REGIONAL PROGRAM POLITICAL DIALOGUE SOUTH MEDITERRANEAN

No. 5

OIL, BANKS, AND GOVERNANCE: ECONOMIC REALITIES IN A DIVIDED LIBYA

AUTHORS: Dr Barah Mikaïl and Simon Engelkes

Despite limited improvements, the Libyan economy still lingers well below its potential, obstructed by continuing violent conflict and political uncertainty. Libya's poor economic performance is evident in the numbers, and it is rendered even more obvious by the population's claims. Many efforts – including specific policies and economic orientations - have been developed by Libya's political authorities, in the East and in the West, to try and limit the effects of economic problems on the society. However, results remain limited so far.

To contribute to a deepened understanding of the Libyan economy in its current state, the KAS Regional Program South Mediterranean in cooperation with the Madrid-based think tank Stractegia organized a roundtable within the framework of a two-year series of dialogue rounds dedicated to assess the state of play and identify a possible way forward in order to overcome Libya's key socioeconomic dilemmas and difficulties. The roundtable on 8 March 2018 in Tunis provided a platform for Libyan-Libyan dialogue by bringing together a variety of experts and stakeholders from within the Libyan economy, who exchanged their analyses and testimonials during panels on the country's oil and banking sectors, the role of the private and shadow economies in absence of effective state governance and the function of municipalities in filling the gap of public service provision.

Libya, the country with the largest oil reserves on the African continent, stopped being a stable supplier to the regional economy. Oil revenues have decreased by a quarter and despite reports of increasing production, the country lags far behind its potentials. The economic crises – seen by some of the experts present as the main motivation behind many faces of the conflict – undermines both social peace and public confidence in the state while it requires the country to stay on the drip of foreign humanitarian and development aid. Inflation accelerated, the black market is thriving, and the future challenges for the Libyan economy range from the reconstruction of the country's infrastructure and a diversification of the sources of revenue to nurturing the private sector and fighting organized crime and corruption. Thus, finding sustainable solutions for the key economic issues in Libya can be the start for a resolution of the crisis, and an emphasis on a united political economy and 'good governance' could be a catalyst for Libyan development. The expert roundtable concluded with five main recommendations:

- **Rebuild the oil and gas infrastructure**

Oil is central to Libya and its economy; it is its first source of revenue. Although diversification is important for creating a vital Libyan economy, as will be argued below, the oil industry should remain a priority considering that it still constitutes the most important source of wealth for Libya. 97 percent of state revenues rely on oil and gas production, which creates a weakness of dependency within state structures. Furthermore, disruptions in Libya's oil activity and the long-term closing of important fields – such as Mabrouk and Ghani – had a negative impact on the country's economy. Irregular production further hinders the country to rely exclusively on oil income. Despite the oil benefits that Libya expects in 2018, 22,5 billion dollars, the country's current production of 978,000 bpd (as of January 1st 2018) is low and deceptive.

The National Oil Company (NOC) is expected to have a strong role in this regard. In reality, its influence and its impact on the country's oil prospects are rather limited. For instance, the NOC has repeatedly asked national authorities to repair the production fields that have been damaged, but its query was not met with any success. The Libyan NOC is perceived as an institution that should be able to pressure authorities into taking the necessary decisions; but the reality of the NOC is one of a divided institution, unable to appear as a strong body. Moreover, political divisions at the national level make it in any case quite difficult for Libyan 'official' institutions to have their say and impose their will on actors throughout the whole country.

