PRISONERS' FINANCIAL DILEMMAS: A CONSOCIATIONAL FUTURE FOR LEBANON?

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Lebanon's banking system is viewed as an "international regime" that held the country together in the face of all pervasive warfare. The system illustrates the underlying logic of such regimes, in that the banks' credit policies operationalized the rational choice model of an iterated prisoner's dilemma game. And just as international regimes are supposed to reflect the interests of state actors, analysis of the banks' balance sheets and income statements reveals changes in capital structure that reflect changes in Lebanon's political balance. While sustaining elite cohesion, the banks serviced political clienteles and might, if a political settlement were reached, support the restructuring of a consociational system more in line with Lebanon's demographic balance. If, on the other hand, no settlement is reached, the poor country's suicide may highlight certain aspects of international reality that seem recalcitrant to the theory of international regimes.

Whereas Plato sought ethical principles by "writing large" the travail of the human soul into a well-ordered political macrocosm, contemporary students of international relations write small. They derive theories of cooperation from microeconomics and prisoners' dilemmas. In a world without enforceable centralized authority or the proxy of a hegemonic state, the Hobbesian sovereign gives way to intermediaries who, like used car dealers, are supposed to prevent "market failure" (Akerlof 1970; Keohane 1984). This fresh, albeit shadowy, "grey in grey" (Hegel 1953, 13) perspective on international regimes may also shed light on domestic situations. In Lebanon the level of conflict possibly exceeds even Hobbes's visions of brutality and nastiness. In this paper I will view Lebanon's banking system as the principal "regime" that supported the country's political elite as well as its economy in the facce of uncivil, multidimensional warfare.

The new perspective of international cooperation rests squarely on concepts of transaction and information costs borrowed from financial rather than political theory. As is well known, however, "economics proceeds in a context framed by law and order, established by politics. Economic life continues in wartime and in periods of revolution and anarchy, but under conditions that must be regarded as pathological" (Kindleberger 1970, 15). How then can financial concepts apply to a world of anarchy, in which property rights and contracts are unenforceable? Lebanon offers a practical illustration in

AMERICAN POLITICAL SCIENCE REVIEW
VOL. 81 NO. 1 MARCH, 1987

which to ground these concepts and recognize their limits.

Since 1975 the country has replicated in microcosm the condition of international anarchy posited by the structural realists, yet its "pathological" economy survived and in some sectors prospered until the Israeli invasion of 1982. Its banking system continued for a time to finance industry, illustrating the new logic of international cooperation and its limits. The bankers cooperated by rolling over their shares of loans, unwittingly operationalizing the rational choice model of an iterated Prisoner's Dilemma game. They also unintentionally adapted to shifts in political power. The banking regime, in fact, supported a potentially functioning polity. In this light, financial intermediation can be understood as the elite adhesive required to make consociational democracy work. It will be shown that the banks' capital structure changed —and could change further—in ways that better reflect the country's changing political and demographic balance.

The argument of this paper will be developed in four stages. First, the theoretical rationale for international regimes is translated back into its financial nexus. A theory of financial intermediation can shed light on the Lebanese banking system and explain why a "regime" was needed. Secondly, the system will illustrate the functioning of the regime under conditions of anarchy. Thirdly, the conditions for its demise or transformation will be analyzed in light of the Prisoner's Dilemma. And, finally, Lebanon's banking regime will be related to conventional political analyses of the country's past and its potential futures.

International Regimes and Theories of Financial Intermediation

In systems lacking centralized enforcement, *regimes* can be generally defined as "sets of implicit or explicit principles, norms, rules, and decision-making procedures around which the actors' expectations converge" (Krasner 1983, 2). Keohane (1984) compares them to credit markets (p. 129) and explains in his seminal work why actors' expectations might continue to converge around them even when the balance of power changes: regimes can be understood "as information-producing and transaction cost-reducing entities rather than as quasi-governmental rule-makers" (p. 101). They are supposed to enable the actors—typically state actors—to stave off market failure in some sense. The concepts, however, were extracted from the world of finance, not politics.

The spectre of market failure may be easier to locate in purely economic activities, however political they may also be, than in conventional power relationships among states. Most intended regimes, of course, comprise interrelationships between state actors, but the actors need not be states. The international banking system may display a regime, for instance, insofar as banking operations across national lines escape the jurisdictions of the banks' parent countries. To the extent that relationships between Less Developed Countries (LDC) debtors and creditors remain viable, it makes sense to speak of an international banking regime of nonstate actors (Lipson 1985). Our theoretical problem is to discover the sources of Pareto-deficient equilibria—or market failure—that a regime of financial intermediation might remedy.

The financial literature offers a variety of models to explain the underlying rationale for financial intermediation in advanced capitalist systems. The multiplicity of explanations is due, of course, to the variety of possible market imperfections financial theorists may model (Campbell and Kracaw 1980; Chan 1983). If the present analysis were intended to offer historical clues about the rise of

banking systems, an eclectic approach would be in order (Kindelberger 1983). Transaction costs are obviously fundamental to explanations of financial systems in trading countries like Lebanon. So, too, a developmental perspective would stress transaction costs and asset transformation because the focus is on mobilizing savings for industrial investment (Abdi 1977). But most of the market failure literature is really about information (Chan 1983), and some of it analyzes conditions in advanced capitalist societies under which banks may substitute for capital markets. This analysis is the most useful for Lebanon because it was the banks' medium and long-term lending, not their principal business of trade financing, that was the greatest anomaly in the wartime situation.

The source of the problem is quality uncertainty offered in markets characterized by informational asymmetries (Akerlof 1970). Without reliable used car dealers, for example, people will only offer lemons for sale because buyers will be unable to distinguish them from cream puffs. Buyers will not have adequate incentive to acquire the information needed to make the necessary distinctions, nor will anyone else, given the public goods nature of information, unless perhaps a used car dealer can trade on (lower-cost) information and acquire a good reputation. Financial theorists have developed this line of argument into a convincing rationale for financial intermediation in societies where contracts can be enforced. It is useful to summarize the argument and its underlying assumptions before extending it to other societies where contracts cannot be enforced.

