INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/150

LIBYA

2013 ARTICLE IV CONSULTATION

May 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Libya, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 7, 2013, with the officials of Libya on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 2, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the staffs of the IMF and the World Bank.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its May 17, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Libya.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

LIBYA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

May 2, 2013

KEY ISSUES

Context. Libya is at a crossroads. Decisions taken today will have profound implications for the future. Libya could follow a roadmap for sustainable, inclusive growth or face deepening hydrocarbon dependency. In the short term, sustainable growth would require managing the political transition and addressing security challenges while maintaining budget discipline and macroeconomic stability. Severe institutional capacity constraints need to be addressed, particularly in the areas of economic management and statistics. Over the medium term, structural challenges include improving the quality of education, rebuilding infrastructure, putting in place an efficient social safety net, and developing domestic financial markets. Private sector-led growth is a precondition for sustainable job creation. Reducing regulatory uncertainty and establishing a well-functioning financial sector are essential to foster private sector development.

Outlook and risks. Hydrocarbon output should reach pre-conflict levels in 2013, while reconstruction and private demand should facilitate an improvement in the nonhydrocarbon sectors. Oil price volatility makes economic performance vulnerable and complicates fiscal management. Necessary reconstruction and development spending will eventually push the budget into deficit in the absence of a curb on current spending. The hasty implementation of legislation prohibiting interest poses risks to the financial sector. Until Libya generates private employment and makes progress in curbing corruption, it will not address key causes of the revolution.

Macroeconomic policy. Macroeconomic policy is underpinned by the currency peg to the SDR, supported by ample foreign exchange reserves. Current spending is high, and the ramping up of necessary reconstruction and development spending will begin to erode fiscal buffers.

Financial sector. A recently-adopted law banning interest could interrupt commercial bank lending, until a new Islamic banking framework is put in place. The banking system appears to be well capitalized, but is not intermediating effectively to support private sector-led growth.

Approved By
Adnan Mazarei and David Marston

The mission visited Tripoli February 20–March 7, 2013. The team consisted of Messrs. Chami (head) and Charap (both MCD), Messrs. Cevik and Fenochietto (both FAD), Mr. El Khoury (LEG), and Mr. King (MCM). Mr. Carpenter, a long-term macro-fiscal advisor, accompanied the mission. The mission met with Prime Minister Zeidan, Central Bank Governor El-Kaber, Minister of Finance Al-Jazi, General National Congress (GNC) Chairman Magariaf, and other government and central bank officials, as well as members of the GNC and representatives of the private sector and civil society.

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APPENDICES

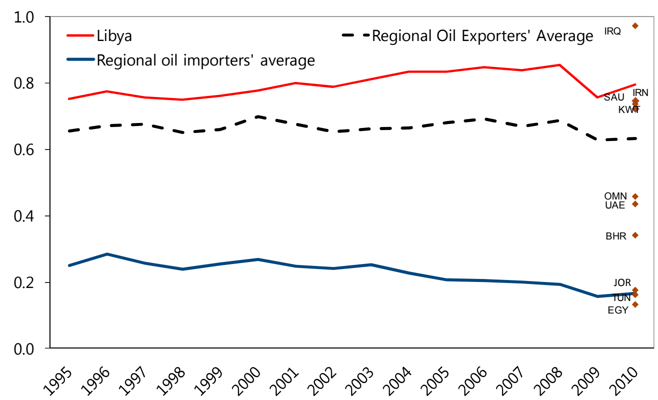
CONTEXT

1. **Following the revolution, Libya has made major strides toward establishing a democratic system of governance.** Elections were held on July 7, 2012 for the General National Congress (GNC), which installed a new government on October 31, 2012. Nevertheless, well-armed, autonomous militias continue to hold considerable power, making security precarious.

2. **Libya is dependent on hydrocarbons, which account for over 65 percent of GDP and 96 percent of revenue.** Hydrocarbon dependency makes economic performance vulnerable to oil price shocks and complicates fiscal management. To quell discontent, the Qaddafi regime used oil revenues to provide grants, increased salaries, and expanded subsidies, which have been maintained by subsequent governments. As a result, fiscal spending has become skewed toward current expenditure. Although Libya can afford high current expenditure for a few years, wages and subsidies are eroding buffers and undermining prospects for fiscal sustainability and intergenerational equity.

Hydrocarbons are Most of Libya's Exports

(Export concentration index, 1 = maximum concentration)



Source: United Nations Conference on Trade and Development.

3. **Libya faces the challenges of stabilizing the economy and responding to the aspirations of the revolution.** The short-term challenges are to manage the political transition, normalize the security situation while exercising budget discipline and maintaining macroeconomic stability. Libya also needs to address issues including capacity building, improving education, rebuilding infrastructure, establishing a social safety net, developing the financial system, and reducing hydrocarbon dependency. Against the backdrop of weak institutions to enforce the rule of law, the government faces pressures for fiscal largess to buy peace and social stability. Libya also needs to set up a governance framework linked to transparency and accountability, including governance elements that would promote private sector-led growth.

4. **Fund engagement will focus on technical assistance and training, as well as policy advice on expenditure management and financial development.** In light of Libya's wealth, staff does not envisage financial assistance from the Fund. Technical assistance and training needs are vast; areas for Fund engagement are set out in Appendix IV.

RECENT DEVELOPMENTS

5. **The political situation is normalizing, but the government lacks control over parts of the country.** While the new government brings together various interest groups, it continues to face a fragmented political landscape and tribal power struggles, which complicate the writing of a new constitution and efforts to reestablish security and the rule of law.

6. **The loss of hydrocarbon revenues during the crisis and UN sanctions on Libya created considerable pressures.** On March 17, 2011 the UN Security Council froze Libya's foreign assets, which made the Central Bank of Libya (CBL) unable to provide adequate foreign exchange to the market. In response to foreign exchange shortages, demand for cash, and increased government spending, on March 6, 2011 the CBL imposed limits on deposit withdrawals. Nevertheless, the impact of the conflict was mitigated by confidence arising from large foreign exchange reserves.[1]

7. **Economic activity collapsed during the conflict, but is recovering rapidly.** In 2011, real GDP contracted by 62.1 percent and average consumer prices rose by 15.9 percent with inflation peaking at a year-on-year rate of 29.7 percent (Figure 1). By end-2012 most hydrocarbon output had been restored. Growth in 2012 is estimated at 104.5 percent with annual average inflation declining to 6.1 percent.

8. **The fall in hydrocarbon exports in 2011 led to a budget deficit and a sharply reduced current account surplus.** The overall budget deficit was 15.4 percent of GDP in 2011, compared to a surplus of 8.9 percent in 2010.[2] Similarly, the current account surplus narrowed from 19.5 percent of GDP in 2010 to 9.1 percent in 2011. With the restoration of hydrocarbon production in 2012, the budget had a surplus of 20.8 percent of GDP, and the current account surplus widened to 35.9 percent.

9. **The financial situation began to normalize in early 2012 after the CBL regained access to its assets abroad (Figure 2).** After the removal of UN sanctions on CBL's foreign assets on December 16, 2011 the CBL was able to provide foreign exchange to banks.[3] The limits on cash withdrawals were eased gradually prior to their elimination on June 7, 2012. The lifting of restrictions improved confidence in the banking system. In 2012, broad money grew by 11.5 percent with a modest shift from currency into deposits, and credit to the private sector increased by 30.3 percent. Although the conflict will have caused asset quality to deteriorate, the systemic impact should be modest in light of the liquidity buffer provided by banks' substantial reserves, along with limited claims on the private sector and the implicit government guarantee of loans to state-owned enterprises. Preliminary data show that nonperforming loans increased from 20.2 percent of total loans in 2010 to 20.6 percent in 2011 and 21.0 percent as of end-2012.

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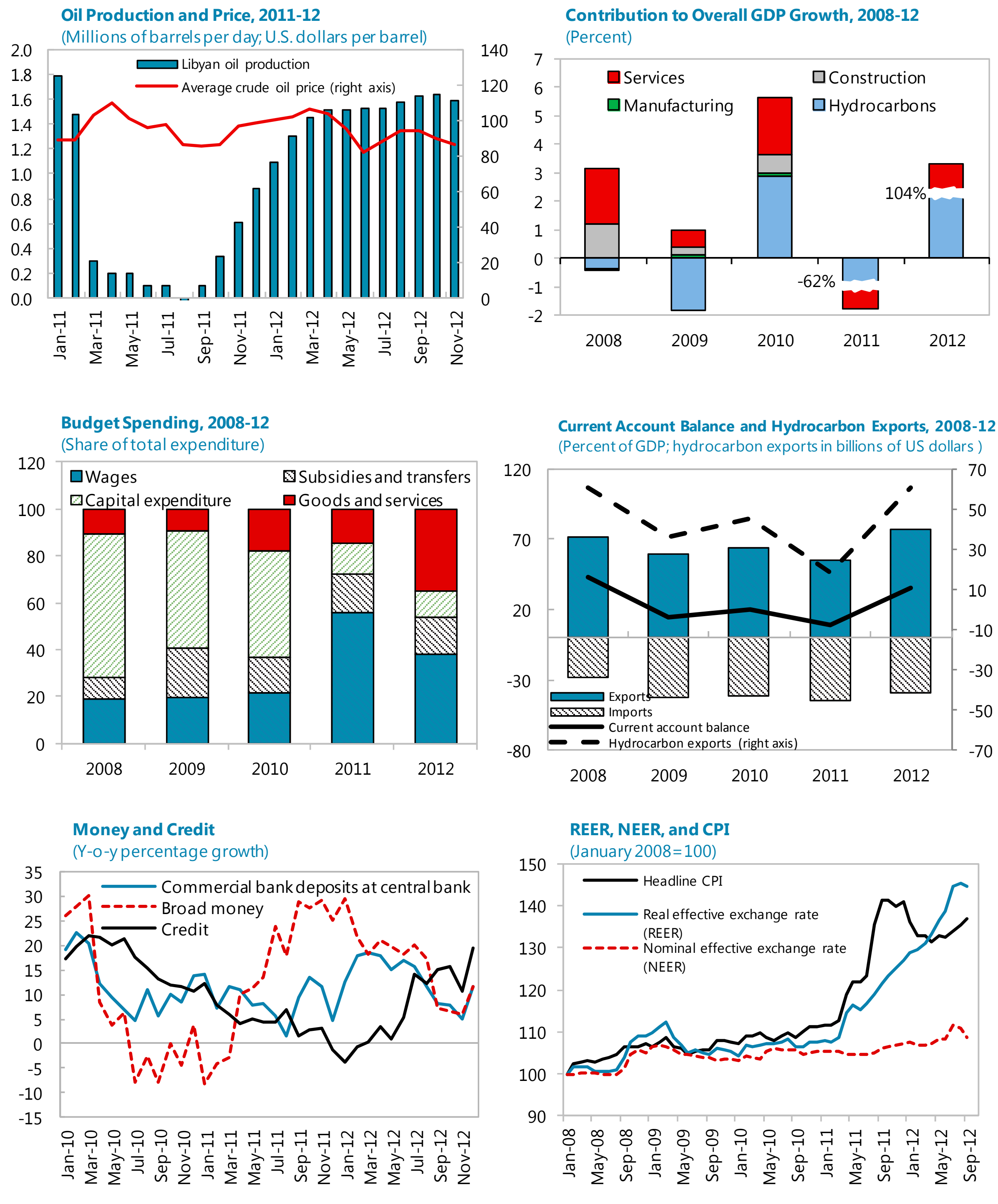
[1] During the conflict the currency traded on the parallel market at about two-thirds of its official value.

[2] The budget deficit was financed by money creation—initially in cash and subsequently by central bank transfers to household bank accounts; although some arrears were reported, they do not appear to have been pervasive.

[3] The parallel market premium for foreign exchange became negligible by April 2012.

Figure 1. Libya: Context and Recent Developments

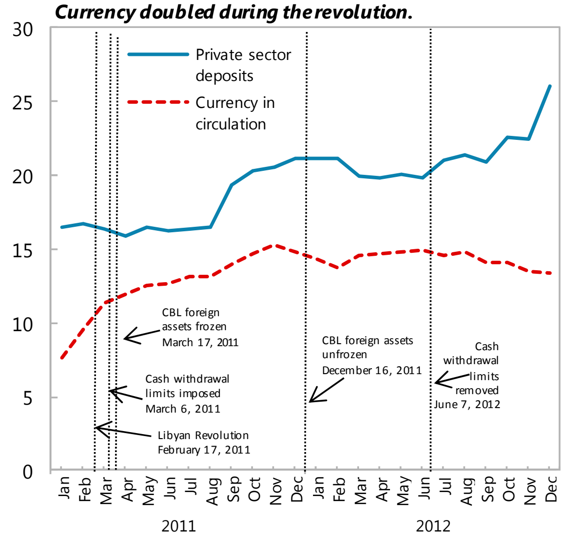


Sources: IEA, Central Bank of Libya, national authorities; and Fund staff estimates.

Figure 2. Libya: Recent Monetary Developments

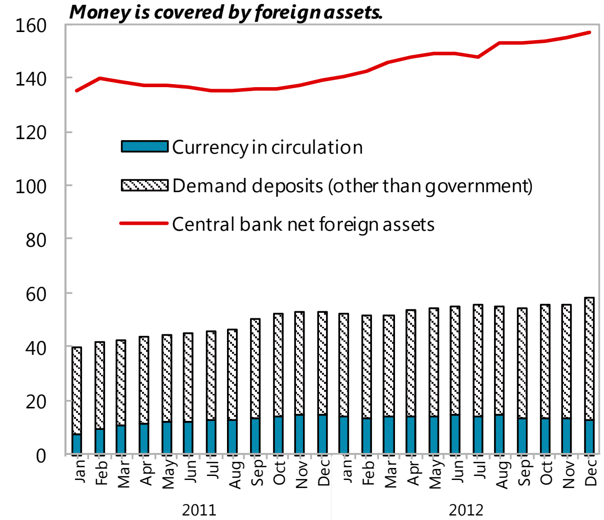
Private Sector Deposits and Currency in Circulation
(Billions of Libyan dinars)

Currency doubled during the revolution.



