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April 2006
IMF Country Report No. 06/137

The Socialist People's Libyan Arab Jamahiriya: Selected Issue—Medium-Term Economic Reform Strategy, and Statistical Appendix

This Selected Issue paper on Medium-Term Economic Reform Strategy, and Statistical Appendix for The Socialist People's Libyan Arab Jamahiriya was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on March 2, 2006. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of The Socialist People's Libyan Arab Jamahiriya or the Executive Board of the IMF.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

THE SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA

Selected Issue—Medium-Term Economic Reform Strategy, and Statistical Appendix

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March 2, 2006

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Medium-Term Economic Reform Strategy for Libya[1]

I. Introduction and Background

1. **Libya is generously endowed with energy resources, but has one of the least diversified economies in the Maghreb region and among the oil producing countries**. (Table 1, Figure 1). In the early 1970s, Libya opted for a command economy with essentially state-driven investment, a strictly controlled external trade, widespread price controls and subsidies, and an almost nonexistent private sector. The government's stifling interference in the economy resulted in a continuous deterioration in the business climate, low economic growth, declining living standards, fragile macroeconomic conditions, and increased vulnerability to external shocks. Other impediments to economic development included weak institutions and poor governance. Economic conditions started to deteriorate in the mid-1980s with the fall in world oil prices, and worsened in the 1990s as a result of international sanctions.

Table 1. Libya: Comparative Indicators, 2004

(In percent of GDP unless otherwise specified)

	Libya	Maghreb 1/	OPEC2/ 3/
GDP per capita (in US$)	5,321	2,605	8,594
Nonhydrocarbon GDP per capita (in US$)	1,629	2,024	5,331
Share of nonhydrocarbon GDP (in total)	30.6	77.7	62.0
Real GDP growth	4.6	5.3	7.5
Government expenditure	44.0	36.7	31.7
Fiscal surplus/deficit	17.5	-0.5	9.8
Government revenue	59.1	35.7	41.3
External trade balance	24.2	-1.0	16.6

Sources: WEO; and staff estimates.

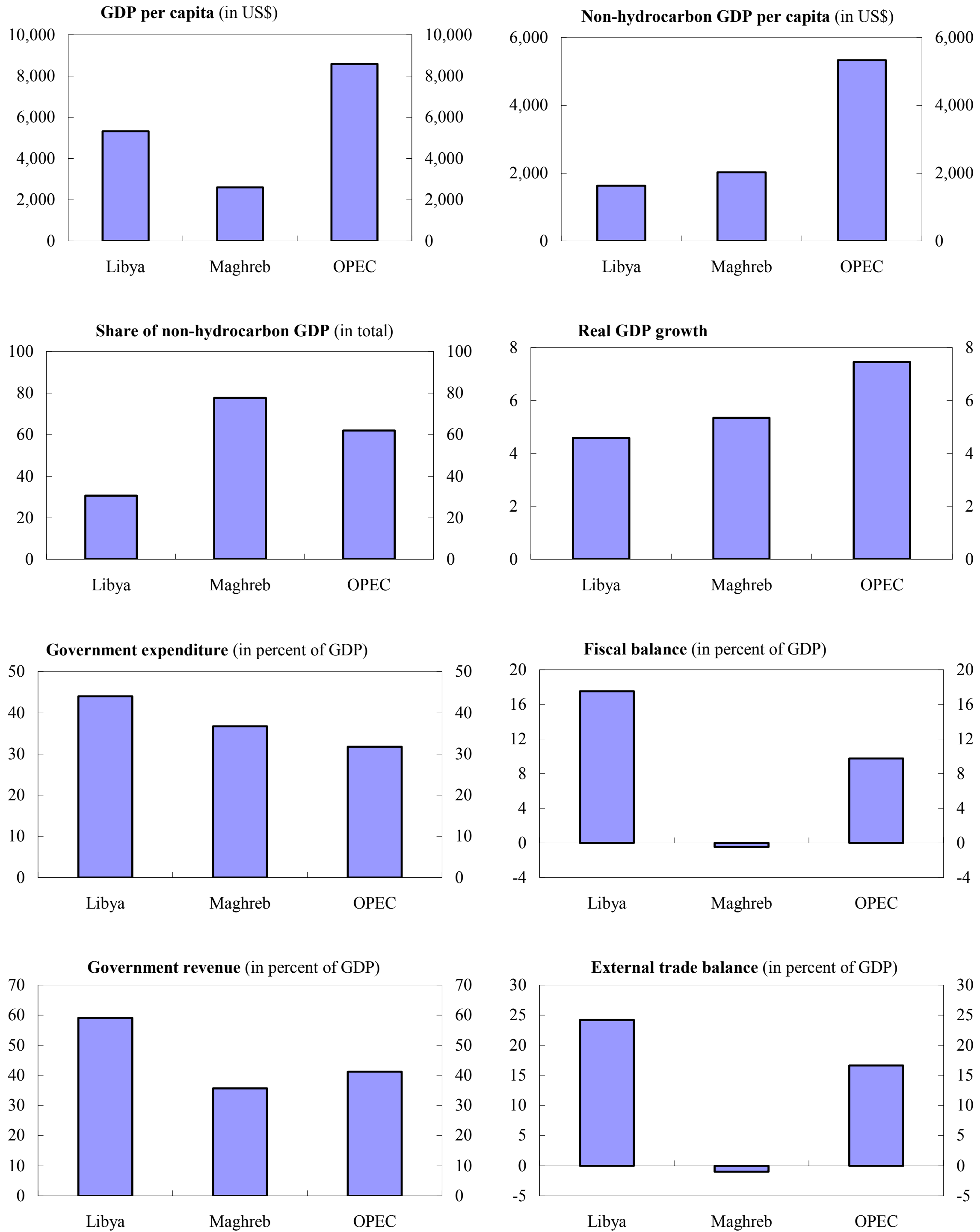
1/Maghreb: Algeria, Libya, Mauritania, Morocco, and Tunisia.
2/ OPEC: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, UAE, and Venezuela.
3/ Excluding Iraq.

