

BUFF/ED/23/66

May 19, 2023

**Statement by Mr. Bijani and Mr. Sassanpour on Libya
Executive Board Meeting
May 24, 2023**

At the outset, we would like to convey the appreciation of our Libyan authorities to Fund management and staff, and particularly Mr. Azour, for the resumption of the Article IV consultations with Libya, supported by the flexibility afforded by the Fund's strategy on Fragile and Conflict-Affected States. We would also like to thank the competent Libya team led by Mr. Gershenson for its constructive engagement with the authorities during the Article IV discussions that were preceded by a staff visit in November 2022—both held in Tunis.

The authorities highly appreciate staff's professional views and their recognition of the realities on the ground. They are in broad agreement with the staff's assessment and policy advice and intend to use the staff's sound recommendations in formulating their own reform agenda. The process has already begun.

Political and Institutional Context

Libya is emerging from over 10 years of internal political strife and a costly civil war which has come at a devastating cost for Libya's physical and human capital. The conflict in Libya has had adverse implications not only for Libya itself, but also for its neighbors and the region. Libya's political fragility is being compounded by external actors who are direct participants in the political and security realms in Libya's ongoing conflict, further aggravating the crisis. Consequently, a stable and secure Libya could have immense positive spillovers, particularly given the country's strategic location and its political and economic relations with Europe, Africa, and the Middle East.

Libyans had high aspirations after the February 2011 Revolution that nation-building could soon start through an inclusive participatory political process and establishment of new democratic institutions. Political reconciliation, however, proved elusive. The armed conflict that broke out in July 2014 and persisted until October 2020 fragmented the country and its institutions along the political divide. Two parallel governments with parallel institutions emerged. This affected the Central Bank of Libya (CBL)—always an anchor of economic stability—as its branch in Benghazi in the East became the central bank of the parallel government (later moved to Al-Bayda), but country-wide banking operations continued by

resourcefulness of the CBL based in Tripoli. Even at the height of the hostilities, elements of Libya's institutional framework—notably the CBL and the Libyan National Oil Corporation—managed to help navigate the country through significant macroeconomic turmoil. The civil conflict proved very costly in terms of human lives and livelihoods, economic dislocation and destruction of infrastructure. The economic disruptions were further exacerbated by the wide fluctuations of international oil prices in 2014–15, 2020 and in 2022–23, as well as periodic stoppages of Libya's oil production and exports due to blockades of oil fields and export terminals by the powers in the East. The economy and the population suffered greatly, but the biggest loss was the opportunity for Libya to use its enormous natural wealth to build a new prosperous nation. A relatively calm political climate has prevailed since early 2021, but Libya is still some distance away from establishing nation-wide political cohesion, and democratic elections initially planned in December 2021 have been postponed because of disagreements over the legal framework for elections. It is against this background that the 2023 Article IV Consultation discussions were held with Libya after a hiatus of 10 years.

The international community and the Fund have continued to recognize the Tripoli-based Government of National Accord, and since October 2020, the Government of National Unity (GNU) as the sole legitimate executive government in Libya, and the Governor of the CBL in Tripoli as the Governor for the Fund. Policy dialogue is conducted with the CBL and GNU representatives, although representatives of CBL-Al Bayda have also participated in discussions as part of the CBL team

Economic Context

Production and exports of oil and gas have been the core of the Libyan economy for decades. In the period prior to the 2011 Revolution, and despite the large accumulation of external reserves, the then-Libyan authorities missed the opportunity to optimize Libya's vast natural resource endowment effectively and efficiently to build a dynamic market-oriented economy to ensure intergenerational prosperity for its small and homogenous population. While the population's basic needs for food, health, education, shelter, and employment were met, the prevailing political and economic framework discouraged private sector activity, and economic development was greatly constrained by various structural deficiencies. The oil income was spent very inefficiently but was sufficient to meet the basic needs of the population and still build a strong reserve position. Libya also became a major donor and creditor to many developing countries, mostly in Africa. Many of the legacy loans are being settled now.

The post-Revolution authorities inherited many of pre-existing structural shortcomings and vulnerabilities that had been firmly entrenched in the Libyan economy for decades. Post-Revolution, and especially after the breakout of the armed conflict, the wide fluctuations in oil production, exports and prices were reflected in wide swings in economic activity, and fiscal and external balances, with the net outcome reflected in foreign reserves. In 2020, the loss of oil income was particularly acute as production fell sharply because of the blockade of oil fields by forces in the East combined with the steep decline in international oil prices because of pandemic-related demand destruction. Procyclical spending mitigated the impact

of revenue shortfall on the economy at the cost of high fiscal and current account deficits and loss of reserves.

