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The Libyan Economy after the Revolution: Still No Clear Vision

The Libyan economy collapsed in the wake of the popular uprising in February 2011 that led to the overthrow of the Muammar Qaddafi regime later that year. As the war raged, virtually all economic activity, especially oil production (the mainstay of the Libyan economy) witnessed a dramatic decline. While there was some recovery in 2012 when the war ended and oil production came back faster than expected, the economy has not yet reached a point of sustained, longer term economic growth. In fact, by 2013, the economy has only just got back to what it was prior to the uprising.

The upbeat assessment of the International Monetary Fund (IMF)[1] on completion of the annual Article IV consultations in May of this year is overly optimistic about current economic developments and prospects, and that the Libyan government is following the right economic policies to address the underlying systemic problems. As is the case in each of the Arab Spring countries, in Libya today politics continue to override economics. The government's attention has been focused almost entirely on uniting disparate interest groups and tribal powers to establish a cohesive government and draft a new constitution.

The government to date has largely paid only lip service to economic policies. While there have been pronouncements of measures the government intends to take to address the aspirations of the Libyan population that rose up in rebellion, as yet there is little to show for it.[2] It can of course be argued that the current government is transitional and therefore has a limited mandate. Nevertheless, it could still formulate economic policies and reforms that will be needed to transform Libya into a market-oriented economy where the private sector plays a central role.

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Giving the private sector the incentives and room to grow to create badly needed jobs will require major structural reforms in many areas. Changes will need to be made in the labor laws, business and investment regulations, the education system, and the financial system. Furthermore, the government will have to improve the existing infrastructure, which lags behind other countries in the region and is a binding constraint on private sector development.

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1 IMF, Libya: Public Information Notice No. 13/60, May 23, 2013. See also the interview of Ralph Chami, IMF mission chief for Libya, in the Libya Herald titled "Libya: the new Norway on the Mediterranean", June 4, 2013.

2 IMF, Middle East and Central Asia Department, *Libya beyond the Revolution: Challenges and Opportunities*, 2012.

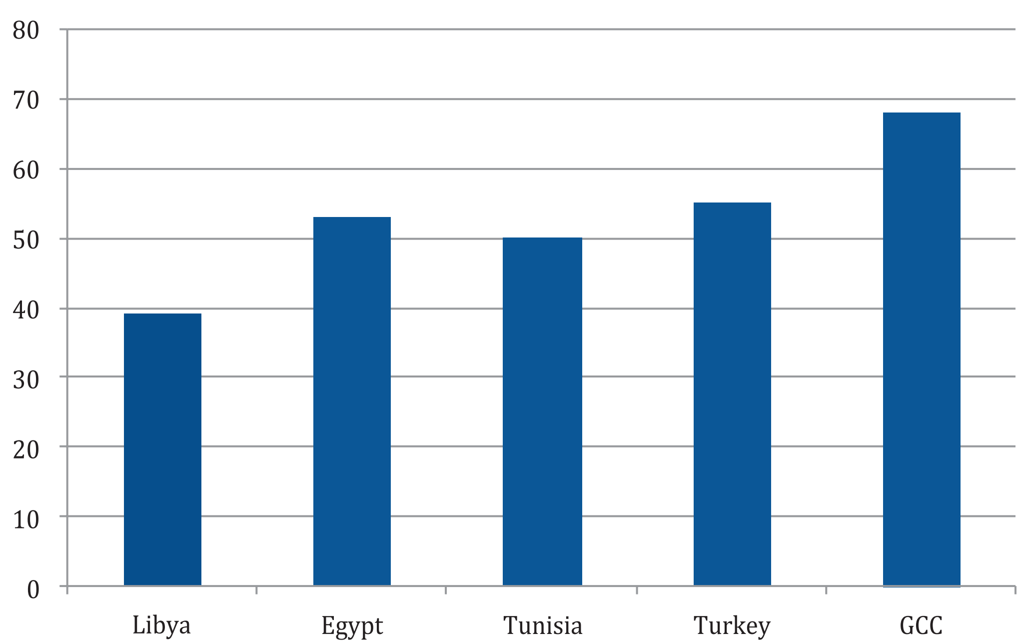
The key question is what the Libyan economy will look like in the future.[3] Will it revert back to the model of the Qaddafi regime where the economy was tightly regulated and the government was the central player? Or will the new government opt for a more market-oriented economy where the private sector takes the lead? If the latter, the current government can make a start by laying the groundwork for this objective by developing a comprehensive reform blueprint for the next government, which will necessarily have to focus on the economy.

