An examination of Libya's business sector in the midst of political tension and economic reforms

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Abstract

Libya is an oil rich country that has for decades performed well economically. The country is self-sufficient with most of its economic activities centred on the hydrocarbon sector which accounts for the bulk of export earnings, approximately 97% and with contribution to GDP of almost 70%. The country, since the 2011 ousting of the Gadhafi regime, continues to struggle with political strife and uprising as well as civil disobedience. To assess the impact of political tension and the government's push for reforms, the qualitative research method was used to inform this paper. In essence, the paper aims to examine the business climate of Libya in the context of the Doing Business Report for 2015; the impact of existing reform measures on the success of the businesses including the framework in place for business facilitation and private sector involvement. Recommendations on the way forward for Libya are proffered in the concluding section of the paper.

Introduction

`Libya is an upper middle income country with a population of over 6 million people. The country is known as an oil producing country with one of the largest oil reserves in the world and with one of the highest dependencies on the hydrocarbon (oil and gas) sector. According to the statistics cited in the UNCT Strategic Framework 2013-2014, the hydrocarbon sector contributes about 97% of export earnings, 75% of GDP and 90% of government revenue (p.16). This level of dependence on the oil and gas export for government revenue exceeding 90% categorizes the country as having a rentier economy (Beblawi, 1987). The rentier economy is perceived as an obstacle to the government thrust for democracy and capitalism. As such, it is even more vital for the business sector to not be observers but to support the government's efforts toward economic reform.

In 2011, the country experienced an extremely sharp contraction of 62% in economic activity as political revolution and civil war disrupted all forms of business undertakings. The hydrocarbon sector was negatively impacted by the turmoil which led to an over 70% reduction in oil and gas production. This fall off in production had a debilitating effect on the economy evidenced by the significant decline in real GDP, foreign exchange earnings and fiscal revenues. The contribution to GDP by the hydrocarbon sector in 2008 was 69.7% but by 2012 it had fallen to 65.6% (AfDB et al., 2014).

According to KPMG (2013), "before the onset of civil war in 2011, Libya produced around 1.55 to 1.6 million bpd [barrel per day] of crude oil, had a refining capacity of 380,000 bpd, and crude oil exports of around 1.3 million bpd"(p.2). It is this heavy reliance on oil and gas as an export earner that led to significant economic declines in a period when there was low or no oil production.

The hydrocarbon sector quickly recovered in 2012, with crude oil production increasing by approximately 200% (KPMG, 2013). Arising from this increase in oil production, the country experienced strong growth in the region of 110.9% but contraction of 9.4% and 7.8% in 2013 and 2014 followed respectively.

Political pundits maintain that although growth is expected near-term, a stable recovery is currently unlikely as further political and security unrest threatens. Today, these concerns continue to inhibit oil production, investment and capital spending. The government, in addition to having high fiscal deficit, is faced with issues relating to national security, high unemployment, frequent labour strikes, civil protests, mismanagement of oil revenues, capital flight, increased worker demands for better wages and working conditions, inter alia. According to AMB (2014), "Libya's financial system remains heavily under state influence and foreign investment is subject to numerous restrictions" (p.3). It would take some time before investors' confidence is restored.

Although the hydrocarbon sector is the main stay of Libya's economy and is certainly more susceptible to upheavals, the non-hydrocarbon sectors suffered significant blows during the political turmoil of 2011 and as such experienced an estimated 50% contraction in economic activities. The contraction was due primarily to the damages caused to existing infrastructure and to low production. The unrest also caused disruptions in the financial sector where access to money was limited. As a consequence, total real GDP in 2011 was 60 percent lower than in 2010. It was not until early 2012 before normalcy returned to the financial sector when the UN sanctions on Central Bank of Libya's foreign assets were removed (IMF, 2013).

Not to be overlooked is the impact that the uprising had, not only on Libya but around the world, particularly with trading partners. According to the IMF (2012) there was a temporary shortfall in the international oil market when oil exports from Libya were contracted by some 70%. Additionally, approximately 1.5 million migrant workers were affected; the impact of which was the abrupt exodus of expatriate workers. As a result, the pool of unemployed persons grew larger and remittances were reduced.