2. **Since the freezing of the UN sanctions in 1999, Libya has been implementing measures to reform and open its economy,** but progress in developing a market economy has been slow and discontinuous. Libya needs strong and sustained economic growth to meet the demands of its rapidly growing labor force, which requires high investment in physical and human capital, and an efficient use of the country's resources. This can only be achieved through the implementation of far-reaching market-oriented structural reforms that would enhance the role of the private sector, improve the business climate, and promote economic diversification.

3. The purpose of this paper is to present a medium-term reform strategy that could be pursued by Libya in order to accelerate its transition to a market economy and achieve the above objectives. The paper is composed of four sections, including the introduction. **Section II** reviews the main characteristics of the Libyan economy, and medium-term prospects under current policies. **Section III** presents the proposed reform strategy in two subsections: subsection III-A examines the priority reforms that Libya needs to implement in order to accelerate its transition to a market economy, while maintaining macroeconomic stability; and subsection III.B deals with a second set of reforms that aim to consolidate the reform process and advance the restructuring of the economy in favor of the non-oil sector. The

[1] Prepared by Ramdane Abdoun.

Figure 1. Libya: Comparative Indicators, 2004



Source: *World Economic Outlook* , 2005; and Fund staff estimates.

paper has four appendices: Appendix I (Revenue Administration); Appendix II (A Stabilization and Savings Fund for Libya); Appendix III (Bank Restructuring Strategy); and Appendix IV (Statistical Reforms).

II. Main Characteristics of Libya's Economy

A. Recent Developments

4. **The Libyan economy continues to be driven by the oil sector,** which contributed about 56 percent of GDP in 2000-05. The remaining economic activities include services (28 percent of GDP) and the sectors of agriculture, industry, transportation, and construction, whose size remains very modest (about 4-5 percent of GDP each).

5. **The predominance of the oil sector is also highly noticeable in the country's external and fiscal accounts**. During 2000-05, hydrocarbon exports accounted for about 97 percent of total exports receipts and were the main source of official reserves.[2] Overall, the non-oil sector remains largely dependant on imports, as evidenced by the high non-oil imports- to non-oil GDP ratio (70 percent) and the low coverage of non-oil imports by non-oil exports (11 percent in 2004). On the fiscal front, coverage of government expenditure by non-oil revenue was less than 30 percent, resulting in a non-oil deficit of about 30 percent of GDP.