Like Akerlof's used cars, investment projects vary in quality. Assume that each entrepreneur knows the value of the project but is unable reliably to communicate it to potential investors. In the investment market, bad projects will drive out good ones, and potential investors will be unwilling to invest their funds, assuming that alternative placements (e.g., in other markets, outside Lebanon) are available. As Leland and Pyle (1977, 383) point out,

> two problems . . . hamper firms which might try to sell information directly to investors. The first is the appropriability of returns by the firm—the well known 'public good' aspect of information. . . . The second . . . is related to the credibility of that information. It may be difficult or impossible for potential users to distinguish good information from bad. If so, the price of information will reflect its average quality. And this can lead to market failure if entry is easy for firms offering poor quality information.

This as may safely be assumed in unregulated settings. In the absence of intermediaries, unreliable information would have resulted in a suboptimal level of investment in Lebanon.

Financial intermediaries "will be the preferred form of information producer" (Campbell and Kracaw 1980) if entrepreneurs desire confidentiality (as modeled by Campbell 1979). A Pareto-preferred rational expectations equilibrium will emerge as long as it can be assumed that the intermediaries are producing reliable information. Without assuming "pathologically honest" information brokers, the moral hazard question may be resolved if there are capital barriers to entry into the information market or at least a context of law and order for enforcing contracts. Otherwise, however, a rational expectations equilibrium between investors and financial intermediaries will not ordinarily be achieved through market forces. Some sort of regime will be needed to make the market work. In Lebanon, as we shall see, the government had to impose order on the banking system in the late 1960s. Subsequently, when the government could no longer enforce contracts, much less the banking regulations, the bankers themselves had to keep up their own regime.

Iterated Prisoners' Dilemmas and Discount Rates

Regimes of this kind arise, or at least may be sustained, in response to dilemmas of common interest or common aversions (Stein 1983). The theoretically more interesting dilemmas, requiring collaboration rather than mere coordination, are those of common interests, as expressed in the prisoner's dilemma.

The two prisoners, it will be recalled, can either stick to their alibi when the district attorney separately interrogates them or confess to the crime. The sentence for sticking to one's alibi (cooperating) will be longer than that for confessing (defecting) if the other prisoner gives in to the DA's bait of confessing and going free. The payoffs may be summarized: $DC > CC > DD > CD$. The prisoners have a common interest in cooperating ($CC > DD$), but each is better off defecting, whether the other cooperates ($DC > CC$) or defects ($DD > CD$). Their rational expectation, given the DA's incentive scheme, is mutual defection. The actors' dominant strategies produce, in microeconomic language, a Pareto-deficient equilibrium.

Though the prisoners' rational expectation is mutual defection in a one-play game, mutual cooperation becomes possible if they can expect an indefinite future of interactions. In the iterated version of the game proposed by Axelrod (1984), the two players know their past "prison" of interactions, anticipate an indefinite future of interactions, and value present payoffs over uncertain future ones. They can escape the dilemma if they can rationally expect each other's continued cooperation. Axelrod proposes that they may reasonably cooperate rather than defect if, in addition to expecting an indefinite future of interactions, each player does not discount expected future values of the increments of collaboration as compared to defection enough to make the present benefits of the latter offset the former. The critical variable is each player's discount rate.

The Lebanese bankers operated, of course, with real discount rates, or opportunity costs of capital, and these may serve to flesh out Axelrod's model. The following exposition about Lebanese banking will lead into the model of a prisoner's dilemma among bankers who roll over doubtful loans. By such "thick" analysis of an international regime, throwing financial metaphors back into context (Sartori 1970), I do not intend to criticize Axelrod or Keohane, much less to deter others from letting their metaphors fly further afield—rather, a firmer grounding may lead to higher rebounds.

The Lebanese Banking Regime

In the 1950s and 1960s, Beirut was the principal trading entrepôt for the Middle East, including the oil states of the Persian Gulf. Its physical and political conveniences also made Beirut the region's principal information center for exchanging commercial as well as other sorts of intelligence, but the banks were primarily engaged in reducing transaction costs associated with domestic and regional trade. Letters of credit and short-term commercial loans, often triangular deals connecting Lebanese traders with their clients around the world, continue to be the banks' bread-and-butter business.

The commercial banks became involved, however, in financing industry with medium- and long-term credit. Formal capital markets never functioned properly (Hoss 1974, 38), for investors had little reason to believe that stock prices, manipulated by inside dealers, reflected publicly available information. Moreover, very little reliable information was available to the public: published financial statements could not reflect generally accepted accounting procedures because the Lebanese accounting profession was unregulated, its practitioners at

the mercy of their wealthy clients. Most entrepreneurs, too, preferred to keep ownership within closed circles of family and friends rather than to sell equity on an open market.

The situation of the typical Lebanese entrepreneur was analogous to that of the manager in more complex financial markets who prefers inside debt to equity or bond issues so as to hide strategic plans or marketing secrets from competitors (Campbell 1979). The banks were attractive to the entrepreneur because banks "do not always know the final purpose for which loans have been granted. This is mainly due to the multipurpose activities undertaken by a large number of major bank clients" (Saliba 1981, 152). Not always knowingly (though better informed than other potential investors), the commercial banks, by rolling over short-term commercial loans—in effect translating them into medium- or long-term financial instruments—sustained optimal levels of investment in Lebanese industry.

The Origins of the Banking Regime

The Lebanese government undertook its first serious efforts to regulate the banking industry only after it was rocked by a major financial crisis. In October 1966 the Palestinian-owned Intra Bank, by far the largest of Lebanon's banks, ceased to meet its payments after a run on its deposits. Whether, as its defenders argued, the bank merely faced a temporary liquidity problem or, as its critics insisted, it had been mismanaged to the point of insolvency, the immediate cause of the crisis was that Intra had engaged in too much long-term lending of short-term deposits. In reality this bank was only the tallest tree in a forest of overextended and mismanaged banks (Moore 1983, 33–34). The crisis enabled the government to implement the Code of Money and Credit enacted in 1963 over the opposition of Lebanon's freewheeling bankers, represented by their Association des Banques du Liban (Asseily 1967, 16–22).

