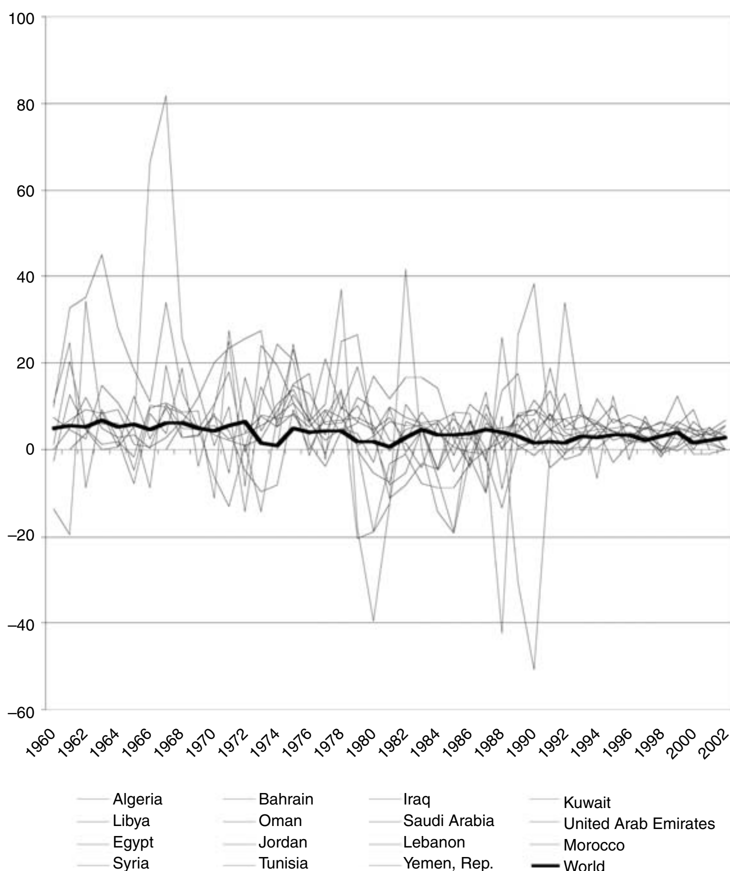

Figure 2.6 Volatility, GDP percentage change from previous year: world versus 15 MENA countries, 1960–2002

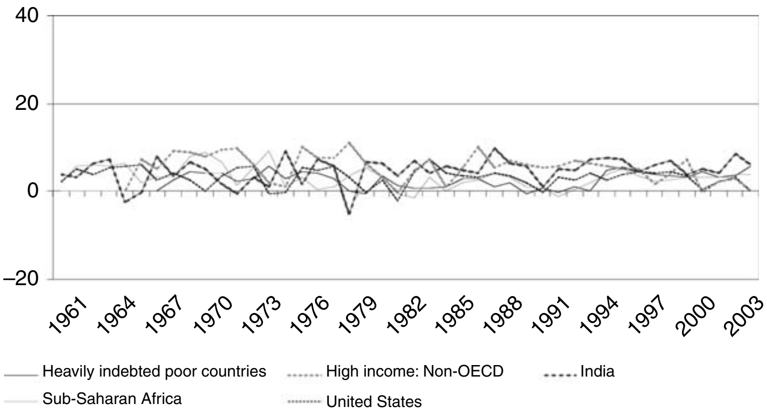

Figure 2.7 Volatility, GDP percentage change from previous year: selected examples, 1961–2003

of the oil economies. The recent military history of the region is a terrifying story of generations lost: the Arab-Israeli conflict, the Lebanese Civil War, the Algerian Civil War, the Yemeni Civil War, the Iran-Iraq War, the 1990–91 Gulf War, the Sudanese Civil War, the Somali Civil War, and the American conquest and occupation of Iraq.

The drama of war often conceals its long-term impact on human economic insecurity and the way wars suddenly reshape regional economic inequality in far-reaching and unexpected ways. To take one example, the 1990 Iraqi invasion of Kuwait resulted in the expulsion of 1.2 million migrant laborers from Saudi Arabia (Stevenson 1993), not to mention hundreds of thousands of Jordanians and Palestinians. Kuwait was devastated, but recovered rapidly. Meanwhile, as the devastation of Iraq was being accomplished, the war precipitated a huge economic boom in the surrounding states. Jordan boomed because that was where wealthy Iraqis fled, sending real estate prices soaring and generating a new market for consumer goods. Saudi Arabia boomed because oil prices peaked and the U.S. troop presence created a buoyant climate for service providers in the private sector; Qatar and the UAE because of spikes in trade and services, not to mention oil prices. Out of war also come other kinds of opportunities. Massive debt forgiveness for Egypt in return for her support in the 1991 liberation of Kuwait is a recent example. The second American invasion of Iraq too yielded dividends for Egypt and Jordan. The Yemeni government's post–9/11 cooperation with the U.S. global "antiterrorism" campaign has, similarly, resulted in the inflow of military and other aid

and investments in the oil sector (Dunkley 2004a, 2004b, 2004c; Everett-Heath 2004; Irish 2004a, 2004b, 2004c, 2004d; James 2004a, 2004b; Klaus 2004; Lidstone 2004; MacDowall 2004).

The current U.S. invasion of Iraq has produced a massive economic boom in the surrounding countries. Kuwait, Qatar, and the UAE are experiencing a construction and service sector boom of such proportions that they are finding it difficult to spend the cash that is flooding in. The misfounded anticipation is that Iraq will soon provide unprecedented opportunities for investors. Saudi Arabia has been able to retire its domestic debt and spend more on social services. Turkey's exports to the Arab world are soaring, and there has been a revival of Anatolian Tigers like Gaziantep that were particularly badly affected by the embargo on Iraq.

Wars and economic volatility reshape economic fortunes in the region across countries in ways that are unanticipated and sudden. A case in point is changing patterns of labor imports. Although aggregate cross-regional flows such as labor remittances have continued to grow over time (see table 2.2), spurring a higher level of dependence on the export of labor as a source of foreign exchange, there is an increasing level of flux in who gets to migrate and how long they are allowed to stay. Apart from politically motivated labor-import preferences that sought to replace Arab labor with Asian labor, the GCC states adopted a policy of deliberately rotating labor to prevent laborers from forming economic and political networks starting in the mid-1980s (Adams 1991; Abdel Jaber 1993; al-Amin Fares 1993). To the extent that this policy spreads opportunity through a larger number of families, the impact of this policy on the exporting country's income distribution is most probably positive. The effect on the individual laborer and his family, however, cannot but be economically disruptive and psychologically disorienting (MERIP 1984). At the individual level, economic volatility produces a propensity to

Table 2.2 Worker remittances in selected MENA countries (USD million), 1970–95

Country	*1970*	*1980*	*1985*	*1990*	*1995*
Algeria	211	241	313	321	NA
Egypt	29	2,696	3,212	3,744	3,417
Jordan	16	NA	1,022	500	NA
Morocco	63	989	967	1,995	1,890
Tunisia	89	207	351	539	590
Yemen	60	NA	1,391	1,366	NA

Note: NA, Not available.

Sources: *World Development Report*, various years.

consume rather than invest. It also has deeply disruptive effects on the individual's capacity to plan and on the stability of household economies. Moreover, the social effects of unstable access to migration are disruptive at the local level, producing sudden changes in the relative economic status of families living in close proximity. Where tribal, religious, or ethnic divisions exist, such changes can and do spill over into violent conflict.

New Forms of Inequality

As the largely ideological debate rages about whether or not international integration has led to an increase in poverty on a global scale, it is now commonly recognized that the neoliberal reforms of the last two decades have created greater inequality, both globally and within countries. In the Arab world, as elsewhere, economic reorientation has created novel forms of inequality that have social and political consequences. Most of these changes are notoriously difficult to quantify at the macro level and are best captured in local-level ethnographic research.

On account of the bright light that has been trained on the issue of gender inequality in the recent literature on the Middle East, I refer to the topic only briefly (Papps 1992; UN/ESCWA 2004; World Bank 2004a, 2004b). Historically stable cultural practices of gender discrimination aside, a couple of new developments deserve mention. First, 20 years of heavy spending on education, combined with lack of employment opportunities, have generated a mismatch between education levels and employment opportunities. Particularly in the Gulf, women tend to acquire higher levels of education than men, but are only marginally represented in the job market. Education levels for males in primary education in Saudi Arabia are only 60%, despite the fact that government spending on education is a robust 9.2% of the GNP (UNDP/RBAS 2003). Female enrollment in tertiary education is higher than that of males in Bahrain, Jordan, Kuwait, Lebanon, Qatar, and Saudi Arabia (UNDP/RBAS 2003). A new form of inequality that has emerged in the past 20 years is thus an inverse relationship between education and opportunity that is not only wasteful but also a potential source of familial tensions.

At the same time, particularly in the Gulf after 1990 and in the export-promoting economies of Morocco, Tunisia, Jordan, and Egypt, there has been a feminization of the labor force that belies the routine quip that empowering women in the economic realm should be a central focus. Female labor tends to cluster either in public sector jobs or in the informal sector. The reality is that nonagricultural female employment has been growing dramatically in both the GCC countries and in the non-oil exporters (see figures 2.8 and 2.9).

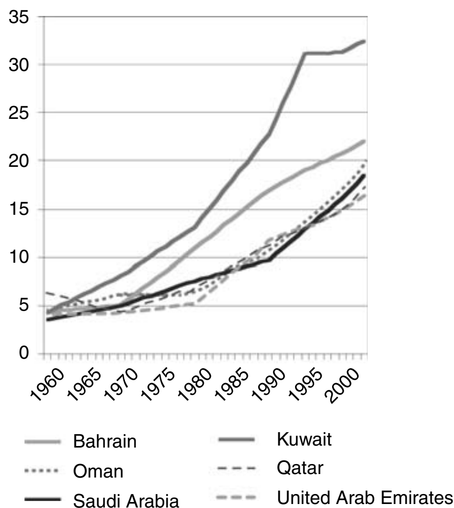

Figure 2.8 Percentage of labor force female: GCC countries, 1960–2000

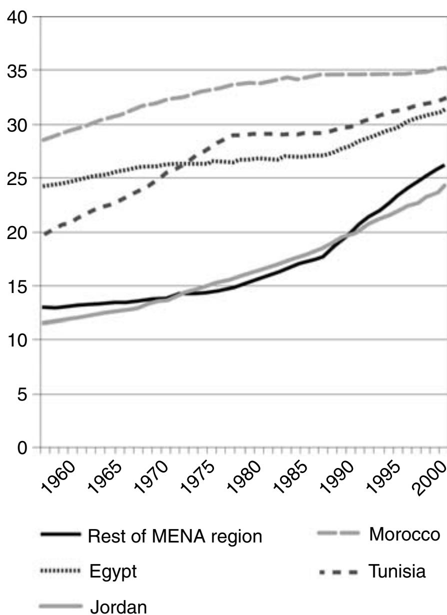

Figure 2.9 Percentage of labor force female: selected countries, 1960–2000

The trend toward feminization of labor among youth is even more striking: in *every* Arab country except Yemen, females are *more* likely to be economically active than males (see table 2.3).These trends mirror a global phenomenon of the feminization of labor, as reflected in the transnational studies conducted by Guy Standing (1999). As his data show, the absolute number of employed males has been on a decline as women are recruited into low-paying jobs marked by high levels of insecurity (Jones 1989; Mirchandani 2004). Case studies across the developing world reflect this reality (Jenson 1989; Walby 1989; Raynolds 1998; Tyner 1999; Gottfried 2000). Meanwhile, male unemployment rates in the MENA are among the highest in the world, approaching 30% in Algeria, Iran, Libya, and Yemen (see figure 2.4). Export concentration in textiles and ready-made garments—sectors that favor female workers—has created social and familial tensions in countries where male unemployment is high (Lynch 1999; Fontaine and Schlumbohm 2000). These trends have created and can be expected to continue creating a backlash as more and more men encounter the emasculating experience of being unable to provide for their families (Janssens 1997; Joshi 2002).

The feminization of labor builds on other, quite vivid sources of what one might call the "crisis of Arab masculinity." Events that have little meaning for the American public have inflicted a steady series of psychological traumas on Arab and Muslim males. Whereas the televised medical examination of Saddam Hussein (widely regarded as an emblem of masculine power), or the racist overtones of ongoing military conflicts in Israel-Palestine and Iraq, or the graphic evidence of torture and gratuitous sadistic acts performed in Abu Ghraib prison raise questions of international law for Western liberals, Arab males experience them as deeply humiliating and emasculating. These psychological traumas map onto the economic reality of the feminization of labor and male unemployment. The point here is not to decry the financial independence that female employment affords women, but to suggest that the social, familial, and psychological adjustment to these changes is made even more difficult in the context of these collective traumas.[1] One consequence of this trend that has escaped the attention of policy makers in the United States is that resistance fighters in Iraq, Palestine, Saudi Arabia, and elsewhere have come to embody the only symbols of masculinity that are left standing (Kimmel 2003). These symbols of masculinity, as I have argued elsewhere, appeal not only to men, but also to women.

At the same time, employment in the emerging export sectors tends to be poorly paid, informal, and highly unstable, raising the question of whether the global phenomenon of the feminization of labor is delivering the liberation that liberal feminists hoped for. Forms of subcontracting in

Table 2.3 Indicators of economic youth activity by gender, 1990–95

Country	*Youth population (000s)*						*Indicators of economic youth activity*			
	1990			*1995*			*Economically active youth, % of total*		*Change per year, 1990–95 %*	
	Male	*Female*	*% of total population*	*Male*	*Female*	*% of total population*	*Male*	*Female*	*Male*	*Female*
Algeria	1,869	1,796	19.6	3,020	2,892	21.0	26	30	2.4	5.9
Bahrain	42	33	21.6	42	40	14.6	11	19	−4.3	2.4
Egypt	4,608	4,291	20.3	5,982	5,595	18.6	22	26	1.6	3.3
Gaza Strip	54	45	22.0	78	67	18.4	26	36	5.2	10.2
Iraq	1,288	1,230	19.4	2,083	1,986	20.3	25	26	2.2	4.2
Jordan	299	268	19.4	592	551	21.3	27	35	3.5	7.4
Kuwait	139	109	18.0	156	155	18.4	17	20	−6.2	−3.3
Lebanon	263	281	20.4	303	298	20.0	24	36	0.8	2.7
Libya	276	259	17.6	531	514	19.3	24	37	3.3	5.9
Morocco	1,951	1,990	20.3	2,889	2,778	21.4	27	33	1.7	2.5
Oman	104	95	17.6	192	189	17.2	19	27	2.4	9.0
Qatar	27	17	19.0	34	30	11.6	6	13	−1.1	10.2
Saudi Arabia	998	783	18.5	1,671	1,633	18.1	17	31	−0.2	6.5
Sudan	1,784	1,750	18.9	2,788	2,731	20.7	26	27	3.0	4.2
Syria	875	836	19.7	1,493	1,448	20.7	28	35	2.7	4.8
Tunisia	702	669	21.3	927	886	20.2	25	36	1.1	1.9
UAE	120	59	17.6	165	132	13.4	9	19	3.7	7.0
Yemen	700	813	18.4	1,608	1,435	20.3	31	29	5.3	4.6

Sources: UN statistical charts and indicators on the situation of youth, 1990–95.

the textiles and food processing sectors, in particular, produce intense periods of work punctuated with periods of idleness of unpredictable duration. The human experience of these new forms of production is the mirror opposite of public sector employment, where labor laws, pensions, regular work schedules, and so on have been the norm. The reality of informal labor in export-oriented production, particularly in Jordan, Morocco, Tunisia, and Egypt, adds to the economic insecurity and volatility that characterize the Arab economies at the macro level (Doan 1992).

Another source of new inequality stems from cuts in government services, the privatization of education, the elimination of subsidies and price controls, and the decline of state-sector employment and wages. As local-level ethnographic research has shown, the mechanisms that have emerged to cope with scarcity tend to undercut uniform notions of citizenship, creating or reenforcing links based on family, tribe, or religious affiliation (Denoeux 1993). Scarce resources, including jobs, education, access to health care, child care, loans, and even lower-priced goods, increasingly flow through such networks. A dramatic example of this trend is illustrated in Anne Marie Baylouny's study (2006) of hundreds of newly created extended "families" in Jordan. Belonging to a "family" not only gives access to exclusive benefits, but also excludes those who do not belong or who belong to a less well-connected network. In postconflict situations or contexts where conflict is ongoing, these networks can assume an overtly political or military form, or at least fragment society on a permanent basis.

These are not trivial issues that affect access to immediate needs—although access to goods, water, sewage systems, medicine, electricity, and transportation can hardly be described as minor human preoccupations. Apart from raising issues of what the state actually *becomes* when it steps out of social service provision, where access to education or jobs is concerned, the effects of exclusion can be life transforming on a long-term basis. Driven by the patently ideological stance of international agencies and the very real fiscal crisis of the Arab state, these developments are certain to reshape identities in ways that we can hardly be sanguine about. To the extent that these networks extend into migrant labor and regional groups, their disciplinary strictures, their politics, and their capacity to shape economic outcomes cross borders.

Far from the rosy outcomes predicted by proponents of NGOs and "civil society" (Carapico 1998; Moghadam 2003), such developments actually create novel forms of inequality that undercut norms of universal citizenship (Davis 1997). What does economic precariousness and instability do to the emergence of democratic norms, participation, and interest articulation? The long-lamented "democracy deficit" in the MENA region

has ritually been explained with reference to cultural or religious practices. Theorists of the rentier state, on the other hand, cite the resource abundance of oil states as the source of continued authoritarianism. I seek to highlight a different possibility: *Individuals living in economically precarious conditions cannot generate the stable set of goals and priorities central to political aggregation, organization, thought, and action* that cut across ascriptive identities. In an economy experiencing rapid, dramatic, and unanticipated shocks, with attendant institutional and social effects, stable political preferences lack a firm basis, and politics devolves onto the "certainty" of family, kin, and coreligionists.

One of the unique features of development in the MENA region has been the presence of an inordinately large number of foreign workers (Feiler 1991). Despite laws promoting indigenization of labor, reliance on foreign labor has increased rapidly in the GCC: where in 1975, 61% of jobs were filled by citizens, by 1985, the number was 33%, and by 1995, only 26%. Foreign workers outnumbered Kuwaitis by 500% and UAE nationals by 1,000% in 1995 (Humphrey 1993; Choucri 2002; ERF 2002). Housed separately from nationals, and usually geographically segregated by country of origin, migrant labor has virtually no rights in most Gulf countries (Longva 1999; Jureidini 2003). Labor laws are exceedingly liberal, but they are not applied. The sponsorship system continues to be the mechanism through which workers enter labor-scarce Gulf countries. Domestic workers, except for drivers, are almost exclusively female; there is virtually no female labor outside of the housework context (MERIP 1984; Tyner 1999; Siddiqui and Perera 2000; Jureidini 2001). Much has already been written about the conditions under which domestic workers labor and I will not repeat those findings here (Hammam 1986; Thompson 2000; al-Najjar 2002). It goes without saying that temporary migrant labor constitutes a major line of inequality in labor-importing, oil-rich states.

Quite apart from the myriad forms of discrimination, stereotyping, and rank violence experienced by laborers historically, there have been several new twists to these lines of inequality. First, as unemployment rates rise among Gulf-state citizens, conflicts have begun to flare up between them and foreign laborers. Businessmen have been very reluctant to obey laws to use domestic labor that have been on the books since the mid-1980s. Second, as the preference for non-Arabs grows, owing to a variety of factors, laborers are increasingly drawn from the poorest countries whose home governments are ill equipped and least interested in promoting the rights of their citizens. Non-Arabic-speakers have great difficulty functioning outside of their own networks and have no access

to government agencies or police. Post–9/11 regulations not only subject foreign workers to increasing degrees of surveillance and arbitrary police harassment (Russell and al-Ramadhan 1994), they have also cut out many of the remitting mechanisms used by laborers—a policy supported by some "region experts" (Looney 2003). Thus, although worker remittances are a major source of favorable income distribution trends in exporting countries, working conditions in the host country are deteriorating.

Obviously, in countries such as Iraq, where "reconstruction" is likely going to be the preserve of U.S. multinational companies, cheaper foreign labor will be used in massive construction projects. Very high rates of joblessness among Iraqis have spawned and will continue to spawn antiforeign violence, as in the liberalization era of the 1989–90 period, when Egyptian workers who availed themselves of the new GCC open-Arab migration policies became the targets of violence. The U.S. administration has failed to understand the extent to which acts of violence against foreigners in Iraq today are related to the influx of foreign workers for "reconstruction" projects. A testimony to this fact is that the biggest and most active union in Iraq is called the Union of the Unemployed.

Finally, an entirely new group has entered the labor market in the Arab world: post-Soviet women (McMurray 1999). Although they work in a variety of positions, the vast majority of post-Soviet migrant workers are engaged in sex work. In Dubai, Bahrain, Kuwait, Jordan, Syria, and elsewhere, post-Soviet sex workers are an entirely new group of expatriate labor which, as such, generates complex and vexing questions about inequality and exploitation in arenas ranging from the status of the family in host countries to health issues. Israel, a hub for the regional export of sex workers, is an important player in facilitating access (Stone and Vandenberg 1999). Obviously, post-Soviet sex workers build on an existing regionwide hierarchy of sex work. In Iraq, prostitution is rampant today, but had already been steadily growing since the 1989 reforms when female government workers were summarily fired to make room for returning military men. Egypt, Morocco, Tunisia, and Lebanon are also regional centers for Arabs seeking the services of sex workers. The advent of the post-Soviet women introduced a reshuffling of the existing nationally based hierarchy of sex workers. Thus, in the past, the hierarchy ran from Lebanese sex workers to Tunisians and then Moroccans and Egyptians. Now, subgroups within the post-Soviet sex workers have reshuffled those status hierarchies. With local availability, aesthetic preferences are being transformed to the detriment of Arab women, raising the possibility of a "crisis of Arab femininity" to parallel the "crisis of Arab masculinity." To

the extent that the attraction of the post-Soviet women is connected to notions of dominating and possessing these blond icons of the "West," their entry into the Arab world could well add another twist to experiences of inferiority and insecurity wrought by colonization, economic dependence, and the occupation of Iraq.

International Sanctions

Economic sanctions have been used with growing frequency as a juridical tool to shape the political or military behavior of developing countries. The scope of sanctions and the instruments with which they are enforced have varied. Sanctions are applied at the bilateral level or through UN resolutions; they can be general or sector related and can vary over time depending on a host of interests that the sanctioning power may have (Delevic 1998). Countries in the MENA have been subject to some of the most stringent sanctions regimes in history: Libya (1982–2005), Iraq (1990–2003), and Iran (1979–present) have experienced some of the most punitive sanctions; and the threat of sanctions has become a ritual tool of enforcing compliance to particular U.S. policy goals in the region. Syria, Pakistan, and Afghanistan (prior to U.S. invasion) are recent examples of the use of this instrument.

In an era when the rhetoric of global economic integration has been the dominant trope of the G-7 countries, often presented as the panacea not only for growth but also for the "doux commerce" hypothesis that trade civilizes and undercuts passions that lead to confrontational and violent policies, sanctions seek to bring about compliance through severing the links between national economies and the international system. Stated aims rarely cohere with actual goals; in none of the most stringent uses of the sanctions tool (Libya, Iraq, Iran, Cuba) has the goal of regime change been achieved through sanctions. Nevertheless, economic sanctions have radically reshaped the economic lives of citizens living under sanctions regimes, generating new lines of poverty and inequality. I use two examples, Libya and Iraq, to illustrate two substantively different ways in which sanctions regimes have this effect.

Following the Lockheed bombing incident of 1982, Libya was put under international sanctions that were comprehensive. The aim was to force Colonel Muammar Ghaddaffi to extradite Libyans suspected of orchestrating the bombing for trial in the United States. After 22 years of the sanctions regime, Libya finally complied with U.S. demands in 2004, having witnessed the effects of the war waged on Iraq by the U.S.-British coalition. The war demonstrated to all countries a new willingness to

ignore international law and use unilateral force to achieve rather unspecified goals and a general inability to even plan a military campaign, and gave new meaning to "sanctions" as a precursor to massive military action.

I seek here to highlight only one aspect of the Libyan experience that builds on points made earlier about economic volatility and its effects. Although it is widely recognized that the sanctions against Libya were regularly violated by European and U.S. multinational corporations, particularly in the petroleum industry, Libya's own ports were closed during the sanctions period. Since Libya's import needs include virtually all basic commodities, a host of alternative overland transportation mechanisms emerged over time to supply the domestic consumer market. The main route, in this case, was through Tunisia, where a new international airport and a six-lane highway were built close to the Libyan border to truck goods into the Libyan market. As the sanctions regime continued, the entire trading structure of the country was rearranged. A highly statist system of supplying imported consumer goods was replaced by networks of Tunisian and Libyan entrepreneurs, who, in collaboration with border police, came to constitute an entirely new business class. Wholesale and retail networks, transportation companies, and connections with international suppliers were thus linked in novel ways across the border. In short, sanctions created two new nexuses of inequality. The first was the rise of a new and highly affluent business elite functioning in a newly liberalized price regime on which domestic consumers were completely dependent. This meant that, unlike the presanctions economy, where most goods were imported, subsidized, and distributed to the wholesale market by the state, private entrepreneurs gained control over both supply and prices in the context of limited competition. The losers in this scenario were the previously favored groups of domestic consumers (writ large) and government employees.

Under the sanctions regime, the entire property rights regime and class structure of Libyan society were entirely transformed through a new kind of international integration that was radically different from that which had existed in the presanctions era. This transformation, moreover, had nothing to do with an internally generated and developmentally oriented change in economic policy and philosophy. Just as the sanctions regime created, stabilized, and entrenched new groups in positions of economic privilege and disenfranchised previous beneficiaries of the presanctions economy, the end of sanctions delivered another shock to the system. The end of sanctions suddenly severed the links between Tunisian businesses involved in the overland trade networks and their Libyan interlocutors, undoing the basis for their collaboration and adversely affecting Tunisian

manufacturing and service sectors. The end of sanctions once more rearranged lines of inequality within the Libyan political and economic system, restoring, to a large degree, the privileged position of the state in the economy.

Although it is too early to analyze the impact of the postsanctions era in Libya, this case is suggestive of politically generated changes in inequality that originate in the international system, but are quite dissimilar to the kinds of processes highlighted by the Dependency and Dependent Development schools. The rise and fall of whole new classes as a result of sanctions, coupled with the natural patterns of boom and bust that typify oil exporters, add another source of volatility that affects not only the country under sanctions, but also its neighboring countries. One-time opportunities, thus, can turn quite rapidly into an imperative for sudden economic adjustment for countries such as Tunisia and Libya, representing another way in which economic volatility and its distributional effects cross borders in the MENA region.

Iraq constitutes perhaps the most dramatic example of the enforcement of a total international sanctions regime between 1990 and 2003. Much has been written about the human toll of the embargo and the inadequacy of the Oil for Food program, and debate still rages about the legitimacy of the war that followed. Iraq is presented here as a stark example of the impact of the juridical tool of economic sanctions on poverty and inequality.

Basic indicators are sufficient to summarize what happened to Iraq over the 13 years of the sanctions regime (see, inter alia, Mahdi 2002). Despite its eight-year war with Iran (1980–89), Iraq in 1987 was an industrializing country with a respectable per capita GNP of $3,503 and the country ranked in the upper "medium" category of the Human Poverty Index (HPI). By 1995, only four years into the sanctions regime, per capita GNP had fallen to $705, comparable to that of Rwanda. The HPI ranking of Iraq in 1998 had fallen to 42 among the 77 poorest countries in the world (UNDP 1999). Inflation ran at 250% between 1994 and 1997 and unemployment rose from 4% to at least 50% in 1999 (UNDP 1999). By 1993, 81% of the population lived below the international poverty line of $14.4 per month (UNDP 1999). Since the U.S. invasion of the country, the situation has worsened dramatically (Ramcharan 2004).

There was a marked divergence in the economic fortunes of different regions because of the sanctions: the situation in the northern provinces improved enormously, whereas that in the central and southern provinces deteriorated in a way that can only be described as tragic. For example, in the central and southern provinces, infant mortality rates rose from

35 per 1,000 in 1990 to 125 per 1,000 in 1998, and the under-five mortality rate rose from 31 in 1989 to 130 in 1998 (Ali et al. 2003). In the northern provinces, which had been granted autonomous status and where aid organizations worked freely, infant mortality rates were 60 per 1,000 in 1989, peaked at 115 in 1991, and subsequently fell to 47 in 1998. Under-five mortality rates went from 80 per 1,000 in 1989, peaked at 120 in 1991, and then fell to 50 in 1998. The initiation of the Oil for Food program in 1997 had no visible impact on these trends (Ali et al. 2003). The zigzag in regional economic fortunes within Iraq is fundamental to the sectarian and ethnic conflicts that rage today.

Does death and debilitation qualify as "poverty"? Consider this fact: "The calculation of excess mortality, based on the survey mortality rates and the UN 1998 birth projections, yields an estimate of between 400,000 and 500,000 excess under-5 deaths during the period 1991–98" (Ali et al. 2003: 224). Chronic and acute malnutrition more than doubled between 1991 and 1996. After a brief stabilization following the institution of the Oil for Food program in 1997, acute malnutrition rose again after 1999 (WHO 1999).

These aggregate figures are tragic and shameful indicia of a brutal policy that also failed to fulfill the various renditions of its stated aims that were put forth by the U.S. government. A closer look at targeted research, however, permits us to construct a more nuanced picture of the contours of poverty and inequality wrought by the international economic sanctions.

It is important to keep in mind that until Iraq began its radical and unsuccessful economic and financial reforms in 1988, immediately after the end of the Iran-Iraq War, Iraqis were utterly unaccustomed to economic instability and insecurity. Through borrowing, oil exports, and grants in aid from Arabs and the West alike, the government of Saddam Hussein had managed to completely control prices for almost all commodities by directly importing and distributing them to the population. The economic chaos created by the reforms thus meant that the benchmark year of 1991 was already reflective of a less stable economic environment than that which had existed until 1988. As I have argued elsewhere (and as Saddam Hussein, in captivity, confirmed in an interview), the mobilization for war and the subsequent occupation of Kuwait were directly related to the consequences of the reforms (Chaudhry 1991, 2002).

Even before the invasion of Kuwait and the ensuing sanctions regime, the economic fortunes of many groups in Iraq had already been rearranged. Where largely family-owned businessmen, Baathists, and, in particular, private sector contractors amassed property and wealth in this period,

inflation cut deep into the salaries of state sector employees. Educated women, who during the Iran-Iraq War had comprised 40% of the upper echelons of the state bureaucracy, were summarily dismissed to make room for demobilized army officers; unemployment was rampant among the rank and file of the demobilized army of almost 1 million. The reforms signaled a massive and sudden restructuring of property rights and institutions, similar in magnitude to those that had taken place with the overthrow of the monarchy in 1964 and the onset of the Iran-Iraq War in 1979–80.

The sanctions, not to mention the bombardment of Iraq's infrastructure in the 1991 attack and all subsequent military actions, were thus visited upon a population that was already experiencing novel and highly disruptive changes in access to goods, services, and security. It is well known that the sanctions created black markets and smuggling networks that enriched those closest to the Hussein regime. But what did the rest of society look like?

First, the fortunes of different regions changed. The north, in general, with its relatively autonomous status, fared better than it had prior to the sanctions. The central and southern provinces did much worse than in the past. Second, people on fixed incomes—government officials, disabled persons, and pensioners who had been well provided for in the past—fell into the ranks of the destitute. The monthly average government wage dropped to between $3 and $5 a month, forcing state employees to take second jobs (UNDP 1999). In short, the middle class of Iraq had all but disappeared even before the United States launched its invasion in 1991 and since then there has been a mass out-migration of skilled and educated professionals.

In contrast to the other Gulf oil states, where there is an inverse relationship between education and employment because of high levels of educational achievement among women, in Iraq the sanctions wrought massive de-professionalization. Highly skilled men with postgraduate degrees sought work as drivers or petty vendors; Iraqi women, many widowed by the war, met their obligations as the family breadwinners by seeking informal employment in the so-called service sector. Prostitution, almost unheard of in the presanctions era, became rampant, with attendant pressures on social norms and patriarchal family structures (UNDP 1999).

Hardest hit, not surprisingly, were children. Iraqi society placed an inordinately high premium on education and the Baathist state had made huge investments, and could boast enormous success, in eradicating illiteracy and in scientific training. With the sanctions, not only did the educational system collapse owing to lack of funding, but a phenomenon

unheard of in the past also emerged as a central feature of cities, where the vast majority of Iraqis live. Child labor and begging replaced school (WHO 1999). Juvenile crime cases doubled between 1991 and 1996 and the rate of convictions among boys rose from 18% in 1990 to 32% in 1994 (UNICEF 1999).

The psychosocial effects of the sanctions and the continuous bombing by allied forces throughout the 1990s were devastating for the population at large. According to one report, there was a 157% rise in mental patients seeking outpatient care between 1990 and 1998 and a 137% rise in hospital admissions for severe mental disorders. More strikingly, and in addition to explicitly psychological admissions, between 30% and 50% of medical or surgical patients admitted to hospitals in the same period were also found to be severely mentally ill, although psychological disturbances were not the reason they sought medical intervention. These figures, drawn from government sources, are supplemented by the finding that citizens seeking private sector psychological care rose by 200% in the 1990s (WHO 1999). Children are typically least able to express or recognize mental illness verbally, yet even reported cases suggest that children were very hard hit by the familial distress and the shortages caused by the sanctions. Mental disorders among children aged 14 and younger rose by 124% between 1990 and 1998. In the single year when economic insecurity and food shortages were highest (1996–97), there was a 15% rise in the number of mental cases admitted to hospitals in the pre-10-year-old age category.

The U.S. occupation of Iraq and the preceding 12 years of sanctions have resulted in the virtually complete destruction of what was once the only Arab country poised for long-term and relatively equal growth. I have already alluded to what the war has done to regional inequality. Suffice it to say here that if there is one people who experienced the ravages of international power struggles, imperialism, and devastation more than the Palestinians, it is the Iraqis. Here, then, the dimensions of global inequality—of resources, power, and the ability to inflict large-scale violence—are vivid and naked.

Conclusion: The Past as Future

In his essay on "The Uncanny," Freud suggests that a variety of strange and bizarre experiences can be understood as the product of a blurring of the boundaries between the past and the present. Freud discusses a wide range of uncanny experiences. Thinking of this article reminded me of one particular example he focuses on: unconscious repetition, the feeling that we have been somewhere before. When we have the sense that something

has happened before, he claims, we are actually revisiting a repressed sentiment or fantasy:

> [I]f psychoanalytic theory is correct in maintaining that every emotional affect, whatever its quality, is transformed by repression into morbid anxiety, then among such cases of anxiety there must be a class in which the anxiety can be shown to come from something repressed which recurs. This class of morbid anxiety would then be no other than what is uncanny . . . [and] *this uncanny is in reality nothing new or foreign, but something familiar and old-established in the mind that has been estranged only by the process of repression*. (Freud 1963: 47; my emphasis)

In the boom-bust cycles of Arab economies, too, the past revisits the present, producing disorientation and fear; the post-oil future looms as a return of the pre-oil past. The future will be the past: the desert sweeps over the shiny buildings . . . all that has been built, collapses, the state of nature returns. The progeny of Nejdi fathers who used to sell their labor in Bahrain spawn great-grandchildren who are forced to do the same. All is temporary. All will eventually be as it was before. Arabs not only look back on the Golden Age; they are also, in a fashion, constantly looking forward to a pre-oil past.

Economists thinking about the region are also having the experience of the uncanny when, in adopting the mantras and dogma of the authoritative institutions of international capitalism, they embrace fantasies whose unreality has long been established.

> *[A]n uncanny effect is often and easily produced by effacing the distinction between imagination and reality, such as when something that we have hitherto regarded as imaginary appears before us in reality, or when a symbol takes over the full functions and significance of the thing it symbolizes, and so on* . . . [. . .] An uncanny experience occurs either when repressed infantile complexes have been revived by some impression, *or when the primitive beliefs we have surmounted seem once more to be confirmed.* (Freud 1963: 50, 55; my emphases)

The notion of the uncanny struck me as particularly relevant when reading the Arab Human Development Reports (UNDP/RBAS 2002, 2003), wherein a group of Arab economists thoroughly indoctrinated in the ideology of the Washington Consensus use Arab "tradition" and a selective vision of the Arab "past" to pronounce on the need for a completely imagined and unattainable future that appears in the uncanny guise of something called "a knowledge society." Just as telemarketers

from India call people with Indian names and proceed to try and sell their products by speaking Hindi, the commodification of identity is rife in current economic studies of the Arab world. There is, therefore, a striking parallelism in the Arab fear of the return of the impoverished pre-oil past and the Arab economists' use of the "glorious" version of that past to promote a fantasy future reflecting the repressed wish for parity with the West. Reading contemporary texts on the Arab economy is thus as vivid an experience of the uncanny as is the reality that Arabs live every day.

The economies of the Arab world are, contrary to the prognoses of the authoritative bodies of economic governance, in a state of long-term crisis. They have, moreover, been in this state for more than two decades. Despite the astonishingly large flows of capital into the region, the region is deeply indebted. Almost all of the debt was accumulated after 1970, and it continued to rise in the 1990s. Yet, repayments of debt have actually declined, suggesting that the debt burden on future generations will be high. Tax capacity is low, so budget deficits can only be made up by external sources. What is left to cut? According to the World Bank, state employment continues to remain high in countries like Egypt, but as I showed above, salaries have declined sharply. Indebtedness can no longer be attributed to social spending, since even food subsidies have been almost completely eliminated.

Economists in charge of the production of authoritative knowledge on the Arab world should focus on two projects. First, they should engage in collective research projects focused on the local experiences of communities in the region. Second, they should be thinking about ways to attenuate the impact of macroeconomic instability and flux on the lives of Arab citizens and expatriate workers. This is a tall order. Yet, the contemporary political climate in the United States expands the imagination: if democracy can cure economic inequality, then anything is possible. To paraphrase Richard Nixon, "we are all economists now."

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Note

1. My own local-level research in sectors that grew rapidly following the economic liberalization in India shows that though opportunities were regularly created for the lowest-status groups, the social reaction to their economic mobility produced highly undesirable, often violent, responses on the part of high-status castes and groups (*Economies and Identities*, forthcoming).

3

Illicit Economies and Reconstruction in Iraq, Palestine, and Algeria

Bradford Dillman

Violence has devastated the economies of Iraq, the Palestinian Territories, and Algeria since 1992. Although Algeria's Islamist insurgency has tapered off in recent years, reconstruction is hampered by continuing civil conflict. National elites face the daunting challenge of reestablishing security, strengthening state institutions, enforcing the rule of law, expanding social services, and providing productive employment for large numbers of youth entering the workforce. This chapter examines the impact that illicit international transactions have on economic recovery efforts. Understanding the importance of actors in illicit transnational networks allows us to better assess the roadblocks in front of different policy options. Illicit international transactions are defined as activities that result in a transfer of goods, services, and money across borders by actors who contravene domestic laws or violate international norms of good governance. These transactions typically involve the misuse of public resources, evasion of economic regulations, and undermining of competition. Some of the most important examples of transnational shadow activities are smuggling, money laundering, illegal capital flight, commission taking on international contracts, monopolization of importing through coercion, sanctions busting, and misappropriation of external rents such as aid and oil revenues. The central thesis of this chapter is that cross-border "shadow" networks imperil reconstruction in conflict-ridden countries.

A brief look at several recent "funny money" activities in the three Arab cases illustrates some of their broad implications for rebuilding. In Iraq, four cabinet members in the former interim government, including Defense Minister Hazim al-Shalaan, apparently approved the physical transfer of $300 million from the Iraqi Central Bank to Lebanon for the purchase of weapons from international arms dealers.[1] The actors who either participated in or "green-lighted" the unorthodox transaction—which may have been part of more than $1 billion in misappropriations in Iraq's Ministry of Defense in 2004 and 2005—allegedly included Iraqi cabinet officials, American financial overseers, a private Iraqi bank, intermediaries in Lebanon, and manufacturers of weapons in Poland, the Czech Republic, Turkey, the Ukraine, and the United States.[2] In the Palestinian Territories there was much ballyhoo at the time of Yasser Arafat's death about the fate of billions of dollars of "hidden cash" he had allegedly skimmed from public coffers and stashed in international assets. An International Monetary Fund audit of Palestinian Authority (PA) finances in 2003 estimated that since 1995 Arafat had diverted $900 million to a variety of commercial investments outside the West Bank and Gaza.[3] In Algeria, the country's largest private bank, Khalifa Bank, collapsed in 2003 and entered into government receivership following a financial scandal. The managers of the bank duped depositors, many of whom were state entities, and embezzled funds estimated at some $1.5 billion that were transferred out of the country.[4]

These cases are emblematic of a wider set of illicit transactions about which several arguments can be made. First, grand corruption is rarely confined to the domestic sphere; proceeds from "swindling" are often parked outside the territorial unit from which they were derived. Carrying out shadow activities typically requires a network of domestic *and* international actors.

Second, although economists often portray the key actors as "private rent seekers" who illegally extract gains from public officials, and policy makers in the post–9/11 world tend to identify culprits as organized criminal mafias and terrorists, the key initiators and participants are often *public* officials. Opinion polls have repeatedly registered the widely held perception in the Middle East and North Africa that governments act like kleptocracies.

Third, analysts often assume that economic and political elites want more transparency and rule of law to dampen opportunities for transnational corruption. However, the record in Iraq, the Palestinian Territories, and Algeria suggests that power holders rarely police themselves or their private allies, especially during periods of civil violence. It is unlikely that leaders, even with international support, have the capacity to do anything

significant in the short term to reduce illegal transactions without risking violent political backlash.

Finally, well-intentioned reconstruction policies sometimes make the illicit problems worse, and illicit actors often hamper policy reform. Policy prescriptions focused on economic liberalization, international aid inflows, foreign investment enhancement, and democratization may unintentionally complicate matters.

Illicit Economies and the Middle East

The rentier state literature, unlike many studies of domestic corruption, focuses on transnational transactions that fundamentally structure political economies and resource distribution. Comparative and statistical analysis of rentier states suggests, among other things, that rents tend to facilitate corruption, impede economic reform, and limit democratization (see Karl 1997; Vandewalle 1998; Ross 2001). Iraq, the Palestinian Territories, and Algeria—all rentier states—show evidence of these effects. If reconstruction efforts center on expansion of the oil sector and increases in international aid, they may actually reinforce some of these negative structural characteristics.

Another body of literature on economic reform that prominently factors illicit transactions into development processes has not been systematically applied to a wide range of Middle East cases. Literature on the politics of economic reform, much of it drawing on postcommunist cases, has traced a number of unintended illicit effects of market-oriented transitions: personalization of public property, privatization scams, stripping of industrial assets, capital flight, money laundering, and the rise of a mafia-oligarch-state nexus. Joel Hellman (1998), for example, argues that economic liberalization in former command economies creates a set of early "winners" who seek to monopolize ill-gotten gains by preventing complete liberalization from occurring. Béatrice Hibou (2004), looking at sub-Saharan Africa, contends that adoption of Washington Consensus policies has led to a thoroughly corrupt "privatization" of the state. My own analysis suggests that North African elites tap international resource inflows during partial economic reform to bolster extra-budgetary funds, consolidate patronage, and re-regulate the economy (see Dillman 2000, 2001, 2002). These writings, which also includes *infitah* studies, caution that economic reform as envisioned by the Washington Consensus is not a panacea; it often creates shadow networks with damaging consequences.

A third body of literature of relevance to the Arab cases looks at economies of violence. The International Peace Academy's Economic

Agendas in Civil Wars program has published a number of cases studies of societies engulfed in war or extreme violence (unfortunately there are no studies of Arab cases). The studies suggest that illicit trade in commodities such as blood diamonds, small arms, and timber lengthens the duration of conflict and creates potential "peace spoilers" (see Ballantine 2004). Rebel financing tends to come from external third parties, whereas government elites in times of war often loot private and public assets. A separate ethnography by Carolyn Nordstrom (2004) uncovers entrenched illicit networks in African conflict zones where foreign military actors, foreign donors, and foreign commercial actors join in the profiteering. Iraq, the Palestinian Territories, and Algeria have suffered prolonged violence with similar processes of smuggling, profiteering, conflict financing, and (shadowy) "differential accumulation."

Multilateral institutions and policy-oriented organizations are also generating studies of illicit activities and ratcheting up funding for programs to combat corruption and create transparency in state finances. The International Monetary Fund and the World Bank have touted good-governance and anticorruption programs. Many of their studies suggest that illicit activities tend to lower growth, reduce social trust, and discourage foreign investment. World Bank President Paul Wolfowitz has led a powerful but controversial effort to condition bank loans on anticorruption progress. The World Bank now compiles Investment Climate Surveys and a "Doing Business" database to measure perceptions of corruption, lack of contract enforcement, and regulatory unpredictability.

The United States and the EU have also promoted anticorruption funding through USAID and the Euro-Mediterranean Partnership's MEDA program. These actors, joined by international NGOs such as Transparency International, tend to focus on reforming Middle East administrative apparatuses, legal systems, and law enforcement capacities. Their policy targets are usually domestic Middle East actors and institutions. The problem, however, is that policy prescriptions that focus solely on the domestic level are unlikely to have a significant dampening effect on shadow economies. Grand corruption that impacts the prospects for reconstruction usually has an important transnational dimension. International organizations increasingly advocate policy interventions that can be targeted at different points in the illegal transnational chain.

The Centrality of State Actors in Shadow Economies

Who are the primary illicit transactors, facilitators, and beneficiaries in the Middle East? Often the answers to this question focus on ordinary citizens,

businessmen, mafias, terrorists, and "meddling" rogue states. Theorists of "rent seeking" tend to define the main instigators of informal transactions as private actors who offer public officials bribes to gain government-granted privileges. Petty illicit activities in some instances can be a survival mechanism for the poor and low-level bureaucrats, especially in societies beset by civil conflict. Supplementing a salary or loss of salary, or getting access to gasoline or permits, drive most people into the extralegal realm. The risk of punishment in Iraq, the Palestinian Territories, and Algeria tends to decrease at the same time that scarcity of goods and services creates windfall profits for those willing to deal in the shadows. In better economic times, petty corruption can grease the wheels of government with positive macroeconomic effects.

We can also gain some insight into who is transacting and facilitating black markets by looking at two proxy indicators of *transnational* illicit activities in the Middle East: capital flight and contract-intensive money. It seems reasonable to assume that mafias and businessmen in devastated economies or countries with civil conflict want to hold a significant proportion of their money (legal or ill-gotten gains) outside the country. Capital flight is a means of transferring or laundering illicit proceeds to banks and other depositories outside one's borders. By many estimates, wealth flight as a percentage of Middle East GDP is higher than for almost any other region in the world. In the 1990s, a commonly accepted figure for the amount of Arab capital invested abroad was $500 billion (Henry and Springborg 2001: 97). A proportion of this flight capital was generated through shadow activities. Volatile exchange rates and significant variations between official and black market foreign currency rates could also reflect capital flight.

Similarly, Henry and Springborg (2001) assess levels of institutional credibility and accountability in the Middle East by measuring the ratio of contract-intensive money in banks to the total money supply. The ratio is lowest in "bunker" regimes such as Iraq and Algeria, where weak property rights, corruption, and violence dissuade people from parking funds in domestic commercial banks. This proxy indicator also seems to correlate with corruption perception surveys and other measures of rule of law. If illicit accumulators of funds are not parking assets in banks, under their beds, or in local real estate, we would expect a significant proportion to be parked outside the country.

Since the start of the second Intifada and the 9/11 attacks, security-oriented policy makers have focused on insurgents and terrorists who engage in money laundering and arms trafficking. They also try to tie these actors to foreign governments. For example, U.S. pressure on Syria and Iran to prevent smuggling of weapons to Iraqi insurgents is part of a more general effort to police importing into Iraq.

Western officials frequently accuse foreigners as key facilitators and beneficiaries of illicit activities, although often without much evidence. U.S. efforts to secure the return of Saddam-era funds deposited in foreign banks are one example. Lebanon, Syria, Jordan, and the Gulf countries have in the past been blamed for being banking havens for corrupt elites throughout the region. Under pressure from the EU and the United States, Gulf Cooperation Council members have gotten more serious about imposing international banking standards, increasing banking oversight, and regulating money transfer agents. Nevertheless, it is likely that some regional actors will continue to use regional banking and trade entrepots for laundering money and financing a wide range of illicit current transactions.

Acknowledging that terrorists, criminals, and businesspeople are a subset of the actors involved in Middle East shadow economies does not necessarily mean they are the most important ones. Participants often hold formal positions in the government or the state apparatus. Paul Salem (2003) argues that in state-socialist holdovers such as Iraq and Algeria, massive corruption and profiteering reached into the highest levels of government, security, military, and party elites, turning the regimes into what the public regarded (or regards) as kleptocracies. Moreover, as James Henry (2003) and Raymond Baker (2005) make clear, there are plenty of Northern "blood bankers" who accommodate kleptocrats and criminals seeking to launder absconded public funds.

In the cases under consideration in this chapter, I argue that, on balance, the key shadow actors are public officials, military and security elites, and their allies in the private sector. This is not to deny the significance of insurgent/terrorist/rebel actors and networks. Hamas, Ansar al-Islam, Saddam loyalists, al-Qaeda, and the GSPC also operate in the shadow economy and affect prospects for reconstruction. Yet, the state-military-business troika—what Algerians often refer to as the "politico-administrative mafia"—has its hands in the public coffers and probably has a much more significant impact on resource redistribution. This troika often has privileged access to international rents and controls large interstate trade. It is often the predominant holder of the means of coercion, and it can put those means of coercion to use for extortion and racketeering as well as for security operations. Military, security, and intelligence services are particularly important members of this troika.

Steven Heydemann (2004) and Reinoud Leenders and John Sfakianakis (2003) argue that we should focus on cross-juridical and cross-institutional domestic networks. A network or transactional approach concentrates on chains of connection between a range of individuals and entities who structure the interests of political and coercive institutions. Within these networks, there are varying degrees of separation between actors who

cooperate for mutual gain. The networks are not simply government patronage systems in which the "state" is the distributor and "social actors" are the recipients, nor are they simply bribery rackets in which businesspeople "pay" for officials' favoritism. Political elites may be part of the networks but exercise little control over them. Actors frequently "straddle" formal juridical categories and associate through some degree of separation with actors in various juridical and institutional categories.

In a similar fashion, Ballantine (2004) advocates a focus on "stakeholders" in conflict economies. The aim is not to distinguish between actors merely on the basis of where they "sit," but rather in terms of their motivation: whether they enter illicit economies for survival, exploit war to amass resources, or steal resources in order to conduct war.

The centrality of state officials in illicit networks can be seen in the Palestinian Territories, Algeria, and Iraq. After the Oslo Accords, Arafat constructed a neopatrimonial regime, much of whose revenue ultimately came from outside the territories. According to Hans-Joachim Rabe (2004), a core economic elite emerged involving Arafat loyalists, security officials, PA professionals, and private businessmen. Similarly, Markus Bouillon (2004) argues that the political economy of peace initially rewarded the "Tunisians" and diaspora entrepreneurs who wove a fabric of corruption based on indirect collaboration with Israelis and foreign aid providers. PA authorities and security services became the key intermediaries between foreign actors and local actors. PA officials established their own private businesses and channeled government purchasing to foreign firms in which they had financial interests. Importing, public procurement, and taxation became important mechanisms to accumulate private capital. The dividing line between legitimate government extraction and illegal personal rent taking was blurred, just as it has been blurred in Iraq and Algeria.

