EuroMeSCo policy brief

No. 66
6 October 2016

THE LIBYAN POLITICAL ECONOMY: POLITICAL CONFLICT, CRISIS MANAGEMENT AND STRUCTURAL REFORM

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Introduction

Since 2014, Libya has been divided by political conflict and military confrontation. The election of the Libyan House of Representatives in June 2014 marked the beginning of a series of political and military events that led Libya by late 2014 into a state of multiple-sovereignty. The inability of either faction to triumph over the other or to merely practise comprehensive sovereignty over its political and geographic landscape has contributed to worsening the situation in Libya and prolonging the conflict. As a result, Libya stands today between fierce internal militarised conflict and impotent international political solutions.

Expectedly, the political conflict in Libya and its diverse effects domestically, regionally and internationally have overshadowed the Libyan economy and the steady setbacks it has been experiencing. Libya's accumulated oil wealth has indeed prevented an economic crisis, one that would have been expected in a post-revolutionary state that witnessed Libya's pattern of revolt. However, Libya's oil wealth has also been one of the pillars of the political conflict and one of the main factors behind the internal division and the regional and international alignment and action.

It is sometimes argued that Libya's oil wealth has been a factor in undermining the extent of the country's economic crisis. International action has been mostly directed towards the political conflict and the security concerns with little attention to the Libyan economy. On the other hand, some believe that recovery of the Libyan economy depends on political stability and ending the ongoing decline in daily oil production rates. While all those arguments are appropriate and logical, they are only partly true. The recovery of the Libyan economy does depend on political stability and effective security but these factors will mean nothing if not accompanied by a structural reform process of which the Libyan economy is in dire need.

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All the figures in the different reports point to a steady decline in the performance of the Libyan economy since the beginning of the political and military conflict between the House of Representatives in the East and the General National Congress in the West in the last quarter of 2014. The decline is obvious in a number of indicators like Libya's foreign exchange reserves, the value of the Libyan Dinar, the daily production rate of oil, the total yearly oil revenue and economic growth rates. Undoubtedly, this decline is related to the political and military conflict dividing the country. However, it is also related to the structural nature of the Libyan economy and the rentier mechanism that Gaddafi consolidated within the Libyan state. Moreover, there are more problematic issues related to the obvious weakness of vital economic sectors like the industrial and agricultural sectors, the absence of an effective private sector and a pressing need to revise the subsidy system in the Libyan economy.

Therefore, an economic reform strategy for Libya must be developed on two parallel tracks; resolving the structural challenges facing the Libyan economy and the larger framework of resolving the political and military division. However, Libya also needs a more efficient system of transparency to guarantee the minimal efficiency of economic administration until the political division is resolved.

The Structural Nature of the Libyan Economy

Libya is an extreme case of a rentier state economy, a system based on the revenue generated by some of the resources owned by the state. In most cases these revenues come from foreign sources that line up to buy the rentier state's resources. Rentier economies do not depend on production as much as they depend on the distribution of the revenues and rewards of state resources. Among other characteristics of rentier economies is the decline in the performance of productive economic sectors, the control of a few over state revenue and the exclusion of the public from decisions related to the mechanisms of administration of those revenues (Mehdavi, 1970). Libya represented the classic rentier model where a select few are in charge of administering revenue while the rest of society is engaged in the utilisation of state revenues distributed by the state, without any participation in the production of the revenue (Beblawi, 1990). As a result, the Libyan state, specifically during Gaddafi's 42 years in office, was run by a "rentier mentality" where revenue and personal gain are not related to work or productivity but rather to non-objective factors like coincidence, proximity to the ruling elite, loyalty and the various political contexts that could make a rentier state implement policy changes.

The structural nature of the Libyan economy and its utter dependence on oil revenues did not just affect production ethics and social justice; it also had significant political implications. Like traditional rentier economies, Gaddafi did not depend on popular support or on a solid state structure, but rather relied on a powerful security sector that was enabled and empowered separately from the structure of social classes in society. Gaddafi's practice of the rentier mentality over a time period that exceeded 40 years has redefined citizenship in Libya on the basis of receiving state rewards in exchange for loyalty and compliance. The rentier economic structure in Libya has also created a very weak middle class, an absence of accountability and an inefficient tax system (Herb, 2005). It is important to note that Gaddafi did not pay much attention to countering the negative impact of Libya's rentier economy. Therefore, it is commonly mentioned in research on the Libyan revolution of 2011 that among the main factors that explain the revolution are the failures of the Libyan rentier state as an economic system to guarantee full employment and modernisation of the economy, and the underdevelopment of the eastern region of Cyrenaica and its marginalisation from the centres of economic and political power (Mezran, 2014).