The economy before the uprising

Libya has a classic oil-dominated economy. Oil (and to some extent gas) represents some 65 percent of the country's GDP, 96 percent of export revenues, and nearly 98 percent of government revenues. This high degree of dependency makes oil production and oil price movements drive the economy. Because oil production is managed by the National Oil Corporation (NOC), which transfers oil revenues from foreign and domestic sales to the government, it makes the government the principal economic actor in the country.[4] The tax and royalty payments by foreign oil companies (including Total from France, ENI from Italy, Repsol from Spain, BP from the United Kingdom, and Occidental from the United States) operating in Libya also accrue to the government via the NOC. The oil sector is an enclave and only affects the rest of the economy when the government spends the oil revenues. By its control over the oil sector, the government is able to influence virtually all economic activity in the country.

The Qaddafi regime exercised this control over the economy to hold back the development of the private sector. As a consequence, Libya was less market-oriented than its neighbors, and significantly less than its fellow oil producers in the Gulf Cooperation Council (GCC). A 2010 Business Monitor International (BMI) rating on the market orientation of Libya and other relevant countries bears this out (see Figure 1).

Figure 1: Market Orientation Rating, 2010



Source: Business Monitor International (BMI)

3 In fact, the discussion over the future economic model is taking place in all the Arab Spring countries. See Mohsin Khan and Svetlana Milbert, "Economic Policies in Egypt: Populism or Reforms?" *Atlantic Council Issue Brief*, October 10, 2012.

4 African Development Bank, *African Economic Outlook: Libya*, 2012.

During 2000-10, Libyan oil production averaged about 1.6 million barrels a day (mbd) with exports averaging 1.47 mbd (Table 1). In 2008, there was an increase in oil production to 1.78 mbd as Libya sought to take advantage of higher international oil prices, but the production rate fell back to historical levels a year later as oil prices declined in the second half of 2008 and stayed relatively low through much of 2009. Real GDP grew over that period at an average annual rate of 4.5 percent, slightly below the average growth rates of oil exporters in the Middle East and North Africa (MENA) (Table 1). Real non-oil GDP grew at a more impressive rate of 6.3 percent per year, but this too was almost a full percentage point below that registered by other MENA oil exporters. Inflation was moderate throughout 2000-10, averaging below 3 percent per year. There was a jump in inflation in 2008 as international food prices—Libya imports about 75 percent of its food requirements—rose significantly. But as food prices moderated, inflation in 2009 settled back to its original path. On the inflation front, Libya outperformed other MENA oil exporters where average annual inflation was close to 7 percent.

As international oil prices rose steadily over the decade and increased spectacularly in 2007 and the first half of 2008, Libya's export earnings more than doubled and the country ran large external current account surpluses throughout 2000-10. The stock of international reserves in the Central Bank of Libya (CBL) reached $101 billion by end-2010, with an additional $70 billion in foreign assets transferred to the Libyan Investment Authority, the government's sovereign wealth fund.