The new regime sponsored by the government consisted of a Supreme Banking Council headed by the governor of the Bank of Lebanon (as the new central bank was named) and performing "the function of a banking court with authority to impose controls and various degrees of penalties on banks, including the withdrawal of the banking license." An independent Banking Control Commission was set up at the central bank to supervise the commercial banks and recommend to the Supreme Council any action to be "taken over banks facing special difficulties or banks violating the rules and regulations prescribed by the Code of Money and Credit and the directives issued by the Bank of Lebanon or the Banking Control Commission itself" (Saliba 1981, 149). In the spirit of Lebanon's constitution, it was informally understood that the governor of the central bank would be a Maronite, the chairman of the Banking Control Commission a Sunni Muslim, and so on down the line, replicating the country's system of countervailing minorities.

Authorized to clean up the system, the Banking Control Commission closed down ten of Lebanon's remaining 85 banks, permitted four others to go into voluntary liquidation, and supported a moratorium against issuing new bank licenses (Hoss 1974, 32). The managers of some of the liquidated banks were brought to trial and convicted for lending substantial sums to friends and fellow board members without adequate prospects of repayment, and some twenty members or former members of parliament were implicated (Messara 1977, 151). The Banking Control Commission was not able, however, to impose ratios or other restrictions upon banks in need of "improving their special situations" (Hoss 1974, 26) before the government collapsed in 1975. It had not resolved the basic problem of mismatched maturities

and tacit term-lending by rollovers. Banks were still permitted to make loans of up to 30% of their capital per individual to their shareholders, families, and friends (Banker Research Unit 1980, 116).

The Regime's Survival under Conditions of Anarchy

Despite the collapse of government, however, the banking system survived without a single bank failure between 1975 and 1984. Fluctuations in international interest rates were far more volatile and threatening to Lebanese liquidity than those upon which Intra had foundered (Ghattas 1971). When, as in 1979-80, Eurodollar rates skyrocketed, local banks were tempted to speculate in foreign exchange transactions at the expense of liquidity in pounds. Another factor that had contributed to the problem of Intra and other banks was the scarcity of short-term commercial lending opportunities in Lebanon relative to the supply of short-term deposits. The warfare naturally accentuated the disproportion, for the deposits kept coming in—remittances from abroad, salaries from militias, and high hashish sales—partially offsetting the general slowdown in economic activity, whereas the slowdown restricted short-term lending, tempting some banks into excessive long-term lending and real estate speculation. In response to these pressures the central bank tried on occasion to restrict credit and reduce the ceiling on the net foreign exchange positions banks were in theory allowed to hold.

The regime survived in no small measure because of the commitment, and indeed heroism, of the Lebanese central and commercial bankers and their employees, who dodged bullets, paid off rival militias, and managed to keep their doors open for all but a few months of a 10-year nightmare. But economic factors were also at work. The central bank's ample gold cover, safely stored (the writer suspects) in the vaults of the New York Federal Reserve, increased sufficiently in market value to keep the Lebanese pound more amply covered than any other freely convertible currency in the world. And, of greatest import, the underlying Lebanese economy was sufficiently resilient to support a free banking system. The value of Lebanese industrial exports (mainly to Saudi Arabia and Iraq) increased from $64 million in 1970 to $528 million in 1980 (Rivier 1982, 123). But this economic miracle begs the question of why bankers remained willing to roll over the loans needed to finance it—even after the Israeli invasion of 1982 destroyed much of Lebanon's industrial plant.

Bankers became entrapped in ever-growing mountains of debt, much of it in the form of nonperforming commercial loans. By the end of 1983, bad debts "rolled over on a yearly basis . . . were conservatively estimated at around 15 percent of total loans outstanding" (Iskander and Baroudi 1984, 207). The Lebanese bankers had become the prisoners of their clientele but had to keep pumping and priming them, as do the multinationals with their LDC debtors for lack of better alternatives. Writing off even that conservative 15% of their loan assets, amounting to 169% of their capital accounts (Banque du Liban 1984, 41), would have entailed collective bankruptcy. Instead they cooperated, resolving their dilemma of common interests by rolling over the loans rather than individually defecting. Like blind soccer players they continued to exchange unreliable information about their clients in a stadium where, as one leading politician observed, not even the law of the jungle prevailed, so dense and overgrown was its underbrush of class, regional, and international, as well as sectarian, conflicts.

The very failure of the Banking Control Commission to rationalize the system and foster specialized medium- and long-term credit institutions may have helped the banker-prisoners to adapt to the new war-

time situation. Credit analysis remained, for the most part, as refractory to modern techniques as when Yusif Sayigh had interviewed Lebanese bankers (1962, 94). Despite professional credit analysis seminars introduced by a dynamic chairman of the Bank Control Commission in 1981 and 1982, with the help of leading U.S. banks and continued by the American University of Beirut's Business School in 1983, the Lebanese paid only lip service. As one leading banker explained, credit was a function of trust and friendship, not of projected cash flows based on tenuous, primarily political assumptions. The high number of Lebanese banks meant that only trust and friendship could prevent market failure and throw bankers who were not necessarily trusting friends into each other's arms. The logic of the system rested on a classic creditors' dilemma of common interests.