6. **On the structural front, some progress in liberalizing the economy has been made in recent years,** including unifying the exchange rate; passing a new banking law that enhances the role of the Central Bank of Libya (CBL) and opens up the banking sector to domestic and foreign competition; privatizing some state enterprises; simplifying procedures for business application; removing customs duty exemptions enjoyed by public enterprises; liberalizing most prices; removing restrictions on external trade; and allowing foreign investment in some sectors. More recently, in 2005, the government created an investment fund (IF) to manage part of the government's foreign exchange holdings, and significantly streamlined the customs tariff. Also, as a first step toward improving transparency in and consolidation of public finances, the government abolished all extrabudgetary expenditure from the Oil Reserve Fund (ORF).[3] Finally, the CBL partially liberalized interest rates, issued a number of decrees to improve the operations of commercial banks, and launched the privatization of a major bank, Sahara bank (see Box 1).

7. **However, reform implementation continues to suffer from lack of coordination, including between the CBL and the Ministry of Finance (MOF).** Also, effectiveness of reforms was affected by the absence of an overall reform strategy, serious human capacity constraints, and weak institutions. As a result, the Libyan economy remains largely state-

[2] Official reserves increased by US$26 billion during the period.

[3] This decision was taken after the adoption of a LD3 billion multi-year lending program of subsidized loans to households, private farmers, and entrepreneurs.

controlled, three quarters of employment are in the public sector, and private sector investment remains minuscule (2 percent of GDP).

Box 1. Libya: Reform Measures Implemented in 2004–05

Year 2004

- Approval by the government of the privatization of 360 state-owned enterprises.
- Simplification of procedures for business application.
- Submission to parliament of a plan to replace the current subsidy system with a cash subsidy.
- Passage of a new banking law that enhances the role of the CBL and opens up the banking sector to the private sector (including foreign banks).
- Passage of an Anti-Money Laundering law.

Year 2005

A. Management of Oil Revenues

- Creation of an Investment Fund (IF) to manage part of government oil revenues.

B. Tax and Customs Policy

- Simplification of the tariff schedule. The new import tariff has two rates (10 percent for tobacco products and 0 percent for all other products), and all imported goods are subject to a 4 percent service fee.
- The *production and consumption tax* was increased to 25–50 percent for imported goods and reduced to 2 percent for domestically produced goods.

C. Revenue Administration

- Beginning to put in place a three-year modernization plan for the tax and customs directorates.

D. Interest Rate Liberalization

- (i) Unification of the CBL's deposit rates; (ii) liberalization of the banks' deposit rates; and (iii) replacement of the banks' multiple lending rates by a ceiling 250 basis points above the CBL discount rate (currently at 4 percent).

E. Bank Restructuring and Banking Supervision

- Initiation of the privatization of Sahara bank.
- Various measures to strengthen banking supervision.

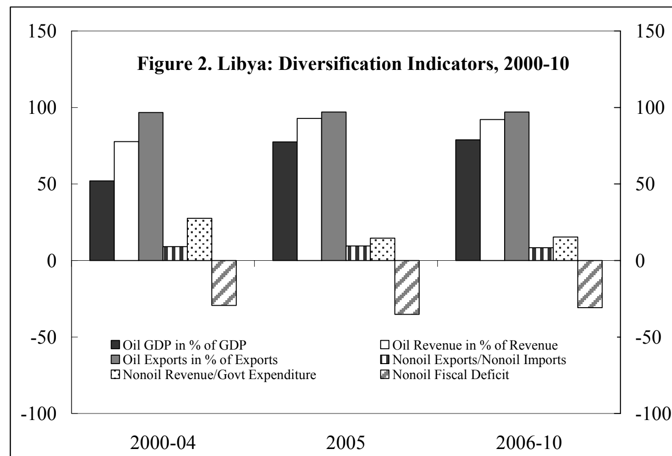
F. Trade Policy

- Decree 12 of 2005 (which allowed the import of a number of consumption and investment goods only through an agent) has been replaced by Decree 190, which limits such restrictions only to six categories of imports for which after-sale service is necessary.

B. Medium Term Prospects Under Current Policies

8. Based on WEO's latest oil-price projections and current policy stance, **Libya's outlook for 2006–10 remains favorable and does not raise sustainability concerns**. Under these projections, both the fiscal and external current account balances will continue to register

large surpluses during the period 2006-10.[4] However, the non-oil fiscal deficit is projected to remain substantial (31 percent of GDP). Moreover, while the oil sector is projected to grow at an annual rate of 6-7 percent, the non-oil sector's real growth would be about 3 ½ percent per year, and non-oil private sector investment would barely exceed 2 percent of GDP, as the current pace of government reforms will fall short of generating a sustained increase in private investment and non-oil output. This projected level of growth for the non-oil sector would not be sufficient to generate employment opportunities for the rapidly increasing labor force (about 4 percent per year) (Figure 2).



