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IMF Executive Board Concludes 2008 Article IV Consultation with The Socialist People's Libyan Arab Jamahiriya

On July 18, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Socialist People's Libyan Arab Jamahiriya.[1]

Background

Since the lifting in 2003-04 of the UN sanctions, which lasted more than 10 years, Libya has launched a series of structural reforms and accelerated its transition to “people’s capitalism.” The normalization of diplomatic relations with the U.S. and the EU in the second half of 2007 has contributed to increased foreign investors’ interest, particularly in the hydrocarbon, banking, and infrastructure sectors. However, while progress has been made in recent years to liberalize the economy, it remains largely state controlled and heavily dependent on hydrocarbon resources. Crude oil and gas accounted for about 70 percent of GDP, 90 percent of total government revenues, and 98 percent of total exports in 2007.

A Wealth Distribution Program (WDP) was launched in March 2008 to distribute part of the oil wealth to the population and reduce the size of the government. Disbursements will be in the form of both cash and shares in projects. The initially announced amount was LD 25-30 billion ($20-25 billion), but subsequently only LD 4.6 billion ($3.8 billion) were approved for this year. The authorities are still considering the size, form, and modalities of the annual distributions in the years ahead.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Macroeconomic performance strengthened further in 2007, notwithstanding an acceleration in inflation. Real GDP grew by 6.8 percent, supported by an expansion in the hydrocarbon sector (3.9 percent) and a rapid increase in nonhydrocarbon activities (10.3 percent). Growth was particularly strong in construction, transportation, and trade. At the same time, average inflation increased substantially to 6.2 percent, largely driven by higher food prices and a marked increase in public expenditure. Inflation accelerated further in the first quarter of 2008, averaging about 12 percent (year-on-year).

Despite higher oil revenues, Libya's fiscal surplus in 2007 narrowed to 26 percent of GDP, compared to 35 percent in 2006. This reflected a rapid increase in virtually all expenditure items (45 percent), albeit at a slightly slower rate than what was envisaged in the budget. The decision to raise public wages resulted in an increase in the wage bill of around 50 percent. Capital expenditure also grew rapidly.

On the external side, The current account surplus declined to 34 percent of GDP, compared to 46 percent in 2006, due to a marked increase in imports (33 percent). Continued high oil exports resulted in a further build up of the net foreign assets of Central Bank of Libya (CBL) to almost $80 billion. The real effective exchange rate of the dinar appreciated by 1 percent in 2007, and about 5 percent in the first quarter of 2008 due to the combined effects of the rising inflation and the strengthening of the euro against the SDR (to which the dinar is pegged).

Broad money growth accelerated to 41 percent in 2007, reflecting the substantial increase in net foreign assets and the rapid increase in public expenditure, including on-lending by SCIs. Credit extended to the nongovernment sector by these institutions grew by about 36 percent, while that extended by commercial banks grew by about 15 percent. Interest rates remained low and became negative in real terms with the rise in inflation. In an effort to address excess liquidity, the CBL recently increased its policy interest rate to 2.25 percent and the reserves requirement to 20 percent. It introduced in May 2008 its own certificates of deposit as part of its ongoing effort to enhance the monetary policy framework.

The Libyan Investment Authority (LIA) was established in March 2007. The authorities plan to invest the LIA's initial $40–50 billion mostly abroad on a commercial basis and ensure that the LIA will be run by a qualified and independent management. Recent enhancements of its operational framework are largely in line with staff's recommendations.

Progress has been made in various structural reforms, partly in line with past Fund TA recommendations and the Medium-Term Reform Strategy (Country Report 06/137). A sound framework for the management of the oil wealth has been established through the creation of the LIA. Customs administration has been reformed and a large taxpayer's office established; the presentation of the budget has been consolidated and a macrofiscal unit initiated; a large number of public enterprises have been privatized; and one third of public employees are being retrenched to the private sector. Two large state-owned banks were privatized in 2007 and 2008, and two of the three remaining public commercial banks were merged in April 2008. Most regional banks have also been merged into one bank, and agreement has been reached with financial institutions from UAE and Qatar to establish two new banks.

Libya's debt relief to heavily indebted poor countries (HIPCs) continues to be based on forgiving interest payments and using a combination of swaps and rescheduling of principal. The authorities indicated that agreements based on these modalities have already been reached with some HIPCs, and that negotiations are ongoing with others.

Executive Board Assessment

Executive Directors welcomed Libya's continued solid macroeconomic performance, as reflected in the acceleration in GDP growth—in particular in the non-hydrocarbon sector—and the large fiscal and external current account surpluses, based on both the favorable external environment and the authorities' ongoing economic reforms. Directors agreed that Libya's medium-term outlook remains positive, but underscored the need to reverse the recent acceleration in inflation—caused in particular by the increase in food prices—and to further advance structural reforms in the period ahead, in support of the authorities' welcome initiative to speed up the transition from a state-dominated to a market economy.