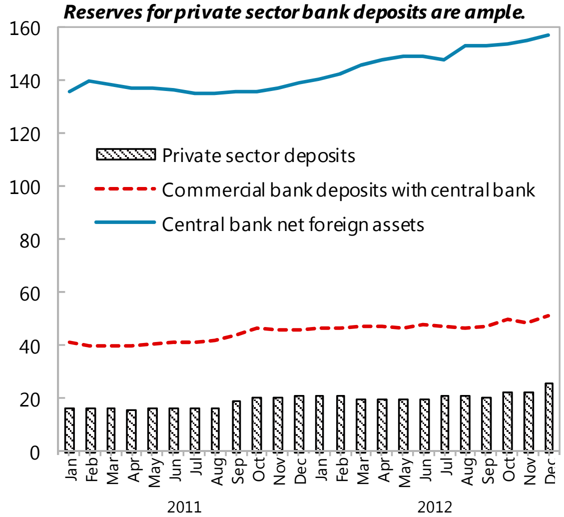
Central Bank Net Foreign Assets, Currency, and Demand Deposits
(Billions of Libyan dinars)

Money is covered by foreign assets.



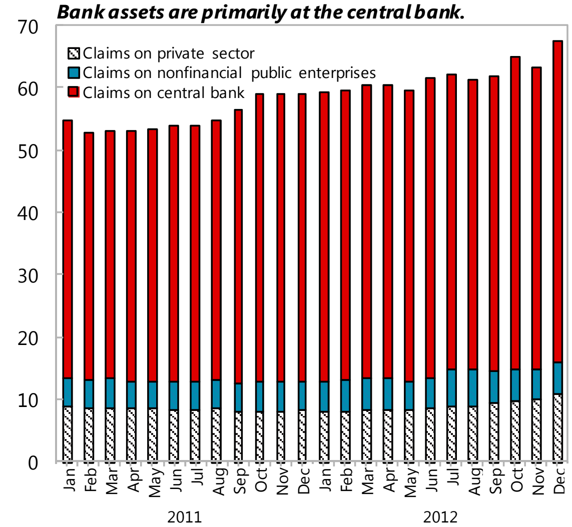
Commercial Bank Deposits and Central Bank Foreign Assets
(Billions of Libyan dinars)

Reserves for private sector bank deposits are ample.



Commercial Bank Claims on Private Sector, Nonfinancial Public Enterprises, and Central Bank
(Billions of Libyan dinars)

Bank assets are primarily at the central bank.



Source: Central Bank of Libya.

10. **The external and fiscal sustainability assessments indicate the need for higher savings.** The external and fiscal balances will deteriorate with the increase in capital expenditure that is envisaged over the medium and long term. Methodologies developed by the Consultative Group on Exchange Rate issues (CGER)—adapted for oil exporters—point to overvaluation (Appendix I). Most results from the macro-balance approach indicate that the projected current account is below the norm. The external sustainability approach indicates that the exchange rate will become overvalued from 2014. The equilibrium real exchange rate approach finds that the dinar was overvalued by 15.3 percent as of November 2012. For the fiscal analysis, the permanent income hypothesis (PIH) approach suggests that the nonhydrocarbon primary balance will be 5.2 percentage points of GDP above its equilibrium value in 2013; from 2015, expenditures will be in line with their equilibrium value with an oil price of $100 per barrel (Appendix II).[4] Beyond 2018, with unchanged current expenditure and expected capital expenditure increases, fiscal policy will not be sustainable.

11. **On January 6, 2013 the GNC passed a law banning interest in financial transactions.** The law was gazetted on March 21, 2013, and banks are no longer allowed to pay interest to or receive interest from individuals. Companies and state entities will be prohibited from receiving and paying interest from the beginning of 2015.

OUTLOOK AND RISKS

12. **Libya will remain hydrocarbon-dependant, with limited growth in private sector jobs over the foreseeable future.** Hydrocarbon production should reach pre-conflict levels in 2013, while reconstruction expenditure and private demand should facilitate an improvement in the nonhydrocarbon sectors of the economy. Nonhydrocarbon growth will be strong, averaging 15 percent during 2013–18 and raising output to the pre-conflict level by 2015. Nevertheless, a significant reduction in unemployment, which is largely structural, will not occur as a result of a return to the pre-conflict status quo. Until Libya generates private sector employment it will not address a key cause of the revolution.

13. **The near-term outlook is favorable, but there are significant risks.** The economy is projected to grow robustly, but risks include delays in normalizing the political environment and security situation, which could be aggravated if the government fails to keep pace with expectations including progress in curbing corruption. Security-related spillovers from neighboring countries are a risk, and Libya remains a potential source of spillovers to the region via renewed conflict and to the world via disruption of hydrocarbon production.

14. **Oil price volatility makes economic performance vulnerable and complicates fiscal management (Figure 3).** With the recovery in hydrocarbon exports, the fiscal and current account surpluses in 2013 are projected at 19.2 percent of GDP and 25.3 percent, respectively. Necessary

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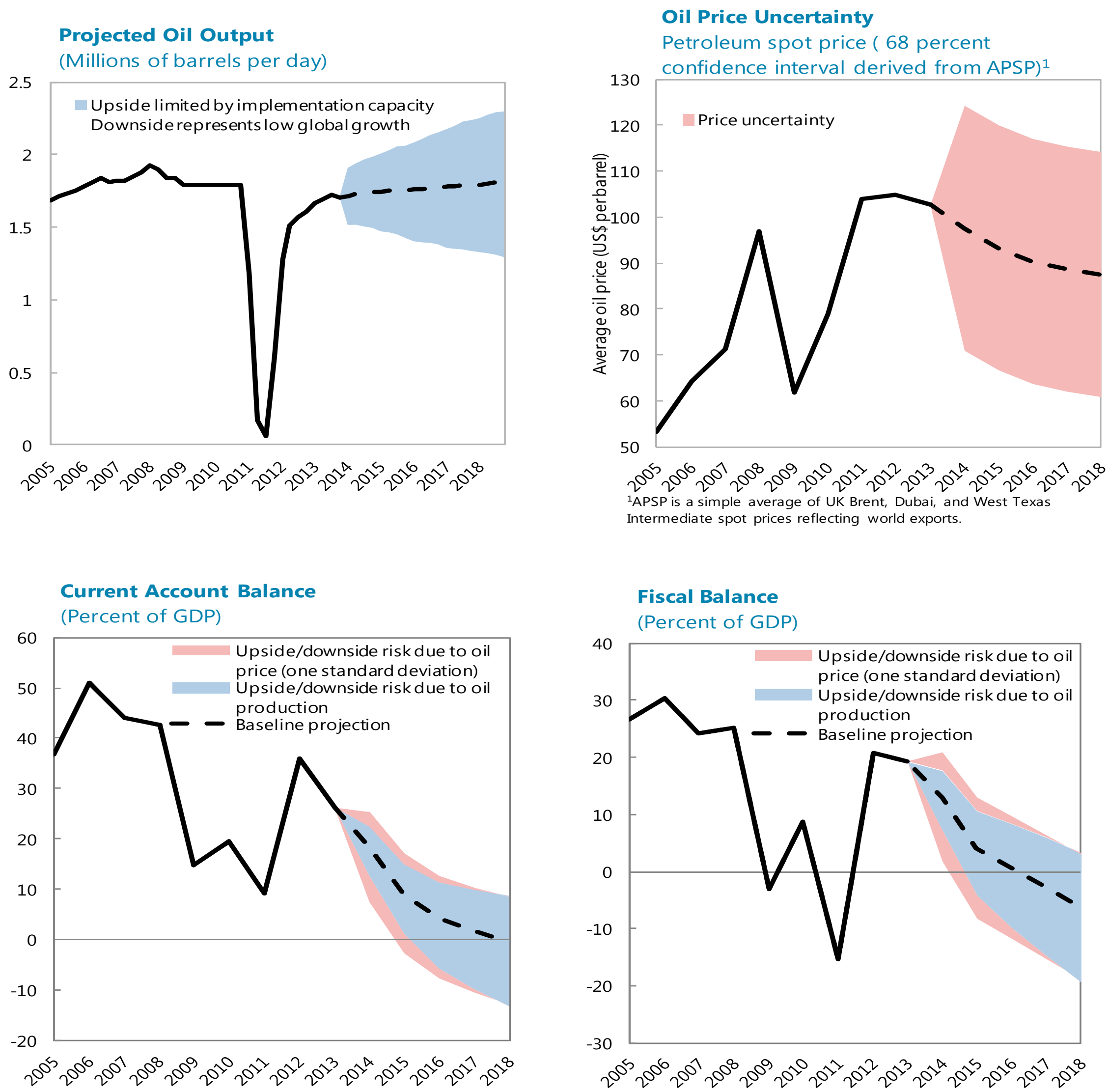
[4] The assumptions for the PIH analysis are: (i) constant real per capita government expenditure that delivers a constant real per capita annuity after the depletion of hydrocarbon resources, and (ii) crude oil prices at $100 per barrel.

reconstruction and development spending will eventually push the budget and current account into deficit in the absence of a curb on current spending.

15. **With the removal of crisis-related bottlenecks, inflation has eased.** Annual inflation was -3.7 percent in December 2012, and average inflation will be low in 2013 due to the base effect. Nevertheless, rapid nonhydrocarbon growth will put upward pressure on prices, particularly given fiscal largesse and bottlenecks in housing and transportation. Higher international food prices would be mostly absorbed by the budget through increased subsidies for staples, posing a fiscal risk with possible spillovers on prices of nonsubsidized items.

Figure 3. Libya: Risk Profile of Fiscal and External Balances Given Oil Output and Price Uncertainty



Source: Fund staff calculations.

Box 1. Inflation Dynamics in Libya[1]

Empirical analysis covering the period 1964–2010 shows that despite pervasive price controls inflation inertia, money supply growth, and government spending are the major determinants of consumer price inflation in Libya. Results also indicate that global inflation and the exchange rate pass-through effect have statistically significant effects on domestic inflation. Finally, international sanctions and embargoes imposed on Libya during the period 1983–99 had a highly significant effect on consumer price inflation. As in most resource-dependent economies, the fiscal policy stance has a ubiquitous influence on the economic cycle and inflation dynamics. Therefore, ensuring an appropriate balance between economic growth and price stability requires closer coordination between monetary policy and fiscal policy.

[1] Based on "Hitchhiker's Guide to Inflation in Libya," by Serhan Cevik and Katerina Teksoz, IMF Working Paper, No. 13/79.

16. **The hasty introduction of legislation prohibiting interest would pose risks to the financial sector and could undermine efforts to diversify the economy.** A law banning interest has been passed by the GNC on January 6, 2013 and published in the official gazette on March 21, 2013. The prohibition of interest-based transactions, without the foundations of Islamic finance in place, will stop private banks from lending, thereby constraining private sector efforts to invest and create employment. Meanwhile, although the banking sector appears well capitalized, it may be vulnerable to asset quality deterioration.

17. **The authorities broadly agreed with the staff's assessment of the economic outlook and associated risks and policy options.** While recognizing risks associated with an unanchored fiscal policy, the government opts for fiscal largess to bring peace and stability in the short run. Despite the passing of a law banning interest, the CBL prefers the development a dual banking system with both conventional and Sharia-compliant financial institutions.

POLICY DISCUSSIONS

The overarching macroeconomic policy objective is to foster inclusive growth, underpinned by reforms to bolster private sector led economic diversification while ensuring transparency and accountability. Policy discussions focused on: (i) the near-term policy mix and macroeconomic conditions; (ii) growth and job creation; (iii) the monetary and financial sector; (iv) fiscal expenditure, public financial management, and subsidy reform; (v) transparency and statistical capacity building; and, (vi) technical assistance.

A. Near-Term Outlook and Policy Mix

18. **The near-term economic outlook is favorable, albeit with risks associated with an unanchored fiscal policy.** The economy is set to grow at a robust pace, driven by private demand and government reconstruction spending, and inflation will remain low. On the fiscal front, however, spending on wages and subsidies will remain high, while increasing capital expenditures will begin to erode fiscal buffers. On the monetary front, the pegged exchange rate regime will remain the policy anchor, thanks to ample foreign exchange reserves that preserve confidence in the currency. Staff welcomed the intention of the authorities to maintain the current exchange rate of the dinar, which has and continues to serve Libya well as the anchor of macroeconomic policy. Nevertheless, staff cautioned that the currency is overvalued and urged the authorities to strengthen the policy mix through fiscal consolidation.

19. **Staff urged the government to contain current expenditures in the 2013 budget and address critical capital expenditure priorities.**[5] Since the revolution, the level of recurrent spending has been inconsistent with appropriate budgetary prioritization. Increases in the wage bill continue to undermine fiscal stabilization efforts, given the volatility of oil prices and a narrow nonhydrocarbon tax revenue base. Compared to 2012, the 2013 budget presents an increase in wages of 1.5 percent of 2013 GDP and in subsidies and transfers of 4.3 percent of 2013 GDP, including a fund for cash transfers. Staff recommended limiting current expenditure, in particular to contain increases in salaries and the number of public employees, as well as streamlining generalized subsidies. The authorities responded that the wage bill was rising due to higher salaries in some sectors, such as the judiciary, as well as new hiring to address skills mismatches and to maintain social peace. The authorities expect subsidy reform to begin in 2013 (see below).