In 2013, protest actions by workers and by rebels groups at major oilfields resulted in increasing disruptions in oil production. The economy was once again in major decline as oil exports and the revenue thereof plummeted. "The oil blockades cost the Libyan economy over USD 10 billion in 2013, threatening the government's fiscal stability and, hence, its ability to concentrate efforts on economic recovery and political transition following the 2011 unrest" (AfDB Libya 2014, p.3). The continued political uncertainty is beleaguering for the country and its citizens.

Impact of Reform Programmes on Businesses

Reforms Pre 2011 Uprisings

Libya's' attempts at reform in the late 1980s and 1990s were unsuccessful leaving economists uncertain as to the possible cause. While there are those who felt that there was a lack of political will and commitment to the process, others were of the view that institutional flaws were at the centre of the failure (AfDB, 2011). Further reforms were pursued by the Libyan government between 2003 and 2010. These reform efforts showed marked progress in their implementation. Information gleaned from a report on Libya's National Economic Strategy (Porter, 2007), indicated that businesses, whilst benefiting from low labour cost and modest formal tariffs, were faced with high taxes and disincentives to foreign competition, dominance in state owned enterprises, which limited private sector competition, corruption and favouritism by government. Porter (2007) identified as priority areas human capital, education, and unemployment. However, the pace of implementation of the related reforms was very slow.

Some of the main areas targeted for reforms by the Libyan government were agriculture, construction and finance although the reform agenda appeared to have been more centred on the financial sector than any of the other sectors. According to IMF (2012), "financial-sector intermediation is necessary to foster private-sector development. Well-functioning banking and

financial sectors that provides broader access to finance for small and medium-sized enterprises" (p.17).

The government in early 2010 overhauled its legal framework in an effort to spur private sector led growth. Arising from that process, "22 new laws were passed to make fundamental changes to a range of activities including commerce, customs, income tax, the stock market, labour, communication, and land registry (IMF, 2012). However, according to the Competitiveness and the Business Environment Rankings, the reforms did not improve business conditions.

Other reform measures pursued by the Libyan government under the watchful gaze of international institutions like the IMF and World Bank included: the upgrading of some of its industries, infrastructure; investment legislation allowing foreign investors to access up to 50% debt from local banks; partial privatization of some state owned enterprises; abolition of taxes and import duties on agricultural products, and; privatization of several financial institutions as part of liberalization of the sector. All these measures were pursued prior to the 2011 political unrest. The IMF in February 2011 commended the reform efforts of the Libyan government and encouraged the authorities heighten its support for private sector development through its structural reforms (IMF, 2011). Smits et al. (2013) asserted that "although interest in the private sector is increasing, it is too early to state that a 'new business elite' is emerging in Libya. The increase in private entrepreneurship is largely confined to small-scale business" (p.36).

An estimated 1.2 to 1.6 million people in Libya, most of who are considered unskilled, poor and marginalized, are informally engaged in trading activities in the agriculture, construction and retail sectors. Although no official statistics are available, it is presumed that the informal sector accounts for up to 60% of the total employment in Libya. This estimate is plausible given that the hydrocarbon sector is capital intensive and therefore can make only a very limited contribution to employment growth. In addition, the non-hydrocarbon sector is not sufficiently developed to absorb the bulk of the labour force. According to AfDB et al. (2014), "the poverty implications of high unemployment in the formal sector of the economy have thus far been mitigated by the government's generous yet untargeted social subsidy programme" (p.13).

The level of unemployment was also a concern for external observers like the IMF. In Article IV (2011), the IMF indicated that its directors saw as the main challenges for Libya, "the need to provide employment opportunities for its young and growing labour force, and steadfast implementation of reforms to diversify the economy and reduce the high dependence on oil revenues" (IMF, 2011, p.3).