III. Medium-Term Reform Strategy

9. In view of the above, **Libya needs a comprehensive medium term strategy (MTS) to reform its economy** and make better use of its economic and financial potential, by diversifying the economy and reducing the country's dependency on oil. The proposed MTS aims to maintain macroeconomic stability and rationalize the use of the country's oil wealth, accelerate the transition to a market economy, and establish a solid basis for the development of the non-oil economy. It could be implemented over a 5–6-year period in two phases of 2–3 years each.

A. Phase One: Acceleration of the Transition to a Market Economy

10. Maintaining a sound macroeconomic framework, sending a clear signal to the market on the authorities' commitment to reform, and implementing the reform measures for which IMF technical assistance (TA) has been provided[5] will constitute major steps toward recapturing the confidence of the private sector and enhancing the country's economic potential. To that effect, during the first reform phase, priority should be given to (i) consolidating public finances and streamlining budgetary management and procedures; (ii) enhancing the role of the central bank and implementing market-based monetary reforms; (iii) removing remaining external trade restrictions; (iv) completing price liberalization and rationalizing the subsidy system; (v) developing a vigorous and coherent privatization program; and (vi) improving the business climate.

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[4] Under current projections, oil and natural gas revenue windfalls are projected to increase from an average of US$16 billion per year (54 percent of GDP) in 2000–05 to an average of US$38 billion per year (76 percent of GDP) in 2006–10.

[5] The IMF has already provided TA in the monetary policy, bank restructuring, banking supervision, tax policy, revenue administration, and statistics areas.

Public Finance

11. Although the overall fiscal position is projected to remain comfortable over the medium term, **the structure of the budget needs to be rationalized and fiscal policy will need to be geared toward maintaining macroeconomic stability**. Three categories of reforms are required to achieve these objectives, including measures to (i) bring total control of fiscal policy under the responsibility of the ministry of finance and improve transparency in government operations; (ii) enhance the quality of government spending and broaden the non-oil tax base; and (iii) improve the management of the country's oil wealth in order to reduce the overall fiscal vulnerability to oil shocks (Box 2).

12. **The first category of reforms would require consist of** (i) **unifying the budget** by integrating the administrative, development, and subsidies budgets and all extrabudgetary operations in a consolidated budget under the responsibility of the MOF; (ii) **modernizing the treasury system**; and (iii) **strengthening budgetary procedures**.[6]

13. **The second category of reforms could be accomplished by broadening the tax base to enhance non-oil revenue collection, and strengthening expenditure management and control** to improve the efficiency of public spending. Reforms on the revenue side include simplification of the tax system, tax cuts to reduce the costs of doing business, elimination of widespread exemptions, and improvement in revenue administration (Box 2-A and B, Appendix I). On the expenditure side, efforts would focus on reinforcing the budgetary process, strengthening expenditure management and control, and improving governance. The development of Medium Term Expenditure Frameworks (MTEFs) aimed at achieving long-term fiscal sustainability, and based on stable expenditure policies with quantifiable targets to be reflected in the government's annual budgets, is an important step in that direction (Box 2-C). Also, the MTEF could be an efficient instrument for the reallocation of resources toward basic infrastructure, social services, and capacity building which have deteriorated significantly under the sanctions.

14. **The third category of reforms will need to be centered on the establishment of an oil fund in the form of a stabilization and savings fund** (SSF) to reduce the impact of volatile revenue on public finances and the economy, and save part of the oil revenue for future generations (Box 2-D, Appendix II). During upswings in oil prices, the existence of the SSF could help the government better manage its fiscal operations in line with the country's absorptive capacity. During oil price downturns, the recourse to SSF resources would help maintain expenditure stability. For these reasons, strict rules governing the SSF's revenue and expenditure policies would need to be established and fully enforced, and performance would need to be periodically assessed. Achievement of these objectives would

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[6] In particular, abolishing the 70/30 rule under which 70 percent of budgetary oil revenue is allocated to capital spending and the remaining 30 percent to current expenditure. The detailed measures to undertake these important reforms will be based on the findings and recommendations of the planned FAD mission on budgetary procedures and expenditure management and control scheduled to take place in the second quarter of 2006.