PA authorities in collusion with security services and diaspora conglomerates established import monopolies over cement, gasoline, cigarettes, flour, and just about everything else (Bouillon 2004). Importing became a "zero-sum" game, where one actor's ability to get trucks through the border with Israel denied another actor the opportunity to import (Rabe 2004). Post-Oslo conditions of "privileged movement" helped determine the set of actors who could consistently make connections to the main territorial supplier, Israel. The monopolization of importing damaged Palestinian businesses, at the same time providing extra-budgetary resources for power holders. On the export side, the IMF notes that despite post-2000 closures, large West Bank and Gaza companies with "good connections (especially with the Israelis)" had little trouble getting their goods through checkpoints and into Israeli and foreign markets (IMF 2003c: 17).

Palestinian security services also diverted money from the Customs Office that was supposed to go to the Treasury. The IMF describes the process as "the diversion of excise revenue . . . to off-budget activities outside the control of the Ministry of Finance, which contributed to liquidity problems and a buildup of expenditure arrears" (63).

Sara Roy (2002) and Bouillon (2004) argue that the devastation of the Palestinian economy can be traced to the onset of Oslo, and the second Intifada accelerated negative trends. Roy attributes most of the decline to Israeli closure policies, territorial fragmentation, and destruction of infrastructure, but she also cites PA mismanagement and corruption. Beginning in 2000, Israel's refusal to transfer VAT and customs duties to the PA threatened privileged networks. EU donors and the Arab League ratcheted up funds and diverted project-oriented aid to emergency budgetary support. Corruption has a large part to play in explaining why a "peace process" does not necessarily rebuild a devastated economy. Although Israel's separation wall may, among other things, prevent arms smuggling into the West Bank and constrict the points through which Palestinians can access Israeli goods that end up in the hands of PA monopolies and illicit trade networks, the wall itself makes possible the state-sanctioned, illegal expropriation of Palestinian land inside the barrier. This Israeli process of primitive accumulation hampers Palestinian state-building. And because Palestinians cannot import and export directly with other countries, they are completely dependent on Israeli middlemen who have the ability to extract legal and illegal rents from the trade transactions.

In Algeria, public officials and military elites have also been implicated in a series of scandals and shadow activities. In 1989, former prime minister Abdelhamid Brahimi accused officials of having appropriated $26 billion in bribes and commissions from foreign companies with contracts in Algeria in the 1980s. (Brahimi later became an Islamist oppositionist in exile. Several dozen members of his extended family were reported to have been killed during one of Algeria's "mysterious" massacres in the 1990s.) In another scandal in 1990, the National Chamber of Commerce, a public institution, was accused of illegally granting scarce foreign exchange to private sector "insiders."

The outbreak of civil violence following the 1992 coup created an environment in which clandestine transactions flourished. Luis Martinez (2000) traces the creation of new fortunes by both military elites and Islamist networks. Isabelle Werenfels (2004a: 178) observes,

> The involvement of current and retired military officials in the private and the informal sectors of the economy had been increasing since the 1980s and

> was indirectly encouraged by an early retirement regulation for civil servants. Not surprisingly, many members of the core elite, for example Belkheir and Mohamed Lamari, placed family members in privileged positions in the private sector and were reputed to have made fortunes.

Algeria's military elites and private allies took advantage of trade "liberalization" to stake a claim to the lucrative import trade (Dillman 2000). Military elites and other public officials are alleged to have protected an Orani drug cartel moving Moroccan marijuana to the European market since the 1990s.[5] As with so many rumors in Algeria, it is difficult to find hard evidence to substantiate claims of black market networks.

Djillali Hadjadj (1999) describes a set of state officials, security officers, and private mafias who monopolized the importing of foodstuffs and pharmaceuticals. Generals and security officers set up a host of lucrative private security firms offering protective services to public and private enterprises. He also notes that the army, gendarmerie, and military police oversaw imports of arms and security equipment estimated to cost about $3 billion per year during the height of the violence. The amount of this public procurement—much of it conducted without solicitation of competitive bids—is still unknown, and Hadjadj guesses that this type of procurement gave rise to all sorts of misappropriation of public funds. Similarly, opaque public contracts with international firms for the supply of airplanes and engineering services presumably involved a lot of under-the-table money.

In Iraq it is probably too early to know whether a durable state/security/business troika will emerge in a unified state. In other countries experiencing conflict, illicit activities flourish where military and security budgets are nontransparent and military actors procure supplies from abroad. Security forces and their allies often try to "expropriate" monopolies over cross-border exchange, or at least get into the "game." During the first year of the U.S. occupation of Iraq, the Coalition Provisional Authority (CPA) managed the Iraqi budget by drawing on oil revenues and repatriated assets in the Development Fund for Iraq (DFI). The CPA transferred control of this fund in June 2004 to the Iraqi interim government, but the assets were subject to oversight by the International Advisory and Monitoring Board (IAMB) until the end of 2006. The newly constituted government in 2005 gained control over the fund, which is replenished with revenues from oil exports. The IAMB's audit of the DFI in the first half of 2004 found serious deficiencies in the management of more than $4 billion of Iraqi finances (OSI 2004: 2). The CPA usually disbursed funds without seeking competitive bids from contractors. In many cases, the CPA did not monitor the use of funds by Iraqi ministries. The Kurdish

Regional Government denied the IAMB access to all of its accounting records.

Similarly, in its October 2004 report to Congress, the Coalition Provisional Authority Inspector General (CPA-IG) found many irregularities in the use of DFI funds by the CPA and Iraqi ministries (OSI 2004: 3–4). Among other things, the CPA-IG could find no data on how the Iraqi Ministry of Finance utilized a $1.4 billion disbursement from the fund just days before the transfer of sovereignty. It noted the lack of transparency in the interim government's use of Iraqi finances. In its January 2005 report, the inspector general found that before the turnover of sovereignty, the CPA gave hundreds of millions of dollars to Iraqi ministries that had not presented plans for how the money would be used, opening the door to corruption and fraud.[6]

Iraqi ministries' lack of skilled workers, equipment, and accounting oversight has opened the door for massive personalization of public resources. A 2006 external audit of the DFI for the IAMB found serious problems of governance over the DFI—the main repository of Iraq's oil revenues until the end of 2006—and poor financial and auditing systems in government ministries that spend monies from the fund (IAMB 2006). Likewise, in 2006 the head of the Iraq Inspectors General Council estimated government losses from corruption at $4 billion annually. Iraq's Commissioner of Public Integrity also reported in 2006 that his office was tracking fraud and criminal activities estimated to amount to $5 billion (US/SIGIR 2006: 5).

Oil Rents and Corruption

Iraq and Algeria are rentier states that derive a majority of government revenues from oil and gas sales. They will remain rentier states for a long time. In fact, reconstruction will necessarily require investment and expansion in the hydrocarbons sector, making both countries even more dependent on international rents. Efforts to establish financial transparency and reduce corruption will have difficulty counteracting the structural effects of natural resource dependency. The line between use of these hydrocarbon resources for "legal" patronage and misuse for personal accumulation is often blurry.

A wide body of literature contends that access to natural resource rents and strategic rents tends to make public expenditures nontransparent. Moore (2004: 309) notes that "external banking sanctuary" facilitates nontransparency in natural resource–based regimes that have the "capacity to stash illicit capital in developed countries and enjoy it later." Moreover,

according to Karl and Gary (2003: 20), international financial institutions "support lending to deeply indebted oil-exporters, along with private commercial banks, even when it is clear that debt only supports unproductive activities or papers over rent-seeking behaviors."

Transparency International's 2004 Corruption Perceptions Index ranks Algeria, the Palestinian Territories, and Iraq as having rampant corruption. According to TI Chairman Peter Eigen, many of the worst scorers in 2004 were oil-rich countries where "public contracting in the oil sector is plagued by revenues vanishing into the pockets of western oil executives, middlemen and local officials." He argues that, "without strict anti-bribery measures, the reconstruction of Iraq will be wrecked by a wasteful diversion of resources to corrupt elites" (TI 2004). Saddam Hussein's end run around the UN Oil for Food program is one of the most extraordinary examples of the difficulty of accounting for oil revenue use. Surcharges, kickbacks, and oil-smuggling involving a host of countries, oil companies, and purchasers allowed Saddam to garner over $20 billion in illicit revenues from 1992 to 2003 despite one of the most elaborate sanctions regimes ever devised by the international community.

Karl and Gary (2003: 19) argue that "only those who control political power can grant the opportunity to make money from oil, and only those who receive this opportunity can provide the revenues to keep regimes in power." Control over hydrocarbons generally means control over the budget, foreign exchange, and the ability to import. Prolonged conflict in Algeria and Iraq decreased industrial production in the public sector and increased an already-high reliance on imports of foodstuffs, machinery, and industrial inputs. It is state officials who control the terms of access to foreign exchange for the public sector and for many private businesses, and therefore the state often determines who can profit from importing. Insiders who get rationed foreign exchange at official exchange rates get a subsidy: low-cost credit. The Algerian government also has a history of rationing licenses for trade franchises and importers.

The international oil boom since 2003 has enhanced growth rates in Algeria but probably has not laid the foundation for structural change. Sustained high oil prices increased the country's foreign exchange reserves to $60 billion in 2006. President Abdelaziz Bouteflika has launched a massive, multi-year, state spending program. "Black gold," however, makes possible huge kickbacks and commissions when states issue international contracts for supply of military equipment, turnkey projects, and engineering services. During Vladimir Putin's March 2006 visit to Algiers, Algeria apparently signed a massive deal to buy $7.5 billion in Russian military equipment in exchange for a write-off of Algeria's $4.7 billion debt to Russia. A frenzy of international oil companies seeking oil drilling

concessions, joint ventures, and oil services contracts in Algeria has opened the door to extraordinary graft.

Leenders and Sfakianakis (2003) provide indirect evidence of the oil-creates-graft thesis by pointing out that corruption in the Middle East and North Africa actually declined in 2001–02 because an oil-price slump and global recession, which reduced investment in the emerging markets, curtailed opportunities for "commission taking" by state elites. Paul Stevens (2004) contends that the recent rises in oil and gas prices are dampening the momentum for economic reform. Absent profound political change and legislative oversight of the executive branch, ruling elites will continue to line their pockets with oil windfalls, reinforcing public perceptions that they are kleptocrats.

In its 2005 Article IV Consultation Report on Algeria, the IMF (2006a) noted that the turnaround in oil prices after 2002 contributed to higher growth and public investment, and lower poverty, unemployment, and external debt. At the same time, however, structural reforms ground to a halt, banking reform stalled, and the quality of government statistics actually deteriorated. Even though the treasury between 1992 and 2001 repeatedly recapitalized public banks which had huge lines of credit to unprofitable state enterprises, the IMF found that in 2004, 40% of Algeria's public bank loans were nonperforming (2006a: 10). The fund worried that Algeria's oil and gas windfall would be wasted on poor-quality spending.

Iraq's oil industry has been plagued since 2003 with production and distribution chaos stemming from corruption and security problems. Oil is still the "only game in town" when it comes to grand corruption. (However, a number of newspaper reports in 2004 indicated that since the U.S. invasion, criminal networks had been dismantling Iraqi infrastructure and factories and smuggling the stripped machinery, parts, and scrap metal into Jordan and other neighboring countries.) Policing of illicit oil *exports* had stalled by 2005, even though these oil exports were a direct drain on public resources. A 2004 audit of the CPA by the IAMB concluded that the CPA could not estimate the amount of illegal oil smuggling when sovereignty was handed over to the Iraqi interim government, partly because there was a lack of metering equipment in the oil industry (OSI 2004: 1–2). The Oil Ministry's Inspector General (Iraq OMIG 2006) and the IMF (2006b) reported widespread export of illicit crude and refined oil products, stemming in part from the continued lack of metering equipment. Criminal rackets continue to illegally tap crude oil pipelines and ship the diverted oil out of the country.

Even more important has been massive corruption in oil and oil products importing. Because of lagging domestic production, Iraq by 2005 was importing nearly $4 billion in oil products, most of the price of which was

heavily subsidized. The Oil Ministry's Inspector General estimated in 2006 that smugglers were reselling the subsidized oil in the local black market or reexporting it, garnering as much as $800 million (Iraq OMIG 2006). The Inspector General also reported widescale theft of imported products and diversion of subsidized, rationed oil and gasoline from its intended recipients. The problem was so bad by 2006 that the IMF was urgently pushing the Iraqi government to privatize gas imports and raise prices dramatically to eliminate the high differentials between official and black market prices (2006b).

Will Elites Promote Transparency and Good Governance?

Reducing transnational criminality in countries seeking to recover from civil conflict depends on the extent to which political elites are willing to confront the shadows. Extra-legal actors seek to avoid the public spotlight, and states run by "information-shy" elites seek to cover their tracks. There are any number of actors who "talk the good-governance talk" in consultation with international institutions and foreign governments. Many may do so based on a conviction that corruption devastates the economy or based on a cost-benefit analysis that better governance will enhance state capacity.

The easiest policy in many countries is to create "pockets of efficiency" in the administration, which amounts to targeting particular officials or bodies for cleanup. Targeted campaigns against weak links in the shadows can be successful and not too costly politically. The hope is often that a demonstration effect will occur, persuading illicit actors to be more circumspect, legalize their activities, or withdraw completely from the shadows. In this regard, public scandals can have a catalytic effect, drawing civic groups, legislatures, and authorities into a temporary alliance to root out particular networks.

However, Leenders and Sfakianakis (2003: 203, 208) argue that most anticorruption discourse is rarely translated into sincere policies, and public corruption cases are frequently an effort by governments to "settle political scores." In countries with pervasive violence or threats to security, taking on powerful networks is politically and personally risky. Michael Johnston points out that the strong civil societies that fight against corruption in today's developed countries took generations to build. Therefore,

> [t]oo great an emphasis on civil society in many of today's high-corruption societies, by contrast, may amount to little more than expecting the weak to

> restrain the strong, and to do so in the name of reform as a public good, rather than as a way to protect people's interests and well-being. (2005: 427)

Those who would enforce transparency may themselves engage in shady transactions or be part of a network that is involved in domestic or crossborder corruption. Werenfels (2004a) recounts an interview with an Algerian private sector consultant who is conversant in World Bank anticorruption lingo and is a participant in fora publicizing governance problems. The same person also has close ties with *décideurs* and uses those connections to "mediate" between Algerian elites and international organizations. In this case, the actor apparently perceives no contradiction between his public persona and his private economic activities. It should not be surprising that public officials who straddle the public and private realms will not make a crusade of the fight against illicit activities but will choose their targets.

Whether authorities decide to earnestly promote transparency depends on calculations of political and economic rationality. In some cases attacking political competitors in illicit networks may enhance one's political power and also benefit the economy as a whole. Alternatively, it may be politically rational to attack illicit networks in order to "appropriate" their activities, but society will reap no gains. In many cases it is politically suicidal to pressure shadow actors who control government resources or means of coercion. Of course, political and economic self-interest may compel some elites to participate fully in shadow economies. In studies of sub-Saharan African cases, William Reno (2004), Béatrice Hibou (2004), and Carolyn Nordstrom (2004) argue that leaders who deliberately undermine their national economy and state institutions in pursuit of personal enrichment are often still able to sustain a system of governance.

Establishing budgetary transparency is a necessary but insufficient means to attack public corruption. Extra-budgetary funds are a key source of personal gain and patronage. Military and security actors, for example, often morph into entrepreneurs or godfathers for importers, security services contractors, and factory owners. Their activities, which are often technically illegal and have an international dimension, may depend only tangentially on the state budget. Actors are loath to give up these activities when violence subsides. Legalization of these activities during reconstruction is one means to create a more vibrant private sector.

Public pressure, legislative activism, and international assistance have for the most part failed to insure significant progress on the transparency issue, good governance, and anticorruption. The PA, Iraq, and Algeria are still foot-draggers. A Palestinian ministerial reform committee initiated legal changes in 2003 to create a quasi-autonomous financial monitoring

office and to require officials to submit financial disclosure statements. A Palestinian Investment Fund was supposed to manage the PA's commercial assets, many of which are invested in other countries. The Finance Ministry was consolidating budget accounting and expenditures. However, the IMF was a bit too congratulatory in its claim that "reforms have placed the Palestinian Authority to a level of fiscal responsibility, control, and transparency which rivals the most fiscally advanced countries in the region" (2003c: 9). El-Aryan (2004) noted that pensions and insurance funds have not been included in the Palestinian budget, and security agencies have resisted distributing payrolls through the banking system.

Although one is hard pressed to identify any senior PA official who has been convicted for corruption, there is growing public pressure to attack extra-legal behavior, especially as economic depravation gets worse. In the lead-up to elections in January 2006, Hamas promised to tackle pervasive corruption. In a public survey of Palestinians several weeks after the elections, the Jerusalem Media and Communication Center (2006) found that 43% of respondents said they had voted for Hamas because they hoped that it would end corruption. In February 2006 the Palestinian attorney general announced that his office had uncovered more than $700 million worth of theft and misappropriation of funds by officials in the PA. Given concerted international pressure on Hamas, it is unlikely that it will be able to carry out any significant anticorruption programs.

Iraq will make little progress in combating any illicit activities until indigenous political authority and military control are reestablished. The United States has called some attention to illicit activities, but mainly those that involve American aid. The Office of the Special Inspector General for Iraq Reconstruction (SIGIR) has made regular reports to Congress about funds intended for Iraq reconstruction programs. Most of the $19 billion in funds committed to the Iraq Relief and Reconstruction Fund had been spent by late 2006, and there were numerous causes of fraud, abuse, and lax oversight.

Algeria's President Bouteflika has repeatedly emphasized the importance of establishing the rule of law and rooting out corruption. In 2002 he issued a decree requiring the government to publish provisional awards of contracts so that unsuccessful bidders could appeal the government's decisions. The public outrage over Algeria's Khalifa Bank scandal pushed the government to question hundreds of current and former government officials, charge a former governor of the Central Bank, and issue an international arrest warrant for the president of Khalifa Group. The National Assembly in 2005 ratified an international money laundering and antiterrorist financing treaty. However, since early 2003 Bouteflika has conducted a campaign of intimidation and imprisonment against journalists and publishers,

particularly those who have reported on corruption, embezzlement, and mismanagement by public officials.

Unintended Consequences of Well-Intentioned Reconstruction Policies

Many of the policy proposals to help devastated economies are based on a neoliberal worldview. These solutions stress the virtuous, mutually reinforcing effects of economic liberalization, democratization, security building, and North-to-South financial transfers. In a recent article in *Foreign Affairs*, Stuart Eizenstat, John Porter, and Jeremy Weinstein (2005) argue that the United States should aid, develop, and stabilize weak or failed states. This is to be accomplished in weak states by enhancing their capacity to protect borders, strengthening their security forces, strengthening good governance, and promoting an expansion of world trade. Similarly, the EU since 1995 has touted a Euro-Mediterranean Partnership in the southern Mediterranean designed to bolster development through free trade and generous aid for structural adjustment and administrative reform.

Pollyannaish policy makers and liberal cheerleaders greatly underestimate the extent to which illicit political economies can undermine these reconstruction polices. At the same time, the actual success of some reconstruction programs can unintentionally expand opportunities for illicit transactions. Moisés Naím (2005) has argued convincingly that globalization itself facilitates the rise of global illicit trade networks. The spread of a free-market ethos blurs divisions between licit and illicit activities, and it makes effective control of borders a chimera. To expect states, particularly weak states, to slowly but surely diminish illicit markets by expanding political freedom, better securing borders, and institutionalizing markets is to ignore fundamental processes occurring since the end of the cold war.

Economic liberalization—absent the establishment of powerful legislative and regulatory institutions—can easily facilitate large-scale personalization of public property. Heydemann (2004: 6) observes that economic reform in the Middle East "reorganizes opportunities for rent seeking" but does not necessarily eliminate rent seeking and disproportionate gains by members of preexisting "networks of privilege." Economic transition that expands the realm of economic activities to a wider range of actors requires both weakening some regulations and re-regulating some economic activities. Ballantine (2004) finds that donors who promote rapid economic liberalization in postconflict societies can produce perverse effects that encourage criminality. To the extent that liberalization expands access to international actors—multinational corporations, foreign contractors,

international banks, aid agencies, and Northern donors—it also expands opportunities for illicit exchange of resources. In addition, privatization often degenerates into personalization of public property. Hibou (2004) notes that in sub-Saharan and Northern Africa privatization still allows public officials to indirectly govern through the use of private intermediaries. It allows for new negotiations among public and private actors, blurring public/private and licit/illicit distinctions.

In postinvasion Iraq there emerged a new constellation of foreign contractors, foreign buyers of oil, foreign trading partners, and Iraqi "intermediaries." Paul Bremer's precipitous attempt to liberalize the economy may have caused more harm than good. Expansion of the legal market has been concomitant with expansion of the gray market. In post-Oslo Palestine there was a new constellation of Palestinian, Israeli, and Jordanian trade partners, foreign contractors, and aid agencies. Public officials routinely "moonlight" in private business. Some private investors such as the head of the Palestine International Bank found their businesses targets of public shakedowns, unfair judicial proceedings, and outright seizure (Abu Issa 2004).

Postcoup structural adjustment in Algeria has encouraged new oil investments, joint ventures, and import privatization. Under the guise of "financial restructuring," the government in the 1990s spent billions of dollars to recapitalize state banks and "clean up" ailing state enterprises in preparation for their privatization. Most of the money was misappropriated or wasted. Only a small portion of the largest public enterprises have been privatized in the last decade. Full or partial sales of state-owned enterprises ground to a halt in 2003. Poorly managed public banks—whose only purpose seems to be to fund current operations of devastated public enterprises—continue to dominate the financial system, holding 90% of long-term loans and more than 80% of banking deposits. Public banks are not audited by reputable foreign companies. In a recent report, the IMF assessed that within Algerian state banks, "[o]bservance of existing standards is not effectively enforced and a framework of sanctions and penalties is missing" (IMF 2004a: 17). The two largest private banks in the country went bankrupt in 2003 following financial scandals, and their remaining assets are under government control. Prime Minister Ahmed Ouyahia's decision in August 2004 to require all public funds to be held in public banks probably spells the end of Algeria's experiment with private banking. The experiences of all three economies with civil conflict or on the cusp of recovery suggest that conventional economic reform may not be a viable solution.

Is international aid a panacea, capable of jump-starting economic recovery and decreasing the need for shadow economies? To answer this

question, we need to look at cross-border networks, where distinguishing between the motives of actors becomes an important issue with ramifications for reconstruction. Non-national actors and aid institutions are not necessarily willing accomplices; their presence in illicit networks may simply be functional to the achievement of the ends of some of the network's members. In other words, the "complicity" of international actors is not necessarily one of intent; it may occur by default. International financial institutions and aid donors who facilitate financial flows to Iraq, Algeria, and the Palestinian Authority create opportunities for funds diversion, but they can be unwilling or unwitting participants. Even if they know that funds are misused and placed in secret accounts, the alternative of cutting off flows may be worse politically. It remains to be seen whether the European Union and the United States will achieve any useful outcome from their cutoff of aid to the PA after Hamas' electoral victory in early 2006. Whether out of strategic self-interest or some notion of respect for the principle of sovereignty, the United States, the EU, and international organizations generally do not "take to task" friendly kleptocrats—they tend to target pariahs and rogue states. When domestic actors know this, or when they know that foreign actors are not willing to unseat them or push the reform agenda too far, they are in a better position to instrumentalize foreign actors to support their extra-legal activities.

Ballantine (2004) observes that donor countries and international financial institutions that provide "state-focused" development aid during conflict may actually increase opportunities for illicit activities. Similarly, Leenders and Sfakianakis (2003) contend that donor conditionality has had very little effect on corruption in the Middle East and North Africa (MENA). World Bank programs to clean up privatization and USAID judiciary-strengthening programs have had limited success. The EU's MEDA funds are mostly funneled through the hands of authorities who determine which groups in society can join the gravy train. The EU itself recognizes that auditing of funds is inadequate. Part of the problem is that aid money is fungible. It indirectly allows governments to personalize other state resources.

In Palestine it seems clear that massive foreign aid helped institutionalize a rentier system and provides greater opportunities for top-down patronage. Donors seem to believe that their rigorous monitoring before 2006 prevented misuse of funds. In his assessment of aid effectiveness during the Oslo process, Lasensky (2004: 231) finds, "donor insistence on transparency and accountability had a positive, but extremely limited effect on PA administrative practices and good governance." Like the PA, Iraq has become an international mendicant. The Center for Strategic and International Studies estimates that some 15% of U.S. funds spent in Iraq

thus far have been lost to corruption, fraud, and mismanagement (CSIS 2004: 1).

Increased foreign direct investment (FDI) may not be a savior either. A significant proportion of MENA FDI in non-oil sectors is thought to come from nationals *reinvesting* in the countries in which they made their fortunes. This recycling will not necessarily enhance transparency or the rule of law. In Iraq and Algeria, the hydrocarbons sector will remain the only big attractor of FDI. We should not expect existing rentier states to become more transparent when investments enhance their main source of rent. Foreign investors may be just as likely to pay bribes and commissions to state officials. International NGOs suggest that one way to increase transparency is for international oil companies to adopt the practice of "Publish What You Pay." Similarly, the IMF and World Bank have been touting an Extractive Industries Transparency Initiative designed to "open the books" on oil industry income and the fiscal management of these revenues. Algeria has resisted this idea in its consultations with the IMF. And as late as summer 2006 the Iraqi government was resisting IMF and U.S. pressure to establish an independent audit oversight committee for the oil-revenue controlling body that would succeed the DFI (IMF 2006b).

Better security policies will not in and of themselves weaken illicit economies. Ironically, costly efforts in Iraq, the Palestinian Territories, and Algeria to bolster the size and scope of military and police forces may in the very process expand the size and scope of these same forces' extralegal "moonlighting." If rebuilding a devastated economy means reestablishing the government's monopoly on the legitimate use of force, and assuming that the use or threat of force is an important tool in many illicit activities, the rebuilt state apparatus—especially if unaccountable to the electorate—may increase corruption.

Ironically, peace can sometimes be much better for criminals than conflict. To the extent that civil strife reduces overall legal economic activity, government revenue, or aid inflows, it also cuts into the sales of illicit actors. If the World Bank's predictions for the Palestinian Territories in 2006 (and after) are correct—a 40% drop in personal income and two-thirds of the population falling into poverty—illegal suppliers and rent seekers are going to suffer as much as legal businesses (see World Bank 2006). Similarly, an ongoing peace process can facilitate crime more than the breakdown of peace negotiations. A revealing example is motor vehicle theft. In the 1990s auto theft in Israel was estimated to amount to $1 billion. According to Sergio Herzog (2002), the Oslo process helped spur a thriving, professionalized trade in stolen Israeli vehicles into PA-controlled regions. Palestinian "chop shops" dismantled the vehicles and reexported car parts to Israel. In this case, peace was good for cross-border criminals

and their protectors. Auto theft and smuggling have decreased significantly in the face of Israeli border closures and curfews since 2000 and a 1999 Israeli administrative decision to ban the purchase of used car parts from the Palestinian Territories (Herzog 2002).

Conclusions

This chapter has argued that cross-border illicit activities and the interests of those who operate in the shadows will hinder reconstruction. Corruption is both a cause and a consequence of economic devastation. If illicit state-private networks are one of the biggest problems, it is questionable whether international reconstruction policies predicated on cooperation with and strengthening of public officials who are already complicit in national predation will quickly transform economies.

Naím (2005: 252) argues that fighting shadow economies requires states and societies to shift from costly, supply-reduction policies to harm-reduction strategies that include the possibility of "deregulation, decriminalization, and legalization." Successful rebuilding may in some instances require that the state "legalize" past illicit gains of ruling elites and former combatants. That could mean, regrettably, that many criminals and illicit predators will never face justice. It may mean allowing some trade networks created through extortion, violence, and theft to become legitimized. Algeria's recent "amnesty and amnesia" route to reconciliation is essentially an application of these principles, and the results have probably benefited society as a whole.

Profound political change—rather than counterinsurgency—may be one of the most important preconditions for national reconstruction. Leenders and Sfakianakis (2003) contend that real structural change to address grand corruption will not occur without dramatic political reform. Salem (2003) states, "until democratization has reached the highest level of state rule, large-scale corruption will remain a structural fact of public life in the Arab world." However, much as we might like to see democratic regimes based on inclusionary politics, free and fair elections, and powerful legislatures, political change may look decidedly less pluralistic.

Hellman (1998), Ballantine (2004), Dillman (2002), and Heydemann (2004) emphasize that allowing a strong role for the previously disenfranchised can temper "unfair winners" during transition. This may mean weakening some of the political power of existing elites, allowing more actors to get a piece of the economic pie, or consolidating sovereignty. In the short term, this transition can be violent because it is a process of determining who can actually enforce their claim to rule and tax in a given

territory. In Iraq, "enfranchisement" seems to be heading in the direction of three autonomous political units based on religious-linguistic identity. Ironically, the regionalization of illicit actors could actually strengthen would-be state builders. In Iraq and the Palestinian Territories, the eruption of Islamist parties into positions of political power could foster anticorruption programs and strengthen rule of law (assuming some modicum of international support). Algeria's general amnesty may be a small step toward political inclusiveness that will allow civilian leadership to weaken the military's role in illegal economic activities. In all these cases, some kind of political accommodation with powerful neighbors will also be necessary to reduce the structural conditions that foster cross-border illicit transactions. Reconstruction, like the fight against shadow economies, is not about establishing national justice; it is better understood as a process of harm reduction that sometimes arises from political necessity.

Notes

1. Dexter Filkins, "Mystery in Iraq as $300 Million Is Taken Abroad," *New York Times*, January 22, 2005.
2. Patrick Cockburn, "Britain 'Trying to Stall $1.3bn Theft Inquiry that Could Hurt Allawi's Election Chances,' " *The Independent*, December 12, 2005.
3. Steven Erlanger, "Arafat Mystery: The Hidden Cash," *New York Times*, November 11, 2004.
4. See Bruce Crumley, "Crash and Burn," *Time Europe*, September 22, 2003.
5. Salima Tlemçani, "Révélations sur le cartel d'Oran," *El Watan*, October 18, 2006.
6. Eric Eckholm, "Occupation Authority Did Not Properly Monitor Spending of Iraqi Money, U.S. Audit Says," *New York Times*, January 31, 2005, Late Edition Final, p. A15.

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4

Complex Consequences

Hydrocarbon Production as a Route to Economic Health

Mary Ann Tétreault

When President Richard Nixon realized that he would not be able to keep U.S. forces engaged actively in America's long war in Southeast Asia, he prodded international oil companies (IOCs) to explore for oil in South Vietnam. His goal was to secure for South Vietnam an income stream large enough to enable the government to continue the war on its own if Congress were to cut it off financially (Wesseling 2000). The notion that oil production is a great way to pay for a war persists today. It underpinned assumptions of strategists planning for the 2003 U.S.-U.K. invasion of Iraq. Conventional neocon wisdom assumed that Iraqi oil would pay at least part of the costs of war and that it would also support U.S.-based contractors engaged in reconstruction.[1] U.S. aims to expand Iraqi oil production in a tight global market constitute another impetus to the invasion of Iraq that inaugurated this Third Gulf War (Freeman and Kagarlitsky 2004; Tétreault 2004). Indeed, U.S. desires to guarantee access on favorable terms to Persian Gulf oil have shaped U.S. foreign policy for almost 30 years, the lifetime of the so-called Carter Doctrine (Smith 1992; Nitzan and Bichler 2002; Hollis 2004; Mann 2004).

Indigenous oil can fuel a domestic economy and is even more valuable as a source of foreign exchange and a magnet for foreign investment. Yet, to oil-producing developing countries, a curse often comes with these blessings (Amuzegar 1982). For more than one hundred years, even a suspicion that a developing country might have large oil reserves has

attracted major power intervention, directly and through oil company intermediaries (e.g., Sampson 1975; Tolf 1976; Stoff 1980; Anderson 1981). The vast sums to be made in the oil business tempt governments to engage in corruption and militarization and, paradoxically, to accumulate foreign debt (Pearce 1983; Tétreault 1985; Nitzan and Bichler 2002). Dependence on oil as the main source of national income is said to distort national economies through such pathologies as the Dutch Disease,[2] and to interfere with broadly based development strategies (Luke 1985). Although hydrocarbon reserves can also be translated into economic growth and political stability, benign outcomes require goodwill and foresight on the part of political leaders, and appropriate state capacity to ensure that the host nation and its population receive the benefits from oil investment.

The curse of oil is often linked to a colonial past. One example is the unequal partnership between Iran and the Anglo-Iranian Oil Company,[3] whose bitter fruit continues to poison Iranian politics today (Sampson 1975; Farmanfarmaian and Farmanfarmaian 1997). Oil's social and economic effects differ from the impact of other forms of colonial exploitation, such as the shattering disruption inflicted on all but the most local life patterns by the shift from subsistence agriculture to cash crops (compare Munif 1989 with Polanyi 1944). Oil production is geographically localized and its technology and capital intensity minimize its social impact. Historically, the relative ease with which foreigners could control oil exploitation in their own interests encouraged them to transform local rulers into clients rather than taking over their territories and ruling directly (e.g., Anderson 1981). Even so, oil money changed the balance of power between state and society in oil-exporting countries. In the beginning at least, it gave local rulers tools to suppress popular institutions, thwart traditional checks on their authority, and distort political development, tending on the whole to increase the power of rulers and decrease the scope for legitimate political participation (Crystal 1990; Gasiorowski 1991; Tétreault 2000; Ross 2001). But for some, as social groups grew in strength and capacity, oil provided resources enabling states and social groups to negotiate political pacts and move toward more democratic rule (Karl 1987).

In this chapter I argue that projected fiscal benefits should be balanced against problems that come from a narrow focus on oil industry development. Indeed, I argue that exploiting oil and gas reserves can be a route to economic devastation. Devastation is an extreme, though not uncommon, result of the structural dependency, criminal governments, great-power intervention, and unregulated globalization that often accompany oil exploitation (Luke 1985; Bull-Berg 1987; Reno 1998). Even in countries

that have benefited greatly from oil exploitation, there is plenty of evidence to support my contention that reliance on oil as the bedrock of economic development is, at best, a problematic strategy.

A Perverse Industry

Vast oil wealth induces a rentier mentality that grows directly out of the structure of the industry (Beblawi 1990; Luciani 1990). Like drugs, gems, and weapons, oil is a highly lucrative tradeable good, and the private and mixed-ownership firms responsible for its historical development proved to be successful rent seekers from the start (Penrose 1968; Sampson 1975; Yergin 1991). Rent seeking is virtually guaranteed by the capital intensity of the oil and gas industries, which used to be classed as "natural monopolies" because of their cost structure (Frankel 1946). Natural monopolies require large investments in capacity but spend relatively little on labor. Although the average cost of producing additional increments of product falls as capacity expands, the marginal cost falls even faster, to minuscule proportions. For oil and gas, the cost of incremental production is close to zero. Consequently, individual producers with excess capacity may be tempted to produce as much as they can, but the consequent oversupply depresses prices and profits for all.

Periodic price collapses drive out producers with high average costs. Some survivors might help this along by flooding markets to drive out weaker competitors. Afterward they may acquire bankrupt firms at distress prices, thereby increasing their future market power. The decrease in the number of competitors on the supply side, coupled with higher demand stimulated by low prices during the previous phase, encourages lower production without decreasing incomes and profits. Over time, extravagant profits invite new producers to try their luck, inaugurating another cycle of capacity building, production expansion, overcapacity, and a new price collapse. This drives the next round of consolidation and the cycle starts over (Morse 1986; Nitzan and Bichler 2002).

Regulators tried to modify natural monopolies so that prices, profits, and production would approximate their values under market conditions but not vary so greatly. Even omitting serious issues such as depletion, environmental damage, and social concerns from urban sprawl to political corruption, deciding how to regulate is difficult. Hydrocarbon producers vary greatly. They have different costs and locations with respect to markets. The quality of crude oil varies from field to field. Consequently, even a perfectly uniform global regime would not be "fair" because some producers would "naturally" benefit more than others. Even if it were fair, producers, especially small ones (whether they are states or firms), are

likely to "cheat" on their quotas, offer discounts and subsidies to expand sales, and behave as free riders who enjoy the benefits of price supports but leave it to others to pay the costs (Prindle 1981; Tétreault 1985; Moran 1987). Petroleum regimes are further flawed because so many legitimate interests have no say in making the rules. Importing countries vulnerable to the cost and balance-of-payments consequences of high prices, populations of exporting countries whose corrupt leaders siphon off the lion's share of oil revenues, and end users of products such as gasoline and heating oil who may have purchased cars and houses on the assumption that fuel prices would be stable are not consulted. Neither are those who bear the costs of externalities such as smog, oil spills, ground water contamination, and global climate change.

Gas markets proved to be easier to regulate historically because gas distribution pipelines are more costly and cross many political jurisdictions. Governments had to fund pipelines and, in return, were able to ensure that at least some of the usually omitted interests could have a voice in how the gas regime would operate (Blair 1978). Yet, as gas discoveries proliferate and technology improves, deintegration is promoting the same fragmentation, competition, and exclusion in gas that characterizes oil markets.[4]

Price volatility is devastating whether prices rise or fall. For sellers, it makes economic planning difficult,[5] forces governments and firms to struggle during prolonged periods of low prices, and contributes to domestic unrest and international conflict (e.g., Hunter 1986; Tétreault 1993; Nitzan and Bichler 2002). To protect itself from these consequences, Kuwait builds an error factor into its annual budgets by setting the price it anticipates receiving for crude oil sales at one-third or more below what it really expects to get. This seems like a prudent policy—won't any surprises be happy ones?—but only because we imagine income windfalls as unmitigated goods. In reality, windfalls encourage waste and imprudent spending, including on new capacity (usually at inflated prices because "everyone is doing it"), setting up the next price collapse (Pearce 1983; Tétreault 1985).[6]

Devastated (and other) economies that import oil also face budget and payment difficulties. Cash-squeezed governments add to the income effects of higher fuel prices on consumers by increasing taxes and reducing services. Large oil price increases depress demand throughout the economy, triggering both recession with its painful job losses, and inflation by adding to the cost of producing energy-intensive products and services (Nitzan and Bichler 2002: chap. 4). High oil and gas prices push poor consumers out of the market, increase drains on importing countries' foreign exchange, and contribute to individual and state debt burdens. These problems are exacerbated by globalization, which I discuss later.

State Capacity

Oil exploitation under the direction of IOCs marries a host economy to international investors. The host country starts out as a debtor to the firm(s) whose capital investment will produce the income stream it seeks. The host's share of the income stream depends on its bargaining power. It is seduced by the rosy visions spun by expert wooers and then subjected to the irreversible social, environmental, and financial effects of fulfilling its contractual obligations.[7] But marriage is a fluid arrangement, even in the oil industry. As Edith Penrose (1968) described, once an IOC has invested fixed capital and becomes dependent on host country production, the balance of power shifts in favor of the host. How far it shifts and to what effect depends on circumstances such as the value of a particular host to the IOC's global operations, the type and range of alternatives the IOC can tap to make up for losses of goods and services denied by the host, how willing and able the IOC is to apply force against the host to get what it wants, and how astute the host is in pressing its advantages.

Iran's experience in the early 1950s illustrates the difficulties that even a very rich oil-exporting state can encounter in conflicts with an IOC, especially one with a powerful home government. Iran's operating company,[8] Anglo-Iranian, refused to extend a new industry-standard 50–50 profit-sharing agreement to Iran. Iran's Prime Minister Mohammed Mossadeq responded by nationalizing the oil industry in 1951 and, in retaliation, Anglo-Iranian imposed sanctions on Iran. Anglo-Iranian was an unusually powerful IOC, even among operators in the Middle East (Tétreault 1985, 2004). It was owned by a single company that itself was majority-owned by its home government, Great Britain. Anglo-Iranian also owned half of the Kuwait concession. During the Iran crisis, it was able to do without Iranian oil because its downstream contracts allowed it to expand production in Kuwait to make up for the shortfall (Moran 1987).

British ownership made obtaining court orders enjoining other companies from buying Iranian oil virtually *pro forma* for Anglo-Iranian. Britain also enlisted the help of the United States, home government of five of the "seven sisters," the dominant international firms of that time (Sampson 1975).[9] Afraid of the example that a successful nationalization might set,[10] both governments made every effort to destabilize and eventually to overthrow the Mossadeq regime (Kaufman 1978; Gasiorowski 1987). The CIA-assisted reinstatement of the Shah in 1953 following a brief period of ouster put IOCs back in charge of Iranian oil. But Anglo-Iranian lost its position as the only owner of Iran's oil company, a "least bad" alternative as compared to either redistributing its own production among its host governments or assuming that the restored production from Iran would

be compensated by other firms cutting their production to keep prices up. Instead, the five largest U.S. firms, along with a gaggle of smaller "independents" and the French firm, CFP, were allocated shares of Iranian production under an agreement that incorporated highly restrictive procedures for off-take, leaving the final decision regarding how much to produce in the hands of the largest shareholders (Moran 1987).

State capacity is key to oil-exporting country autonomy. Some see developing areas as sites of primitive politics, but Gulf rulers were noteworthy for the skill they displayed managing late nineteenth- and twentieth-century imperial and IOC intervention (Anscombe 1997). Following the example set by Mubarak al-Sabah, the most ruthless amir in the 250-year history of Sabah family rule in Kuwait (r. 1896–1915), Abd al-Aziz Ibn Saud and the al-Thanis in Qatar consolidated their regimes by manipulating the Ottomans, the British and Americans, and the proto-IOCs to support their dynastic ambitions even before they could use oil as leverage (Chisholm 1975; Anderson 1981; Crystal 1990). In some sense they were "cheated" by the terms of the initial contracts they had signed with their IOCs (Penrose 1968; Tétreault 1985, 2004). But when oil income finally arrived, it went directly to these rent-seeking rulers and most managed to extract additional goods and services from the IOCs and their home governments above what was mandated in concession contracts. Gulf rulers used their oil incomes to attract domestic allies and maintain their regimes in the face of domestic rivals, and external pressures emanating from their neighbors and from the great powers (Dickson 1956; Anderson 1981; Rush 1989: vol. 2; al Rasheed 1991).

In spite of its greater total resource endowment, larger population, and long history as a power in its region, Iran was less capable than most of its Arab neighbors of defending its interests against IOCs and their home governments. Its state was more complex than the tribal systems in the Arab Gulf, leaving openings for individual office holders to cut their own deals with foreign interests, while years of imperial penetration by Britain and Russia had made structural inroads into Iran's economy in the form of unequal terms of trade, give-away monopolies and tax concessions, and an accumulation of foreign debt (Keddie 1981; Foran 1993). Iran also suffered because it was the first oil producer in the Persian Gulf, with no local experience to draw upon. Even so, it started out in a better structural position than Iraq, whose domestic industry was entirely under the control of multiple foreign owners who guided its development according to a contract designed to protect the interests of the largest firms in the group. In practice, this meant limiting exploration and development in Iraq as a way to keep excess oil off the market (Moran 1987).

Ironically, internal development trajectories and the world historical timeline left more autonomy with the small, tribally organized Gulf regimes. The

relative sufficiency of state capacity rather than its absolute level explains their initial advantage. With regard to world historical time, each subsequent hydrocarbon developer in the Gulf benefited from what its leader had observed about a neighbor's contracts and how they had worked out in practice. Both during the early days of the industry (Chisholm 1975) and during the years immediately preceding the oil revolution of 1970–74, several Arab Gulf producers managed without violence to alter contract terms in their own favor (Penrose 1968; Sampson 1975). IOCs used that same historical knowledge on their own behalf but, as their fixed capital expanded, they became less capable of maneuvering within the vertically integrated systems they relied upon at that time to run the global petroleum regime.[11]

The limits of historical knowledge as leverage for either side is demonstrated by the experience of the Organization of Petroleum Exporting Countries (OPEC), which was formed in reaction to massive shifts in the distribution of costs within the industry—from segment to segment in the supply chain—and also across producers, as Latin American exporters lost out to lower-cost operators in the Gulf. Sharing information and coordinating policies toward the IOCs was an important goal of OPEC members (Mikdashi 1972), especially Venezuela, which was marginalized geographically from global oil's "center of gravity" in the Middle East and economically by its high cost structure. The advantages from collective action were equally clear to the home governments of the IOCs. The United States, for example, refused to recognize OPEC and ordered its IOCs to deal with OPEC members only as individual countries, rather than collectively via OPEC (Sampson 1975).[12] Even without externally mandated fragmentation, however, Ted Moran notes that OPEC is inherently less able to regulate production than the IOCs, which had devised legally enforceable contracts designed to limit the autonomy of the firms most likely to overproduce (Moran 1987). OPEC members had no such legal instruments and, preferring sovereignty and autonomy over coordination, continue to resist demands for effective collective action to limit production.

Hyperglobalization

For the purposes of this chapter, I use a definition of globalization suggested by economist Joseph Stiglitz:

> [T]he closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of costs of transportation and communication, and the breaking down of artificial barriers to the flows of goods, services, capital, knowledge, and (to a lesser extent) people across borders. (2002: 9)

Compared to its more leisurely progression in earlier eras, globalization since the early 1970s has accelerated in producing a rapid compression in space and time such that people, goods, and places are coming closer to one another at a faster and faster rate. As a process, globalization is amoral—inherently, it is neither good nor bad. Among its pleasures are easy international travel, the Internet, an enlarged vision of civil society, and the cornucopia of products and services readily available to affluent consumers. Globalization's dark side includes the proliferation of private and relatively unpoliced networks for raising and transferring money and armies (Singer 2003), human trafficking, the drugs and arms trade, spreading economic devastation, and an enlarged uncivil society of criminals and terrorists. Olivier Roy (2001a, 2001b) argues that the infrastructure of globalization actually generates terrorists as violent activists are able to move resources and operations from one jurisdiction to another to recruit, raise money, and conduct operations (see also Rashid 2001; Hersh 2004).

Globalization is multivalent in other ways. It operates through the conscious agency of people at the bottom of social, political, and economic hierarchies as well as those higher up. Yet, critics (e.g., Rist 1997) argue that large majorities of those living in low-capacity states that rely primarily on "the market" for "development" have experienced little, if any, of globalization's promised benefits, even if they also receive state-of-the-art foreign assistance. To attain significant improvement in the social, political, psychological, and material conditions of life for most residents of presently un(der)developed areas requires far stronger measures than unprotected exposure to "the market." It would take policies that are capable of reversing the direction of net material resource flows to the developed from the developing world. Democracy is another goal of hopeful developers. But democracy includes rights to goods and services, along with elections and civil liberties guarantees (Gould 1988; Sen 1999). It is threatened by extreme globalization and market-oriented liberalization, both of which undermine state capacity to protect populations, even in developed countries (Panitch 1996; Thomas and Tétreault 1999).

The oil industry was the cutting edge of globalization in the nineteenth century. It connected far-flung producers in North America and Eastern Europe into a steadily widening net of financiers, investors, and consumers worldwide (Tolf 1976; Blair 1978). Even after World War I, which halted most of that first wave of modern globalization (Schwartz 2000), and the Russian Revolution, which nationalized proto-IOC properties in the new Soviet Union (Sampson 1975), oil globalization continued until U.S. policy changed in the 1930s to insulate devastated domestic producers from the pressures of the global market (Blair 1978; Prindle 1981; Moran 1987). World War II intervened shortly after the reserves of Arab Gulf producers

were discovered; it was not until the postwar era that the petroleum foundations of the global economic regime we live in today were laid by IOCs and their home governments.

Europe was both pulled and pushed to rebuild economically as an oil-dependent region (Gardner 1980; Painter 1986). Reducing the dominance of coal as a fuel in Western Europe enriched the IOCs, strengthened the dollar as the currency used for most oil transactions, and intensified oil's strategic and economic role in the cold war order. After Kremlin policy changed in the 1960s to emphasize foreign sales of oil and natural gas, European fuel-dependency became a superpower battleground whose stakes included both economic returns to owners of hydrocarbon resources and the political alignment of governments (Jentleson 1986). Yet, as we see more clearly today, globalization as an amoral process has its own imperatives independent of great-power politics. Before development of domestic oil and gas reduced Western Europe's energy dependency, oil-led globalization helped to wreck the post–World War II Bretton Woods monetary regime along with the international hydrocarbon regime managed by the IOCs (Tétreault 1985).

The oil revolution that effected this transition was not simply a price revolution. More fundamentally, it changed the ownership of oil and attempted to re-create state-led price regulation. During the oil revolution, many oil-exporting countries nationalized their industries and also took effective control of them. As we saw earlier, Iran had nationalized Anglo-Iranian in 1951 but the restoration of the Shah also restored and even enhanced foreign control over Iran's oil. Throughout the 1970s, other oil-exporting countries nationalized their industries and some assumed equity control more gradually through a process known as "participation." As a result, decision-making power passed from the multinationals to the oil ministries of the host governments. This transfer of authority also took place in Iran. Yet, the oil revolution, like so many others, did not turn out as its advocates expected.

The IOCs adjusted rapidly to their new roles as operators, so readily that critics like M. A. Adelman accused them of being "tax collectors for OPEC" (Adelman 1972–73). Indeed, the nationalizations neither cut off nor reduced the revenues of most IOCs operating in the Middle East (Nitzan and Bichler 2002). Large aliquots of these rivers of returns were invested in high-cost exploration and development outside OPEC, much in the very expensive United States (and in nonfuel enterprises where the IOCs had little useful knowledge and often lost money). As I noted earlier, the oil revolution also offered political and economic opportunities for the IOCs to divest and reorganize, allowing them to improve their positions for the next round of strategic investing, both greenfield and via acquisitions.

Ironies abounded in this new oil regime. Instead of stepping into the positions vacated by the IOCs, OPEC members found themselves with few of the companies' structural advantages. The IOCs had a global reach through their home governments, transnational locations, opportunities for coordination through legally enforceable contracts, and a presence in every segment of the industry, even though they did not have to own everything to exercise significant control over production and pricing (a truth that John D. Rockefeller grasped early in his Standard Oil odyssey). OPEC had a far smaller international network and, at first, little more than production equity to work with. Even after some OPEC members acquired downstream properties in importing countries, their market power was far smaller than what the IOCs had enjoyed during their heyday (Tétreault 1985, 1995).

OPEC governments could not exercise the strategic muscle that IOC home governments had provided, either to coordinate their own actions (Moran 1987) or to protect themselves from envious neighbors—indeed, some were bullied successfully to "invest" in those neighbors regardless of the prospects of a return (Tétreault 1995). Rich oil-importing country governments made them scapegoats for the global recession that followed the hefty price increases of 1973–74 and even for the global inflation that had preceded the oil revolution by some years.[13] Anti-OPEC vituperation included veiled threats of military retaliation from Henry Kissinger delivered in an interview with *Business Week* magazine, and endless accusations that OPEC was responsible for all the economic ills of the "NOPECs" (developing countries without indigenous fuel sources), all of which confirmed the producers' continued political vulnerability (e.g., Tomeh 1976; Olson 1981).

Also, despite their expectation that they could make globalization work for them, OPEC members found their economic vulnerability heightened after they had removed the IOCs from their mediating role between producing countries and consumers. Oil's fungibility and its complex global distribution network contributed significantly to the inability of producers to defend their interests—they were too weak and too fragmented to exercise effective control over a global market. During the 1973–74 oil embargo, IOCs had piously assured embargoing Arab host governments that they were complying with the embargo rules at the same time that they swapped cargoes with other companies, ensuring that only the letter but not the spirit of the embargo would be observed (Weisberg 1977). It was convenient for everyone to say that OPEC controlled the oil market where prices were concerned, but OPEC's power was only apparent, an artifact of transient market conditions rather than a new principle of global oil trade. OPEC's inability to manage prices was exposed for everyone to see

when prices soared during the Iranian revolution. Within a very short time, OPEC became the marginal supplier of crude in a global market full of non-OPEC sellers who could advertise "security" as the reason why customers should buy from them first (Tétreault 1985).