The Libyan economy witnessed a steady rate of growth during the 1960s after the country's oil resources were discovered. Economic growth rates of the Libyan economy during the 1960s exceeded 20%, which was the highest rate in the world at that time (Vandewalle, 2016). It was during the 1960s that the Libyan economy began to rely heavily on oil revenues and ignore other economic sectors. In 1960, the agricultural sector represented 25% of Libya's GDP, a number that declined to only 5% in 1969. After Gaddafi took control in 1969, the situation was not changed. By the late 1970s Libya had multiplied its oil revenues as a result of the oil boom after the 1973 war between Egypt and Israel, relied more on imports with systematic decline in all economic sectors except for the oil sector and depended on foreign labour as a result of the scarcity of skilled labour.

The purpose of this very brief history is to demonstrate that the crisis of the Libyan economy transcends the political division. Libya's economy has core structural issues that need to be addressed in any economic reform plan in a manner independent from the developments of the political conflict.

Libya's Post-Revolution Economy: the Oil Sector Dilemma

Despite the crucial role played by the oil sector in partially sustaining Libya since the fall of Gaddafi, it was and still remains a central element in the political and military conflicts. As mentioned earlier, the Libyan economy relies heavily on the oil sector. In Libya, oil sector revenues constitute 65% of national GDP, 96% of total exports and 97% of government revenue. The political and military conflicts that took place in Libya from the struggle against Gaddafi in 2011 until the political division in 2014 have had a negative impact on Libya's oil production rates (see Table 1).

Table 1: Oil production rates in Libya from 2010-2015	
Date	Oil production rate (mb/day)
January 2010	1.6
June 2011	100,000
January 2012	1.2
January 2013	1.3
January 2014	300,000
January 2015	480,000

Source: OPEC, 2016.

This table demonstrates the close relationship between political stability and oil production rates. Since 2003, Libya has managed to maintain a daily oil production average of 1.6 million barrels per day, a rate that allowed Gaddafi to rule through a security apparatus operating under high standards of living and promising economic growth indicators. However, this revenue was not directed towards sustainable development or infrastructure reform, it was rather one of the causes of further marginalisation of the East. While government expenditure was substantial in the western region, the eastern and southern regions of Libya did not receive the same attention.

After the fall of Gaddafi in August 2011, the National Transitional Council took control of the country until the General National Congress was elected in the summer of 2012. Despite the presence of armed militias and the recurring acts of violence during that time, the existence of one central authority managed to maintain the negative influence of such incidents. The oil sector recovered much faster than what was expected during 2012 and the first half of 2013. In 2012 Libya's total GDP reached 81 billion dollars (see Table 2), a number that is 8% higher than the last recorded GDP under Gaddafi's rule in 2010 (Khan & Milbert, 2014).

Table 2: Libya GDP Annual Growth Rate	
Year	Growth Rate
2006	6.5
2008	2.67
2010	5
2011	-62.1
2012	104.37
2014	23.5
2016	-6

Source: Trading Economics, 2016.

However, the speedy recovery did not last very long, and by mid 2013 there were military confrontations between armed militias over control of the oil infrastructure. These tensions began as oil sector labour strikes to demand higher wages, a claim that the government of Ali Zidan could not fulfil. It was at that time that different militias started to exercise control over oil refineries and fields, which was a very early alarm pointing towards how weak the central government was and how inefficient its performance has become. During that time oil production rates dropped from 1.3 million barrels/day to 300,000, and oil export revenues declined from 27 billion dollars in 2012 to 13 billion in 2013.