The regime survived anarchy because it did not need to rely on the authorities to enforce regulations and directives. The central bank exercised authority over weaker banks that had lesser stakes in the system—even so, without operative legal sanctions, its tactics smacked more of carrots than sticks. Authority over the larger banks seems to have been minimal. When, for instance, the Bank Control Commission once confronted a major bank head-on, insisting that it remedy its woeful capital inadequacy, the dynamic chairman of the Control Commission lost his job despite full support from the Governor of the central bank (himself the son of a Lebanese president and a potential presidential contender). The Christian who managed the bank in question, a former finance minister, successfully negotiated the support of the incumbent Sunni prime minister, who disposed of this bit of Sunni patronage and was anticipating future electoral expenditures—high in Lebanon by international standards, as Hudson noted (1968, 255). The successor to the Control Commission was equally unable to impose prudent liquidity and solvency ratios upon the banks.

Most borrowers eligible for government subsidies to cover damage incurred in the 1975–76 fighting had preferred privately to renegotiate their loans with the banks, thereby preserving mutual honor and confidentiality, rather than be listed as receiving handouts. To assess the prospects for continued renegotiations, it is useful to try to reconstruct plausible parameters for their prisoners' dilemmas.

The Prisoners at Work: The Model

Suppose, not unreasonably in the conditions prevailing in Lebanon between 1976 and 1982, that an entrepreneur enjoys a close, possibly family relationship with the owner-manager of a bank that enjoys a good reputation with other banks. The bank may exchange shares of the entrepreneur's loans with other reputable banks for shares of their loans to other equally well-placed entrepreneurs —normal portfolio diversification to spread the risks—or the entrepreneur may patronize several banks. Wishing each year to roll over the loan, the entrepreneur who can credibly threaten his banks with default yet promise ultimate repayment "when the security conditions in the country improve" then enjoys a position of strength analogous to the district attorney's in a prisoner's dilemma. In practice, more than two banks will be renegotiating their loan with the entrepreneur, but the flavor of the situation can be conveyed by imagining just two banks, locked into a prisoner's dilemma by the shared prospect of having to refinance the entire loan or lose its share if the other defects. Assume in this simplest symmetrical case that each bank's share, k, is equal and that the perceptions of the probability of ultimate repayment, p, communicated by the original lending bank, are believed by the

other banks. Then the expected identical payoffs are as follows:

$DC = k(\text{loan})$

$CC = pk(\text{loan} + \text{interest})$, where p is the probability that the loan and interest will be repaid in a year.

$DD = 0$

$CD = p(\text{loan} + \text{interest}) - (1 - k)(1 + r)(\text{loan})$, where r is the discount rate, or opportunity cost, of the additional funds required to finance the debtor if the other bank refuses to roll over the loan.

Assuming perfect symmetry, the banks will have the same opportunity cost of capital. The problem, following Axelrod (1984, 207–08), whose w can be transformed into a real discount rate $r = (1 - w)/w$, is to determine the maximum value of r, or the minimum of p, the probability of repayment, for which the payoff, DC, for unilateral defection will be offset by the stream of future benefits from mutual cooperation. If the players employ Axelrod's tit-for-tat strategy, the defector can expect a total stream of payments $DC + DD/(1 + r) + DD/(1 + r)^2 + \ldots$, whereas the bank that rolls over the loan can expect a total stream of CC/r. Since $DD = 0$, cooperation on a tit-for-tat basis is defensible as long as

$$DC < CC/r$$

$$k(\text{loan}) < pk(\text{loan})(1 + i)/r$$

$$r < p(1 + i), \text{ or } p > r/(1 + i)$$

In other words, if $r = .25$ and $i = .15$ (plausible in 1981), future expectations of cooperation could offset the temptation unilaterally to defect as long as the chances of repayment were at least one out of five. Banks where opportunity costs of capital were a bit higher—up to 45% return on equity—could still reasonably roll over loans if they perceived the chances of repayment to be better than two out of five. As long as the bankers could believe there were some prospects of an eventual recovery of the Lebanese economy, there seemed little reason for not continuing to lend to one's kin or friends or, by sharing in other banks' loans, to friends of other intermediaries.

Strategies to Avoid Playing Chicken

The model helps to explain banks' strategies as well as why they might keep cooperating in rolling over commercial and industrial loans under conditions of general anarchy. The assumption of perfect symmetry can be relaxed to reflect some of the variances in the luxuriance of strategies, types of ownership, styles of management, and clienteles displayed by the 80-odd commercial banks operating in Lebanon. After 1977, when the moratorium on issuing new bank licenses was lifted, 10 new banks squeezed into the crowded market place in search of prime clients while a number of established banks were sold to aggressive new owners, enabling potential prisoners to escape.

The banks can be situated in strategic niches defined by their opportunity costs of capital and perceptions of credit risks. Banks with high opportunity costs of capital and "conservative" habits of estimating risk would prefer to reduce their portfolio of doubtful debts and escape playing iterated prisoner's dilemma games. But it was better to qualify as a prisoner than be perceived as a less credible chicken ($DC > CC > CD > DD$) (Oye 1985, 8). Chickens had less bargaining power than real prisoners because their threat of defection was less credible. If $CD > DD = 0$, then

$$CD = pL(1 + i) - (1 - k)(1 + r)\text{loan} > 0$$

$$p > (1 - k)(1 + r)/(1 + i)$$

A bank could be perceived as playing chicken if p (the banker's estimate of the probability that the loan would even-

Table 1. Profiles of Owner Nationalities and Loan Portfolio Growth Rates of the Top 15 Creditor Banks by Rank: 1974–1982

Rank 1974	Rank 1982	Bank	Ownership	Annual Growth of Loan Portfolio 1974–82 (%)
1	15	G. Trad-Crédit Lyonnais	French, Lebanese	11
2	9	Société Nlle. de la Banque de Syrie et du Liban	French, Lebanese	17
3	1	Banque Libano-Française	French, Lebanese	26
4		Citibank	U.S.A.	-8
5		Banque Nationale de Paris	French	9
6		Chase Manhattan	U.S.A.	-9
7		Moscow Narodny[a]	U.S.S.R.	4
8		Société Générale Libano-Européenne	French, Lebanese	14
9		Arab African International Bank	Egyptian	-12
10		Bank Almashrek	U.S.A., Lebanese	14
11	3	Fransabank[b]	Lebanese	22
12	4	Banque Audî	Lebanese	29
13		Banco di Roma	Italian	3
14	8	Banque Libanaise pour le Commerce	Lebanese	25
15		Bank of America	U.S.A.	-11
	2	Banque du Liban et d'outre-Mer	Lebanese	36
	5	Banque Byblos	Lebanese	31
	6	Banque de la Méditerranée	Lebanese	31
	7	Beirut Riad Bank	Lebanese	29
	10	Banque Sarader	Lebanese	44
	11	Bank of Beirut and the Arab Countries	Lebanese	35
	12	Crédit Libanais	Lebanese	27
	13	Banque de l'Industrie et du Travail	Lebanese	35
	14	Crédit Populaire	Lebanese	40

Sources: Association des banques du Liban 1974; Baz 1984.