Globalization integrates markets. It prevents oil from being anything other than a blunt instrument when states attempt to use it as a strategic weapon because everyone lives in the same oil world. One example comes from the application of oil weapons, purposely and not, during the First Gulf War (1980–88). Price swings occurred in both directions as Iran sought to punish Iraq and its Arab Gulf supporters by attacking tankers carrying their oil exports. Oil prices and incomes rose, providing more money for arms purchases all around. The reverse occurred when, in response to the lethal combination of marginalization and free riding, a massive increase in Saudi oil production caused the undermined global price structure to collapse completely in 1986. All oil producers suffered, but Iran was disproportionately injured because it did not have external "bankers" in the form of rich neighbors to compensate for its income losses (Tétreault 1993).

Devastation

Among the devastated economies that we are concerned about repairing is that of Iraq, the country where the hazards of hydrocarbon dependency are most starkly revealed. Iraq's oil industry is widely viewed as underdeveloped,[14] but this condition began well before Saddam seized power in Iraq. Iraq was the linchpin of the "Red Line Agreement" during the consolidation of the IOC-dominated petroleum regime. The Red Line set off a portion of potential Middle Eastern oil fields as a strategic reserve for the IOCs. Any new oil field development inside that zone, which included Iraq, had to have the unanimous approval of the signers of the agreement, companies that had owned equity in the pre–World War I Turkish Petroleum Company (Sampson 1975; Blair 1978; Moran 1987). Although the agreement was abolished after World War II to allow two Red Line companies to buy into the Saudi concession, Iraq continued to have difficulty attracting IOC investment. Glutted oil markets in the 1950s made the large firms reluctant to spend on new capacity anywhere, especially in a country where they anticipated discovering large oil fields. After Iraq's 1958 revolution, domestic political instability convinced most IOCs that investing there would be politically risky.

Iraq's already discovered oil reserves were concentrated in regions occupied by domestic "minorities"—the Kurds in the north, an ethnic numerical minority among Iraqis, and the Shia in the south, a religious

numerical majority. Before the 1958 revolution, these minorities were merely marginalized; afterward, they were increasingly persecuted (Hiro 1991). Kurdish bids for autonomy incorporated demands for formal rights to income from oil produced in "Kurdistan." This made their movement appear even more threatening to a shaky regime (Hiro 1991) that was already reacting to insurgency in Shii areas by executing dissidents and hardening its stance toward Iran (Gause 2002). Saddam used oil money to buy off potential dissidents even during the First Gulf War (Farouk-Sluglett et al. 1984), but it brought him neither security nor victory. Indeed, the need to avoid casualties and continue the flow of material benefits to a restive nation dashed his best chance of defeating Iran early in the conflict (Hiro 1991).

Iraq's oil nationalization in 1972 increased the power of the state and economic returns to the nation. Oil income rose from $75 million in 1972 to $8 billion in 1974 (Hiro 1991: 21), a reflection both of the four-fold increase in world oil prices that occurred during this period and the extent to which foreign owners of Iraqi oil had been taking a disproportionate share of the profits. Nationalization gave the government control of national oil policy but, as compared to Kuwait where the income and authority from nationalization enabled the state to invest heavily in its oil industry (Tétreault 1995; Marcel 2006), Iraq had both less excess income and a more corrupt government (Farouk-Sluglett et al. 1984). Some oil investment did take place, but by the time Saddam Hussein had consolidated his power in 1979, Iraq was on the cusp of three major wars that devastated its economy in almost every way. Iraq's oil income financed its military build-up[15]; it allowed Saddam to start his long and bloody war against Iran and, a decade later, to mount an armed invasion and occupation of Kuwait. Oil money also financed a huge domestic security apparatus and the violent repression of Iraqi Shia and Kurds. It is true that vicious governments do not need oil money to wreak havoc at home and in their regions—Idi Amin's regime in Uganda is one of many examples. But Iraq's history shows how much more thorough a job they can do when they have oil to finance their activities (Makiya 1989, 1993).

In addition to the physical destruction wrought by these wars, Iraq's oil industry was vulnerable to a kleptocratic ruler who used its financial resources for self-aggrandizement and to build a totalitarian national security state (Makiya 1989, 1991, 1993; Hiro 1991). Even after UN sanctions were imposed on Iraq following its invasion of Kuwait, Saddam sold truck-loads of Iraq's fungible, portable, ostensibly boycotted oil to Jordan and Turkey under the noses of the sanctions managers, and shipped it out by sea to other black markets. The furor over UN corruption in administering the Oil for Food program masked the larger corruption of UN Security

Council members, which prevented the secretariat from intervening in lucrative contracts between Saddam and their national firms. Also, the fact that the sanctions could be so easily evaded with or without Oil for Food intermediation illustrates once again the connection between oil and corruption.

What Is To Be Done?

This is a pessimistic assessment of the utility of oil development as a priority in the rescue of devastated economies. Let me conclude by outlining what I believe needs to happen if oil investment is to overcome the many pitfalls I have discussed. One prerequisite is effective checks and balances within the oil-exporting state. Even before Kuwait had a written constitution, Kuwaitis had some ability to inhibit their governors from appropriating the bulk of national oil revenues for themselves. Government accountability is far from perfect in Kuwait, but its constitution prevents rulers from making unilateral decisions about how the oil industry will be developed or how oil income is spent. A constitution that incorporates institutional checks remains strong in Kuwait even though the regime has forsaken, with parliamentary approval, what Jill Crystal (1990) identified as a pact between Amir Abdullah al-Salim (r. 1950–65) and the merchant class to keep the ruling family from dominating the private sector. But this pact was not concluded at the expense of the underclasses, as in Venezuela (Karl 1987). High oil revenues, coupled with a desire to nourish social forces that could oppose these merchant challengers, supported programs redistributing significant proportions of Kuwait's oil rents across the population as a whole.

These programs reinforced Kuwait's oil dependency at the same time that their careless generosity reduced accountability and incentives to invest in other segments of the economy. Until the lead-up to the Third Gulf War when the movement of forces preparing to invade Iraq stimulated the market for real estate and consumer goods, the economy was stagnant and unable to generate enough jobs to employ new graduates. This highlights another problem arising from favoring oil over other development. The capital intensity of the industry provides few jobs. Although most jobs in Kuwait are funded with oil money, they are indirect products of distributive policies that vitiate feedback mechanisms that come from market relations, reducing both productivity and the capacity for autonomous development (Luciani 1990; Chaudhry 1997). As a result of the Third Gulf War, however, demand for Kuwaiti employees in the private sector has risen along with domestic investment opportunities in non-oil industries. Whether this stimulus has inaugurated structural changes able to persist into peacetime is yet to be determined.

It is unfashionable to recommend self-sufficiency over David Ricardo's recipe for better living through comparative advantage; even so, attention should be paid to encouraging domestic production by nationals of goods and services required by the local population. These strategies are also difficult to pull off, as decades of experience with import-substitution industrialization show (e.g., Richards and Waterbury 1996). Jobs are every bit as important for a healthy economy as investment, yet employing tools such as capital controls risks retaliation from the international economic regime. Hartmut Elsenhans (2003) suggests an innovative, if eccentric, program that involves throwing large rocks out of helicopters and then paying people to collect them. His "solution" is a reminder that conventional economists focus too closely on aggregate measures of growth at the expense of the devastation that most conventional growth strategies impose on substantial segments of populations even in "developed" states (Freeman and Kagarlitsky 2004). Microlending is the engine driving another development strategy, one that emphasizes job growth and self-sufficiency, and it might well be extended to encompass larger enterprises focusing on basic services in health and education (Sen 1999). Yet, here too, pressures to privatize basic services such as drinking water and to open ownership to foreign investors put governments attempting to apply strategies oriented toward the well-being of their populations at risk of retaliation from powerful states and international financial institutions.

The American record in Iraq, which has emphasized privatization and internationalization over domestic jobs and local service provision, is an extreme case of the perversity of globalization and the effects of rent seeking on domestic peace. Measured in terms of employment, health, and security, the already devastated economy of prewar Iraq deteriorated sharply under U.S. occupation, while corruption in postwar contracting that began under the Coalition Provisional Authority continues to privilege rent seekers over Iraqis in the repairing of the devastation from sanctions and war (OSI 2004; TI 2005).[16] Concentrating on oil over other local industries also offers a tempting target to insurgents, driving a destruction-reconstruction-destruction cycle that is as much a product of how the reconstruction is being carried out as it is of the ease and effectiveness of striking the government by striking oil infrastructure.[17] Transparency International, using Iraq as a case study, published a report focusing on the problems of postconflict reconstruction there as the source of a long list of things not to do (TI 2005).

Among the positive recommendations in this report are several that I have already highlighted as necessary for any development program,

especially one with access to income from exploiting hydrocarbon reserves: assuring transparency as an aid to checks and balances against corruption; incorporating local ownership and participation, along with safeguards to prevent the already privileged from rent seeking at the expense of returns to individuals and firms engaged in projects; opening participation in projects to all, thereby avoiding aggravation of preexisting social fault lines that could undermine economic and political stability; and refusing to create the equivalent of an informal economy inside the state itself through the establishment of parastatal companies with access to off-budget funding and preferential treatment (TI 2005: 80). The prompt application of these rules in postconflict Iraq is likely to have produced a very different outcome from the one that occurred in their absence.

Gilbert Rist (1997) and others lament the failure of many post–World War II development efforts that have resulted in more devastated economies today than existed in 1950. Amartya Sen (1999) concentrates on the importance of development efforts that put the well-being of people and nations suffering from devastated economies as the first priority. In doing so, Sen returns to an understanding of the Greek root of the word "economy," which is the security and well-being of the household. Our global economy has at best neglected and at worst plundered households, socializing too many of the costs of production and privatizing too many of the benefits. Devastated economies are the result of this kind of thinking, planning, and project execution. Oil is not an exception—even oil-rich countries have not been able to protect themselves from devastation resulting from commodity price swings, including the prices of their local currencies, or from the plundering of their hydrocarbon resources by the major powers, their IOC allies, and the governments themselves. In one of his several justifications for keeping troops in Iraq, U.S. President George W. Bush cited the need to keep Iraqi oil out of the hands of terrorists and safe for Americans.[18]

Dependence on oil revenues is an even more perilous prospect in the twenty-first century than it was in the past. This is because the effects of the excessive exploitation of hydrocarbons on the earth's climate have become impossible to ignore. As nations and individuals revise their energy-use patterns, the costs of these changes and who will bear them become salient issues. Adjustment following the oil revolution was displaced on less powerful actors such as oil importers and creditors (Olson 1981). As high prices depressed demand, oil exporters also were affected, especially the Third World producers who had nationalized their industries (Tétreault 1985). The same pattern is likely to hold in

adjustment to the effects of policies designed to reduce hydrocarbon emissions, many of which will hinge on reduced oil use. National governments once again will protect domestic firms, industries, and markets unless massive price concessions, like the famous "Aramco advantage" conferred on its IOCs by Saudi Arabia in the 1980s, are offered by developing country producers. Even national oil companies that are internationally competitive (Marcel 2006) could face declining demand and reduced profits, at least in the short to medium term. To a responsible government attempting to repair a devastated economy, hydrocarbon development should clearly be only one element of a prudent strategy for achieving long-term security.

Notes

1. "US Delays Planned Meeting on Exploiting Iraq's Oil and Gas Reserves," October 30, 2002, *Alexander's Gas & Oil Connections, News & Trends: North America* 7:23 (November 27, 2002), http://www.gasandoil.com/goc/news/ntn24886.htm.
2. The Dutch Disease is an ailment of globalization. It makes a country's manufactured products more expensive if monetary inflation results from high, externally generated income. The result is that labor and other costs of production rise and so do the prices of finished goods, making them less competitive in both home and export markets.
3. Anglo-Iranian is an ancestor of today's BP-Amoco.
4. Daniel Pearl and Peter Fritsch, "Deep Pockets: Natural Gas Generates Enthusiasm and Worry in Oil-Soaked Mideast," *Wall Street Journal*, August 11, 1997, pp. A1, A8.
5. The "posted" or reference price system used by the international petroleum regime during much of the IOC-managed post–World War II period was an attempt to smooth out prices to reduce the impact of income volatility on oil-exporting country budgets.
6. One contemporary example is the Kuwaiti plan to invest $40 billion in infrastructure development, a large part of which will be devoted to doubling current production capacity (AFP, "Kuwaiti Petro-Dollars Roll into Projects Worth $40 Billion," December 20, 2004; Ahmad al-Fahd al-Ahmad al-Sabah, speech delivered at the National Bank of Kuwait Seminar on the Future of the Oil Industry, Kuwait City, December 4, 2004). For a discussion of the excess capacity situation worldwide, see Mitchell et al. (2001).
7. For example, David R. Baker, "Seeking Iraq's Oil Prize: Government May Allow Foreign Petroleum Firms to Invest," *San Francisco Chronicle*, January 26, 2005, http://www.globalpolicy.org/security/oil/2005/0126prize.htm.
8. The operating company conducts activities in the host country. Because of the capital intensity of oil production and processing, most operating companies in the Middle East of that period were joint ventures among two or more IOCs.

9. The U.S. firms were Jersey Standard, Socony, Texaco, Socal, and Gulf. Anglo-Iranian was British, and Royal Dutch Shell was joint British-Dutch.
10. The 50–50 profit-sharing regime was inaugurated by demands from Venezuela, which traded on the fear of nationalization evoked by Mexico's successful nationalization in 1938. U.S. companies complied with little fuss, but British companies did not enjoy the same tax advantages and resisted the application of 50–50 to protect their profit margins and their competitive standing among oil company peers (Tétreault 2004).
11. Producers had grown used to attributing profits to production as a way to avoid home country taxes, and neglected the "losing" segments of the industry such as refining. As production costs actually rose in response to host pressures, the IOCs had to revise their investment policies, especially with regard to downstream industry segments. Most engaged in significant divestment of marketing and some divestment of refining, especially of technologically outmoded and highly regulated facilities in Europe, when the oil revolution provided them with the money and incentives to do this (see, e.g., Tétreault 1995).
12. A similar effort to thwart collective action by the small Gulf states guides recommendations to the Bush administration by conservative think tanks to refrain from dealing with the Gulf Cooperation Council (GCC), the association of Saudi Arabia, Kuwait, Oman, Qatar, Bahrain, and the United Arab Emirates, as a unit (see, e.g., Henderson 2003). A bilateral free-trade agreement (FTA) between the United States and Bahrain signed in September 2004 has raised concerns that it "sets a precedent for the GCC by letting national interests and bilateral talks over-ride collective interests and multilateral talks" (N. Janardhan and Emilie Rutledge, "U.S.–Bahrain Trade Deal Exposes GCC Chinks," *Daily Star* [Beirut], December 28, 2004). The FTA opens the rest of the GCC states to market penetration by the United States, using Bahrain as an intermediary. Before it went into effect, other GCC members asked Bahrain to reconsider on the grounds that the FTA violated provisions of the economic agreement signed by the GCC states in 2001, which says that "no member state may grant to a non-member state any preferential treatment exceeding that granted herein to member states, nor conclude any agreement that violates provisions of this agreement" (Janardhan and Rutledge 2004). Other GCC members moved to reach individual FTAs with the United States, showing that the divide-and-rule strategy long used by powerful states against oil-exporting countries continues.
13. And whose effects had helped to encourage it. Price increase demands made during the "Tehran-Tripoli" price negotiations were justified by OPEC as responses to the falling dollar and its impact on their purchasing power.
14. Baker, "Seeking Iraq's Oil Prize."
15. As it financed military expenditures in neighboring countries, most notably Iran which, until the revolution, was cleared to purchase from the United States virtually any arms it might desire other than nuclear weapons (Hiro 1991: 15; also Nitzan and Bichler 2002: chap. 5).

16. See also Griff Witte, "Audit of Iraq Spending Spurs Criminal Probe," *Washington Post*, May 5, 2005, p. A22.
17. James Glanz, "Thanks to Guards, Iraq Oil Pipeline Is Up and Running, On and Off," *New York Times*, September 3, 2005, p. A6.
18. Jennifer Loven, "Bush: U.S. Must Protect Iraq from Terror," *washingtonpost.com*, August 30, 2005, http://www.washingtonpost.com/.

5

Rebuilding without Resolution

The Lebanese Economy and State in the Post–Civil War Period

Samir Makdisi

Introduction: The Geopolitical Context

Since its independence in 1943, Lebanon's national development has been profoundly affected by the interlocking influences of geopolitics and regional conflicts, domestic political institutions, and the impact of a long-lasting major civil war (1975–90).

The creation of Israel in 1948 and the ensuing inflow of Palestinian refugees into neighboring countries including Lebanon was to have a major impact on the Lebanese domestic political scene. Indeed, the persistently sectarian nature and behavior of Lebanon's political institutions interacted with the Arab-Israeli conflict to bring about the civil war that brought havoc to the Lebanese state and economy. The settlement of this war by the Taif Accord (1989)[1] permitted the stationing of Syrian forces in Lebanon, with a consequent Syrian hegemony over Lebanon's political and, to a much lesser extent, economic affairs until they were forced to withdraw in April 2005. At the same time, poor political governance, intrinsically (but not solely) linked to the sectarian system, led to major shortcomings in the quality of development.

In 2005 and 2006, Lebanon witnessed profound political, security, and military developments. On February 14, 2005, former prime minister Rafiq Hariri, an influential Sunni politician, was assassinated. The assassination

set in motion a series of events that, among others, led, mostly under Western pressure via UN Security Resolution 1559 of August 2004, to a Syrian troop withdrawal. In consequence, Syrian dominance over postwar Lebanese domestic politics was greatly diminished. A new political environment has since emerged in which Lebanese political actors and parties have a wider scope than before to compete and influence domestic outcomes, although strong external influences, now mainly Western, Iranian, Syrian, and Saudi Arabian, continue to prevail. Other major developments in 2005 included not only the return from exile and the release from prison of two major political actors of the civil war,[2] but also the assassination of politically active personalities.[3] Furthermore, new parliamentary elections due in 2005 were held in May and June of that year with strong encouragement from Western powers not to delay as some, mainly Christian parties, had wished, pending the enactment of a new electoral law. The elections led to alliances of former civil war adversaries forged in response to mutual political interests. This resulted in a small majority in parliament, supported by the West, comprising the Hariri political grouping and its allies,[4] but the elections also brought in their wake a continuation of heightened political tensions, especially as the major parties in the election coalition went their separate ways (for details, see note 24).

Beginning in early March 2006, the speaker of parliament convened a series of meetings that brought together the leaders of the major political groups represented in parliament, in a dialogue meant to settle disagreements over major political issues, a process that had not yet yielded successful results when it was completely overtaken by the war Israel waged on Lebanon from July 12 to August 14, 2006.[5] The war was ostensibly triggered by the capture of two Israeli soldiers by Hizbullah, although the Lebanese government declared that it was neither aware of nor responsible for the capture. But more fundamentally, as openly stated by both the United States and Israel, it was related to regional political objectives, including the intended containment or bringing to heel not only of Hizbullah, but also of Iran and Syria, with open Western (principally and most actively U.S.) support.[6] As it turned out, the immediate outcome of the war failed to attain these objectives.[7] However, continuous Israeli aerial attacks against Lebanon resulted in immense destruction of a substantial portion of Lebanon's infrastructure: scores of villages in southern Lebanon, large parts of the southern suburbs of Beirut, as well as many factories and other enterprises, and hundreds of lives were lost.

The above developments together define the context in which the achievements and failures of Lebanese development through 2006 must be assessed. Equally importantly, they explain the major national issues, with

their major regional dimensions, that Lebanon has been facing since independence and continued to face in the post–civil war era as it attempted to rebuild its shattered state and economy, only to receive a severe blow to its infrastructure and national unity as a result of this most recent war.

Whatever the ultimate outcome of the political events of 2005 and 2006, they have again demonstrated the persistent challenge facing Lebanon: how to manage its sectarian political system whereby it is better able to cope with or minimize the domestic impact of disruptive regional influences from which it cannot altogether shield itself. This, of course, is not an easy task, not only on account of the entrenched domestic sectarian influences, but also because the rapidly globalizing world perforce locks national development, especially that of the smaller states, to the economic and political global environment and agenda dominated by major Western countries, in particular the United States. As will be argued later, the reform of the country's political institutions with a view to dramatically enhancing the quality of political governance would go a long way toward enabling Lebanon to meet this challenge. Until then, the foundations of a viable national rebuilding remain to be laid.

With the above in mind, this chapter addresses basic issues related to the multidimensional rebuilding of the Lebanese state and economy in the aftermath of the civil war. It is divided into two main sections. The first section is a background discussion that begins with a review of the major political and economic features of the prewar period, then moves on to a brief analysis of the major determinants of the war and its economic and political impacts, and concludes with a discussion of the formal settlement of the conflict in 1989. The second section analyzes the process of rebuilding both the shattered state and the national economy. An attempt will be made to assess to what extent this process has been successful, and the questions to be addressed, if viable long-term political and economic development is to be achieved. Four questions will also be briefly taken up: (a) political governance, (b) growth and macroeconomic performance, (c) the dominance of the private sector in the national economy, and (d) the new global environment.

Background to the Civil War

The pre–civil war period

Three salient features of the prewar years are highlighted: "consociational democracy," market-oriented economy and robust economic growth marred by socioeconomic gaps, and domestic political tensions.

"Consociational democracy"

The political system that emerged after independence was based on an arrangement for power sharing in the affairs of the government and public sector institutions among the country's officially recognized religious communities, a system commonly described as "consociational democracy."[8] In its essence, however, the emerging system reflected what elsewhere I have termed as "constrained democracy" (Makdisi 2004: 3), in that, irrespective of the agreed arrangement, under the sanctioned sectarian formula for power sharing, individual citizens, by virtue of belonging to different religious communities, enjoy unequal political rights.[9] I will come back to this issue in the second section.

The three principal religious communities—Maronite Christians, Sunni, and Shii Muslims, or perhaps one should say their respective business and political classes—stood to gain most in terms of political power and influence, with clear advantages being initially accorded to the Maronite community specifically.[10] In practice, a sectarian formula was applied to cabinet posts that were apportioned among the six largest religious communities in the country (normally along with representation of the Armenian community, considered an additional but separate community), but frequently to the exclusion of other officially recognized (minor) religious communities.[11] An overall balance between Christians and Muslims has been maintained in the cabinet to this day. The discriminatory aspects of the system also pertain to the personal status laws, which deal with marriage, divorce, and inheritance, among other things. These laws fall under the jurisdiction of the official bodies of the respective religious communities.

The fact that a sectarian balance had to be maintained implied that no single political, religious, or politico-religious group (including the army) could impose its hegemony or ideology. As it turned out, this had its positive aspect in that it tended to promote political liberalism, albeit in the context of the prevailing sectarian system. Indeed, the prewar years were characterized by periodic parliamentary elections (no matter how imperfectly conducted), religious freedom, relative freedom of expression and association, the generally peaceful change of presidents and cabinets, and the growth of sectarian and nonsectarian political parties. On the other hand, the dictum of delicate sectarian balance led to the emergence of a weak state and, as a consequence, the inability of the coalition governments to implement substantive political and/or administrative reforms. Given the sectarian-familial-clientist nature of the political system, political governance was marred by corruption, nepotism, clientism, and laxity in upholding the public interest when it conflicted with private interests (see, e.g., Picard 1996). The negative impact of these shortcomings on the

quality of development was perhaps partly countered by the relatively rapid economic growth and expanding work opportunities in the pre-1975 period (see the following section).

Market-oriented economy, robust growth, socioeconomic gaps

From the beginning of independence, there was political consensus among the major political groupings that the national economy should basically be market oriented. This was fostered by the existence of a traditionally influential business class and a political leadership (close to the business class) that supported liberal economic policies (generally conservative fiscal and monetary policies) and the opening of the national economy to the outside world. As early as the 1950s, the Lebanese exchange system became completely free of any restrictions on either current or capital movements, in contrast to the prevailing exchange systems in countries of the region and elsewhere that were characterized by exchange controls and other restrictions. Governmental policy was business friendly, being mostly noninterventionist and supportive of private sector initiatives. The role of the state was thus minimal, whereas in neighboring Arab countries development was state-led, with most of the major economic enterprises being nationalized. In consequence, private capital in those countries tended to seek refuge and investment opportunities abroad, especially in Lebanon with its private sector–oriented and open economy. This tendency was reinforced by political upheavals in neighboring countries. At the same time, while experiencing serious domestic political tensions of its own (discussed later), Lebanon managed to attract other foreign capital and enterprises supplemented by emigrant remittances from the Lebanese diaspora, especially from Lebanese living in the United States and South America.

The Lebanese private sector, traditionally enterprising, took full advantage of these favorable conditions. In consequence, the national economy experienced a relatively rapid and broad-based expansion, with high investment rates accompanied by relative financial stability.[12] This expansion, however, concealed substantial socioeconomic gaps and highly uneven distribution of the benefits of the liberal economic system that largely accrued to the political and business class and, to a lesser extent, the professional class. The main reason for this lopsided domestic development was the relatively poor institutional performance attributable to the sectarian-familial-clientist nature of the political system. Development of the various regions of the country was strikingly uneven, and limited progress was made in narrowing the gap, in real terms, between the high-income and low-income groups.[13] Furthermore, the social conditions of a sizable portion of the population were extremely inadequate and were

exacerbated by the migration from rural areas to urban centers, especially Beirut, which in effect became surrounded by belts of poverty (for a review, see Makdisi 2004: 23–8).

The prevailing inequality in income distribution might not have been as skewed as in other developing countries. However, it must be considered against Lebanon's regional inequalities and their confessional dimensions. For example, the position of the middle class was much more salient in Beirut (dominated by Sunni Muslims and Christians) and in the central mountain region (dominated by Christians) than in regions like the south, the Beqaa, the northeast, and Akkar in the north (dominated by Shii and Sunni Muslims), where large landholdings and class distinctions were common. This gave a clear confessional coloring to the question of inequity in income distribution, particularly with regard to the Shia community.

Political tensions and confrontations

What is striking about the prewar period is that the country experienced robust economic growth and rising per capita income despite the emergence of major political tensions and confrontations attributable to both domestic and regional factors. The domestic factor was directly related to the sectarian system of power sharing, principally among the three leading religious communities. There were constant domestic calls by Muslim political leaders for more equal power sharing between the Christian and Muslim communities. Such calls implied a shift of economic benefits in favor of the Muslim community that would arise from greater access to public sector employment as well as opportunities to participate in or control private economic enterprises that were to a large extent in the hands of the Christian community. The Maronite establishment tended to ignore such calls, fearing the political implications of even a limited loss of constitutional power. Additional strains emanated from the uneven development among the various regions and the wide disparities in income distribution that led to migration from rural to urban centers and to the rapid and unchecked growth of poor suburbs around the major cities (Beirut in particular).[14]

The external factors, which placed increasing strains on the Lebanese political system, related to the rising military power of resident Palestinian political and military organizations, particularly after the 1967 Arab-Israeli War. Although their activity was ostensibly directed at keeping the Palestinian cause alive and continuing the struggle to reclaim Palestine, these organizations' presence in Lebanon became intricately linked to Lebanese domestic political affairs. The domestic and regional political agendas could hardly be separated. The prevailing weaknesses of the political system were exploited by Palestinian organizations to enhance their

political and military positions. For this purpose, they forged alliances with disenchanted Lebanese sectarian (Muslim) and nonsectarian (leftist and other nonestablishment) political parties, which regarded such an alliance as a means of pressuring the Maronite establishment to accept political reforms that implied wider economic opportunities for these parties. Domestic political tensions, not surprisingly, invited indirect external interventions (later to become direct), most notably by Lebanon's immediate neighbors, Syria and Israel.

This combination of domestic and external factors eventually led to the inevitable outbreak of civil conflict on April 13, 1975. Irrespective of the particular circumstances that ignited it, what matters is that the clouds of an impending widespread armed confrontation between Christian political parties and Palestinian organizations had been gathering for a number of years, particularly after the expulsion of the PLO from Jordan in 1970. With this expulsion, southern Lebanon became in practice the only sanctuary for PLO operations against Israel, no matter what measures the Lebanese state undertook to control Palestinian military activity. Fueled by mutual mistrust and opposing objectives, periodic armed clashes took place between the Palestinians and the Lebanese army and/or Christian parties. All efforts, domestic and Arab, aimed at reconciling existing differences failed to produce more than a temporary reprieve. This was the prevailing atmosphere prior to the clash in the Beirut suburb that ignited the civil war.[15]

The civil war

On the causes and duration of the civil war

There is a growing cross-country literature on the causes of civil conflict and the factors that account for its duration. A basic question that has been addressed (which we can only refer to here) is whether the underlying causes of civil conflict are attributable to economic greed (opportunity) or some form of grievance linked to political and/or economic and/or social injustice. Though the role of economic, political, and other factors in the outbreak of civil conflict may differ from one case to another, there is perhaps wide agreement that the causes of civil conflict are complex, and that they include a combination of greed and grievance, or both economic and political elements, let alone external interventions in a good number of such conflicts that actively contributed to both their outbreak and their prolongation. The importance of each set of these factors differs from one country to another. Whereas in certain cases economic factors (e.g., level of per capita income, rate of growth, and the importance of natural resources in the economy) played a key role in the outbreak of civil war, in other

cases they either hardly mattered or perhaps acted to weaken the probability of civil conflict. Similarly, while in some countries social divisions (e.g., ethnolinguistic and/or religious) contributed significantly to the onset of civil conflict, in other countries such factors did not figure prominently. In other cases again, political factors (e.g., the nature of the political system or unequal political rights and privileges among various groups) played a significant role, but were hardly present in still other cases. Some civil wars have witnessed active external interventions, whereas others have not.[16]

How long a civil conflict endures is also influenced by many factors, among them economic greed, in that war economies become lucrative sources of income and wealth for the warring parties; external interventions, whereby the interests of the intervening powers favor prolongation of the war; ethnolinguistic and/or religious conflicts that prove difficult to settle; as well as the influence of the diasporas, to the extent that they constitute a significant source of funding for rebel or opposition movements. But again, the relative significance of these factors differs from one case to another.[17]

Economic factors did not play a determining role in the onset of the Lebanese civil war. At the time that it broke out, Lebanon had been enjoying, as already observed, one of the highest levels of per capita income among developing economies, as a result of robust economic growth in the preceding two decades. As a small country with a relatively small population, limited natural resources, and a trade- and services-oriented economy, the potential underlying economic motives for civil conflict were weak.[18] Rather, as noted above, the primary causes of the civil war were religious divisions (sectarianism) and the state-PLO confrontations, with associated external interventions, principally Syrian and Israeli, that combined to ignite the conflict.[19] These confrontations served to inflame an already tense political situation arising from simmering domestic disputes over sectarian power sharing. The Christian-Muslim religious divide (akin to ethnolinguistic divisions in other countries), which on the eve of the civil war was roughly 45% and 55%, respectively, appears to have been conducive to the outbreak of the Lebanese civil war. Empirical cross-country studies on the role of social fractionalization or polarization in the onset of civil conflict lend support to the potentially high risk that a social divide similar to that of Lebanon carries in this regard.[20]

Once the war broke out, economic greed associated with the financial benefits accruing to the warring parties and their leadership increasingly became a major factor in sustaining it for 16 years.[21] At the same time, multiple external interventions, directly on the part of Syria and Israel and indirectly on the part of others, helped not only to ignite the war but also to prolong its duration: the main militias were able to secure sufficient

resources from Arab and non-Arab countries to finance their costly military and civilian operations, and in the process their leaders and henchmen managed to amass substantial personal wealth. The fact that the war was fought along largely sectarian lines facilitated Syrian and Israeli interventions in pursuit of their own vested interests. Their opposing objectives helped create a *modus vivendi* that helped prolong the war as long as the Lebanese parties concerned could not independently arrive at national reconciliation. Empirical studies indicate that the average length of a civil war that experienced external interventions is nine years (cf. Lebanon's 16 years), whereas in which there were no such interventions had an average length of one and a half years (Elbadawi and Sambanis 2000a: 10).

Political fragmentation and economic impact

The war led to political fragmentation and consequently a greatly weakened central authority. Various parts of the country came under the control of the warring militias and/or the Syrian forces that entered Lebanon in 1976, ostensibly at the request of the Lebanese authorities. Over the course of the conflict, Syria shifted alliances with Lebanese and Palestinian parties. Israel for its part intervened directly on several occasions. In 1982 it invaded Lebanon and laid siege to Beirut. Though it ostensibly supported Lebanese parties in conflict with the PLO, it did not fail to play one Lebanese party against another, and there was no shortage of inter-militia fighting within each of the two major camps of the civil war. By the time the conflict ended, effectively in 1990, most public sector institutions were in need of major administrative overhaul and reform, within of course the imposed constraints of the time-honored sectarian approach (see the second section).

The disastrous impact of the civil war was multifaceted. Apart from the tremendous loss of lives (estimated at about 150,000 or 5% of the resident population toward the end of the war), downtown Beirut and whole villages and towns were completely destroyed and the infrastructure of the country was severely damaged. The amount of production foregone as a result of the destruction and dislocations the economy sustained was huge, although estimates depend upon the assumed rate of growth that would have prevailed in the absence of war. For example, adopting a reasonable 4% annual rate (in comparison with the over-6% prewar annual rate) would yield a foregone output of about $30 billion at 1974 prices (for 1974, GDP was estimated at about $3.5 billion). Estimates of real per capita GDP for 1990 (admittedly, they may include a wide margin of error) indicate that it was about one-fifth of its level for 1974.

In the aftermath of the Israeli invasion of 1982 and the consequent intensification of the political-military conflict, the financial situation

began to deteriorate rapidly. Budgetary deficits increased and the Lebanese pound depreciated quickly, accompanied by mounting inflation. Real wages suffered and socioeconomic conditions worsened. Although a weakened state attempted to counter the deteriorating economic and financial situation, at times successfully, it was the resilience of the private sector, including an expanding informal sector, that prevented a total collapse of the national economy, of course at substantial social and economic cost.[22]

Settlement of the conflict: The Taif Accord

The Taif Accord that formally put an end to the civil conflict amounted to a major readjustment of the sectarian formula for power sharing in favor of the Muslim community, rendering it more equitable among the three largest religious communities, a long-standing demand of the prewar years. In consequence, the positions of prime minister (Sunni Muslim) and speaker of the house (Shii Muslim) were strengthened, although some of the privileges of the president (Maronite Christian) were curtailed.[23] The council of ministers (evenly divided between the two communities) was collectively given executive authority. Furthermore, instead of the small advantage previously enjoyed in parliament by the combined Christian community (a five to four majority), the Accord specified equal representation for the two communities, albeit with a finely tuned formula for the distribution of seats among the various religious sects. Thus, while the Taif Accord envisaged a more collegiate political governance, the essential features of the sectarian system remain unchanged.

Significantly, the Taif Accord also allowed for the temporary stay of Syrian troops in Lebanon to help establish order. Two years after the election of a new president, the formation of a government of national reconciliation, and approval of the constitutional amendments in accordance with the Accord (approved August 21, 1990, and signed into law by the president on September 21, 1990), the Syrian troops were to be redeployed to the Beqaa Valley in eastern Lebanon. Their eventual total withdrawal from Lebanon was made subject to agreement between the two governments. As already noted, effectively total withdrawal of Syrian troops from Lebanon did not take place until April 2005, and then only under Western pressure reinforced by repeated street demonstrations demanding their withdrawal following the Hariri assassination.

Initial resort to Syrian security assistance seems in line with the conclusion of a recent study on the successful settlement of civil wars, namely, that whatever the reasons that bring combatants to the negotiating table and whatever the terms of their power-sharing pacts, the successful settlement of such wars would still require third-party security guarantees concerning the safety of the combatants and the enforceability of the agreed pacts

(see Walter 2002: 90–1, 160–1). On the other hand, it is also important to understand the nature, extent, and duration of third-party (external) security intervention. The Lebanese case demonstrates that this intervention could go beyond its originally intended objectives: until the withdrawal of its troops in April 2005, Syria had exercised a determining influence on Lebanon's postwar political developments. Hence, inasmuch as third-party security guarantees may be necessary to help postconflict governments enforce power-sharing pacts and maintain domestic peace, it is equally important to ensure that the third party entrusted with this task does not, for self-serving reasons, become perennially embroiled in domestic political processes and outcomes. This, of course, would depend on the nature of the agreed political compromises that paved the way for the settlement of the civil conflict and whether they are inherently stable in the long run, as well as the vested interests of the influential outside powers involved in bringing about the settlement (discussed later).

Rebuilding the State and the National Economy

Sixteen years have now passed since the settlement of the civil conflict. But in the sixteenth year Lebanon could not escape the war waged by Israel, whose full ramifications for Lebanon and the region are yet to unfold. Whatever its ultimate outcome, I do not expect it to trigger a new civil conflict, despite the deep domestic political divisions that openly preceded and silently accompanied its outbreak and continued after the UN-imposed cease-fire effective August 14, 2006 (UN Security Council Resolution 1701). The main reason for this contention is that the civil war and its disastrous consequences remain vivid in Lebanese collective memory. In turn, these would check the divisive impact of regional conflicts on the domestic political scene, whether the older Arab-Israeli conflict or the more recent U.S./Israeli–Iranian confrontation.

Although huge shortcomings have characterized Lebanon's political governance after the civil war, there continues to be a strong desire among major political/religious groups to make consociational democracy work, no matter how imperfectly, with its implied balance of power sharing among these groups. This desire is partly based on their mutual concern that no single domestic group should emerge as the dominant political player. I should add that despite the heightened political divisions in the wake of the July–August 2006 war, the risk of a renewed civil conflict does not appear to have increased substantially, although its possible recurrence cannot be altogether dismissed, especially if the leaders of any one of the main political/religious groups, supported by outside powers, should feel

that their stake in power sharing is threatened. Hence, the question of the long-term viability of sectarian power-sharing arrangements in Lebanon remains to be addressed, especially given that the dangers of strong destabilizing external influences can always reemerge.[24] The basis for sustained long-term stability is yet to be laid, and the viable rebuilding of postwar Lebanon still awaits a final resolution of the fundamental weaknesses of its political system and institutions.

I shall take up four fundamental questions related to national rebuilding that need to be addressed if long-term national stability is to be established: (a) political governance, (b) the quality of growth and economic performance, (c) the dominance of the private sector and the issue of sustainable development, and (d) the challenges of the new regional and global environments. The issue of political governance, as will become apparent, underlies all of the above questions.

Political governance

The question of political stability revolves around whether "consociational democracy" as practiced in Lebanon is viable in the long run. This type of democracy has been advocated by writers and politicians across the sectarian divide in the belief that it is the most appropriate form of democracy in a multireligious society such as that of Lebanon. Their reasoning is that mutually accepted political concessions among the various religious communities safeguard their respective identities and rights in power sharing, at the same time allowing for parliamentary elections and, in principle, the trappings of modern democracies. In the same vein, certain observers argue further that the elimination of the sectarian system could lead to the political—and possibly cultural—hegemony of a single religious community, or even to the emergence of a military dictatorship. In consequence, Lebanon's cultural wealth associated with the existence of various religious communities and the measure of freedom that the delicate sectarian balance has provided would be greatly diminished. Thus, according to this argument, husbanding the sectarian system by redressing whatever elements of instability it might embody would be a preferable alternative to doing away with it altogether. The Taif Accord is seen as an attempt in this direction, although it has not been properly implemented.

If this accord was necessary for a formal settlement of the conflict, the question remains as to whether it provides the conditions for long-term stability. Whereas the readjustment of political power sharing among the religious communities was intended to contribute to the stability of the sectarian system, the post-Taif experience reveals the persistence of important

potential elements of instability. The council of ministers has yet to assume the role assigned to it under the Taif Accord as the collective executive governing body. Until the Syrian troop withdrawal in April 2005 and the consequent drastic curtailment of Syrian influence, the phenomenon of "troika rule" (the troika comprising the president, the speaker of parliament, and the prime minister, all of whom were allies of Syria) emerged and had generally tended to dominate political life. Without going into the reasons behind it, what was significant about the troika was that not infrequently disagreements among its members were not necessarily settled within the council of ministers or parliament but outside these institutions. Failing their resolution, Syrian-imposed mediation had become the effective alternative to settling existing disputes. Syria thus became the dominant domestic political player and the stabilizing force, serving, of course, its own interests.

Indeed, some political observers across the sectarian divide argue that Lebanon's sectarian system is not necessarily unstable. They attribute the lack of stability in the post-Taif era up until Syria's withdrawal to its political and military presence. Not surprisingly, Syria had supported, to varying degrees, political parties, groupings, and actors it regarded as reliable allies, and opposed the resurgence of those it considered unfriendly to its interests in Lebanon and the region. Syrian support often translated into its Lebanese allies occupying high political, administrative, and cabinet positions. Even among its allies, Syria tended to maintain a balance of power that it did not hesitate to alter in light of its evolving interests. This situation, it is pointed out, rendered the domestic political situation potentially unstable, even though the security situation was more or less under control.

Following the withdrawal of Syrian troops, there emerged, as noted earlier, a new political environment that was marred by deep political divisions, intensive external political interventions, and a greatly weakened role of the government as a collective executive body. Though the Israeli war on Lebanon in July–August 2006 did not fulfill its declared objectives, it did lead to the wider involvement of outside powers in the internal affairs of Lebanon. It also revealed once again the vulnerability of Lebanon to destabilizing, and in this case, tragic interventions.

Whatever the eventual ramifications of this war, one important question that has arisen since the Syrian withdrawal and was tragically underscored by the Israeli attack is whether the post-Taif political system is inherently capable of accommodating major internal political divisions without inviting (willingly or unwillingly) outside interventions that could take the form not simply of political pressure, but of military action as well.[25] In my opinion, irrespective of the role of external influences in preventing

stability, there are inherent elements of instability associated with the nature of the political system itself, as demonstrated by developments subsequent to the Syrian troop withdrawal. For whatever its merits, the finely tuned sharing of political power among Lebanon's religious communities remains inherently discriminatory. Sectarianism has continued to act as the mainstay of political behavior, the Taif settlement notwithstanding. Although at present there is a general acceptance of this settlement and of the form of "consociational democracy" it carries with it, there is no guarantee that sectarianism will not always be exploited by political groups to serve their own political agenda even at the cost of destabilizing the existing political system. The events of 2005 and 2006 illustrate this type of destabilization. The long-term viability of the readjusted sectarian power-sharing arrangement that ended the civil war is a question that, I believe, needs to be thoroughly examined. Here a few remarks will suffice.

To begin with, the system has been undermined by poor political governance: generally inefficient governmental institutions and pervasive corruption.[26] According to World Bank indicators on corruption for 2005, Lebanon did not rank well even by comparison with other countries in the region. Indeed, the data show that the level of corruption worsened over the period 1996–2005.[27] No doubt sectarianism contributed to the prevalence of an inefficient public sector marred by corruption. But so did the familial and clientist nature of the political system. The entry of war militia leaders with their own agendas into the postwar governments, alongside super-rich individuals whose use of political money to achieve their objectives had become widespread, further strengthened the "culture" of corruption. Whatever the merits of Lebanon's "consociational democracy," poor governance has reinforced its low-level efficacy. Nonetheless poor governance, on its own, would not necessarily lead to fundamental changes in the political system, especially in the absence of a nationally agreed alternative.

In principle, if they agree, major political players could implement measures that would improve the stability of the prevailing system, at least for the short run. For example, a new electoral law could be adopted to ensure a fairer representation. Under Syrian influence, the electoral laws had been tailored to serve the vested interests of particular groups. Reforming the electoral law with the above objective in mind would give parliament and by extension government greater legitimacy and render both more accountable.[28]

Whatever reforms are deemed necessary to enhance stability in the foreseeable future, over the long run this stability, it seems to me, can only be achieved if the present power-sharing arrangements give way to a more democratic and secular system.[29] I submit, however, that elimination of

the confessional features of the system would not, on its own, lead to firm long-term political stability and better governance. It must be considered as part of a broad-based reform of the management of government and its institutions, essentially laying the ground for the creation of a new political-administrative culture. Otherwise, simply discarding the sectarian formula in favor of a nonconfessional parliamentary system might only amount to a different political power structure and alliances that are outwardly nonsectarian but effectively behave under sectarian influences, with no guarantee of improved political governance. In fact, it is possible that the checks and balances of the Lebanese sectarian system that have allowed a good measure of political freedom and guaranteed the right of free religious expression could give way to the emergence of a political regime that, in practice, would be less democratic than the existing one.[30]

Until a broad-based and viable political reform is put in place, the question of what I referred to elsewhere as "unstable political equilibrium" facing the Lebanese political system will not be laid to rest (Makdisi 2004: 166). Indeed, the political events of 2005 and 2006 demonstrate how divisions among major political and/or religious groups can quickly threaten to destabilize the existing political set-up and, consequently, how vulnerable it remains to external influences and interventions. One major lesson to be drawn from the vicious war waged in July 2006 by Israel with open Western support is that, pending major long-term political reforms, there is urgent need to improve the workings of Lebanon's political institutions by rendering them more open and accommodative of political conflicts and therefore more capable of dealing with external destabilizing influences.

Growth and macroeconomic performance (1991–2006)

Four phases of growth can be discerned since the end of the civil war (see table 5.1). The first phase, stretching from 1991 through 1994, witnessed an accelerating growth rate peaking at 8% in 1994; it was induced by increasing public sector expenditure and private sector investments led by the construction sector. The increased expenditure took up existing slack in the postwar economy while private sector expectations were initially positive regarding future prospects.

The second phase, from 1995 to 2000, saw a gradually declining growth rate becoming slightly negative in 2000. This may be partly attributable to continued borrowing by the government at relatively high (although over time declining) real interest rates to finance persistent budgetary deficits, with a consequent dramatic rise in public debt (climbing from about 48%

Table 5.1 Lebanon: Rate of growth, public debt, inflation and exchange rates, fiscal operations (1991–2005)

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
Nominal GDP (USD million)[a]	4,452	5,546	7,535	9,110	11,119	12,992	15,595	16,909	17,013	16,679	17,065	18,462	19,895	21,768	22,052
Rate of real growth (%)	NA	4.5	7	8	6.5	4	4	3	1	−0.5	2	2.9	5	6	1
Public debt (USD million), end of period	3,114	2,635	3,821	6,557	8,870	13,008	15,390	18,555	22,365	25,200	28,312	30,727	33,381	35,861	38,507
Foreign currency	NA	NA	NA	772	1,305	1,908	2,432	4,166	5,842	7,529	10,223	13,943	15,575	17,491	—
Domestic currency	NA	NA	NA	5,785	7,565	11,100	12,958	14,389	16,525	17,442	18,052	16,784	17,806	18,357	—
Debt / GDP (%)	69.9	47.5	50.7	72.0	79.8	100.1	98.7	109.7	131.5	151.1	165.9	166.4	167.8	164.7	174.6
Inflation (YTY % change)	50.0	99.8	24.7	8.0	10.6	8.9	7.7	4.5	0.2	−0.4	−0.4	1.8	1.3	−1.3	0.3
Avg annual exchange rate (LL / USD)	928.23	1712.8	1741.4	1680.1	1621.4	1571.5	1539.5	1516.22	1507.5	1507.5	1507.5	1507.5	1507.5	1507.5	1507.5
(LL billion)															
Government revenues	522	1,138	1,855	2,241	3,033	3,534	4,010	4,449	4,873	4,684	4,646	5,830	6,655	7,515	7,405
Government expenditures	1,196	2,219	3,017	5,204	5,856	7,225	9,162	7,906	8,453	10,621	8,875	10,139	10,593	10,541	10,203
(Of which, interest payments)	204	519	784	1,488	1,875	2,653	3,378	3,352	3,625	4,197	4,312	4,622	4,874	4,021	3,534
Budget deficit/surplus	−674	−1,081	−1,162	−2,963	−2,823	−3,691	−5,152	−3,457	−3,580	−5,937	−4,229	−4,309	−3,938	−3,026	−2,798
Primary deficit/surplus	−470	−562	−378	−1,475	−948	−1,038	−1,774	−105	45	−1,740	83	313	936	995	736
Budget deficit/GDP (%)	−16.3	−11.4	−8.9	−19.4	−15.7	−18.1	−21.5	−13.5	−14.0	−23.6	−16.4	−15.5	−13.1	−9.2	−8.4
Primary deficit/surplus/ GDP (%)	−11.4	−5.9	−2.9	−9.6	−5.3	−5.1	−7.4	−0.4	0.2	−6.9	0.3	1.1	3.1	3.0	2.2
Budget deficit/expenditures (%)	56.4	48.7	38.5	56.9	48.2	51.1	56.2	43.7	42.4	55.9	47.7	42.5	37.2	28.7	27.4

Note: NA, Not available.

[a] Beginning in 1997, a new series for GDP was published (see Lebanon 2005), which is not strictly comparable to the pre-1997 series.

Sources: Lebanon, Ministry of Finance; IMF, various reports.

of GDP for 1992 to a little over 150% for 2000), which in turn led to a "crowding-out effect" with respect to private sector investments, and the persistence of generally relatively high borrowing costs for private enterprises (see figure 5.1). Other factors contributing to the declining rate of growth were prevailing regional political uncertainties and clashes associated with the Arab-Israeli conflict, which tended to restrain the flow of private investment. Furthermore, the decline in the oil revenues of the Gulf region from 1990 to 1999 negatively affected regional investments by the Gulf countries and the inflow of expatriate remittances from the region. In addition, although the rehabilitation of the infrastructure had a positive impact on the investment climate, lack of progress in administrative and political reform, not to mention increasing corruption, influenced this climate negatively.

The third phase, from 2001 through 2004, experienced a recovery of the growth rate, reaching an estimated 6% in 2004. This improvement is mainly related however to post–September 11 developments that caused a reflow of Arab capital toward Lebanon, as well as other Arab countries, especially in the real estate sector, and of tourists from the Gulf region. This, in turn, has contributed to the expansion of bank deposits, easing the pressure on banks in accommodating budgetary deficits.

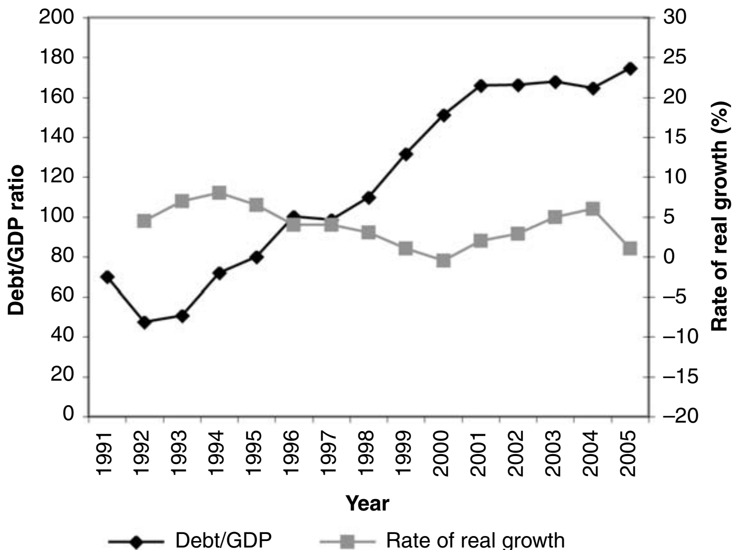

Figure 5.1 Lebanon: Debt/GDP ratio versus rate of real growth, 1991–2005

The fourth phase (2005–06) witnessed a human tragedy and vast economic destruction (infrastructure, dwellings, factories, other enterprises, etc.) brought about by the war waged by Israel in July 2006. For 2005, the rate of growth is estimated to have dropped to 1% as a result of the political-security turmoil following the assassination of former prime minister Hariri. For 2006, as a consequence of the war's extensive damage to physical capital (estimated at about $2.5 billion) and the disruption of economic activity, the rate of growth turned negative, estimated at about −3%, thereby putting a further temporary halt to the process of economic recovery.[31]

Sixteen years after the end of the civil war, the Lebanese economy thus faces anew the challenges of economic recovery and reconstruction, especially in the regions devastated by Israeli air attacks. Equally important, if not more so, is the challenge of political reconstruction alluded to in the previous section.