From mid 2013 the oil sector became heavily politicised. The weak performance and the utter lack of vision of the Ali Zidan government allowed crucial oil facilities to be dominated by militias or armed groups. In more than one instance there was proof of oil exports made by individuals or by militias, interactions that did not involve the state or any of its institutions ("Libya: Armed Conflict", 2015). In fact, the oil sector was the starting point of an informal system of interaction between the legitimate government and individuals or armed groups. The Prime Minister Ali Zidan was removed from office on account of corruption in the oil sector; however, his successor Abdallah Al-Theni was not at all free of the grip of militias.

The overall performance of the General National Congress was extremely inefficient, and the decisions made at that time rested mainly on tribal, geographic and political considerations rather than any concept of national interest. By the summer of 2014 Libya had officially entered into a state of multiple sovereignty with two political and military entities in both the East and the West. Needless to say, the division had a negative effect on Libya's oil production rates and caused damage to parts of the oil infrastructure. Although the Libyan National Oil Corporation (the state institution responsible of administering the country's oil resources) has worked hard since 2014 to maintain equal distance from the various warring factions, the general atmosphere of conflict and contention overshadowed those efforts.

The division has strengthened the position of the Oil Guard militia and consolidated their control over oil facilities and their presence as one of the most important and influential militias in Libya. In November 2015, the Oil Guard militia closed down the Zwaytina port and stopped all oil exports from the port in the context of the conflict between the East and the West. The Libyan National Oil Corporation issued a statement explaining that the closure of the port is "coercive" and out of the corporation's control. The statement clearly referred to the obstructive role played by the Oil Guard militia in the centre region.[1]

Tracing the different developments in the oil sector in post-revolutionary Libya clarifies two crucial points. First, the weak military presence of the state and the non-existent security structure have allowed armed militias practical control over oil facilities. In addition to being highly corrupt and easily politicised, militia control over oil facilities created a

1 For full text of the statement see http://www.raya.com/home/print/f6451603-4dff-4ca1-9c10-122741d17432/8700ca80-a85c-4640-add0-523a0de9941a

semi-formal system of interaction between the state and the militias. This system of interaction, although originating from the oil sector, has expanded to include different dimensions of the Libyan state. As a result, armed militias did not only become an acknowledged political player but also an important aspect of the decision-making process in Libya.

Second, the political division proved to be harmful to the oil sector due to the necessity of sufficient coordination between the three regions of the East, the Centre and the West. Libya's oil infrastructure is almost equally divided geographically between the three regions. Efficient administration of Libya's oil sector requires appropriate coordination between the oil fields, the refineries and the export ports in the three regions of the country.

Expectedly, the political division and military conflict has affected Libya's status as an exporter in the international oil market. Despite the ongoing violent confrontations and the lack of domestic political consensus, Libya has to interact with the international oil market to export its only product. This hostile trade environment has increased the price of importing Libyan oil due to the increase in the costs of insurance and transportation. The overall environment in Libya is characterised mainly by uncertainty, which in turn threatens the set of interactions between Libya and the international oil market (Jowiyaa, 2015). In an economy totally dependent on oil exports, unstable interactions with the international oil market is a threat to the economy's ability to survive. Comparing economic data from 2014 and 2015 would demonstrate in numbers the influence of the political division on the performance of the Libyan economy (see Table 3).

Table 3: Key Economic Indicators 2014 & 2015

Indicator	2014	2015
Inflation Rate	2.4	9.2
Fiscal Balance (% of GDP)	-43.3	-75.3
Current Account Balance (% of GDP)	-54.8	-75.6

Source: The World Bank, 2016.

In light of the previous challenges to oil production and exports in Libya, both governments in the East and the West tried to implement economic policies to counter the setback in oil revenues. However, due to the struggle over legitimacy between the two entities, decisions like reducing subsidies on oil products or banning the import of some goods were never taken. As a result, the Libyan economy has relied on withdrawing from its foreign exchange reserves for the past 2 years. According to the figures published by the Central Bank of Libya, foreign exchange reserves were 105 billion dollars in 2013. In early 2015 the reserves were only 70 billion dollars. Moreover, the Libyan dinar has lost 35% of its value to the US dollar since January 2015 (Laessing, 2015).

