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Libya: Post-War Challenges

1 – Introduction

The economic, social, and political challenges Libyans will face in the aftermath of its civil war will be enormous. With the state's economic and political institutions having been weakened, Libya will need to restructure its economy. It will need to move away from excessive reliance on the state and on hydrocarbon revenues while becoming more subject to regulation, efficiency concerns and diversification required to put to work its large number of unemployed citizens. In order to make economic reforms work, Libya will simultaneously need to develop a political formula that is acceptable to different segments of the population. Finally, in support of its economic reform and reconstruction efforts, Libya will need to create a system of law and accountability that serves its citizens equitably and provides clear guidelines for its economy.

Strictly speaking, the re-construction of the institutions of the former Libya will not be necessary. Rather, Libya will need to create for the first time, the kinds of rules, mutual obligations, and checks and balances that mark modern states and modern economies.

In light of Libya's traditional distrust between different tribal groups and between the different provinces, and due to the absence of necessary frameworks and institutions to resolve differences, governance challenges in the post-conflict period will prove enormous.

Furthermore, the reconstruction of Libya will need to be both integrated and systemic, interweaving various social, political, legal, and economic initiatives that can help prevent the kind of backsliding that disparate efforts at economic and legal reform or political liberalization, if made in isolation, often provoke.

The impact of the conflict on Libya's economy will have significant ramifications on the country's economic reconstruction. The assumption in this paper is that Libya's oil infrastructure has emerged relatively unscathed from the conflict.

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2 – Background: The Economics of a Rentier State

Voluminous literature exists on the impact of large inflows of unregulated capital on the economic and political fortunes of so called rentier, allocative, non-productive, or distributive states.[1] The following contains a highly stylized account of the literature, mostly by institutional economists and political economists–meant to not only elucidate the economic problems oil exporters face, but to elaborate on how closely economic strategies and political survival become intertwined in countries like Libya, something all future economic interlocutors in Libya will need to keep in mind.

The concept of the rentier state has become a commonly accepted paradigm, albeit often a conceptually inadequate one, through which oil exporters' development has been viewed. Despite suffering from definitional ambiguities, a number of findings on so-called resource curses, and of links between the economics and politics of natural resource-led development, have become standard aspects of development debates. One set of findings centers squarely on the deleterious economic consequences of rentier-type development.[2] The most specific problem observed is the inability of governments to create what one could call "more decisive macroeconomic institutions" that allow for swift and efficient adjustment. The broader charge is that serious economy-wide distortions take place: Dutch Disease[3] and what are called institutional shifts (the distortion or evisceration of regulatory and extractive institutions in favor of distributional mechanisms that can be politically manipulated).[4]

The arguments about weak macro-economic management and Dutch Disease are sufficiently robust in the literature to not warrant further discussion here.[5] Institutional shifts, and the two-way link between institutional deficiencies and a more open political system, have been less frequently discussed. The argument is that in productive economies, the ability to extract resources has resulted in two complementary developments: the appearance of a host of regulatory institutions (including fiscal, legal and information-gathering mechanisms) to respond to the growing complexity of the state's economic organization, and the demand for representation in return for taxation.

In countries like Libya this iron triangle of extraction, institutional development and representation over time did not take place. Indeed, the country witnessed a gradual disarticulation of the country's institutional structures, and felt no need–or proved unable–to create institutional diversity. In such states rulers face minimal pressures to specify property rights[6] in order to help maximize income. They neither need to create nor monitor internal taxes to maximize income from their citizens, they do not have to worry about transaction costs, and they need relatively few agents (who can furthermore be temporarily imported) to run their economies. The direction of macroeconomic policy, as the most glaring example, becomes less subject to the need for consensus within local societies.

As long as oil revenue remains high, there is little need for individuals to influence public agencies and to help shape public policy to their material advantage. There is little incentive to actively engage the state to determine the contours of local social contracts. With citizens acting as rent takers, and there being no need for clearly articulated bureaucracies and state institutions to evolve in order to capture gains from trade, perverse growth ensues. Governmental bureaucracies—swollen as part of implicit or explicit social contracts—turn into a rentier class. Beyond that, because citizens do not contribute to the creation of wealth, they are hard pressed to argue for either a greater share of the state's distributive largesse or for reform. The atomistic tendency of this type of development, particularly at the popular level, is to create personal rather than group interests.

Also, as a result of the emphasis on distribution, rulers in oil exporting countries tend to spend inordinate amounts of time trying to promote their clients and to create supporting coalitions to stave off other claimants to the country's wealth and power. Much of this maneuvering is concealed by the way in which the country's revenues are shielded from public scrutiny. Decisions concerning economic policies, distribution and investments are, as a control mechanism, kept to the purview of small coalitions, rather than assigned to the market.

Not surprisingly therefore, distributive largesse is more often than not augmented with reliance on informal mechanisms linked to history, religion or culture.[7]

When the ruler's fortunes and existence are closely tied to distribution of revenues and to his effectiveness in managing support coalitions, economic crises invariably threaten to become political crises. As a result, oil exporters tend to postpone reform of their economies, and their existing economic institutions, that were created as a direct response to international economic forces during the oil booms. To avoid reforms oil exporters create intricate social contracts that target specific groups that are judged crucial to regime survival or that are more geared toward the general population. They consist of extensive patronage and intermediation that turn into entitlements–and that prove extremely difficult to dislodge when economic reform is needed.[8]

In the wake of Libya's unsuccessful attempts at economic reform in the late 1980s and early 1990s, most international financial institutions agreed that a far-reaching economic reorientation would have been essential in light of the country's dire economic circumstances. Economists were undecided on the reasons for Libya's unsuccessful reform attempts. They wondered whether the attempts themselves had simply been dilatory, or whether Libya's economy was structurally and institutionally flawed. The former would indicate proximate causes: a country where the policy pieces are in place, but that was underperforming relative to its factor endowments because of a lack of commitment and will. The latter is qualitatively different, and would indicate that Libya was saddled with deeper and more intransigent obstacles: weak institutions, problems of governance, and a host of socio-cultural factors (including an encrusted social contract) that effectively prevented reform. This paper argues that Libya fell squarely within the second category.