Standard macroeconomic indicators suggest that the Libyan economy during the Qaddafi years was performing reasonably well, on par with other oil-exporting countries in the Middle East. However, this generally positive picture masks a number of underlying structural problems. First, the private sector stagnated under the almost total government control of the economy. The Qaddafi government showed a distinct lack of interest in developing the private sector and imposed a number of regulations inhibiting its growth. These included onerous business and labor regulations that kept private businesses small and largely involved only in the provision of

Table 1. Libya: Main Economic Indicators, 2000-2012

	Average 2000-2010	2011	2012
Real GDP (percentage change)	4.5	-62.1	104.5
Non-oil real GDP (percentage change)	6.3	-52.5	43.7
Oil production (mbd)	1.6	0.48	1.45
Inflation (percentage change)	2.5	15.9	6.1
Fiscal balance (percent of GDP)	13.5	-18.7	20.8
Current account balance (percent of GDP)	24.5	9.1	35.9
Exports (billions of US dollars)	31.8	19.1	62.7
Imports (billions of US dollars)	15.9	15.6	32.2
International reserves (billions of US dollars)	41.8	111.6	124.5
Total foreign assets (billions of US dollars)	–	171.5	176.9

Source: IMF

services, particularly retail and wholesale trading. Restrictions on the development of the private sector led to an expansion of the informal economy, which is estimated to have reached one-third the size of the formal economy in 2010.[5]

A second major structural problem was unemployment. In 2010, the official unemployment rate was 13.5 percent, with youth unemployment estimated to be 25-30 percent.[6] The absence of employment opportunities mainly resulted from the domination of the state in the economy with the public sector employing some 85 percent of the labor force, a mismatch between the skills demanded by the private sector and the skills of Libyan workers, labor laws that constrained private businesses from hiring, and generally low labor productivity. Foreign nationals, as in other MENA oil exporters, took both the high-skilled and low-skilled jobs, leaving Libyans to work for the public sector.

Third, the Libyan financial sector was remarkably underdeveloped given the country's level of wealth and GDP. Indeed, the Qaddafi government recognized this as a serious problem and banking system reforms were introduced in 2006 to upgrade banks, handle non-performing loans, and establish a national payments system. Despite these reforms, which included some privatizations of banks and foreign participation in banks, access to financial services remained limited.[7] The state-owned Special Credit Institutions, which provided low-cost financing to privileged customers, effectively crowded out other financial institutions from the market, leaving small businesses and enterprises to fend for themselves at a much higher cost, primarily in the informal market. As such, the financial sector even today remains underdeveloped, with the *2012-13 Global Competitiveness Report* published by the World Economic Forum ranking Libya 140th out of 144 countries sampled in terms of financial sector development.

Finally, there was the large and highly inefficient subsidy system that the Qaddafi regime had in place. The government provided subsidies for health, education, and housing, and it imposed controls on many basic food products as well as fuel. Total subsidies in 2010 amounted to 10 percent of GDP, covering fuel (7 percent), food (2 percent), and electricity (1 percent). Gasoline prices in Libya were among the lowest in the world, averaging $0.15 per liter; only Iran and Saudi Arabia had lower gasoline prices in 2010. Government expenditures were highly skewed toward current spending (mainly wages and subsidies), with development expenditures receiving lower priority and therefore less resources.

Economic developments since the uprising

The economy went into a freefall in 2011 as the civil war resulted in a severe cut in oil production, which fell to less than 0.5 mbd from 1.7 mbd in 2010, and also because of the UN-sanctioned freezing of Libya's foreign assets. The drop in oil production, the country's main product and source of revenue, led to overall GDP falling by 62 percent (Table 1). Because of the dependency of the rest of the economy on the oil sector, non-oil real GDP declined by 52 percent. Nominal GDP in 2011 fell to $35 billion from $75 billion in the previous year. This was a catastrophic collapse by any measure.

Consumer prices rose on average in 2011 by 16 percent and by the end of the year inflation hit nearly 30 percent. The budget turned from continuous surpluses to a deficit of 19 percent of GDP. The external current account surplus fell to 9.1 percent of GDP after averaging nearly 25 percent a year over the previous decade. Exports fell by more than half relative to 2010 but so did imports, enabling the country to run a current account surplus and to continue to add to its international reserves, the only bright spot in an overall dismal economic picture.