The postwar macroeconomic performance through 2005 is mixed. On the positive side, anchoring the Lebanese pound to the U.S. dollar beginning in late 1992[32] helped to restore exchange rate stability and gradually bring down the rate of inflation from its high levels in the immediate postwar years (a peak of 100% for 1992) to low levels by the end of the decade, estimated at close to zero percent for 1999–2001 and remaining at low levels in subsequent years through 2005 but rising to around 6% for 2006 (see figure 5.2).

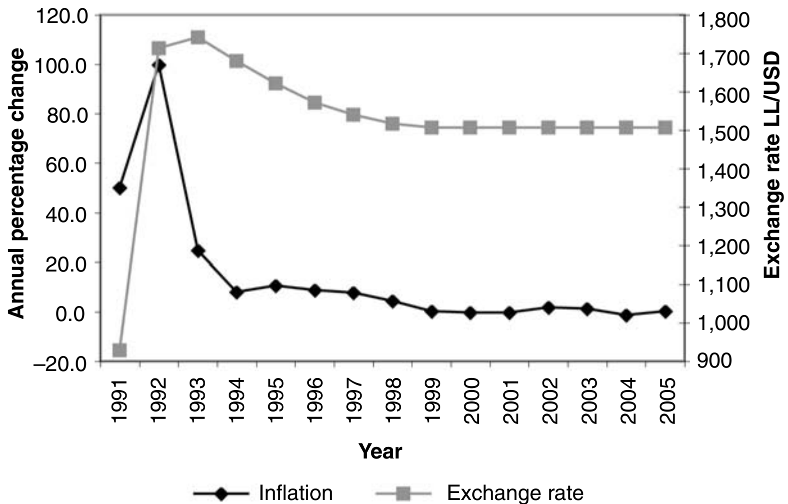

Figure 5.2 Lebanon: Exchange rate versus inflation, 1991–2005

On the negative side, persistent large budgetary deficits kept the level of public debt rising to reach about 175% of GDP for 2005 and 186% for 2006, among the highest in the world. Furthermore, insofar as the fiscal situation was not brought under control, exchange rate stabilization carried with it substantial economic costs. The authorities tended to maintain relatively high real rates of interest on Treasury Bills (TBs), not only to ensure bank accommodation of the budgetary deficits but also to defend the pound, with consequent high borrowing costs for the private sector from the banking system. Moreover, adverse domestic political and economic developments were sometimes reflected in heavy and sustained pressure on the pound, which the Central Bank was forced to counter by sustained intervention on the foreign exchange market. At times this was accomplished at the cost of a substantial and threatening decline in its net foreign reserves, prompting outside financial support to avert a potential domestic economic and financial crisis.[33]

Altogether the emerging unhealthy macrofiscal environment not only contributed to the overall decline in the rate of growth, particularly after 1995, but also exacerbated the unemployment problem and encouraged the emigration of Lebanese skills.[34] As noted earlier, the economic turnaround in 2003–04 is related more to favorable external factors than to a major improvement in the macroeconomic environment. This turnaround was halted by the security-political events of 2005 (although Lebanon continued to benefit from inflows of direct investments in the real estate market), followed by the disastrous war of July–August 2006. Significantly, no substantial financial pressures emerged, thanks mainly to the stability of the Lebanese pound which the Central Bank, via its intervention on the foreign exchange market, could maintain in the face of increased but relatively limited pound conversions into dollars.

What should be underscored is that, in the context of the postwar political system, the checks and balances that could have prevented the emergence of major macroeconomic imbalances seem to have been weakened at a time when regional economic conditions had become less favorable, while Lebanon was in need of implementing a proper coordination of its economic and reconstruction policies. Budgetary outcomes were not governed by built-in institutional restraints against financial indiscipline. Despite attempts at fiscal reform, fiscal matters to a large extent continued to be subject to a political and administrative decision-making process in a political environment that did not impose the required accountability, not to mention conflict of interest on the part of high governmental officials and widespread corruption in the public sector. It is an open question whether the war of 2006 will force a positive change in the management of the country's political and consequently fiscal affairs.

However, irrespective of the macroeconomic and growth outcomes in the postwar period, what is equally significant is the quality of development. Although progress has been achieved in a few areas such as health and education, in other areas little if any improvement was accomplished or else conditions noticeably deteriorated, as in the case of the environment, income distribution, and the level of poverty that was accompanied by the increasing concentration of political and economic power in the hands of the few (see Makdisi 2004: 148–57). This matter is directly attributable to poor institutional performance and to a political set-up where the distinction between public and private interest is blurred, to say the least.

As already observed, one of the major challenges that Lebanon has been facing all along (reinforced by the major political developments of 2005 and more importantly by the war of 2006) is how to reform its political institutions and raise the level of political governance so as to render the decision–making process more accountable and transparent. This should enhance developmental performance and specifically the quality of development.

On the dominance of the private sector and sustainable development

The fact that the Lebanese private sector has played and continues to play the central role in the national economy carries with it two important implications: the first is that, unlike other countries where the public sector has been dominant, the role of the Lebanese state in the economic domain does not need to change significantly to comply with the international calls (and pressures) to give an increasing role to the private sector. Indeed, the issue Lebanon has been facing in the post–civil war period is that the dynamism of its private sector has not, as yet, been matched by a political-administrative performance that would ensure, in case of conflict, the prevalence of the public interest over the private. If anything, the performance of the public sector, characterized by a relatively higher degree of corruption, is generally less adequate than in the prewar period.

Public interest has often been sacrificed in favor of private interests, either with political protection or with the outright involvement of influential political actors that permitted frequent violations or inadequate implementation of existing rules and regulations.[35] To the extent that the distinction between private interests and the public interest has been and remains blurred and the required guarantees to keep them separate are not in place, the public good will continue to suffer and so will the quality of development. Institutional performance is an area awaiting major reform.

This matter leads to the second implication related to the impact of poor political governance on public policy. As noted earlier, poor governance eventually contributed to major economic imbalances. Equally importantly, this has been paralleled by the lack of a coherent national policy focusing on sustainable development. While recognizing progress in specific areas such as health and education, it would not be difficult to state that the Lebanese economy has been less than successful in becoming a modern one in which the quality of development, including questions of social equity, occupies a central place. Indeed, if the present rate of environmental degradation continues, along with inefficient and hence costly institutional performance, one cannot but conclude that the Lebanese economy—irrespective of its purely macroeconomic performance—will in fact be moving away from rather than toward a modern economy. A basic condition for assuring that this will not be the case would be a drastic improvement in Lebanese political and institutional performance.

The significance of this matter is that, unless checked, the worsening socioeconomic conditions carry with them potential elements of instability in addition to those already embodied in the sectarian system.

On the new global environment

Lebanon and other developing countries have to cope with the influences of powerful industrial countries, in particular the United States, that dominate the political and economic agenda of globalization. At the economic level they may not be fully convinced of the policy dicta of international monetary and trade organizations entrusted with the task of managing the rules of globalization: notably, the almost complete opening up of their national economies and concomitantly transforming them into market-oriented economies. Nonetheless, in designing their own national economic, developmental, and social strategies, they have to account for the policy agenda of these organizations. Some countries have been more successful than others in this endeavor.

Equally important, in this new open global environment a major issue that many developing countries have been facing is that the development of their political institutions has lagged behind the globalization of technology, trade, and investment. This has tended to further weaken their capacity to govern in a globalized world that itself entails the diminished national sovereignty of individual states. In other words, for many developing countries, globalization has come to imply a weakened ability to manage their national economy and to set their own national agenda without being subject to major outside influences. In certain instances their weakened capacity to govern (manifested, e.g., in weak and/or

lopsided development, nondemocratic practices and/or domestic political tensions or violence) has been used as a pretext by outside powers to intervene, for self-serving purposes, sometimes via direct military action. The emerging global environment, therefore, has various implications for national building in developing countries (or rebuilding in the case of devastated economies) that would need to be thoroughly analyzed.[36]

Currently, in addition to Lebanon, Iraq and Sudan are obvious cases in point. The long-lasting conflict between northern and southern Sudan was settled in January 2005 on the basis of a political and economic power-sharing arrangement but not without substantial external pressure and involvement. In certain respects this arrangement is similar to the Taif agreement that settled the Lebanese civil conflict. Whether the Sudan settlement will prove successful in the future (the question is principally whether or not the South will secede) and to what extent this success will be dependent on outside assistance remains to be seen. An intriguing question is whether a successful broadly based and largely market-oriented national economic development (as per the prevailing rules of globalization) will constitute a sufficient condition for Sudan's future stability.

As for Iraq, it remains to be seen whether, in the aftermath of the U.S.-U.K. invasion in the spring of 2003 and the ensuing violence, the agreed political settlement (a federal Iraq with wide autonomy enjoyed by the Kurdish region) will prove viable and lead to domestic stability. In practice, the Iraqi settlement appears to be based on power-sharing arrangements similar to those of Lebanon and Sudan, although it remains uncertain whether these arrangements are generally acceptable to the major Iraqi communities. On the assumption that internal security is eventually restored, the question remains whether, as in the case of Sudan, the new political settlement will survive in the absence of outside support, and to what extent a successful market-oriented national economic development will contribute to sustained domestic stability.

For Lebanon, the impact of the new global environment clearly does not concern the issues of openness and the market orientation of its economy. These have been in place for a long time. Rather, the question that needs to be addressed is how this new environment will affect the performance and development of its political governance and domestic stability and how Lebanon can deal with regional challenges. UN Security Council Resolution 1559 (2004) which, among other things, calls for disarming Hizbullah, led to serious domestic political divisions and strained Syrian-Lebanese relationships. Domestically, the parliamentary elections carried out in May–June 2005 brought about new political alliances, a new parliamentary majority, and a new government all amenable to Western (specifically American and French), rather than Syrian, influences.

Nonetheless, this did not prevent Israel from waging an all-out war on Lebanon and in the process destroying a substantial portion of its infrastructure as well as many villages, with the declared objective, among others, of implementing by force that part of Resolution 1559 pertaining to the disarming of Hizbullah, which the Lebanese government has so far not carried out, preferring (and correctly so) to accomplish this objective through national dialogue in order to avert a potentially severe domestic conflict. If, as noted earlier, the capture of two Israeli soldiers was the immediate pretext for the attack (in lieu of negotiation with Hizbullah through a third party for an exchange of Lebanese prisoners held by Israel), its wider and far-reaching regional objectives were clearly stated, as mentioned earlier, by both the Israeli and the U.S. governments. The war waged by Israel is a cruel demonstration of the negative influences of the new U.S.-dominated global environment.

It is too early to discern the ultimate ramifications of the war (which has so far failed to achieve its declared U.S.-Israeli objectives) and whether it will result in greater political stability, at least in the short term. But the war has compellingly brought forward the long-standing issue of how Lebanon can cope with ongoing regional conflicts that have a direct bearing on its own domestic political and economic situation. Lebanon cannot extricate itself from regional influences or be neutral on the question of the Arab-Israeli conflict. But improving the workings of its political institutions, even in a sectarian context, whereby they become more open, inclusive, and capable of resolving national disputes, would strengthen its ability to withstand the disruptive impact of any regional conflict.

In the longer run, there is no substitute for substantive national reform leading to a more democratic and secular system with accountable political institutions that will permit Lebanon to take advantage of the benefits of globalization while minimizing its economic, political, and human costs.

Concluding Remarks

The rebuilding of the post–civil war Lebanese economy cannot be separated from the rebuilding of the postwar Lebanese state and political system. The postwar experience clearly indicates that macroeconomic and developmental performances are closely intertwined with political/institutional performance, a matter that presumably applies with equal force in other countries. What perhaps distinguishes the Lebanese case is the traditional dominance of the private sector and its close alliance with the ruling political coalitions. Indeed, in the postwar period, major political actors have emerged from the business class (albeit with clearly defined

sectarian affiliations) and have come to share power in the readjusted sectarian system with militia leaders of the civil war, and with traditional political families and parties whose power has been relatively diminished. Until the withdrawal of Syrian troops in April 2005, Syria had a major influence on domestic political and, to a much lesser degree, economic outcomes. These are the developments that, until the Syrian withdrawal, defined the postwar context within which the questions of national rebuilding had to be addressed.

Since then the political context has changed dramatically as a result of the Hariri assassination. Major events include the withdrawal of Syrian troops, the appointment by the UN of a commission to investigate the assassination, new parliamentary elections resulting in new political alliances including political groups that previously had not been allowed or had been pressured not to participate directly in such elections, and, most profoundly, the war waged by Israel in July–August 2006 and UN Security Council Resolution 1701. The resolution, although intended to end hostilities by enhancing the role of UN peacekeeping forces in southern Lebanon, in its vagueness carries with it potential pitfalls that, unless carefully avoided by the country's major political players, could threaten Lebanon's political stability. This is one of the most outstanding political challenges the country has come to face in the aftermath of the war.

Indeed, this last war constitutes a watershed in Lebanon's development. It has brought forward with full force the dominant question of how to reconstruct the country's political institutions so that they become more inclusive of all political parties, both sectarian and secular, and more accountable and transparent in charting Lebanon's political future. I submit that Lebanon has emerged from the war with a blurred national vision of how to rebuild the state with the objective of making it more capable not only in its role as overseer of equitable and sustainable social and economic development but also in coping with the fundamental regional challenges facing the country. In brief, the major question Lebanon now faces is how to substantially enhance the institutions of its consociational democracy (which all major political parties presumably embrace) as a transitory stage toward a more viable democratic system. Whether recent tragic developments will lead to the hoped-for reform of Lebanon's political-administrative institutions remains to be seen. However, if it is to be durable and beneficial, such reform, I believe, should reflect the end result of national dialogue and processes, and not be externally imposed.

It is true that recent political and military developments have carried with them substantial destabilizing influences at the domestic level, but they are unlikely to provoke a new civil war. The devastations brought about by the 1975–90 civil conflict are still fresh in the Lebanese collective

memory, while the political parties are uncertain about the outcome of any new conflict. These are factors that significantly reduce (but do not altogether eliminate) the risk of a renewed civil conflict.

Successful national economic and social development will increase the probability of an enduring peace but will not eliminate potential elements of instability in the political system or necessarily shield it from external destabilizing influences. Only a successful resolution of the weaknesses of Lebanon's political institutions, including in the longer term the move toward a more democratic, open, and secular system, will ensure the country's long-term political and economic stability in an increasingly integrated world. The political alternative, advocated in some quarters, of cantonization or a highly decentralized federal system along sectarian lines has historically proven not to be viable.

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Notes

1. Under pressure from Western and Arab governments, the war officially ended with an accord of national reconciliation, negotiated under Arab auspices in Taif, Saudi Arabia, in October 1989, and thus known as the Taif Accord. Constitutional amendments were adopted by parliament on August 21, 1990, and signed into law by the president of the republic on September 21, 1990. Actual fighting, however, did not end completely until October of that year.
2. They are General Michel Aoun who, as interim prime minister toward the end of the civil war, was forced to leave the county in late 1990, and returned on May 7, 2005, and Samir Geagea, leader of the (Maronite) Lebanese forces (LF), one of the major militias of the civil war, who was imprisoned in 1994 and freed on July 26, 2005.
3. Namely, the journalist Samir Kassir, on June 2, 2005, and the former secretary general of the Communist Party, George Hawi, on June 21, 2005. Attempted assassinations were made on Minister of Defense Elias El Murr on July 12, 2005, and TV journalist May Chidiac on September 25, 2005. On December 12, 2005, Gibran Tueni, chair of the board of the daily *al-Nahar* newspaper and a recently elected member of parliament, was assassinated.
4. One reason why the Western countries and their Lebanese allies did not wish a postponement of the elections was their concern that the emotional backlash against Syria and its Lebanese allies engendered by the Hariri assassination

might have been diminished and might have led to a different election outcome.

5. Israel maintained a sea and air blockade of Lebanon from the beginning of the war until September 7, 2006, that is, 25 days beyond the effective date of the cease-fire and in violation of UN Security Council Resolution 1701 which called for the cease-fire.
6. Secretary of State Condoleezza Rice spoke of a "new Middle East" as a major objective of the war. Fearful of the growing strength of Iran, even Egypt, Jordan, and Saudi Arabia initially indirectly encouraged the Israeli attack by openly criticizing the capture of the two soldiers. With the great destruction and loss of lives that was to follow in subsequent days and the inability of Israeli forces to defeat Hizbullah on the ground, they tended to change their position by calling, along with other countries, for an immediate cease-fire. In the context of regional rivalries, the initial position taken by these three countries is highly significant. To them, the control or weakening of Hizbullah meant the weakening of Iranian regional influence.
7. In the aftermath of the war, many commentaries in the Western and Israeli press (let alone the Lebanese and Arab press) reflect this conclusion. See, e.g., *The Guardian*, August 17, 2006, *The Economist*, August 26–September 1, 2006, and *Haaretz*, August 16 and September 7, 2006.
8. In the literature this term has been used to refer to proportional representation in elections and public office among different groups in society, among other attributes. For a review of consociational democracy, see Andeweg (2000) and Binningsho (2005).
9. Article 95 of the constitution of the newly independent republic stated that, for a temporary but unspecified period, religious sects (currently, 18 are officially recognized) would be equitably represented in public employment and cabinet posts. The principle of equitable representation was not defined. However, an unwritten national accord reached among political leaders on the eve of independence specified that the post of president of the republic was to be held by a Maronite Christian, that of speaker of the house by a Shii Muslim, and the premiership by a Sunni Muslim.
10. Among other privileges, the "Maronite" president enjoyed executive authority, assisted by cabinet members whom he appointed and from whom he designated a prime minister, although in practice the latter shared in executive authority to a greater degree than specified in the constitution. With the approval of the council of ministers, the president had the prerogative of dissolving parliament before the expiration of its mandate. Furthermore, under the unwritten national accord, the Christian community (comprising the several subgroups) enjoyed a five to four majority in the distribution of parliamentary seats.
11. These include the Protestant, Roman Catholic, and Assyrian communities, among others.
12. The average annual rate of growth from 1950 to 1974 was estimated at about 7%. Per capita income increased significantly, standing in 1974 at about $1,200 (about $4,800 in 2000 prices), one of the highest levels for a developing

country at that time. Up to 1970 the annual rate of inflation was estimated at 2–3%. Educational standards were also relatively advanced. For 1974 gross school enrollment for the first and second levels stood at 74%. Again, this was a higher level than then prevailing in neighboring Arab countries, as well in many other developing countries. National health standards improved, though mainly in urban centers and especially in the city of Beirut. See Makdisi (2004: 14–29).

13. Available empirical studies indicate that over the prewar period the percentage of the very poor/poor groups in the total population may have declined from the 1950s to the early 1960s, but thereafter remained the same at roughly one-half of the total. A study conducted in the mid-1970s indicates that for 1973–74 the middle class accounted for 25% of the population, the well-to-do and the very rich for about 20%, and the remaining 55% consisted of the poor and the very poor (see Schemeil 1976).
14. Indeed, in 1974 the religious leader of the Shia community, Imam Musa al-Sadr, launched a political movement, Amal, as a political and economic thrust intended to enhance the position of the Shia community in the Lebanese sectarian system, as well as to act as a countervailing force to the growing influence of Palestinian organizations in southern Lebanon. Amal presented itself as a "movement of the dispossessed," and its appeal was to a large extent based on the lagging socioeconomic conditions of the Shia community in comparison with other communities in Lebanon. It was to develop, especially after 1982, into one of the major warring factions in the Lebanese civil war.
15. For details about political and military developments in 1970–75, see El Khazen (2000) and Salibi (1976: 54–98).
16. For a recent review of the civil war literature, see Collier and Sambanis (2005a, 2005b); Berdal and Malone (2000); Arnson and Zartman (2005).

    The crucial role of economic greed (in contrast to political grievance) has been stressed in particular by Collier and Hoeffler (2004). According to their findings (embodied in the so-called CH model), the higher the level of per capita income, the more robust the rate of growth, the smaller the ratio of primary commodities to GDP, the smaller the size of the population, the higher the level of education, and the longer the period of time that has elapsed since the last war, the less the risk of a civil conflict breaking out. On the other hand, ethnic dominance (i.e., where the single largest ethnic or ethnolinguistic group comprises between 45% and 90% of the population) raises the risk of civil conflict and so does active financial support extended by the diaspora to the rebel group. In this connection, certain researchers investigating the role of external interventions (which the CH model neglected) have concluded that such interventions are less likely in ethnic wars or in regions that are democratic or where the state has a strong military. However, for a given level of ethnic polarization, external intervention will prolong the duration of the civil war. On the role of ethnicity, certain studies point out that it is shaped by conflict rather than the other way around; others find that it does play a central role in certain conflicts. Some indices of religious polarization that prove to be insignificant when all civil wars are considered, have a positive and significant

relevance in the case of civil wars in which ethnicity plays a role (see Berdal and Malone 2000; Elbadawi and Sambanis 2000a; Keen 2000; Sambanis 2000; Reynal-Querol 2002). Reynal-Querol finds that religious/animist polarization, rather than ethnolinguistic fragmentation, is the relevant index that captures social conflict. According to the index the author adopts, the degree of polarization depends upon two variables: the number of different social groups and their respective shares in the total population. The point of maximum tension is reached when there are two social groups of equal size.

17. For references on the factors affecting the duration of civil war, see note 16 above.
18. Applying the CH model (which stresses economic factors) to the Lebanese case suggests a very low probability of conflict breaking out in the years immediately preceding the actual onset of the war in 1975. On the basis of available data, it predicts for 1970 a probability of only 2.6% for an outbreak of civil war, bearing in mind that the calculations of probability are based on five-year intervals prior to the outbreak of the conflict. This is less than the mean probability for countries that did not experience civil war (see Makdisi and Sadaka 2005).
19. For a detailed review of the causes of the civil war, see Makdisi and Sadaka (2005).
20. Lebanon's religious divide fits in nicely with the factor of ethnolinguistic dominance shown to raise the risk of conflict in the CH model. It also places the index of polarization adopted by Reynal-Querol (2002) near its point of maximum political tension. However, it should be mentioned that in this article religious polarization is assigned a more important role in civil conflict than linguistic differences, bearing in mind that the effect of religious polarization on the incidence of ethnic civil wars is reduced where consociational democracy prevails.
21. For details, see Makdisi and Sadaka (2005).
22. For a detailed analysis of the war period, see Makdisi (2004: chap. 2).
23. To illustrate, under the pre-Taif constitution, the president of the republic appointed cabinet ministers, designated one of them to serve as prime minister, and chaired the council of ministers. In contrast, the constitution based on the Taif Accord stipulates that the prime minister shall be designated by the president of the republic on the basis of binding consultations with members of parliament. The council of ministers is chaired by the prime minister unless the president chooses to attend its meetings, in which cases the president presides. In practice, over the post–civil war period as a whole, the president has chosen more often than not to chair the council of ministers.
24. It was noted earlier that following the Hariri assassination and the withdrawal of Syrian troops, rising domestic political tensions (with encouragement by outside powers) escalated at times into severe political conflicts. In particular, developments after the parliamentary elections of May–June 2005 eventually gave rise to two opposing political camps whose parties and groupings had earlier cooperated in the parliamentary elections. The first camp, supported principally by the United States, France, and the United Kingdom, included

the Hariri political group (the Future Movement, Sunni) and its allies comprising the Progressive Socialist Party (PSP), led by Walid Jumblatt (Druze), and a grouping of various Christian politicians who had been critical of the Syrian presence in Lebanon, along with a resurgent LF. Together they came to comprise a small majority in parliament. The PSP and LF had been major adversaries during the civil war. The second camp included the Shia alliance, supported by Iran and Syria, comprising Hizbullah (led by Hassan Nasrallah) and Amal (led by Speaker of the House Nabih Berri), and at some distance from them the Free National Movement led by Michel Aoun which ran in the elections on its own platform and swept the mainly Christian mountain regions. On February 6, 2006, General Aoun and Hassan Nasrallah came closer together by signing an agreement of understanding on various major national issues facing the country. Basic disagreements between the two camps related to, among other things, (a) the issue of Lebanon's relationship with Syria (as a corollary of the Hariri assassination, Syria had been accused by the Hariri group and its allies of being responsible for this and the subsequent assassinations), and (b) the question of disarming Hizbullah which had hitherto been considered by most political parties as a resistance movement to Israel and hence justified in carrying arms (the PSP, in particular, changed its traditional position on this issue, demanding that Hizbullah give up its arms). In February 2006, the first camp began to pressure unsuccessfully for the removal from office of the president of the republic, considered an ally of Syria, whereas Hizbullah decried the explicit intervention by the United States and France in Lebanon's internal affairs. As mentioned above, on March 2, 2006, the speaker of the house convened a series of meetings (under the slogan of national dialogue) that included the major political leaders, to try to resolve pending national issues, but this initiative was completely overtaken by the Israeli war on Lebanon in July 2006.

25. UN Security Council Resolution 1701, which called for a cessation of hostilities between Israel and Hizbullah, did not clearly define the enhanced role of the UN peacekeeping forces (UNIFIL) in southern Lebanon. As some observers put it, this role, kept deliberately vague by the United States and Israel, should be properly amended (under chapter 6 rather than 7 as some of the Western powers might wish) to take account of Lebanon's internal dynamics in order to avert the possibility of a new round of violence (see Timur Goksel and Karim Makdisi, "Vague UN Plan Not Realistic," *Toronto Star*, August 22, 2006). In practice, given the Western position on the war, such an amendment would be very difficult to achieve.
26. There are various indicators of governance that I do not go into here. For an overview of what good governance implies in postconflict countries, see Debiel and Terlinden (2004). The authors take up four dimensions of the governance issue: (a) horizontal division of power and interethnic cooperation, that is, consociationalism; (b) vertical division of power through integrative decentralization; (c) democratization and elections; and (d) rule of law.
27. Whereas for 1996 Lebanon's percentile rank stood at 51.3 (i.e., the percentage of countries worldwide that rate below Lebanon), compared with the Arab

region's rank of 46.3, for 2005 Lebanon's rank declined to 44.1 (39.9 for 2004), compared with the region's rank of 52.1. For both years, the average percentile rank for Lebanon's corresponding income category (upper-middle income) was 60.1 and 64.9, respectively (source: World Bank Institute data on governance and anticorruption, 2005, and Kaufmann et al. 2003).

28. A national commission was appointed in July 2005 to look into this matter; it submitted its recommendations to the government on June 1, 2006. It remains to be seen whether in fact a new electoral law will be enacted.
29. This matter is discussed in Walter (2002). The author states that consociational power-sharing solutions are appealing to groups that fear political domination. But power-sharing pacts are not stable over time unless they evolve into liberal and open political institutions (167–8).
30. Some political analysts have proposed a bicameral system as one step in the direction of reforming Lebanon's political system. The upper chamber, comprising the elected representatives of the various religious groups, would be vested with the power to decide on major national questions facing the country. The lower chamber would include members elected on a nonconfessional basis, subject to an electoral law that would ensure appropriate representation of the various regions and districts.
31. For the entire period (1992–2006), the annual rate of growth averaged about 3.4%; excluding 2006, the rate would be 3.8%. In late September 2005, the government published a new national account series for the period 1997–2002 (see Lebanon 2005). For this period, the new estimates for GDP are on average about $0.65 billion, or 4% greater than the previous estimates. However, the trend of the real rate of growth is basically similar except for 2001. According to the new series, for the period 1998–2002 the average rate of growth was 2%, compared with the previous estimate of 1.5%.
32. The exchange rate was initially pegged to the U.S. dollar with a crawling-up policy, i.e., gradual upward adjustment of the pound vis-à-vis the dollar throughout 1993–98. In late 1998, this policy was discontinued in favor of a fixed rate vis-à-vis the dollar which has since been maintained at USD = 1,507 LL with very narrow margins around parity.
33. On November 23, 2002, President Chirac called for a Lebanon donor meeting (the so-called Paris II) to assist the Lebanese government in meeting mounting financial pressures that threatened the Lebanese pound. Donors approved a financial package of $4.4 billion in financial and developmental assistance, thereby providing an opportunity for the authorities to reverse foreign exchange market trends that had exhausted the Central Bank's foreign exchange reserves in its sustained defense of the pound. Among the reasons that led to the pressures on the pound were fears related to the worsening fiscal situation, including an uncontrolled rise in public debt and the consequent due principal repayments and service payments in both pounds and dollars. On January 25, 2007, a similar meeting (Paris III) was called by President Chirac. It resulted in pledged aid totalling $7.6 billion. This aid was intended to help Lebanon meet reconstruction costs following the Israeli war of July 2006, as well as the mounting financial pressures due to rising public

debt which had not been brought under control following the Paris II meeting.

34. The real rate of growth averaged annually 6.5% for the period 1992–95, declining to 2.3% for 1996–2000, and rising to 3.4% for 2001–04, only to fall back to an average of −2.0% for 2005–06. For the whole period of 1996–2006, the rate of growth averaged annually 2.3%. If we exclude 2006 as an exceptional year, the average would rise to 2.8%.
35. Environmental degradation, deforestation and other illegal exploitation of natural resources, and inappropriate, not to mention chaotic, urban and rural planning are glaring illustrations of the disregard of the public interest in favor of the private.
36. In a recent article in *Foreign Affairs*, Eizenstat et al. (2005) argue that the crisis of governance in a large number of weak, impoverished states poses a serious threat to U.S. national security. In meeting this challenge, they advocate a U.S. strategy with a greater focus on economic development, security assistance, and diplomacy (rather than reliance mainly on military power), but they do not exclude the use of military force when necessary to advance development. The conditions that would justify the use of force are not spelled out. What is intriguing, however, is their injection of "force" as a factor in development (albeit in the context of defending U.S. national interest), presumably alongside capital, labor, and technology.

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6

War-Torn or Systemically Distorted?

Rebuilding the Algerian Economy

Miriam R. Lowi

Introduction

Algeria today is emerging slowly out of more than a decade of civil war, during which perhaps as many as 150,000 Algerians died. Sporadic violence in the country persists, with roughly 700 insurgents and unknown numbers of government-backed militias still operative. Nonetheless, the climate of fear and insecurity of the mid-1990s is no more. However, the economy, which went into a downward tailspin in the mid-1980s when oil prices plummeted, and did not even begin a recovery until the late 1990s with the dramatic increase in the price of oil, has remained more or less moribund, and this despite several World Bank and IMF interventions—including both structural adjustment programs and massive rescheduling of foreign debts—and incessant talk of reform. The hydrocarbon sector and the parallel sector remain the only vibrant terrains of economic activity.

The endemic economic problems of Algeria are not derivative primarily of misguided economic policies, or inadequate technical capacities, or even resource deficiencies—although the domestic political economy has by no means escaped such afflictions. Nor are they the result of 10 years of civil war, even though the violence provided a cover for the perpetuation and exacerbation of unhealthy political and economic arrangements.

Rather, they are institutional: they are derivative of a patrimonial system of clan politics elaborated by a military-bureaucratic oligarchy, which, along with its clients, are the principal beneficiaries. It is a vertically fashioned system, composed of intricate and overlapping networks of interests, in which some of the most lucrative economic transactions take place in the shadows, and where the principal objective of all players is to increase their access to the rent and to power. This is a system that resists reform.

Given this evaluation of the source of Algeria's economic malaise, my central argument is two-fold: first, since rent seekers are unlikely to concede their privileges unless forced, or tempted, to do so, a viable economic strategy for addressing the condition outlined above would convert the rent deployment system from one of redistribution to one that creates wealth, and would discourage rent-seeking behavior by changing the prevailing incentive structures. Second, a strategy for rebuilding the Algerian economy requires a concomitant political strategy for reforming the system and moving in the direction of

- building robust, effective, and accountable institutions;
- enhancing leadership commitment to inclusiveness, coherence, and transparency;
- restoring citizen confidence in the system.

No doubt, accomplishing the above tasks may be unrealistic in the short term, but that should not mean that taking small steps so as to eventually achieve them be eschewed. Furthermore, such an agenda presupposes the existence of a determined will to reform: it is that will that may be the most elusive of all. Given that economic outcomes depend on political structures, rebuilding a devastated economy requires the reconfiguration of political structures. Hence, pursuing the agenda described above implies that there will be a redistribution of powers, a reworking of the relations of authority between the state and economic actors, and a rethinking of the relationship between the state and social forces.

I agree, as international financial institutions insist, that macroeconomic stabilization is important, but I add, reflecting on the experience of Algeria, that it is so only when carried out effectively. Focusing squarely on economic policy prescriptions and ignoring fundamental reforms of the political system—the ways in which power is utilized, by whom, and to what ends—will not achieve the objective of rebuilding the Algerian economy. When new economic strategies are adopted in the absence of necessary political reform, the former can easily become politicized. Indeed, in the case of Algeria, several areas at the very heart of the macroeconomic

stabilization and liberalization policies of the 1990s were fraught with the same dynamics that governed, and distorted, political-economic relations: among these are the thorny issues of privatization, import licensing, Central Bank autonomy, and the "sacred cow" that is the hydrocarbon sector.

The remainder of this chapter is organized thus: First, I discuss how the Algerian economy fell apart. I offer an abbreviated analysis of the country's political-economic development. Second, I explore the institutional context of economic crisis, highlighting the sources of power, privilege, and enrichment. I underscore the ways in which the civil war environment during the 1990s facilitated the manipulation of institutional arrangements to the advantage of protagonists. Third, I consider the relationship between Algeria and the international community. I examine the stakes that certain international actors have held in Algerian affairs and the impact that those actors (and their interests) may have on domestic outcomes. Finally, I offer suggestions as to what needs to happen for the economy to be resuscitated. My suggestions cover the short, medium, and long terms, and include immediately realizable measures, as well as ideals to strive for. I insist, however, that in the absence of a leadership that is truly committed to change and an overhaul of the political system, it is unlikely that the Algerian economy will be rebuilt in a salutary fashion for the benefit of Algerians.

The Unraveling of the Algerian Economy

Though the Algerian political economy went into "crisis mode" in the late 1980s and remained so through the 1990s, there had been, since the late 1970s, a progressive degradation of the quality of life of the Algerian population, combined with growing inequalities and glaring corruption. The result was the aggravation of social conflicts in an incontrovertible manner (Hidouci 1995; Hassan 1996; Lowi 2004).

In conjunction with the dominant socialist rhetoric, a Soviet-style state capitalist development strategy, that combined *dirigiste* central planning and controls, guided the economy for much of the Boumedienne era (1965–78), while a heavy industrialization program, financed by oil revenues and severe constraints on personal consumption, was the engine of growth (Entelis 1982; Roberts 1983; Hassan 1996). Until the early 1980s, economic growth indicators were impressive: hovering around 8.5% in the 1970s and averaging 7.5% between 1965 and 1980, they were the highest among oil-exporting, late-developing countries (Gelb 1988). Nonetheless, severe distortions characterized the economy, and their effects became increasingly evident. For one, as much as four-fifths of the oil windfall in the 1970s was invested.

Not only was precious little saved, but the government also augmented the windfalls with massive foreign borrowing that would begin to fall due in the mid-1980s (Auty 2002a: 4). Second, over 90% of the investment was in the public sector, and primarily on capital-intensive industrial projects. Not only was Algerian industry uncompetitive internationally, but also capital-intensive industry created insufficient jobs. Unemployment, which had fallen from 28.5% in 1970 to 16.2% in 1980, climbed to 20% in 1990 and close to 24% in 1992, the year in which the civil war began (Aissaoui 2001: 238). Third, with the focus on industry, agriculture, which had produced a surplus before independence, shrank considerably, and the country became increasingly dependent on imports. By the 1990s, Algeria was importing as much as 75% of its food; that figure would continue to increase throughout the decade (Swearingen 1992; Auty 2002a: 4). The neglect of agriculture, and of the rural sector in general, encouraged an ongoing migration from the countryside, which added to the precariousness of socioeconomic conditions in urban areas: the cities could not successfully absorb the increased numbers. In fact, migrants from the countryside would form the core of the rank and file of the insurgency in the 1990s, as in Turkey in the 1970s, and Sierra Leone in the 1990s (Lowi 2005).

Algeria exemplifies many of the characteristic features of oil-exporting states with authoritarian political systems, as elucidated in the rentier state literature (see, inter alia, Mahdavy 1970; Beblawi and Luciani 1987): victims of the "staple trap," the almost total dependence of economic activity and government revenues on the export of a single high-valued commodity that is subject to exogenous shocks, which has profound repercussions on the domestic political economy (see table 6.1). First, because such states have a weakly developed extractive capacity, they lack the information they need to formulate sound development strategies. Moreover, the lure of easy wealth encourages short-sighted economic policies. Second, unpredictable resource windfalls adversely impact macroeconomic management because of relative price changes and fiscal distortions. Third, since these are "allocation" and not "production" states, the state sector grows in size

Table 6.1 Algeria: Primary commodity dependence, 1975–2002

	1975	*1985*	*1995*	*1999*	*2002*
Oil/gas as % GDP	38	25.8	30	28	
Oil/gas as % government revenues	53.8	57.9	60	62	62.9
Oil/gas as % exports		95	95	97	96.8

Sources: Algeria, statistical abstracts, selected years; IMF 2000.

and importance; entrepreneurship is not encouraged, and rent seeking, often in alliance with the state, is key to social mobility. Fourth, windfalls in the hands of heavily centralized governments, plus the overwhelming perception of well-being elicited by relative abundance, foster resistance to reform. Fifth, as hydrocarbon rents accrue directly to governments that may disburse them as they choose, patrimonial qualities of leadership are reinforced and democratization is eschewed (see, among others, Boone 1990; Chaudhry 1994; Shambayati 1994; Vandewalle 1998). Several of these features have characterized the Algerian political economy since the late 1960s.

With the international recession and the gradual depletion of oil revenues as of 1982, followed by the 400% collapse in oil prices in 1985–86, Algeria's external revenues declined by more than 50%; export earnings from hydrocarbons fell from a peak of $14.2 billion in 1981 to $7.3 billion in 1986 (Aissaoui 2001: 15; ICG 2001: 7). Consider the impact of falling export revenues on the population: per capita hydrocarbon rents fell from a high of $1,200 in 1981 to a low of $200 in 1988; they would approach $400 in 1990, only to fall to $250 in 1994, two years into the civil war. By the end of the decade, they had risen to just slightly over $400 (IMF 2000; Aissaoui 2001: 30; Auty 2002a). Note, as well, that in the mid-1980s, international borrowing possibilities dried up. Besides, the Algerian debt was already onerous: the debt service ratio had increased from 33% in 1982 to 68% in 1986; it would reach a whopping 86% in 1988, the year of the riots that would begin the descent into civil war.[1] It was at this time that government revenues—reflecting 27.56% of GDP, as opposed to 38.18% in 1984 (and 29.53% in 1992)—were at an all-time low (World Bank Data Base).[2] Rather than implement decisive reforms, as Indonesia did, for example, as soon as oil prices dropped in the mid-1980s, by devaluing its currency substantially and broadening the tax base to boost the non-oil tax share, the government simply curtailed imports and held back on distribution (Auty 2002a: 8–11).[3] Society was subjected to massive shortages, and essential goods became increasingly scarce. (This nurtured substantially an already extant, but not yet vibrant, parallel economy, as we will see later on.) The debt service ratio would fall from 72% in 1992 to 49% in 1994, after the IMF-backed rescheduling, and would hover between 29% and 45% for the remainder of the decade, before dropping to 21% in 2000 (IMF 1998, 2000; ICG 2001, 7). Per capita GNP declined by roughly 2.5% annually, from a high of $1,789 in 1985 to a low of $1,370 in 1994, two years into the civil war: a drop of 24% in nine years (ICG 2001: 7). It would climb to $1,495 by 1999 (World Bank 2001a). The economy had indeed undergone a growth collapse. As has been found elsewhere—Iran in the mid- to late 1970s, Zaire in the mid-1990s, and Indonesia in the late 1990s,

for example—growth collapses are invariably periods of high risk for domestic political stability.

The country's financial woes coincided with enormous demographic pressures. By 1980, the population of Algeria had reached 20 million, having doubled in less than two decades. Although population growth had fallen from 3.2% in the 1970s to roughly 2.6% from 1985 to 1988, the labor force, because of a disproportionately large young population, was growing at over 3.8% (World Bank 2001a). Since 1980, over 70% of the Algerian population has been under 30 years of age. That is to say, masses of young people were entering the workforce precisely when the economy was shrinking dramatically. The unemployment rate would reach an alarming 28% in 1995 and 30% in 2000 (Aissaoui 2001: 238; Byrd 2003: 3–4) (see table 6.2). According to the World Bank, the fraction of the Algerian population living in poverty had doubled through the 1990s: from 12.2% in 1988 to 22.6% in 1995 (World Bank 2001a).[4] In summer 2005, a prominent Algerian journalist reported that 45% of the population was living below the poverty threshold.[5]

Prior to the initiation of piecemeal market reforms in the early 1990s, the regime's response to the economic malaise was to focus on the budget deficit alone, and therefore on monetary policy. It chose first to simply print more money, despite the inflationary effects, and only later, to devalue the currency. The initial resistance to devaluation derived from an effort to avoid further inflation that would increase the cost of essential imports (such as food and medicine) in local currency, exacerbate domestic hardship, and discourage investors (Aissaoui 2001: 244).[6] Nonetheless, there were several devaluations between 1987 and 2003. The dinar lost 1,800% of its value, and the standard of living of those social categories with fixed incomes diminished markedly.[7] Though the state had more of the local currency in its coffers, national production was strangled, in part, by the excessive cost of imported goods, and domestic society—at pains to make ends meet—was faced with such aberrations as a 2,000% increase in the price of milk in a 10-year period![8]

Table 6.2 Algeria: Selected social and economic indicators, 1970–2000

	1970	*1975*	*1980*	*1985*	*1990*	*1995*	*2000*
Unemployment rate (%)	28.5	22.7	16.2	16.5	19.8	27.9	30.2
5-year real GDP growth (%)	4.9	7.5	8.7	3.9	−1.2	0.7	3.4
Per capita GDP (current USD)	324	930	2,268	2,654	2,479	1,410	1,600
5-year inflation rate (%)	5.0	6.3	11.0	9.2	11.6	27.5	6.0

Source: Aissaoui (2001: 10).

By 1994, however, the state was on the brink of a balance of payments crisis, with foreign debt service absorbing about 90% of foreign exchange earnings.[9] Algeria, which had consistently resisted IMF intervention because of concerns regarding external scrutiny and foreign involvement in domestic policy, could not put off debt rescheduling any longer. Debt relief, negotiated with both the Paris Club (1994 and 1995) and the London Club (1995 and 1996), was conditional upon acceptance of a macroeconomic stabilization and structural adjustment program (Aissaoui 2001: 236–7).[10] While there was much progress in macroeconomic stabilization between 1994 and 1998, significant problems remained with structural reform, and most notably, as we will see later, in the areas of privatization and financial sector liberalization.

In accordance with IMF conditions, the regime continued the process, begun in the mid-1980s, of dissolving hundreds of public enterprises that had been the hallmark of the Boumedienne/Abdesselam state capitalist strategy, and replacing many of them with smaller commercial entities. One of the most devastating results of this maneuver was that more than 200,000 people, many of whom were among the best educated of Algerian society, lost their jobs virtually overnight.[11] Not only did the unemployment rate continue to climb, reaching an alarming 28% in 1995, but also thousands of the most qualified cadres chose exit: they left the country—a brain drain of enormous proportions—for a better life in Europe and North America.[12] Some portion of those who were laid off may well have found compensation in Algeria by joining government-supported and -financed militias, constituted in the mid-1990s to fight the "Islamist" insurgents.

The Institutional Context of Economic Crisis

In the late 1960s, a private trading sector had emerged at the interstices of the state capitalist system. Composed initially of former military officers, high-ranking administrators, and the few local capitalists, these individuals have enjoyed privileged access to markets, credits, and contracts (Henni n.d.). The private sector, which has remained the purview of the military-bureaucratic oligarchy and its clients, has consistently been weakly rooted in production; it has preferred, for the most part, commercial opportunities and clientelist protection that have favored the capture of the rent managed by the state. Furthermore, in the name of the technological and material imperatives of defense and development, the state, as of the mid-1970s and especially in the early to mid-1980s, systematically used the (hydrocarbon) rent to finance expensive importation programs; more often than not, these lucrative programs fell into the hands of

individuals within the military-bureaucratic oligarchy or their close relatives.[13] An important result was that over time, the political, military, and business elites became increasingly entwined, interconnected, and mutually dependent (Werenfels 2004b: 82–3). Furthermore, comfortable revenues were generated, in the form of commissions, for the masters of the *dirigiste* economy and their clients (Hadjadj 1999: 90–113, 197–211). State-directed economic patronage of this sort, largely for political purposes, has nurtured state power and the personal enrichment of a few, but also large-scale corruption for high stakes.[14] It is not surprising that there has existed a powerful resistance to reform not only on the part of those at the highest echelons of the state, but also throughout the state apparatus and in the networks emanating therefrom: vested interests in the status quo are both divergent and robust.

The hydrocarbon sector, the backbone and principal instrument of state power, has remained above supervision, regulation, and accountability. Sonatrach, the state-owned oil company in the hydrocarbon sector, has been referred to as a "state within a state" (Entelis 1999), for it has never been subjected to the monetary and fiscal controls that are imposed on other companies, while reliable information regarding its methods of distribution, the amounts distributed, and their recipients, is unavailable.[15] Created in 1963 as the hallmark of the state capitalist sector and the principal instrument of the state's hydrocarbon policy, Sonatrach escaped the restructuring measures of the 1980s and early 1990s. Nonetheless, there have been and continue to be various efforts, beginning with the Hamrouche government (1989–91), to reform the company's organization and operational procedures.[16] Perhaps more than any other state institution, Sonatrach is deeply enmeshed in a web of political, economic, and administrative relationships that have "weakened its corporate governance and undermined its incentive structure." Given its critical economic and rent-channeling roles, it is systematically exploited by different government circles for special interests; entangled with several government ministries, it is susceptible to vested interests and its decision-making powers are compromised. Since the minister of energy retains sweeping powers and all senior managers are presidential appointees, Sonatrach is by no means an autonomous actor (Aissaoui 2001: 202–14). Indeed, not only because of the strategic importance of hydrocarbons, but also because the company is the primary vehicle for channeling rents and the principal source for the enrichment of individuals within the elite, Sonatrach has been treated as a "sacred cow." Hydrocarbon rents have facilitated the consolidation of a vast informal clientelist organization that operates under the cover of official institutions. This being the case, Sonatrach remains the locus of some of the most virulent political struggles, at the same time as it resists reform.

By the mid-1980s and the contraction of oil revenues in an environment where state controls on imports and on prices had been important, the rationing system began to create very big rents just as the economy as a whole was getting poorer. This created enormous opportunities for contraband activities of all sorts; goods were acquired increasingly through smuggling networks and exchanged on the black market. Moreover, as inequalities and unemployment worsened in Algeria by the end of the 1980s, contraband activity seduced the unemployed, disillusioned, and marginalized of Algerian society into its smuggling and distribution networks. Contraband activity had become one of the few remaining avenues for getting by, especially for those who were not *pistonné* (connected) and could not attach themselves to a network. In no time, the *trabendistes*,[17] as they came to be called, became linked to the private trading sector (Martinez 1998): they mirrored the organizational choices (the more or less well-oiled, opaque networks) and mimicked the practices (the exchange of favors) of the latter. Together, the private traders and the *trabendistes* have nourished the parallel economy, the extent of which has been thought to account for anywhere from 30% to 70% of GDP, depending on the source (Henni 1991; Talahite 2000; ICG 2001).[18] The parallel economy would eventually attract insurgency groups as well, who would exploit it for financing and recruitment by linking up with *trabendo* networks and engaging in smuggling and racketeering.[19] With time, the parallel economy would become part of the violence: note that the infrastructure of parallel economies provides those involved an organizational advantage for perpetrating violence, insofar as they operate "in the shadows" and evade the state with relative ease. Indeed, the three sets of actors—the state-sponsored (and state-implicated) private sector, *trabendo* networks, and insurgents—have been living vicariously off each other in their dealings with the parallel economy, and off the climate of fear and uncertainty that reigned in the country until very recently (Talahite 2000). There had been a conjoining of interests between those who practiced violence initially for political motives (insurgents) and those who were well placed for engaging in violence (public-private sector *mafia*). Because of this conjoining of interests, with state actors themselves deeply implicated, and because of the high stakes involved, it has been exceedingly difficult to end the violence once and for all, undermine the parallel economy and the corruption that is associated with it, and fortify a—still incipient—market economy.

In an environment of persistent economic crisis and woefully inadequate regulatory institutions—which includes insecure property rights, weak rule of law, and a regime whose own record on accountability and transparency is far from unblemished[20]—but a flourishing informal

sector, an attitude of "catch as catch can" has reigned supreme. Even the IMF-backed structural adjustment program of 1994 could be manipulated for private gain: measures that were part of the reform package—the abolition of price controls, deregulation of food and agricultural distribution, privatization, and liberalization of both trade and access to foreign exchange—enhanced, in addition to bureaucrats' and military officers' access to financial resources, that of guerrillas as well, permitting all of them to get involved in often dubious, but highly lucrative, business ventures (Hadjadj 1999: 92–4; Martinez 2000: 202–3, 213–18).[21]

Let us reflect on the way in which privatization has been carried out. In 1988, state-owned enterprises (SOEs) were organized as joint-stock companies under the authority of fiduciaries, known as *Fonds de participation*. The latter were charged with restructuring the companies as private entities and improving their governance, incentive structures, and productivity (Aissaoui 2001: 217). In 1995, however, the *Fonds* were eliminated and replaced with state holding companies, empowered to divest state assets, under the tutelage of the Ministry of Privatization. The aim, according to one Algerian economist and former member of the Hamrouche government, was to prevent the evaluation and control of transactions by the market, and return to the opacity of administrative arbitration (Benderra 2002: 20, 31–4). If we consider the privatization of the pharmaceutical sector, for example, the former state monopoly was replaced by an oligopoly of private businessmen tied to military elites and government officials. It is said that the last two have become the real financial beneficiaries of this newly privatized sector (Hadjadj 1999; Joffé 2002: 46). The same is true throughout much of what had been the state sector (excluding hydrocarbons) and including the importation of essential items such as milk, rice, and cement, in addition to pharmaceuticals: former public monopolies have been converted into private oligopolies, in the shadows of which there stands a mafia-like "godfather," more often than not deeply implicated in the military-bureaucratic apparatus. Similarly, state import monopolies simply moved from industrial SOEs to oligopolies of private importers close to the army,[22] or, in some cases, belonging to armed groups.[23] This is not privatization at all: it is the replacement of state ownership with a fiction of private ownership that is little more than a cover for the state and for covert parasitic elements.[24] Furthermore, the banking system has been implicated in the scam, to its great disadvantage: over the past 10 years, the *décideurs*[25] have forced the (public) banks to extend loans to private entities without evaluating the solvency of the borrowers beforehand, while normal recourse for recovering all or part of the credit has been short-circuited by *le système de pouvoir parallèle* (the system of parallel power), which has provoked important losses (Byrd 2003: 12).[26] According to one

keen observer of Algerian affairs, "Now that administrative barriers have been removed without having been replaced by the rules and institutions of the market, corruption, offenses, and economic crimes have no limits" (Talahite 1998). So-called market reform, as carried out by the Algerian leadership, simply blurred further the already highly porous boundaries between the public and the private, the formal and the informal, the economic, the political, and the military (Werenfels 2004b: 62–3). Market reforms thus nurtured highly profitable patron-client networks, thereby consolidating predatory structures that remained at the core of the domestic political economy, and enhanced the power of the generals.[27]

Over time, the violence that began in 1992 became increasingly articulated with the microeconomy, and has provided a cover for corruption and contraband. In essence, the violence represented a struggle for power and control over the rent, in which several different parties were involved, sometimes as rivals, sometimes as collaborators. For example, as late as 2002, the transport of building materials in the east of the country, between Constantine and Tebessa, required a stamped permission slip, after payment of a fee, from Hassan Hattab, who, although the then leader of the *Groupe Salafiste pour la Prédication et le Combat* (GSPC)—one of the remaining prominent insurgency groups—functioned, it would seem, like a member of the regime (Chouet 2003). Another interesting example concerns the large number of attacks on state enterprises, forcing several in various sectors to close down. These attacks have been attributed, in official circles, to the *Groupe Islamiste Armé* (GIA). In the transport sector, for instance, many state-owned buses, as well as trucks used for the distribution of goods, were attacked by armed groups, and then run by private entrepreneurs with ties to armed groups and/or the regime (Werenfels 2002). Thus, a veritable "market of violence" was created: the interests of those who practiced violence initially for political objectives would coalesce with those who, by virtue of their involvement in economic activities that required evading the state, were well placed to carry out violence.