Reflecting the growing importance of institutional economics in the mid-1970s and beyond, the economic development literature, particularly pertaining to oil exporters, noted that economic growth and reform should not simply consist of an emphasis on privatization and deregulation that would endogenously create in its wake institutions as a byproduct of economic growth. But it should include—and be preceded by—an emphasis on governance and supervision, incentives, assurances about property rights, the creation of social safety nets, transparency, capable bureaucracies, and a host of other supportive mechanisms that must support reforms. This included taking into consideration a host of non-market institutions that reflect the differing social contexts within which they operate.[9] The broader lesson was that institutional solutions and appropriate policies for growth and reform are subject to and embedded within a certain political context that, unless taken into account, may doom whatever recommendations are provided. This is particularly the case—as Libya proves–in countries where calculations about growth and reform are subject to many of the larger political difficulties as outlined in this paper.

The economic characteristics of oil exporters outlined above quickly became apparent in Libya after the first sales of oil in 1961. By 1969, when Colonel Qadhafi came to power, the country already exhibited all the characteristics of an oil exporter: a dualistic economy where, beyond the oil sector, a number of other inefficient sectors and bureaucracies still employed the majority of the Libyan population. Although per capita income at $2,168 in 1969 had improved dramatically from the subsistence level at the beginning of the monarchy, the increase was almost solely due to oil revenues.[10]

When the first tentative and cautious directives for the country's economy emerged in March 1970, they were marked by a suspicion of the role of the private sector, and aimed to bring the non-oil sectors as well under state control. The country's history of crony capitalism during the monarchy had sparked much anger among those who had led the coup, and they clearly considered private entrepreneurship suspect. The private sector was, at least temporarily, retained, but the new decrees clearly stated that it could not impinge upon or contradict the economic policies of the government. It was also clear that retaining the private sector was a policy the government intended to correct when it was in a position to do so.

By the time of the first oil crisis in 1973, Libya exhibited the typical economic and political pathologies of an allocative, non-productive state:

- Regulatory deficiencies
- Pervasive rent-seeking
- Incoherent and low levels of economic regulation
- A dualistic economy
- Incoherent economic policies
- State dominance of the economy
- Excessive patronage and intermediation
- High regime autonomy
- Fragmentation of society

The economic policies of the Libyan government in the wake of the quadrupling of oil prices proved even more destructive. It is difficult in this regard to underestimate the immediate and long-term impact of the Green Book that appeared after the mid-1970s. The Green Book's economic directives led to a further weakening of whatever regulatory mechanisms the country had at the time, and it led to a more determined effort to hollow out institutions that were meant to provide coherence and guidance to economic planning. In the process a number of ancillary institutions–such as a coherent and transparent legal framework–that underpinned them were left neglected. In several cases this involved the physical destruction, the shifting around, or the actual abandonment of government ministries, planning institutes, and research centers. Where they continued to exist, their coherence was dramatically reduced, or subject to directives by the Revolutionary Committees that protected the revolution.[11]

In contrast to more mature economies where the state over relatively long periods of time develops and fine-tunes a set of regulatory, extractive and distributive mechanisms to guide economic development, in Libya this evolutionary process was curtailed and undermined by the stipulations of the Green Book. Ideological considerations, together with the power afforded by rapid inflows of capital produced a curious example of a centrally unplanned state: a state where a panoply of social, economic and political challenges far outstripped its capabilities and its ability to address them. As a result, wholesale "management" and extensive patronage and intermediation became a dominant feature of the economic landscape.

Access to the tiny circle of trust at the highest decision-making level provided intricate channels for economic largesse and distributive purposes, while the regulatory and legal capacities of state and economic institutions—already weakened by the initial state-building processes described above–tended to remain inefficient and underdeveloped. The lack of economic data in Libya, the physical destruction of state bureaucratic offices and records, and the state's sporadic, direct intervention in issues ranging from employment to price setting to property rights issues were all shortcuts–signs of regulatory weakness.

The Libyan economy thus grew in a peculiar fashion as a result of how its revenues were obtained. The questions that are at the heart of every political system were historically less pressing to the Libyan government: how revenues are gathered, what compromises the ruler must make with his subjects to obtain them, which institutional capabilities the state needed to develop this task, and how those institutional arrangements reflected the interests of both ruled and ruler. The result in Libya was the emergence of a state that was seemingly highly autonomous, but without much regulatory capacity, exacerbated by an official ideology that celebrated this hollowing out of state power and regulatory capabilities.

As Libya's efforts at reform–in 1987, after 1990, and after 2003–would show, the legacy of this avoidance of creating modern institutions for economic management would cast a deep shadow. Efforts at sustained economic reform throughout the world have shown that moving toward markets, under conditions where there is no real history of them, requires careful and greater regulation by the state. This implies not simply handing over everything to the market but at least, initially, a greater willingness of the state to get more involved in regulation. For reasons that closely linked economic strategy to regime survival, Libya at several junctures deliberately stepped back from this kind of regulation and from creating or maintaining state institutions that could have established such regulation.

It explains why a seemingly very powerful state like Libya, capable of determining the minutiae of its citizens' lives, did not, as this paper will argue below, have the capacity to successfully implement reforms at the end of the 1980s and during the early 1990s. And it also makes it clear why the proposed reforms continued to create such resistance after 2003. The reasons clearly lie within the broader social and political structures within which Libya's economy is embedded. The country's institutions, often created as a direct response to international economic forces during oil booms, appeared inflexible and undifferentiated to deal with fiscal crises that threatened previous distributive policies. In Libya, as in all oil exporters, economic crises and economic reform threaten to become profound political crises–and hence rulers tend to avoid or circumscribe them.