Budget for 2013
(percent of GDP)

Total Revenue, *of which:*	51.9
Hydrocarbon	48.5
nonhydrocarbon	3.4
Total Expenditure, *of which:*	55.8
Current Expenditure, *of which:*	39.8
Wages	17.2
Goods and Services	8.8
Subsidies	13.8
Development Expenditure	16.0
Overall Balance	-3.8

Source: Ministry of Finance.

20. **Staff was encouraged by the authorities' intention to implement a national system for the identification of individuals.** The envisaged system will help to: (i) encourage the development of the formal financial sector, including fostering financial intermediation; (ii) reduce ghost workers in the civil service; (iii) provide scope to target social expenditure; (iv) improve revenue administration; and, (v) bolster the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework.

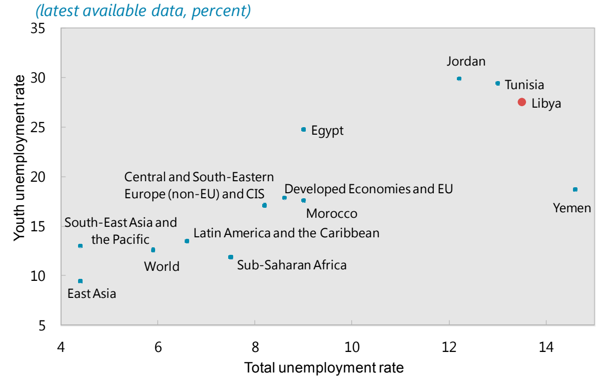
[5] Staff projected revenue of LD 87.7 billion (27.9 percent of GDP) with crude oil output of 1.7 million barrels per day and an oil price of $103 per barrel; capital spending was projected to be LD 13 billion (10.8 percent of GDP).

B. Growth and Job Creation

21. **The authorities and staff agreed on the need to develop a strategy for diversification through private sector-led growth.** Libya's economy is dominated by oil and the state with the public sector employing 85 percent of the workforce. International indicators show a difficult business environment and lackluster infrastructure (Figure 4). Libya scores poorly in international competitiveness, at 113 out of 144 countries, below Egypt at 43 and the GCC average of 22, as well as regarding the legal framework, labor market efficiency, and the business environment.[6] Libya is well positioned to develop tourism and services, as well as to serve as a regional transit hub with construction of north-south and an east-west highways. The authorities are working to remove legislative uncertainty and improve the business environment by rationalizing the regulatory framework. Public spending, particularly on wages and subsidies, needs to be reined in to maintain overall macroeconomic stability. Financial sector reform is critical to ensure that entrepreneurs and private businesses have access to finance. Private sector development and diversification will be bolstered by strengthening regional integration, which will facilitate the flow of technology, expertise, and entrepreneurship. The government also intends to launch specific programs aimed at increasing credit to the private sector with a focus on small and medium enterprises. Staff also encouraged the authorities to strengthen the AML/CFT framework to improve the business environment.

Unemployment rates by region

(latest available data, percent)



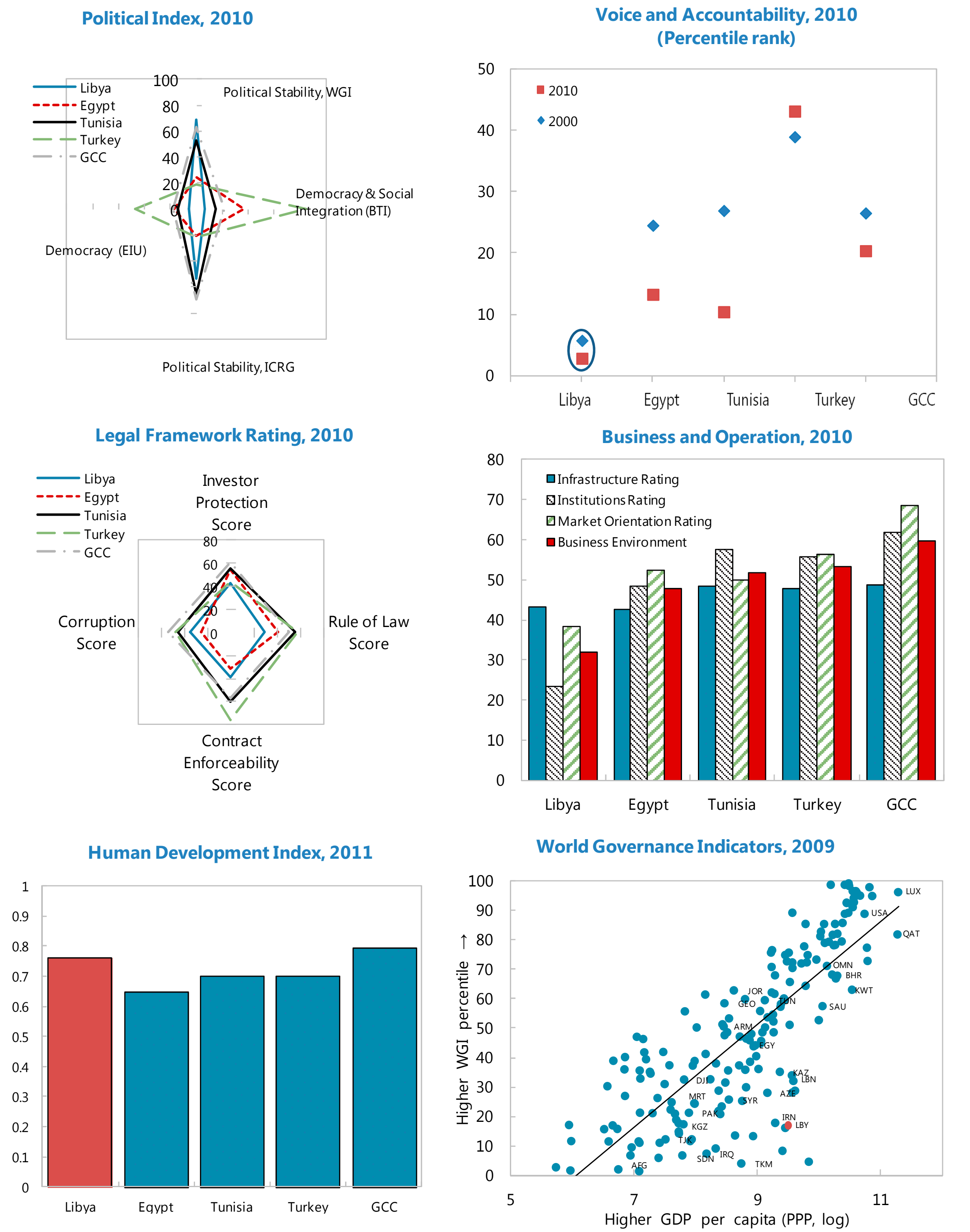
Sources: International Labor Organization, national authorities; and IMF staff calculations.

22. **Staff noted the importance of diversification to create employment opportunities in the private sector and reduce hydrocarbon dependency.** As of end-2010, unemployment was officially 13.5 percent with youth unemployment estimated at 25–30 percent.[7] The lack of employment opportunities for nationals can be traced back to the domination of the economy by the state, a mismatch between the skills of workers and the demands of the private sector, as well as insufficient labor productivity, all of which limit demand for Libyan workers. In this connection, the authorities need to focus on governance reforms, education, and training to provide potential employees with the skills that are in demand by the private sector. The authorities agreed with staff that private sector investment is necessary to create sustainable employment. Public sector investment will need to be supportive of the private sector and should be well-targeted to alleviate bottlenecks and well-monitored with a focus on quality rather than quantity.

[6] World Economic Forum *Global Competitiveness Report, 2012–13*.

[7] Data provided to the staff in 2012 indicated that unemployment at end-2010 was 26 percent.

Figure 4. Libya: Selected Political and Social Indicators



Source: BMI, EIU, ICRG, UNDP, and World Bank.

C. Monetary and Financial Sector

23. **The pegged exchange rate is sustainable only as long as fiscal and monetary policies are supportive.** The CBL should ensure that its monetary policy stance is consistent with the peg and that monetary operations are consistent with the desired stance. With no interest paid on retail deposits, their real rate of return is negative. Looking forward, the CBL should start to assess liquidity conditions with a view to moving toward positive real interest rates in order to increase the savings rate and forestall overheating. Furthermore, the CBL will need to develop Sharia-compliant liquidity management instruments before the payment of interest on current CBL facilities is prohibited by law.

24. **Staff cautioned that the prohibition of interest would interrupt financial intermediation unless and until Sharia-compliant instruments and institutions are operational.** The CBL has taken steps toward developing a dual system of conventional and Islamic banks. Staff noted that implementation of an interest ban could reduce access to credit for startups, entrepreneurs, and small and medium-sized enterprises (SMEs), and urged the authorities to develop and articulate a roadmap that is consistent with supervisory and implementation capacity, as well as the objective of promoting financial sector development. CBL management favors continuing with the dual system despite intense political pressure to adopt a Sharia-compliant system. The authorities recognized the importance of access to credit for entrepreneurs and SMEs.

25. **Staff suggested that the authorities focus on efforts to develop a vibrant formal financial sector that caters to the needs of the economy.** A number of entities currently provide financial products and services (currency exchange and transfers and short-term lending) outside of the formal banking system. In this respect the CBL has adopted procedures with respect to foreign exchange transfers abroad through the announcement of licensing requirements for exchange operators. The growth of this informal sector, operating beyond regulatory and supervisory reach, undermines public policy and potentially increases risks to financial stability and macroeconomic performance.

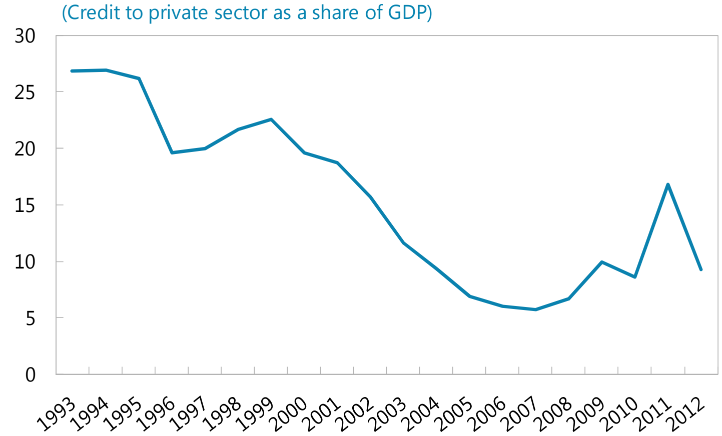
Box 2. The Finance-Growth Nexus in Libya[1]

Libya has moved forward with reform initiatives prior to the revolution, but the banking system remains predominantly in the hands of the public sector. The extent and diversity of financial services provided are limited and hindered by institutional weaknesses including the lack of a robust system of property rights, the absence of credit assessment information, the lack of competition, and government ownership.

The financial system in Libya has undergone substantial changes over the past decade, but remains shallow and bank-dependent. Commercial bank lending to the private sector increased from 2.2 percent of GDP in 1970 to 31.5 percent in 1990, but then declined to 21.8 percent in 2000 and 9.5 percent by end-2010. Furthermore, the share of credit to the private sector in total banking assets declined from over 40 percent to about 13.5 percent. Empirical results, in general, indicate a lack of relationship between financial intermediation and output growth.

Low Financial Intermediation Limits Private-Sector Development

(Credit to private sector as a share of GDP)



Sources: Country authorities; and IMF staff estimates.

Nonhydrocarbon economic activity depends largely on government spending, which is in turn determined by hydrocarbon earnings. The lack of a long-run relationship between financial intermediation and nonhydrocarbon growth reflects factors including the volatility of hydrocarbon earnings, lack of adequate lending opportunities, and institutional bottlenecks. Financial development is a critical channel for fostering economic growth and maintaining macroeconomic stability, and will require a comprehensive strategy based on a well-sequenced set of structural reforms and policy measures.

[1] Based on "Searching for the Finance-Growth Nexus in Libya" by Serhan Cevik and Mohammad Rahmati, IMF Working Paper, No. 13/92.

26. **Additional structural reforms are required for the development of a growth-enhancing financial system.** Financial intermediation remains rudimentary and shallow, reflecting a number of factors including the lack of adequate lending opportunities in nonhydrocarbon sectors of the economy and competition from specialized credit institutions (SCIs) that are directed to implement social programs.[8] Looking forward, staff suggested a comprehensive reform strategy aimed at: improving the legal framework; streamlining the insolvency regime; enhancing competition in the banking sector; reducing the role of state-owned commercial banks and specialized credit

[8] As of end-2010, SCIs accounted for over 65 percent of credit.

institutions; and, improving the credit information system to enable banks to better assess credit risk and improve access to finance. In particular, the reform strategy should seek to wind down the operations of the SCIs.

27. **Staff urged the authorities to enhance regulatory and supervisory capacity.** Measures to mitigate systemic risk should address vulnerabilities arising from macroeconomic developments, market infrastructure, and bank balance sheets. Staff argued that streamlining regulation while strengthening the supervisory framework remains key to promoting financial intermediation that would help underpin investment, growth, and macroeconomic stability. Staff urged the authorities to consider measures to strengthen balance sheet resilience and risk management and prevent the buildup of excessive sectoral exposures.

28. **An AML/CFT Law should be brought in line with international standards, and resources should be devoted to its effective implementation.** Financial sector development should be accompanied by strengthening AML/CFT supervision to ensure compliance. Adequate preventive measures and reporting to an independent and operational Financial Intelligence Unit will help limit destabilization from illicit financial flows. An effective AML/CFT system would also assist in recovery of stolen assets.