Although the country presented improved macroeconomic indicators in the late 1990s and early 2000s, there continues to be minimal foreign investment outside the hydrocarbon sector, inadequate local private investment, very high unemployment, and insufficient local production—in agriculture, manufacturing, and the non-hydrocarbon industries—to replace imports (Benderra 2002). The housing sector continues to be in deplorable shape, given that "Algeria has four million housing units for its 30-million-strong population—one of the highest occupancy ratios in the world." Though an additional 2 million units are needed, the state builds less than 7% of that per year, and the *auto-construction* system—which accounts for 15–20% of what is built, and which is privately owned but

largely publicly financed—is marred by massive speculation and recurrent scandals (ICG 2001: 6). In place of the low-income housing that is needed, uncontrolled private construction is widespread, and yet another means of profiteering. Given the absence of a regulatory environment, private construction of this sort is part and parcel of the vibrant parallel economy.[28] That such deplorable socioeconomic conditions, including an incidence of poverty affecting close to 45% of the population, should prevail is truly remarkable given Central Bank reserves in 2005 of roughly $50 billion.[29]

Finally, it is hard to qualify Algeria's economy as truly "war-torn." Some of the problems have been in place for decades and have evolved over time. For one, as noted above, active or retired members of the Algerian military had been involved in private sector activities from the 1960s. Their implication in both the private and the informal sectors has been increasing since the 1980s; it has been encouraged by both government legislation that has favored the "conversion of army into pseudo-private entrepreneurs" (Dillman 2000: 134, fn. 5) and the very peculiar ways in which economic liberalization has been carried out. In other words, the violence since 1992 has exacerbated an already problem-ridden economic environment. At the same time, it has provided a cover for the persistence of extreme oil dependence and a "shadow political economy."

Dependence on the hydrocarbon sector has characterized the Algerian state since the 1960s. Moreover, control over the hydrocarbon rent (and its distribution) has been among the principal—if not *the* principal—instruments of state power since the mid- to late 1960s.[30] It is through the selective distribution of rent and other material favors that loyalties are bought, alliances are cemented, and networks are greased. Similarly, the withholding of material favors is itself a powerful means for destroying alliances and networks, as the Khalifa saga so colorfully portrays.[31] During the civil war years, the hydrocarbons sector and the parallel sector were the only domains of vibrant economic activity; virtually all else was moribund. Moreover, oil rents, in the hands of the state, financed the anti-insurgency throughout: government revenues from the sale of oil have been used to arm the security forces of the state, as well as the civilian militias, and finance their operations. They have been utilized to maintain incumbents in power (Lowi 2005).[32]

No doubt, the civil war favored opacity and lawlessness. New actors—not only insurgents, but also government-backed militias—emerged on the scene. Both have been instrumentalized by different clans—in politics, the military, and the mafia—to defend their property and interests. The context has become more complex over time. There are those who, because of the benefits they enjoy, have a stake in ongoing low-level conflict (Lowi 2005). Those whose preference is for the status quo include several key

forces within the domestic political economy: the upper echelons of the state apparatus and their clients, the *trabendistes*, and insurgents. As long as the civil war raged, the regime insisted that security was its priority; until security was achieved, it would put off addressing economic issues that were deeply threatening to its hegemony. The climate of insecurity has promoted the regime's incumbency.

The Impact of the International Environment

Given the extent of Algeria's dependence on the export of oil and natural gas, the domestic political economy is inextricably tied to changes in the international economy and the vicissitudes of oil prices and demand. Barring significant diversification of the Algerian economy, the international environment will continue to exercise an important, albeit at times indirect, role in internal developments: Algeria will remain victim to exogenous shocks, and foreign interests, lured by the vast hydrocarbon wealth, will continue to scrutinize changes to domestic political arrangements.[33]

Having said this, it is important to note that the regime made significant gains when the army interrupted the 1991 elections, which the Islamic Salvation Front (FIS) was poised to win. Despite a period of international isolation following the 1992 coup that brought the democratic transition to an end, the military-backed regime has managed to gain much support from Western governments and international institutions. By cleverly designating Islamism, assimilated to terrorism, as its alibi, it has enjoyed considerable financial assistance, as well as much indulgence relative to corruption and human rights violations. In more recent years, it has also received practical support for combating the insurgency.[34] First, many Western powers supported the coup that brought the democratic transition to an end; like the Algerian power holders, they too feared "Islamic government," even when democratically elected (Bedjaoui et al. 1999: 695–963). Second, they have consistently rejected demands from Algerian nationals and human rights organizations for the creation of international tribunals to adjudicate alleged government-perpetrated disappearances and massacres (interview, March 6, 2002).[35] Third, in 1994, in the midst of the civil war, the international community, via IMF intervention, saved the Algerian state from bankruptcy. The two agreements for debt rescheduling in 1994 and 1995 gave the state about $20 billion that included deferred payments, as well as credits made available by the IMF, European Union, and European Investment Bank (Talahite 2000; Benderra 2003). Bailed out, incumbents retain power and additional means for nourishing their networks. With the assistance of the international community, they have also maintained their ability to pursue the costly repression of

insurgents.[36] Fear of Islamism and perception of an "Islamist threat"—no doubt linked to foreign interests in the oil wealth of the Middle East–North Africa region—promise uninterrupted external support for incumbents, hence for the status quo.[37]

Moreover, by transforming the oilfields in the south into heavily guarded zones of exclusion, the regime convinced foreign oil companies, throughout the civil war years, that it was safe to continue to invest in the Algerian hydrocarbon sector.[38] To be sure, hydrocarbons constitute the only sector that both attracts foreign capital and has remained intact. It is, as well, the reserved domain of the highest echelons of the state and their international clients.[39]

What Is To Be Done?

To revitalize the Algerian economy and ensure that all groups in the country have a stake in its success, a variety of steps can be taken. These steps include economic, political, and institutional reforms; they cover the short, medium, and long terms.

One of the first things that needs to be done—and that can begin immediately—is to pay off the losers of the civil war. Insurgents, as well as counterinsurgent militias, must be encouraged to put down their arms and work toward rebuilding the country. Doing so requires that they receive guarantees that they will be amnestied; that they will be fully reintegrated into Algerian society[40]; that they will be provided means of livelihood—for themselves and their families; and that their political views will receive some form of representation. Inclusion is the only effective response to the perversions that derive from exclusion. Besides, rebuilding the economy cannot take place in an environment of insecurity and lawlessness.

In the economic sphere, and in the short term, the government should take full advantage of the more recent high oil prices and invest an important fraction of its receipts in infrastructure projects that would stimulate, among other things, labor-intensive private sector investment. Surely some portion of the $50 billion it holds in reserves could be allocated in this way. No doubt, massive investment in housing, for example, and other construction projects would be wise; it would address both the acute housing crisis and the deplorable unemployment situation.

A longer-term strategy, but one that is essential for encouraging rent seekers to forego their (nationally destructive) privileges, is to transform the rent deployment system from one of redistribution to one of wealth generation: that is, to use "oil rents to create the capacity for rapid and sustained accumulation of output" (Auty 2002a: 13). Reducing protective tariffs may be one way of achieving this, since import protections allow

privatized monopolies to persist. However, some protection for struggling nascent industries would have to be provided. The availability of wealth-creating activities and efficiency incentives may push rent seekers to make socially better use of their rent. If successful, they would have less interest in manipulating political connections and engaging in dubious practices to generate income, and greater interest in promoting a vibrant economy. They would choose to invest in efficient wealth generation if they could be convinced that, in this way, their medium- to long-term gains would be significantly greater: they could earn more from an economy that is growing at, let us say, 10% per year—which quadruples the size of the economy within almost fifteen years—than from an economy that is imploding.[41] However, this strategy presupposes a very different environment from the one that currently exists.

There is for Algeria, as for many other states for which hydrocarbons are the single most important export item, a set of reforms to be undertaken that are intimately linked to the particular problems faced by oil exporters. The most obvious and most critical reform is the reduction of Algeria's dependence on the sale of hydrocarbons, a dependence that, as noted above, tends to distort both the economy and political relations in important ways, and ties the domestic political economy inextricably to the vagaries of the international environment. Economic diversification would entail building up the country's non-oil productive capacity. It would do so by promoting much needed labor-intensive, growth-generating activities. It could involve resuscitating agriculture, which has suffered from policy neglect since the early 1970s and protracted violence since 1992.[42] If farmers are provided incentives to invest in improvements, invigorating agricultural production could reverse the extreme food-import dependence of the country, whereas investing concomitantly in backward and forward linkages could generate new export items for the European and African markets. This would begin to correct the very lopsided relationship that currently exists between imports and exports (see table 6.3). Furthermore, development of non-hydrocarbon sectors may

Table 6.3 Algeria: Exports and imports, 1970–2000

	1970	*1980*	*1985*	*1990*	*1995*	*2000*
Total exports (USD billion)	1.1	13.8	13.7	12.9	10.4	21.1
Of which non-hydrocarbon exports (%)	18	1	7	4	7	2
Total imports (USD billion)	1.2	10.5	10.9	10.6	10.8	10.5
Of which consumer goods (%)	27	36	33	32	42	41

Source: Aissaoui (2001: 10).

stimulate, in the long run, the emergence of a productive class and/or the broadening of a middle class. Economic diversification is a medium- to long-term strategy, but efforts in that direction can get underway without too much delay.

Related to the above, Algeria needs to adopt institutional mechanisms that allow for using resource rents both to achieve competitive diversification of the economy, as described above, and to reduce the risk from over-rapid absorption of the rents and from economic shocks. The suggestion that a fund be created in which hydrocarbon revenues in excess of budget needs, plus income from investments, are saved for longer-term budgeting is not new: it has been tried elsewhere—in Kuwait, Norway, and Venezuela, for example—with varying success (Aissaoui 2001: 288). Algeria ought to do what Kuwait set out to do: capture rents, sterilize them in a fund managed by the Central Bank—to be withdrawn only gradually and after rigorous evaluation—and even invest a portion of them offshore.[43]

The Algerian government did establish an oil rent stabilization fund in 2000, on the advice of the IMF, and managed by the Central Bank. However, it used the funds for debt relief rather than for productive investment (Auty 2002b: 10). Furthermore, effective implementation of rent stabilization programs presumes, as the Algerian experience demonstrates by its absence, that fiscal transparency is assured. It presumes, as well, that the distribution and prerogatives of power are unlike what exist in Algeria today.

Most other necessary structural reforms are largely institutional in nature. Carrying them out is tantamount to an overhaul of the system. At the very heart of the problem is, as mentioned above, what the Algerians refer to as *le système*, the persistence of a military-bureaucratic oligopoly and clan politics, which dominates all aspects of political and economic life, and where much takes place in the shadows, on the basis of client networks, and in the absence of regulation and accountability. As noted, the oil-dependent economy is part and parcel of this system of rule insofar as the important rents generated by hydrocarbons finance the oligarchy's incumbency, exacerbate patrimonial and predatory features of the system, and encourage resistance to reform. Many institutional deficiencies—such as weak rule of law, insecure property rights, a warped incentive structure for productive activities, an inept financial system—are intimately related to, indeed they are both derivative of and buttressed by, *le système*: it is they that enhance payoffs to the "winners." Transforming them effectively is imperative so as to promote growth, ensure a safe and predictable environment, and meet societal needs.

Reforming the system, however, is a long-term project. In the short and medium terms, there is a set of proposals that could facilitate the realization of longer-term goals. For example, the rejuvenation and renewal of the

political elite is already underway. Without too much effort, the *décideurs* are naturally going to change, as the "old guard" retires and is replaced with younger members of the elite.[44] So-called revolutionary legitimacy, which colored the official rhetoric for decades and sanctified the policies of its bearers, no longer carries weight. If anything, it has become an object of derision. With new and younger elites in power, there is the possibility of fresh ideas and alternate avenues of influence. Indeed, there has been, since 1989 and the brief democratic opening that accompanied the new Algerian constitution and the *de jure* end to the *parti unique*, a growing number of political actors from different backgrounds and communities exerting influence upon the system. The Kabyle protest movement that emerged in full force in the late 1990s, and the various opposition parties that entered electoral politics and, in some cases, gained seats in Parliament, are cases in point.[45] No doubt, several of these forces have already been co-opted: they have been fractionalized through the machinations of the regime and/or seduced by various "rewards." Hence, it appears at this time that the system, despite new injections, is reproducing rather than reforming itself. Nonetheless, there is a chance that in an even slightly altered context, the proliferation of influences may eventually push the bounds of the possible.

Ideally, the combination of new, younger elites and different sources of influence engaged in a renewal of politics and a resuscitation of the economy may encourage some portion of the *émigré* community to return to Algeria. If those cadres who left the country in the 1990s are not enticed on their own to return, the new elite would have to find ways to lure them back: it would have to integrate these individuals—many of whom are highly skilled—into the administration of the country and the economy. Besides, "returnees" may bring fresh ideas about how to accomplish the tasks that face the country.

It may be that from this new elite, a committed "change team"—what Algeria needs most of all—would eventually emerge.[46] Here we can think of the leadership structure in Botswana that has been successful in managing its diamond wealth and developing its economy in a salutary fashion, or that of Turgut Ozal of Turkey, who had a compelling socioeconomic agenda that he pursued relentlessly.[47] No doubt, a new leadership structure, composed of individuals with considerable expertise and committed to unmitigated change for the sake of bettering the lives of all Algerians, would face enormous challenges. It would, by definition, give up its own personal stakes in *le système*, if indeed it had any. It would devise a formula for liberalizing government and bringing into the political process the array of concerned social forces in the country: to wit, military officers, nationalists, Berbers, Islamists, and even former insurgents must find a voice in a transformed domestic political economy. This could lead the

way for an eventual "pacted transition," not unlike what transpired in some countries of Latin America. A new leadership structure would have to find ways not only to integrate those who had been excluded, but also to pay off "losers"—all those who reaped significant benefits from *le système*—so that they do not oppose real reform.

Much of what went awry in the 1989–91 transition period had to do with two inherent features of *le système*: first, that the Hamrouche government "reformers" (*les réformateurs*), while given a mandate to resuscitate the economy and prepare the transition to democracy, were not given a free hand to implement the reforms they elaborated.[48] The reformers sought to create a dynamic of rupture with the political system that had been in place since 1965 by permitting those currents that accepted the democratic process to express themselves openly outside the traditional clan networks. However, the military and the various client networks associated with the regime did not envisage a formal modification of the rules of the exercise of power that did not include the preservation of their own hegemonic control over society. As soon as the reforms began to threaten the opaque interests of the power holders, they were interrupted and the reformist agenda was terminated. Second, both political culture and regime dynamics prevent the emergence in Algeria of effective nationwide political parties with agendas that could bridge the many cleavages and embrace the interests and concerns of a broad cross-section of Algerian society. Except for the FIS, virtually all the parties that emerged in the 1989–91 period (and that exist today) are built around a single individual—the party founder—and promote the interests of a single, relatively narrow community.[49] Nonetheless, a FIS-led government, despite being mass-based, would have excluded the military from power. To date, whatever reform measures have been implemented have precluded real transformation of *le système*.

Let us consider, for example, the much needed and interminably discussed privatization of the economy and the formerly omnipresent state sector. Thus far, "real" privatization has been handicapped largely because it remains under the umbrella of *le système*, whereas changing property rights—what privatization implies—necessarily affects the distribution of power. Privatization of SOEs, for example, impinges on the distribution of rents by undermining the patron-client networks in which those SOEs are embedded. It poses a threat, as well, to those who currently enjoy rents from the import monopolies that had "belonged" to SOEs before they were transferred to "private" hands after trade liberalization (Werenfels 2002). In short, because changing property rights transforms both the distribution of power and access to rents, it has not been executed properly (see, among others, Charef 1998 and Hadjadj 1999).

To be successfully executed, privatization must be accompanied by what the IMF refers to as a "facilitating environment—a new regulatory framework to deal with private sector involvement" (IMF 1998: 22). It may be that only private sector–led growth in the non-hydrocarbon sector could generate the required employment opportunities and assume the enormous infrastructural development needs (e.g., telecommunications) of the country.[50] However, until the necessary institutional reforms—among them, the clarification of property rights and the provision of and adherence to a legal framework for a market economy—are implemented, investors will remain reluctant to gamble in such a high-risk, constraint-bound environment, where what matters most is proximity to power and to powerful networks. Algerian investors will continue to prefer to send their money out of the country, whereas foreign investors will avoid the non-hydrocarbon sectors altogether. For them, investing in the private sector in the current climate is most discouraging.[51] Investor confidence needs to be rebuilt in order for the economy and the quality of life of the population to be revived. However, that is not likely to happen unless political and economic relations are transparent and there is a return to the market. In the meantime, the combination of corruption and insecurity ensures that investors turn elsewhere. Indeed, the new leadership structure—that skilled, dedicated "change team"—would remain steadfast in its insistence on transparency: that (information about) the business of political and economic actors, and the resources available to them, are in the public realm.

Conclusion

The problems of Algeria today are not fundamentally economic, but rather, institutional and political. Nonetheless, the Washington Consensus, to which the regime is beholden during times of crisis, has been blind to institutional failures and the absence of political will. It has also been relatively indifferent to the politicization of macroeconomic liberalization and to the thorny issue of inclusion. In this sense, it dovetails, to some degree, the preferences of the regime in power in Algeria.

Until these issues are addressed, there may be little hope for legitimate growth-promoting economic activity outside the hydrocarbon sector and for generalized prosperity. Moreover, as long as low-intensity conflict persists, it not only precludes the restoration of security, but also provides an effective cover for the diversion of rent out of the official economy that remains moribund, and into the hands of parasitic elements that prosper.

However, reestablishing security is by no means the full answer to curing the country's condition. Rebuilding the Algerian economy is

dependent upon the establishment of effective institutions under the rule of law and a political leadership that shares a commitment to implementing the necessary reforms—no matter how draconian they may be—and doing so effectively for the sake of the collectivity. In the long run, rebuilding for the collectivity entails system change; *that* can only be envisaged under the aegis of a completely new leadership structure, in the form of a "change team," backed by popular mobilization. In the short and medium terms, a variety of steps could be taken that would move the country, slowly, out of its current malaise. The challenges and the interests at stake are enormous.

Acknowledgments

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Notes

1. On the events of October 1988, see, among others, Moussaoui (1994: 1318–20).
2. They would hover between 28% and 30% of GDP for the remainder of the decade (IMF 2000).
3. It would devalue for the first time in 1987.
4. For an interesting, although undocumented, discussion of the vicissitudes of the Algerian economy from 1989 to 1998, see Benderra (2002: 1–15). For an evaluation of the Algerian economy, with emphasis on the period since 1992, see Byrd (2003).
5. This despite Central Bank reserves of $50 billion (with a population of 31 million)! See the fascinating interview with Akram Belkaid, "Les Algériens ignorent le Polisario," in *TelQuel*, no. 184 (July 9–15, 2005), p. 31. The poverty rate is confirmed by the *Conseil National Economique et Social*, which reported in 2002 that 13 million Algerians were living on less than $1 per day.
6. Constraints on imports were minimized by the extension of lines of credit and stand-by loans, in 1988 and 1989, through multilateral, public bilateral, and private commercial facilities (Benderra 2002: 4).
7. Lahouari Addi, "Réformes économiques et obstacles politiques," *Le Quotidien d'Oran*, June 24, 25, and 27, 2004.
8. Florence Aubenas, "Algérie: Les friqués du chaos," *Libération*, April 6, 2004.
9. As with several South American countries in the early 1980s, systematic recourse to short-term credit launched the country into a "debt trap" characterized by

more expensive loans, heavier payments, closure of the mid-term capital markets, and deterioration of the "country risk" status (Benderra 2002: 4).

10. The regime's first dealings with the IMF were in 1988. At that time, however, no conditions were attached to drawing down the country's reserves.
11. Addi, "Réformes économiques."
12. According to the *Conseil National Economique et Social*, 400,000 Algerian cadres left the country between 1992 and 1996. Among them were numerous former ministers, prime ministers, and members of parliament, as well as hundreds of university professors. In 2003, the number of Algerians in France alone was estimated at more than 1.5 million. In the mid-1980s, even before the start of the civil war, there were roughly 800,000 Algerians living in France. Of these, 200,000 had been naturalized French.
13. Werenfels (2004b: 107, n. 440) notes that the most prominent generals in the 1990s had children in the private sector, and specifically in businesses involving high-priced imports: medicines (Generals Lamari and Mediène) and cars (Mediène), for example. Other power brokers—generals and (former) ministers—have also been implicated in the business of importing pharmaceuticals, in which profits have been exceptionally high (Hadjadj 1999: 162–71). They have secured monopolies of other key imports as well: among them, rice, milk, and cement.
14. Note that in 1999, the assets outside the country of Algerians linked to the military and security services were estimated, by one analyst, at $40 billion (*Challenges*, no. 135, April 1999). Recall, as well, that in 1990, former prime minister and minister of planning and organization Abdelhamid Brahimi revealed that between 1970 and 1990, $26 billion worth of "corruption money" had been generated in dealings between Algerian government officials and foreign companies. He derived that figure by adding up total investments and assuming a 10–15% commission, equivalent to bribery.
15. Nonetheless, it is the subject of many colorful stories. This author was informed by an Algerian with a relative who works in an official capacity at the port of Algiers that periodically, undocumented oil tankers would leave the port for destinations unknown to the port authorities, and return empty (interview, Paris, December 2001). Werenfels (2004b: 166, n. 641) notes that Europeans who had worked in the Algerian hydrocarbon sector informed her that "OPEC-installed meters measuring output were frequently broken and that this was one way of diverting hydrocarbon revenues."
16. See Aissaoui (2001: 207–10) for the various restructuring and modernization schemes.
17. *Trabendo*, from the French *contrebande*, refers to a "parallel trade based on smuggled goods combined with access to state supplies" (ICG 2001: 10); those who engage in such activities are referred to as *trabendistes*.
18. According to a study conducted by the Algerian *Office National des Statistiques*, 40% of GDP in 2003 derived from informal economic activity.
19. After 1986, networks within the informal sector, excluded from "official" avenues of distribution, began to lend support to the Islamist and non-Islamist opposition. Rallying to the informal sector assured the Islamist opposition, in

addition to its capacity to create employment, a social base among the poor, many of whom chose to try their hand at informal activities. It is interesting to note that the opposition, whether Islamist or not, demanded that the economy be privatized and the privileges of the public sector reduced to a minimum (Benderra 2002: 20–1). The Islamic Salvation Front (FIS), for one, advocated market reforms, including lower taxes and incentives for private sector development (al-Ahnaf et al. 1991: 179–87; Willis 1997: 138–49). No doubt, its call for economic liberalization and investment of oil revenues in local economic projects threatened the interests of the politico-military oligarchy.

20. See, in this regard, AI (1997).
21. For a fascinating description of how the contraband import business is carried out, including the furtive departures to Europe and Turkey to collect goods, the politicking at the ports, and the networking in the bars of Algiers, see Aubenas, "Algérie: Les friqués du chaos."
22. Werenfels (2004b: 62) points out that it has become commonplace to refer to one general or another as "*le général du café*," "*le général du sucre*," "*le général du médicament*," etc.
23. One of the striking results was that, by 2001, the number of so-called import-export agencies "dealing mainly with imports on which commissions are skimmed" and better known, tongue in cheek, as import-import firms, was reported to exceed an alarming 27,000, when registered *bona fide* import companies numbered little more than 3,000 (ICG 2001: 6). In 2002, the Algerian press reported that there were 40,000 importers in the non-hydrocarbon sectors, but only 400 exporters (*El Moudjahid*, October 17, 2002).
24. There are (unverifiable) suggestions that involvement in private sector activity is dependent upon ties to the DRS (*Département du Renseignement et de la Sécurité*), since the latter supposedly controls import licenses and the customs department. If this were true, any entrepreneur who needs to import goods would have to enjoy good relations with the security services (Werenfels 2004b: 111–12).
25. The principal decision makers—*le pouvoir réel*—at the end of the 1990s included President Bouteflika and five generals: Mohamad Lamari, Mohamad "Tewfik" Mediène, Smaïl Lamari, Mohamad Touati, and Larbi Belkheir. Khaled Nezzar may or may not have been among them at that time.
26. The collapse of the Khalifa empire, noted below (nn. 27 and 31), is a case in point. It has been suggested that the bankruptcy cost the Algerian state more than $1.5 billion. See *Le Quotidien d'Oran*, November 10, 2003.
27. For a look at the opaque interlacing of private interests with state power, see the intriguing case of the Khalifa financial and industrial "empire," which included both a bank and an airline, and its breathtaking dissolution overnight (see below, n. 31). The Khalifa debacle is a striking illustration of the dysfunction of this system. See, among others, Florence Aubenas, "Khalifa, un empire en désintégration," *Libération*, March 20, 2003, and *Le Monde*, March 21, 2003.
28. Needless to say, this type of construction defies whatever building codes may exist, with the result that there are regular tragedies in which, e.g., roofs literally fall on people's heads; it also makes a mockery of any sense of urban planning.

29. Supra, n. 5.
30. The *biens vacants*, or abandoned colonial property, also constituted an important form of rent, especially between 1962 and 1973, before oil revenues soared (Lowi 2004).
31. Apparently, the Khalifa Bank was used for money laundering and providing credit to people close to the regime; it was also the repository for pension funds of several public institutions and the labor union (UGTA). It had enjoyed credits from public Algerian banks. However, because the bank had close connections to President Bouteflika and his closest associates, it escaped Central Bank supervision. When the bank developed an unforeseen liquidity problem, there was a run on the bank. The bank collapsed, as did the rest of the Khalifa business empire. It was rumored that Bouteflika failed to protect Rafiq Khalifa at this critical juncture because the latter had refused to support him openly as he campaigned before the 2004 elections. Supra, nn. 26 and 27.
32. Werenfels (2004b: 167) describes how record oil revenues in 2003 allowed President Bouteflika to distribute very generously throughout the country as he campaigned before the 2004 elections (in which he eventually won).
33. No doubt, the choice of Abdelaziz Bouteflika—a member of the war-time "*clan d'Oujda*" and foreign minister under Boumedienne for more than a decade—as president of Algeria in 1999, after Zeroual's resignation, was significant. He was reputed to have considerable skills in diplomacy and good relations in the international arena. The hope was that he would be instrumental in enhancing Algeria's image abroad and reinserting the country more squarely into international affairs after years of it having been so focused on the political crisis at home.
34. The solidarity of foreign governments was especially forthcoming once terrorism was exported to Europe; see the attack on the Paris subway in 1995, attributed to the Algerian *Groupe Islamiste Armée* (GIA). Since September 11, 2001, the Algerian military has received much-sought-after equipment, such as infrared night lights (*New York Times*, spring 2003; interviews, October 28–29, 2002). At a conference in Algiers in the fall of 2002, organized by the army for the obvious purpose of positioning itself in the international "war on terror," a number of participants "in uniform" made pleas, in public as well as in private, for such equipment.
35. In fact, a triple lawsuit against former Algerian Defense Minister Khaled Nezzar was submitted, in France in 2001, by the family of an Algerian victim of torture, plus two survivors. At that time, Nezzar himself was on a private visit in France. No doubt anxious to avoid a scandal, the French authorities alerted Nezzar and facilitated his speedy departure from French soil. For details, see Algeria Watch, http://www.algeria-watch.org/.
36. See Lowi (2005) for the number of armed men involved in the anti-insurgency, as well as a description of the state-created "*Groupes de Légitimes Défenses*" and the "*Patriotes*."
37. More frightening than Islamic government per se may be its control over hydrocarbon wealth. This author was told by a former member of the Mitterand government that to legitimize the interruption of the electoral

process in 1991–92, the Algerian regime—no doubt reflecting its own concerns—posed the following question to the French authorities: "Would you accept that the oil rent fell into the hands of the Islamists?" (interview, May 26, 2003).

38. Much of the south, where the oil and gas reserves are located, has become a zone of exclusion. Anticipating that oil wells could be obstructed by hostile forces, the Algerian regime, assisted by its Western allies, has stationed 45,000 men in the region to safeguard its control, and entry into the zone is granted with special authorization only (Ait-Larbi et al. 1999).
39. Not surprisingly, commissions received for hydrocarbon contracts are thought to be the most important source of large-scale corruption.
40. Consider the amnesty of the late 1990s: many former fighters complained that despite guarantees, they could not live safely and comfortably in their new residences, nor were their identities and past actions protected. Many of them rejoined the insurgency (interviews, Algiers, February 26 and March 20, 2002). See, as well, the referendum on a Charter for Peace and National Reconciliation, which took place on September 29, 2005, and passed. The charter includes a set of juridical and social measures to reintegrate members of armed Islamist groups who have not been implicated in "collective massacres, rapes, or attacks with explosives in public places." However, it remains adamant about prohibiting the two leaders of the former FIS from engaging in political activities. See *Le Monde*, August 16, 2005, and "Algerian Voters Back Peace Plan," *BBC*, September 30, 2005, http://news.bbc.co.uk/.
41. I am grateful to Richard Auty for this insight. Auty (2002b) has proposed the establishment of Early Reform Zones (ERZ), or Enterprise Zones (EZ) that provide "an enabling environment that is free of the distortions pervading the rest of the economy" (49–50) as a possible strategy for achieving this. "Successful EZs provide secure property rights and investment conditions, no restrictions on foreign exchange, low or zero tariffs on inputs imported for exported goods, moderate levels of taxation and effective (usually private) administration." In the ERZs, investors could make money legitimately, as well as attract investment, create employment, and generate taxes for social expenditure. In principle, a successful ERZ would, through a "demonstration effect," encourage capitalists to change their ways and pursue profits through more respectable channels. Auty notes that Mauritius has been especially successful in this domain. What he does not mention, however, is that Algeria is not Mauritius, and Algerians are not likely to import Chinese labor.
42. During the civil war years, the region most affected by violence was the north-central portion of the country, in the districts of Algiers, Blida, and Medea, and the vast Mitidja plain. This very small portion of the country is the most fertile, the most urbanized, the most densely populated, and of greatest economic potential (Lowi 2005).
43. In principle, Kuwait's intentions were reasonable. By investing oil wealth in real estate ventures outside the country, the aim, it seems, was to transform a nonrenewable resource into a renewable one. The strategy entailed important guarantees for future generations. Nonetheless, the strategy has not been

successful, for a variety of reasons. Interestingly, the Ahijo government (1960–82) of Cameroon tried something similar: it froze the state's oil revenues and kept them outside the country. At the time, prominent international financial institutions lauded Ahijo's move as a judicious leadership choice insofar as harmful Dutch Disease effects were thereby attenuated. Unfortunately, the president's appropriation of the state's revenues in his own personal accounts (outside the country) meant that the domestic economy could not benefit from them at all. See van de Walle (1994).

44. Recall that the youngest revolutionary leaders and activists in the early 1960s were then in their mid-twenties; today they would be in their mid- to late sixties. The *décideurs* in 1999, for example, when Bouteflika was elected, were all part of the youngest cohort of those who had participated in the war of liberation. For further details, see Werenfels (2004b: 69–71).
45. On the Kabyle protest movement, see, among others, ICG (2003a). Once membership in the FIS became illegal, the most prominent opposition parties have included *Rassemblement pour la Culture et la Démocratie* (RCD) led by Saad Sadi; *Mouvement de la Société pour la Paix* (MSP, formerly HAMAS) led by Mahfoudh Nahnah (until 2003) and then Aboudjerra Soltani; *Mouvement pour la Réforme Nationale*, *El Islah* (MRN, formerly *Ennahda*) led by Abdallah Djaballah; *Parti des Travailleurs* (PT) led by Louisa Hanoune; and *Front des Forces Socialistes* (FFS) led by Hocine Ait-Ahmed.
46. John Waterbury (1993) coined this term to refer to politically insulated economic reform teams engaged to direct import-substitution industrialization and later, the privatization of SOEs.
47. For the case of Botswana, see, among others, Clapham (2004). I am grateful to Alan Richards for highlighting the example of Turkey, and for nuancing the successes of Botswana, given the deadly HIV/AIDS epidemic in the country.
48. This allegation was repeated to this author in interviews (1999–2001) with four different members of the reform team.
49. Besides, clan-, region-, and personality-based parties cannot engage effectively in democratic politics.
50. According to Aissaoui (2001: 237), roughly 400,000 additional jobs would have to be created each year between 2000 and 2010 to bring the unemployment rate back to its 1980 level of 16%.
51. In addition, business transactions in Algeria can include required "under the table" payments to so-called *sousmarins*, frontmen who provide a link between patrons (usually connected to the army) and investors, and tend to negotiate commissions (ICG 2001: 13).

7

No Quick Fix

Foreign Aid and State Performance in Yemen

Sheila Carapico

Few of the world's poorest countries better exemplify American interests in government performance than Yemen. Long overshadowed by its oil-rich Persian Gulf neighbors, Yemen gained attention as both an occasional target and a natural haven for militant regional paramilitary groups (including but not limited to al-Qaeda). Headlines were made at a time when development analysts were already worried about ecological and economic stresses exacerbated by the strains of structural adjustment and critical water scarcity. In view of these circumstances, analysts began wondering whether Yemen is an example of the combustible mix of poor governance and economic stagnation that could blow up or melt down. Realizing that the stability, safety, and welfare of the most populous and poverty-stricken country on the Arabian Peninsula matter, the Bush administration promised substantial U.S. assistance for the first time in Yemeni history. The question is, can American aid fix Yemen's problems?

This cautionary tale by an old Yemen watcher is divided into four parts. After reviewing sources of military-political and socioeconomic insecurity and prospects for their amelioration, it traces the effects of past international aid programs, first at the level of international relations and then at the level of infrastructural and institutional development. It describes and analyzes how Soviet and Eastern European security assistance, fat subsidies from Arab neighbors during the oil boom, loss of both communist and Gulf aid between 1989 and 1991, and statist institution-building efforts by

the World Bank and Western donors all affected state budgetary allocations, institutional development, and ultimately, performance. The caution is that just as past bilateral and multilateral assistance ultimately centralized authority in executive institutions, an infusion of security assistance may tip the delicate balance between the state and civil society; among the executive, legislative, and judicial powers; between the military and civilian arenas; between the public and private sectors; or between the political center and the localities. My greatest fear is that, in an effort to ward off the Somali scenario of chaos, American policies may bolster the Saddam model of dictatorship. In any case, there are no quick fixes to Yemen's national security problem that do not address government performance in the areas that matter most to households. These too are not easy.

Security Dilemmas

Yemen offers a series of enigmas to the outside observer. On the one hand, in cross-national comparison it lags behind most other countries on virtually any development indicator and shares certain disturbing social and ecological similarities with famously collapsed states such as Somalia and Afghanistan. Yet, by most narrative accounts, Yemen enjoys a kind of political equilibrium, some prospects for democratization, and possibilities for economic stabilization led by its infant oil industry. Its people hardly resist modernization but, to the contrary, are always migrating and trading abroad, improvising roads and electricity, clamoring for schools, and demanding progress.[1] In the field of international security, although the combined effects of poverty, unruliness, and regime acquiescence left room for small-scale paramilitary groups to operate inside the country, the Yemeni government has embraced the American war on terrorism, cooperating with U.S. authorities in the pursuit of al-Qaeda and its affiliates. Having all but ignored this poor, unstable corner of Arabia in the past, Washington now regards Sanaa as an ally against an elusive common enemy.

Yemen is not a failed state but a new state, a teenager, born only in 1990 of the marriage of two weak, unstable governments in their twenties: North Yemen, or the Yemen Arab Republic, based in Sanaa, where military officers deposed the last imam in 1962, and South Yemen, where revolutionaries seized power in Aden after the British departure in late 1967 and later declared the People's Democratic Republic. The two Yemens merged in 1990, only to face off again in a brief conventional civil war in 1994. Having reduced Aden's governance institutions to rubble, the victorious

Northern army for the first time overran what had been South Yemen. Rather than in the process of breaking, then, Yemen is a state in the making. National legislative and judicial institutions are not well rooted; the executive branch rules in conjunction with the armed forces, manipulating elections and the administration of justice to its own advantage (see Glosemeyer 1998; Saif 2000). Greatly strengthened in the past half-decade, the central government's authority is still not uncontested, either in the North or in the South. Border agreements with neighboring Saudi Arabia and Oman were drawn finally in the 1990s after decades of negotiations.[2] Basic services and systems of taxation, representation, and law enforcement are all under construction.

Long notorious for its Wild West frontier, where bloodless kidnappings and hijackings were commonplace, Yemen became a rather natural haven for groups later associated with al-Qaeda for several reasons. Its wide-open plains, towering mountains, and obscure valleys along a mostly unpatrolled 1,400-km boundary with Saudi Arabia offered many excellent hideouts. Usama bin Laden and several associates have Yemeni roots, especially in the distant southeast province of Hadramawt. Like other Middle Eastern governments (including those of Israel, Saudi Arabia, and Egypt), Sanaa had encouraged radical Islam as a counterweight to its socialist rivals up until the 1994 civil war, when veterans and admirers of the much-glamorized anti-Soviet Afghan jihad joined the North Yemeni army in sacking the former South Yemeni capital of Aden. As elsewhere, the clampdown on leftists and Marxists emboldened right-wing fanatics, who attacked socialists, beauty parlors, and even ("idolatrous") Islamic shrines in the mid-1990s. Moreover, Yemen had an unusually liberal immigration policy, especially with regard to fellow Arabs and Muslims.

So it is not surprising that groups known locally as, variously, Afghan-Arabs, Salafis, Wahhabis, the Aden-Abyan Islamic Army, al-Qaeda, and other general and specific names were able to make homes, conduct military training, toss the occasional bomb, and spread propaganda inside Yemen. Nor is it surprising that Yemeni intelligence was no better able than the FBI, the CIA, or the authorities in Hamburg, Germany, to detect the extent of its internal al-Qaeda network until they all began comparing notes. The Yemeni government's initial reaction to the *Cole* incident was as to another in a series of bombings in and around Aden, not as to another in a series of attacks on Americans. Between October 2000 and September 2001, Sanaa began to uncover connections between a radical fringe within its borders and international terrorism.

Until then, the U.S.-Yemeni relationship remained at arm's length. The United States never invested heavily in Yemen, nor have Yemenis seen the United States as a benefactor. A few early showpiece projects like the Kennedy

Water System for Taiz notwithstanding, American generosity was pretty paltry. Yemen was twice punished with the suspension of U.S. aid for opposition to Israeli or American military actions against fellow Arabs. The number, cost, and visibility of U.S. programs pale in comparison to Chinese roads, Kuwaiti hospitals, Saudi schools, and World Bank consultants. The American corporate presence, led since the mid-1980s by Hunt Oil of Texas, was nothing compared with the massive American business community in neighboring Saudi Arabia. On the other hand, hard-hit by suspension of aid from both Warsaw Pact and Arab Gulf donors, Sanaa has been desperately seeking American approval. Parliamentary elections in 1993, 1997, and 2003 drew some positive publicity. But for the most part the government of President Ali Abdallah Salih failed to convince the United States of its importance until Americans came under attack in Yemen. Anxious to be treated like Pakistan, not Afghanistan, in the wake of September 11, 2001, the Salih administration is keener than ever to curry American favor and use it to domestic political advantage.

Yemen appeared on Washington's radar screen after internal security, always precarious, deteriorated from frontier lawlessness to deadly paramilitary operations against Yemeni and international targets.[3] Although Somalia-bound American sailors were targeted in Yemen in the early 1990s, the first incident to warrant wide international coverage was the kidnapping of 16 Western tourists in the district of Abyan on December 28, 1998; four of them died in a botched rescue mission by the Yemeni government. Explosions aboard the USS *Cole* in Aden harbor in October 2000 and the French tanker *Limburg* in 2002—costly especially in terms of inflated insurance premiums for the shipping industry, a potential growth sector for investment and revenues—gave the country a reputation as a site of international terrorism.[4] The assassinations of three Baptist medical missionaries and a prominent Yemeni socialist politician in late 2002 and protests against the American invasion of Iraq in early 2003 threatened another sector slated for growth—tourism—as the country appeared increasingly dangerous (World Bank 2002f).[5] These and other signs of a high-risk, low-security environment multiplied disincentives to private investors, including resident Yemenis, Yemenis living abroad, and foreign companies (World Bank 2002a). Security trepidations and constant contestation of land rights hampered further oil, gas, and mineral exploration so essential to scenarios for income growth.

The American and Yemeni militaries have joined forces to patrol Yemen's borders and coasts and to share intelligence. After Yemen's opposition to the Saudi-U.S. alliance against Iraq in the 1990–91 Kuwait War severely strained U.S.-Yemeni relations, the Yemeni government took several steps to improve its image in Washington. It welcomed the U.S. Navy

to Aden, implemented an unpopular austerity package recommended by the IMF, mended fences with Saudi Arabia, and began issuing tourist visas to Israeli Jews. Evidence of a closer relationship included FBI participation in the investigation of the attack on the USS *Cole* in 2000, Yemeni President Ali Abdallah Salih's Washington visit in November 2001, Vice President Dick Cheney's trip to Yemen in March 2002, the resumption of military education and training, and Yemeni approval of the U.S. Hellfire missile strike on a vehicle carrying al-Qaeda operatives inside Yemen in November 2002. By that time the United States was already providing military assistance in the form of training, special forces and security specialists, and materials to support Sanaa's own counterterrorism campaign. Everyone expects this cooperation to expand in coming years into hundreds of millions of dollars. As in the past, therefore, events in the larger world arena—this time the September 11 attacks and the occupation of Iraq—are influencing domestic policies via government budgets.

Depending on how you look at it, Yemen is either a fledgling polyarchy or an imperfect dictatorship. Among Arab states it is widely considered one of the more promising "emerging democracies," in which a relatively laissez-faire policy betokens some prospects for political as well as economic liberalization. Token female parliamentarians, contested multiparty elections, and freewheeling public discourse make it look more enlightened than most of its neighbors. All the political parties—including the ruling General People's Congress, the conservative, religiously based Reform Party, the Yemeni Socialist Party, and the smaller parties—at least pay lip service to electoral representation, universal suffrage, human rights, and the rule of law. But although democratic practices in parliament, the press, and the courts are sometimes vivacious, they are hardly robust. The same clique has ruled from Sanaa since the late 1970s. After the civil war the liberal unity constitution was amended to reconcentrate power in the central executive and restrict the authority of the elected legislature. The parliamentary elections of April 2003 served to consolidate the ruling party's strong majority.

Still, North-South fissures endure, and the North itself is riven by center-periphery tensions often cast in tribal idiom. Although the regime resorts to more bargaining than brutality in its quest to consolidate control, the military already governs. Loyal army, air, republican guard, internal security, and now coast guard forces police more effectively than ever. Armed forces moved against political paramilitary groups long before the *Cole* bombing, chasing the Abyan-Aden army out of Aden, conducting sweeps in other regions, expelling hundreds of non-Yemeni Arabs, and closing some paramilitary camps. New laws and death sentences seem to have curbed kidnappings, and scores of suspected militants have been

rounded up or gunned down. Some regions can resist army incursions, but direct military challenges anywhere in the country have been crushed.

Tempting though it is for the United States to concentrate on counterterrorism and state-strengthening measures, I fear that a security-driven infusion of resources and expertise into selected military institutions risks reinforcing authoritarian tendencies. Surveillance agencies or antiterrorism squads can be disproportionately empowered by dollars and elite training. This influences the power of the military-security apparatus over civilians and also power struggles within the military regime. An important example of this has already happened: after the Yemeni army fatally botched an attempt to rescue kidnapped Western tourists around Christmas 1998, a new special forces unit was established under the command of the president's son and successor designate, Ahmad Ali Abdallah Salih, to deal with quick strikes and hostage situations. The U.S. military's efforts to strengthen these special forces have fed rumors in Yemen that the Bush administration approves of the presidential succession from father to son and favors the special forces over other branches of the military and their officers.

Nor, whatever the immediate exigencies, are the demonstration effects of high-powered remote-control executions, like the Hellfire attack, conducive to the rule of law. Human rights and due process had already been violated in the prosecution of the domestic war against regime opponents in the 1990s, though outright extrajudicial killings that could be pinned on the government were unusual. The unfortunate precedent is not likely to be offset with a few human rights conferences or help with elections administration if the net gain in resources engorges a police state. Economic logic can justify an investment in stability in order to lure private investors. But if Yemenis perceive a trade-off between utilities and the military, or experience governance as more surveillance than responsiveness, this strategy could backfire on both the government and the United States. People expect security (within legal parameters) *and* a decent standard of living.

Socioeconomic Insecurities

Although location gives it a strategic importance that landlocked countries in resource-poor environments lack, Yemen's development conundrum echoes that of other poorly performing states. The lack of financial and technical wherewithal to deliver essential services to more than 18 million people scattered over a vast terrain perpetuates a vicious cycle of poverty. Private investment capital remains scanty, scared, and small-scale, whereas

the terms of structural adjustment have raised the costs of investment and reduced the level of consumption. Civil war, elite corruption, and disproportionate spending on domestic security have all drained public coffers. All in all, the peculiarities of Yemen's internal and external affairs notwithstanding, it is similar to other so-called basket cases, desperate for any sort of finance. Although national leaders have not managed resources well, the economy has also borne the brunt of regional and global forces beyond its control.

By virtually any comparative indicator, Yemen now fits the profile of poor performance. It scores among the poorest performers in the world on five major indicators: civil and political liberties as reported by Freedom House; the United Nations Development Program's (UNDP) human development index; negative gross domestic product (GDP) per capita growth during the 1990s; the proportion of the population living on less than a dollar a day; and the World Bank's measure of rule of law, including things such as contract enforcement. The UN puts Yemen in the group of 49 countries that it has identified as least developed in terms of their low GDP per capita, weak human assets, and high economic and trade vulnerability (see UNCTAD 2002). Life expectancy seems to be declining, despite negligible known AIDS cases (USAID 2001). With birth rates outstripping economic growth, widening inequality, and bad risk ratings—all despite being an oil exporter—prospects for affluence seem dim.

It was not always so. As explained more fully below, in the 1970s and 1980s foreign aid supplemented by labor remittances enabled urban and rural households to acquire electrical power, running water, imported goods, and better access to schools and medical attention. On the eve of unification, the North, with a per capita income of over U.S. $600 a year, was close to "graduating" into the World Bank's middle-income category. Then, due primarily to exogenous factors that suspended both aid and remittances, the economy crashed. The poverty rate doubled during the 1990s, whereas real GDP per capita tumbled to about U.S. $300. Once rather rare, malnutrition now plagued nearly half of young children, a serious deterioration of nutritional standards from a generation earlier, when indigenous grains, vegetables, and dairy products were dietary staples. Whereas 1990s' parents had experienced great gains in literacy in their school years, their children were crammed into crowded, crumbling classrooms. Households that secured water and electricity hookups not long before, now found themselves unable to pay for these services. New fees made hospitals inaccessible to the burgeoning poor. Cities, which had seemed to offer a better life, had become crowded, messy, anomic places. High aspirations were dashed, prompting people to take to the streets on numerous occasions.

Environmental disaster looms in southwestern Arabia, heretofore a semiarid, temperate region of self-sufficient agriculture and herding known historically as Arabia Felix. The calamitous shortage of clean water, water delivery services, and new water sources to meet mounting urban demand is undermining the agricultural economy to such an extent that World Bank experts anticipate social conflicts over contesting claims to water. The urban centers served by huge public water corporations have drained their hinterlands even as the availability of household water delivery is a major incentive for rural-to-urban migration. International experts point out that over-irrigation and over-cultivation of qat, a cocaine-like shrub that is the country's most profitable alpine cash crop, grown entirely for the domestic market, are lowering the water table throughout the central highlands.

Profligate pumping for other crops and purposes in the coastal regions is intensifying the salinization of groundwater. These conditions endanger production and jeopardize social relations among neighboring villages and between cities and rural areas. The water sector is an example: in instituting agencies for the central control of ground and surface resources, donors inadvertently disrupted intricate local water laws in favor of corruption-prone central bureaucracies by assuming the latter's eminent domain rather than exploring the question.[6]

Some optimists in the donor community point to economic and political liberalization as well as growth in the nascent oil and gas sector. International financial analysts have approved of modest steps toward privatization and compliance with World Trade Organization standards. Government deficits were brought under control. Small declines were posted in fertility, infant mortality, and illiteracy. Population growth rates peaked at 3.9% and then inched downward. Actual GDP growth, fueled by the petroleum sector, fluctuated in the range of 3–8% a year from the mid-1990s onward, prompting the World Bank to report "recovery" even as the non-oil economy remained "sluggish" (World Bank 2001b). Donors and planners attributed the economic crisis of the early 1990s to the triple shock of the 1991 Gulf War, the drought, and the 1994 civil war, but hoped that strategic, environmental, and oil price conditions would become more auspicious. A great deal depends on petroleum revenues, and great hopes are pinned on returning Aden to its former glory as a world-class shipping hub—that is, on exogenous variables.

It is easy to blame political leaders and the ruling class for poor management of the economy.[7] Noting that Yemen ranks below most of its neighbors in regulatory framework, government effectiveness, rule of law, and its handling of corruption, World Bank experts enumerated problems, including poor domestic security, arbitrary regulations, lack of clear

property rights and other legal uncertainties, high taxes, corruption, smuggling, inefficiencies in public service delivery, weak contract enforcement, and an absence of mechanisms for settlement of business disputes.[8] Along with other contemporary donors, the World Bank has also criticized Yemen for a bloated public service, excessive public management, and bad decision making in such sectors as electrical power and water resources management. Yet, these criticisms of past policies overlook the role of the World Bank and bilateral donors in guiding development decision making.

Erratic Development Finance

Like many other poor performers, Yemen's macroeconomy is buffeted by regional and global geopolitical forces beyond its control.[9] It is not (or not simply) that Yemen is the victim of large amorphous forces of globalization, nor apart from the colonial era in South Yemen is it a classic case of dependency. Its strategic position in the lower Arabian Peninsula—between the Suez Canal, the Horn of Africa, the Indian Ocean, and the Persian Gulf—places the country along key fault lines in the international system. Through the mechanism of military and economic aid, Yemen felt the impact of the cold war and inter-Arab conflicts in every bone of its rather skeletal state structure(s). Events such as the waxing and waning of Soviet power, the rise and fall of oil fortunes in neighboring Arab Gulf states, and the Kuwait War of 1990–91 directly affected what was spent for what purposes and where. This was not bilateral dependence on a single rich patron that deliberately maneuvers outcomes, but a sort of multilateral pegging of fortunes to a capricious world system. Here I examine two historic periods, before and after unification, when events elsewhere directly affected the domestic political economy.

Boom and bust in the two Yemens

For at least a generation, while communist, Arab, European, and Asian donors were feeling generous, Yemen enjoyed significant improvements in standards of living. Roads, ports, schools, hospitals, and utilities were installed with generous cold war, Arab Gulf, and multilateral aid packages. The population per physician dropped from nearly 60,000 to 6,000 in North Yemen in the 20 years after 1962. In the postcolonial People's Democratic Republic of (South) Yemen (PDRY), where the British had established some services and revolutionaries promised better, the population served by each doctor fell from nearly 13,000 to about 4,000 (World Bank 1989: table 28). The percentage of children in school in the North

rose from 9% to 79% during this period, a remarkable achievement made possible by a combination of local efforts and Saudi-Kuwaiti largesse (table 29).[10] In the PDRY, half of all girls attended secondary schools, double the rate for colonial Aden, and the number of mothers losing infant children each year dropped from 197 to 120 per 1,000 births. North Yemen cut infant mortality too, though female secondary school attendance rose only from a very low 3% to 12% (table 32). The urban proportion of the PDRY's population swelled from 30% to 42%, and city dwellers in North Yemen increased from only 5% in the early 1960s to nearly 25% by the late 1980s (table 31).