Reforms Post 2011 Uprisings

Of immediate concern to the government of Libya in the aftermath of the uprising was the unfreezing of assets by the international community to carry out critical reform programmes. Having suffered a $15 billion loss, oil rich Libya required no financial aid but it needed assistance with its recovery efforts. As such the Libyan authorities sought assistance from the international financial institutions in "policy consultations and technical assistance, aimed at maintaining macroeconomic stability and developing an institutional infrastructure to promote economic diversification and employment growth" (IMF, 2012, p.1).

According to information outlined in Table 1, the mining (extraction), manufacturing, construction, finance and public sectors are major contributors to the GDP growth. In 2012, the contribution to GDP from mining, manufacturing and construction showed marginal declines. Of significance, was the increase growth from public sector activities and from wholesaling and retail trade. The construction sector suffered major declines due to the suspension of contracts

and the withdrawal of foreign investors during the 2011 uprisings, who had not yet returned to the sector.

GDP by Sector (Percentage)

	2008	2012
Agriculture, hunting, forestry, fishing	1.9	0.8
of which fishing		
Mining	69.7	65.6
of which oil		
Manufacturing	4.2	3.2
Electricity, gas and water	1.0	1.2
Construction	5.1	1.3
Wholesale and retail trade, hotels and restaurants	3.4	4.2
of which hotels and restaurants	0.2	0.1
Transport, storage and communication	3.3	3.0
Finance, real estate and business services	5.3	5.6
Public administration, education, health and social work, community, social and personal services	5.7	14.8
Other services	0.3	0.3
Gross domestic product at basic prices / factor cost	**100**	**100**

Table1: Extracted from Libya 2014, AfDB, OECD, UNDP

The economy showed remarkable signs of recovery in 2012 and in 2013 with the fiscal balance recording large surpluses. Earnings from exports were significantly higher than some years leading up to 2011. Real GDP reached a whopping 104.5% in 2012 tapering off to 20.2% in 2013 (see Table 2). Inflation, which had climbed to double digits in 2011 on account of government's increase spending in public administration and social services, was restored to pre 2011 rate of 2%. Also, the accumulation of sizable external reserves resumed in the post 2011 period.

Libya: Selected Economic and Financial Indicators, 2008–13

	2008	2009	2010	2011	2012	2013
	(Annual percentage change, unless otherwise					
Production and prices						
Real GDP	2.7	-0.8	5.0	-62.1	104.5	20.2
Nonhydrocarbon	6.5	7.1	6.1	-52.5	43.7	24.6
Hydrocarbon	-0.5	-7.7	4.0	-72.0	211.4	16.7
Nominal GDP in billions of U.S. dollars	87.2	63.1	74.8	34.7	61.9	94.6
CPI inflation (average)	0.0	2.0	2.5	15.9	6.1	2.0
	(In percent of GDP)					
Central government finances						
Revenue, *of which:*	68.4	52.9	64.9	50.3	72.3	72.9
Hydrocarbon	61.3	44.7	58.8	47.8	69.2	69.5
Expenditure and net lending, *of which:*	43.1	55.9	56.1	65.7	51.5	53.7
Capital expenditure	25.4	26.1	25.6	8.2	5.3	10.8
Overall balance (deficit -)	25.2	-3.0	8.9	-15.4	20.8	19.2
Nonhydrocarbon balance	-36.1	-47.6	-50.0	-63.2	-48.4	-50.3
	(Changes as a percent of beginning of the year					
Money and credit						
Money and quasi-money	47.8	12.5	3.6	25.0	11.6	4.5
Credit to the economy	5.6	0.5	4.1	-2.6	4.5	1.4
	(In billions of U.S. dollars; unless otherwise indicated)					
External Sector						
Exports, *of which:*	62.1	37.1	46.8	19.1	62.2	64.6
Hydrocarbon	60.7	35.7	45.4	18.7	61.0	63.1
Imports	20.9	22.0	24.6	11.2	25.7	30.5
Current account balance	37.1	9.4	14.6	3.2	29.4	24.9
(As percent of GDP)	42.5	14.9	19.5	9.1	35.9	26.3
Overall balance (deficit -)	15.7	5.2	4.5	6.0	16.9	18.2
(As percent of GDP)	18.0	8.3	6.1	17.2	20.7	19.2
Reserves						
Total foreign assets (NFA + LIA investments)	126.1	138.3	171.6	176.9	190.3	208.7
Net international reserves	91.9	100.3	101.8	111.6	124.6	142.7
(In months of next year's imports)	40.7	39.0	76.3	41.6	39.1	40.0
Exchange rate (dinar/US$)	1.2	1.3	1.3	1.2	1.3	1.3
Real effective exchange rate (eop)	108.6	104.8	107.0	122.8	147.9	...

