



Editors: Paul Rivlin and Yitzhak Gal, Assistant Editor: Teresa Harings

Vol.1, Edition No.6, October 2011

## **The Libyan Economy and Oil Prospects as the War Ends**

**Paul Rivlin**

Muammar Gadhafi is the first leader to die and the third to be deposed in the Arab Spring uprisings. His passing following 42 years in power is of great significance for Libya and the rest of the world. Gadhafi was the first Middle Eastern leader to successfully nationalize the oil industry in his country and his example was followed by others, with revolutionary consequences for the international economy. His years in power resulted in economic development and in the massive use of terror at home and abroad that on balance left his country underdeveloped and now suffering huge war damage.

Libya is, by Middle Eastern standards, a small country with a population of 6.5 million, 50 percent of which is under 30 years of age. In 2010 the national income was \$63 billion, or \$9,500 per capita, most of which was derived either directly or indirectly from oil. Because of its geographical location and the nature of its oil, Libya's strategic importance is greater than these figures suggest.

The country's area is about 1.76 million square kilometers and its coast is 1,800 km, the longest in the North Africa. Ninety percent of the land is

desert; about 85 percent of the population lives on the coast. The Libyan economy is oil-led, as 95 percent of total Libyan exports are crude oil. Libya's oil markets are mainly in Europe and in particular the Mediterranean European countries.

Libya's imports are dominated by foodstuffs, machinery, finished consumer products, semi-industrialized products and capital goods. During the last five years, the country had a positive balance of payments. Little transparency has existed as to where the positive balances have been placed during these years. Investments abroad, in Africa, Europe and America, have accounted for part of the funds, but much remains unaccounted for.

As the war in Libya draws to a close, economic issues are gaining attention. This is both because of Libya's role in international oil markets and the need for reconstruction of the economy. Libya is heavily dependent on the hydrocarbon industry, which accounted for 95 percent of its export revenues in 2010. It has 46.5 billion barrels of oil reserves (the largest in Africa) and 55 trillion cubic feet of natural gas reserves. Natural gas production rose sharply between 2003 and 2009 when it reached 1.034 billion cubic feet, over half of which was used to enhance oil production. Almost 80 percent of oil reserves are in the Sirte basin, on the Mediterranean.

Libya's oil production fell from 1.6 million barrels a day (mb/d) on average in 2010 to about 3,000 barrels a day (b/d) in August 2011. (Peak production was reached in the 1960s at 3 mb/d.) According to the International Energy Agency (IEA), production is likely to recover to 350-400,000 b/d by the end of 2011 and to 1.1 mb/d by the end of 2012 assuming that security and political stability are restored. The amount of

oil available for export will depend on domestic demand as well as production. The faster normality is restored, the quicker domestic demand will grow and so the amount available for export will be smaller. The IEA forecasts domestic demand rising to 200,000 b/d by the end of 2011 and to 220,000 b/d or more by the end of 2012. This would leave 200-250,000 b/d for exports by the end of 2011 and 650-850,000 b/d by the end of 2012. Libya's exports in 2010 averaged 1.1 mb/d. In 2012, on the basis of these optimistic assumptions, the amount of Libyan oil available on international markets may be up to 42 percent less than in 2010. These forecasts are much less optimistic than those issued by National Transitional Council, which is taking over the reigns of government and the state-owned Arabian Gulf Oil Company (AGOCO) that is based in Bengazi and that is part of the National Oil Corporation.

At a price of \$100 per barrel, the IEA forecasts suggest that oil revenues may reach between \$7.3 billion and \$9.1 billion annually at the end of 2011 and between \$23.7 billion and \$31 billion annually at the end of 2012.

The main immediate problems are the continued fighting against forces loyal to Gadhafi in Sirte, divisions in the new leadership along regional and tribal lines, and the possible threat of Islamist groups. Assessing war damage, securing equipment and protecting workers in the hydro-carbon sector will take time; according to the IEA, the operating status of much of the country's oil infrastructure is unclear. Libya has five refineries: the Ras Lanuf refinery with a crude oil refining capacity of 220,000 b/d; the Az Zawiya refinery with a capacity of 120,000 b/d; the Trobuk refinery with a capacity of 20,000 b/d; Sarir, with 10,000 b/d and Brega with 8,000 b/d. These refineries have not only suffered war damage but also the effects of international sanctions implemented since 1993 under UN

resolution 883, which banned the sale of refining equipment to the country.