[a]Growth of loans is calculated until 1981.

[b]The Banque Française Pour le moyen Orient was merged with Banque Sabbagh and renamed Fransabank.

tually be repaid) were sufficiently high, k sufficiently high, and/or r sufficiently low. The profile of the chicken player was that of an unprofitable family bank saddled with high shares of loans on which its outlook remained bullish.

Foreign banks, especially the big U.S. multinationals, were among the first to cut their loan portfolios, while Lebanese-owned banks took over many of the former's prime Lebanese customers' loans (and corresponding deposits). Although most of the big foreign banks retained a presence in Lebanon after the first rounds of fighting in 1975–76, their position relative to Lebanese banks altered dramatically. Table 1 lists by rank the top 15 creditor banks in 1974 and in 1982, along with profiles of their principal owners' nationalities and the average annual rates of increase in the size of their loan portfolios between 1974 and 1982. Lending remained as concentrated in 1982 as in 1974—the top 15 accounting in both years for slightly over half of the banking system's credit to the private sector—but foreign banks and Lebanese banks owned in large part by foreign interests removed themselves from the competition. The fully Lebanese-owned banks, seeking market share and having greater confidence, perhaps, in their borrowers, were more willing to become prisoners.

The larger aggressive Lebanese banks

could divide up shares of prime customers' loans no longer wanted by Citibank or its peers, whereas family banks that elected to remain small risked becoming ever more burdened by undiversified chunks of debt of friends or relatives. If a bank's share of a doubtful debt were high, however, it would not qualify as a player in prisoner's dilemma because it would be better-off rolling over the loan even if other banks defected. Always concerned to prevent any bank failures that would adversely reflect upon the system, the central bank kept ailing family banks in business and encouraged their sale, wherever possible, to outside investors or their merger with healthier banks. In one case it even permitted the new investors (headed by a former finance minister) to acquire the bank *without* its portfolio of doubtful debts.

Most of the aggressive banks, in turn, seem to have regained relatively healthy returns on their capital after a period, between 1975 and 1978, of plowing their revenues back into reserves ("provisions") for doubtful debts. Among the 10 of the 15 top credit banks that had published income statements since 1973, only 3 were not declaring consistent profits—averaging 27% return on equity—during those golden years of banking under conditions of anarchy, 1980 and 1981. Their go-go growth strategies, however, generally sacrificed profits for market share and resulted in steady decreases in capital adequacy (i.e., higher leverage and risk).[1] Staying small and nursing a less diversified portfolio, on the other hand, could be riskier because other banks would have less incentive to cooperate in rolling over any problematic loans. The high-growth, undercapitalized banks could at least be each other's prisoners rather than succumb to the largesse of the central bank.

To qualify as a prisoner rather than a chicken, a bank needed size and corresponding market power (and possibly political power) as well as profitability to keep its individual shares of dubious loans to a minimum. No prisoner's dilemma model fully captures the process of loan renegotiations between unequal partners (Telhami, n.d.), but occasionally, as with Sinno and Jabbour in 1982, the negotiations became public knowledge. The banks broke out of their prisoners' dilemmas and delegated the head of a leading Lebanese bank, a former finance minister, to renegotiate the loans. The Sinno and Jabbour Group in the end agreed to sell off some real estate (including interests in a nightclub in Rio de Janeiro) and convert its short-term debt into a medium-term loan. The exposure of the bank that renegotiated the package was reduced by more than two-thirds, to a mere 5% of the term loan; another prominent Lebanese bank, enjoying especially close relationships with both the lead bank and their common French banking connections, also had its exposure whittled down at the expense of other Lebanese and Canadian banks (Abu Zaki 1982; Restructuring 1982).

The Apparent Breakdown of the Regime

Banks could reasonably continue to roll over dubious loans until 1984, when the political and economic consequences of the Israeli invasion and its aftermath, including the bombing of the U.S. and French peacekeeping forces, became fully apparent. Much of Lebanon's industrial plant had been destroyed, and exports to the Gulf were adversely affected also by the uncertainties of overland transportation through Syria and reduced demand in Iraq and Saudi Arabia. Because taxes could not be collected, the government experienced alarming deficits and a burgeoning public debt. For lack of exports or foreign investment, there was a record balance of payments deficit in 1984. The central bank insisted, however, that "exchange controls cannot be a solution to the balance-of-payments problem

because it would finally sweep away confidence in the Lebanese economy" (Banque du Liban 1985, 20).

The new phase in Lebanese banking was anticipated by a swindle. The manager of First Phoenician (purchased from First Chicago in 1982) made fraudulent loans (Summary 1984, 31–34) financed in part by interbank deposits at high interest rates and departed for Brazil in March 1984 (Iskander 1984). The central bank rescued the depositors and put the bank under new management, but might not other banks finance borrowers speculating in foreign exchange with similar results? Assuming that most banks still acted "legally" and restrained their financing of foreign exchange speculation, what were their new parameters for rolling over old loans as expectations hardened that the bottom had fallen out of the foreign exchange market for the Lebanese pound?