As a result, oil production in Libya depends on many factors that include the political context; the security situation; the question of who is in control of oil fields as well as who among the involved external actors has more influence in cooperating with Libyan oil companies. The oil production output dropped after 2011 and productivity levels broke down completely in 2015 due to the security-related closure of oil fields and general instability. The haphazard shutdowns of key fields and ports during a long blockade of oil terminals in the Eastern Oil Crescent have reduced the pressure at the oil wells. Repsol, OMV, Total, and Waha are some of the companies that make a significant contribution to both Libya's oil production and its level of exportation. Sharara, al-Fil, Wajala, and Abou Tefla, on the other hand, are important oil fields that notably participate in the country's economy. The aforementioned disruptions in oil production make it hard for Libya to project itself on the long run and to proceed with a better organization of its economic prospects. Data and statistics insist on this reality; while Libya's oil production was limited to 550,000 bpd in February 2017 given the developments in the Oil Crescent at that time, production went up to 1,01 Mbpd in July, before going down again to 917,000 bpd in December. In a country where 80 percent of the working population is said to earn a salary directly from the public sector, this creates a situation that is all too uncertain and problematic for a major part of the population.

Today, albeit producing again, oil facilities are used as "bargaining chips" for militias' financial and political demands. A lot of the production is smuggled outside of the country. Reportedly, 40 percent of Libya's neighboring countries' markets are covered by smuggled Libyan oil. Experts called upon the authorities to find other forms of social support for citizens in need than oil subsidies. Libya is currently facing a budget deficit of around 12 billion Libyan dinars between state expenditure and revenues, which barely pays the income of its beneficiaries. Thus, efforts to reconstruct oil and gas infrastructure, revive the oil sector, and unlock the exploitation potential of existing resources require funds between $46-81 billion. Experts further noted that contracts with foreign oil companies need to be reviewed "for the sake of the Libyan people" and a prerequisite for this is an environment of united institutions.

Besides the oil, Libya has one other underexplored asset: it has comfortable volumes of gas and making a better use of it would considerably back the country's sources of revenue. And this despite the fact that, like for oil, both infrastructures and the political context would need to be reassessed and to improve before Libya reaches a satisfactory level of oil and gas production. Some countries, such as Russia and Italy, have understood well the benefits that Libya's oil and gas resources could provide; but their strategy is still at the very beginning, and it needs to be completed with an official and clear grand strategy that would also suit Libya's interests.

Diversify economic activities and sources of revenue

The limited performance of Libya's economy stands in the way of a prosperous future. Indeed, most of the Libyan economy is linked to the action of the public sector, while the private sector deals with few and very modest projects. This situation adds to the lack of dynamism that prevails at the economic level, though it also generates some contradictions: systems of production are generally obsolete, the Libyan market is not competitive compared to the outside, the Libyan working force lacks training, and the constant quest for projects that would guarantee immediate benefits is simply not realistic.

Moreover, there are many factors that limit the prospects of the Libyan private sector. These include the obvious security challenges; lacks and deficits in terms of human resources; the weak performance of the banking sector; the difficulties that private companies face in the real estate sector given the lack of capacities and financial resources, as well as the lack of anticipation of existing opportunities in general.

The private sector in Libya holds the potential to diminish poverty and to play an important role in securing investment in infrastructure, electricity, water, and health care. It has been impacted strongly by the economic, political, and social factors driving further division in the country, such as the continuous fluctuation of prices. Nevertheless, in the fields of finance, health, transport, trade, and general services, the private sector seems to perform better when compared to previous years. This might give the impetus to municipalities and actors in the private sector to set up Private-Public Partnerships based on a common strategy to boost economic prospects.

During the roundtable, experts referred to "a certain chaos in the activities of the private sector in Libya" and laid emphasis on the need to create a legal framework for an involvement of the private sector in the economy. Attempts should also be made to start relying on new and alternative sources of revenue by diversifying the market and expanding industrial activity. Similarly, empowering the private sector entails an efficient strategy against the black market economy and transboundary smuggling as well as providing a more stable security environment for companies and investors.

Stabilize the banking sector, overcome divisions of the internal market, and rebuild trust in institutions

In economic terms, the true decision maker in Libya is the Libyan Central Bank (LCB). However, even the LCB hardly provides official and reliable data and statistics on the country's economy. The most recent information available dates back to 2016, and even then, not all the data available was necessarily reliable. Nevertheless, there are some indications that can help understand where the country stands economically.