Table 2: Extracted from IMF Country Report No. 13/150 on Libya

Prior to the uprisings, foreign companies were investing in the hydrocarbon industry as well as other industries such as construction and transport. Activities in the private sector increased on account of government workers being allowed to establish businesses; some partnering with foreign companies in joint ventures. However, new laws, introduced in 2013 to govern businesses were more restrictive than encouraging. For example, the Companies Law had serious implications for joint venture partnerships as the permitted shareholdings to foreign companies could no longer exceed 49%. As a consequence, foreign investors would no longer

provide financial support for many Libyan start–up ventures. This is particularly troubling given the country's "high-risk environment" (AfDB et al., 2014).

Other reform measures created undue burden on the business sector. For example, the government imposed a new minimum capital requirement of LYD 1 million; a significant outlay for most companies, in particular for small and medium sized enterprises (AfDB et al., 2014). This action went against the gain of business facilitation and private sector engagement. The private sector was impeded further with labor law restrictions and regulations in 2013 which made it difficult for them to have access to qualified and skilled labour. Instead, they were compelled to hire within a quota system where restrictions were also imposed on the hiring of expatriates.

Doing Business in Libya

The obligation of any government to its people is the provision of basic social services such as social protection, health, education as well economic infrastructure on which the country can be developed. Governments are increasingly recognizing that they must move away from being just providers of goods and services to creating a stable and predictable environment for investment. In this sense, they are realizing their roles as facilitators and enablers, even partners in the active participation of the private sector in the economy. To this extent, countries around the world are assessed on the degree to which they foster private sector growth and are opened to foreign investment and new business development.

The ease of starting a business is an assessment that is performed on economies globally by the World Bank. This assessment is carried out on a yearly basis and reported in its Doing Business Report publication. The 2014 report, was the first to report measures pertaining to business regulations in Libya, Myanmar and South Sudan; countries, whose economies, according to the report, "emerged from conflict or are starting to open up to the global economy after years of isolation" (World Bank & International Finance Corporation, 2013, p.5).

The Doing Business Report for 2015 showed Libya as ranking 144 out of 189 economies. The report highlights key areas such starting a business; dealing with construction permits; getting electricity; registering property; getting credit; protecting investors; paying taxes; trading across borders; enforcing contracts; and resolving insolvency. By identifying structural weaknesses and inefficient business facilitation practices countries have the opportunity of improving their ranking by addressing areas of impediment to business start-up, investment and economic activities.

The report outlines Libya's ranking in each of the 10 indicators for doing business, summarized below in Figure 1.

In assessing the report with respect to improvements in Libya's ranking from one year to the next, the report shows that in most instances Libya either not improved or the ranking worsened when compared to the previous year of 2014. Areas showing no substantial improvement include: registering property, getting credit, protecting minority investors, enforcing contracts and resolving insolvency. Critical to note is that no change in the rankings should not be interpreted as Libya not implementing improvements as this could be the case but the changes were not sufficient when compared to those made by other countries to affect a change in the indicators.