An expected depreciation rate, d, of the Lebanese pound must be included in the model. The temptation of cashing in a loan might then be offset by the present value of the rewards of future repayment if

$$r < p(1 + i)(1 - d), \text{ or}$$
$$p > r/(1 + i)(1 - d).$$

By late 1984 there seemed little reason not to expect a continuing annual slide of the pound against the dollar (or a basket of foreign currencies) of 50% or more. Consequently, the probability of repaying a loan had to be at least $1/(1 + i)$ for banks to fit the prisoners' model of cooperation and at least to break even ($r = d$). Yet interest rates were being kept well below the rate of expected depreciation; and peace seemed ever less likely, diminishing the probability of repayment of doubtful debts.

Why banks continued to roll over loans is not altogether evident. For customers who could never repay or who had perhaps run off to Brazil with no intention of repaying, Lebanese banks still had no alternative but to keep the loans on their books. There was no legal way of writing them off unless the customer were declared bankrupt, but without functioning law courts, bankruptcy could not be declared (Saliba 1981, 154). Solvent clients, however, had their cash "outside" Lebanon. Any bank's advantage in collecting loans in depreciating Lebanese currency could still be offset by the rewards of other ongoing business relationships with the client. Because banks representing 60% of the banking system's total assets (Iskander 1984, 3) had established branches in Paris, Geneva, London, and Brussels, they might still be rolling over some of the nonperforming loans under the shadow of a shared future.

Dilemmas of common interest had meanwhile supported a bankers' regime inside Lebanon during a period of anarchy lasting from 1975 until 1984 or so, independent of continuing relationships abroad. The banking system was also one of Lebanon's few institutions to have preserved the values of mutual intraelite accommodation enshrined in its prewar consociational "democracy" (defined by Kerr not as "the rule of the *demos* but simply the distribution of guarantees to the recognized factions coexisting in the country of the means to defend their minimum interests" [1986, 188]). The banks prevented market failure despite asymmetric information segmented along sectarian as well as along family lines. They often cooperated across sectarian lines—a big syndicated loan for a cement works at Sibline, near the Shouf mountain strongholds of the Druze, being a good political example. Lebanon's leading Christian- and Sunni-owned banks participated in Druze chieftain Walid Jumblatt's project, whereas the major Druze-owned bank did not.

The banks were almost as much political as financial intermediaries. They help

explain not only financial cooperation during Lebanon's war but also a political anomaly, namely why the antediluvian political chiefs—despite a revolutionary situation in 1975 (Johnson 1983)—could return to power or at least fight over its absence. "Writing large" the banking interests back to their political nexus, Lebanon's multibank system effectively performed a function of elite integration, whether for consociational democracy or for the more authoritarian regime attempted by the Gemayels after the Israeli invasion.

"Writing Large": Capital Adequacy and Political Change

Unlike Austria or Holland, Lebanon never evolved mass parties of social integration, even among lower-middle class Maronites (Entelis 1974, 101–23), that would make the consociational formula work under modern conditions. Instead, clientage networks not dissimilar to the ones described by Albert Hourani (1968, 41–68) in eighteenth century "Syria" persisted in the Lebanon of the 1970s. In part, the civil war signified the breakdown of the patrons' control over socially mobilized and politically awakened masses. One astonishing feature of Lebanon's superstructure by the late 1970s, however, was the resurrection of many of the political patrons whose grips over their respective communities had been weakened in the heat of the battles of 1975–76. The status of these putative warlords was apparently hereditary—as attested by the careers of Walid Jumblatt, Bechir and Amin Gemayel, and many others (Khalaf 1980, 254–58; Messara 1977, 183–201).

Durable patron-client networks may be presumed to have permitted these families to retain their grip, even as their locus of economic influence shifted after the Second World War from rural landholdings to urban commerce (Dekmejian 1975; Harik 1975). Banking then became so central to Lebanese politics that, in alliance with other commercial interests, it prevented the building of an interventionist Lebanese state (Dubar and Nasr 1976, 67–75; Owen 1976, 28–31). The country was to be a safe haven for senior French and then U.S. multinational partners in the 1950s and 1960s. Clientelist practices usefully insulated the commercial center against sectarian pressures (Lemarchand 1981, 23) even as the specter of "confessionalism" paralyzed efforts to change the political system. But the commercial machinery that materially sustained the political networks also contributed to the elite's cohesion. Without denying its possible basis in a shared class interest, this cohesion was most visibly displayed in concrete interconfessional commercial ties centered in the banking system.

The banks contributed to intersectarian cooperation by sharing in the financing of entrepreneurs, thereby directly or indirectly supporting the clienteles of the political chiefs. By exchanging information and sustaining capital markets, they provided those tangible "first-order" resources needed to preserve durable patron-client structures (Moore 1977; Scott 1972). The greater the number of "competing" banks, in fact, the better the chances of keeping the elite mutually accommodating despite acerbic cleavages that confessional violence further embittered after 1975. The system, however, also eliminated some elites who appeared too powerful (anticipating the Palestinian Liberation Organization), notably those Palestinians who, through Intra Bank, had controlled a host of strategic industries such as the Middle East Airlines, the Port of Beirut, and the Casino du Liban. Portfolio diversification mitigated other cleavages among Lebanese in the sectors that counted most: the commercial and industrial sources of political revenues

inside the country. Indeed the leading political families shared just as many dilemmas of common interest as the bankers, but the bankers were the necessary mediators. Dilemmas of cooperation are less amenable to rational solutions among actors who, unlike bankers, are too envious and "too clever" (Axelrod 1984, 23).

Obviously bankers without guns could not control warlords (though a couple of prominent bankers were considered to be the principal financial promoters behind the elections of two presidents in 1982). With or without guns, the political chiefs hardly seemed capable even of primitive sociability, much less of reshaping a consociational formula, which requires an accommodating political elite. Salman (1984) compared their discussions at Geneva and Lausanne in 1983 and 1984 to those of hashish addicts living out Egyptian illusions and realities after 1967 on a houseboat in Naguib Mahfouz's *Chatter on the Nile.* Unfortunately, political Lebanon cannot survive unless they can agree on a new form of consociation (Messara 1983), yet most moderate non-Christians view the open recognition and legitimation of confessional cleavages required to make a consociation work (Lijphart 1977, 103) as a step toward the partition favored only by some Maronite and Israeli interests.