When the Transitional National Council (TNC) took control of the country at the end of 2011, the economy began to recover. In 2012, oil production reached a near

5 African Development Bank, *African Economic Outlook: Libya*, 2012.

6 IMF, *Libya: 2013 Article IV Consultation*, IMF Country Report No. 12/150, May 2013.

7 Fayruz Abdulhadi, "Libya's Credit Crunch," *Libya Herald*, June 18, 2013.

pre-uprising level of 1.47 mbd, and as a consequence overall real GDP bounced back and grew by over 100 percent, with non-oil real GDP growing by 44 percent. Nominal GDP in 2012 reached $81 billion, about 8 percent above the 2010 value. Inflation came down to 6 percent and the external current account and fiscal balances registered surpluses of 21 percent and 36 percent of GDP, respectively. The recovery was due almost entirely to the increase in oil production rather than any specific economic measures taken by the government. Furthermore, while the rapid recovery of oil production and exports was important in the turnaround of the economy in 2012, it is unlikely that Libya will reach the levels of oil production achieved in the past decade. The reason being, according to oil analysts, Libya's fields are aging and production from some wells will not be possible because of damage to facilities during the almost complete shutdown in 2011.[8]

As long as oil production and prices remain at their current levels, the Libyan economy will continue to grow at about the same rates observed during the Qaddafi years. In other words, the government does not have to do much to keep the economy moving along as it has a momentum of its own.

Indeed, the government did not do much on economic matters as it was totally preoccupied with political and security issues. The paralysis of the TNC and of the government of then-prime minister Abdel Rahim al-Kib was due to various factors: unclear definition and division of powers between the TNC and the government; absence of a legislative framework; and unanswered questions over whether to respect the old regime's laws or wait for the adoption of new ones.[9] More importantly, neither institution enjoyed clear legitimacy as neither was elected. After the successful elections of July 2012, this last problem was resolved by the emergence of the first elected assembly of the post-revolution period, the General National Congress (GNC). In October 2012, the GNC appointed Ali Zidan as prime minister and approved the formation of his cabinet.

In theory, this new government was in a position to undertake the steps necessary to ensure the country's security, restructure its administration, and restart the economy. Unfortunately, it did none of these, due in large part to the increased insecurity in the country (namely, the proliferation of militias and weapons, as well as terrorist activities against the security forces), many ministers' inability to act, and a perennial confusion of the roles and duties of the GNC and the government. In particular, the lack of security as well as the difficulty of reorganizing the national army and the national police force have plagued and paralyzed the Zidan government.[10]

The situation became especially difficult in the spring of 2013 when, facing government attempts to disarm them, some militias began to undertake attacks against state institutions to force them to bend to their will. So far, this method has seen some success, most notably when the GNC, under siege by the militias, passed the political isolation law, which forces anyone who held a position under Qaddafi's rule to resign from public office. The ongoing disorder also cost the interior and defense ministers their positions. The situation remains fluid and there continues to be considerable uncertainty about when the country will achieve political stability and some degree of security.

Because the government was focusing exclusively on political and security developments, economic policies did not change significantly. Take for example the case of subsidies. The Qaddafi regime had a policy of using oil revenues to provide subsidies and wage increases to suppress popular discontent. Subsequent governments have continued with this same strategy of trying to buy peace. In fact, the budget for 2012 increased subsidies for fuel, food, and electricity to 11 percent of GDP, and the 2013 budget further increased these subsidies to nearly 14 percent of GDP.

Furthermore, even though the economy was in dire straits in 2011, wages in the public sector were

8 African Development Bank, *African Economic Outlook: Libya*, 2012.

9 Karim Mezran, Fadel Lamen, and Eric Knecht, "Post-revolutionary Politics in Libya: Inside the General National Congress," *Atlantic Council Issue Brief*, May 2013.