By 1995 half of all Yemenis had access to safe water and sanitation; literacy rates were about two-thirds for men and one-quarter for women (al-Maytimi 2002). Many of these advances sprang directly from foreign finance and expertise. The transportation sector, for instance, was improved by contributions from the United States, the Soviet Union, and the People's Republic of China. South Korean companies paid by Saudi Arabia paved the major arteries of the North Yemeni road network. The Russians and the World Bank worked on port development for Aden and the Northern port of Hodeida.

Such external largesse was a function of superpower competition and the extraordinary riches of nearby oil-exporting states. Postcolonial South Yemen was backed financially by communist governments, Arab neighbors, and even the World Bank. Between 1968 and 1980, the USSR disbursed over U.S. $150 million to the PDRY, or about one-third of its total aid receipts for the period; it was spent for irrigation works, a thermal power station, a joint fishing enterprise, port facilities, public health, and oil exploration (Halliday 1990: 199–200). Hundreds of millions more went to arms, which were exported on easy long-term credit. China provided about U.S. $84 million, especially for road construction, a textile factory, and agricultural development. East German experts trained police and security forces (Page 1985: 26–7). Bulgaria, Czechoslovakia, Albania, Hungary, and Poland also sent commodity credits and technical experts. Hundreds of Socialist Party members studied in Eastern Europe. The state socialist model was clearly preferred, and it showed in public investments.

Aden was not entirely dependent on communist resources and models, however. Perhaps surprising in light of its socialist aspirations, the World Bank's International Development Association (IDA) provided about one-third of the PDRY's development loans in the 1970s and more in the 1980s. Official grants from Kuwait and other Arab countries had reached U.S. $125 million in 1982, and total transfers from Organization of Petroleum Exporting Countries (OPEC) countries from 1973 through 1981 were estimated at U.S. $399 million.[11] Although the Soviet Union and China were

extending about half of all new development loans, Arab sources (directly or indirectly through multilateral organizations) generated most of the remainder (World Bank 1984: 12). By the late 1980s, loans and grants from Arab sources far surpassed ruble transfers. Overall, South Yemen gradually moved from dependence on communist states to dependence on Arab and multilateral sources. Still, the demise of European communist states left Aden bereft. In the end (following an intraparty bloodbath in 1986), the state ceased to exist.

The picture in the aspiring capitalist North was not as different from the socialist South as one might expect. During the cold war, North Yemen's fortunes too were enhanced by global and regional power politics. The USSR, China, and the United States vied for influence via large infrastructural projects in the 1960s, when few other countries were getting aid from all three superpowers. Subsequently, the World Bank, the UN, West Germany, the Netherlands, and Japan became active donors. The United States (which branded the PDRY a terrorist state) had only a small USAID mission in Sanaa, which was suspended between 1967 and 1972 on account of the Arab-Israeli conflict, and its Yemen policy was always tempered by American deference to Saudi interests.[12] Between 1973 and 1982, gifts, grants, and loans from Arab oil exporters outstripped all other sources, although as the main supplier of weaponry, the Soviet Union was also Sanaa's principal creditor, holding nearly half of outstanding debt in 1986 (YAR/CYB 1987).[13] Hundreds of North Yemenis, civilians as well as officers, also studied in communist Eastern Europe (as they did in Western Europe and North America, although Yemen was very marginal to the United States in economic terms, especially compared to Saudi Arabia).

The Saudi kingdom exercised considerable influence over its southern neighbor by providing weapons, petroleum supplies, direct-grant budgetary subsidies, turnkey construction projects, salaries for teachers recruited elsewhere in the Arab world, covert payments to individuals and factions, and easy access to work permits for Yemenis.[14] Estimates of total annual Saudi payments range between about U.S. $400 million and U.S. $1 billion during the oil boom, when Iraq, Kuwait, and other Arab OPEC donors also helped keep Sanaa afloat financially. For a while Iraq was the largest financier of government projects. OPEC sources provided some U.S. $1.4 billion between 1973 and 1981, almost all financial rather than technical assistance (Mattione 1985: 148).[15] OPEC assistance leveled off after 1981. Saudi Arabia and the other Persian Gulf states funded North Yemen heavily because of its poverty and proximity and as part of their regional anticommunist strategy. So in the cold war standoff between Sanaa and Aden, Saudi Arabia represented Western interests by backing the North. Washington recognized a Saudi sphere of influence in Yemen most visibly

when, during an inter-Yemeni border skirmish in 1979, "the United States cooperated with Saudi Arabia to greatly expand the security assistance program to the Yemen Arab Republic by providing F-5 aircraft, tanks, vehicles, and training" (USDOS/BNEA 2002).

Before unification, then, both Yemeni republics dealt with a mixed bag of benefactors. The American role was negligible. Moscow held nearly half of both governments' debts, mostly for military equipment, a major factor in their budgets. China, Czechoslovakia, East Germany, Hungary, and Bulgaria accounted for another fifth of Aden's outstanding debt and a fraction of the North's. Japan and Western Europe lent funds for projects in the North but not in the South. The World Bank and Arab Gulf states favored Sanaa over the PDRY, but supplied credits to both.[16] In short, both Yemens depended on international aid rather than any special patron. Although a good deal has been written about dependence on a single bilateral donor, often the United States, this situation has been less investigated and may be characteristic of other poorly performing states. But Yemen had then and has now rather more strategic salience than many other poor countries.

External shocks to a unified Yemen

Unification in 1990 was a product of domestic politics intersecting with a seismic global shift and clear economic incentives. Yemeni unity roughly coincided with the demise of the Soviet Union, the Warsaw Pact, the cold war, and the Berlin Wall, and just preceded German unification. Negotiations between Sanaa and Aden, intermittent for over two decades, now offered each regime a means of survival.[17] Economic logic also played a role. Texans and Russians prospecting on their respective sides of the inter-Yemeni frontier discovered common oil deposits in the 1980s. Soon the two nascent state petroleum companies merged into a Yemeni oil investment corporation. For all intents and purposes, state socialism and state capitalism had converged. Cost-benefit analysis favored joint ventures in electrical power, mutual road connections, and countrywide adventure tourism, antiquities tourism, commercial fishing, export agriculture, and certain manufactures. There was some hope that the law and order mentality of the PDRY would have a settling effect on the rampant petty entrepreneurship of the North. Initially, then, the plan was that oil, economies of scale, and redevelopment of Aden as a free port could offset dwindling external public assistance. It might have worked but for a number of setbacks.

The discovery of commercially viable oil deposits in 1984 had signaled new-found possibilities to attract international direct investment. Even in

the heyday of British Aden, when the port was a major naval hub between the Suez Canal and India, few foreign investors were ever attracted to Yemen. A British Petroleum (BP) refinery was Yemen's only significant commercial venture even in the colonial era, and no large private investments in any sector survived anywhere in Yemen in the tumultuous 1970s. In 1984, when the Dallas-based Hunt Oil Company found commercially viable petroleum deposits near Marib in southeastern North Yemen, prospects for attracting foreign private investment improved for the first time since 1962. Vice President George Bush attended Hunt's going-online celebrations in 1986, underscoring American interest in Yemen's petroleum sector. Soon Exxon, and then a consortium of South Korean firms, bought into Yemen-Hunt; Texaco, Elf Aquitaine, Total, Canadian Occidental, and USSR firms negotiated to drill for Yemeni oil. The Soviet company Technoexport made a major find in 1986 at Shabwa across the border from Marib.

The oil sector generated subcontracting opportunities for suppliers and builders such as the U.S. firm that built a small modular refinery near Marib and a Lebanese-Italian-German group that laid the pipeline. There were new commercial finds in 1987, 1988, and 1989, mostly south of the inter-Yemeni border, including the major Hadramawt concession that went to Canadian Occidental (Sultan 1988; Barakat 1991; Edge 1992). Soon there were discussions of refurbishing the old BP refinery at Aden and of exporting via a revitalized Aden port. Given discoveries under their common border and the increasingly clear advantages of cooperation (see Burrowes 1989), the two Yemeni public petroleum companies merged their operations into the joint Yemen Company for Investment in Oil and Mineral Resources. This company signed a production agreement in late 1989 with an international consortium consisting of Hunt and Exxon, the Kuwait Foreign Petroleum Exploration Corporation, Total, and two Technoexport subsidiaries.

Aspirations for growth led by oil and shipping were dashed within a couple of months after unification, however, by the fighting in the Gulf in 1990–91. By mere luck of the draw, newly unified Yemen held both the "Arab seat" and the rotating chair of the Security Council when the U.S.-backed resolution authorizing force to dislodge Iraq from Kuwait came up for a vote. When Yemen voted no, Secretary of State James Baker admonished it for what he called an expensive mistake. Indeed it was, for Saudi Arabia and the other Gulf monarchies reacted angrily. Ultimately the war disrupted the private remittances and international public finance that heretofore kept all of Yemen afloat.[18] In the clash among its most generous Arab benefactors, Yemen lost hundreds of millions of dollars from Kuwait, Saudi Arabia, other Gulf Cooperation Council monarchies, and republican

Iraq, not to mention the token U.S. $30 million a year or so from the United States. Moreover, Saudi Arabia suspended work visas for most Yemenis, sending some 750,000–800,000 people (male workers or traders and some families) over the border (see Colton 1993).

A hefty one-time infusion of migrants' savings notwithstanding, the combined loss of public (aid) and private (remittance) access to hard currency sent the domestic economy into a tailspin (Van Hear 1994; Lucet 1995). Urban services, most conspicuously in the Red Sea port city of Hodeida, were overwhelmed by the influx of returnees. Exacerbated by drought and the financial costs of relocating officials from Aden to Sanaa, by 1993, despite modest oil sector growth, real per capita income was 10% lower than in 1989. Unemployment was more than 25%, and the inflation rate hit 50%. Public sector employees went unpaid for months. The current account deficit for 1990–93 topped U.S. $3 billion. Central Bank reserves plummeted to the equivalent of a month's import bills. The debt overhang, measured by the ratio of debt to GDP, barely noticeable a few years earlier, was 200%, among the highest in the world. Now the IMF was recommending stringent adjustment measures (IMF 1993).

Declining aid receipts, the concomitant free fall in hard currency reserves, and depressed oil prices forced the riyal downward in the early 1990s, exacerbating the zero-sum reasoning that led to the civil war of 1994 (Stevenson 1993; Watkins 1993; Ross 1996).[19] Neighboring Gulf monarchies rewarded the Southern socialists' separatist aspirations with covert payments (see Parodi et al. 1994). In the end, Sanaa's army encircled the rebels in Aden and disabled the city's main water supply. With some help from irregular "volunteers," the army plundered the city's public infrastructure, systematically destroying the files of the former PDRY ministries of planning, housing, justice, social security, labor, and security. It also looted foreign consulates, UN agency compounds, the Red Cross, oil company offices, hotels, museums, prisons, factories, port warehouses, and selected private homes (Rone and Carapico 1994). Later the central banks, the national airlines, and other public companies were merged and the pace of privatization of PDRY enterprises accelerated. Note the destruction of institutions and services as the physical manifestation of the old PDRY state.

Victorious over the socialists, Sanaa begged for hundreds of million of dollars to reconstruct what had been destroyed. Talks with the World Bank and the IMF focused on reducing a cumulative combined public debt of between U.S. $8 billion and U.S. $10 billion, especially the Russian portion of the debt. Indeed receipts surged from a little over U.S. $200 million in 1995 to more than twice that amount the following year. Virtually the entire increase came from the IMF and the World Bank's IDA, in conjunction

with the Economic, Financial, and Administrative Reform Program (EFARP). Now multilateral assistance, including Arab and EU funds and especially the IDA, accounted for over three-quarters of external financing. The IMF's contribution soared from near zero to nearly 30%. Whereas past loans and grants had covered projects, usually involving physical construction, the EFARP focused on programs leading to debt reduction (Fergany 1998). Though donors, led by the World Bank, the Netherlands, and Germany, expressed faith in development cooperation, new aid was hardly on the generous terms of an earlier era (World Bank 2002e).[20] As poverty, inflation, and unemployment skyrocketed, households, social services, and enterprises faced their own deficits. Spending on education slipped from 19% to 16% of the government budget (al-Maytimi 2002: 7).[21] The burden fell disproportionately on the unemployed, landless peasants, and female-headed households (see, for instance, Hashem 1998).

Petroleum, the economy's potential savior, generated much-needed but unreliable revenues. By the mid-1990s oil earnings of about U.S. $300 million a year covered around half of a leaner, meaner state budget. This was nowhere near enough to halt Yemen's fall into the ranks of the world's poorest countries nor to reduce the government's need for foreign grants and loans to cover its expenses. Although as a small, non-OPEC exporter Yemen had no control over them, world prices increasingly drove government accounts, the balance of trade, and national income. Other sectors were still ignored by large multinational corporations and were barely attractive to Yemenis living abroad. Therefore, a policy favoring privatization and foreign investment notwithstanding, the state's share of the economic pie was actually expanding because oil rents replaced migrants' remittances as the main source of earned foreign exchange (Schmitz 1998). Aid per capita slipped from U.S. $22 to U.S. $15 between 1997 and 2000, rising again following the reinstatement of a U.S. economic aid package worth about U.S. $56 million in 2000. Debt service increased from 2.6% to 3.2% of the value of exports in the same three years (World Bank 2002d). Domestic tax collection remained moribund. Rises in world prices for oil in 2000–03, combined with a slight increase in rates of production, boosted gross national income, per capita GDP, and earnings from exports. With no significant nonfuel exports, however, a steep rise in oil prices would sustain economic growth.

Public Sector Growth

Foreign aid affected not only the economy as a whole but also budgetary and policy decisions that determined the distribution of resources in society. This section explains the decisive impact of international

development assistance in a country without the wherewithal to create basic socioeconomic infrastructure. When state construction projects began in the 1970s there was a colonial legacy in Aden but not, really, in the rest of South Yemen; the Northern imam heretofore maintained only the most minimal civil service and public works. Bilateral and multilateral assistance enabled both fledgling governments, but especially the North, to build institutions as well as infrastructure. This is how the state structures grew—one aid project at a time—and it is how public sectors came to dominate both Yemeni economies. East German training of domestic security forces, Soviet credits for arms purchases, World Bank loans to public corporations, billions of dollars spent on a nationwide power grid, Saudi funds for conservative education, and too many uncoordinated projects in the water sector all left a direct imprint on an inchoate bureaucratic structure. Thus, when the World Bank and other donors criticize centralization and the large state share in the economy, they are implicitly repudiating at least some of their own past institution-building efforts. I demonstrate this point with respect to the power and water sectors in North Yemen (both sectors being essential to meet basic human needs, to stimulate economic development, and to afford citizen appraisals of government performance), in which substantial international investments have only partly solved some problems while creating others.

Let us focus on North Yemen, the larger and surviving partner, embarking on state construction from scratch with a capitalist model in mind. Quite simply, the state sector, including its bureaucracy and its public corporations, came to resemble what one expatriate called "the sum of past aid projects." In national plans recommended by donors to rationalize investments, foreign public sector loans and grants were expected to cover the lion's share of new investment and a very high proportion of spending in such sectors as education, power, water, and even manufacturing. Indeed, with North Yemen's acute shortages of technical expertise, anticommunist bent, empty public coffers, and perennial instability, only the influx of international assistance can explain the engorgement of the state sector. How else could a coup-ridden government with negligible domestic revenues amass such a relatively large centralized public sector so quickly? Consider the period between the late 1960s and the early 1980s when North Yemen experienced the improvements in standards of living cited above and the institution building explained below, along with a civil war, a military coup, two subsequent presidential assassinations, domestic insurrection, Saudi antipathy, and skirmishes with South Yemen.

It may at first seem incongruous that five-year plans, normally thought of as a socialist mechanism, were introduced into North Yemen by "bastions of neoliberal orthodoxy" like the World Bank. The bank's very

first order of business was the establishment of a North Yemen Central Planning Organization to compile a national three-year plan.[22] In the process, the bank, the UNDP, and the Kuwait Fund collaborated to enlarge the Central Planning Organization to manage hundreds of externally funded projects. The UNDP, the IDA, the Kuwait Fund, and West Germany provided technical experts to ghostwrite the ambitious five-year plan, 1976–81, beautifully published in a 924-page hard-bound English version that devoted an entire subchapter to listing needs for foreign experts (YAR/CPO 1977: 809–50).[23] In this plan, foreign loans and grants were to cover roughly half of all investments; at least three-quarters of government investments; and nearly all new projects in power, water, education, health, and other civilian sectors.[24] It was an ambitious program that would create massive bureaucracies to manage centralized universal public services.

In the electrical power sector, the World Bank took the lead in replacing the jumble of private, cooperative, and municipal generators—which had begun to light most towns and some villages in the evenings—with a nationwide power grid.[25] Since electricity consumption surged steeply (from near zero) during the affluent 1970s, and in consideration of technical snafus that plagued early municipal suppliers, a nationwide megaproject was recommended. Under a series of multimillion-dollar loans, steam turbine engines were installed in the Red Sea near the port city of Hodeida and a network of high-tension transformers was built to supply hundreds of thousands of homes and businesses in the northern half of North Yemen. In 1988 the Arab Fund approved a second grid to serve the Taiz region of the Yemen Arab Republic and Aden in the South, where the aging Soviet-built thermal plant needed refurbishment.

Huge investments in centralization notwithstanding, the grid never operated very well. By the mid-1990s the Yemen General Electric Company (YGEC) was wired to only one-third of households, and power outages forced businesses and hospitals to maintain backup generators. In retrospect, using sea-powered generators in a country soon discovered to be endowed with oil, liquid natural gas, and solar potential seemed shortsighted (Barakat 1998). Power stations on both sides were damaged on the first day of the 1994 civil war. The North-South network recommended in the 1980s was completed in 1997, with funding primarily from the Kuwait-based Arab Fund for Social and Economic Development (Ewing et al. 1998: 28). As creditors, the Paris Club urged the YGEC to phase out subsidies, sell shares to the private sector, and break up the national monopoly; other consultants drew up a master plan for electricity and gas calling for more loans and contracts to enable the YGEC to alleviate scheduled rolling blackouts and unscheduled brownouts (Khatib 1998).

All of this was very political. North Yemen's nationwide grid was part of the centralization of heretofore local services into a public corporation. The Aden-Taiz link was a step toward unity. Blowing out power stations was later a tactic of war. Blackouts and brownouts in the vanquished South caused such bitterness that the Netherlands embassy took the lead in upgrading the system in the far southeastern Hadramawt region to assuage political tensions there. Power failures are still not uncommon in the urban centers, and many communities remain off the "national" grid. Not surprisingly, those same communities are wont to resent government interference in local affairs. Erratic electricity supplies discourage investors and technology users while reminding everybody that the government is not working properly.

The water sector was a different story. Whereas electricity is widely considered a natural monopoly, the water sector in a semiarid, mountainous country is naturally decentralized. Yemen's traditional water resource management mechanisms—canals, cisterns, shallow wells, spate systems, and other devices tailored to each microenvironment—were ecologically elegant, separating every drop of water by use: drinking, cooking, livestock, bathing, irrigation. Private and community water rights, with minute provisions for drinking and irrigation, were a central feature of both Islamic and tribal law: water management was a crucial part of the agrarian order. But household supplies fell unhealthfully short of WHO standards. New pumping and drilling technology introduced in the 1970s revolutionized water utilization. Even collectively, international developers can hardly be blamed for all the profligate pumping that now threatens long-standing aquifers, since municipalities and farmers were often wasteful. Still, a range of donor agencies contributed to the strange, ultimately counterproductive development of water management bureaucracies. When the concept of eminent domain applied by foreign donors to water resources enabled national agencies to pump farm water to the cities, this wreaked havoc with a critical feature of indigenous Islamic or tribal law.

Water engineers were quick to recognize both the peril of overpumping and the dysfunctionality of the hydra-headed water bureaucracy assembled through "institution-building" projects (see Merabet 1980a, 1980b). The National Water and Sewerage Authority (NWASA) was established in 1973 at the urging of lenders to assume oversight of huge urban delivery systems under construction in Sanaa, Taiz, and Hodeida. Later, NWASA expanded, was moved from one ministry to another, and then became a semiautonomous public corporation, like the electricity company, with a large well-paid professional staff in a huge central office (Garner et al. 1985).

The management of the rural water supply—for three-quarters of the population spread out over mountainous, semiarid terrain—was another matter. As each of eight or ten donor agencies introduced its own unique technology, management systems, and accounting methods to a different selected counterpart bureaucracy established and trained for this purpose, units and outposts of the Rural Water Supply Department proliferated. More water agencies were initiated by other international development agencies in the Ministry of Agriculture, the Civil Aviation Authority, the federation of development cooperatives, the Central Planning Organization, and the Ministry of Oil and Mineral Resources' Geological Survey Division (the latter an American Trojan horse). By the mid-1980s, at the urging of the UNDP, a cabinet-level Supreme Water Council began requiring private drillers to obtain signatures from each of several water commissioners. On one level the state was asserting its ownership of natural water (and mineral) reserves; on another, a new state class enjoyed unprecedented opportunities for private enrichment. Both levels encouraged heavy water usage.

Another way in which international development agencies facilitated over-exploitation of water resources was by constructing large-scale, capital-intensive Ministry of Agriculture irrigation schemes intended to stimulate cultivation of semitropical crops such as citrus fruits in an otherwise semiarid climate (Ward 2001). Cheap credits for private irrigation and import policies discouraging production of indigenous drought-tolerant cereals in favor of exotic fruits and vegetables for export also contributed to heavy water utilization. While Yemeni policy makers, corrupt bureaucrats, wildcat entrepreneurs, and ordinary farmers smitten with a new technology made enough of a mess on their own, international experts recommended and funded some terrible policy decisions.

By 1995 annual freshwater withdrawal was estimated at a phenomenal 136% of total water resources, second in the world only to neighboring Saudi Arabia (World Bank 1997: table 10). Yet, half of Yemeni households had no access to safe water, and the per capita water supply was among the most meager in the world. In 1997 IDA, UNDP, and the Netherlands formed the Multi-Donor Group for Yemen Water to study and help alleviate a perilous water shortage. One recommendation—no longer ecologically or institutionally practical, though repeated in a number of reports—was a return to local, indigenous water management (Ward 1998). It was certainly too late for Taiz, where the Kennedy Water System (built by USAID and improved by the World Bank and other funders) drew from wells in a verdant valley to supply a city whose population grew 10-fold in less than two decades. The verdant farms are gone, and yet neighborhoods in Taiz go thirsty or buy water retail. This project and others based on the

principle of eminent domain for public works—such as roads and oil fields—also had unforeseen consequences for the practice of religious and common law in the Taiz region and elsewhere. Always contested but subject to a substantial body of Qur'anic law and communal tradition, water rights were an inherently local matter of inestimable value. The nationalization of water rights for urban use, however rational or justified in terms of public policy, undermined important legal practice and rights without replacing them with an alternative legal structure. The implicit trade-off was a promise of urban-like services including a different sort of "right" to utilities. But villagers saw a net drain of resources to the urban centers, resources of which water is the most vital.

Similar effects were to be found in other important sectors. Foreign aid enabled the Ministry of Education to centralize and nationalize schools, while Gulf funding of primary, secondary, and higher education helped shape the curriculum at all levels. Saudi aid for education was especially capricious, first assisting the ministry and Sanaa University but later aimed at private parochial schools and colleges. Both the health and education ministries became sprawling central bureaucracies. One development expert called the Ministry of Agriculture "a clearing house for foreign aid." Thanks to access to transnational credits and tenders, the Ministry of Public Works owned what was for a time the largest company in the country. "Capitalist" and "communist" donors alike funded agricultural projects and industrialization until the state had become the principal source of new investments in both sectors. Overall—indeed, rather surprisingly—the state's share of large enterprises in the "capitalist" North was not much less than in the PDRY (although petty trade flourished in the former and languished in the South).[26]

The emergence of a technocratic elite within the executive branch of government to manage what became the Ministry of Planning, the water and power corporations, ministries of public works and education, and other important central institutions was directly connected to study-abroad possibilities. A political leadership otherwise composed of semiliterate officer-tribesmen had not envisioned national development plans, nationwide power grids, or curricula. These were planned, funded, and executed by donors and staffed by a new class of foreign-educated technocrats. The World Bank, consistently the leading financier and policy adviser, designed and financed some of the very same public corporations its economists wished to see privatized, decentralized, and streamlined. Overall, then, the cumulative effects of the institution-building efforts of a dizzying array of donors was the accumulation of public sector entities controlled by the central executive. Unlike oil rents that enter the general coffers of the kleptocracy, or for that matter migrants' remittances that

used to evade bureaucratic siphoning, aid programs channel resources to particular institutions and individuals whose political and economic fortunes are thereby greatly enriched. Substantial investments naturally affected the distribution of values in a resource-poor environment.

Conclusions

Clearly Yemen faces many obstacles to security and prosperity. It is a new state with a long-entrenched regime but incomplete sovereignty. It has not all that much oil and even less water. Popular aspirations have been repeatedly elevated and dashed, and millions of teenagers face an uncertain future. Regular elections have not produced regime change but only reinforced the monopoly of the ruling General People's Congress. Even without detailing how Sanaa and Riyadh encouraged the Islamist right as a counterweight to the socialist left, fed subsidies to key tribal militia, or subverted law and order, and even assuming optimal political will on the part of the Salih administration, it is easy to see that improving governance and government performance would be a tall order. Providing universal access to electrical power and water alone is still a daunting yet indispensable task, essential to meeting basic human and entrepreneurial needs; the inability to deliver power and water even with significant sustained international investment represents a fundamental kind of state malfunction.

This chapter makes four main points. First, the United States can no longer afford to ignore problems of law and order in southwestern Arabia because they impinge on Red Sea shipping and the stability of the entire peninsula. Although in the short run Yemen is unlikely to either blow up or melt down, its relative tranquility is fragile and unfinished. Second, deteriorating utilities and inadequate services matter not because misery and frustration necessarily breed terrorism but because infrastructure represents the physical and social girding of the state apparatus and the main criteria by which ordinary men and women assess government performance. Third, Yemeni states' ability to offer citizens basic services in exchange for governance has hung on decisions of external donors in light of capricious global and regional circumstances—in a boom-bust cycle. Finally, bilateral and multilateral donor programs have always been statist by definition, greatly expanding the power, wealth, and bureaucracy of the central executive and, in many sectors, contributing to unwieldy, ineffective public agencies and corporations. Thus, external donors, led by the World Bank, must share responsibility for creating an institutional structure that is both too big and not big enough.

It is still not clear whether the current consortium of the United States, the World Bank, Japan, the Netherlands, Germany, other European countries, the EU as such, UN agencies, and presumably soon some Arab OPEC governments can or will help lift Yemen out of the ranks of the world's poorest and poorest performing countries. Perhaps a unified condominium of donors is an improvement over the past multiplicity of competing models, from the point of view of rational policy making. On the other hand, pressures from international creditors to raise prices for basic commodities and services have been greeted with street demonstrations and other forms of protest. Other Arab, African, and Asian governments have learned that prosecution of economic austerity measures and a simultaneous security crackdown risk kindling popular support for right-wing causes. Outside of widespread opposition to American policies regarding Israel and Iraq, Yemen is by no means a hotbed of anti-American or anti-Western sentiment (I detected outrage at the murder of the Baptists but not over the Hellfire assassination; and Islamists in the Reform Party angry over the ballot count in the 2003 elections complained to American and European delegations). Such sentiments may be stoked if Washington and the West are seen as conspiring with an extractive national security state responding to external powers, as for instance when FBI operatives were reportedly "crawling all over Aden" in the *Cole* investigation as Yemeni forces were conducting dubious mass arrests.

This conclusion offers no specific policy recommendations. If anyone knew how to fix Yemen's water and electricity problems, they would have done it in California by now. Guns and cowboy tribesmen are not necessarily more of a problem in rural Yemen than in Wisconsin. Primary schools and teacher education are surely needed, but we know from Egypt that mass education does not automatically boost economic performance. Having seen so many projects that seemed reasonable on technical grounds at the time of implementation result in deleterious long-term consequences, I am not urging more, less, or even different American programs in Yemen but only asking donors and experts to be aware of the political and policy implications of institution-building programs.

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Notes

1. Elsewhere I credit civic initiatives with major contributions to the process of state formation (see Carapico 1998). Without contradicting myself here, I examine effects of past donor efforts at state construction.
2. On the issues and terms, see Schofield (1997).
3. On security issues in the face of paramilitary attacks, kidnappings, and other problems, see ICG (2003b).
4. For background, see Carapico (2000) and Schmitz (2001).
5. For more on the political assassinations, see Carapico et al. (2002).
6. This problem has been recognized and addressed by the government of Yemen, which, in consultation with donors, passed the Eminent Domain Protection Law in 1995 (see World Bank 2002b).
7. Schmitz (2002) considers the wisdom of IMF advice. My focus here is more historical.
8. World Bank (2002a: 58–9, citing Kaufmann et al. 1999).
9. To paraphrase Karl Marx and credit Andre Gunder Frank, it can be said that leaders in places like Yemen mismanage, but not under conditions of their own making.
10. The 79% figure is inflated by the large number of adults belatedly attending schools.
11. These figures are from, respectively, Nonneman (1988: 103) and Mattione (1985: 148).
12. On the history of this relationship, including diplomatic relations and the oil industry, see Almadhagi (1996).
13. On Soviet military aid, see Nyrop et al. (1977: 233–9).
14. For an analysis of Saudi influence, see Gause (1990).
15. Note that, unlike Northern donors, the Gulf donors did not subcontract work to their own contractors but rather asked for international bids and tenders. Saudi-financed roads, for instance, were built by South Korean workers.
16. Data from Bank of Yemen, Aden, December 12, 1983, and Central Yemen Bank, Sanaa, June 30, 1987. That the data are several years apart makes little difference in the long time frame for accumulated debt; in addition, they are consistent with the data in World Bank, *World Debt Tables, 1986–87*, pp. 410, 414.
17. As their tumultuous, interconnected history reveals, many domestic political forces were at work (Gause 1988, 1987; Katz 1992).
18. On Yemeni-Saudi relations in the 1990s, see PF/MIS (1992), Katz (1995), and Okruhlik and Conge (1997).
19. On the civil war, see Schmitz (1995) and Warburton (1995).
20. Country participants in the October 2002 donors' conference were, in alphabetical order, France, Germany, Hungary, Iran, Italy, Japan, Malaysia, the Netherlands, Oman, Poland, Qatar, the Russian Federation, the United Kingdom, and the United States. Among other participants were the Arab Fund for Economic and Social Development, Arab Monetary Fund, Kuwait Fund for Arab Economic Development, OPEC Fund for International

Development, European Commission, Islamic Development Bank, Saudi Fund for Development, UN Development Program, UN Children's Fund, UN Population Fund, IMF, International Finance Corporation, Adventist Development Relief Agency, Benevolence International Foundation, CARE, Handicap International Belgium, Mercy International, OXFAM, and the World Bank.

21. Meanwhile, private domestic and foreign contributions to private education, especially conservative Islamic education, increased. See al-Abbasi (1998).
22. For a review of early planning history, see UNECWA (1977).
23. On the role of donors, see König and Bolay (1982).
24. Military spending was never included in the national plans but accounted for at least half of all government expenditures in both systems.
25. I took part in the 22-community national rural electrification feasibility study undertaken by National Rural Electric Cooperatives, an American concern, under contract with the World Bank.
26. For more evidence of this, see Carapico (1993).

8

A Millennium Development Goals–Based Strategy for Rebuilding the Postconflict Sudanese Economy

Ibrahim Ahmed Elbadawi

Introduction

Like many large and populous African countries, Sudan has been defined by conflict and disappointing development performance.[1] It has suffered through more than 37 years of civil war, beginning upon independence in 1956. The fighting was briefly interrupted by an uneasy peace from 1972 to 1983, after which the country fell back into the civil strife that continued until recently, before a historic peace agreement was concluded in January 2005, formally ending the longest civil war in Africa. Throughout the more than 40 years since 1960, Sudan's average annual growth rate per person was a miniscule 0.4%. Moreover, this growth has been very volatile, and high per capita growth could only be sustained for two disjointed periods: the first half of the peace era following the Addis Ababa Agreement (1975–79), and the current growth spell (1995 to the present), mostly driven by exceptionally favorable weather conditions and the emergence of oil as a major contributor to Sudan's economy. The failure of growth in Sudan is associated with a broad and multifaceted development crisis, the most serious manifestation of which is widespread poverty and a tragic human development crisis.

Indeed, Sudan has been caught in an underdevelopment trap. The fundamental question, therefore, is what explains this trap and how might the country break free of it and begin to develop a strategy for sustainable, equitable, and peaceful development? Addressing this question requires understanding the genesis of the development crisis as a basis for thinking through such a strategy. The first section discusses these issues, and the second section outlines a development strategy focused on dealing with the twin aspects of the underdevelopment trap: poverty and conflicts. The third section contains a detailed analysis on operationalization of this vision through the achievement of the poverty target of the Millennium Development Goals (MDGs).

Understanding the Root Causes of Underdevelopment

Systematic analysis of the failed development experience of Sudan would require probing deep into the historical preconditions precipitated by the colonial encounter. This is important because the colonial legacy has had profound effects on the civil war as well as the nature of the development institutions, both of which have been the major factors behind Sudan's development crisis.

Legacy of polarization and conflicts

Historical, social, and geographic factors have all contributed to the nature and duration of the Sudanese conflict. In particular, Sudan is not only a fairly socially diverse country, but it is also characterized by a major divide between the Arab and Arabized Muslim majority in the northern two-thirds of the country and the relatively underdeveloped, African, and animist- and Christian-populated South. This major divide was further polarized by the policy of the British colonial administration, which was aimed at insulating the South from the North, pending its eventual integration into East Africa. This policy was finally reversed less than 10 years before the country's independence, but by that time the two parts of the country had substantially drifted apart. Conflicts and political polarization in Sudan are both products of the extreme social polarization (ethnic, religious, and cultural) that characterizes Sudanese society.[2] Based on the shares in total population of the major groups classified by religion, ethnicity, and culture, it can be shown that Sudan is polarized along a North-South divide in addition to other second-order (although by no means insignificant) overall country-wide cleavages along tribal, ethnic, and regional lines within both parts of the country (see Balamoan 1981, especially table 35).

The inherited legacy of the colonial encounter was further reinforced by the dynamic of civil war and the failures and lack of vision of the Sudanese political establishment following independence. The ensuing political landscape was, therefore, characterized by a high degree of political instability that produced three short-lived periods of democratic rule and three more long-reigning military regimes. Given the historical background to the rise of political parties and the nature of the inherited parliamentary democracy, the democratic regimes were characterized by highly polarized political practices that left very little room for the articulation, design, and implementation of long-term development. On the other hand, despite the long duration of the military regimes, they were unable to establish a stable polity and their economic strategies were subject to reversals, corruption, and nontransparent management.

The same colonial legacy that made the country essentially ripe for civil war has also been associated with a false start with regard to economic and political institutions. It has been argued that where the colonial powers decided to settle they devised what are now called "market-supporting" institutions, while where they decided not to settle they opted for "extractive institutions" (Acemoglu et al. 2001). Evidence from the economic growth literature has emphasized the importance of the rule of law and solid institutions for the growth and structural transformation of economies. Institutions promote growth through facilitating investment, learning, and innovation. It is also generally recognized that institutions evolve over long periods of time in response to the demands of social, political, and economic interactions. The evolutionary processes involved are influenced by the geography, history, and culture of the societies concerned.[3] Colonial institutions, it is argued, persisted into the postcolonial period.[4] It is these inherited institutions that have influenced growth and overall development in postcolonial developing countries. The legacy of these colonial institutions, I would argue, has been particularly devastating for Africa, including Sudan. The colonization of Africa not only endured much longer than elsewhere, but was also by and large associated with "extractive" institutions.

The period 1899–1956, under the British colonial administration, saw the laying of the foundation of the modern economy of Sudan. The pillar of this economy was long-staple cotton. The cotton economy and the Gezira scheme were directly linked to the interests of the British textile industry and were aimed at providing reliable exports of raw and high-quality cotton to this industry. The emergence of the cotton-based irrigated agricultural sector during the colonial era has been associated with a whole ensemble of extractive economic institutions, especially with regard to the traditional rain-fed rural economies in the western parts of the country. It

is not surprising, therefore, that the whole modern economic system was conceived around irrigated agriculture and the cotton economy in particular, where the bureaucracy, the infrastructure, development planning, and the educational and health and welfare systems were all geared toward this economy. Admittedly, the colonial administration created highly professional and efficient administrative and economic institutions, including a first-class educational system, a sophisticated agricultural research infrastructure, and a strong and independent judiciary and civil service, as well as efficient post and railway systems. However, the inherited institutional structure was obviously lopsided and was, therefore, not suitable for broad-based development aimed at uplifting the entire country, especially the vast majority of the population in the rain-fed regions. National income estimates for 1956 show that the Blue Nile region, the heart of agricultural development during the colonial period, was relatively better off than other regions of the country, with a per capita GDP that amounted to about LS 42 (USD 118), followed by the northeast region with a per capita GDP of about LS 33 (USD 92), and the northwest region with a per capita GDP of LS 27 (USD 76). The South fared much worse than the northern regions, with a per capita GDP of about LS 14 (USD 39) reflecting years of neglect and marginalization during the colonial period. The poorest northern subregion had almost twice the per capita income of the South.

Unfortunately, mainly due to the political instability that has engulfed the country since its independence, only marginal changes were effected to this dominant development model. Therefore, national rule has only managed to widen the major economic disparities among the country's regions. The failure to radically restructure the development strategy and the associated institutions has not only produced disappointing development outcomes and poverty and deprivation, but it has also contributed to the conflictive discourse of Sudanese politics.

The civil war

Although civil wars are themselves endogenous, as explained above in the Sudanese context, once ignited, they in turn become the direct cause of untold human suffering, massive economic decline, and political instability. Therefore, it is not surprising that the Sudanese civil war has been by far the most significant factor behind the crisis of economic and political development in the country. Some of the consequences of the Sudanese civil war include

1 failure to develop and implement a long-term development vision, due to the massive political instability precipitated by the war;

2 detrimental consequences for the nascent Sudanese democracy, through the creation of conditions conducive to repeated interventions by the military, which weakened and ultimately ended three elected civilian democracies;
3 loss of life and displacement of people, destruction of physical and environmental assets, and various other aspects of manmade human suffering and destruction;
4 misallocation of physical and human resources toward military activities and assets;
5 disruption of the country's external political and economic relations and the diminished legitimacy of the state (as a result of being forced to fight some of its own citizenry);
6 hatred generated by violence, which reduces trust in society and promotes opportunism and reduces social capital.[5]

The political instability precipitated by the war produced two types of regimes, neither of which has been effective in promoting equitable and sustainable development. Sudan has been ruled either by unstable short-lived democracies or long-reigning military regimes. Although periods of democracy have managed to provide a bargaining platform for addressing the interests of various social and regional groups in the North, they have failed to address the major divide between the North and the South. Moreover, the highly centralized parliamentary democracy has failed to evolve into other, arguably more suitable forms of democratic governance, such as a federal presidential system. It has been argued that such a system would give more space to regions in formulating and implementing development policy, while empowering a nationally mandated presidential authority to ensure the continuity and stability of long-term development planning.

On the other hand, the tendency of military regimes to adopt force as a means of conflict resolution, including the North-South civil war as well as other conflicts or movements of political dissent, has only served to aggravate the negative consequences of the civil war discussed above. Therefore, aside from the three short-lived periods of democracy, Sudan achieved among the lowest scores in terms of standards of democracy, political rights, and civil liberties as measured by the Polity IV Index of the Center for International Development and Conflict Management, and by the Political Rights and Civil Liberties Indices of Freedom House. Moreover, the country also fared very badly in terms of any systematic measures of good governance—such as control of corruption, rule of law, government effectiveness, or voice and accountability—even by the modest standards of the sub-Saharan Africa and the Middle East and North Africa (MENA)

regions (see Kaufmann et al. 2006). This should not be surprising because in fractionalized or divided societies, such as Sudanese society, autocratic regimes will ultimately be captured by the special interests of regional, tribal, ethnic, or ideological persuasions.

Attempts to quantify the economic costs of the above have led economists to estimate the economy-wide cost of civil wars in terms of foregone growth. Analysis of the economic cost of civil war recognizes the fact that wars usually cause the immediate and substantial decline of output, and when they last long enough they can also destroy the physical, human, and "social" capital of the affected countries. The loss of productive capital, especially human and social capital, takes more time to reverse. Economists distinguish between five effects of conflict (e.g., Collier 1999): (a) military destruction reduces the capital stock; (b) the government diverts its expenditure from economic services, such as the police, to military expenditure; (c) disruption raises the cost of transactions and lowers the cost of opportunistic behavior so that social capital starts to break down; (d) because incomes are seen as temporarily low, agents will dissave; (e) because investment opportunities are unusually poor and risky, agents will shift their portfolios abroad. These five effects have implications for both the level and the composition of economic activity. During civil wars, per capita GDP is estimated to decline at an annual rate of about 2% relative to periods of no war. Moreover, the sectors that are intensive in, or are suppliers of, capital and transaction (e.g., manufacturing, construction, transport, distribution, finance) tend to suffer more disproportionate losses. So civil wars not only reduce the overall level of economic activity, but they are also particularly damaging to the most dynamic sectors of the affected economy.

Therefore, analyzing the economic consequences and causes of civil war is central to understanding the growth and development process in Sudan. Elbadawi (1999) provides estimates of the possible costs incurred by Sudan during just four years (1989/90–1993/94) and due to just two of the above channels: (a) the intensity of the war, which is assumed to lead to political instability, erosion of the state and civil society instruments, and the consequent decline in property rights and enforcement of contracts, and (b) the diversion of limited human, financial, and physical resources to military ends. The estimates are, therefore, very conservative, yet they reveal how destructive the Sudanese civil war was. According to these estimates, the civil war caused the country's investment ratio to be less than one-third of its potential level under normal conditions and reduced real national output growth per person by a cumulative rate of 8%. On average, therefore, the war can be seen as having reduced real growth per person at an annual rate of 2%.

The human development crisis

The other side of the underdevelopment trap is manifest in widespread poverty and deprivation. According to some recent surveys, about 60–75% of the population in the North is estimated to be living on an income below $1 per day, whereas estimates for the South are around 90% poor, and this level of poverty is also evident in a variety of human development indicators.[6] Despite sustained growth since the second half of the 1990s, most experts believe that poverty remained widespread and that it actually increased, not declined, during this period. These estimates appear remarkably consistent with indirect evidence on the dynamics of poverty in the 1990s found in Ali (2003). Professor Ali's analysis hinges on contrasting the relative influences of consumption growth and inequality as the two key determinants of poverty. He finds that, as expected in a growing economy, per capita consumption grew (at rates ranging between 1.6% and 2.8%), whereas inequality worsened at a much higher rate (4.5%). Owing to the much higher influence of inequality as compared with consumption growth, poverty rose during the 1990s, despite relatively high growth during the second half of the decade. Simply put, growth in the second half of the 1990s was too regressive, to the extent that it was associated with rising, not declining, poverty.

Corroborating these aggregate findings with evidence from sectoral growth might help explain why growth in the 1990s was so regressive. Several pieces of evidence from the traditional agricultural sector can be cited. This sector grew very fast during the period, at annual growth rates of 20% for crops and 10% for livestock. In fact, however, it only managed to achieve a rebound from the steep decline of earlier drought-stricken decades.[7] Moreover, even during years of high growth, the contribution to the economy of the traditional agricultural sector (as high as it may be) has always been lower than the share of the population it engages. For example, it is estimated that while the traditional rain-fed sector contributed 56% of agricultural GDP in 1999, it supported about 77% of the population; whereas the irrigated and rain-fed mechanized subsectors contributed, respectively, 22% and 7% of agricultural GDP, they supported only 12% and 0.7% of the population (World Bank 2003a). As noted by the same World Bank report, "Clearly, there is a skewed distribution of income from an aggregate agricultural growth that is quite substantial" (34). Therefore, low productivity in the traditional agricultural sector and high inequality within the wider agricultural sector suggest that despite high overall agricultural growth, rural poverty is likely to be persistent.

Finally, the rise in urban poverty was also caused by high inequality as well as low productivity due to the informalization of the urban economy

during the 1990s, especially in the capital city, which now accounts for more than one-quarter of the entire population of the country. A partial picture of urban inequality is reflected by the evidence from labor surveys, which suggest that the top 10% receiving salaried income accounted for 51.6% of all earnings in 1990 and 64.3% in 1996.[8]

In terms of the overall human development situation, recent estimates suggest that Sudan appears to be significantly lagging behind the average for sub-Saharan Africa (World Bank 2003a). Taking into account that sub-Saharan Africa is experiencing a human development crisis makes clear the extent of the tragic collapse of human development in Sudan. A summary of the status of the main human development indicators in Sudan and the gap relative to the targets of the MDGs follows[9]:

1. high incidence of poverty all over Sudan (ranging between 50% and 90%), especially in the South;
2. widespread acute and chronic malnutrition, estimated at about 35% in the North and 48% in the South;
3. all MDG indicators show inequalities in gender, rural-urban divide, and North-South and other regional differences, especially in basic education and health;
4. high incidence of child and infant mortality, infectious diseases such as malaria and tuberculosis, and rising rates of HIV/AIDS (2.6%).

The National Poverty Strategy

Against this backdrop, any appropriate development strategy must aim to simultaneously reduce poverty and deprivation and minimize the risks of future conflicts. Such a strategy will necessarily constitute a development vision firmly anchored in a deep understanding of the root causes of the conflicts and underdevelopment in Sudan. Therefore, the proposed strategy would seek to achieve the following two overarching goals:

1. achieve peace and reduce the hazards of future conflicts;
2. make a lasting impact on poverty and make progress on other MDGs.

These two goals would both require the achievement of widely shared growth as an intermediate development target, for addressing the accumulated historical horizontal inequities along regional, ethnic, and gender lines. This concept of "widely shared growth" was articulated in a concept note jointly issued by the then Government of Sudan and the Sudanese People's Liberation Movement prior to the formal signing of the

Comprehensive Peace Agreement (CPA) in January 2005.[10] The note explicitly identifies the various types of political and economic exclusions as the major sources of poverty and deprivation. Moreover, the note also recognizes that the achievement of widely shared growth would require political accountability and good economic governance, especially with regard to management of oil resources and aid effectiveness. In turn, both political accountability and prudent economic management must be underpinned by a social-economic contract, anchored by broad-based political participation and support from the international development community. Finally, the poverty strategy should also explicitly account for the "one country, two systems" model as a direct implication of the peace agreement. Moreover, the strategy should go beyond North-South issues to stress the importance of the realignment of economic and political powers from the central government to the states in all of Sudan. Again, this can be seen as yet another implication of the peace agreement, which also happens to be indispensable for fulfilling the objectives of the strategy.

Meeting the poverty MDG by 2015

The year 2005 was a watershed in the history of Sudan, ushering in an era of postconflict highlighted by the signing of the peace agreement in January, and the envisaged resolution of the Darfur conflict. In the same year, a relatively more broad-based government of National Unity was to be formed, paving the way for midterm elections in 2008 and the eventual referendum on self-determination for the Southern Sudanese in 2010.

With the peace agreement in place, Sudan can now focus on economic development in order to make significant progress toward MDGs by 2010, especially through substantial economic and social gains for Southern Sudan and other marginalized areas. This would suggest an explicit strategy for "making unity attractive" by the time of the referendum. Moreover, significant progress toward the poverty target and other MDG targets will facilitate the achievement of the ultimate objective of reducing poverty by half by the year 2015. The potential for postconflict growth is large, especially in the South and other war-affected regions, and the peace agreement provides a unique opportunity for the central development goal of the poverty strategy (achieving MDGs by 2015), which forces galvanizing economic policies and programs to accelerate social and economic development.

Progress toward the poverty MDG requires policies and programs consistent with a poverty strategy. The achievement of this goal requires

both sustained growth and adequate resources, given the efficiency of resource utilization in the economy (see Ali forthcoming):

1. Reducing poverty by half in 10 years requires the head-count ratio to decline by an annual rate of about 6.7%.[11]
2. Using a plausible estimate of the growth elasticity of poverty (of −1.357), real GDP per capita must grow at an annual average rate of 5% throughout the period.[12]
3. With the Sudanese population assumed to grow at around 3%, the economy must grow by an average rate of about 8% per year throughout the period.[13]

To derive the resource requirements for achieving these rates of growth, we follow the conventional approach by setting the rate of GDP growth equal to the investment rate (investment/GDP ratio), divided by the incremental capital output ratio (ICOR)[14]:

1. Set the ICOR = 3.5: average for the peaceful period of 1975–79 and the more recent 1990s, as well as comparable to the median for recent African postconflict experiences.
2. With the assumed ICOR, an average annual investment rate of 28% of GDP will be required to achieve the 8% real GDP growth rate.

The growth potential over three postconflict episodes (2005–15)

The literature suggests that in the 10–12 years following the end of a conflict, growth follows a fairly robust pattern across three episodes: the Peace Onset episode, composed of the first two peaceful years, including the year when peace is signed; the Post-Conflict I period of the following four to five peaceful years; and the Post-Conflict II period of the second four to five peaceful years (Collier and Hoeffler 2002). Subscribing to this literature, the estimated annual average growth rate of 8% required for halving poverty (which amounts to a total growth rate of 88% between 2005 and 2015) is assumed to broadly follow the postconflict growth dynamics discussed below (see table 8.1).

Peace Onset (2005–2006) Postconflict growth in this period *for the Sudanese economy as a whole* is not likely to be significantly higher than in 2004. First, growth was already quite high throughout the second half of the 1990s, although it was not pro-poor. Second, the risk of war recurring

Table 8.1 Postconflict growth and resource requirements for Sudan as a whole

	Peace Onset 2005–2006	*Postconflict I 2007–2010*	*Postconflict II 2011–2015*	*2005*	*2010*	*2015*
Population (million)	40.4	44.8	51.1	39.7	46.8	54.0
GDP (dinar and USD)						
GDP (current billion dinars)	5,858.1	7,801.8	11,152.7	5,603.3	8,978.5	12,710.5
GDP (current billion US dollars)	21.9	27.2	39.9	21.0	32.1	45.4
GDP PPP (billion)	71.7	92.6	130.6	69.0	105.2	148.9
GDP per capita (dinar and USD)						
Per capita GDP (current 1,000 dinars)	144.8	173.8	217.9	141.2	191.8	235.2
Per capita GDP (current USD)	541.0	630.1	778.8	530.3	685.3	840.7
Per capita GDP PPP	1,173.1	2,065.1	2,552.3	1,737.9	2,246.0	2,755.2
Required growth/investment						
Real GDP growth (%)	8.0	9.0	7.2	8.0	9.0	7.0
Real per capita GDP growth (%)	4.2	5.7	4.3	4.2	6.1	4.1
ICOR	3.5	3.5	3.5	3.5	3.5	3.5
Required investment (% of GDP)	28.0	31.5	25.2	28.0	31.5	24.5
Of which:						
CCE on social sectors	12.0	12.0	12.0	12.0	12.0	12.0
Other physical investment	16.0	19.5	13.2	16.0	19.5	12.5
Required investment (current million USD)	6,129.5	8,925.9	10,008.2	5,893.8	10,108	11,130
Per capita required investment (USD)	151.5	163.3	182.1	148.5	215.9	206.0
Memo: Exchange rate (dinar per USD)	267.6	275.7	279.8	266.2	279.8	279.8

Notes: PPP, purchasing power parity in constant 1995 international dollars; ICOR, incremental capital output ratio; CCE (current and capital expenditures) on social sectors based on expenditure allocation for advanced African reforming countries (i.e., Tanzania, Uganda).