Box 2. Libya: Public Finances: First Phase Reforms (2006–08)	Proposed timing
A. **Budget**	
• Develop a unified consolidated budget framework under the responsibility of the Ministry of Finance, including the administrative, development and subsidies budgets, and all the other extrabudgetary government operations.	End-2006
B. **Revenues**	
1. **Tax Policy**	
• Integrate the service fee and consumption tax on imports in the tariff structure.	April 2006
• Simplify the tax rate structure, introduce new payment arrangements for corporations, repeal current provisions relating to tax incentives (tax holidays), and strictly limit tax exemptions.	End-2006
• Introduce appropriate rules for neutral tax corporate restructuring, in order to facilitate privatization.	End-2006
• Revisit excises.	2007
• Prepare for the introduction of the VAT.	2007–08
2. **Revenue Administration**	
2.1. **Tax Directorate**	
• Establish reform committees at the tax and customs directorates to oversee the reforms.	April 2006
• Restructure the tax department, establish a large tax-payer office, introduce self-assessment, supported by redesigned business process and IT systems.	2006–08
• Strengthen human resource development and training, and upgrade tax office buildings and equipment.	2006–08
2.2. **Customs Directorate**	
• Introduce risk-based controls.	2006–08
• Change procedures to meet WTO obligations.	2006–08
• Introduce automation to customs-import processing.	2006–08
• Introduce management information systems.	2006–08
• Strengthen human resource development and training, and improve office buildings and equipment.	2006–08
C. Expenditure	
• Enhance the efficiency of public expenditure, by improving the preparation, content and execution of the public investment program, through stricter project selection and solid project execution review process.	2006–08
• Strengthen expenditure management and control and reform the procurement code.	2006-08
• Strengthen the budgetary system.	2006-08
• Develop an MTEF.	2007
D. Establish a Stabilization and Savings Fund (SSF)	
• Enact a law establishing the SSF.	2006
• Integrate the SSF in a unified consolidated budget under the responsibility of the Ministry of Finance.	2007
E. Governance	
• Develop a plan to improve governance.	2006-08
F. Preparations for Second Phase Reforms	
• Undertake a comprehensive census of the civil service.	2006
• Undertake a study of the social security system.	2006

enable the government to implement strong macroeconomic policies necessary to achieve strong, sustainable, and noninflationary economic growth.

Monetary Reforms

15. **Monetary policy should aim to maintain price stability**, while allowing for an adequate expansion of credit to the economy at competitive interest rates. In this context, the recent partial liberalization of interest rates represents an important first step in the CBL's progressive move to indirect monetary management. However, for this measure to produce its full impact, it is important that the CBL stop directed credit allocation and channel all credit subsidies through the budget.[7]

16. **The CBL should develop indirect monetary policy instruments, starting with the issuance of CDs, and the reactivation of the interbank money market** as a first step toward the development of open market operations. Also, the CBL needs to strengthen the monetary policy committee responsible for key policy decisions, improve the monetary policy framework with the strengthening of its database and economic monitoring capabilities, and reinforce its daily monetary management. Other reforms are needed, including the reorganization of the CBL in line with the requirements of the new banking law and the expected transformation of the domestic economic environment. These reforms, together with the gradual restructuring of the banking system, will create the conditions for an efficient allocation of credit, essential to jump-start private sector activities and increase the potential and efficiency of the non-oil economy (Box 3-A and E).

Bank Restructuring

17. **A more efficient, market-oriented and sound banking system is also needed** if Libya is to succeed in reforming its economy. This will require (i) enhancing banking supervision; (ii) restructuring the banking system; (iii) modernizing the domestic payment system; and (iv) revising the legal and regulatory frameworks.

18. **The CBL should continue implementing the strategic work plan to strengthen banking supervision agreed on with the Middle East Technical Assistance Center** (METAC), in order to accelerate the building-up of an effective banking supervision capability. The main objectives of this plan are to upgrade and improve the onsite and offsite inspection systems, develop new key prudential regulations in line with Basel banking supervision requirements and international best practice, and strengthen capacity building (Box 3-B).