In summary, oil revenues produced the usual rentier economy pathologies in Libya–and the Green Book exacerbated them: low and inconsistent regulation, overcentralization of economic power in the hands of the regime, Dutch Disease, lack of diversification, high inefficiencies, and extensive patronage. These negative developments were heightened even further by an insistence that the institutions of a modern state were inappropriate and should be abandoned. State intervention in the economy nevertheless was pervasive but primitive: it dominated all manufacturing, agriculture, foreign and domestic retail trade; banking, insurance, as well as major services. State trading companies were in charge of all industrial, manufacturing and agricultural imports. The government furthermore intervened indirectly through interest-free credit, state spending, subsidies, and price manipulation of goods. By 1987 an estimated 70-75 percent of all Libyans were government employees. The creation of state supermarkets extended state control down to the retail level.

3. Economic Reforms in Libya

Early Reform Efforts

In 1987, in the wake of the US sanctions, Libya embarked upon its first wave of reforms.[12] These reforms centered around the introduction of tashrukiyya (self-management) enterprises that allowed for the creation of cooperatives despite the earlier injunctions of the Green Book against private enterprise. Within one year, approximately 140 medium- and small-scale enterprises were created that, at least in principle, no longer enjoyed state subsidies. Simultaneously, the ban against the retail trade was lifted, allowing private shops to re-open. In September 1988, the state's monopoly on imports and exports was abandoned, as well as subsidies on tea, flour, salt, and wheat. Farmers' markets – officially abandoned but reluctantly tolerated during the revolutionary decade – reappeared. Professionals were allowed to resume private practices, even though the government maintained its role in setting fees.

The range of measures taken after 1990 were meant to reinforce and extend this earlier wave of reforms. Private sector enterprises were now allowed to "take the burden off public institutions."[13] The new regulations suggested the closing of unprofitable state enterprises, the imposition of higher fees for state-provided services like water and electricity, and a reduction of the number of state employees. In a decision that some Libyans viewed as a means to further provoke de-politicization, there was also a further populist measure: a decentralization of the country that would shift the administrative burdens and expenses away from the major coastal cities into smaller administrative communities responsible for their own budgets.

The country's legislature (General People's Congress–GPC) simultaneously adopted a number of laws that provided for joint-stock companies, creating the ability to open foreign currency accounts and to obtain import permits for private companies. For that purpose, a number of state and commercial banks were created. Hoping to capture some of the capital flows that sustained the informal economy, special laws were passed to offer protection for reinvested capital. The second wave's final directives, in the Spring and Summer of 1993, focused on efforts to promote tourism – hoping to capitalize on the country's desert and archaeological sites – and to provide greater guarantees for foreign investment. Convertibility of the Libyan dinar was taken up by the GPC in January 1994 but remained unaddressed.[14]

At the surface, the number and range of measures suggested in the adopted legislation would have made the Libyan infitah (liberalization) one of the most dramatic in the region's history of economic reforms during the 1980s and 1990s. It would also have dramatically recalibrated the position of the state within the economy and, by implication, altered the way in which economic patronage could be used for political objectives. Starting in early 1988, Libya's official gazette and the GPC proceedings included a wide array of regulations meant to speed up the reform process.

The reality, however, contrasted sharply with the proposed intentions. Most of the adopted laws were never implemented although some private traders returned–suspicious and reluctantly–to re-open their businesses. Few proved willing to take serious risks amidst the remaining uncertainties and unpredictability of economic and political life in Libya. They opted instead for small-scale economic activities – usually of a service nature – that carried low risks and required little private investment. There was no evidence that the new tashrukiyya enterprises ever operated as envisioned. There was similarly little evidence that a real retreat of the state had taken place. Although some subsidies were lowered, the proposals for increased fees for government services were never implemented. Whatever cutbacks took place were often put on the shoulders of the country's foreign labor, in effect protecting the country's own consumers.

From 1987 through 1989 Libya consistently ran trade deficits that were only turned around by rising oil prices in 1989 when the country's current account moved once more into the black, bringing its international reserves to $5.8 billion. Despite the announced changes in the country's banking system, the Jamahiriyya's commercial banks were non-functioning, and would only be revived almost fifteen years later. Banks in general supported public enterprises at the behest of the ministries to which public enterprises were consigned – and thus indirectly at the discretion of the government.

In effect, liberalization's impact could perhaps best be described as a subterfuge – where a hesitating, newly created private sector was allowed to provide and distribute what the state through its inefficient distribution system of state supermarkets could not deliver to Libyan citizens, leaving the state in charge of the distribution of welfare provisions. As a result, by the mid-1990s Libya was filled once more with the kind of consumer goods and food supplies it had enjoyed before the revolutionary decade. The lack of confidence in the local economy, however, was demonstrated by the fact that for most everyday purchases the US dollar had become the currency of choice.

Government pronouncements further added uncertainty. The Leader noted that Libya's attempted reforms only represented failure, and would lead to a new form of economic colonialism.

Reforms in Libya Since 2003

In retrospect, the period between 2003 and early 2011 would mark Libya's most significant attempt at reforming its economy–but it would once more be significantly circumscribed by the politics of the regime. The country found itself at a particularly important fork in the road. On the one hand, it could pursue the type of state-led market reform that relied on cooperation between the state and a number of business coalitions. Alternatively, Libya could pursue economic liberalization and reform while moving away from what one could conclude as a patronage-driven and patrimonial system of the past.

In January 2002 already, the country had announced its intention to open up its economy further and to attract foreign capital to the country. For that purpose, it unified its exchange rate, pegging the Libyan dinar to the IMF's Special Drawing Rights, in effect devaluing the country's official exchange rate by more than half as part of a strategy toward unification of the country's multi-tier (official, commercial, black-market) foreign exchange system. The devaluation was also meant to increase the competitiveness of Libyan firms and to help attract foreign investment into the country. The same month Libya cut its customs duty rate by 50% on most imports, hoping to offset the effects of its currency devaluation.