D. Fiscal Strategy

29. **Staff highlighted that procyclical policies threaten macroeconomic stability as well as fiscal sustainability and intergenerational equity.** In light of hydrocarbon dependency and the CBL's commitment to the pegged exchange rate, fiscal policy remains the main instrument for maintaining macroeconomic stability. Staff noted that current policies will erode Libya's hydrocarbon wealth as necessary reconstruction and development spending will eventually push the budget into deficit in the absence of a curb on current spending. Staff suggested that scaling up of development expenditure should take into account the institutional and absorptive capacity of the economy. This would ensure the efficiency of capital investment, mitigate the buildup of inflationary pressures, limit real exchange rate appreciation, and be consistent with the accumulation of precautionary savings.

30. **Staff called for reprioritizing government spending to enhance growth and efficiency.** Libya has a large infrastructure gap, which requires government spending to alleviate infrastructure bottlenecks to development. Some components of public spending, including on education and infrastructure, will also contribute to nonhydrocarbon growth. Reducing distortions due to high public sector wages and subsidies would improve incentives and resource allocation, leading to an increase in private capital formation and foster the growth of employment opportunities outside the public sector. The authorities acknowledged the importance of speeding up the implementation of already-approved development projects with large employment impact.

Box 3. Designing a Rule-Based Fiscal Framework for Libya[1]

The Libyan authorities are interested in adopting a fiscal rule to anchor fiscal policy. International experience has shown that a rule-based fiscal framework helps insulate an economy against volatility and ensure fiscal sustainability. Budget formulation lacks an explicit policy or development strategy, and has a weak linkage between policy priorities and expenditures. Taking into account hydrocarbon wealth and large infrastructure and reconstruction needs, the adoption of a rule-based, transparent medium-term fiscal framework would provide an anchor for stabilization and intergenerational equity objectives and support the fixed exchange rate regime. Furthermore, given the politically-induced bias toward increasing expenditures in the short run, a transparent and well-designed fiscal policy rule constitutes a compelling option for decoupling government spending—and the nonhydrocarbon budget balance—from the volatility of hydrocarbon revenues.

The simulation results suggest that the "enhanced" structural balance rule—taking into account the output gap and commodity price deviations from their long-term trend—would be the strongest anchor for fiscal policy in Libya. However, in view of institutional capacity constraints that may prevent its implementation in the near future, an expenditure rule—refined to take into account the front-loaded needs for infrastructure spending in the immediate post-revolution period—appears to be the most feasible option to anchor fiscal policy formulation, with a view towards transitioning towards the adoption of the "enhanced" structural balance rule.

[1] Based on "The Day After Tomorrow: Designing an Optimal Fiscal Strategy for Libya" by Carlos Caceres, Serhan Cevik, Ricardo Fenochietto, and Borja Gracia, IMF Working Paper, No. 13/79.

31. **The authorities agreed with staff on the need to develop a rule-based medium-term fiscal framework.** Libya's public finances are heavily dependent on volatile hydrocarbon earnings, with an annual budget preparation that is characterized by a short-term horizon with little reference to longer-term policies and objectives. Furthermore, beyond building fiscal buffers against exogenous shocks to the revenue stream, Libya needs to cast its spending in a framework designed to support intergenerational equity in the allocation of wealth. Accordingly, a credible fiscal policy anchor would delink the economy from oil price fluctuations, improve the management of resource wealth, and safeguard macroeconomic stability (Box 3). The authorities were keen to examine the scope to institutionalize a fiscal rule in the forthcoming constitution and welcomed Fund advice in this area.

32. **Staff argued that the Libyan Investment Authority (LIA) should be integrated into the fiscal framework.**[9] Libya's sovereign wealth fund (SWF) system, operating through the LIA and the budget reserve account (BRA) at the CBL, should be fully integrated into this framework, with well-defined and transparent rules determining the inflows to and outflows from the LIA and the BRA. Currently, the LIA lacks a clear definition of objectives and the rules governing the accumulation,

[9] Based on a Bank/Fund TA report on governance arrangements for the LIA.

management, and use of its resources. Accordingly, staff recommended that the LIA should function as a savings fund for future generations as well as a stabilization fund to better manage oil price cycles. In this respect, the SWF system should not participate in domestic investment projects—directly or through the Social and Economic Development Fund and the Libyan Fund for Domestic Investment and Development. Along with well-defined investment objectives, the LIA also needs to improve transparency and accountability in its governance, consistent with international good practices. The authorities were grateful for Fund advice on the institutional arrangements for the LIA and were keen to address shortcomings in the governance framework.

33. **Staff suggested the adoption of a comprehensive reform strategy to strengthen the public financial management (PFM) system.**[10] The core functions of the Ministry of Finance to effectively play its role of stewardship of public finances remain to be fully established.[11] Staff highlighted that the separation of institutional responsibilities between the Ministry of Finance and the recently created Ministry of Planning for the preparation and execution of the recurrent and investment budgets poses a challenge to implementing a unified system of budget management. Fiscal forecasts—covering only the ensuing year—and the budget have yet to become effective tools for successful implementation of a fiscal strategy reflecting national policy objectives and the volatile and exhaustible nature of hydrocarbon revenues. Fiscal accounts and budget reports are prepared with substantial time lag undermining the government's ability to monitor fiscal developments and enforce accountability in public service delivery. Moreover, government banking arrangements remain fragmented and cash resources are dispersed across numerous bank accounts. Accordingly, staff argued that the thrust of PFM measures in the near term should be to address key priorities with a view to building the institutional capacity for more fundamental reforms. The authorities welcomed Fund advice on PFM reform as well as the opportunity to have a long-term expert advise them on reforms.

[10] Based on Bank/Fund TA report "Public Financial Management Reform: Priorities in the New Environment," April 2012.

[11] The authorities have requested a Capability Assessment Program from the Fund.

34. **Staff recognized the efforts of the authorities to elaborate a subsidy reform strategy.** Energy prices are highly subsidized in Libya with gasoline prices one of the lowest in the world.[12] Food price subsidies are also large at the equivalent of 2.0 percent of GDP. Government spending on subsidies increased from 8.5 percent of GDP in 2010 to 11.0 percent in 2012, more than half of which was on fuel subsidies. The authorities are planning to move from price subsidies to cash transfers, supported by a request from the GNC for a report on reform modalities from the Ministries of Economy, Finance, and Planning, which is due by August 2013.

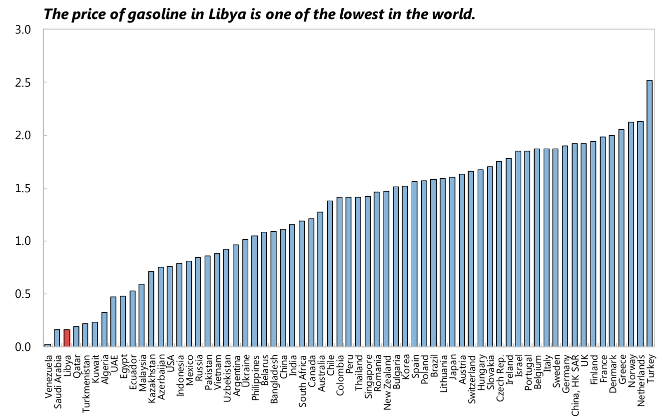
Libya: Subsidies in 2012[1/]

	Share of GDP	U.S. dollars (billions)
Total, *of which:*	11.0	9.1
Fuel	6.1	5.0
Food	2.0	1.7
Electricity	1.1	0.9

Source: Libyan authorities.

1/ Excludes implicit subsidies.

Price of Gasoline, end-2010
(U.S. dollars per liter)



Sources: FAD database on cross-country gasoline prices, Deutsche Gesellschaft für Technische Zusammenarbeit, and Libyan authorities.

E. Transparency and Statistical Capacity Building

35. **The authorities agreed with staff on the need to enhance transparency throughout the public sector.** Data compilation remains weak and responsibilities are spread over several agencies. Compilation of many key indicators was interrupted by the conflict and has not been restored. The authorities requested assistance from staff in data compilation and in setting out a transparency strategy that will include the CBL, the Ministry of Finance, the SWF system, and the National Oil Corporation.

F. Staff Appraisal

36. **The political and security environment remains uncertain.** Lacking the capability to enforce the rule of law, the government has had limited success in bringing autonomous militias under control and dealing with a fragmented political landscape and tribal power struggles. Consequently, short-term stability concerns continue to trump much-needed medium-term structural reforms.

[12] Domestic gasoline consumption in 2010 was 4.1 billion liters with a retail price of $650 million, compared to the pre-tax price in Italy of $3.1 billion.

37. **Economic activity has rebounded.** Hydrocarbon output has been restored, generating large budget and current account surpluses. Nonhydrocarbon growth has been strong, underpinned by private demand. Inflation has returned to single digits, reversing price increases that took place during the conflict.

38. **The near-term outlook is favorable, but there are significant risks.** Risks include delays in normalizing the political environment and security situation. Oil price volatility makes economic performance vulnerable and complicates fiscal management. A significant reduction in unemployment, which is largely structural, will not occur as a result of a return to the pre-conflict status quo. Until Libya generates private sector employment it will not address a key cause of the revolution.

39. **The overarching policy objective should be to foster inclusive growth.** Diversification will be key to create employment opportunities in the private sector and reduce hydrocarbon dependency. The authorities need to articulate and then implement a strategic vision for economic development which includes steps to set up a governance framework linked to transparency and accountability, including anti-corruption elements. Sustainable growth requires a business environment that is conducive to private sector development.

40. **Banks are not intermediating effectively.** Banks continue to suffer from the presence of the government in the sector and the lack of an enabling legal environment. Staff encourages the authorities to develop a comprehensive financial sector reform strategy, including a roadmap to wind down the operations of the SCIs. Streamlining regulation while strengthening the supervisory framework remains key to promoting financial intermediation that would help underpin investment, growth, and macroeconomic stability.

41. **An AML/CFT Law in line with international standards is needed, and resources should be devoted to its effective implementation.** An effective AML/CFT system will help limiting illicit financial flows including corruption and will support the recovery of stolen assets.

42. **A law banning interest in financial transactions was enacted.** Implementation of the law in the absence of Sharia-compliant institutions will preclude conventional lending. Until Sharia-compliant institutions are able to deliver the services required by the private sector the interest ban should be suspended and commercial banks should be allowed to operate.

43. **Expenditure is skewed toward wages and subsidies.** The lack of institutional capacity is constraining execution of urgent infrastructure projects, while an entitlement mentality is encouraging recurrent spending. Current spending is eroding buffers and undermining prospects for fiscal sustainability and intergenerational equity. Efforts to implement subsidy reform in 2013 are commendable. Libya would be well-served by a fiscal rule to help ensure sustainability of fiscal policy.

44. **The LIA should be integrated into the fiscal framework.** The LIA should function as a savings fund for future generations as well as a stabilization fund to better manage oil price cycles. The SWF system should not participate in domestic investment projects—directly or through the Social and Economic Development Fund and the Libyan Fund for Domestic Investment and Development. The LIA also needs to improve transparency and accountability in its governance, consistent with international good practices.

45. **Libya needs to adopt a comprehensive reform strategy to improve its PFM system.** The thrust of measures in the near term should address key priorities with a view to building the institutional capacity for more fundamental reforms.

46. **Libya's macroeconomic statistics are barely adequate for surveillance.** In light of hydrocarbon dependency and limited financial intermediation, the data provided by the authorities is adequate for surveillance. Nevertheless, data compilation remains weak and responsibilities are spread over several agencies.

47. **The currency peg to the SDR has served Libya well.** In an environment marked by uncertainty, volatile oil revenues, and the absence of alternative tools for monetary policy, the peg has provided a pragmatic policy anchor supported by ample reserves. Under the baseline scenario, continued fiscal expansion is likely to lead to a deterioration in the external position, an appreciation of the real exchange rate, and overvaluation of the currency. Staff urges the authorities to be mindful of this dynamic in formulating fiscal policy and to enact structural reforms that improve external competitiveness.

48. **Staff is in the process of reviewing the foreign exchange system of Libya including related legal instruments to assess Libya's compliance with its obligations under Article VIII of the Fund's Articles of Agreement.** There are issues that raise potential Article VIII concerns including the imposition and lifting of UN sanctions freezing Libya's foreign assets, the existence of parallel market premium for foreign exchange and procedures with respect to foreign exchange transfers abroad.