19. **Bank restructuring is urgently needed.** Given that the CBL currently owns the main commercial banks, the first step should be to transfer the ownership of these banks to an independent government bank restructuring agency (BRA). The CBL would remain in charge

[7] The scheme to administer these subsidies should be based on two rates: the rate received by the bank, which will be increasingly market determined; and the subsidized rate paid by the borrower, which is set by the government. The difference between the two rates should be financed by the government and budgeted.

of banking supervision, but would not be directly involved in the restructuring/privatization process. Its responsibilities would include ensuring that the new private owners are fit and proper, and that the banks meet all prudential requirements. The main tasks of the BRA would be to (i) exercise ownership rights over the banks currently owned by the CBL; (ii) safeguard the banks' value and stability during the interim period before restructuring/privatization; (iii) organize and monitor a proper due diligence for each bank; and (iv) implement a resolution strategy for each bank (Box 3-C, Appendix III).

20. **The reform of the domestic payment system is another key action in support of the restructuring of the banking system**.[8]The CBL should continue implementing its plan to modernize the payment system through the acquisition and use of automated systems and the introduction of noncash payment instruments that it has developed with the technical assistance of the World Bank. This plan, expected to be fully implemented by 2007, will enhance markedly banks' performance by expanding and improving service delivery and reducing costs.

21. **Finally, upgrading the legal, regulatory, and institutional framework for the banking sector in order to remove existing legal and other impediments to financial deepening will also be a key element of reform**. In particular, opening up the banking sector to external competition; strengthening the judicial system to speed up and improve conflict resolution; and reforming the existing legislation in the areas of accounting and bookkeeping, and bankruptcy are critical to strengthen the development of, and competition within, the banking sector, and improve financial deepening. (Box 3-D).

Exchange Rate Policy

22. The absence of pressures on the exchange rate following the implementation of current account convertibility and the increased liberalization of external trade are indications that **the current exchange rate of the Libyan dinar is broadly appropriate**.[9] While implementation of the MTS should reinforce non-oil production and export prospects, a close monitoring of the non-oil economy's external competitiveness would need to be done to assess the appropriateness of the exchange rate policy, including the level of the peg.[10]

23. **By the end of the first reform phase (2008)**, as structural and macroeconomic reforms progress and the non-oil economy starts to develop, **the authorities could consider the desirability and feasibility of switching to a more flexible exchange rate regime** that would give them more room of maneuver to respond to sharp changes in oil prices.

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[8] The current system is particularly inefficient, with clearing varying from 7 to over 20 working days.

[9] The fact that non-oil exports are low reflects lack of structural reform and investment, rather than an overvaluation of the exchange rate.

[10] In addition to monitoring unit costs, surveying the views of the business community, including investors, bankers, and enterprises involved in external trade, could help in assessing the appropriateness of the exchange rate level.

Box 3. Libya: Money and Banking -- First Phase Reforms(2006-08)	Proposed timing
A. Monetary Reforms	
• Terminate directed credit allocations.	April 2006
• Channel all credit subsidies through the budget.	April 2006
• Strengthen the role of the Monetary Policy Committee.	April 2005
• Fully liberalize interest rates.	June 2006
• Issue CBL bills and establish an auction system.	2006
• Allow commercial banks to issue CDs and manage their liquidity.	2007
B. Banking Supervision	
• Upgrade on-site and off-site supervision.	2006-08
• Improve accounting and financial reporting systems.	2006-08
• Strengthen credit-risk assessment, in line with Basel requirements.	2006-08
• Develop capacity building and staff training.	2006-08
• Strengthen prudential supervision and include specialized banks.	2007
C. Bank Restructuring:	
• Postpone the privatization of Wahda bank.	April 2006
• Repeal the decision that limits any private investor's share in the capital of a bank to 4 percent, and open domestic market to foreign banks.	June 2006
• Transfer public banks' ownership from the CBL to a bank restructuring agency.	2006
• Complete the due diligence process.	2006
• Consolidate the 48 regional banks into one entity.	2006
• Start the restructuring/privatization of the remaining state-owned banks.	2007
D. Other Reforms to Improve Financial Deepening and Strengthen the Sector	
• Reform existing legislation on accounting and bookkeeping, and bankruptcy, in line with international standards.	2006-07
• Strengthen the judicial system.	2006-08
• Complete the modernization of the payment system.	2007
E. Enhance the Status of the Central Bank of Libya (CBL)	
• Introduce an amendment in the banking law stipulating that the central bank does not take instructions from the government.	June 2006
• Restructure the CBL	2007
F. Exchange Rate Policy	
• Closely monitor the exchange rate and external competitiveness.	2006-08

Trade Reforms

24. The significant progress that has been made in recent months in reforming the trade system and in simplifying the trade regimes should be maintained. In particular, all remaining state monopolies on imports should be terminated;[11]the remaining 10 nonreligious

[11] Including monopolies on imports of tobacco, veterinary medicines, and vaccines.

and non-health-related import bans should be replaced by import tariffs; and customs procedures should be simplified in line with international standards (Box 4-A).