In March 2003, the General People's Congress adopted legislation meant to augur in the country's third attempt at liberalization and reform. It included an authorization to privatize a large number of the country's state-owned economic enterprises. In June, the government admitted that the country's public sector had failed and should be abolished, and called in addition for privatization of the country's oil sector. Shukri Muhammad Ghanem, known as a proponent of liberalization and privatization, became Prime Minister. After a period working at OPEC, the Prime Minister clearly saw his task as removing, as much as possible, the inefficiencies that the state-controlled economy had created in the previous decades.[15]

The Energy Ministry was restored and the Libyan National Oil Company (LNOC) negotiated the return of the Oasis Group (Marathon Oil, ConocoPhillips, and Amerada Hess) to their Waha and Zueitina concessions, a move that was meant to send reassuring signals to other US oil companies.

After decades of avoiding the advice of international financial institutions, the country also accepted its obligations under Article VIII of the IMF's Articles of Agreement and in October 2003 released the details of the IMF's first Article IV consultations which called, among other issues, for wide structural reforms, improved macroeconomic management, and the removal of trade barriers and price subsidies. The IMF report in part informed the deliberation and adoption of a number of the economic directives taken up by the General People's Congress in March 2004. The same month a list of 360 state-owned companies that would either be privatized or liquidated was published.

Over two decades of sanctions, the combination of the country's economic legacy of a widely perceived inefficiently state-run economy, together with economic and political hardships engendered by those sanctions, had increased internal pressures from a burgeoning younger population with scant possibilities of meaningful employment. Libya's unemployment in 2003 was estimated at 30% and in 2004, 862,000 Libyans still depended on the state for their livelihood. Libya needed outside investment and expertise for new oil and natural gas exploration, and for restoring or updating some of the oil industry's industrial and oil infrastructure which the LNOC readily admitted was outdated.[16]

Libya's objectives under the economic reforms were clearly spelled out by the Prime Minister:

"The strategies and initiatives that we are taking... [are] trying [to create] a new and comprehensive architecture for the national economy... [which includes] a lot of incentives to foreign investors, such as tax exemptions in the first few years, a major cut in corporate taxes, establishing a free zone in Misurata [Misrata] and opening the capital of public companies for foreign investors... [and] to cut down mismanagement and corruption and of course bureaucracy."[17]

The practical measures in support of the new strategy were adopted by the General People's Congress at its March 2004 annual meeting. In addition to the 360 companies singled out for privatization, the new measures included extensive banking sector reform and the introduction of private banks. The proposals also encompassed tax reform, the creation of a stock exchange, newly relaxed rules for foreign companies investing in Libya, and a plan to promote the country's almost non-existent tourist sector.

The technical language of the IMF report at the time summarized the challenges Libya would face as it embarked upon the proposed reforms: *"The key challenge facing the authorities in the medium and long-term is to achieve sustainable high rates of economic growth to generate employment opportunities for a rapidly growing labour force. The authorities agreed that this goal would not be achievable without a drastic reduction in the dominant role of the public sector ...*

Unemployment, which may be as high as 30 percent, remains one of Libya's greatest problems, with the bloated state sector unable to accommodate the many new job-seekers produced by the fast growing population. Until private sector reform starts delivering tangible results, the problem – compounded by the 1997 move to open Libya's border to 2 million African immigrants – is only likely to worsen."

The IMF urged the Libyan authorities to move toward greater budget transparency and to cast the country's budget within a coordinated medium-term framework that would take into account the non-renewable nature of Libya's hydrocarbon resources.

Although the new reforms asked for greater diversification of Libya's economy, the hydrocarbon sector would once more be called upon to provide the necessary revenues. By 2003, only one quarter of the country's territory had been seriously explored for oil and, except for one patch along Libya's western coastal area, only one area for offshore drilling. Both the Libyan government and international oil companies expected that the country's proven reserves of 30 billion barrels could easily be raised to 130 billion barrels, clearly making Libya one of the top three investment destinations worldwide for oil companies.

In 2003 Libya was exporting roughly 1.5 million barrels per day, significantly less than its 1970 production. The LNOC now wanted to increase production to 3 million barrels per day – the equivalent of its 1970 production – but admitted that Libya needed roughly $30 billion of FDI to do so, $10 billion alone by 2010. In addition, plans were developed to extensively explore the country's enormous natural gas deposits – increasing production for export to 40–50 billion cubic meters per year within ten years – and to update the country's Liquefied Natural Gas (LNG) infrastructure which was limited to one liquefaction plant at Marsa al-Burayqa. In order to encourage investment in the hydrocarbon sector, Libya carefully designed a new set of Exploration and Production Sharing Agreements (EPSA IV) that, judging by the enthusiasm with which international oil companies flocked to Tripoli, proved once more the attractiveness of Libyan oil.

The awarding of the EPSA concessions in January 2005 revealed Libya's priorities. Eleven of the fifteen oil exploration licenses went to US companies, including Occidental, Amerada Hess, and Chevron Texaco. Clearly, one of Libya's priorities was to have United States firms closely involved once more in the country's oil industry, even if doing so seemingly came at the expense of the European companies – particularly French-owned Total – that had supported the country during the sanctions period.