Directors stressed that efforts to contain inflation should focus on tightening the fiscal stance by limiting the rapid increase in public expenditure, which could also pose risks for expenditure quality. They welcomed the authorities' plans to limit any further increases in public sector wages and to complete the civil service reform. While recognizing the need to upgrade the infrastructure, Directors encouraged the authorities to continue to prioritize public investment and to stand ready to scale back more of the planned projects if inflationary pressures do not recede. Public financial management also needs to be strengthened further, including by unifying the process of budget preparation and implementation under the Ministry of Finance.

Directors welcomed the authorities' decision to limit the scope of the Wealth Distribution Program in 2008—while maintaining the focus on strengthening human capital—against the background of the economy's absorptive capacity constraints and increased inflation. This conservative approach will need to be maintained in the period ahead in order to avoid crowding out priority spending, to discourage rent-seeking activities, and to further reduce inflationary pressures. Directors considered that the planned reform of the public administration in the context of the WDP could present an opportunity to address inefficiencies, but care should be taken not to jeopardize the delivery of essential public services. They recommended that the authorities consider the reform plans carefully in consultation with the World Bank.

Directors commended the authorities for launching the Libyan Investment Authority in a transparent fashion, and the recent enhancement of its operational framework. They emphasized the importance of limiting domestic investments by the LIA. Directors encouraged the authorities to continue to enhance the operational framework of the LIA in line with the evolving best practices for sovereign wealth funds.

Directors commended the recent efforts of the Central Bank of Libya to tighten monetary policy by raising both the CBL policy interest rate and the reserves requirement. They noted that greater reliance on indirect monetary policy instruments would be beneficial, and in this regard, they welcomed the recent introduction of CBL certificates of deposit.

Directors commended the authorities for the progress made in bank privatization and restructuring. They encouraged the authorities to finalize the plans to privatize the two remaining public commercial banks. It would also be important to establish an independent bank restructuring agency that would take over ownership of the specialized credit institutions and oversee their restructuring and privatization.

Directors agreed that the dinar's peg to the SDR has served Libya well as it provides a strong monetary anchor while allowing some flexibility in the dinar's exchange rate vis-à-vis individual major currencies. An eventual move to greater exchange rate flexibility would be beneficial, but would need to be gradual and preceded by a switch to market-based monetary management and development of expertise in foreign exchange markets. Directors took note of the staff assessment that the dinar is moderately undervalued at present, but that this undervaluation is likely to be transitory given the expected evolution of the fiscal and current account positions based on current policies.

Directors welcomed the authorities' commitment to continue to improve economic and financial statistics in order to facilitate better monitoring and analysis of developments to guide policy formulation. They urged the authorities to establish a framework for Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) in line with international standards.

Directors encouraged the authorities to continue to provide full debt relief to heavily indebted poor countries in line with the Heavily Indebted Poor Countries (HIPC) Initiative.

Libya: Basic Economic and Financial Indicators, 2004-07
(Quota = SDR 1,123.7 million)
Population (million): 6.04 million (2007)
Per capita GDP: US$11,484 (2007)

	2004	2005	2006	2007 Prel.
	(Annual percent changes)			
National income and prices				
Real GDP	6.0	9.9	5.9	6.8
Nonhydrocarbons	6.8	13.6	7.9	10.3
Hydrocarbon	5.5	7.2	4.3	3.9
CPI inflation	1.0	2.9	1.4	6.2
	(In percent of GDP)			
Central government finance				
Revenue	53.6	62.9	65.1	61.4
of which : Hydrocarbons	46.4	58.5	60.2	55.2
Nonhydrocarbon	7.2	4.5	4.9	6.2
Expenditure and net lending	39.7	32.1	29.5	35.2
Current	23.5	13.9	13.4	14.2
Capital	16.2	18.2	16.2	21.0
Overall fiscal balance	13.9	30.9	35.5	26.2
Nonhydrocarbon balance (deficit -)	-32.5	-27.6	-24.7	-29.0
	(Annual percent changes, unless otherwise specified)			
Monetary indicators				
Broad money	13.3	30.6	15.3	40.8
Deposit rates (1 year deposits, in percent)	4.5	4.5	4.5	4.5
Claims on the economy	-1.1	8.4	11.7	14.5
	(In billions of dollars, unless otherwise specified)			
External sector				
Exports of goods	20.4	31.4	39.2	44.5
of which: Hydrocarbons	19.5	30.5	38.2	43.4
Imports of goods	8.8	11.2	13.1	17.4
Current accounts balance	7.4	17.4	25.2	23.8
In percent of GDP	22.3	38.4	45.8	34.0
Net foreign assets of CBL	25.9	39.3	58.7	78.8
of which: Net international reserves	16.2	23.0	27.9	35.7
(In months of next year's imports)	14.4	17.4	16.2	15.7
Real effective exchange rate (percent change)	-8.50	9.11	-3.14	0.40

Sources: Libyan authorities; and IMF staff estimates.