With the strong recovery of oil production and prices in 2021 and 2022, the economy rebounded sharply, and the fiscal and external balances recorded sizable surpluses, and reserves increased. Libya's oil production, if not disrupted by the internal conflict, is governed by the OPEC's production sharing agreements. The authorities are planning to increase oil production gradually from 1.2 million barrels per day (mbd) in 2023 to around 1.5 mbd by 2026. This, and further production increases, however, will be contingent on major investments in the oil sector, the evolution of world demand for oil, and OPEC's global role as the oil market stabilizer.

Fiscal Management

The authorities are cognizant of the policy vacuum and the absence of linkages between fiscal planning, macroeconomic sustainability, and a development strategy. With oil revenues determined by a rather unpredictable production pattern and volatile international oil prices, the budget outcome is driven by spending on wages and benefits, basic government services, untargeted subsidies and transfers to loss-making state enterprises. In fact, the budget has been an important redistributive vehicle, but at a great cost. With 90 percent of all workers notionally employed by the public sector, and domestic energy prices heavily subsidized, the government policy has been to protect the population nationwide during the internal economic turmoil. The GNU has also paid for salaries of public sector employees in areas controlled by the parallel government, and the highly subsidized fuel is available at a uniform price across the country. In general, the Government seeks to provide inclusive quality public services through strengthened implementation capacity, while ensuring adequate resources to meet existing and future needs.

The authorities recognize that fuel subsidy in Libya is highly regressive primarily benefitting its wealthier population and, through smugglers operating on both sides of the porous border, the neighboring countries where fuel prices are significantly higher. The recent hikes in fuel prices in neighboring countries have further raised the incentive for smuggling at a greater cost to Libya. Increasing domestic fuel prices has been on the authorities' radar for some time, but they have found it difficult to implement reforms in the current environment. Some entrenched subsidies and benefits are very difficult to dislodge. Nevertheless, as part of the efforts to rationalize public spending, the National Economic and Social Development Board of Libya has submitted a subsidy reform proposal to the GNU suggesting a roadmap for the gradual removal of subsidies and improved targeting of direct cash transfers.

Non-oil revenues comprise only 2-3 percent of GDP,¹ but there is some limited short-term potential for increasing customs and tax revenue through better enforcement and improved administration. In 2020 Libya received Fund TA—both by HQ-based staff and by METAC—in the areas of tax and customs administration but more intensive and hands-on CD is needed. The authorities have requested Fund technical assistance in designing a VAT.

¹ Ratios to GDP should be viewed with great caution given the high variability of the nominal GDP.

Monetary and Exchange Rate Management

Monetary developments are largely driven by large swings in net claims on government as the government resorts to (interest free) monetary financing to meet budget shortfalls. Monetary management is further complicated by the parallel government's borrowings from CBL-Al Bayda and printing bank notes on which the CBL-Tripoli has no control. The CBL has no instruments to control the monetary aggregates. Since the 2013 prohibition on interest, commercial banks have been setting their own internal rates in lending to the private sector. The CBL intends to develop Islamic finance products and has requested Fund TA.

The exchange rate continues to serve as the economy's principal anchor. While the official rate remained pegged to the SDR, a parallel market developed after the 2015 plunge in oil prices and as the CBL imposed capital controls to safeguard reserves. As the exchange rate gap widened subsequently, the CBL effectively closed the difference by imposing a tax on FX transactions, until the official exchange rate was formally devalued in relation to the SDR in January 2021—the gap narrowed and remained small. The CBL is of the view (also shared by staff) that the SDR peg at current levels is appropriate and intends to maintain it. The CBL is resisting strong political pressures to revalue the currency as the oil market conditions have improved in the last two years. The measures taken by the CBL have helped maintain a large buffer of international reserves.

Financial System

The CBL has kept the financial system functioning during the political and economic turmoil of the past decade. The progress towards the reunification of the Tripoli and Al-Bayda branches of the central bank has been uneven, reflecting the unsettled political situation, but the CBL is committed to bringing the process to fruition. The reunification is the first critical step in reform of the banking sector. The authorities acknowledge the current weaknesses in the banking sector and are addressing them. Over the last three years, the CBL has put great effort in developing the AML/CFT framework; expanding e-payment services; enhancing banking regulations, developing systems and tools; increasing transparency and disclosure; and improving commercial bank reporting, among other proactive initiatives. The CBL is also determined to review bank recapitalization requirements and intends to disinvest commercial banks under its ownership gradually over the longer run. The authorities find the Selected Issues Paper on banking sector reform very useful and will seek scaled up support from the Fund and other development partners to develop the financial sector and promote financial inclusion, especially of women and youth.