That same month, at the Davos World Economic Forum, a vast reform program for the Libyan economy was announced in these terms,"the old times are finished and Libya is ready to move onto a new stage of modernization… [which] will be conducted in a well organized manner that ensures new ownership and ownership by the people of Libya, not just a small class of oligarchs." It was added that Libya had recruited some world experts to help in the effort, and conceded that" [t] here may be some reaction against them in Libya, but they are the best."[18] Following this announcement, the publication of the *National Economic Strategy: An Assessment of the Competitiveness of the Libyan Arab Jamahiriyya* by the Monitor Group was meant as an overall blueprint for future Libyan development.[19]

The Monitor report provided the first country-wide outside review of Libya's economy since the revolution. It not only summarized the purely economic challenges of the country, but also alluded to the non-economic considerations–lack of a positive environment, of trust, of lack of incentives, of regime security concerns– that had kept the Libyan economy in a state-dominated straightjacket.[20] It proposed "A Vision for Libya 2019" that would make the country a regional leader in development. It suggested a number of areas, dominated by the country's energy sector, that could lead to diversification, employment opportunities, and growth: tourism, agriculture, construction, and transit-trade–and of clustering economic activities within those sectors for greater efficiency. And it reiterated that Libya showed all the economic and social pathologies of a distributive state: low productivity, neglect of sectors outside the energy revenue-producing sector, obstacles to private entrepreneurship, a non-transparent business environment, weak legal statutes, "bad" bureaucracies, the inefficient use of the banking sector, the neglect of FDI, a host of governance and regulatory weaknesses and, as a result of the latter, the omnipresent patterns of patronage and informal transactions.

The report recommended the establishment of an Economic Development Board, gingerly suggesting that one of the key challenges in Libya centered around "defining the role of government in facilitating wealth creation" in a fashion that goes to the heart of the argument this paper makes about its possible reconstruction:

"The New Economic Strategy Project aims to move Libya from a distributive economy with under-developed institutions to a unique mixed economy model that balances market mechanisms with the values [of the Green Book]... The government has a major role to play: creating political and legal stability, an efficient basic infrastructure and strengthening both the macroeconomic and microeconmic environment for private enterprise to prosper. This will be a critical issue in the Jamahiriya, where state legal and regulatory institutions traditionally have been weak."[21]

And it pointed at precisely the nexus between patronage and state resources that add to the difficulty of reform in distributive states like Libya:

"... there is typically resistance to change from those who benefit from the distribution of revenues from natural resources such as oil, import licenses and other government-granted privileges. On the other hand, those in government may also be wary of economic reform, knowing it will create new power centers in civil society which do not depend on government patronage."[22]

In the years following the Davos speech and the publication of the Monitor report, the Libyan government embarked on an ambitious set of initiatives to reform the country's economy by reducing the public sector, adjusting employment patterns, promoting diversification, and creating greater transparency and regulatory mechanisms. Salaries for government employees and those working in state-owned companies, after being frozen for decades, were raised substantially. Several major companies, including banks and the country's mobile phone sector, had been selected for privatization. Many of the onerous requirements for business visitors were eased, and custom tariffs on a whole range of goods and commodities reduced or abolished. Local technocrats investigated the possibilities for increasing the efficiency and attractiveness of free economic zones along the coast. Domestic fuel prices were allowed to rise, and traditional subsidies for water and electricity were reduced.

As suggested by the National Economic Strategy plan, the Economic Development Board was established in early 2007, and was meant to coordinate, speed up and oversee the different privatization and liberalization initiatives. As always in the past the oil and gas sector had been the recipient of the most prudent, independent advice, further indicating the privileged position it enjoyed in the country's economy.

But the resistance the proposed reforms generated proved enormous.[23] The removal of the prime minister in March 2006 marked the beginning of a marked slowdown of the reforms.[2] This was perhaps not so surprising, the proposed reforms entailed a substantial upgrading of the state's ability to regulate in order to, down the road, augur in a more de-regulated economy. It was clear from unfolding events during the period that many of the regime's most powerful economic clients preferred to retain the old structures.[26]

As was noted at the time, the most essential questions regarding the long-term feasibility of real reform had not changed:

"How far can these reforms take place in a political system where extensive patronage has been part and parcel of political survival for so long? How does a state where unchecked leadership has been such a dominant feature of politics respond and adapt to a slow process of more effective bureaucratization that inevitably accompanies real economic liberalization, and that would inexorably reshape the interaction between the Libyan state and its citizens? Fundamentally... the two essential questions Libya faces in its latest attempt at reform–neither of which is inherently easier than the other—is whether to create viable institutions beyond the coercive and distributive ones that can then guide the economic reforms, or whether to reform and adapt existing institutions to reduce powerful coalitional and patronage systems?"[27]

The 2003-2011 period clearly and unambiguously provided answers to those questions. And the government's own pronouncements on the country's economic strategy, reflecting political and security considerations at the expense of economic ones, proved unhelpful. The Leader continued to show a strong personal suspicion of the new economic plans. Where the National Economic Strategy had urged diversification into health, tourism, construction, and other non-oil projects, he derided the presence of foreigners in the country, arguing that they drained Libya of its resources. This was followed soon afterwards by a number of speeches in which the Leader took his own citizens to task for their dependence on oil revenues, expatriate labor, and on massive imports, then later urged Libyans to start manufacturing the goods they needed.

In March 2008 the country's cabinet was dissolved because it had failed to distribute the country's revenues adequately to Libyan citizens,[28] and the idea to distribute oil money directly to all Libyans was reintroduced.[29] Finally, in a move that augured badly for the new economic approach, several businessmen were arrested on the grounds that they had violated the principles of the Green Book's people's socialism.

While it was also clear that these pronouncements were unlikely to derail the larger initiatives the country had embarked upon, they reinforced the uncertainty that had long prevailed in Libya and that made individuals suspicious of becoming entrepreneurs. As a result, they further slowed down the needed changes in the five areas identified in the National Economic Strategy plan within the non-hydrocarbon sectors. In many ways, the differing pronouncements on Libyan economic reforms at the highest decision making levels were good indicators of the larger, more structural obstacles at hand.

Despite this inevitable slowdown, Libya's economy continued to show slow and incremental improvements toward greater efficiency in its regulatory capacities. By end 2010, the country had made some progress in creating the statutes necessary to implement some of the reforms, leading to the adoption of a series of major laws governing economic life that were adopted after 2003 (See Box 1).