49. **Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.**

Table 1. Libya: Selected Economic and Financial Indicators, 2010–14

(Quota = SDR 1,123.7 million)
(Population: 6.36 million, 2010 estimate)
(Per Capita GDP: US$13,700 2010 estimate)
(Poverty rate: n.a.)
(Main Export: Crude Oil)

		Est.	Est.	Projection	
	2010	2011	2012	2013	2014
	(Annual percentage change, unless otherwise indicated)				
National income and prices					
Real GDP	5.0	-62.1	104.5	20.2	10.1
Nonhydrocarbon	6.1	-52.5	43.7	24.5	19.5
Hydrocarbon	4.0	-72.0	211.4	16.7	2.0
Nominal GDP in billions of Libyan dinars	94.7	42.5	103.3	120.3	126.1
Nominal GDP in billions of U.S. dollars	74.8	34.7	81.9	94.6	98.7
Per capita GDP in thousands of U.S. dollars	11.7	5.5	12.8	14.5	14.9
CPI inflation					
Period average	2.5	15.9	6.1	2.0	5.2
End of period	3.3	26.6	-3.7	6.9	3.8
	(In percent of GDP)				
Investment and saving					
Gross capital formation	39.6	20.0	16.5	20.9	23.4
Public	23.6	7.6	4.9	9.9	12.4
Private	16.0	12.4	11.6	11.0	11.0
Gross national savings	59.1	29.2	52.4	47.2	41.5
Public	34.5	-7.2	26.2	30.0	26.5
Private	24.6	36.3	26.2	17.2	15.0
Saving-investment balance	19.5	9.1	35.9	26.3	18.1
	(In percent of GDP)				
Central government finances					
Revenues, *of which:*	64.9	50.3	72.3	72.9	70.4
Hydrocarbon	58.8	47.8	69.2	69.5	66.4
Expenditure and net lending, *of which:*	56.1	65.7	51.5	53.7	57.4
Capital expenditures	25.6	8.2	5.3	10.8	13.5
Overall balance	8.9	-15.4	20.8	19.2	13.0
Nonhydrocarbon balance	-50.0	-63.2	-48.4	-50.3	-53.4
Nonhydrocarbon balance in percent of nonhydrocarbon GDP	-139.6	-130.6	-188.7	-187.2	-164.4
	(Changes as a percent of beginning of the year money stock)				
Money and credit					
Money and quasi-money	3.6	25.0	11.5	…	…
Net credit to the government	-26.6	18.5	-24.8	…	…
Credit to the economy	4.1	-2.6	4.5	…	…
	(In billions of U.S. dollars; unless otherwise indicated)				
Balance of payments					
Exports, *of which*	46.8	19.1	62.2	64.6	62.5
Hydrocarbon	45.4	18.7	61.0	63.1	60.6
Imports	24.6	11.2	25.7	30.5	34.2
Net factor income	0.0	0.1	-0.1	-0.8	-1.1
Net current transfers	-1.8	-0.4	-1.0	-1.3	-1.4
Current account balance	14.6	3.2	29.4	24.9	17.8
(As percent of GDP)	19.5	9.1	35.9	26.3	18.1
Overall balance	4.5	6.0	16.9	18.2	12.8
(As percent of GDP)	6.1	17.2	20.7	19.2	13.0
Reserves					
Total foreign assets (incl. LIA investments), *of which:*	171.5	176.9	190.3	208.7	221.9
Gross official reserves	101.8	111.6	124.5	142.7	155.5
In months of next year's imports	78.3	41.6	39.1	40.0	37.6
Exchange rate					
Official exchange rate (LD/US$, period average)	1.27	1.22	1.26	1.27	1.28
Real effective exchange rate (change in percent)	-0.3	6.4	...	...	...
Crude oil production (millions of barrels per day - mbd), *of which:*	1.69	0.48	1.45	1.70	1.73
Exports	1.35	0.38	1.28	1.36	1.38
Crude oil price (US$/bbl)	79.0	104.0	105.0	102.6	97.6

Sources: Libyan authorities; and Fund staff estimates and projections.

Table 2. Libya: Consolidated Fiscal Operations, 2010–18

	2010	Est. 2011	Est. 2012	Projection 2013	2014	2015	2016	2017	2018
				(In millions of Libyan dinars)					
Total Revenue and Grants	61,504	21,349	74,714	87,676	88,743	89,400	91,326	92,233	93,646
Hydrocarbon Revenue	55,713	20,293	71,491	83,575	83,784	83,487	84,317	84,359	84,811
Nonhydrocarbon Revenue, *of which:*	5,791	984	3,223	4,101	4,959	5,913	7,009	7,874	8,835
Tax Revenue, *of which:*	3,642	699	1,200	1,650	1,909	2,188	2,506	2,763	3,043
Taxes on income and profits	2,248	461	500	900	1,120	1,368	1,653	1,877	2,127
Taxes on international trade	1,394	238	700	750	789	821	853	886	917
Nontax Revenue	2,149	285	2,023	2,451	3,050	3,725	4,502	5,111	5,792
Grants	0	72	0	0	0	0	0	0	0
Total expenditure and net lending	53,111	27,891	53,190	64,570	72,349	83,822	90,310	96,367	103,509
Total Expenditure	51,831	26,891	53,160	63,070	70,782	82,164	88,554	94,528	101,574
Current expenditure, *of which:*	27,553	23,388	47,660	50,070	53,782	58,164	61,554	65,227	69,729
Wages	11,383	14,800	18,924	20,746	22,862	24,920	26,070	27,887	29,976
Goods and services	8,151	2,780	17,333	12,717	13,569	14,880	16,044	16,982	18,330
Subsidies and transfers 1/	8,019	4,414	11,400	16,607	17,351	18,364	19,440	20,358	21,423
Capital expenditure	24,279	3,503	5,500	13,000	17,000	24,000	27,000	29,301	31,845
Net lending	1,280	1,000	30	1,500	1,567	1,659	1,756	1,839	1,935
Overall balance	8,393	-6,542	21,524	23,107	16,394	5,577	1,016	-4,134	-9,863
Nonhydrocarbon balance	-47,320	-26,835	-49,967	-60,468	-67,390	-77,910	-83,301	-88,493	-94,674
Domestic Financing, *of which:*	-11,904	8,596	-21,524	-23,107	-16,394	-5,577	-1,016	4,134	9,863
Banking system	-11,904	8,596	-21,524	-23,107	-16,394	-5,577	-1,016	4,134	9,863
				(In percent of GDP, unless otherwise indicated)					
Total Revenue	64.9	50.3	72.3	72.9	70.4	66.7	64.1	61.7	59.3
Hydrocarbon	58.8	47.8	69.2	69.5	66.4	62.3	59.2	56.4	53.7
Nonhydrocarbon	6.1	2.3	3.1	3.4	3.9	4.4	4.9	5.3	5.6
Total expenditure and net lending	56.1	65.7	51.5	53.7	57.4	62.6	63.4	64.4	65.6
Total Expenditure	54.7	63.3	51.4	52.4	56.1	61.3	62.2	63.2	64.4
Current expenditure, *of which:*	29.1	55.1	46.1	41.6	42.7	43.4	43.2	43.6	44.2
Wages	12.0	34.8	18.3	17.2	18.1	18.6	18.3	18.6	19.0
Goods and services	8.6	6.5	16.8	10.6	10.8	11.1	11.3	11.4	11.6
Subsidies and transfers	8.5	10.4	11.0	13.8	13.8	13.7	13.7	13.6	13.6
Capital expenditure	25.6	8.2	5.3	10.8	13.5	17.9	19.0	19.6	20.2
Net lending	1.4	2.4	0.0	1.2	1.2	1.2	1.2	1.2	1.2
Overall balance	8.9	-15.4	20.8	19.2	13.0	4.2	0.7	-2.8	-6.2
Nonhydrocarbon balance (in percent of nonhydrocarbon GDP)	-139.6	-130.6	-188.7	-187.2	-164.4	-154.9	-137.2	-128.8	-122.3

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ For 2013, includes an earmarked budgetary reserve for cash transfers.

Table 3. Libya: Monetary Survey, 2010–14

	2010	2011	2012	Projection 2013	Projection 2014
	(In millions of Libyan dinars)				
Net foreign assets	137,157	143,821	160,058	186,029	203,302
Central bank	133,696	139,668	156,611	182,185	199,064
Foreign assets	134,006	139,875	156,818	182,394	199,274
Foreign liabilities	310	206	206	209	210
Deposit money banks	3,461	4,152	3,446	3,844	4,238
Net domestic assets	-90,807	-85,880	-95,462	-118,526	-133,099
Domestic credit	-75,256	-67,875	-79,650	-103,342	-116,717
Net claims on government	-90,021	-81,425	-95,821	-120,402	-137,104
Central bank claims	1,055	4,617	2,388	2,388	2,388
Government deposits with central bank	71,877	65,892	74,844	98,490	115,193
Commercial banks' claims	0	0	0	0	0
Governments' deposits with commercial banks	19,199	20,150	23,365	24,299	24,299
Claims on the rest of the economy	14,765	13,550	16,171	17,060	20,387
Claims on nonfinancial public enterprise	5,363	4,594	5,275	5,620	6,202
Claims on the private sector	8,843	8,363	10,896	11,440	14,185
Claims on specialized banking institutions	20	62	0	0	0
Claims on nonbank financial institutions	539	531	0	0	0
Other items (net)	-15,551	-18,005	-15,812	-15,185	-16,382
Broad money	46,351	57,941	64,596	67,503	70,203
Money	41,321	53,437	58,694	61,427	63,183
Currency in circulation	7,609	14,840	13,395	13,501	12,496
Demand deposits	33,712	38,597	45,299	47,927	50,686
Quasi-money	5,029	4,504	5,902	6,075	7,020
Memorandum items:					
Net claims on the government	-91,076	-86,041	-98,209	-121,316	-137,710
	(Change in percent)				
Broad money	3.6	25.0	11.5	4.5	4.0
Money	6.7	29.3	9.8	4.7	2.9
Quasi-money	-16.1	-10.5	31.0	2.9	15.6
Net claims on government	-15.2	9.5	-17.7	-25.7	-13.9
Claims on the economy	14.3	-8.2	19.3	5.5	19.5
Claims on nonfinancial public enterprises	22.2	-14.3	14.8	6.5	10.4
Claims on the private sector	3.8	-5.4	30.3	5.0	24.0
	(Percent change over beginning broad money stock)				
Net foreign assets	13.9	12.9	29.2	39.6	25.0
Domestic credit	-22.5	15.9	-20.3	-36.7	-19.8
Net claims on government	-26.6	18.5	-24.8	-38.1	-24.7
Claims on the economy	4.1	-2.6	4.5	1.4	4.9
Claims on nonfinancial public enterprises	2.2	-1.7	1.2	0.5	0.9
Claims on the private sector	0.7	-1.0	4.4	0.8	4.1

Sources: Central Bank of Libya; and Fund staff estimates and projections.

Table 4. Libya: Balance of Payments, 2010–18

(In millions of U.S. dollars)

		Est.	Est.	Projection					
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Current account	14,578	3,173	29,371	24,853	17,838	9,394	4,676	1,911	-545
In percent of GDP	19.5	9.1	35.9	26.3	18.1	9.0	4.2	1.6	-0.4
Goods and services	16,428	3,494	30,508	26,957	20,274	11,363	5,970	1,991	-2,281
Goods	22,253	7,860	36,562	34,149	28,363	20,734	16,066	12,764	9,291
Exports (f.o.b)	46,845	19,060	62,220	64,629	62,515	60,302	58,696	58,253	58,152
Hydrocarbon	45,410	18,679	61,000	63,104	60,609	58,014	56,066	55,228	54,673
Others	1,435	381	1,220	1,525	1,906	2,288	2,631	3,025	3,479
Imports (f.o.b)	-24,592	-11,200	-25,658	-30,480	-34,152	-39,568	-42,630	-45,489	-48,861
Services	-5,825	-4,366	-6,054	-7,192	-8,089	-9,371	-10,097	-10,774	-11,572
Receipts	410	30	451	536	570	661	712	760	816
Payments	-6,235	-4,396	-6,505	-7,728	-8,659	-10,032	-10,808	-11,533	-12,388
Income, *of which:*	-22	56	-93	-842	-1,066	-419	256	1,548	3,463
Direct investment income	-1,745	-678	-3,067	-3,588	-3,447	-3,299	-3,188	-3,141	-3,109
Other investment income	561	204	1,929	1,649	1,228	1,669	2,173	3,354	5,170
Current transfers	-1,828	-377	-1,045	-1,262	-1,370	-1,549	-1,550	-1,628	-1,727
Capital and financial account	-9,466	-2,460	-9,305	-6,688	-5,001	-5,037	-3,884	-5,126	-7,113
Direct investment (net)	-813	-131	1,390	1,529	1,681	1,850	2,035	2,238	2,462
Portfolio investment (net)	-4,396	-324	-308	-354	-425	-510	-612	-734	-881
Other investment (net)	-4,257	-2,005	-10,387	-9,896	-8,530	-8,919	-8,154	-9,824	-12,280
Errors and omissions	-575	-5,260	3,123	0	0	0	0	0	0
Overall balance	4,537	5,973	16,943	18,165	12,837	4,357	792	-3,215	-7,658
In percent of GDP	6.1	17.2	20.7	19.2	13.0	4.2	0.7	-2.8	-6.2
Memorandum items									
Total foreign assets (in billions of U.S. dollars)	171.5	176.9	190.3	208.7	221.9	226.7	228.3	226.5	220.9
Gross official reserves (in billions of U.S. dollars)	101.8	111.6	124.5	142.7	155.5	159.9	160.7	157.5	149.8
in months of next year's imports	78.3	41.6	39.1	40.0	37.6	35.9	33.8	30.9	28.0
Export growth (in percent)	27.6	-61.0	238.4	4.8	-2.8	-3.1	-2.3	-0.5	0.1
Hydrocarbon	27.2	-58.9	226.6	3.4	-4.0	-4.3	-3.4	-1.5	-1.0
Nonhydrocarbon	6.0	-73.4	102.0	25.0	25.0	20.0	15.0	15.0	15.0
Import growth (in percent)	15.1	-51.1	112.6	19.8	12.5	16.1	8.0	6.9	7.6
Nominal GDP (in billions of U.S. dollars)	74.8	34.7	81.9	94.6	98.7	104.7	110.9	116.3	122.5

Sources: Central Bank of Libya; and Fund staff estimates and projections.

Appendix I. Risk Assessment Matrix[1]

	Likelihood of Realization in the Next Three Years	Expected Impact on Economy if Risk is Realized
Sustained reduction in oil prices	***Staff assessment: Medium*** • The economy is heavily dependent on hydrocarbons.	***Staff assessment: High*** • Ample foreign exchange reserves would mitigate the immediate impact of lower export earnings. Fiscal consolidation would be necessary over the medium term.
Implementation risks related to capital spending	***Staff assessment: High*** • Limited capacity to implement reconstruction and development spending. • The political imperative to demonstrate government effectiveness will encourage spending.	***Staff assessment: High*** • Investment spending will not deliver high quality infrastructure nor alleviate bottlenecks to private sector growth and much needed employment generation.
Delays in normalizing the political and security situation	***Staff assessment: High*** • Well-armed militias hold most of the real power, while government authority remains weak in security areas.	***Staff assessment: High*** • Economic policies continue to focus on buying peace rather than setting the stage for growth. High current spending would erode fiscal space for much-need capital expenditure.