Economic Diversification and the Path Forward

The Libyan authorities fully recognize the need to reduce the economy's reliance on energy production and exports, and an often-volatile international oil market, but are also equally aware of the daunting challenges ahead. Economic diversification was not a focus area of the pre-Revolution government and the post-Revolution administrations have been in a crisis management mode from the start. The authorities agree with staff that Libya needs a clear,

comprehensive long-term plan for the economy, and will strive to develop a shared vision for development and to lay the foundation for a new social contract.²

Institution building is the first building block. With that recognition, the Libyan authorities have been engaged in an active dialogue with the World Bank that together with other development partners has identified and catalogued the challenges and needs that Libya faces in different areas today, and policies that could be used as input in a planning process for the future once conditions permit.³ Moreover, as the political uncertainties and the civil conflict intensified, challenges that existed in the health sector prior to 2011, including poorly functioning health systems, limited services in remote areas, and inefficient use of health financing, the authorities have entered into an agreement for reimbursable advisory services with the World Bank Group to improve the primary health system and health financing. The Libyan authorities also intend to draw from the successful experiences and avoid the pitfalls of other major oil producing countries in the area of diversification.

Data Deficiencies, Technical Assistance and Capacity Building

Libya has major data shortcomings that limit economic analysis as well as evidence-based policy making. Although there are some recent improvements in data production and dissemination, and better coordination among data-producing agencies, there are still deficiencies in macroeconomic and financial statistics, as clearly identified in the Staff Report. The Libyan authorities will continue to rely on the Fund for technical support and capacity building in the area of data collection and dissemination

Even over this difficult period, Libya has benefitted from the Fund technical advice through virtual meetings as well as in-person meetings held in neighboring countries in the areas of national accounts; PFM; financial regulations and supervision; tax and customs administration; and AML/CFT. During the Article IV discussions, the authorities requested further technical assistance and capacity development in number of areas, some of which have already been mentioned above. Related to the CBL, the TA and CD needs are: Islamic financing instruments; macroprudential tools; payments system strategy; central bank transparency; and CBDC and FinTech. Related to the Ministry of Finance, the Ministry of Economy, and the Ministry of Planning, the needs are in areas of national accounts; macro-fiscal framework and forecasting techniques; tax and customs administration; treasury single account; SOE management; subsidy reform; and VAT.

Concluding Remarks

² Libya has been closely engaged with the World Bank Group in this area. The World Bank Group Executive Board discussed the FY2019-21 Country Engagement Note (CEN) for Libya in February 2019, which framed a 3-year engagement strategy to address urgent priorities for recovery, while building the foundation for a new social contract and long-term transformation. More recently, in February 2023, the World Bank Group Executive Board approved the FY23-25 CEN for Libya, built on the previous CEN, centered around two pillars: namely, setting the foundation for evidence-based and inclusive policy decisions and strengthening the social contract through equitable and accountable local service delivery.

³ See, *The Long Road to Inclusive Institutions in Libya: A Sourcebook of Challenges and Needs*; released May 18, 2023

Holding the Article-IV consultation discussion after a pause of 10 years was a major step towards bringing Libya—a major oil producer located strategically in a volatile region—back to the international financial fora. Admittedly, data deficiencies constrain economic analysis, while weaknesses in the authorities’ implementation capacity amidst the current circumstances limit follow ups on staff’s sound policy advice. Nonetheless, the authorities find the exercise extremely useful in showcasing the efforts in developing Libyan institutions and the challenges faced by Libya to reestablish political and social cohesion and to plan for a brighter economic future for all Libyans. The expectation is that future reports will build on this first report as data improve, policies are formed, and the authorities’ implementation capacity expands. Libya is endowed with vast mineral resources that could support rebuilding its institutions and finance major investments in infrastructure and in human capital that are all critical to building a prosperous and inclusive Libya. In closing, a strong, stable and prosperous Libya is not only beneficial to its neighbors, but also to the broader international community. Promoting political, social and economic stability, and sustaining development in Libya can therefore be viewed as a global public good.

The Libyan authorities would like to express their appreciation to Fund management and staff for their willingness to re-engage formally with Libya, and once again gratefully acknowledge the Fund policy advice and technical support over the years.