Box 1: Recent reforms in Libya

- Creation of the Tripoli stock market in March 2007, meant in part to speed along the privatization of public companies.
- Creation of a more streamlined banking system, with the privatization of the banking system and foreign investment as majority stake holder starting in 2007 (Sahara Bank).
- Reduction of the minimum investment threshold from $50 million to $1 million in 2006.
- Creation of the Libyan Investment Authority as the country's sovereign wealth fund.
- August 2009: establishment of the Privatization and Investment Board, meant to establish a one-stop shop to streamline business license applications, and to instill greater investor confidence.
- New income tax (January 2010), flat rates of 10 and 20 % for individuals and corporations.
- Creation of an Export Promotion Center to boost trade, and to boost agriculture, light manufacturing and under-promoted sectors.
- The establishment of a centralized export center at the Tunisian border to help market Libyan products in regional markets.
- Legislation that would push forward attempts to have the Tripoli airport and free zones on the coast act as regional hubs.
- Legislation in support of tourist projects around Cyrene and other archaeological sites.

Also by 2010, a further plethora of stipulations regarding Commercial Law, Customs Law, Income Tax Law, Stock Market Law, Labor Law, Communications Law, Land Registry Law, and laws regulating the activities of the Libyan Investment Authority had been adopted. The IMF's 2010 Article IV Consultation's preliminary conclusions that year reflected both the positive side of these developments, but once more underscored the persisting lack of reliable data, the continued over-reliance on hydrocarbon revenues, and it hinted at the broader governance issues that persisted.[30]

In sum, though the 2003-2011 period saw some improvements in reforms, the period carried some contradictory messages that demonstrated the political pressures to which the reforms were subjected:

- There is little doubt that compared to its previous attempts at economic reform, Libya had made progress, and that slowly pockets of greater efficiency, of more consistent regulatory practices, and of adherence to international norms were emerging.

- Diversification and privatization of the economy lagged far behind. There was little evidence that either the Export Promotion Center of the Privatization and Investment Board had produced noticeable results.

- The country's institutional and legal frameworks remained highly opaque; the business environment remained in most instances unpredictable.

- Ideological proclivities continued to play havoc with the implementation of the planned reforms, particularly since there were no formal (and only weak informal) mechanisms to reduce their impact. The climate of uncertainty and ineffectiveness that had somewhat diminished, but never disappeared, kept hampering progress.

- Overall coordination remained weak, decision-making remained fragmented, and there were clear signs that the power of intermediaries and brokers—had increased.

- The economic reforms remained to some extent non-institutionalized—with no official representation, and plans did not carry the imprimatur of the country's existing political structure.

- In some of the main areas the National Economic Strategy had identified as priority areas–human capital, education, and unemployment–very little progress had been made.[31]

4. Reconstructing Libya: Post-conflict Realities and Economic Planning

This paper so far has analyzed the characteristics of Libya's economy as it emerged and was managed until early 2011. Its main arguments were that for a number of reasons related to how Libya emerged, to the role oil played in its development, and due to the impact of ideological beliefs, the country's economy continued to show economic disequilibria, and appeared to remain subject to political manipulation at the expense of economic expertise. While the country after 2003 moved slowly toward a more rational management, the momentum of reform had started to slow down and Libya was essentially stagnating at the eve of the February 2011 uprising.

In thinking about reconstructing the Libyan economy in a post-civil war situation, there are three points to make:

(1) The emergence of a new government will make possible the rethinking of the future of Libya's economy.
(2) The realities of Libya's economic development described in this paper, the physical damage inflicted by the civil war, as well a number of social and political legacies related to the civil war and how it is eventually settled will have a major impact on how deep and lasting economic reforms will be.
(3) The replacement of the current government will not deus ex machina obliterate the patterns of patronage in existence since 1969. Only a restructuring of political and economic institutions can achieve that goal, and undoubtedly many individuals in Libya will want to maintain the old structures to preserve their own patronage and power.

These necessitate not only obvious changes to how the economy of Libya has been managed, but also to the broader political and social structures that must underpin and inform those new economic initiatives.

As in many countries where the state has played an overwhelming role, in Libya the state's challenge in a post-civil war economy will be to provide enough regulatory energy to eventually reduce its own role for the benefit of private initiatives. Since the central and uncontrolled inflows of oil revenues have been at the heart of what fueled the patronage–, the management of these revenues and the checks and balances of budgetary oversight and control will be the most critical element for Libya's economic reforms. Undoubtedly there will be disputes over what kind of institutional expression this should assume–whether in a federal or a unitary system–but the ability to prevent "leakage" will be crucial in preventing "defection" from taking place.

What the reforms after 1987, in the 1990s and (to a lesser extent after 2003) made clear is that without state support for the creation of the larger institutional settings within which economies "moving toward market" operate, those reforms are bound to fail or will be highly inadequate and inefficient. The new Libya therefore will need to provide sufficient guarantees on a number of issues in order to escape the patterns of the past: beyond the hard constraints of macroeconomic stability, a sufficiently clear system of property rights and contract enforcement for individuals and companies alike, mechanisms to avoid anti-competitive behavior, ways to promote trust and cooperation, and social and political institutions that can mitigate social conflict. The bottom line is that given Libya's particular history incentives alone will not work in preventing coordination failures. In Libya the absence of institutions that can prevent coordination failures–rule of law, an independent judiciary, independent labor or social groups, any type of social partnerships–have been conspicuously absent over the last decades.

Beyond these larger regulatory and institutional issues remain the practical realities that, as the National Economic Strategy pinpointed, need to be addressed. The first concerns labor. Formal employment in Libya consists of 43,000 people in the oil sector, but 840,000 in public services. The energy sector contributes 60% of Libya's GDP but employs only 3% of the formal workforce. Public services, including healthcare and education employ 51% of the formal workforce, but only contribute 9% to GDP. The country's informal economy provides as much as 30-40% of the official GDP while formal employment is marred by "welfare employment"–one third of the country's 200,000 primary school teachers and 30,000 nurses on government payrolls are inactive, but enjoy monthly salaries. At the same time there is massive over-employment, estimated at 30-40% in banking sector, hotels and utility companies.