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities.

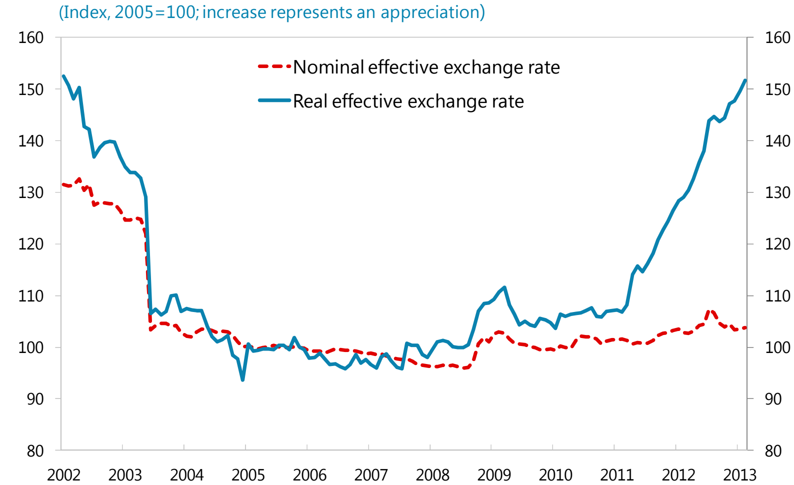
Appendix II. External Sustainability and Exchange Rate Assessment

Estimates from CGER-type methodologies indicate that the Libyan dinar was broadly undervalued prior to the conflict. As spending picks up, however, the current account will become unsustainable according to the external sustainability approach. The results of the macroeconomic balance indicate that the projected current account balance is below the current account norm, indicating overvaluation. The equilibrium real exchange rate approach indicates modest overvaluation.

1. **Due to high inflation during the conflict the real effective exchange rate appreciated sharply.** The real effective exchange rate (REER) was broadly stable from mid-2003 until the beginning of the conflict. In light of the currency peg against the SDR, the monetization of the budget deficit, and supply bottlenecks caused by international sanctions, inflation was high in 2011, leading to an appreciation of the REER. Consumer prices continued to increase in 2012, causing a further real appreciation.

Figure 1. Libya: Real and Nominal Effective Exchange Rates, 2002-13

(Index, 2005=100; increase represents an appreciation)



Sources: National authorities; and Fund staff estimates.

2. **The macroeconomic balance (MB) approach indicates that the projected current account balance is below the current account norm.**[1] The macroeconomic balance approach calculates the difference between the projected current account balance and an estimated current account norm. As presented in Table 1, the estimated current account norm for Libya ranges from a deficit of 0.24 percent of GDP to a surplus of 6.3 percent of GDP, depending on the model specification. Looking forward, Libya is expected to run current account deficits once capital spending picks up, which implies the need for higher savings.

[1] According to the MB approach, the current account norm is calculated using coefficients obtained from a dynamic panel regression for 24 hydrocarbon-exporting countries (Beidas-Strom and Cashin, 2011)

Table 1. Libya: Current Account—GMM Estimation and Implied Norms

(Dependent variable: Current account balance, as a share of GDP)

	Specification I		Specification II		Specification III		Specification IV	
	GMM coefficients	Contribution to CA norm 6/	GMM coefficients	Contribution to CA norm 6/	GMM coefficients	Contribution to CA norm 6/	GMM coefficients	Contribution to CA norm 6/
Core CGER Regressors 1/								
Constant	0.039	3.92%	0.035	3.50%	0.043	4.30%	0.044	4.40%
Lagged dependent	0.330	6.55%					0.383	7.60%
Fiscal balance/GDP 2/	0.851	-5.75%	0.385	-22.94%	0.363	-21.63%	0.391	-23.30%
Oil trade balance/GDP			0.454	16.96%	0.469	17.52%	0.459	17.15%
Old age dependency 3/	-0.053	-0.36%	-0.059	-0.40%	-0.034	-0.23%	-0.034	-0.23%
Population growth	-0.693	-1.27%	-0.930	-1.71%	-0.632	-1.16%	-0.589	-1.08%
NFA/GDP	0.023	2.68%	0.022	2.56%				
Relative income	-0.017	-0.56%	0.044	1.44%	0.071	2.34%	0.073	2.41%
Economic growth	-0.053	-0.26%	-0.069	-0.34%	-0.064	-0.32%	-0.056	-0.28%
Net Oil-Exporter Specific Regressors								
Oil wealth 4/			0.0002	0.69%	0.0006	2.08%	-0.0004	-1.39%
Degree of maturity in oil production					0.1601	2.20%	-0.1701	-2.34%
Additional Regressors								
REER 5/	0.073	2.19%						
Terms of trade	4.269	-0.80%						
Estimated Current Account Norm (2018)		**6.33%**		**-0.24%**		**5.11%**		**2.95%**
Projected Current Account (2018)	*-0.45%*							
R-squared	0.63		0.63		0.63		0.63	

1/ Based on annual data from 1989–2009 from the WEO database Autumn 2010 vintage, 4-year non-overlapping averages. Projections are from the WEO Spring 2013 database. Unreported core-CGER regressors (which are available upon request) were small, positive and significant (between 0.00-0.005), thus contributing marginally to the estimated norm. The level of significance of each regressor is reported in Appendix Table A.3. We ran these specifications with time effects. The result was larger constant terms, with little else varying. Higher order-lags/instruments did not yield tangible benefits or significantly alter the coefficients.

2/ The full fiscal balance is employed for specification I, while the non-oil fiscal balance is used for specifications II, III and IV.

3/ Latest available is used.

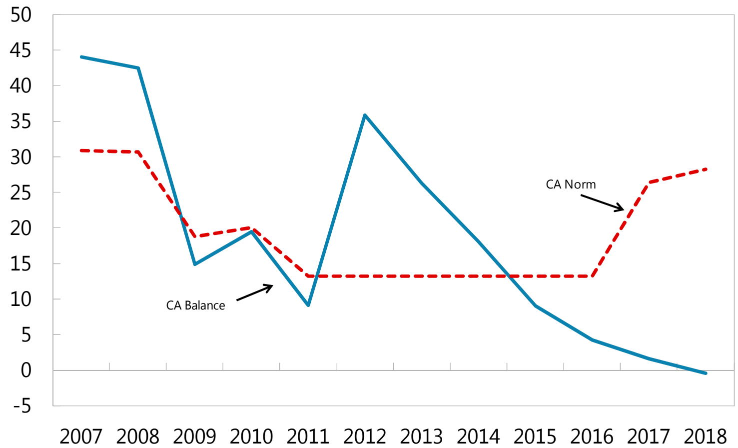
4/ In the absence of projections on oil and gas reserves, reserves are held constant (i.e. no new discoveries and no depletion).

5/ In the absence of projections, REER growth is constant at 2011 level.

6/ Contribution to CA norm=coefficient*medium-term projection/steady state value (in percent).

3. **The external sustainability (ES) approach suggests that the exchange rate is overvalued.** The underpinning of this approach is that sustainability of the current account trajectory requires that the net present value (NPV) of all future hydrocarbon and financial income (wealth) be equal to the NPV of imports of goods and services excluding non-hydrocarbon exports. This constraint determines a current account norm that would support intergenerational equity through an appropriate pace of accumulation of net foreign assets. The external sustainability approach indicates that the exchange rate will become overvalued beyond 2014.[1]

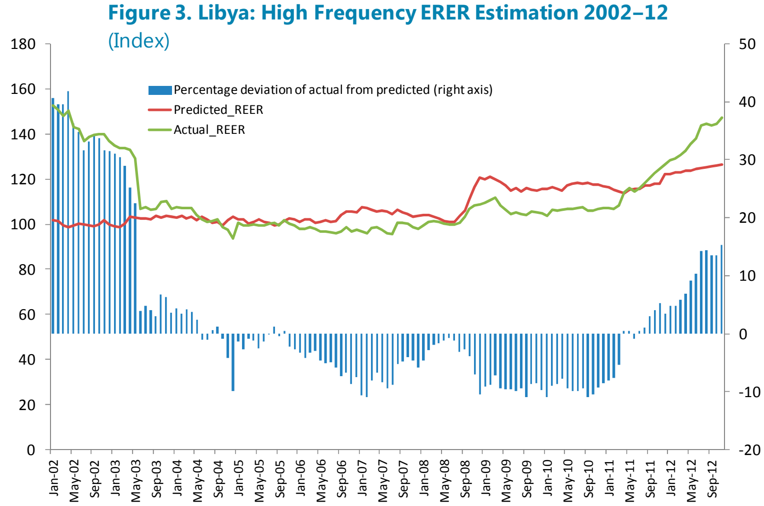
Figure 2. Libya: ES Approach: Projected CA and CA Norm
(In percent of GDP)



Sources: National authorities; and Fund staff estimates.

4. **The equilibrium real exchange rate (ERER) approach finds that the dinar is overvalued.** High frequency estimation finds cointegration between the real exchange rate and real oil prices (as the only explanatory variable). The long-run elasticity is about 0.14, and, as of November 2012 the REER is overvalued by 15.3 percent.[2]

Figure 3. Libya: High Frequency ERER Estimation 2002–12
(Index)



Source: Fund staff estimates.

[1] According to the ES approach, the current account norm is derived from the annuity that would finance a constant per capita non-hydrocarbon current account deficit. The key parameters are crude oil reserves of 44 billion barrels, annual population growth of 2 percent, a real rate of return of 4 percent, crude oil prices at an average of $94 per barrel during the period 2013–18 and then constant in real terms.

[2] Using the methodology set out in Cashin, Ouliaris and Poghosyan (forthcoming).

Appendix III. Assessing Fiscal Sustainability

1. **Libya is estimated to have a nonhydrocarbon primary budget deficit in line with its equilibrium level, but deteriorating over the medium term.** Evaluating fiscal sustainability is a challenging task in a hydrocarbon-dependent economy, because of the volatility of hydrocarbon revenues. Although the standard permanent income hypothesis (PIH) analytical framework—limiting government expenditure in a given year to the rate of return on the present value of future natural resource streams including financial assets accumulated until the depletion of resource reserves—is sensitive to parameters such as population growth, real rate of return on financial assets, and the future path of crude oil prices, it still provides a useful quantitative benchmark for fiscal sustainability. Assuming constant real per capita government expenditure that delivers a constant real per capita annuity after the depletion of hydrocarbon resources and crude oil prices at $100 per barrel, the nonhydrocarbon primary budget deficit is estimated to be 5.2 percentage points of GDP higher than its equilibrium value in 2013. However, with the rise in expenditures, the projected primary budget deficit will move about 0.2 percentage points below its equilibrium value by 2015 (Table 1).[1] Beyond 2018, further increases in capital expenditure, which are expected, will raise public spending to an unsustainable level.

2. **The PIH model identifies the vulnerability of Libya's public finances to a decline in oil prices.** At a crude oil price of $80 per barrel the nonhydrocarbon primary deficit would be 4.5 percentage points of GDP higher than its equilibrium value in 2013, with the gap increasing to over 8 percentage points by 2015 and staying broadly constant at that level. This would imply a need for fiscal rebalancing to safeguard long-term sustainability and ensure intergenerational equity in the distribution of resource wealth. The PIH framework does not account for the possibility that the resource base could be extended and broadened through technological developments and the exploitation of probable reserves. Accordingly, a wider resource base would extend the production horizon and raise the sustainable non-hydrocarbon primary deficit. Nevertheless, with the cyclically adjusted nonhydrocarbon primary budget deficit running about 200 percent of nonhydrocarbon GDP, these results indicate the need for fiscal consolidation to reduce vulnerability to lower oil prices, ensure long-term sustainability, and improve intergenerational distribution of resource wealth.

[1] The calculations assume the real rate of return on financial assets, inflation, and population growth of 5 percent, 2 percent, and 1.8 percent, respectively. For Figures 4 and 5, oil price projections are based on the latest profiles published in the IMF's *World Economic Outlook* (WEO) and are assumed to increase at 2 percent thereafter.