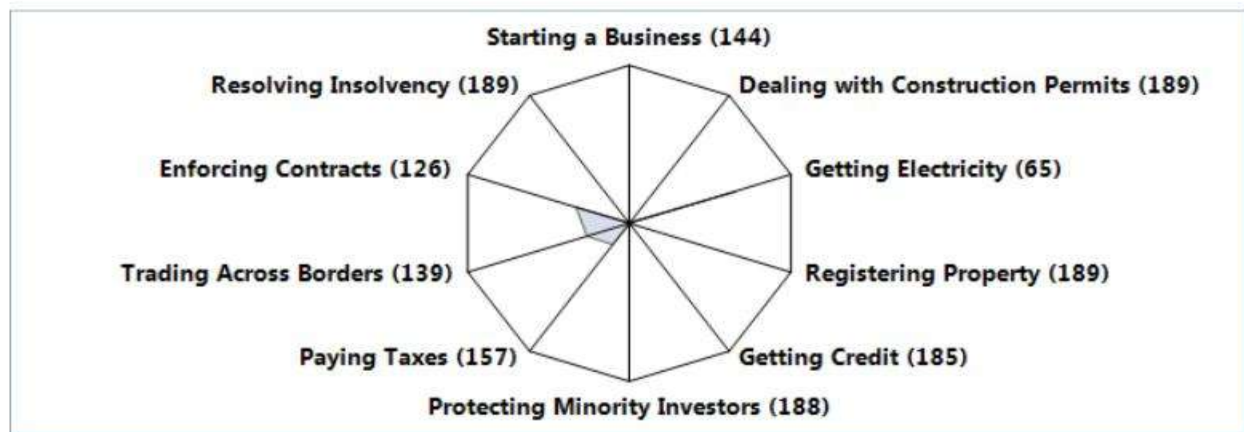

Figure 1: Extracted from Doing Business 2015: Going Beyond Efficiency – Libya

The IMF, in a 2013 report, called on the Libyan government to effect measures to "improve the business climate, improve the quality of education, rebuild infrastructure, put in place an efficient social safety net, develop the financial market, improve the management of oil revenues, and reduce Libya's dependency on oil by encouraging private sector development" (KPMG, 2013). Research shows that economies like Libya that is embroiled in conflict invariably find it difficult to implement structural improvements in the regulatory environment particularly as businesses are confronted with increasing difficulties. "Civil strife, a substantial weakening in the state's ability to enforce the law and other characteristics of conflict-affected states often bring about a substantial worsening of the conditions in which the private sector operates" (World Bank & International Finance Corporation, 2014, p.5).

Whilst Libya will undoubtedly experience growth given its highly placed exports of hydrocarbons, experience has shown that oil price volatility can be problematic particularly where fiscal revenue streams are negatively affected. Therefore, it is imperative that the government continues its efforts toward diversification and modernization across sectors. But such diversification especially where attention is given to the non-hydrocarbon sectors can only be attained in an environment where political conflicts are under control; regulations in place to firmly address corruption and the bureaucratic procedures that often shrouds the formal sector is simplified. "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" (AfDB, 2011,p.4).

Conclusion and Way Forward

Although Libya offers great opportunities for doing business, the political instability that continues to loom creates a great risk for potential investors and for businesses that are already operating in the country. As such these businesses must acknowledge the environment within which they operate and provide the necessary support that will help shape the new political landscape if they are to grow and or remain viable. Already the government of Libya is challenged in its push for diversification and modernization of non-hydrocarbon sectors. The Libyan system of governance is riddled with structural inefficiencies due in part to the absence of necessary checks and balances with respect to the country's finances, which could have a bearing on the government's current attempts at reform. In addition, the institutional and legal frameworks prior to 2013 were deemed to have been non transparent and the business climate volatile.

As the country presses ahead, major consideration must be the rebuilding of trust among the Libyan populace especially placing greater emphasis on transparency, accountability and performance if broader measures are to be taken seriously. The government, therefore, in considering external assistance to aid its reform programme whether economic, social or political, has to be mindful of the country's past and the likely scepticism of outside presence which could be deemed as international interference. Inclusion of the Libyan diaspora can be a conduit for new investment and a potential source of skilled and educated labour force and is encouraged.

The country's reform agenda must be one that gives attention to creating an enabling environment for foreign investment through tax incentives, skilled and educated labour market, infrastructure development and the implementation of mechanisms to encourage business creation and entrepreneurship.

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