Diversification, trade, and entrepreneurship therefore will remain high priorities for any future Libyan government. The clusters suggested by the National Economic Strategy–energy, tourism, agriculture, construction, transit trade–certainly provide a focus worthy of attention but, as the Strategy also points out, will need substantial modifications to the current business environment (The General Planning Council of Libya, 2006).

Libya–in spite of the revolutionary rhetoric–has always managed and operated its energy sector, and particularly the LNOC, in a professional manner. Its actual management and recruitment were virtually immune from the revolutionary diktats and from the patronage across the years.While neither professional management nor expertise is at issue, Libya's oil/gas/energy sector nevertheless faces a number of difficult tasks. In addition to damage suffered during the civil war, these will include a need to substantially upgrade the country's refineries, to determine the pace and scope of further investments in the sector, to fund and expand upstream oil and gas activities, and to rethink the role of fuel subsidies in the country's economy. These actions would necessitate changes within the sector's organizational practice and to institutional arrangements within the country. This will require greater coordination between the LNOC, the General Electricity Company of Libya (GECOL), and the country's Energy Ministry–a task that will likely need an independent oversight and management team. Part of the discussion will need to be fuel price subsidies to reduce local demand and to halt actual subsidies that by the beginning at 2011 were perhaps as high as $7 billion.[32]

As in many oil exporting countries, issues of manpower and adequate training and education have been notable characteristics of development in Libya. Except at very select top institutions like the LNOC and the Central and commercial banks, Libya lacks not only a sufficient number of professional managers but suffers as well from their lack of exposure to international norms and standards that can make companies more efficient and more likely to be competitive. There is a great need for both intra- and inter-sectoral training that needs to be integrated with wider planning initiatives. Together with the relatively "clean management" of the energy sector, Libya's banking system–still largely government-owned–until the civil war of 2011 presented a moderately optimistic picture. The restructuring of the state-owned commercial banks and the privatization in the sector after 2006 had achieved some traction.

By 2011, two of the five public commercial banks had been privatized, with options for foreign investors to eventually purchase up to 51%. Two other commercial banks merged shortly afterwards, and Libyan officials were intent on privatizing the last commercial bank through the stock market. At the same time both the United Arab Emirates and Qatar were engaged in the creation of two new banking groups. Although there was hope at the time that these changes would lead to a further opening up of the sector, analysts warned that some structural issues remained.

5. Strategic Options

When the uprising started in February 2011 the question of whether the voices for reform and effective state consolidation in Libya could effectively coalesce into an integrated channel for continued and meaningful reform remained unclear. While there are undoubtedly signs of pragmatism and a realization among Libyan policymakers for the need for greater efficiency, the country's system of governance remains immovable. With new windfalls from an expanded oil sector flowing into the country, the lack of institutional checks and balances should be the first focus for any reconstruction. The remaining bifurcation between the formal and the informal sectors in the country's political and economic life remained a notable feature of Libya's political economy that had a daily impact on the management of the country's economy.

Under a new government, many of these larger issues of governance will not seem as insurmountable–but decades of structural inefficiencies and widely perceived patronage may prove very difficult to remedy. And although it is still difficult to envision the exact conditions under which the reconstruction of Libya's economy will take place, there are a number of observations we can make, irrespective of those eventual conditions:

- The hard constraints of macroeconomic stability, efficient and transparent budget and sovereign wealth fund management will be a critical, early component of Libya's economic recovery. Particularly in light of disclosures of poor management and lack of checks and balances regarding the country's budgets and its Sovereign Wealth Fund assets in the past, better and more transparent management will not only improve economic performance, but will also provide a measure of trust needed for broader reforms. International expertise can be a valuable aspect of these critical early measures.

- As in most post-civil war countries, Libya's needs in terms of economic and reconstruction expertise will essentially be limitless. This will be particularly the case if the oil/natural gas infrastructure and production facilities are severely damaged or destroyed. The key to reconstruction will be political governance matched by economic reconstruction and by legitimacy for those in charge of the post-conflict governing structures. The ability to synchronize these requirements will be difficult but indispensable.

- Development of an early and detailed, rigorous economic recovery plan that Libyans themselves can manage is critical. For this purpose a proactive set of policies to involve the key players is crucial. In light of the country's history, Libyans will be skeptical of prolonged international presence–whether for humanitarian, economic reconstruction, or aid purposes. Part of this will undoubtedly necessitate the creation of a legal and constitutional framework that makes economic development and equity possible to all Libyan participants.

- There is a need to prevent the realignment of the economic strategies of the different parties currently engaged in the conflict. Civil wars tend to realign local societies and local economies, and unless forcefully resisted, tend to perpetuate pre-civil war cleavages. It is likely that the informal networks of economic power in the country will persist. This applies not only to members of the regime in a post-civil war situation, but also for those rebels who may not find a place in whatever new, formal structures emerge. Pre-existing economic elites almost invariably tend to persist alongside whatever new formal political and economic institutions emerge.

- A crucial component will be the recruitment and retention of competent personnel and bureaucrats from the pre-civil war period, to help break the perceived traditional patterns of patronage through greater transparency and rule of law. This is particularly important since, even if some of the current personnel and bureaucrats are replaced (as seems likely except perhaps at the National Oil Company, the Central Bank, and some of the other ministries), many of the old regime's economic modus operandum will tend to persist. This hints once more at the strong structural characteristics of rentier states, where both the functions of the state and the expectations citizens have of that providential state, become part and parcel of a patronage system, that both old personnel and new personnel find attractive to maintain stability.

- Expertise in providing frameworks for mediating and settling disputes related to new development strategies will be most useful for Libya. Sustained economic reform/reconstruction in economic systems where extensive patronage and very high levels of intermediation by the state have marked earlier development strategies requires consistent energy and political commitment that more often than not recalibrates the economic and political fates of those who were instrumental in controlling the original strategy. Since in the Libyan case those original actors may no longer be on the scene, this should be an opportune moment to move forward.