Table 1. Sustainable Overall Public Expenditure Envelope under Different Oil Price Scenarios, 2007–18

(In percent of GDP)

							Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Estimated sustainable nonhydrocarbon primary deficit (Real)												
$80 pb	35.8	28.0	41.1	34.9	79.2	33.1	28.9	28.1	26.9	25.8	25.0	24.1
Derived sustainable public expenditure												
$60 pb	39.7	35.1	61.9	52.3	131.6	53.1	46.6	48.6	49.5	50.3	51.4	52.2
$80 pb	42.9	37.8	67.1	56.7	143.9	57.9	50.7	52.9	53.7	54.6	55.8	56.6
$90 pb	46.1	40.5	72.2	61.1	156.2	62.6	54.8	57.1	58.0	59.0	60.2	61.1
$100 pb	49.3	43.2	77.3	65.5	168.5	67.4	58.9	61.4	62.3	63.3	64.6	65.5
$105 pb	50.9	44.5	79.9	67.7	174.7	69.8	61.0	63.5	64.5	65.5	66.8	67.7
$110 pb	52.5	45.9	82.4	69.9	180.9	72.2	63.0	65.7	66.6	67.6	69.0	70.0
$120 pb	55.7	48.6	87.6	74.3	193.2	76.9	67.2	69.9	70.9	72.0	73.4	74.4
$140 pb	62.2	54.0	97.8	83.2	217.8	86.5	75.4	78.4	79.5	80.6	82.2	83.3
Nonhydrocarbon primary revenue	6.1	6.6	8.1	6.1	2.3	3.1	3.4	3.9	4.4	4.9	5.3	5.6
Public expenditures	35.3	39.3	55.9	56.1	65.7	51.5	53.7	57.4	62.6	63.4	64.4	65.6
Needed adjustment in public expenditure												
$60 pb	-4.5	4.3	-6.0	3.7	-65.9	-1.6	7.1	8.8	13.1	13.1	13.0	13.4
$80 pb	-7.7	1.6	-11.1	-0.7	-78.2	-6.4	3.0	4.5	8.8	8.8	8.6	8.9
$90 pb	-10.9	-1.1	-16.2	-5.1	-90.6	-11.2	-1.1	0.2	4.5	4.5	4.2	4.5
$100 pb	-14.1	-3.8	-21.4	-9.5	-102.9	-15.9	-5.3	-4.0	0.2	0.1	-0.2	0.1
$105 pb	-15.7	-5.2	-23.9	-11.7	-109.0	-18.3	-7.3	-6.1	-1.9	-2.0	-2.4	-2.2
$110 pb	-17.3	-6.6	-26.5	-13.9	-115.2	-20.7	-9.4	-8.3	-4.1	-4.2	-4.6	-4.4
$120 pb	-20.5	-9.3	-31.6	-18.3	-127.5	-25.5	-13.5	-12.5	-8.4	-8.5	-9.0	-8.8
$140 pb	-26.9	-14.7	-41.9	-27.1	-152.2	-35.0	-21.7	-21.1	-16.9	-17.2	-17.8	-17.7

Sources: Ministry of Finance; and Authors' estimates and projections.

Appendix IV. Fund TA, November 2011–April 2014

Department	Activity	Status
FAD	Energy subsidy reform	Mission April 2012
	PFM reform	Mission January 2012
		Mission February 2013
		Resident PFM Advisor installation planned 2013
		Subject to the availability of external financing
		METAC expert visits on TSA planned 2013
	Fiscal CAP	Mission planned 2013
		Subject to the availability of external financing
	Fiscal Rule	HQ Review
	Energy subsidy reform	FY 2014
	Assistance in establishing a TSA (METAC)	FY 2014
	Tax and customs administration and short-term expert visits (METAC)	FY 2014
FIN	Safeguards Assessment	Mission March 2013
LEG	AML/CFT	Ongoing HQ review
		Mission February 2013
	1. Review of the AML/CFT Law	End of April -Meeting with the Libyan authorities in Sudan on the margin of a regional Plenary
	2. Building Capacity of the Financial Intelligence Unit and AML/CFT Supervision at the CBL	Mission planned May 2013
		Mission planned November 2013
		Mission planned April 2014
	Fiscal Rule	HQ Review
MCM	Libyan Investment Authority governance	Mission November–December 2011
	Central bank CAP	Mission March 2013
	Banking legislation	Mission planned 2013
	Banking supervision	Mission planned 2013
	Central Bank Organisation	2 missions planned FY 2014
	Payment Systems	2 missions planned FY 2014
	Reserves Management	2 missions planned FY 2014
STA	National accounts	Mission planned 2013
	Price Statistics	Mission planned 2013
	External sector statistics (METAC)	Mission planned May 2013
	External sector statistics (METAC)	Mission planned November 2013

INTERNATIONAL MONETARY FUND

LIBYA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 2, 2013

Prepared By

Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of March 31, 2013)

Membership Status: Joined 09/17/58; Article VIII

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	1,123.70	100.00
Fund holdings of currency	827.87	73.67
Reserve tranche position	295.83	26.33

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	1,072.70	100.00
Holdings	1,613.73	150.44

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Obligations to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming					
	2013	2014	2015	2016	2017	2018
Principal						
Charges/Interest	0.01	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01	0.01

Exchange Rate Arrangement:

On January 1, 2002, the authorities adopted a conventional fixed peg to the SDR at a rate of LD 1 = SDR 0.608. In June 2003, the exchange rate was devalued by 15 percent to LD 1 = SDR 0.5175. From February 14, 1999 to December 31, 2001, a dual exchange rate system was in place, with an "official" exchange rate pegged to the SDR, and a "special" exchange rate pegged to the U.S. dollar.

Exchange System:

In June 2003, the authorities eliminated the restrictions that gave rise to multiple currency practices. Libya accepted its obligations under Article VIII, Sections 2(a), 3, and 4 of the Articles of Agreement in June 2003. Staff is in the process of reviewing the foreign exchange system of Libya including related legal instruments to assess Libya's compliance with its obligations under Article VIII of the Fund's Articles of Agreement.

Article IV Consultation:
Libya is on a 12-month consultation cycle. The last Article IV staff report (SM/11/18) was discussed by the Executive Board on February 9, 2011.

Technical Assistance:

1. August 2001: MAE mission in monetary operations, banking supervision, and payment system.
2. December 2003: Two-week course on financial programming (INS and MCD).
3. February 2004: FAD mission on strengthening tax policy and revenue administration.
4. May 2004: MFD mission on monetary policy operations and introduction of financial instruments and markets.
5. June 2005: MFD mission on financial sector reform including bank restructuring.
6. June 2005: STA multisector mission on government finance statistics (GFS) and national accounts statistics (first part).
7. July 2005: FAD mission on reform of tax and customs directorates.
8. August/September 2005: STA multisector statistics on monetary and balance of payments statistics (second part).
9. Missions by Middle East Technical Assistance Centre (METAC) on banking supervision (May, July, August, and September 2005)
10. April 2006: FAD mission on Public Financial Management Reform.
11. June 2006: Posting of a long-term resident advisor on national accounts.
12. Two missions by METAC on banking supervision (May and August 2006).
13. Two follow-up missions by METAC on tax administration reform (August and December 2006).
14. October/November 2006: MCM and LEG mission to complete the standard review of the foreign exchange system under the Fund's Article VIII.
15. February 2007: A METAC follow-up mission on balance of payments statistics.

16. February/March 2007: Preliminary MCM mission on modernization and restructuring of the Central Bank of Libya.
17. March 2007: Two METAC missions on review of consumer price index statistics, and establishing producer price statistics, respectively.
18. July 2007: MCM mission on Sovereign Asset and Reserve Management, Monetary Policy Operations and Central Bank Accounting and Auditing.
19. November 2007: MCM mission on modernization and restructuring of the Central Bank of Libya.
20. January/February 2008: A METAC follow-up mission on balance of payments statistics.
21. February/March 2008: MCM mission on monetary operations.
22. November 2007–April 2008: Three missions by METAC on banking supervision.
23. October 2008: MCM Multi-topic Central Bank modernization mission.
24. March/April 2009: MCM mission on Modernization of the Central Bank of Libya.
25. June 2010: MCM mission on reserves management.
26. 2010: METAC mission on price statistics (PPI, CPI).
27. 2010: a number of METAC missions on banking supervision and monops/debt market development
28. October/November 2010: LEG mission on review of AML/CFT Law
29. November/December 2010: FAD mission on public financial management reforms.
30. January 2012: FAD mission on PFM reform
31. November/December 2011: MCM mission on Libyan Investment Authority governance
32. January 2012: FAD mission on PFM reform
33. April 2012: FAD mission on energy subsidy reform
34. February 2013: FAD mission on PFM reform
35. February 2013: LEG mission on AML/CFT
36. March 2013: MCM mission for Capability Assessment Program
37. March 2013: FIN mission for Safeguards Assessment

RELATIONS WITH THE WORLD BANK GROUP

Prepared by the World Bank Staff
(As of April 16, 2013)

1. Libya has been a member of the World Bank Group since 1958, joining the International Bank of Reconstruction and Development (IBRD) and International Finance Corporation (IFC) in September 1958, International Development Association (IDA) in August 1961, and Multilateral International Guarantee Association (MIGA) in April 1993. There have been no World Bank Group loans made to Libya to date as the development of the country's petroleum assets from 1960 placed Libya among capital-surplus oil-producing countries, and provided resources to build extensive infrastructure and provide social services.

2. In 2007, a Technical Cooperation Agreement was signed between the Bank and the Government of Libya, with a total budget of $1 million contributed jointly by the two parties. The Agreement funded a Joint Economic Advisory Program, geared to support and further Libya's reform process, covering the period of July 1, 2007 to June 30, 2008. Activities were launched in the areas of an Investment Climate Assessment, Business and Legal Environment, and support for the development of the Libya Vision 2025. The ICA report was completed in December 2010. A Public Expenditure Review (PER) was also launched in August 2007, with the main mission taking place in November 2007. Completion of the first draft of the document took place in October 2008. Then, a high level seminar, attended by the entire Economic and Social Cabinet took place in December 2008. After introducing written comments from all ministries and entities, the final version of the PER was delivered to the Authorities in April 2009 for their final clearance. The PER benefits from multiple inputs by IMF staff. The IMF also had active participation in the December 2008 high level seminar.

3. Two other high-level workshops were held in 2008. The first one was on "Libya in Transition." It covered the economic strategy, oil revenue management and social transfers. The second was on "Topics of Private Sector Development" and had an active participation from the private sector. In 2007 work on providing TA on statistical capacity building and surveys started and continues to date. Initially, this activity focused on supporting the 2007/08 Household Survey, the Labor Force Survey, and Poverty Analysis. In 2010, TA in statistics was broadened to the national accounts. TA in statistics resumed following the revolution in 2012, and Bank staff worked with the authorities on their strategy to overhaul the Libyan National Statistical System with an Implementation Action Plan for both components (National Accounts and Surveys) that were adopted and launched in 2012.

4. Following the revolution, a number of activities were undertaken, some jointly with the IMF, leading to the preparation of the following reports: A Public Financial Management assessment (joint with IMF); a report on Governance options for LIA (joint with IMF); a Financial Sector Review; a Rapid Labor Market Assessment; a Cultural Heritage report; and reports on local governance/decentralization. Currently, World Bank staff are working with the authorities to carry forward the recommendations of these reports in various areas (PFM, governance, financial sector, labor market and SME development, public service delivery). It also continues to provide TA in statistical capacity building and is advising the government on stolen assets recovery. In addition, the authorities have asked the Bank for support on subsidy reform.

STATISTICAL ISSUES

(As of April 16, 2013)

I. Assessment of Data Adequacy for Surveillance
General: During the revolution data provision was interrupted. Post-revolution, the authorities sporadically submit monetary data to the Fund. MCD missions are provided with broader data. Prior to the revolution, data provision had shortcomings, but was broadly adequate for surveillance. Pre-revolution weaknesses were in: (i) the conceptual and compilation procedures underpinning the collection of statistics in various sectors; (ii) deficiencies in coverage, periodicity, and timeliness; (iii) lack of consistency of data across sectors; and (iv) with the exception of monetary data, lack of a reporting system to facilitate updating MCD's operational database between missions. These issues are compounded by institutional weaknesses, the lack of interagency cooperation, the proliferation of agencies with unclear and often overlapping responsibilities, and unclear demarcation of responsibilities between agencies. In 2005 a multisector mission examined the conceptual and compilation procedures for national accounts, price indices, foreign trade, money and banking, and government finance statistics. It developed recommendations for improvement in these systems. STA will resume TA later in 2013.
National Accounts: Some progress has been made in the compilation of GDP statistics by economic activity through 2004, based on the 1968 System of National Accounts. However, the compilation process is hampered by high staff turnover and significant delays in the receipt of basic data from various sources, particularly other government agencies. In addition, many of the surveys are outdated. Annual data up to 2002 were reported to STA in 2004 and published in the International Financial Statistics (IFS); however, the estimates are not fully consistent with other data sets. A new household survey was finalized in 2003. To improve the national accounts, the 2005 STA mission made several recommendations including: (i) establishing a National Statistical Agency to produce and disseminate official statistics and coordinate the national statistical program; (ii) creating a National Statistical Council as a legally empowered interagency coordination committee to oversee compilation of national accounts statistics; (iii) transferring responsibility for the national accounts from the National Planning Council to the Census and Statistical Department of the National Information and Documentation Agency (NIDA) and creating 6–10 additional permanent staff positions; (iv) prioritizing implementation of the 1993 System of National Accounts and outlining entailed data requirements; (v) improving the questionnaires used for the construction and manufacturing surveys; (vi) initiating regular surveys of major services, agricultural output, and public and private construction; and (vii) improving estimates for transport, storage, and communication companies.

During 2006-2008, STA appointed a resident national accounts statistics advisor (RSA) to assist in improving the national accounts statistics. The RSA was working on the improvement of the legal and institutional arrangements including, the implementation of the statistics law, appropriate funding for the production of the source data, and the allocation of an adequate number of qualified staff. During 2007, with assistance from the RSA, five surveys and an agricultural census were conducted. The Ministry of Planning was able to compile a revised time series of GDP estimates for the period 2001-2007 at current and constant prices.
Price statistics: An STA mission, in February 2010, noted some progress that has been made on developing a PPI and revising the CPI for Libya. The Tripoli-only based CPI index (2003) will be replaced by an index that broadly represents all households in Libya. There is a need to link the Tripoli (1999) and Tripoli (2003) indexes to create a continuous time series of data. Data from the household budget survey (HBS) conducted during November 2007 - October 2008 had been processed. Once approved, these data will be used to expand geographic coverage of the CPI to include 8 urban and rural areas. An updated and expanded CPI with weights derived from the 2008 household budget survey is planned to be released in early 2011. The initial PPI data have been compiled for July–December 2009. The data cover mining/extraction, manufacturing, and utilities (gas and water); with the on-going goal of expanding coverage to ultimately include all economic activities in Libya. The PPI data are expected to be released in 2011.
Government finance statistics: The fiscal information system remains fragmented and inconsistent with international standards in many aspects, since it was designed for administrative reporting under the government finance law, rather than for purposes of providing timely statistical information for economic planning and analysis. To improve the fiscal data, the 2005 STA mission recommended: (i) adopting centralized management of all budgetary central government accounts at the ministry of finance; (ii) expanding coverage of central government accounts by including extra budgetary and local government operations; (iii) developing GFS metadata on concepts, scope, classifications, basis of recording, data sources, and statistical techniques for posting on the GDDS website; (iv) adopting the Fund's 2001 Government Finance Statistics Manual (GFSM 2001) as a coherent methodological framework for the production and dissemination of monthly, quarterly, and annual fiscal data. STA is prepared to assist the authorities in initiating the compilation and reporting of GFSM 2001-based fiscal statistics.