10 Wolfram Lacher, "Fault Lines of the Revolution," *German Institute for International and Security Affairs*, May 2013.

increased that year by 30 percent. There was another wage increase of 27 percent in 2012 and a 20 percent wage increase is budgeted for 2013. The pattern of expanding current fiscal spending at the expense of development spending has been maintained in the 2013 budget. Current expenditures in this budget account for 80 percent of total expenditures and capital expenditures only 20 percent despite the urgent reconstruction needs of the country, which have been estimated to amount to some $75 billion.

What should be the Libyan government's economic priorities?

All post-conflict countries have to focus first on stabilizing the economy before undertaking the necessary structural reforms to achieve sustained high growth. Fortunately, the Libyan economy has already achieved a substantial degree of macroeconomic stability, as evidenced by the recovery in economic growth, low inflation, and a healthy external position. This was achieved faster than expected as Libyan oil facilities were not severely damaged during the war. This is in contrast to the case of Iraq, a similarly placed oil producer, where it took several years for oil production to reach its pre-war levels and for the economy to recover. Libya has the advantage of having an established base from where it can move ahead to implement structural reforms.

What then does the government have to do to develop the economy into one that meets the needs and wishes of the Libyans that fought against the previous regime? To achieve this goal, the government will have to undertake a comprehensive set of economic reforms, many of which will only show their effects in the long term.

The areas identified by international institutions that will be critical for the development of a new market-oriented Libyan economy include:[11]

- **Diversifying the economy through the expansion of the private non-oil sector.** This has proven to be an elusive goal in most oil-producing countries. The focus in Libya should be to develop the services and tourism industries. For this to happen, major changes will have to be made in the legal framework, labor laws, and business regulations.
- **Reducing youth unemployment.** This will require an expansion of education and vocational training to provide young Libyans with the skills to meet the needs of the private sector. It will also mean changing the employment culture in the country where Libyans have a sense of entitlement to public sector jobs.
- **Developing a modern financial system.** This is needed to support the private sector, and in particular, provide credit to small and medium-sized enterprises and startups so that they can expand and create jobs. Financial reforms would include further privatization of banks, reducing the role of state-owned Specialized Credit Institutions, and allowing the entry of foreign banks. A recent law passed in January by parliament stipulates that starting in 2015 banks will have to follow sharia rules that prohibit the payment of interest, has also constrained bank lending as banks are uncertain of the status of their existing interest-based loans once this new law becomes effective.[12] It is important, as the CBL has argued, to allow both Islamic and conventional banks to coexist, as they do in other Muslim countries.

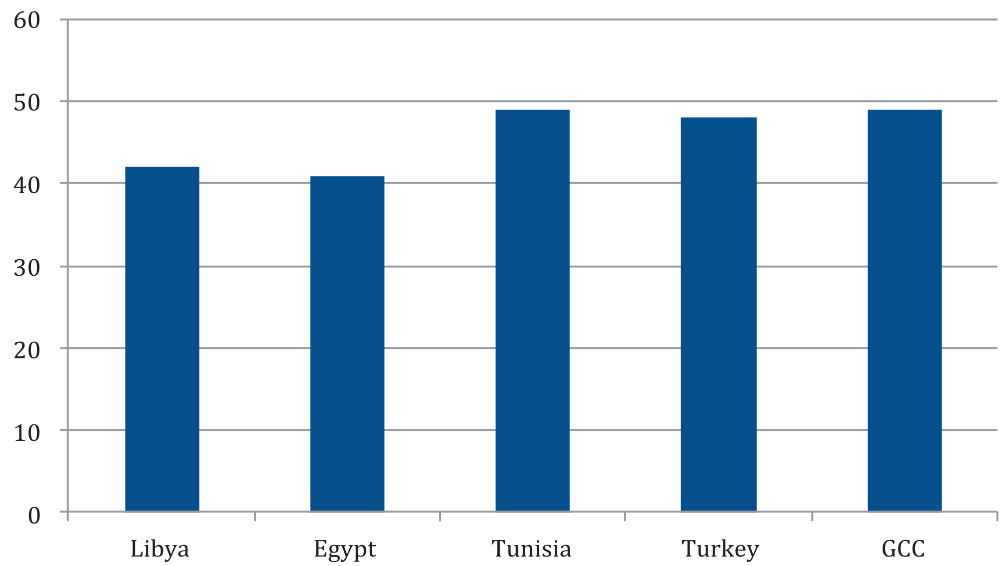
The reforms above will take time to yield results, which will undoubtedly test the patience of Libyans. So what should the government do in the short to medium term to simultaneously transform the economy and satisfy the population?