Although Libya is one of the smaller OPEC producers, its oil is 'sweet,' which means that it contains relatively little sulphur. As a result, it needs less refining than the Saudi oil that replaced it on international markets during the conflict. The world is short of refining capacity in general, and after the damage to Libyan refineries, this is even truer. The restoration of Libyan production is likely to have a moderating effect on world oil prices, especially if world economic growth remains weak.

Despite the fall in oil revenues, Libya should be able to finance reconstruction out of reserves that are becoming available to the new regime. According to the former governor of the central bank, there are \$168 billion in reserves, nearly two thirds of which belong to the central Bank and the balance to the Libyan Investment Authority. Foreign governments have been releasing funds to the new regime that they had frozen during Qadhafi's last months in power. The existence of these funds seems plausible given that Libya had total oil revenues of nearly \$270 billion in 2006-2010, a balance of payments current account surplus totaling \$120 billion and large surpluses in the state budget. Hydrocarbons accounted for 90 percent of government revenues in recent years.

During Gadhafi's last years in power, limited economic liberalization was introduced, designed to encourage foreign investment and the local private sector. Despite this, powerful vested interests close to the Gadhafi regime were unwilling to relax their control over key sections of the economy and so the reforms were limited.

The new regime is likely to continue liberalizing the economy without the need to maintain the interests of Qadhafi's supporters but, inevitably, with the need to accommodate other influential groups. In the oil sector, the need for stability has been recognized with the appointment of Nouri Berouin as chairman of the National Oil Corporation. He was a senior official in the Arabian Gulf Oil Company who defected from the Qadhafi regime during the early part of the conflict. Foreign companies in the oil sector – including Eni of Italy, Wintershall of Germany, Repsol of Spain, Total of France and Suncor of Canada as well as ConocoPhillips, Marathon, Hess and Occidental of the US – evacuated their personnel during the conflict but are keen to return.

Although the economy grew between 2005 and 2010 by an average annual growth rate of almost 5 percent, it had much greater potential. The fact that this potential was not realized reflected the amount squandered by the Gadhafi regime both politically and economically. Evidence of this is the fact that peak oil production was reached in the 1960s under the monarchic rule of Idriss al-Sanusi. The decline since then was not because the country ran out of oil but because it massively mismanaged its resources. The gradual improvement in recent years of Libya's international relations and higher oil revenues resulted in a big expansion of imports, from \$10 billion in 2005 to \$25 billion in 2010. Although the war has disrupted the economy, a gradual recovery as a result of reconstruction will result in further increases.

Estimates of the economic costs of the conflict are varied. One is a GDP loss of nearly \$8 billion and a loss of government revenues of \$6 billion. Another puts losses at 28 percent of GDP. The real figure is likely to be much higher based on the loss of oil revenues alone. Some 750,000 people have fled the country since the start of the conflict, and the severe

disruption in the hydrocarbon sector has devastated the economy. Libya is the only major oil producer to have experienced conflict in the Arab Spring; all the others have benefitted from higher oil prices.

For the West, Libya is first of all an important supplier of oil and gas. It is also a significant market. Reconstruction offers potential for more business. In recent years, Gadhafi helped to reduce the flow of African migrants into Europe and strongly opposed Islamic fundamentalism in Libya. The new regime has every interest in producing and exporting oil and gas, but its willingness and ability to prevent the flow of African migrants to Europe and oppose Islamic fundamentalists is open to question. There are reports that oil production is being restored much faster than had been expected and that it reached 350,000 b/d in October. If this is true and if it can be maintained, then finance for reconstruction will be available without undue reliance on reserves.

There are huge uncertainties ahead. Libya does not have a government based on wide consensus. There are tribal and regional tensions that may impede speedy reconstruction. The transitional authorities have already announced that Libya will become a moderate Muslim state and Gadhafi's ban on polygamy has been cancelled. This trend is also likely to affect economic developments, but this seems to be the direction that Tunisia may follow after its elections (which were won by the Islamist party) and that Egypt may follow after its elections due in November. Libya, under Gadhafi, led the Middle East in nationalizing the oil industry; now after him, it could be a pioneer in the new Arab Islamic model that may be developing.

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