Monetary statistics: While the timeliness and quality of monetary data reported for IFS have improved significantly, some methodological deficiencies remain and the data are still undergoing frequent revisions. To enhance monetary and financial statistics, the STA missions in 2005 and 2007 made the following recommendations: (i) reclassify Libyan Foreign Bank (LFB) as a resident financial institution under other depository corporations and include LFB in the institutional coverage of the monetary survey; (ii) adopt market-based valuation of financial instruments and accrual accounting procedures for adding accruing interest to the outstanding amount of the instrument; (iii) revalue CBL's holdings of monetary gold at end-period market prices; (iv) identify all Fund-related accounts in the CBL's balance sheet as per IMF Finance Department guidelines; (v) if specialized credit institutions start issuing deposit liabilities, reclassify these institutions as other depository corporations and include them in the institutional coverage of the monetary survey; and (vi) revise/develop report forms for banks that would contain a breakdown of positions by currency of denomination, financial instrument, residency, and economic sector of counterparty consistent with the structure of the Standardized Report Forms. The CBL is currently in the process of improving classification and revising the monetary survey.

Balance of payments and International Investment Position (IIP): Since 2000 annual balance of payments data have been regularly reported to STA in the BPM5 format. As part of the Middle East Regional Technical Assistance Center's (METAC) work program, a long-term Regional Statistics Advisor (RSA) was appointed to help strengthen external sector statistics and to provide assistance either directly or through backstopping short-term experts. The main objective is to set up a compilation program for quarterly balance of payments statistics and for international investment position statistics.

The METAC mission that visited Tripoli in 2009 found that the CBL made little progress in implementing the previous missions' recommendations. The balance of payments statistics are still suffering from coverage deficiencies in the services, income and current transfer accounts, and classification errors were detected in reserve assets and trade credits. Furthermore, there are major differences between the trade data compiled by the CBL (based on letters of credit information) and the trade data compiled by the General Authority of Information (GAFI), which are based on customs forms. Oil exports data estimates from the GAFI are largely inconsistent with the CBL's estimates. The inter-agency cooperation is still considered inadequate. To further enhance the coverage of the BOP data, the mission suggested incorporating in the ITRS all the government's and public institutions' inward and outward transaction as well the CBL's own account transactions executed by the CBL's Accounting Department and Transfers Department.

Extensive hands-on training was provided to staff to assist with the establishment of an IIP from available data. However, stock data for FDI, portfolio investment, trade credits, and loans are still unavailable or less comprehensive. Improved estimates and coverage of source data would be achieved through new surveys (as FDI survey), changes to existing surveys, and other data

sources, as well as by making better use of existing data sources. Collaboration with the National Oil Corporation (NOC) is essential to ensure inclusion of the oil companies operating in Libya in the FDI survey. The mission also discussed with the balance of payments compilers the major changes from the Balance of Payments Manual fifth edition (BPM5) to the sixth edition of the Balance of Payment and International Investment Position Manual (BPM6) that are relevant for the compilation of Libya's external sector statistics. To further improve the balance of payments statistics, the 2009 RSA mission made the following recommendations: (i) continue increasing resources; (ii) the General Public Committee of Tourism and the GAFI to conduct a well-designed travel survey with a representative sample to cover the arrivals and departures to/from all Libyan borders points; (iii) the CBL to seek the Ministry of Interior's assistance in collecting information on the numbers of arrivals and departures by nationality (Libyan and foreigners); (iv) the CBL, in cooperation with relevant agencies to conduct an FDI survey in early 2010; the survey should consider the inclusion of large enterprises in construction, oil sector, hotels, and telecommunication as a high priority; and (v) the CBL to enhance the coverage of sources of stock data and start compiling an IIP using the standard instrument classification and sectorization recommended by BPM6.

II. Data Standards and Quality	
Libya participates in the General Data Dissemination System (GDDS) since December 2009.	No data ROSC is available.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/60
FOR IMMEDIATE RELEASE
May 23, 2013

International Monetary Fund
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IMF Executive Board Concludes the 2013 Article IV Consultation with Libya

On May 17, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Libya.[1]

Background

The political situation is normalizing, but the government lacks control over parts of the country. While the new government brings together various interest groups, it continues to face a fragmented political landscape and tribal power struggles, which complicate the writing of a new constitution and efforts to reestablish security and the rule of law.

The loss of hydrocarbon revenues during the crisis and UN sanctions on Libya created considerable pressures. On March 17, 2011 the UN Security froze Libya's foreign assets, which made the Central Bank of Libya (CBL) unable to provide adequate foreign exchange to the market. In response to foreign exchange shortages, demand for cash, and increased government spending, on March 6, 2011 the CBL imposed limits on deposit withdrawals. Nevertheless, the impact of the conflict was mitigated by confidence arising from large foreign exchange reserves.

Economic activity collapsed during the conflict with real GDP declining by 62.1 percent and average consumer prices increasing by 15.9 percent. The fall in hydrocarbon exports in 2011 led to a budget deficit of 15.4 percent of GDP and a sharply reduced current account surplus. The restoration of hydrocarbon production underpinned growth of 104.5 percent in 2012 while

[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. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

inflation declined to 6.1 percent. The budget had a surplus of 20.8 percent of GDP and the current account surplus widened to 35.9 percent of GDP.

The financial situation began to normalize in early 2012 after the removal of UN sanctions on the foreign assets of the central bank. In 2012, broad money grew by 11.5 percent with a modest shift from currency into deposits and credit to the private sector increased by 30.3 percent. Although the conflict will have caused asset quality to deteriorate, the systemic impact on the banking system should be modest in light of the liquidity buffer provided by banks' substantial reserves, along with limited claims on the private sector and the implicit government guarantee of loans to state-owned enterprises. Preliminary data show that nonperforming loans increased modestly in 2011 and 2012.

On January 6, 2013, the General National Congress (GNC) passed a law banning interest in financial transactions. The law was gazetted on March 21, 2013 and banks will no longer be allowed to pay interest to or receive interest from individuals. Companies and state entities will be prohibited from receiving and paying interest from the beginning of 2015.

Executive Board Assessment

Executive Directors welcomed the rebound in economic activity and the favorable growth outlook. They noted, however, that lingering political and security uncertainties and a pronounced vulnerability to oil price fluctuations add to the significant challenges faced by the transition, including the need to support the reconstruction effort while maintaining macroeconomic stability. Against this backdrop, Directors encouraged the authorities to move rapidly in the implementation of their reform program.

Directors welcomed the authorities' intention to articulate and implement a strategic vision for economic development, including setting up a governance framework based on transparency and accountability. They noted that credible and efficient institutions and a favorable business environment will be crucial to create employment opportunities in the private sector and reduce hydrocarbon dependency.

Directors agreed that promoting financial intermediation is key to fostering macroeconomic stability and growth. In this regard, they encouraged the authorities to develop a comprehensive financial sector reform strategy to streamline regulation and strengthen the supervisory framework. In addition, they urged the authorities to adopt an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) law in line with international standards and devote resources to its effective implementation.

Directors noted that the recently-enacted law banning interest in financial transactions in the absence of Sharia-compliant institutions and framework would preclude conventional bank lending. They recommended that the authorities consider delaying the implementation of the new law until the financial sector is able to comply with it.

Directors noted that expenditure is skewed toward wages and subsidies, which is eroding policy buffers, undermining the fiscal position, and reducing space for priority infrastructure spending. They supported the authorities' efforts to implement an extensive subsidy reform in combination with a safety net and welcomed plans to develop a rules-based medium-term framework that would help ensure fiscal sustainability and intergenerational equity.

Directors welcomed the authorities' intention to adopt a comprehensive reform strategy for public financial management. They urged the authorities to integrate the sovereign wealth fund system into the fiscal framework and prohibit all elements of the system from participating in domestic investment. Directors also encouraged the authorities to enhance transparency and accountability in the governance of the Libyan Investment Authority, consistent with international good practices.

Directors noted that the currency peg to the SDR has served Libya well. They cautioned that continued fiscal expansion is likely to lead to an appreciation of the real exchange rate and deterioration in the external position, which calls for prudent fiscal policy and far-reaching structural reforms to improve external competitiveness and boost non-oil growth prospects.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

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	24.5
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	81.9	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	-47.8	-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	11.5	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	171.5	176.9	190.3	208.7
Net international reserves	91.9	100.3	101.8	111.6	124.5	142.7
(In months of next year's imports)	40.7	39.0	78.3	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	…

Sources: Libyan authorities; and IMF staff estimates and projections.

Statement by Mr. Shakour A. Shaalan, Executive Director for Libya
May 17, 2013

Recent Developments and Challenges

On behalf of the Libyan authorities, I thank staff for their recent engagement and constructive Article IV Consultation discussions. The authorities highly value the views of the Fund on Libya's economic policies and institution-building efforts. A wide-ranging package of technical assistance is under development in support of the ongoing rebuilding.

The Libyan economy achieved a remarkable pace of growth in the past year as the economy strongly rebounded from its collapse during the revolution. The fiscal balance recorded large surpluses and the accumulation of sizable external reserves resumed. Notwithstanding the security situation, a considerable pick up in reconstruction and private demand were evident, and both are expected to grow considerably over the next several years.

While Libya's prospects are favorable with continued high growth in the near term, the authorities recognize that the country faces challenges. Addressing these challenges has been the subject of valuable discussions with Fund staff. The authorities' key priorities rightly include plans for extensive institution building, comprehensive fiscal reforms, strengthening management of the country's resource wealth and reducing hydrocarbon dependency through inclusive private sector growth.

Fiscal Developments and Policies

Government finances in Libya are dominated by hydrocarbon income as the main source of revenue. The restoration of hydrocarbon production resulted in a budget surplus of about 20 percent of GDP in each of 2012 and 2013, in spite of a sharp increase in current expenditures. High and rising unemployment and the absence of a social safety net system necessitated higher public spending, particularly on subsidies. Additionally, the wage bill is rising in 2013 on account of higher salaries in some priority sectors, such as the judiciary, and new hiring to address skill mismatches.

However, the authorities are keen to contain the growth of current expenditures and to redirect resources to education and infrastructure that support the private sector. They believe that the subsidy bill will shrink as subsidy reforms are introduced and as a national system for identification is established to help target social expenditures. As for the public wage bill, it will be easier to contain, once private sector employment opportunities are generated. In this regard, the staff's assessment of "limited growth in private sector jobs in the foreseeable future" may be too pessimistic in view of the major reconstruction effort and the expected restoration of security and business confidence.

To preserve fiscal sustainability, the authorities are interested in developing a rule-based medium-term fiscal framework that supports intergenerational equity in the allocation of hydrocarbon wealth. They look forward to Fund advice in formulating a rule that is operationally feasible for the current circumstances. They also look forward to implementing, with Fund advice, a well-sequenced reform strategy of public financial management reform. This strategy would include public employment and wage structure, subsidy reform and establishment of a targeted social safety net. In addition, the strategy would provide a practical road map to enhance capacities in budget formulation, cash management, and the transparency of fiscal accounting.

Exchange Rate and External Policies

Substantial foreign exchange reserves played a key role in mitigating the impact of political turmoil during 2011-12 and sustaining confidence in the currency. The restoration of hydrocarbon exports in 2012 allowed the current account surplus to exceed 35 percent of GDP and reserve accumulation to resume.

The dinar's peg to the SDR provides a strong monetary anchor. The authorities note staff's assessment of the exchange rate level as somewhat overvalued based on the modified CGER methodology in contrast to the findings of the prior Article IV consultation. Caution is needed in treating CGER-type estimates as the basis for prescription of a specific exchange rate target. Questions remain surrounding the validity of the estimates for commodity exporters, particularly amid significant economic uncertainty, including with respect to future oil prices and oil discoveries, as noted in Appendix III. Accordingly, the authorities see merit in formulating alternative scenarios for oil discoveries and prices when considering questions of intergenerational equity or the optimal rate of hydrocarbon resource extraction.

Financial Developments and Policies

The Central Bank of Libya has taken steps to implement a dual banking system that includes Sharia-compliant and conventional banking in Libya. They are keen not to disrupt financial intermediation nor undermine the financial sector's contribution to diversified economic development. The Central Bank of Libya recently adopted procedures to prevent unlicensed financial services (such as exchange and transfer agencies) and is looking into a broader financial sector reform to bolster regulation and supervision. So far, banks held up well in spite of some deterioration in asset quality during the conflict as their substantial reserves helped mitigate liquidity constraints and the impact of sanctions.

Structural Reforms for Inclusive Growth

The authorities attach the highest priority to private sector-led job creation and economic diversification. In addition to gearing public spending in this direction, the government intends to launch programs that facilitate credit to small and medium enterprises and is working to remove legislative uncertainty and improve the business environment, including by streamlining the regulatory framework.