From a financial point of view, the Libyan economy is divided into three main sectors: banking (83 percent), insurance (16 percent), and investment (1 percent). While inflation is said to have stood officially at 26,3 percent for the month of February 2018, in reality, inflation goes as much as five times higher. This situation comes mostly as a consequence of the activity of the black market, but also because the entire country tends to align virtually to the rates practiced in Tripoli. Businessmen and their activities also contribute to the increasing inflation, since many of them – while they keep working in their original businesses – also find interest in currency trading. Besides, Libya has a low industrial and manufacturing activity, which explains why the market is flooded by Turkish (in the West) and Egyptian (in the East) products.

With its heavy dependency on oil revenues, the economic situation in Libya was better placed before 2011. In the 2000-2010 period, agreements signed between Libya, the International Monetary Fund (IMF) and the World Bank (WB) had allowed Libya to benefit from a positive conjuncture. But since 2011, the worsening of the political and security situation had a deep impact on the country's economy. After the revolution in 2011, public funds were spent unwisely in numerous state institutions due to major expectations by the population and the budget deficit widened into the revenues from taxes and customs. In 2015, 36 percent of the central bank's reserves were used to pay for the national budget. A year later, 70 percent of the budget was drawn from the reserves. The country's currency reserves of $120-130 billion were burned at a rate of $20 billion a year, to the effect that now, only an estimated $20-30 billion are left. Bank runs and large cash outs lead to the liquidity crisis at hand today.

Experts confirmed that more than $40 billion, the "real money," are outside the banking system and about 60 percent of state expenditures go to 'officials' on its payroll. The mistrust that citizens feel towards their institutions adds to this uncertainty and results in the population squirrelling away their foreign or local printed money reserves rather than handing it over to the banks. Representatives of the banking sector present at the roundtable accentuated the need to rebuild this trust in financial structures and the Libyan dinar.

All of this led to a catastrophic economic situation fixable only though a coherent economic strategy and a set of measures coordinated amongst central and local government officials as well as stakeholders in the banking sector. Remedies to this situation exist, but they require serious political reforms and a revolution in habits. Solutions can only be straightforward, and some consider that they can only come through dispositions that would include the backing of families with giving them an additional financial aid, restricting the importation of selected products in order to increase prospects for national production, issuing a new currency so that the crisis of liquidities is limited, reducing the state control over the economy, having better state management and good governance, more effectively controlling the currency rates, unifying financial and economic institutions, starting with the LCB, and putting an end to subventions on oil products. A stable Libyan currency adequately managed by a united LCB is crucial for the future of the country.

- **Include local governance structures in economic negotiation and implementation processes**

Notwithstanding, there are some existing institutions that are able to define common priorities for the Libyan economy: local governance structures. One example with regards to infrastructure is the Committee for the Transfer of Competences of the Local Administration which has started several initiatives that nevertheless need backing by a stronger and a more determined political actor. Given that the Tripoli-based Ministry of Local Governance is, according to its own employees, not concerned about the tensions between Libya's East and West, this might be a window of opportunity that should be exploited.

As effectively governing municipalities can stabilize the country not only in terms of providing and maintaining sustainable infrastructure, local structures need to be supported, state institutions need to be rebuild, and the economic and governance systems within Libya need to be decentralized. In light of municipalities being at the heart of Libyan society and economic aspects composing the core of instability in the country, local governance should not only be on the priority list for the central government, but be enabled to bear the main responsibility in service provision.

Decentralization requires a gradual delegation of powers on the basis of municipality performance. The establishment of a Ministry of Local Governance by the GNA is thus a crucial step in supporting local sources of revenue as an alternative to the resources of the central government. Not only due to the large geographical distances between the municipalities, the local coordination of administrations is not an easy endeavor.

In fact, some of the main issues prevailing in Libya are those related to the lack of proximity, both at the level of the relation between the central authorities and the municipalities, and between political/executive structures and the society at large. Neglecting this side will only make it more difficult for Libyans to benefit from improvements in the health sector, sanitation, Foreign Direct Investments, and issues such as the future of IDPs and the impact of migration movements on the country.