The alternatives are bleaker: partition or the unwilling assimilation of remaining Christians in a Muslim majority. A dominating Khomeini-style Shia plurality would be as distasteful to other Muslims and Druze, not to mention most educated Shiites, as to the Christian minorities. As Ajami (1985) explains, "the fight in Lebanon now is not about the establishment of a state of the zealous; it is about the apportioning of power among the country's principal sects. . . . A Shia bid for power that tries to outrun the sectarian compact can succeed no better than the Maronite dream of a state cut off from its Arab environment" (pp. 792–93). The other alternative, partition, may be the outcome of another decade of turmoil and terror unmixing the confessions, but only the Maronite and Druze quarter of the population have safe mountain havens on this gory reading of the future. Partition cannot be the outcome of a deliberate political settlement because the conditions rendering its implementation possible would have already permitted a new consociation.

Toward a Redistribution of Financial Power?

It may still not be too late for the warlords to patch together some settlement. Were the political miracle to occur, the banking system would indirectly contribute to the new equilibrium. The "hell of the old politics resurgent" might yet be reconciled with a "benign utopia of finance" (Ajami 1981, 2) if hard financial logic prevails and the warlords stop playing their perverse games.

Most of the leading Lebanese creditor banks could not sustain their prodigious growth through retained earnings. An examination of their balance sheets and income statements shows that by 1982 capital adequacy (measured by [capital + reserves]/total assets) was woefully inadequate by international standards (Chaib 1983, 13, 17, 18). Most of the banks keeping adequate provisions for their loans, in addition to their capital and other reserves, had required substantial injections of new capital. The new sources of capital were predominantly Muslim and might therefore in time tend to equilibrate the banking system in ways that would support incremental political change within a consociational context.

Most Lebanese freely admit that the old consociational framework's allocations no longer reflect demographic or political realities. It is only possible to suggest the discrepancies between the official alloca-

Table 2. Constitutional, Demographic, and Financial Indicators of Power by Religious Sect

Religions Sect	Seats in Parliament	Percent of Total Population[a] (est. 1985)	Percent of Banking Capital in Top 15 Banks[b] as to lending 1974	lending 1982	net worth 1982
Maronite	30	21			
Greek Orthodox	11	6			
Other Christian	13	8			
Total Christian	54	35	62	47	32
Sunni	20	25			
Shiite	19	36			
Druze	6	4			
Total non-Christian	45	65	18	36	33
Confessionally indeterminate			20	17	35
Totals	99	100	100	100	100

Sources: Chamie 1981, 25, 85; Association des Banques du Liban 1974; Baz 1984, 215, 220.

[a]Estimated growth rates for each sect were projected from the 1932 census. Palestinian immigrants, some of whom became Lebanese citizens, are not included in these estimates of the Lebanese population.

[b]The allocations of capital among the top 15 Lebanese creditor banks of 1974 are calculated from capital book values, whereas the capital of the 1982 creditors includes other reserves and loan provisions as well. Only capital and reserves, not provisions, are counted for the 15 banks having the greatest net worth.

tions, indicated by parliamentary seats, and the demographic realities, estimated impressionistically (the last Lebanese census was undertaken in 1932, and subsequent administrative projections make political but no demographic sense)—without statistically valid margins of error—in light of recent research into the fertility of the respective communities.[2] The results are summarized in Table 2. Comparisons between the first and second columns suggest the extent to which the Maronites, Greek Orthodox, and other Christian communities are overrepresented in the Lebanese parliament at the expense of the Sunni community and especially at the expense of the Shiite community.

The top fifteen Lebanese-owned creditor banks can also be scrutinized, still more tentatively, with respect to their sectarian ownership in 1974 and in 1982. The third column of Table 2 indicates that Christians controlled 62% of the total capital of these 15 banks in 1974, whereas the Muslims and Druze had only 18%, the rest belonging to banks that seemed confessionally indeterminate.[3] With only three exceptions, the same banks occupied the top 15 positions in 1982 (fourth column), but their ownership had changed. New capital injections tended to be Sunni Muslim, mainly from the Arabian Gulf, but many of the large lenders were still inadequately capitalized. A fifth column in Table 2 represents a different, only partially overlapping, set of leading banks, the 15 in 1982 that were the most highly capitalized. In this set the share of Christian equity is further diminished, yet these are the banks that may be waiting in the wings to rescue overextended ones. In the event of peace, a competitive shake-out of Lebanon's overcrowded banking system is to be expected. Comparisons between columns

four and five suggest that the predominantly Christian banks would be the most vulnerable to takeovers. The resulting capital structure might then support a predominantly Muslim allocation of political power, just as the pre-1974 regime supported a Christian one.

Such a shift in financial power would be discreet and subtle: bank owners and managers have never supported the political clienteles of leading politicians along exclusively confessional lines. The logic of loan portfolio diversification encouraged intraconfessional collusion among elites. The most prominent banks were impeccably rooted in other communities as well as their own. One senior banker scolded the present writer for writing of political services Lebanese banks might be performing (Moore 1983)—until a very prominent young politician breezed unannounced into his office, elegantly upholding the author by his sporting presence, to our mutual merriment. Newer banks sometimes lacked subtlety by factoring confessional segmentation into their marketing strategy, putting a token Druze on the board of directors, for instance, to penetrate markets in the Shouf, where the Druze were concentrated. Shared confessional roots might indeed give entrepreneurs better chances to borrow, expand, and then diversify their credit base, especially since so much violence has restricted people and information to ever-tighter communal circuits. Much of any renewed economic activity would in turn reenforce political leaders' clienteles.