(or new wars breaking out, most notably the one in Darfur)[15] may still be high, leading investors to exercise the option of waiting. Third, capacity is usually severely limited, and aid tends to be substantially allocated to livelihood needs (very important for welfare enhancement but not necessarily directly effective for raising growth in the short run). Therefore,

growth rates during the Peace Onset episode (2005–06) are assumed to average 8% per annum, slightly up from the 7% projected for 2004. Assuming that the economy will experience a steady but modest rise in growth during this period is consistent with the growth profile of postconflict countries coming out of long civil wars, when macroeconomic stabilization was achieved (Staines 2004).

Postconflict I (2007–2010) Like other postconflict economies, the Sudanese economy is likely to experience dramatic growth rates during the four to five years following Peace Onset. Perceived risks of recurrence of conflict are substantially reduced. Also, improvements in the institutional and policy environment are likely to be realized, which should be sufficient to enhance absorptive capacity for aid and other domestic resources that will finance the reconstruction. Moreover, the combination of improved policy environment, foreign aid, and the initial conditions of depleted capital stocks and rudimentary infrastructure due to the long civil war, should allow the growth potential to be realized. This is likely to be quite substantial in the case of Sudan, given the longevity of its civil war and the devastation that affected the economy of the South and other war-affected regions in the North, including Darfur. Therefore, growth is assumed to rise to 9% per annum, reflecting, among other things, the envisaged expansion of the Sudanese oil economy, with the expected doubling of production as the new oil fields come on stream. With substantial foreign direct investment (FDI) and more aid, and hopefully, with meaningful improvements in policy and economic management capacity, the assumed growth rates appear plausible. However, to achieve the required rates of growth and ensure that they are sustained and sufficiently broad-based would require considerable political and governance reform. Postconflict Sudan is clearly among the most poorly governed developing countries.

Postconflict II (2011–2015) Growth is also likely to remain high during the third phase, as the economic and policy environments continue to improve, although the impetus due to catch-up growth is likely to moderate over time. This period is assumed to account for the remainder of the required growth, which comes to a rate of 7.2% per annum. Although the assumed growth rates are still high, the economy is assumed to slow down compared to the previous six years, and the economic, policy, and institutional environments are likely to consolidate. Barring new discoveries, the oil economy is envisaged to reach its maximum capacity.

It is obvious that substantial resources will be needed in order for postconflict Sudan to achieve the growth rates necessary to meet the poverty target by 2015 (see table 8.1). The required investment rate amounts to

28% of GDP in the Peace Onset period, reaching a high of 31.5% for Postconflict I, before declining to the more normal levels of 25.2% in Postconflict II. These estimated resource requirements might seem prohibitive, especially if compared with historical growth-oriented expenditures (an overall investment rate of 19% and social sector current expenditure of 3%). However, even though the substantial resource gap will need to be at least partially financed by foreign aid, FDI, even in the non-oil sectors, should also be a major source of development finance. In fact, FDI flows to Sudan were already picking up throughout the 1990s, when they increased from an annual average of 0.3% of GDP for the period 1992–97 to an estimated 7.7% of GDP in 2003. Moreover, with the envisaged budget restructuring required by the poverty strategy, more domestic resources could be reallocated to growth-promoting current and capital investment programs in agriculture and infrastructure as well as the social sectors.

A Focus on Southern Sudan (and the Three Areas)

The implications of the "one country, two systems" initiative The peace agreements grant the Government of Southern Sudan (GOSS) substantial sovereign economic powers. This has important implications for the conceptualization and execution of development policy in Sudan that need to be made explicit. In particular, subject to the provisions of the Framework for Wealth Sharing and the constraints set by an agreed-upon overall macroeconomic policy, GOSS is, essentially, entitled to pursue an independent "development strategy." Therefore, it seems reasonable to discuss the potential for postconflict growth and attempt a projection of the resource requirements for the southern region. Moreover, the CPA also provides for the special status of three small regions, referred to in the agreement as the Three Areas. These areas are historically part of the North but are geographically adjacent to the South and were under the control of the rebel movement during the war. The CPA, I believe, correctly anticipated these "Three Areas" playing an important role, given that they are not only war-affected and marginalized regions, but they also constitute a key economic, geographic, and political link between the North and the South.

Growth in postconflict Southern Sudan and the Three Areas

Given the level of development of the southern region (and the Three Areas) as reflected in per capita GDP, it can be shown that the average

growth elasticity of poverty in Southern Sudan would be equal to −0.653, which is about half the absolute value of the elasticity estimated for Sudan as a whole.[16] With the required reduction in poverty of 6.7% per annum, real per capita GDP in the South (as well as the Three Areas) must grow at an average annual rate of 10.3% per annum. Given the assumed average population growth rates (which account for repatriation of internally displaced persons in the North and of refugees from both the South and the Three Areas), overall real GDP must grow by 15% per annum for the South and by 16% for the Three Areas. These are relatively high rates of growth, although for regions emerging from a long civil war they should not be surprising.

Due to the envisaged massive repatriation of Southern Sudanese (and to a lesser extent, citizens from the Three Areas) during 2005–09, both growth and resource requirements are assumed to vary across the three postconflict episodes (see tables 8.2 and 8.3):

1. GDP in Southern Sudan is assumed to grow by 15% in the first two years of the Peace Onset episode, and by a staggering 18% in Postconflict I (2007–10), but is assumed to decelerate to the still high rate of 12% per annum in Postconflict II (2011–15).
2. For the Three Areas, growth is also assumed to be high, following a similar pattern, at 22%, 18%, and 12% in the three periods, respectively.

Despite substantial capacity constraints during the Peace Onset period, the Southern Sudanese economy is likely to be driven by massive outlays in the social, livelihood, and infrastructure sectors. In the following (Postconflict I) period, growth is likely to continue to be high, where in addition to infrastructure, agriculture will start contributing to growth, especially as the structure of incentives for this sector remains favorable in the face of rising aid and oil proceeds. The high growth trend is expected to continue in the remaining five years (Postconflict II) as the region's average per capita income continues to be lower than the national average.

Resource requirements

Given the assumed ICOR for Southern Sudan and the Three Areas, which amounts to an average of 6 and is almost twice as large as the national average, the following required investment rates (as a ratio to GDP as well

Table 8.2 Postconflict growth and resource requirements for Southern Sudan

	Peace Onset 2005–2006	*Postconflict I 2007–2010*	*Postconflict II 2011–2015*	*2005*	*2010*	*2015*
Population (million)	8.5	10.1	11.7	8.2	10.8	12.4
GDP (dinar and USD)						
GDP (current billion dinars)	325.9	555.1	1,032.0	301.5	706.4	1243.6
GDP (current billion US dollars)	1.2	2.0	3.7	1.1327	2.5245	4.4445
GDP PPP (billion)	4.0	6.6	12.1	3.7	8.3	14.6
GDP per capita (dinar and USD)						
Per capita GDP (current 1,000 dinars)	38.2	54.4	87.5	36.6	65.5	100.2
Per capita GDP (current USD)	142.8	197.1	312.9	137.3	234.2	358.2
Per capita GDP PPP	468.0	645.8	1,025.3	450.0	767.4	1,174.0
Required growth/investment						
Real GDP growth (%)	15.0	18.0	12.0	15.0	16.0	9.0
Real per capita GDP growth (%)	8.4	12.7	9.2	8.3	13.2	6.2
ICOR	6.0	6.5	5.5	6.0	6.5	5.5
Required investment (% of southern GDP)	90.0	117.0	66.0	90.0	104.0	49.5
Required investment (% of overall GDP)	5.0	8.2	6.0	4.8	8.2	4.8
Required investment (current million USD)	1,095.9	2,344.6	2,366.5	1,019.4	2,625.5	2,200.0
Per capita required investment (USD)	128.5	230.0	202.3	123.6	243.5	177.3
Memo: Exchange rate (dinar per USD)	267.6	275.7	279.8	266.2	279.8	279.8

Notes: PPP, purchasing power parity in constant 1995 international dollars; ICOR, incremental capital output ratio.

as in current dollars per capita) can be derived (see tables 8.2 and 8.3)[17]:

1 The required investment for Southern Sudan accounts for 90%, 117%, and 66% of the *Southern* GDP for Peace Onset, Postconflict I, and Postconflict II, respectively.
2 Similarly, for the Three Areas, the required investment accounts for 134%, 116%, and 63% of the *Three Areas* GDP for Peace Onset, Postconflict I, and Postconflict II, respectively.

Table 8.3 Postconflict growth and resource requirements for the Three Areas

	Peace Onset 2005–2006	*Postconflict I 2007–2010*	*Postconflict II 2011–2015*	*2005*	*2010*	*2015*
Population (million)	2.5	3.0	3.4	2.3	3.2	3.7
GDP (dinar and USD)						
GDP (current billion dinars)	93.8	164.3	301.2	84.2	207.2	355.9
GDP (current million US dollars)	350.5	594.7	1,076.4	316.2	740.5	1,271.8
GDP PPP (million)	1,148.6	1,949.0	3,527.8	1,036.1	2,426.8	4,168.0
GDP per capita (dinar and USD)						
Per capita GDP (current 1,000 dinars)	37.9	53.9	82.8	36.4	65.0	97.0
Per capita GDP (current USD)	141.8	195.2	296.1	136.7	232.3	346.6
Per capita GDP PPP	464.7	639.6	970.3	447.9	761.1	1,135.9
Required growth/investment						
Real GDP growth (%)	22.4	17.8	11.5	23.1	16.1	6.2
Real per capita GDP growth (%)	8.4	12.7	8.6	8.3	13.2	3.3
ICOR	6.0	6.5	5.5	6.0	6.5	5.5
Required investment (% of 3 areas GDP)	134.3	115.6	63.1	138.3	104.3	33.8
Required investment (% of overall GDP)	2.1	2.4	1.7	2.1	2.4	0.9
Required investment (current million USD)	469.5	680.3	654.0	437.3	772.5	430.2
Per capita required investment (USD)	190.3	223.7	189.7	189.1	242.3	117.2
Memo: Exchange rate (dinar per USD)	267.6	275.7	279.8	266.2	279.8	279.8

Notes: PPP, purchasing power parity in constant 1995 international dollars; ICOR, incremental capital output ratio.

However, the corresponding rates (relative to the overall GDP of Sudan) appear quite manageable:

1 Southern Sudan: required investment rates (as shares of Sudan's overall GDP) are given as 5.0%, 8.2%, and 6.0% for Peace Onset, Postconflict I, and Postconflict II, respectively.
2 The Three Areas: required investment rates (as shares of Sudan's overall GDP) are given as 2.1%, 2.4%, and 1.7% for Peace Onset, Postconflict I, and Postconflict II, respectively.

3 On the other hand, the corresponding rates for the North would decline steadily from over 21% for the first two postconflict episodes to about 18% for the last episode (starting in 2011).

A much more striking story is provided by required investment in terms of current dollars per capita, with the South (and the Three Areas) projected to account for much higher resources than the national average (and especially the North) under the MDG-based strategy (see tables 8.1–8.3):

1 The share of required investment allocated to the South would grow from less than one-sixth of the total in Peace Onset to about one-quarter of the total thereafter.
2 In per capita current dollars, required investment for the South (and the Three Areas) during Peace Onset is estimated at $129 ($190), which is significantly less (more) than the national average of $152.
3 In Postconflict I, per capita investment for the South (and the Three Areas) is projected to amount to $224 ($182), which surpasses the declining national average of $163.
4 In Postconflict II, the required resources for the South (and the Three Areas) would moderate to about $202 (rise to $190), which is still substantially higher than the national average of $182.

The poverty strategy: Potential gains and aid requirements

An important strategic, economic, and political consideration is how the relationship between Southern Sudan and the rest of the country will evolve between 2005 (the peace year), 2010 (the referendum year), and 2015, the year when the poverty target is to be achieved. The country as a whole will achieve substantial growth, especially the South and the Three Areas (see figure 8.1).[18]

Moreover, the envisaged stellar growth performance under the poverty strategy would also lead to—among other improvements in the political process and democratization—a significant reduction in the risks of future conflicts in Sudan. For example, the huge growth differential between the South and the rest of the country would permit this region to dramatically reduce the initial income gap relative to the national average (see figure 8.2). The income of the average Sudanese living in Southern Sudan was estimated at about one-quarter of the national average in 2005. Under the MDG-based strategy, income per capita in the region would rise to close to 35% of the fast-growing national average in just five years (by 2010). After

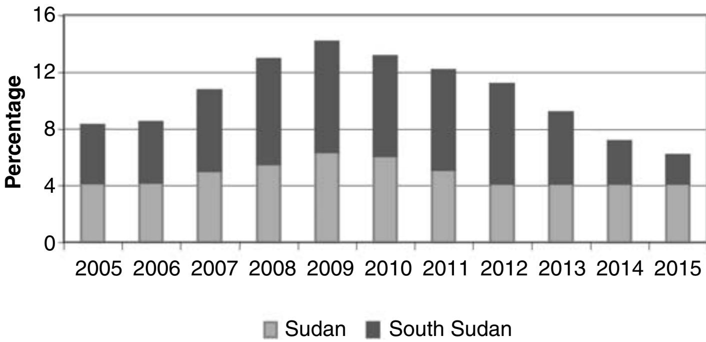

Figure 8.1 Sudan: Per capita GDP growth under PES/MDG strategy, 2005–15

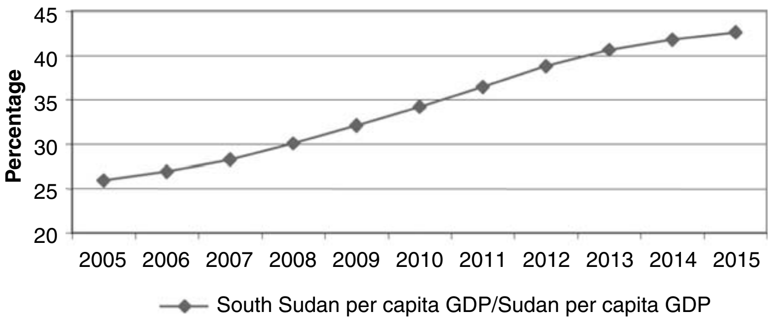

Figure 8.2 Per capita GDP for Southern Sudan as a share of national average under PES/MDG strategy, 2005–15

five more years (by 2015), income levels in the region would exceed 40% of the national average, again in a strongly growing overall economy.

Social welfare, measured by income per capita, will be significantly enhanced, again especially in the South and the Three Areas (see tables 8.1–8.3, and figure 8.3). The income level of the average Sudanese in 2005 may be above the international poverty line ($3.2 a day in 1995 purchasing power parity or PPP). However, the average Sudanese living in the South (or the Three Areas) was likely to have started 2005 with an income level significantly below the international poverty line. By 2010, the income level in these regions would have inched much closer to the international poverty line, but would still be below that target income. Finally, the average Sudanese in the South (and the Three Areas) is projected to make a higher income, enough to put her above the poverty line.

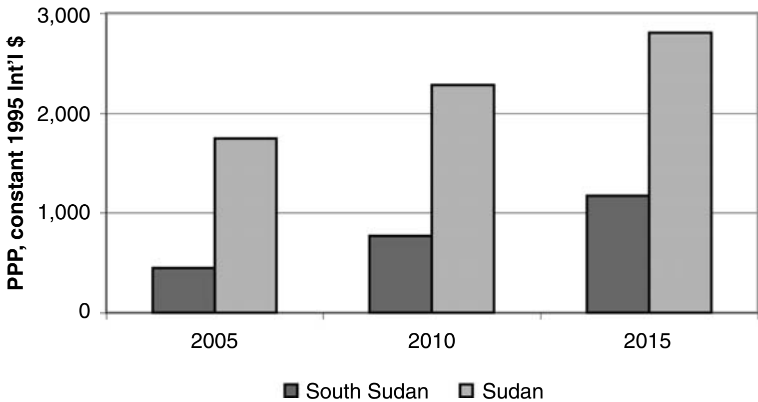

Figure 8.3 Per capita GDP for Sudan and Southern Sudan, 2005–15

An overarching conclusion Even with phenomenal growth levels for 10 consecutive years, the average Sudanese living in the South (and in other war-affected areas) is likely to remain poorer than the overall average Sudanese, especially those living in the North. It will take much longer to shake off the legacy of more than 40 years of civil wars. However, a thousand-mile march must begin with a first step, and it will be a very worthwhile first step.

Resource gap and foreign aid (2005–15)

Net resource gap/ODA: High foreign aid scenario Under this scenario, only modest new resources are expected to come from a combination of new FDI and enhanced domestic private investment, as well as increased allocation to public investment. The combined "historical" growth-oriented expenditure of 22% will be assumed to rise by 1%, 3.5%, and 0.5% for each of the three postconflict periods, respectively. Therefore, under this scenario the resource gap that must be financed by official development assistance (ODA) would amount to about 5%, 6%, and 2.7% of GDP for the three postconflict episodes, respectively (see table 8.4). In terms of current U.S. dollars per capita, under this scenario the average Sudanese would receive $27.1 of ODA per year during Peace Onset, $38.1 during Postconflict I, and $20.6 during Postconflict II.

Net resource gap/ODA: Low foreign aid scenario Under this scenario, substantial new resources are expected to come from a combination of new FDI and enhanced domestic private investment, as well as increased

Table 8.4 Sudan: Resource gap and foreign aid

	Peace Onset 2005–2006	*Postconflict I 2007–2010*	*Postconflict II 2011–2015*	*2005*	*2010*	*2015*
Expenditure as % of GDP						
Physical investment (1990s average)	19.0	19.0	19.0	19.0	19.0	19.0
Expenditure on social sector (per 2003 budget)	3.0	3.0	3.0	3.0	3.0	3.0
Total historical expenditure	22.0	22.0	22.0	22.0	22.0	22.0
Resource gap	6.0	9.5	3.2	6.0	9.5	2.5
Resource mobilization						
High foreign aid scenario						
New FDI/increased budget allocation (% of GDP)	1.0	3.5	0.5	1.0	3.5	0.5
Required ODA (% of GDP)	5.0	6.0	2.7	5.0	6.0	2.0
Required ODA (current million USD)	1,094.6	1,717.1	1,039.8	1,052.5	1,925.3	908.5
Per capita ODA (current USD)	27.1	38.1	20.6	26.5	41.1	16.8
Low foreign aid scenario						
New FDI/increased budget allocation (% of GDP)	3.5	4.5	1.0	3.5	4.5	1.0
Required ODA (% of GDP)	2.5	5.0	2.2	2.5	5.0	1.5
Required ODA (current million USD)	547.3	1,434.4	840.5	526.2	1,604.5	681.4
Per capita ODA (current USD)	13.5	31.8	16.7	13.3	34.3	12.6

Notes: FDI, foreign direct investment; ODA, official development assistance.

allocation to public investment. The combined "historical" growth-oriented expenditure of 22% will be assumed to rise by 3.5%, 4.5%, and 1% for each of the three postconflict periods, respectively. Therefore, under this scenario the resource gap that must be financed by ODA would amount to about 2.5%, 5%, and 2.2% of GDP for the three postconflict episodes, respectively (see table 8.4). In terms of current U.S. dollars per capita, under this scenario the average Sudanese would receive $13.5 of ODA per year during Peace Onset, $31.8 during Postconflict I, and $16.7 during Postconflict II.

Under the high foreign aid scenario, the required per capita "net" aid flows to Sudan are estimated at $23, $32, and $33 for each of the three periods, respectively. These estimates are much higher (at least for the first two postconflict periods) than the median ODA flows of recent postconflict countries. However, under the low foreign aid scenario, required aid will be much lower for the first and last periods but will exactly match the median value of postconflict countries in Postconflict I. Moreover, for both scenarios, the per capita ODA flows for Peace Onset and Postconflict I will be much greater than those experienced by Sudan following the end of the first civil war, but they will be slightly lower in Postconflict II.

Which scenario is more likely? Given the strategic importance of the Sudanese conflict, donors may be willing to commit much higher resources, although most aid is likely to be tied. In addition, addressing Sudan's staggering and unsustainable external debt of more than $20 billion may require significant resource commitments from the donor community. However, several factors may make a modest aid scenario more likely:

1 As an oil producing country, Sudan is expected to generate further resources stemming from the country's ability to attract FDI and from the restructuring of the budget.
2 Absorptive capacity may be limited in the South, at least in the immediate postconflict.

Conclusions

The success of the proposed reconstruction strategy is premised on meeting the poverty target of the MDGs as a pivotal social and economic development goal. Indeed, the achievement of this goal would not only make other social and economic MDGs feasible but it should also contribute immensely to the reduction of the hazard of future conflicts. However, an important cautionary note is in order. Admittedly, this framework hinges upon two fundamental assumptions: (a) that the resource flows (i.e., savings, including foreign savings provided in the form of ODA) are effectively used for growth-promoting investment, and (b) that investment efficiency is high.[19] However, for these two assumptions to be plausible, substantial progress must be achieved on various institutional and policy fronts, including in the areas of fiscal and budget restructuring, aid and oil management, and monetary and financial policy as well as external debt. First, the budget and overall fiscal policies must be explicitly guided by the poverty strategy to ensure that pro-growth and pro-poor programs assume top priority. Second, the ensuing relatively complex postconflict monetary and financial system[20] must not only aim to maintain overall

macroeconomic stability, as critical as it is, but should also aim to create jobs and promote growth. Third, the transparency and accountability of oil and aid management are essential for effective utilization of resources. Fourth, addressing Sudan's external debt is also critical for the success of the poverty strategy. These should constitute the key elements of the macroeconomic policy framework for achieving the MDGs and fulfilling the poverty strategy.

Acknowledgments

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Notes

1. Population size and land area, especially difficult terrain, were found to be among the most robust predictors of the hazards of civil wars (e.g., Elbadawi and Sambanis 2000b, 2002; Collier and Hoeffler 2004; Sambanis 2004; Fearon 2005). This is consistent with the evidence from sub-Saharan Africa, where, e.g., countries like Angola, Ethiopia, the Democratic Republic of the Congo, and Sudan experienced long and sometimes multiple episodes of civil wars.
2. See, e.g., Ali et al. (2005) for a review of the causes of conflict in Sudan and the historical preconditions leading to the civil war.
3. The role of institutions in development has been the subject of an active debate in the development and endogenous growth literature, especially with regard to the dependence of institutions on geography and whether the latter has an independent effect on growth and income levels. According to one strand of the literature, institutions have direct effects on income whereas geography does not, although the latter influences institutions through settlers' mortality (Acemoglu et al. 2001). The most compelling evidence in support of the above is provided by Rodrik et al. (2004), who conclude that "institutions rule" (see also Easterly and Levine 2003). However, Sachs (2003) shows that malaria transmission, which is strongly affected by ecological conditions, directly affects the level of per capita income after controlling for the quality of institutions.
4. A leading African social thinker, Mamdani (1996: 19), argues that the colonial state in Africa was "a double-sided affair. Its one side, the state that governed a racially defined citizenry, was bounded by the rule of law and an associated regime of rights. Its other side, the state that ruled over subjects, was a regime of extra-economic coercion and administratively driven justice."

5. Here the term “social capital” (following Putnam 1993: 167) refers to the “features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated actions.”
6. The Household Survey of 1992 (mainly for Northern Sudan), the Safe Motherhood Survey of 1999 (carried out by the Central Bureau of Statistics in collaboration with the UN Population Fund), and the Multiple Indicators Cluster Survey of 2000 (carried out in collaboration with UNICEF). Though none of these surveys covers the whole country (they cover Northern Sudan and, at best, areas under government control in Southern Sudan), their results can nevertheless be used to shed light on non-income indicators of poverty and highlight regional as well as urban-rural disparities. A series of “poverty maps” based on these surveys has also been produced indicating the wide dispersion of poverty and the areas most affected. These maps show that, other than in a narrow strip covering the area from Khartoum through the Gezira to Gadaref in Eastern Sudan, widespread poverty is common to almost all other areas (Southern Sudan not covered).
7. E.g., the total volume of sorghum production during 1995/96–1999/2000 (at 858,000 metric tons) was approximately equal to the volume produced in 1977/78–1981/82 (World Bank 2003a).
8. These estimates are reported in M. K. Fageer and A. B. Merghany et al., “Poverty and Social Development in Sudan” (mimeo, 2002, originally cited in World Bank 2003a: 27, n. 36).
9. A detailed analysis of the human development crisis in Sudan is provided in Sudan JAM 2005, chapter 5, “Basic Social Services.”
10. This note was a precursor to the “Poverty Strategy Paper,” envisaged as the main policy framework for guiding the economic policies of the Government of National Unity that was formed following the signing of the peace agreement.
11. The MDG requirement can be written out as: $H_{2015} = \frac{1}{2} H_{2005}$, where $H_{2015} = H_{2005} (1 + r)^t$. In order to find the required annual rate of decline of the head-count ratio (r), we solve for r in the latter expression following the expression where H_{2015} and H_{2005} are the head-count ratio in 2015 and 2005, respectively, and t is the amount of time in which the head-count ratio must be halved (in this case 10 years).
12. The growth elasticity of poverty, γ, is given by the following expression: $\gamma = \eta(1 - \epsilon) + \nu\kappa$, where η is the elasticity of the head-count ratio with respect to mean consumption (which is negative), ϵ is the elasticity of the poverty line with respect to mean consumption expenditure (which is non-negative and equal to, or less than, unity), ν is the elasticity of the head-count ratio with respect to the Gini coefficient (which is positive), and κ is the elasticity of the Gini coefficient with respect to mean consumption expenditure (which could be of any sign depending on the stage of development of the economy: at an early stage we would expect it to be positive although at a later stage we would expect it to be negative). Reasonable estimates for the growth elasticity of poverty cannot only be obtained from cross-country regressions but can also be directly calculated (see Ali forthcoming).

13. The repatriation of refugees from abroad as well as the movement of internally displaced persons entails a population growth rate of 3.5% for the period 2005–09; the growth rate drops to 2.9% from 2010 forward.
14. This approach is broadly justified in the framework of the AK model, where K stands for a broad concept of capital including a wide range of growth-promoting programs. See Rebelo (1991) for a development of the AK model.
15. The conflict in Darfur, located in the northernmost western part of Sudan, has pitted the government of Sudan against several insurgent factions for more than three years. This conflict has also involved massive violence against civilians, reported to be mainly perpetrated by government-sponsored tribal militias. The conflict is estimated to have caused more than 300,000 deaths and displaced almost half of the 6 million people of Darfur.
16. The difference in the growth elasticity of poverty between the national average and that of the South is due to the level of development of the southern region as reflected in its per capita GDP and the fact that the growth elasticity of poverty depends on the level of income (see Ali forthcoming).
17. Ali (forthcoming) defends the use of a higher ICOR for the South and the Three Areas with the following statement:

    > In view of the fact that the region will be emerging out of conflict it is possible to argue that despite the empirical relationship we should allow for the risk and uncertainty that may face investment efforts. Such risk and uncertainty will auger for a lower productivity of capital and hence a higher capital output ratio than if we were dealing with a normal circumstance. In addition, in view of the nature of the construction and reconstruction investments that are likely to be undertaken in the early years of the transition to peace, and the fact that these types of investment will be heavily skewed towards infrastructure, a higher capital output ratio seems to be justified.
18. The same analysis should apply to other war-affected regions in the North, most notably Darfur.
19. For a critique of the ICOR model and its assumptions, see Easterly (1997).
20. Although Sudan will continue to have one central bank, and therefore one central monetary authority, the banking system in the North will operate according to non-interest "profit-and-loss sharing" Islamic principles, whereas in the South it will be operated along conventional interest-based principles.

9

Afghanistan

Rebuilding and Transforming a Devastated Economy

Marvin G. Weinbaum

Introduction

The Afghan state and its economy were shattered during more than a quarter-century of almost continuous armed conflict. What remains of the economy faces an extended period of recovery that will necessarily be both restorative and transformational. Although Afghanistan has many features in common with other devastated economies, there is much that sets the country apart in the requirements, impediments, and opportunities for recovery. Afghanistan's distinctiveness grows mostly out of its cold war– promoted rentier state economy, its particular sociopolitical complexion and culture, and its relationships with its regional neighbors, most notably with Pakistan. Prospects for Afghanistan's economy depend to a large extent on overcoming the country's legacy as a historically weak state. The writ of central authority has never been wide or deeply enforced across the country, nor has the state ever tried very hard to meet the basic needs of most of its citizens.

Contemporary Afghanistan has a number of severe economic and social deficits. It is one of the world's poorest countries, with a per capita annual income in 2006 of roughly $300. More than half the population lives below the poverty line. More than 30% of the population is unemployed, and a great many more are underemployed or have short-term employment. Health care and education, historically never very widespread, remain minimal. Literacy at 36% is among the lowest rates anywhere, and

infant mortality is among the highest. Life expectancy stands at 42.9 years of age, 20 years less than in neighboring countries. Clean drinking water for a now expanded urban population is available to only about 13% of all Afghans, and 12% have adequate sanitation.[1]

Afghanistan is landlocked and thus dependent on trade routes through Pakistan, Iran, and the former republics of the Soviet Union. Even in the best of times, the country had only a few modern roads, and perhaps as many as 80% of all roads were destroyed or severely damaged through the years of conflict. Two neighboring-country rail lines penetrated Afghanistan for a grand total of 16 miles. During the Soviet occupation and the civil conflicts through the 1990s, Afghanistan was mostly isolated from the world economy.

The economy has traditionally been based on subsistence agriculture. Afghanistan's mountainous and desert terrain leaves little arable land for a country where agriculture sustains 60% of the population. In an economy that is 80% dependent on agriculture for its economic output, much of the irrigation system is in ruins. Years of drought decimated a once important livestock-raising sector. Aside from cultivation of opium poppy, the major cash crops are fruits and nuts, and more than half of the legal economy is based on agricultural products. Handwoven carpets are one of the country's few competitive finished goods. Natural resources such as mineral and gas deposits are promising but would require substantial investment before becoming economically exploitable. An infrastructure still in massive disrepair limits Afghanistan's hydroelectric potential.

Yet, Afghanistan enjoys some advantages on the way to rebuilding. Its people maintain a strong sense of nationhood despite civil wars, a decade of Soviet occupation, and large population dislocations. Remarkably, sectional and ethnic frictions and multiple transnational identities have never given rise to separatist movements. Though many Afghans lost traditional skills, and their lands and property, the years of hardship have failed to destroy the resourcefulness and enterprise of most farmers and urban entrepreneurs. Importantly, many of the once strongly statist features of the country's economy, if not the Soviet bureaucratic mindset, have disappeared. The very scale of the devastation in Afghanistan—which has displaced much of the traditional leadership and left most national institutions broken or discredited—may have swept away some older impediments to constructing a modern economy. Meanwhile, the country has completed internationally prescribed benchmarks in a formal state-building process, having approved a largely liberal constitution in 2003, and conducted reasonably credible elections for a president in 2004 and parliament in 2005.

This chapter is framed by the identification of eight primary requisites for economic recovery in Afghanistan. The discussion assumes that

economic development cannot be separated from simultaneous tasks of state building and a reconstructed society that strengthens national cohesion. To have a reasonable chance of success, Afghanistan appears to require:

1. a greatly improved security environment;
2. generous, sustained, and appropriate international assistance;
3. resolution or at least better management of center-periphery differences;
4. institutional development and improved governance;
5. measurable progress in liberalizing its political and economic systems;
6. the transcending of ethnic and sectarian differences;
7. freeing itself from an illicit drug economy; and
8. the forbearance and cooperation of neighboring powers.

All eight are to some extent interdependent, and a failure to realize any one of them could jeopardize the success of the others.

The chapter then briefly describes the current state of the Afghan economy and indicates how well it has met the posited conditions for growth and development. It cites the obstacles and opportunities for policy reforms and the prospects for each. Extrapolating from Afghanistan's experiences to date, the chapter concludes by proposing a set of strategies that would likely contribute to reviving devastated economies across the broader Middle East if not beyond.

The Challenges

Security

Security is the sine qua non of Afghan economic reconstruction. Afghans during the post-Taliban era have been regularly concerned about improving their physical security through ending banditry and kidnappings and freeing themselves from intimidation and threats by local private militias. Afghanistan is said to have one of the highest concentrations of guns per person in the world, with up to 10 million small arms in circulation. The security environment has suffered a visible setback, with a growing Taliban-led insurgency that has brought further deterioration of the security environment. Sporadic armed attacks that had persisted after 2001 in the country's ethnic Pashtun–dominated south and west intensified during 2006 and have begun to spread elsewhere in the country. Planned major reconstruction projects intended to provide employment and contribute

to economic growth countrywide have slowed for lack of adequate security. Nongovernmental organizations (NGOs) and UN aid workers have been forced to abandon their development and humanitarian programs in a number of provinces despite the dire need. International security forces that had been expected to promote and protect these activities have instead been deployed for counterinsurgency. It is widely acknowledged, however, that the leading role in providing security that foreign troops currently assume must pass over time to an Afghan police and army that are currently overstretched and poorly equipped.

Foreign assistance dependency

The overwhelming majority of Afghans have welcomed an international presence both to assist with security and to improve the material well-being of citizens. Unlike some other countries with devastated economies, Afghans know that they lack the human and material resources to succeed on their own. Afghan authorities often question the adequacy of development aid and the way it is distributed. Increasingly, officials have come to see this as an issue of national sovereignty. They demand greater responsibility in setting priorities and implementing projects by having more externally provided funds channeled through the central government instead of going directly to NGOs and international agencies. More critically, popular impatience with the slow progress of reconstruction is growing.

Few doubt, however, that foreign donors are for the foreseeable future indispensable for the economy's recovery and the state's survival. For some time the highest priority for international assistance through grants has been Afghanistan's infrastructure, notably for large-scale projects including the reconstruction of roads, electrical grids, and irrigation systems, but also badly needed public buildings such as schools and health clinics. These projects also promise the best opportunities for income-generating employment. Though infrastructural development continues, international attention has shifted to assisting an expanded capacity by provincial and local governments for delivering services. By addressing community development needs, the undisguised aim is to improve local stability and the motivation to fend off insurgency. A strong push by bilateral and multilateral donors for greater progress in poppy eradication is also intended to contribute to less corrupt and more effective government that can win public trust.

At least for the time being, the international donor community has not wavered in making financial commitments to Afghanistan. The willingness

to stay the course comes from a wide consensus that Afghanistan is central to combating today's threats of global terrorism. It also reflects some lingering guilt for having left Afghans vulnerable to extremist forces after the cold war. Donors largely appreciate that a scripted multiyear approach is required for Afghanistan to realize anything approaching economic viability even as a low-income state. Yet, foreign donors to date have underestimated the complexity of the rebuilding process and the costs necessary to have a meaningful impact. Moreover, the window of opportunity during which the international community remains willing to commit large sums of money could eventually close. Countries assisting with reconstruction are likely to develop donor fatigue if there is insufficient progress as a result of mounting insecurity and political instability.

Center-periphery tensions

No planning for the economy will be possible without some resolution of the country's center-periphery power struggle. Kabul government control has historically been conditional, and the formally prescribed unitary state has been de facto decentralized. Importantly, regional warlords with their private armies replaced much of the traditional local leadership in the aftermath of the anti-Soviet struggle and the subsequent warfare among victorious Islamic militant parties. Most of these warlords whom the Taliban chased from the field of battle beginning in 1994 quickly returned following the ousting of the Taliban in late 2001. Although interim governments ruled in Kabul, the warlords assumed effective authority over the rest of the country. Anxious to share in the international largesse for Afghanistan, the warlords have nominally professed allegiance to the Karzai government. Provincial strongmen and the center have regularly struggled over revenues, however. Often hefty incomes from drugs and smuggling activities have afforded them near independence from Kabul.

Critical to central control, internationally led efforts to disarm and demobilize militias were slow in taking off, mainly because of difficulties in reintegrating their members back into civil society and the economy. By the middle of 2005, the UN estimated that approximately 63,000 combatants of the 70,000 loyal to the largest militias had been disarmed, and most of the heavy weapons in the country confiscated (UNAMA 2005). Additionally, since mid-2004, the grip of several of the most notorious warlords has been weakened by threats and enticements from the Kabul government. Karzai's impressive win in the well-participated polls in October 2004 further strengthened his hand against the most prominent regional power brokers.

Weak institutions and governance

Economic regeneration hinges in large measure on supportive institutions serving to regulate and facilitate, and on greatly improved governance. An effectively functioning state can foster economic development by providing well-operating markets and an adequate infrastructure. Government institutions can be expected to create a favorable policy environment, one that improves the regulatory and legislative framework needed to support business and commerce. Rules for banking and a stable currency are essential, as is better property registration. To increase government revenues, the implementation of strengthened tax and customs collection mechanisms is imperative. The expansion of microfinancing through private sources should be especially beneficial to women engaging in income-generating activities. A revived judicial system and a transparent legal framework are necessary to build business confidence, especially for foreign investment. Better statistics through a census and other means are necessary for planning in reconstruction and monitoring development projects. None of these gains is possible without legitimate national authority that is able to succeed in communicating its vision of program accomplishments to the Afghan public (World Bank 2002c: 6–8, 11, 18).

Improved governance involves better administrative capacity for assessment and decision making. In order for reconstruction to move forward, the central government must also upgrade its ability to manage funds and oversee the implementation of programs on a large scale. The "light hand" of the international community in development activities leaves much of the delivery of aid to NGOs. The Kabul government has still to create a method to monitor the performance of the NGOs. Although some progress has been made, obstacles remain in the government's coordinating with UN agencies and NGOs, and realizing policy coherence with the private sector. As a result, the process of reconstruction is at times fragmented and ad hoc.

The bureaucracy is hampered by a lack of skilled people in critical roles. Along with civil service reform, government salaries will have to improve—and be paid on time—to draw and retain qualified individuals and reduce corruption and nepotism. Attempts to bring skilled people back from the Afghan diaspora have met with mixed success. Some individuals have assumed key technocratic roles in the government or have promised to invest in the economy. Yet, those returnees who escaped the years of conflict in relative comfort in Europe and the United States are often resented, and their long-term commitment is questioned.

Economic and political liberalization

Wide consensus exists that Afghanistan faces formidable obstacles in liberalizing its economic and political institutions, but that progress in both is essential to its recovery. The country's democratic constitutional experiment that lasted from 1965 to 1973 was by all accounts a failure. A freely elected parliament showed little capacity for the societal consensus building needed to overcome ethnic and ideological cleavages. Along with a weak executive, it failed to reconcile the country's traditional and modernizing forces. Paralyzed and seemingly incompetent institutions led many to doubt that Afghanistan was ready for democracy. The country's large informal economy has always operated relatively freely. But Afghanistan's legacy also includes a state economy burdened by stifling and ineffective central controls, whether under a monarchy, an autocratic republic, or a socialist dictatorship.

In its struggle to move to a postconflict era, Afghanistan has little choice but to find an appropriate balance between creating broadly representative government and deferring to strong leadership, and between the role of the state and the private sector engine in growing the economy. Complicating these choices is the country's dependence on bilateral partners and multilateral creditors who prescribe political and administrative pluralism but prefer to see accountable central authorities. The consensus is that successful entry into today's globalized economy depends on reforming economies and politics. Differences persist, however, over the pace of change. Debate also occurs over sequencing, that is, whether liberal political institutions act to secure economic freedoms, or whether a mature market economy is a necessary precondition for a stable democracy. The case made for prioritizing economic liberalization is that, initially at least, policy makers insulated from popular demands are better positioned to implement tough choices. The alternative thesis is that democratic regimes, drawing on greater legitimacy, increase the likelihood that difficult policy changes can be sustained (Bellin 2004). Afghanistan's best course over time probably lies in recognizing the strengths and drawbacks of economic and political liberalization, and adopting optimal strategies from each to further its economic recovery.

Socioeconomic divisions

Afghan modernizers and traditionalists differ over such issues as women's role in the economy and adherence to sharia precepts in guiding economic policy, but they share a desire for rapid reconstruction. There is also

agreement that a more capable workforce requires improved social indicators, most notably involving education and health. The most important fault line for controversy over the course of nation building pits the largest ethnic group, the Pashtuns, against all of the smaller groups, principally the Tajiks, Uzbeks, and Hazaras. Although the Pashtuns are concentrated in the country's east and south, large numbers live in the north as well and are prominent in the country's capital. Any economic progress hinges to a large extent on the ongoing struggle for ascendance among these groups as they compete not only for political power but also for economic advantage, including the demands of different groups for a fair share of government offices and the distribution of development monies. Without cooperation among the ethnic communities and a willingness to put aside older grievances, the country may never realize the full potential of a recovery.

There were bound to be many Afghans disappointed with their economic benefits to date, and resentful of others perceived to have benefited more. Having waited for a generation to experience tangible improvements in their lives, most Afghans are understandably impatient. Rising expectations, together with the conspicuous absence of a social safety net, have already begun to pose political difficulties in an expanding economy marked by unequal development and inequitable income growth. In the short term, redistributive problems can be relieved by employment created through rebuilding the country's infrastructure. But for longer-term distributive effects, small-scale entrepreneurship and business activity focused around trade are more promising as growth drivers. Development in the provinces that revives the agricultural sector around high-value crops such as fruits and vegetables would have the widest impact.

The corrosive influence of narcotics

Unless progress, albeit incremental, is made in ending Afghanistan's production and trafficking of narcotics, reconstruction will be stunted, the security situation will worsen, and a constitutionally prescribed political transformation will become irrelevant. The Afghan economy is currently dependent on a massive illegal economy. The growing trade in opium poppy constitutes the equivalent of approximately half of Afghanistan's licit GDP. The crop of 4,100 metric tons that was worth $2.7 billion in 2005 is believed to provide nearly 90% of the world's illicit opium and heroin supply (Blanchard 2006: 2–3, 15). Whereas poppy fields were once found only in half a dozen provinces, production has spread to nearly all of the country's 34 provinces. The industry is estimated to benefit an estimated 356,000 families. Agreement with farmers in several provinces in 2005

brought a decline of cultivation by 21% from the previous year, but higher yields elsewhere lowered overall opium production by only 2.5% (Katzman 2006b: 15). Poppy cultivation rebounded strongly in 2006, increasing over 27%. The government's failure to deliver on promised rural development and crop substitutions is to blame, at least in part. Weakened security in many provinces has also contributed to a failing drug policy.

The lawlessness that accompanies the drug trade stands in the way of executing development projects and the willingness of donors to support these projects. Opium growing and trafficking that finance many of the warlords and other criminal elements also benefit antiregime groups, including the Taliban, mostly for the protection they give to drug production facilities and convoys. The corrupting effects are also apparent among government officials at every level who take their cut from narcotics. As such, there is a serious concern that a more effective strategy must be found if Afghanistan is to avoid becoming a narco-mafia state on the order of Colombia.

Regional ambitions and cooperation

Afghanistan cannot hope to succeed in a recovery without economic relationships with its neighbors that allow the free flow of trade and transfers of energy resources. A greater aim for Afghanistan would be to restore a modern-day equivalent of the legendary Silk Road, the historic trade route linking Central and West Asia with South Asia and China. Afghanistan has emerged as an attractive market for consumer goods from Iran and Pakistan. Improved relations with neighboring countries also offer a transit corridor to more distant markets. This is particularly evident in plans, long under consideration, for a gas pipeline across Afghanistan from fields in Turkmenistan to Pakistan. Construction jobs and transit fees could earn Afghanistan $150 million yearly. In the planning is a 2,400-km-long road to link Uzbekistan, Afghanistan, and Iran. A transnational rail system with Iran and Central Asia has also been discussed. Trade and transit agreements were signed in 2003 with Uzbekistan and Tajikistan, as well as India. Afghanistan has joined the regional, if still dormant, Economic Cooperation Organization (ECO) and been admitted to the also sluggish South Asian Association for Regional Cooperation (SAARC), an organization denied its full potential by the continuing adversarial relations between its two largest members, India and Pakistan.

A major trade agreement exists with Pakistan covering both imports and exports. Mutual trade between Afghanistan and Pakistan amounts to as much as $2 billion annually. Yet, cross-border traffic has long been a point

of contention between the two countries. Many consumer goods arriving at the port of Karachi for duty-free transit to Afghanistan are then smuggled back into Pakistani markets. Smuggling is also a problem along Afghanistan's long border with Iran. Trade between Afghanistan and Iran has grown sharply in recent years, and its annual value totals more than $500 million. Through a trade agreement with Tehran, considerable tariffs are collected, especially on the import of vehicles. Until mid-2004, nearly all of the income from tariffs had gone to enrich a single warlord, Ismail Khan, who was also governor of the province of Herat. Only under threat of military action had Khan—later ousted and then appointed to the cabinet in Kabul—agreed to share his collections with the central government.

Although history has witnessed neighboring states interfering politically and militarily in Afghanistan and exploiting its resources, Iran and Pakistan and the countries of Central Asia have a greater interest for the time being in Afghanistan's political stability and economic growth. Development in Afghanistan can help to bolster security across the region. Regional cooperation is required to develop a regulated trade to control the smuggling of goods that denies the central governments the needed revenue collections, and to help them interdict narcotics trafficking.

The State of the Economy

A more viable Afghan economy requires new structures and norms as much as the restoration of past ones. Although Afghan history has demonstrated the wisdom in avoiding social engineering that violates deeper cultural restraints, so much disruption has occurred and so few national institutions have survived that many must be built anew. To be sure, some sectors of the economy are presently showing considerable vigor. But the most visible improvements have occurred in Kabul and Herat, mainly as a consequence of the spending activities of foreigners and the revenues withheld from the central government.

Accomplishments

Several notable accomplishments mark the interim, transitional, and then elected governments headed by President Karzai. Leaving aside the opium trade, GDP grew by 29% in 2002, 18% in 2003—impressive but mostly an artifact of the previously moribund economy.[2] Economic growth slowed to 7.5% in 2004, blamed mostly on renewed drought conditions, and grew only slightly in 2005 to 8%, a rate expected to carry over in 2006. Afghanistan has met all the targets of the IMF as well as the loan conditions set by the World Bank and the Asian Development Bank. The

government won wide applause for its conservative fiscal and financial policies, and its determination to pursue policy reforms. In September 2002, the Central Bank successfully introduced a new, revalued currency, and a revised law in 2003 leaves the banking sector largely autonomous. An aggressive finance minister brought about a remarkable degree of macroeconomic stabilization and took charge of planning and monitoring the reconstruction agenda. Inflation that had been 48% in 2002 had, by 2005, been brought down to about 15% and was expected to fall below 10% in 2006. An ambitious program of privatization is planned. Slow but perceptible gains have also taken place in building greater capacity into public administration, making it more accountable and representative.

To date, the Kabul government has avoided deficit spending thanks to the willingness of international donors to make up the shortfall. Of the total Afghan operating budget, the government raises enough in revenues to cover only 18–20%, with the rest coming from international donors. Understandably, concerns are raised that Afghanistan will become a ward of the international creditor community and lose its economic independence to foreign dictates. Although conditionality is unavoidable, both the government and its creditors have thus far resisted policies that would push the burdens of heavy external debt on Afghanistan.[3] Assistance to date has been predominantly in the form of grants and no-interest loans.

Revenues and investments

Although domestic revenues grew during FY 2004 to an estimated $308 million, up from $200 million the previous year, and the government's collections were roughly $330 million in FY 2005, the income is inadequate to meet payrolls, much less to invest in development. Afghanistan mobilizes less domestic resources as a percentage of its GDP than any other state in the world. Domestic revenues cover only about 8% of the total budget, with the rest being covered by donor countries. Further tax reform and better implementation of customs are critical to the revenue mobilization needed if the country is ever going to meet on its own a core budget, which consists mostly of government salaries, and a now externally funded development budget.[4]

Tax rates together with problematic legal protections for investors serve as strong disincentives for private sector Afghan or foreign capital in what is an increasingly competitive international investment climate. The current tax system, an amendment of a 1965 law, mildly progressive for individuals, places a flat 20% tax on corporate and general partnership incomes. Income in foreign currency is converted to the Afghani at a rate used by the state bank for purchases (Afghan/MOF 2005: 1–2). One of the

most profound problems is the central government's difficulty in extracting public revenues.

Despite the Karzai government's liberalized trade laws and incentives to attract foreign capital, substantial private investment seems far off. A recent investment law allows 100% direct foreign ownership. Officially, the process of business registration has been cut from 28 steps to just one. But most investors complain of bureaucratic obstacles and heavy corporate and personal income taxes. Turf battles occur among various ministries, and efforts by officials to escape responsibility for decisions continue to frustrate the formulation of a rational development agenda. Only a trickle of investment, domestic or foreign, has occurred, mostly notably in building cellular communications, radio stations, and residential housing, and in symbolically important new hotel construction. Little more is expected until security improves, laws are enforced, and greater profitability is demonstrated. The increased level of violence has further set back ambitious plans to revive and further develop a tourist industry. Without reliable power and water supply together with enhanced transport, industrial projects remain doubtful.

Very little of Afghanistan's electric grid system is left after the years of armed conflict, and less than 10% of the country currently has access to electricity.[5] Several operational dams and their transmission lines offer generating capacity, but no new power stations have been built. For the time being, neighboring countries, principally Uzbekistan and Tajikistan, offer the greatest promise for relieving Afghanistan's severe electrical energy deficit. Iran has assisted with a 132-kw power transmission line from its own northeast to Herat, inaugurated in January 2005.

In the late 1970s, the country's gas production was 385 million cubic feet per day, largely from wells in the north central region, with the Soviet Union taking 70–90% of the Afghan output. These wells were sabotaged during the jihad of the 1980s. A modest revival of gas production is likely, with distribution planned through new and older pipelines to several cities and possibly for delivery to Uzbekistan. A small amount of crude oil, about 300 barrels a day, is produced from one field in the north, leaving the country's needs to be met by imports arriving mainly through Pakistan. Only 1,000 short tons of coal are produced, where 100,000 tons were once mined. By some estimates, coal reserves are as much as 400 million tons, by other estimates, as little as 73 million tons.

Drug eradication

Many farmers' standard of living has risen sharply with their switch to growing opium poppy. Profits from narcotics have lured private capital

investment and created for Afghanistan a flourishing free market system. In fact, the ability so far of the domestic narcotics industry to outpace Afghanistan's legal reconstruction has demonstrated to Afghan and international officials "a capitalist intensity" that in another enterprise would be laudable.[6]

Until recently the rules of engagement for U.S. forces were to deal with the drug problem only in the course of routine military operations. U.S. and NATO commanders have resisted officials in Washington and European capitals who have pressed for a more active role for the military in drug eradication. Military officers in Afghanistan have feared that direct involvement could undermine their counterinsurgency campaign by creating local animosities, pitting their troops against cooperative local militias, and drying up intelligence. Under pressure, however, troops deployed in the major poppy-growing areas are providing logistics and equipment for an intensified effort led by an Afghan police unit supervised by an American subcontractor. The heightened commitment to eradicate cultivation and interdict trafficking was reflected in an increase of U.S. appropriations for counternarcotics operations to over $543 million for FY 2005, up from $130 million in 2004 and $35 million in the previous fiscal year.[7] In 2006, the cost of a U.S. antidrug effort that included an alternative income program for farmers and support for Afghan police training rose to $780 million (Katzman 2006a: 16–17).

Drug eradication, if poorly conceived, could significantly reverse the country's present economic recovery and result in other unintended consequences. Without economically attractive alternatives, the government could easily alienate much of the farming community, undermining its legitimacy and making it more susceptible to the appeals of antiregime insurgents. A sustained and effective program, it is widely believed, requires an expanded rural development effort. This involves providing improved irrigation and roads and microcredits in addition to substitute high-value crops.[8] At present, earnings from poppy are at least 10 times greater than from growing wheat on the same fields. Policies that would legalize poppy growing or heavily subsidize other crops to make them competitive, though promising as a way to put traffickers out of business, would require administrative and enforcement mechanisms well beyond the capacity of the current government. Many believe that the best short-term strategy targets drug traders and labs instead of farmers, and that public funding should go to drug education and rebuilding the judicial system. A newly complicating factor in managing the drug problem was the election in September 2005 of a parliament where perhaps as many as one-quarter of the members are allegedly linked to narcotics production and trafficking.