It is important to be aware of the position in which the Central Bank of Libya finds itself, which is very similar to the position of the National Oil Corporation. Both institutions try to maintain equal distance from the various factions, but the very nature of the conflict in Libya undermines any effort towards objective provision of a public service. As a result, the Central Bank has had several tensions with both governments in the East and the West over yearly budgets or financial requests. In late 2014 the Central Bank refused the national budget presented by the General National Congress in Tripoli due to the expansion in subsidies. Similarly, the Central Bank refused a request by the House of Representatives in Tobroq to provide 150 million Libyan dinars ($120 million) to fund the Libyan National Army's campaign against terrorism (Mansour & Rad, 2015). However, the ongoing friction between the Central Bank and the two governments has decreased the efficiency of the Central Bank and its ability to implement or reform fiscal and monetary policies.

The fast depletion of foreign exchange reserves and the recurrent armed confrontations threaten the Libyan economy with collapse in a few years. Some spectators had pointed to Libya's need to apply for international loans by mid 2016. However, the signing of the Skhirat agreement in December 2015 brought those expectations down with generous international assistance offered to the Presidential Council and the national accord government. In any event, this does not mean that the grave threats to the Libyan economy have disappeared. However, the warring factions in Libya, whether in the East or the West, have not shown any response to or mere awareness of this threat so far. The current state of the Libyan economy points to how international economic assistance will very soon become a bargaining chip in the struggle for legitimacy and sovereignty in Libya.

Prospects of Economic Reform in a Contentious Environment

It is commonly argued that considerations of economic reform will always be unimportant as long as the military and political conflicts remain active. The rationale in those arguments rests on the simple idea that economic reform can never be implemented in a politically hostile and unsecure environment. Although there is some reason and logic within this rationale, it is not exactly applicable to the case in Libya. The ability of both warring factions to exist as military or political entities has been supported by state money withdrawn from reserves. The mere practice of sovereignty in issues like the provision of public goods and services or the monopoly of violence will not be performed by both governments in case the funding from the Central Bank is cut at any moment. The overall performance of both governments over the past two years did not create a supporting stream within the public. In other words, neither government has the sufficient resources or popular support to allow them to exist. Therefore, the economic situation in Libya is not merely dependent on the overall state of political stability; it will soon become one of the determining factors of this stability. Hence, discussing prospects of economic reform in Libya is both crucial and timely.

The Presidential Council, the fruit of a 2 year dialogue process, will soon become a major political player in Libya. Although the friction between the council and the House of Representatives is expected to continue for some time, specifically over the formation of the government, the military operation against ISIS in Sirte and the institutionalisation of different militias into one force fighting under one political leadership has further consolidated the position of the Presidential Council and the amount of leverage it has. The council and its government were promised millions of dollars and Euros by the US and the EU. However, the question remains as to how this money can be put to its best use to save the Libyan economy from collapse and to instil political stability through development and economic reform.

Answering this question requires an economic reform plan, one that takes into consideration the treatment of the structural dysfunction in the Libyan economy. Empowering the private sector will be necessary in any attempts to reform the Libyan economy. The private sector in Libya is very weak and the state still dominates most economic activity. Moreover, the laws and regulations governing private sector activity in Libya almost do not exist. In 2013, there was an attempt to draft a law allowing public-private partnerships, but the political division did not allow this law to see the light. In fact, Libya is in dire need of revised economic legislations that would help institutionalise economic activity and encourage foreign investment. In that regard, a law is indeed needed to regulate the Libyan/foreign partnerships. These procedures should help reduce the unemployment rate, which is another important step towards economic reform. Finally, administrative reform of the public sector is crucial in order for the state to be able to counter corruption and perform its basic functions in an efficient manner.

Conclusion

Despite the devastating effects of the political division and the armed confrontations, the problems of the Libyan economy cannot be summed up and treated as a mere side effect of political instability. The structural faults in the Libyan economy are much deeper than the Tobroq/Tripoli conflict. Therefore, the necessary reforms must be implemented according to a long-term strategic vision. The Presidential Council is moving closer towards political recognition and towards fulfilling the full extent of its role. However, tension between the council and the House of Representatives will be common. Moreover, the council will also face a number of renegade militias that oppose the East and the West equally. Hence, reviving the economy must be one of the winning cards that the council can use in this contentious context.

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