Conclusion

Such visions of incremental change may seem utopian, but the most plausible alternative is an equally incremental, albeit violent, grinding down of geographical units into confessionally homogeneous subunits over another decade or two. If Lebanon became too bloody a laboratory to offer further illustrations of the theory of international regimes, the poor country would, having committed suicide, highlight certain aspects of international reality that seem recalcitrant to theory.

Iterated prisoners' dilemmas assume a pale world, hardly Mediterranean or Middle Eastern, in which economic interest has castrated the passions. A prisoner's dilemma cannot encompass actors who "seek to minimize the difference between their own returns and those of others" (Stein 1983, 134). Its payoff matrices cannot quite do justice to passions like envy (where perhaps $DD > CC$) or to sheer bloody-mindedness (where the other's cooperation may be a source of pathological anxiety: $DD > CD > DC > CC$) —nor even to the uncalculating spontaneity expressed in Rousseau's more famous parable of the stag hunt (1962, 171: $CC > DC > DD = CD$). Bankers may feel more comfortable with Axelrod's tit-for-tat strategies than most politicians or warlords, for status calculations in economic relationships are less likely to transform "a variable-sum game like the Prisoner's Dilemma into a strictly competitive struggle with no possibility for joint gains" than they are in security relationships (Lipson 1984, 15). At least the bankers understand discount rates.

In a real world of anarchy, one that may be all too close to international reality, Lebanese bankers indeed kept faltering capital markets from failing. Their dilemmas of common interests also helped to keep the country together and service the business clienteles of its warring elites. Their banking regime supports Keohane's contention that such regimes may survive the hegemony of their creator, in this case a consociational democracy of sorts, at least for a time. The banking system's adaptation to anarchy also supports Krasner's hypothesis (1983, 361) that international regimes, while depending upon the allocation of power among the state actors that promoted them, may

feed back changes in these relationships.

But meanwhile, Lebanon is committing suicide. Refounding a consociation on which to rebuild its shattered economy and society may require a genie as well as more Syrian military commitment. Most bankers, while prepared to shore up consociational democracy, would favor any Napoleon to protect themselves from the political jungle. Their regime, like the politicians they befriended, is better viewed as the residue of a disintegrated political order than as the proxy for a Hobbesian sovereign. Collusion among financial intermediaries cannot reshape political reality; it can only recall it briefly and perhaps explain it, "grey in grey," after polity and economy have both broken down.

Lebanon may be a plague that should not infect the study of international forms of disorder. But if its internal turmoil is viewed instead as a microcosm of our maladies, then international regimes based on the financial logic illustrated by the Lebanese bankers may be equally pale and unsatisfactory substitutes for more political forms of cooperation.

Notes

I offer this essay in memory of Malcolm Kerr, who supported my work at the American University of Beirut, and of Jim Coleman, who gave me refuge at UCLA. I wish to thank my colleagues in UCLA's Political Economy Colloquia, Jeff Frieden, Mike Wallerstein, and Ahmed Enany for their stimulation. This essay was originally presented at the 1985 convention of the American Political Science Association, New Orleans.

1. Among the 19 Lebanese banks for which income statements as well as balance sheets were available over the years 1980–82, capital adequacy was regressed on the log of the growth of total assets and the ratio in 1982 of the spreads between interest received and interest earned to total assets—a basic measure of profitability. The two independent variables accounted for a corrected r square of .57 of the variance in capital adequacy. The T statistic for growth was −2.1, for spreads, 2.8.

2. Chamie (1981, 85) estimated the net annual percentage growth rates of the respective religious communities as follows: Shiites, 3.8; Sunnis, 2.8; Catholics (of whom 80% are Maronite), 2.0; Druze, 1.8; and non-Catholic Christian, 1.7. Projecting these rates from the 1932 census, the Lebanese population (excluding all Palestinian immigrants, some of whom became Lebanese citizens) was just over 3 million in 1985, distributed as indicated in Table 2.

3. The ownership of each bank was judged with respect to the confessional affiliations of its directors and its suspected sources of capital to be either Christian, non-Christian, or confessionally indeterminate; some had changed between 1974 and 1982. The judgments are subjective; one or two notable Muslim members of the board did not make an otherwise Christian or Franco-Maronite bank confessionally indeterminate if the notables seemed to be tokens without much capital behind them. Each bank's capital was totally allocated to one of the three categories.

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Forthcoming in June

The following articles, controversies, and research notes have been scheduled to appear in the June 1987 issue:

Paul R. Abramson, "Measuring the Southern Contribution to the Democratic Coalition."

Vinod K. Aggarwal, Robert O. Keohane, and David B. Yoffie, "The Dynamics of Negotiated Protectionism."

Jonathan Bendor, Serge Taylor, and Roland van Gaalen, "Stacking the Deck: Bureaucratic Mission and the Search for Alternatives."

Darrel Dobbs, "Rationalism and Heroic Reverence in Homer's *Odyssey.*"

Bernard Grofman, Guillermo Owen, Nicholas Noviello, Amihai Glazer, "The Copeland Winner and Reasons for Stability and Centrality of Legislative Choice in the Spatial Context."

Robert W. Jackman, "Political Institutions and Voter Turnout in the Industrial Democracies."

M. Kent Jennings, "Residues of a Movement: The Aging of the American Protest Movement."

George Klosko, Edward N. Muller, and Karl-Dieter Opp, "The Rationality of Collective Action."

Michael MacKuen and Courtney Brown, "On Political Context and Attitude Change."

Douglas Madsen, "Political Self-Efficacy Tested."

Samuel Merrill, III and Jack Nagel, "The Effect of Approval Balloting on Strategic Voting Under Alternative Decision Rules."

Edward N. Muller and Mitchell A. Seligson, "Inequality and Insurgency."

Richard Niemi and Joel D. Barkan, "Age and Turnout in New Electorates and Peasant Societies."

Alwyn R. Rouyer, "Governmental Performance and the Decline of Fertility in India."