Aside from reconstruction to replace the economy's capital stock that was destroyed in the war, Libya needs to focus on creating better quality infrastructure. Despite its oil wealth, over the past decades Libya has not built the necessary infrastructure that would support private sector investment and growth, or attract foreign direct investment. As a result, Libya's infrastructure ranks

11 IMF, *Libya: 2013 Article IV Consultation*, IMF Country Report No. 12/150, May 2013. African Development Bank, *African Economic Outlook: Libya*, 2012.

12 Saleh Sarrar and Caroline Alexander, "Libya Bank Lending Paralyzed Amid Interest Ban: Islamic Finance," *Bloomberg News*, May 15, 2013.

Figure 2: Infrastructure Rating, 2010



Source: Business Monitor International (BMI)

significantly below that of other MENA oil exporters and lower than neighbors like Tunisia (Figure 2).

At present, Libya has no operating railway system, lagging behind Egypt and Tunisia in this regard. Prior to the civil war the Qaddafi regime had plans for a 3,000 kilometer North-South and East-West national rail network, but they were put on hold. Clearly these plans need to be revived. The country also needs to improve its airports and seaports, which are aging and have limited capacity. To address the housing shortage, the Housing and Infrastructure Board (HIB) was tasked with constructing 200,000 new houses at a cost of 32 Libyan Dinar (LYD) billion. However, only LYD 1.5 billion was provided for this purpose in the 2013 budget. Delays in financing have also prevented foreign construction firms from executing the contracts that have been awarded.

Over the next decade, Libya plans to invest some $140 billion in infrastructure projects.[13] A major imperative should be to frontload these projects and utilize the substantial foreign assets Libya has at its disposal to pay for them. Investment in infrastructure will yield three main benefits. First, it will create productive jobs for Libyans quickly, something which has to be a high priority for the government. Second, it is well established that public investment in infrastructure is complementary to private investment, almost on a one-for-one basis, and thus will lead to higher rates of private investment and private sector growth.[14] Finally, foreign investors tend to move to countries with better quality infrastructure, and foreign direct investment brings with it not only jobs, but also technology transfers that improve the overall productivity of the economy.

To this end, Libya should create a central infrastructure fund that would finance all the major projects envisioned—notably roads, railways, housing, telecommunication, airports, and seaports—and transfer the needed financial resources to this fund. This would be more effective and efficient than leaving

13 *Khaleej Times*, "Libya to Invest $140 billion in projects of the next decade," **http://www.khaleejtimes.com/kt-article-display-1.asp?xfile=/data/uaebusiness/2013/June/uaebusiness_June19.xml&section=uaebusiness**.

14 There is considerable empirical evidence confirming this positive relationship between public investment in infrastructure and private investment. See Mohsin Khan and Manmohan Kumar, "Public and Private Investment and the Convergence of Per Capita Incomes in Developing Countries," *Oxford Bulletin of Economics and Statistics*, February 1997.

each of these projects to separate agencies with their own bureaucratic and budgetary procedures.

Libya now has an opportunity to transform its economy into one where the private sector plays an ever increasing role and the government mainly provides a supporting environment. The current government, although transitional, can lay out a comprehensive and detailed economic plan for this transformation for future governments to implement.

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