This is where "changing habits" and promoting a deep, revolutionary reform of local management and governance is crucial. Thus, Libya is clearly in need of clear regulatory frameworks and policies for local governance as well as a long-term vision of how municipalities can foster local investments in infrastructure to ensure service provision, guarantee state accountability, and bring an end to corruption.

- **Dismantle criminal networks fueling a 'shadow economy' and cut economic links to militias**

The black market has evolved into the controlling element behind the prices in the whole Libyan economy. Lifting this headlock necessitates a clear strategy on how to deal with the parallel markets and an action plan in order to narrow the gaping difference between the official and unofficial currency exchange rates. Many experts agree that the only unified and most active economy in Libya today is the parallel market, which is less impacted by political disputes and conflict than the divided formal economy. Any attempt for a solution must account for the fact that there is a network of interests intertwined with all kinds of criminal activities, ranging from the smuggling of oil and other subsidized goods to weaponry and human beings, and ingrained into the socioeconomic fabric of numerous local communities.

The Libyan regime under Gaddafi exerted a certain level of control over the smuggling business. Since then, open competition has taken over and provoked local conflict. The absence of stable statehood and dominant security actors led to a professionalization of the smuggling economy and – following the spread of armed groups – required smugglers to hire personnel for armed protection which again gave rise to an informal protection market. All throughout the country and empowered by Libya's hybrid security sector, militias are fighting over control of smuggling routes; oil, gas, and transportation infrastructure; the control over borderland territory; state bodies; economic and trade nodes along the coast; and the predation of state revenues in what has been termed a war economy that depends on the dispensation of violence.

Given the fact that a lot of the liquidity in Libya is consumed by armed groups and local militias, these economic links must be interrupted by efforts to reintegrate members of armed groups into the economy and find alternatives to the central distribution of public wealth in order to preserve stability. The wealth of the militias exceeds billions of dinars and any solution requires the inclusion of the local governance level.

➢ Conclusion

Libya lacks the presence of a long-term vision for its economy and this will not change until it becomes clear who exactly is taking decisions. Infrastructure and basic social services, such as health and education, are deficient, but reverting this situation needs time, money, and foreign investors. Oil reserves are important and exploring them accurately could help overcoming the crisis of liquidity and the budgetary problems that Libya is facing. Nevertheless, while having a regular and efficient oil production is critical for the country, positive achievements also need Libyans to clearly set the responsibilities for their core institutional bodies, such as the NOC and the LCB. An often raised question in this regard is on what basis oil benefits will have to be distributed.

Libya is in desperate need for extensive economic reforms before the situation totally slips out of the hands of those still executing some influence. Accurate reforms, however, need to be based on a good assessment and a correct understanding of the current situation in the country. In order to achieve that, Libya requires effective leadership under a government perceived as legitimate by the majority of its population.

While all eyes are on Libya's – possible – upcoming elections, going to the polls might not necessarily contribute to solving the issues at hand, at least for the time being. This is where Libya will most probably need the few truly influential leaders to agree on feasible power-sharing before they develop accurate economic policies that would benefit the country. This, however, still sounds like wishful thinking for now.■

About the Authors

Barah Mikaïl is Founding Director of Stractegia and Associate Professor at Saint Louis University in Madrid.

Simon Engelkes is Libya Project Coordinator at the KAS Regional Program South Mediterranean/Tunis.

Konrad Adenauer Stiftung

Konrad-Adenauer-Stiftung e. V.
Regional Program Political Dialogue South Mediterranean

Contact person:

Dr. Canan Atilgan
Director
Regional Program South Mediterranean
Phone: +216 70 029 460
E-Mail:canan.atilgan@kas.de

Cover photo: Copyright-free image by *Image Science & Analysis Laboratory, of the NASA Johnson Space Center*.