Refugees and displaced persons

Since January 2002, more than 3.5 million refugees displaced by the war have returned to Afghanistan from Pakistan and Iran. International donors and UN agencies have supported the repatriation supervised by the UN High Commission for Refugees. Additionally, there were about half a million internally displaced people, mostly in Kabul, when the Taliban were routed. Many of those returning from abroad have also gravitated to Kabul where, as in other population centers, they rely on international relief agencies for sustenance. Refugees are major contributors to the high urban unemployment rate. For many of these people to return to rural areas, there may have to be, in addition to increased security, greater economic incentives and policies that ensure them legal access to the land they work (Frumin et al. 2004: 11; Katzman 2006b: 35).

Aid flows

Overall aid flows to Afghanistan are low when compared to those for reconstruction received by other postconflict countries. Afghanistan receives only \$57 per capita, whereas other recipient countries such as Bosnia (\$679), Kosovo (\$526), and East Timor (\$233) have received far more per capita (Robichaud 2006). A January 2002 meeting in Tokyo saw pledges of \$4.5 billion over five years. Among the largest pledges were those from the EU, Japan, and Germany. A large part of those funds received went understanda bly to fund humanitarian relief efforts. At the April 2004 Berlin Conference, donors recommitted the international community to long-term support. Afghanistan was promised \$8.3 billion in nonmilitary aid over the period 2004–07, of which \$4.5 billion would be provided in the first year. The promised aid fell short of UN and government estimates in Berlin of what reconstruction would require simply for Afghanistan to become just "a normal low-income country," at least \$27 billion over seven years. Aid commitments by the United States and 31 other countries and international agencies and banks were renewed at the London Conference in February 2006. Overall, \$10.5 billion was pledged over five years to support a Kabul government–proposed Afghanistan National Development Strategy (ANDS).[9]

Many countries have failed to deliver fully on their promises or have delayed their funding. Poor security and Afghanistan's inability to absorb the funds due to poor planning were usually cited as explanations. Coordination among donors has also been a problem; duplication has occurred and some sectors are clearly underfunded. A slow start in

meeting development goals is evidenced by the fact that by fall 2004 only $4.8 billion had been dispersed out of $10 billion committed for reconstruction activities, and less than $1 billion worth of projects had actually been completed (Afghan/MOF 2004). Road building has accelerated, and demining that has resulted in the removal of a million land mines promises to allow agriculture to resume in many places recently out of bounds. Even so, overall development activity remains uneven, and many Afghans have yet to feel its impact.

Over the period of FY 2001–06, the U.S. government provided $4.6 billion in nonmilitary assistance (Katzman 2006c: 34–43).[10] Yet, the amount allocated for reconstruction pales next to allocations through regular appropriations and supplemental legislation earmarked for Afghanistan's security sector. In FY 2005–06, though assistance to strengthen the Afghan National Police (ANP) and National Army was over $2.48 billion, development aid received $587 million, $73 million went to democratization and governance, and $120 million to humanitarian and other assistance. The U.S. Agency for International Development (USAID) largely manages the reconstruction that includes agricultural and rural development, infrastructure (mainly roads), education, and health care, as well as programs to revive basic institutions of government. USAID has helped with the introduction of the new national currency and the new banking law, and has spent over $25 million on cash-for-work or food-for-work programs, creating short-term jobs for 3 million people. Assistance has also been provided for small-scale, income-generating activities at the village level, and for rehabilitation of the irrigation and communication systems.

The highest-profile project has been the U.S.-Japan–funded paving in December 2003 of a 300-mile-long highway connecting Kabul and Kandahar, the country's two largest cities. Pledges of international assistance have been secured to reconstruct the country's primary roads, most importantly the full Ring Road (originally built in the 1960s) that continues from Kandahar to Herat. About 60% of the Afghan population lives within 50 km of this road. Connecting Afghanistan's major cities, so critical for transportation and communication, is also considered symbolically important as a demonstration of national unity. Plans for the yearly addition of 1,000 km of secondary and tertiary roads are specifically designed to improve farm-to-market access.

Regionally, many opportunities exist for economic cooperation in joint projects in Afghanistan in several spheres. Pakistan has pledged over $250 million, half at the 2006 London Conference, for near-term assistance to water and power, health, education, and agriculture projects in Afghanistan.[11] To facilitate trade with Pakistan, Islamabad has agreed to fund a new road from its frontier to Jalalabad, Afghanistan's major eastern

city. Tehran has moved more quickly to assist Afghanistan in its reconstruction. Iran has opened a 123-km road across its border to the western Afghan city of Herat, and in mid-2006 completed the first phase of a road from Herat to the country's northern and northwestern provinces that will eventually provide a transit route between the Central Asian states and the Persian Gulf. In all, the Tehran government has pledged $560 million for reconstruction over a five-year period. By March 2006, China had pledged $150 million to Afghanistan and India nearly $550 million, mostly for highway and hospital construction, power transmission lines, and teacher training.

On indefinite hold are plans for a foreign oil consortium to finance a $3.3 billion pipeline running from Turkmenistan 1,000 miles across Afghanistan to Pakistan. First proposed in the mid-1990s during the rule of the Taliban, the pipeline has seen renewed interest among the affected countries for a route that promises lucrative transit fees and employment opportunities for Afghanistan. It is also favored by the United States as an alternative to a pipeline through Iran. Financing problems and political considerations aside, construction through Afghanistan remains unlikely any time soon in light of continuing security issues.

International agencies have played a central role in the development process. The World Bank administers the Afghanistan Reconstruction Trust Fund that at the 2006 London Conference saw pledges of $1.3 billion from 24 countries for the government's budget and priority investments. World Bank funding is expected to total $893 million in commitments, of which nearly $456 million will be in grants, the rest in no-interest loans. Along with support in such areas as education and urban reconstruction, the World Bank also contributes toward strengthening the government's administrative functions, notably to improve procurement, financial management, and accountability systems. Separately, the Asian Development Bank has plans to provide Afghanistan with $1 billion in low-interest loans and grants over the period of 2006–10. The bank had previously also approved $1 billion in the same form between 2002 and 2005.

There are 335 international NGOs in the country and 2,300 Afghan NGOs. The still limited administrative capacity of the Kabul government has left management and oversight of aid programs to these groups, often effectively bypassing instrumentalities of the state. Many foreign organizations bring long-term dedication and established expertise that is in short supply. Nevertheless, these groups, and NGOs in particular, are often controversial, and the Kabul government has regularly expressed its intention to monitor them for cost effectiveness and the impact of their programs. The government has promised to deregister 1,600 NGOs in an attempt to clean up the list of NGOs, many of which are merely paper organizations.

Above all, government officials are anxious to claim a greater part of the funds coming from international donors. At present, less than 25% of direct foreign aid to Afghanistan is channeled through the national treasury.

To justify its demands for greater control, the government accuses NGOs of wasting money. Their staffs are charged with having relatively luxurious lifestyles, being poor on delivery, and offering opportunities for corruption. The NGOs' recruitment policies are said to distort the local economy, as the offer of better salaries has enabled them to lure away the most qualified personnel from government. Complaints are also raised against private foreign companies that capture the best development contracts and hire imported workers for the most coveted reconstruction jobs. The government is also anxious to play a larger role in providing social services, particularly in the health and rural development sectors. Although conceding that its ministries may lack the full capacity to carry out projects, officials insist that unless allowed to take more responsibility, they cannot be expected to acquire greater competence.

Security

During 2003, the United States began a new approach to deal with security as well as monitor and fund small reconstruction projects. Provincial Reconstruction Teams (PRTs), each composed of roughly eighty military and civil affairs personnel, were located at sites around the country. Representatives of the Afghan army and police were included to suggest the approval and extended writ of central authority. Although initially all PRTs were entirely U.S. operations, several NATO allies and others countries soon created PRTs. By mid-2006, 23 teams were in place, nearly half of them manned by countries contributing to the NATO-led International Security Assistance Force (ISAF). The plan was to eventually locate at least one in each of the 34 provincial capitals. A single NATO command was scheduled to fully integrate U.S. and other foreign forces by early 2007. U.S. forces were slated to fall to 1,600 troops from a high of 23,000, as augmented British, Canadian, and Dutch troops relieved U.S. troops based in several southern provinces, a changeover that began in summer 2006. Almost immediately these non-U.S. forces met a strong insurgent challenge that appeared to be testing their willingness to engage in heavy combat as well as the commitment to the mission back in their home countries.

For future security requirements, the government and its U.S. advisors bank heavily on building an Afghan National Army (ANA). But problems

of recruitment and training have plagued the program. The ANA numbered only 29,000 or so trained troops early in 2006, still well short of the 70,000 initially projected as necessary to take over most of the country's security. Training of the ANP and Border Police is also underway for a force of 62,000, of which as many as 30,000 have received some training.[12] However, the performance of deployed ANP troops is at best mixed. Their training period is short, and building a competent force among these locally recruited men is difficult in view of their high illiteracy and reputation for corruption. During 2006, the U.S. command announced that increased attention would go to police training and that, along with the military, as much as $1.2 billion would be devoted to better equipping these forces to face their adversaries. It also indicated that the United States would support only an army of 50,000 and that responsibility for salaries would be transferred to the Kabul government. This obviously presents a problem for a Karzai government that has only been able to fund 13% of its security forces budget.

A UN-sponsored program of Disarmament, Demobilization, and Reintegration (DDR) of private militia forces to help establish the authority of the central government was scheduled to be completed by the end of 2005. It was claimed that more than 63,000 militia members, mostly belonging to the largest groups, had participated in a program that included training for alternative livelihoods. A second phase of disarmament then began, designed to focus on the numerous smaller illegally armed groups across the countryside. Labeled Disarmament of Illegal Armed Groups (DIAG), it is aimed at an estimated 80,000–100,000 militiamen belonging to some 1,800 groups that regularly prey on local populations in defiance of any rule of law (Katzman 2006b: 14–15). What progress has been realized may be short-lived, however, as the Kabul government proposed in mid-2006 that many of these local militias be rearmed as a community police force to supplement an overwhelmed, outgunned regular police in a growing insurgency.

The Taliban and their allies remain a security threat throughout the south and east of Afghanistan. Using ever more sophisticated and violent attacks, the insurgency has succeeded in slowing and even halting the reconstruction projects on which the economic progress in these largely Pashtun areas is based. Taliban strategy recognizes the impossibility of wresting power from the central government any time soon, especially with the armed presence of international forces. Rather, the aim is to impede economic improvement and for much of the country to lose confidence in the government's ability to deliver a better life and protect its citizens. The Taliban also believe that the international community will tire of its economic and military commitment in the absence of

greater progress. Although most Afghans understand that the Taliban offer no program for the nation's recovery, the insurgents expect that their promise of delivering better security will help them to regain people's loyalties.

Conclusion: Reconstruction Strategies

If ultimately it is political stability, national solidarity, and social cohesion that provide the foundations for the country's economic progress, at this point one can at best be only cautiously optimistic about the future of Afghanistan's economy (see IMF 2004b). The transformation of the heavily drug-based economy to one that is sustainable, integrated, and legal is by no means certain, even with external assistance. Still, the regional and global consequences of an economic breakdown and political disintegration are perilous enough that there is reason to believe that the Afghan state will not be permitted to fail. As Afghan officials are anxious to point out, generous support for Afghanistan's economic recovery and with it the promise of a more politically stable country is a prudent investment for the international community. An economic recovery can help to energize trade across the region which many believe can in turn strengthen independent middle classes and undercut radical Islamists in both Afghanistan and Central Asia (Starr 2002: 18).

Any new radicalization of Afghanistan with economic failure is almost certain to have a blowback effect on the politics of Pakistan and the Islamic states of Central Asia. If Afghanistan succumbs again to chaos, misrule, and widespread armed conflict, and becomes once more the training ground and launching pad for international terrorists, the United States and others will likely have to commit still greater forces and funds later. This, Afghans are fond of pointing out, is the lesson that should have been learned after most countries wiped their hands of Afghanistan following the Soviet withdrawal in 1989 and the demise of the Afghan communists in 1992. Missed opportunities, above all the failure to move ahead with reconstruction in a more timely way strongly contributed to an expanded and intensified insurgency in 2006. Given the stakes for the United States and the NATO countries, these setbacks will probably not seriously weaken their commitment to political stabilization and economic progress in Afghanistan. Still, the achievement of these goals has become more costly.

Projecting from the Afghan experience to other devastated economies in the Middle East is difficult and subject to caveats implying Afghan exceptionalism. Yet, there is much in the country's postconflict history that

seems applicable to other recovering economies. The most instructive strategies call for policies aimed at the following:

1 *Laying sound foundations for economic management and macroeconomic stability* This requires the rehabilitation of such institutions as the Ministry of Finance and Central Bank, and improving expenditure management and the tax system. A credible, stable currency is an early goal, as are policies that seek financial stability and financial discipline. Government and external donors must take responsibility for advocating policies conducive to a liberal economic environment. Laws are needed to create a market-oriented regulatory framework and a legal system that gives protection to property rights and will promote private investment (see IMF 2003b: especially 6–12). The bureaucratic frustrations posed by complex and time-consuming regulations, high registration fees, and complicated procurement rules must be reduced. The private sector and especially its informal economy should be expected to carry much of the early economic expansion.

2 *Strategically sequencing postconflict interventions* Short-term strategies should be integrated with long-term development objectives. Approaches should also form a transition as seamless as possible from humanitarian emergency projects to those that contribute to building a foundation for sustained economic growth. Short-term investment priorities should be designed to maximize visible high returns such as job creation, private sector supports, and major infrastructure rehabilitation. More problematic is finding the right mix of liberal economic and political policies that allow for difficult reforms that can win and hold legitimacy and popular support.

3 *Sustaining generous long-term, predictable, external assistance in support of humanitarian, financial, and developmental goals* Poor domestic income-generation demands generous international aid for an extended period. It is important that bilateral and multilateral donors making commitments be held to their pledges and that their assistance be coordinated as much as possible. It is necessary to show progress to avoid donor fatigue.

4 *Enhancing the authority and the capacity of government actors to make the assessments and decisions vital to economic recovery efforts* Progress in economic recovery cannot be separated from building a national administrative capacity that can deliver and monitor programs, and that also provides for increased transparency in government activities. The host government must begin to assume from international agencies and NGOs fuller responsibility for setting development priorities, dispensing funds, and managing projects. Dominant and intrusive international involvement is likely to undermine government's legitimacy and weaken its ability

to implement hard decisions domestically. Heavy dependence can also engender domestic resentment against foreign governments and nongovernmental actors.

5 Gaining public confidence Specific projects and general policies must be designed for broad impact on individual lives, especially to contribute to the well-being of the large majority who are poor and vulnerable. The focus should be on development projects likely to have the maximum public impact, namely in sectors with the greatest economic multiplier effect, including roads, housing, water, and power. There must also be concern for losing popular support for economic and other policies in a reconstruction process that ignores growing inequalities along with persistent poverty. At the same time, care must be exercised to not build public expectations unrealistically high.

6 Improving human capital development Although progress in building human capital tends to yield a longer-term payoff, it provides the foundation for the skilled, reliable workforce necessary to attract investment. Widening and improving basic education and health service and giving women income-earning opportunities should be early priorities. Precluding foreign companies and international NGOs from monopolizing procurement and construction contracts can raise employment levels and skills. Efforts are also needed to allow public service employment to be more competitive with NGOs and the private sector for qualified personnel.

7 Managing social cleavages and respecting a pluralistic culture So long as deep ethnic, regional, or sectarian divisions are not transcended or at least managed, there is likely to be bitter dispute over the allocation of resources, and economic recovery is almost certain to be delayed. Without institutional means to mitigate these divisions, donors can be expected to lose interest, and neighboring states will probably try to carve out their political and economic spheres of influence.

8 Seeking regionwide solutions One of the best strategies to revive a resource-poor economy is to promote its reintegration with its regional neighbors through mutually beneficial trade and energy resource transfers. Preferential transit fees for regional partners can lead to increased activities and new transportation webs, while also improving national customs collections. New markets can be created, stimulating investment in industry. Greater urgency should be given to infrastructural reconstruction and the need for regional economic organization to further institutional cooperation.[13]

9 Ensuring that economic recovery can go forward within a reasonably safe security environment Where insurgency persists, confronting this challenge assumes the highest priority. So long as poor security obstructs reconstruction activities and leaves commerce unprotected, a devastated

economy is unable to recover. Security requires that, along with the recruitment of competent and trusted security forces, there be a functional and trusted judiciary, whether formal or customary. Serious efforts are also needed to realize the disarmament and demobilization of combatants. To reintegrate them requires labor-intensive programs and community-driven development initiatives. Most importantly, sustainable security and progress in reconstruction go hand in hand. One cannot succeed without the other.

Notes

1. The sources for these statistics are CIA (2006, "Afghanistan," as of January 10, 2006), and World Bank (2005: 3).
2. From statistics released by Afghanistan's Ministry of Finance and reported in Tarzi (2005: 11). Even with this growth over three years, the national economy is less than half its size in 1978 (*Economist*, August 16, 2003).
3. In mid-2006, Afghanistan's major creditors in the so-called Paris Club canceled $10.4 billion in debt. That action wiped out 92% of Afghanistan's debt to the United States, Germany, and Russia.
4. Only 20,000 people paid income tax in 2004 (*Financial Times*, August 19, 2004).
5. The Afghan National Development Strategy articulated in the 2006 London Compact sets as a goal for 2010 that electricity will reach 65% of households in urban areas and 25% in rural areas.
6. Amy Waldman, "Afghan Route to Prosperity," *New York Times*, April 10, 2004, p. A5.
7. Victoria Burnett and Peter Spiegel, "Fear of Fighting and Economic Ruin Hold Back Bid to Stamp Out Opium," *Financial Times*, January 4, 2005, pp. 7, 45.
8. See ICG (2004a: 28). The drug economy is believed to employ 10% of the population or roughly 2.3 million people.
9. ANDS served as the core of the Afghanistan Compact that was approved at the January 31–February 1, 2006 London Conference on Afghanistan, attended by 64 participating and observing countries and 11 international organizations. ANDS lays out benchmarks and timelines that the Afghan government sees as goals, with international support in the areas of security, governance, and economic and social development, and with counternarcotics as a cross-cutting priority.
10. In FY 2005, $985 million was appropriated, and $500 in a supplemental vote (Katzman 2006a: 43, table 4). The assistance does not include roughly $10 billion going yearly for U.S. military operations and $3 billion slated for the Afghan defense forces.
11. Some 60,000 Pakistani workers are employed in Afghanistan, largely in construction activities.

12. The costs for maintaining security forces, according to Afghan government estimates covering 2004–11, will run to a total of $1.77 billion for the ANA and $645 million for police and law enforcement (Afghan Government–International Agency Report, "Securing Afghanistan's Future," January 29, 2004, quoted in Frumin et al. 2004: 24). In 2005, the ANA absorbed one-fifth of the government's operating and development budget.
13. Starr (2002) makes a convincing case for a regional solution. The most comprehensive survey of the potential for regional cooperation is found in World Bank (2005).

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10

Coalition Economic Policies in Iraq

Motivations and Outcomes

Bassam Yousif

It is almost an article of faith that the U.S. administration lacked a postwar plan for Iraq. This chapter poses a challenge to this view, as it will be argued that, at least in the economic realm, the United States did have a plan, and the plan centered on the sweeping and simultaneous liberalization of labor and capital markets, reforms in taxation and foreign trade, and the privatization of state assets. The reforms were intended to open up Iraq's relatively closed state-directed economy and, therefore, improve efficiency in the allocation of resources domestically, as well as to align Iraqi relative prices with international prices in order to expand the country's consumption possibilities. In an immediate sense, the reforms have succeeded, for Iraq's economy has now become one of the most open and unregulated in the world. Yet, sustainable gains in output remain elusive, as incoherent reforms have aggravated structural difficulties and cultivated the conditions for their own failure.

The intellectual point of departure for these measures is the notion that prices reflect relative social scarcities in conditions of perfect competition, where actions are pursued until marginal social costs equal marginal social benefit. When prices fail to do this, either because of endogenous or policy-imposed distortions (arising, e.g., from government intervention), resources do not flow to activities with the highest social rates of return, and output and incomes are consequently lower than what would otherwise be attained. Reforms aim to free prices and hence encourage the flow of

resources to high-return activities. Parallel to this reasoning concerning the domestic economy, the liberalization of international flows of capital and goods—though usually not labor—is advocated, as this allows a society to consume a combination of goods beyond its own production possibilities, thus increasing income and well-being.

Although there may be agreement about the attractiveness of market-based systems of resource allocation, there is substantial disagreement about the proper role of the state in economic transitions and how to best bring about systemic change. Proponents of "shock therapy," responsible for the economic reforms in Eastern Europe and Russia, argue that the simultaneous liberalization of all prices concentrates and minimizes the inevitable hardship; fragmented reforms are thought to be ineffective (see Sachs 1990). Others point to the success of economic transformation in China, where reforms have been applied sequentially by liberalizing individual sectors or a defined set of activities rather than the comprehensive and simultaneous liberalization of all sectors (see, e.g., Griffin and Khan 1996).

The differences are highlighted by dissimilar attitudes toward privatization. Those who advocate shock therapy tend to view the state sector as largely inefficient and unprofitable, and hence a burden on the exchequer. Of course, the presence of externalities of various types implies that profitability is not the proper yardstick with which to measure efficiency for public enterprises, as these are concerned with social costs and benefits that may diverge substantially from market costs and benefits. Consequently, relying on the market to allocate resources under these conditions would result in inefficiency. But some proponents of shock therapy have another argument against state intervention: even in conditions of market failure, state intervention may not be desirable as the possibility of "government failure" is considered to be at least as likely as market failure (see Marangos 2004, chap. 4). That is, government attempts to correct market distortions may magnify the distortions and increase inefficiency. Except for those engaged in the production of public goods, it is argued, state enterprises should meet the market test. If they are unable to do so, they should be privatized. In contrast, proponents of gradualist approaches view the state sector as providing employment and a safety net for much of the population, a much-needed complement to systemic change. The inevitable layoffs that would result from privatization would, they argue, magnify the sense of gain and loss in society, delegitimize the reform process and, ultimately, delay the transition (Griffin and Khan 1996).

Coalition policies in Iraq have followed the first approach, namely the abrupt liberalization of markets and prices. This chapter examines the nature and impact of these policies, with emphasis on the policies implemented during the first year of occupation, and highlights the difficulties

associated with directing job-creating capital formation toward the desired high-return activities. It may appear premature to make judgments about Coalition economic policies in the current conditions of intense political and social turmoil in Iraq. Yet, as we shall see, inappropriate and disharmonious economic policies are in part responsible for this turmoil.

Initial Economic Conditions

The problems confronting the Iraqi economy and society on the eve of the 2003 U.S.-U.K. invasion were immense and included a physical and industrial infrastructure that had been shattered by the 1991 Gulf War and deprived of the ability to rebuild under economic sanctions; a sizable, partly destroyed and in places inefficient state sector; an agricultural sector characterized by low productivity; widespread unemployment, and generally low and declining levels of human development. In sum, Coalition forces took control of a largely ruined economy.

Damage to infrastructure and the inability to export oil under sanctions resulted in drastic declines in income per capita. Before the 1991 war and sanctions, the economy was thoroughly dependent on oil. The sector accounted for most of GDP (75% in 1990),[1] provided almost all the foreign exchange (oil constituted 97% of all exports in 1988 and 1989),[2] paid for imports of food, medicine, machinery, and industrial inputs, and financed government capital and current expenditures. The ban against oil exports resulted in a 72% decline in per capita GDP between 1990 and 1992 and an additional 51% drop between 1992 and 1996.[3] Although incomes recovered somewhat after the implementation of the Oil for Food program, IMF estimates of per capita GDP in table 10.1 show incomes to be only modestly higher than the average for low-income economies on

Table 10.1 Iraq: GDP per capita at current prices (in USD)

Year	*Iraq*	*Low-income economies*
2001	770	
2002	596	
2003	449[a]	450[b]

Notes
[a] Preliminary estimate.
[b] Refers to per capita gross national income.

Sources: IMF (2003a: 22); World Bank (2003b: 257).

the eve of the U.S.-U.K. invasion in 2003. As the figures illustrate, war and economic sanctions had reduced Iraq to a low-income economy.

Parallel to the sanctions-induced decline in incomes, there was a drastic drop in living standards. Sanctions resulted in a severe shortage of foreign exchange and hence in the depreciation of the Iraqi dinar vis-à-vis foreign currencies. This in turn increased the relative price of tradable goods, including food and medicine (most of which was imported), to domestically produced goods and with respect to wages (Gazdar and Hussain 2002: 39). Government was denied access to finance expenditures as physical and social infrastructure remained depleted.

There was a decline in caloric consumption and, consequently, a sharp rise in malnutrition. Famine was probably only narrowly averted by the implementation of a largely efficient and egalitarian government-run food rations program. Farmers received state-subsidized inputs and in return were obliged to sell their entire output of grains to the state, which then distributed these as rations. Due to reduced electricity generation capabilities, there was a decline in both the quality and availability of piped water. This resulted in a spike in water-borne diseases and a sharp rise in infant mortality, which, as shown in table 10.2, more than doubled under sanctions. The reduced health care system was ill-equipped to cure or prevent disease brought on by the consumption of unclean food and water and amplified by malnutrition.

The change in relative prices made agricultural activities relatively more profitable, and this encouraged labor to flow into agriculture. Modest increases in agricultural output were achieved on the extensive margin through increases in labor and cultivated area, but labor and land productivity remained low (US/CRS 2003: 25–6). Meanwhile, the collapse in real wages forced workers to seek second or third jobs, typically in low-skilled, low-wage activities. Layoffs were generally avoided in the large state sector, but private enterprises, especially in urban industrial activities, laid off

Table 10.2 Iraq: Malnutrition and child mortality

Year	*Total daily caloric consumption*	*Provided by ration (in kcal)*	*Child mortality rates (per 1,000)*	
			Under 5	*Under 1*
1990	3,150		50	40
1996	2,277	1,295	126	97
1998			125	103
2002		2,215	125	102

Sources: Garfield and Waldman (2003: 9, 17); Garfield (1999); Pellet (2000: 161); UNICEF (n.d.).

workers, largely because the decline in earnings resulted in inadequate demand. Agriculture absorbed some idle labor from other sectors, but was unable to absorb all, and there was consequently a sharp rise in both underemployment and unemployment.

Beneath the surface lurked additional problems, namely the economy's low absorptive capacity for investment and a largely ruined and often inefficient public sector. In the 1970s and the early 1980s, infrastructure bottlenecks and a lack of skilled labor, rather than funding, constrained capital formation, as evinced by government investment spending, which consistently fell short of investment allocations (Yousif 2001: chap. 3). Since little capital formation occurred in the 1990s, the issue of absorptive capacity did not emerge as a problem. Still, destruction of infrastructure and emigration of a large number of people with technical and managerial expertise in the 1990s could only have reduced the modest absorptive capacity of the economy.

Iraq, like other Middle Eastern countries, has a large public sector, composed of 190 state-owned enterprises producing a variety of goods and services, which employs 650,000 people (ICG 2004b: 6). Some, perhaps most, of these enterprises would not be able to compete under international prices. Physical assets in this sector are by and large antiquated, damaged, or have been destroyed through wars or the lawlessness that followed the Coalition's occupation in 2003.

Coalition Policies

The Coalition's response to these conditions consisted of the sweeping liberalization of markets and prices, which began in earnest with the arrival of Ambassador Bremer in Baghdad in May 2003. In the labor market, the Coalition fired 500,000 state employees, as the Iraqi army was dissolved, and ended the employment of an additional 25,000–30,000 former Baathists (Foote et al. 2004: 55). In total, about 8% of the labor force was made idle. Yet, workers retained in the public sector received substantial salary increases, six-fold on average (ICG 2004b: 1). Saddam's labor law of 1987, which restricted union activity and collective bargaining, was left intact, possibly in order to complement the Coalition's privatization plans.

These were accompanied by reforms in currency, foreign trade, taxation, and capital markets. A new currency was successfully introduced; the value of the new dinar has been stable and has in fact appreciated vis-à-vis the U.S. dollar.[4] Import tariffs and other restrictions on trade were eliminated, although a uniform (nominal) duty of 5%, named "reconstruction surcharge," would later be instituted (Foote et al. 2004: 64). Corporate tax rates were reduced, foreign companies were allowed to acquire Iraqi assets

(except in the oil sector) and to repatriate profits, and foreign banks were invited back—all in order to encourage investment.

The Coalition initially planned to privatize state enterprises, but the 1949 Geneva Convention blocked such plans as the convention prevents occupying powers from selling assets they do not own. When it became clear that privatization was not feasible, the Coalition inserted a clause into Iraq's interim constitution, mandating that Coalition orders, including those relating to privatization, could be changed only by an elected government. The bank accounts of the enterprises were frozen and subsidies (where they existed) were withdrawn, but the Coalition continued to pay the salaries of public employees (Foote et al. 2004: 66). In agriculture, input and other subsidies were terminated, despite World Bank and UN advice to the contrary (ICG 2004b: 5).

Finally, the United States secured the absolution of 80% of Iraq's debt from major creditors and has encouraged the World Bank and IMF to make funds available for reconstruction.

Discussion of Policies

Some Coalition measures have been creditable, such as the decision to not dollarize the economy and the successful U.S. efforts to reduce Iraq's debt. Dollarization would have been fairly easy to effect but would have subjected Iraq—whose economic structure is vastly different from that of the United States—to U.S. monetary policy. More importantly, the political implications of Iraqis being denied their own currency by an occupying power would have been unwelcome. Likewise, the success in reducing Iraq's debt had symbolic import. Although Iraq, in reality, could not conceivably pay the debt, its reduction symbolized international interest in the country's rehabilitation. This section, however, will concentrate on the impact of the reforms in labor and capital markets, for these are central in determining the success or failure of policies.

Impact on employment

The Coalition's demobilization of labor increased unemployment. Although population data are sparse and incomplete, they are nonetheless informative. Estimates of population and labor force, calculated from census data, are presented in table 10.3. Except for total population, all figures for 1997 exclude the three Kurdish provinces, which were outside the control of the central government.[5] The figures suggest that 16.8% of the labor force was unemployed; among young males between the ages of

Table 10.3 Iraq: Population and employment

Category	*1997*
Total population (millions)	22.05
Labor force (millions)	
Female	0.50
Male	4.36
Total	4.86
Proportion in agriculture (%)	19.0
Unemployment rate (%), 15–24-year-old cohort	
Female	7.6
Male	26.6
Total cohort	25.2
Entire labor force	16.8

Sources: Calculated from Iraq CSO (n.d.: 39, 57–60).

15 and 24, the rate was 26.6%. That is, even before the demobilization, unemployment rates, especially among the youth, were high.

Employment has contracted in both the private and the public sectors since the beginning of the occupation. A survey of small- and medium-sized private businesses soon after the end of hostilities revealed that the average number of workers had declined, from 16 employees before the war to 12 in August 2003 (IACCI n.d.: 4), and, following the invasion, conditions of chronic insecurity have impelled minimal employment-generating investments. Moreover, the discontinuation of subsidies to farmers and the appreciation of the dinar have turned the terms of trade against agriculture and made the sector relatively less profitable, inducing a flow of labor into urban areas and other activities.

U.S. contractors have hired some local labor—too little, however, to significantly alter the employment picture. Construction activities are thought to be characterized by substantial opportunities to substitute labor for capital (Little et al. 1970). Yet, abundant Iraqi labor has been underutilized in reconstruction, since U.S. firms, largely responsible for the reconstruction effort, do not face Iraqi relative factor prices. It is likely more profitable for these firms to utilize their fixed assets of physical capital rather than hire local labor. The cost of hiring Iraqis is greater than it appears, as they are considered to be a security risk. As one Coalition procurement officer attests, "from a force protection standpoint, Iraqis are more vulnerable to bad guy influence."[6] Since the Coalition does not require contractors to hire local labor, few Iraqis are hired directly by U.S. contractors. Of course, Iraqi subcontractors do utilize local labor, but they

face competition from non-Iraqi subcontractors who rely on imported, mostly Asian, labor. Whatever cost advantages local subcontractors may enjoy over U.S. contractors, these disappear in certain reconstruction tasks with respect to foreign subcontractors. As a result, imported foreign workers in Iraq are thought to number in the tens of thousands (ICG 2004b: 17–18).

As concerns the public sector, there was a net loss of more than 100,000 jobs as of April 2004. The Coalition sacked over half a million employees but has created only 395,000 jobs (mostly in security and defense activities where labor attrition rates are famously high), well below the target of 850,000 set by the U.S. administration (Howley 2004: 2). Unemployment has swelled in consequence. Although it is unclear whether its methodology is consistent with that of the census in 1997, Iraq's Central Statistical Organization surveys reveal that unemployment climbed to 28.1% in late 2003 (Howley 2004: 3), and declined only marginally to 26.8% in the first half of 2004.[7] Although these surveys show a slight decline in 2004, independent estimates of the unemployment rate are higher and average from 27% to 40% for the period of January to August 2005, the last month for which data are available (Brookings Institution 2005).

Despite the high unemployment, the public sector salary hikes induced a boom in consumption. Rising incomes generated demand for consumer goods, and, as most of these goods could not be produced domestically, this induced a sharp rise in imports. The latter was facilitated by trade deregulation and the relative stability of the new dinar. Yet, though there has been a rise in command over tradable goods in sections of the population that experienced rising incomes, no parallel expansion over nontradable goods has occurred, as prices of nontradable goods have risen along with incomes. Real estate prices in Baghdad, for example, have quintupled (ICG 2004b: 1). Still, tight control of the money supply has kept inflation under rein, as general prices rose by 32% and 20% respectively in 2004 and 2005 (Brookings Institution 2005).

These policies induced sharp and arbitrary changes in the distribution of income. Rising incomes for retained workers paired with growing unemployment have magnified the sense of gain and loss in society at large, and delegitimized the reform process itself. Worse, most of those demobilized were young men from the poorer classes who had few skills or employment alternatives. Thus, Coalition policies made idle those most likely to riot or join militias, and have undoubtedly fueled insecurity. As one exasperated young job seeker in Sadr City (a poor neighborhood on the outskirts of Baghdad) explained, "I haven't been working for the last two weeks. If I stay like this for another week, my family will starve; and if

someone comes with $50 and asks me to toss a grenade at the Americans, I'll do it with pleasure."[8]

Indeed, it is difficult to detect either a political or an economic rationale for the demobilization. Coalition officials have suggested that the Iraqi army mostly "melted away" soon after its defeat and so the official act of demobilization was essentially a formality (Foote et al. 2004: 55). This does not explain, however, why the army could not have been reconstituted with, for example, financial inducements to return to work, especially as former soldiers were pressing the Coalition to pay their salaries. Even less convincing is the claim that the historically destabilizing role played by the Iraqi army necessitated its disbanding (Foote et al. 2004: 55). Control over this assumedly destabilizing force is surely preferable to a loss of control. Disarming and mobilizing this largely conscript army in alternative civilian activities, such as in the country's reconstruction, would surely have enhanced rather than diminished stability.

The curious combination of mass layoffs for some state workers along with large pay increases for others is equally perplexing. Labor market reforms are pursued so that wage rates reflect social opportunity costs of labor. It is, however, difficult to understand how the cost of the retained labor—much of which was idle at state enterprises that were deprived of working capital—was high and rapidly rising, but zero for all other workers. Far from promoting efficiency in labor allocation, these policies precipitated drastic and arbitrary changes in income distribution, which in turn cultivated instability and diminished political support for the reforms.

Whatever the rationale, the rise in unemployment has been accompanied by a decline in human development outcomes. Investment difficulties have delayed the restoration of basic services. For example, March 2003 levels of electricity generation were reached in August 2004, but have since declined. As a case in point, electricity output in Baghdad from January to April 2005 was two-fifths of its pre-occupation level (Brookings Institution 2005). In a near repeat of postsanctions conditions in the 1990s, the lack of electricity has, in turn, led to a diminished availability of safe water and a rise in water-borne disease and child malnutrition, which has almost doubled according to a UN study.[9] Mortality rates increased during the invasion period of March–April 2003 and have remained high. Most deaths have been the result of violence, frequently from Coalition military action but also from crime.[10]

Nor are there signs that the security situation is improving; if anything, the reverse appears true. Crime remains rampant and the insurgency may be gaining strength,[11] so much so that insurgents run a "parallel administration" in some areas, levying taxes and dispensing justice. Moreover, the

claim that the insurgency is largely nonindigenous is no longer sustainable: of the roughly 2,000 men arrested in the battle for Fallujah in late 2004, only 30 were non-Iraqi.[12]

Impact on Investment

In such conditions of lawlessness, Coalition reforms proved ineffective in encouraging private investment. Few foreign investors have been willing to do business at these levels of risk. Proctor & Gamble and GM, for example, put their joint venture plans on hold and Siemens AG has withdrawn most of its staff from the country (Klein 2004). Even nongovernmental organizations, accustomed to conditions of instability, have been reluctant to return to Iraq; in fact, some have left.

Iraqis and U.S.-funded contractors have engaged in some capital formation, but investment rates have been low. The binding constraint on investment has not been the availability of funds, but rather the economy's limit for absorbing investments, reduced further by the spiraling violence. Violence and insecurity have both delayed implementation and raised the costs of reconstruction. U.S.-financed rebuilding proceeded very slowly in the first 18 months of occupation, so that by September 15, 2004, out of the $18.4 billion (later increased to $20.9 billion) allocated for reconstruction by the U.S. Congress, only $1.1 billion had been spent; of the $4.2 billion earmarked for water and sanitation projects, $16 million had been utilized; and of the $786 million for health, a mere $2 million had been spent.[13] These outcomes are consistent with the responses of Iraqis in a May 2004 poll in which most thought that rebuilding had yet to commence (ICG 2004b: 2). Reconstruction accelerated in 2005: a total of $8.6 billion had been spent as of September 28, 2005, including $390 million on water and sanitation projects and $242 million on health (USDOS/BNEA 2005: 23).

Even so, the figure for total expenditure falls substantially short of the allocated expenditures and gives a distorted picture of the actual reconstruction. Much of the U.S.-financed spending on rebuilding has been unrelated to civilian reconstruction: as of September 28, 2005, spending on security and law enforcement—encapsulated in the rushed training and equipping of local security personnel, often to secure vulnerable civilian infrastructure projects—was the largest expenditure item, representing $3.6 billion, or more than two-fifths of the $8.6 billion total (USDOS/BNEA 2005). That is, U.S. spending on all other items, including electricity, oil, civil society, roads and bridges, education, health, transport, and sanitation, amounted to only about $5 billion.[14] But even this modest sum overstates the extent of U.S.-funded capital formation, as the real value of spending is almost surely lower than these statistics indicate.

According to a Center for Strategic and International Studies report, fraud and mismanagement are responsible for soaking up an estimated 15% of reconstruction expenditures (CSIS 2004: 3).[15] Furthermore, because a sizable portion—two-thirds, in terms of value, in 2003 (Le Billon 2005: 696)—of the rebuilding contracts were awarded to U.S. companies on a noncompetitive basis, the costs of reconstruction have swelled. The real value of capital formation is consequently lower than even the small total for U.S.-funded reconstruction suggests. Meanwhile, the Interim Governing Council spent $1.87 billion on reconstruction in 2003 (ICG 2004b: 2), $3.5 billion in 2004,[16] and planned to spend more in 2005. Still, this is a fraction of the $17.5 billion that the World Bank and the UN estimate is required to restore infrastructure and public services to pre-invasion levels (ICG 2004b: 2).

Coalition officials point to the welcome removal of cumbersome red tape that small- and medium-sized businesses faced under Saddam (Foote et al. 2004). These businesses could indeed play a key role in rebuilding and job creation, especially as they tend to use labor-intensive production techniques. But the removal of abstruse regulation is insufficient when replaced with anarchy, and rates of employment-generating capital formation in these businesses have been low as a result of insecurity.

Meanwhile, the Coalition's freezing of bank accounts of public companies denied these firms access to working capital, let alone investment funds. Thus, even firms that could compete under international prices (such as cement producers) have been incapable of contributing to reconstruction. Unable to privatize these companies yet unwilling to concede privatization as a goal, the Coalition in effect ignored public companies, with the result that most of the employees in the sector have effectively become idle, not for technical reasons, according to Iraq's Industry Minister, but because of the Coalition Authority's ideological distaste for the public sector (Klein 2004: 49). This has encouraged the belief, not unreasonable under the circumstances, that these enterprises have been deliberately neglected so that they could be sold cheaply later—a hindrance that future Iraqi governments will face when it comes time to privatize inefficient firms.

Policy Parallels

Although Coalition policies may appear to be rather disharmonious, they are representative of the approach used to transform the state-directed economies of Eastern Europe and the former Soviet Union into market economies. Of course, the level of state ownership and intervention in Iraq

never reached that of the former communist world, but a comparison of the outcomes is instructive nonetheless.

The abrupt liberalization of markets and prices in former communist countries induced widespread inflation and unemployment, a collapse in investment and, consequently, in output (Griffin and Khan 1996), so much so that incomes per capita in some of these countries have yet to return to their prereform levels (Stiglitz 2004). Although there was an abrupt change in relative prices following liberalization, there was no corresponding change in the structure of production. As such, these countries by and large were unable to take advantage of changed relative prices. Immobility and sector specificity of resources imply that resources cannot be easily or costlessly transferred from activities with low social rates of return to the desired high-return activities. Under these circumstances, the speed of structural transformation, if it occurs at all, depends critically on the rate of investment in high-return activities. But because price liberalization in these countries induced rampant inflation, price signals were weak and failed to direct investment to high-return activities, resulting in a sharp decline in output and, in turn, additional contractions in investment. Jeffrey Sachs, a proponent of the shock therapy approach, blamed the prolonged difficulties faced by countries using this method of adjustment on the unwillingness of Western countries to provide the financial assistance required for macroeconomic stabilization and price stability (Sachs 1995).

In contrast, investment difficulties in Iraq have stemmed not from the lack of financial capital but from the low capacity of the economy to absorb investments, as testified by the inability of the United States to spend its allocated reconstruction funds. These difficulties have been magnified by the security crisis, for which Coalition policies are partially responsible. If entrepreneurs are to be encouraged to engage in capital formation, a government that is able to enforce property rights is essential to systemic transformation. Yet, this has been absent in Iraq, in contrast to the former communist countries where, although its powers were eroded, the state could still enforce rights.

Reforms inevitably produce winners and losers. In the absence of investment and job growth in high-return activities, political opposition to the reforms from losing sections of the public, such as those who have experienced job loss or declining real incomes, is likely to intensify and therefore taint the reform process. This explains why, with one exception, all governments in Eastern Europe that pursued radical price liberalization were voted out of office. The exception, Latvia, received substantial international financial assistance and was under authoritarian rule, with little prospect of a change in government (Marangos 2004: 106). This underscores the importance of financial assistance to the success of shock

therapy and brings out an interesting irony to this approach: the liberalization of markets, often justified in ethical terms of expanding freedom, is more likely to succeed under repressive rather than democratic political regimes.

The parallel with Iraq is of interest, as Coalition economic policies have been unpopular and have induced resistance to further reforms. Had Iraqis been able to vote out the Coalition, they would have undoubtedly done so: in a poll conducted in March–April 2004, 80% of respondents had a negative attitude toward the Coalition Provisional Authority, whereas only 14% expressed a positive attitude (Brookings Institution 2005). When given the choice in January 2005, Iraqis sent the U.S.-backed interim Prime Minister Iyad Allawi packing, awarding his party only 14% of the votes—this despite the prominence given to his candidacy in the local media (Ismael and Ismael 2005: 624).

Although Barakat et al. (2005: 835) warn against the hasty evaluation of postconflict reconstruction efforts, they nevertheless emphasize "the need to assess wider social and political impact, not just measurable and immediate socio-economic outcomes." In reference to this larger impact, the ramifications of Coalition policies on two fundamental features of Iraq's modern history—namely public apprehension about the market and the indefinite nature of property rights—are of great interest.

Coalition policy aimed to nurture promarket sentiments on the part of Iraqis and so reduce reliance on the state (Foote et al. 2004). This aspiration was never going be easy, given Iraq's economic history. But Coalition policies have promoted the reverse—a solidification of the view of the market as largely arbitrary and unfair. Coalition officials expressed disappointment that 49% of Iraqis expressed their desire for a political platform that called for more government employment as opposed to private sector jobs (Foote et al. 2004: 68). Yet, support for state intervention in the economy is well established; in fact, it predates the Baath regime and was formed in the context of historically devastating market failures and intense economic insecurity (see Chaudhry 2002). The desire to correct these failures impelled successive Iraqi governments, including promarket administrations under the monarchy, to intervene in the national economy. Oligopoly control of markets by foreign (particularly British) companies and local merchants resulted in domestic shortages and runaway inflation during and after World War II, when shortages prompted high profits for merchants and landowners but severe declines in real wages and salaries (Chaudhry 2002: 236–41).[17] Activist and interventionist measures by successive governments, including the nationalization of the oil sector in the early 1970s, were thus greeted with general acclaim, as these were seen to promote domestic price stability. Indeed, as most Iraqis recognize,

had market price mechanisms been relied upon to allocate food during sanctions, a famine would have likely resulted. In contrast, Coalition policies have worked to reinforce rather than alleviate the suspicions that Iraqis harbor about markets.

Nor have Coalition reforms helped fortify the historically precarious nature of property rights in Iraq, where frequent and arbitrary changes are the norm, not the exception. In order to secure the administration of rural areas and, later, to check the power of the more nationalist urban centers, the British favored tribal sheikhs during their occupation of Iraq beginning in 1917. In time, "a society of generally free tribesmen became transformed into one of groups of near-serfs" as new shaykh-landlords gained power (Sluglett 1976: 231). With the overthrow of the monarchy in 1958, this landed group would lose political power through the abolition of parliament which they had dominated, and economic power via land reform. Subsequent nationalizations, in 1964, of large banking, commercial, and industrial establishments and later measures under the Baath eroded the rights of the domestic industrial and commercial bourgeoisie. Under sanctions, while the savings of the lower and middle classes were wiped out, a hated class of "nouveaux riches" (Marr 2000: 90), composed of Sunni and Shii Arabs as well as Kurds with close ties to the former regime, emerged as a social force. Yet, none of the instability surrounding assets has been assuaged by Coalition policies. If anything, the chronic lawlessness that has resulted from these policies has aggravated the issue. To note one example, neither Coalition nor Iraqi authorities have been able to prevent the returning Kurdish refugees—working with the active support of Kurdish political parties represented in the Iraqi government—from seizing the properties of and expelling the Arab inhabitants of Kirkuk, a relatively peaceful city (Packer 2004). Hasty and inappropriate Coalition policies have, therefore, reinforced the extant anxieties about the market and buttressed the traditionally tentative character of property rights.

Conclusion

The brusque liberalization and rushed privatization in Iraq have to date failed. Moreover, the failure to appreciate the political dimensions of economic policies has delegitimized the reform process and, ironically, made future reform more difficult. Overthrowing a dictatorship, however repressive or violent, is not enough to establish legitimacy for a reform process.

None of this implies that the reform of Iraq's economy is not needed, but instead suggests that there ought to be a change in focus, away from

radical attempts to restructure the economy and toward a more people-centered approach. Many state-owned enterprises may need to be privatized eventually, but insistence that this be done immediately would further swell joblessness and likely prove self-defeating.

Iraq's real GDP was estimated to have increased by almost 50% in 2004 and was projected to rise, albeit by much less, in 2005, largely because the price of oil (the chief export) had been increasing and was expected to remain high (IMF 2005a: 30). Yet, an oil-induced rise in GDP will not necessarily bring about a general rise in incomes, because the oil sector, which generates most of the income, employs only 1% of the labor force (Foote et al. 2004: 50). The real challenge will be to convert oil income into increased employment and output in sectors with high social rates of return, thus raising living standards for the majority—not easy given the current technical and security constraints.

What are needed are policies that perceptibly and rapidly raise the living standards of the population, especially the poorest and most destitute, and improve the economy's aptitude to absorb investments. As such, a program of guaranteed public employment in labor-intensive reconstruction work, at relatively low wages in order to minimize labor market distortions (see Griffin and McKinley 1994), would greatly assist rebuilding and transition. The program ought not to be perceived as a public assistance effort, but a public investment program that encompasses a range of activities from rubbish collection and street cleaning[18] to the construction of a physical infrastructure and the repair of agricultural drainage canals. When possible, labor that resides close to project sites ought to be utilized, as this will reduce transportation costs for labor and give the employees of the program a sense of participation in their own communities. That is, such a program would have the advantage of involving large numbers of Iraqis in their nation's rehabilitation, with resultant gains in political legitimacy and improved security, essential to alleviating the investment difficulties.

Properly designed, such a program, though it may require a change in the composition of expenditures, need not be a large fiscal burden. This is significant in light of the present fiscal difficulties facing the Iraqi authorities. For in conditions of rampant insecurity, the Iraqi authorities have been unable to increase the quantity of oil exports,[19] and hence fiscal revenues to the extent desired, despite the rise in the price of oil. The state is consequently in substantial fiscal deficit. In contrast, by providing much needed jobs to reduce poverty and by assuaging the investment and security constraints, a program for human development would save money in the medium to long term. No less important, the success of these indigenous

efforts—in contrast to those of a global superpower—would imbue Iraqis with the self-assurance essential to nation building.

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Notes

1. Gazdar and Hussain (2002: 36).
2. Calculated from OPEC (1999: 4–7, 24).
3. Calculated from UN/ESCWA (1997: 214; 2001: 153).
4. For exchange rate statistics since October 2003, see Brookings Institution (2005).
5. Unemployment data for these provinces are unavailable, but since the combined population of these provinces is only 15% of the total, the unemployment data for the entire country are unlikely to be changed significantly by the addition of the missing data.
6. Quoted in ICG (2004b: 17–18).
7. United Press International, "Iraq Unemployment Drops Despite Violence," December 4, 2004, http://washingtontimes.com/upi-breaking/20041204-061822-5610r.htm.
8. Quoted in Foote et al. (2004: 58).
9. Karl Vick, "Children Pay Cost of Iraq's Chaos," *Washington Post*, November 21, 2004, p. A01, http://www.washingtonpost.com/wp-dyn/articles/A809-2004Nov20.html?sub=AR.
10. Roberts et al. (2004) suggest that the war resulted in 100,000 civilian deaths.
11. See Steven Komarow, "U.S. Chipping Away at Al-Qaeda Leadership, But Attacks Climbing," *USA Today*, October 2, 2005, http://www.usatoday.com/news/world/iraq/2005-10-02-iraq-leaders_x.htm.
12. *The Economist*, "When Deadly Force Bumps into Hearts and Minds," January 1, 2005, pp. 30–2.
13. Jonathan Weisman, "US Plans to Divert Iraq Money," *Washington Post*, September 15, 2004, http://www.washingtonpost.com/wp-dyn/articles/A21489-2004Sep14.html.
14. Calculated from USDOS/BNEA (2005).
15. For an exploration of the role of corruption in Iraq's reconstruction, see Le Billon (2005).
16. Calculated from IMF (2005b: 8, 11).
17. For estimates of inflation and declining real earnings in this period, see Batatu (1978: 471, 474).

18. U.S. military commanders used funds under the Emergency Response Program, designed for humanitarian relief and reconstruction, to pay for precisely such activities. However, because only $140 million was allocated, the impact of the program was insignificant. See ICG (2004b: 18).
19. Oil output has yet to regain its prewar, 1999–2001, level. See US/CRS (2005: 1–2).

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