[1] Among an abundance of sources, see Jacques Delacroix, "The Distributive State in the World System," Studies in Comparative International Development, 15, no. 3 (Fall 1980), Hussein Mahdavi, Kiren Chaudhry, Thad Dunning, *Crude Democracy: Natural Resource Wealth and Political Regimes* (Cambridge Studies in Comparative Politics, 2008), Hazem Beblawi and Giacomo Luciani, eds. *The Rentier State: Essays in the Political Economy of Arab Countries* (London: Croom Helm, 1987), Rudolf Hablutzel, *Development Prospects of Capital Surplus Oil-Exporting Countries: Iraq, Kuwait, Libya, Qatar, Saudi Arabia, UAE* (Washington, D.C.: The World Bank, 1981), Hossein Mahdavy, "The Patterns and Problems of Economic Development in Rentier States: The Case of Iran," in M. A. Cook, ed., *Studies in the Economic History of the Middle East from the Rise of Islam to the Present Day* (Oxford: Oxford University Press, 1970). For Libya and for a more extensive bibliography, see my *Libya Since Independence: Oil and State-building* (Ithaca: Cornell University Press, 1998).

[2] Leite and Weidmann (1999); Sachs and Warner (1995, 1999); Auty et al., (1995) Auty (2001); A slightly different interpretation can be found in Ross (2001)

[3] From among the voluminous literatures, see Timmer (1994)

[4] As a shortcut, and for the purpose of this chapter, these subsidiary institutions may be divided into five categories: regulatory, coercive, participatory, extractive, and distributive.

[5] For an excellent summary of the arguments and an evaluation, see Ross (1999)

[6] Hence the efforts of most Gulf Cooperation Council countries, for example, during the last decade to increasingly clarify and extend property rights and "rules of the game" for the sake of attracting international capital without, however, providing the same clarifications to their own citizens-- a phenomenon that applied to a lesser extent to Libya as well.

[7] The invention and re-invention of tradition and the use of history by the power in place as a means to greater legitimacy was very widespread.

[8] For a more in-depth discussion of these social contracts and their link to more general economic reform, see Dirk Vandewalle, "Social Contracts, Institutional Development, and Economic Growth and Reform in Middle Eastern Oil Exporters," written for the World Bank, 2006.

[9] *The World Bank* (2000)

[10] Middle East Economic Digest, 31 August 1979.

[11] An anecdote suffices to demonstrate this infusion of revolutionary rhetoric: during a visit to Al-Fatih University at the time, the author was invited to an economic class entitled "Econometrics According to the Green Book."

[12] For the impact of the United States and then (in the 1990s) the multilateral sanctions, see D Vanderwalle *A History of Modern Libya*, chapter 6, "The Limits of the Revolution."

[13] The most public instance of the infighting between "reformers" and "revolutionaires" opposed to the reforms came at the meeting of the General People's Congress in January 2005 in Sirte where PM Ghanem obliquely argued for a more predictable political system of governance so that economic reforms could move forward. See pp. 189-192 in *A History of Modern Libya.*

[14] See the comments of Mahmoud Jibril and Matuq Matug (Secretary of the General People's Committee for Manpower, Employment and Training) made in November 2008, in "Al-Qadhafi and the Reform "Vision Thing"".

[15] In his speech before the GPC, Ghanem had implicitly called for a constitution for Libya, something the "revolutionaries" argued was not necessary.

[16] Interview with Shukri Ghanem, 16 January 2005

[17] The most recent statement by Shukri Ghanem can be found in Ivo Bozon and Giorgio Bresciani, "The outlook for Libya's oil sector: An interview with the chairman of the National Oil Corporation," McKinsey & Company, November 2010. Shukri defected from the regime in May 2011.

[18] Saif al-Islam al-Qadhafi, quoted in The Daily Star, 29 January 2005.

[19] Monitor Group, National Economic Strategy: An Assessment of the Competitiveness of the Libyan Arab Jamahiriyya (The General Planning Council of Libya, 2006).

[20] "The focus of Libya's top leadership has been on securing the country-in which it has been successful--and not so much on creating a positive business environment, which must be the next priority," National Economic Strategy report, p. 1.

[21] National Economic Strategy, p.12.

[22] ibid., pp.12-13.

[23] The most public instance of the infighting between "reformers" and "revolutionaires" opposed to the reforms came at the meeting of the General People's Congress in January 2005 in Sirte where PM Ghanem obliquely argued for a more predictable political system of governance so that economic reforms could move forward. See pp. 189-192 in D Vanderwalle *A History of Modern Libya.*

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26 "The Institutional Restraints of Reform in Libya: From Jamahiriyya to Constitutional Republic?" Paper presented at the Oxford Libya Conference, Pembroke College, 25-27 September 2009.

28 Libyan television on 11 November 2008 aired a program in which senior government officials disagreed with the leader on his proposals to disburse oil income directly to the Libyan people. Central Bank Governor Farhat BenGadara in particular warned that it woul lead to "undisciplined consumption, spark inflation, precipitate devaluation of the dinar, create a balance of payments deficit and cause a decline in real income." Cited in "Al-Qadhafi and the Reform "Vision Thing"", WikiLeaks telegram from US Embassy, 18 November 2008, published in The Telegraph, 31 January 2011.

29 Reuters, "Gaddafi says cabinet fails to enrich Libya, must go", 2 March 2008.

30 International Monetary Fund, The Socialist People's Libyan Arab Jamahiriya—2010 Article IV Consultation, Preliminary Conclusions of the Mission (Washington: International Monetary Fund, October 2010).

31 See also African Development Bank, "African Economic Outlook 2010 - Libya Country Note" (2010) and an earlier report by the National Democratic Institute for International Affairs, "The Libyan Political System and Prospects for Reform: A Report from NDI's 2006 Delegation," April 2006.

32 The National Economic Strategy report details, for example, that "GECOL's transmission and 'other' losses--essentially, nonpayment for electricity--amount to 40%." NES, 159.