25. **WTO accession negotiations will require Libya to adjust its trade laws and institutions to conform to basic WTO norms**. A number of reforms are to be accorded high priority, including inter alia (i) ensuring that all regulations are applied equally to foreign and domestic investors; (ii) incorporating the internal taxes that are levied on imports but not on domestically supplied goods in the tariff schedule; (iii) adopting WTO rules on customs valuation; (iv) limiting import licensing; and (v) bringing Libya's Intellectual Property Rights (IPRs) regime in line with international best practice. In order to speed up the review of all laws, regulations, and policies that affect international trade and investment, and prepare the Memorandum of the Foreign Trade Regime, Libya could seek outside technical assistance, including from the World Bank, whose experts have prepared similar documents in other countries.

Pricing and Subsidy Policies

26. **Price liberalization should continue with the lifting of the remaining controls on price and profit margins**. A limited number of goods, which the authorities feel are not sufficiently exposed to competition, could remain under a temporary pricing formula; the number of these goods should, however, be gradually reduced and eventually eliminated.

27. **Streamlining the subsidy system, which includes explicit subsidies** (mainly for food items) **and implicit subsidies in the form of low consumer prices** (for petroleum products, natural gas, electricity, and water) should be high on the government's agenda.[12] In this context, the government's plan to replace explicit food subsidies with cash payments should be better explained to the public in order to gain the support of the Basic People's Congress. Moreover, at a later stage, the case could be made to reverse the universality of these subsidies and progressively restrict them to the most vulnerable segments of the Libyan population. The issue of implicit subsidies would also need to be addressed by undertaking a comprehensive study to assess their size, and by implementing a plan to gradually reduce them overtime and limit them to the poorest segments of the population (Box 4-B).

Privatization and Foreign Direct Investment

28. **Encouraging private sector development, and in particular strengthening the small and medium-sized enterprises (SMEs), is key to promoting economic diversification, an objective that will require long and sustained efforts**. To that effect, priority should be given to enhancing the government's privatization strategy, ending all remaining monopolies and other impediments to economic competition, and attracting foreign investment.

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[12] In 2005, explicit subsidies were estimated at about 2 percent of GDP. The implicit subsidies, which are concentrated in the energy and water sectors, are assumed to be large, in the order of 14 percent of GDP for the energy sector; there are no current estimates of the size of the implicit subsidies in the water sector.

Broad money grew 9.2 percent. As a result of the improved government financial situation, the government's net creditor position with the banking system was about 50 percent of GDP. Overall credit to the economy declined by 1 percent, mainly reflecting a government buy-back of public enterprises' bank debt and a limited increase in credit to the private sector.

In 2005, macroeconomic performance remained relatively strong. Real GDP growth was about 3½ percent, and inflation low (2.5 percent). In contrast to previous years, economic growth is estimated to have been generated mainly in the non-oil economy (4½ percent). While activity in the oil sector grew only 1½ percent, due to output capacity constraints, the pick-up in activity in the non-oil sector was essentially the result of the increase in government spending. The main sectors that registered strong growth include trade, hotels, and transportation (7 percent); and construction and services (5 percent). Gains in agriculture remained modest (2.5 percent), but the manufacturing sector registered its first positive growth in five years (1.8 percent).

Based on preliminary data, the overall fiscal surplus reached 32½ percent of GDP, reflecting strong oil revenues (68 percent of GDP) and reduced expenditure (in terms of GDP). Non-oil revenue is estimated to have declined by about 15 percent, notably because of the nontransfer of the interest on the Oil Reserve Fund balances by the Central Bank of Libya (CBL); and lower collections by customs and local governments, partly reflecting the downside effects of the new tax law and customs tariff. Overall, the non-oil fiscal deficit widened to 35 percent of GDP.

Monetary developments were characterized by strong broad money growth (29 percent). Both money and quasi-money grew markedly, by 33 percent and 20 percent, respectively. These developments also reflect a remonetization of the economy consistent with improved domestic economic conditions and increased public confidence following the lifting of sanctions, and the sharp increase in bank credit to public enterprises (23 percent). With the sustained improvement in the government's financial situation, the government's net creditor position with the banking system reached 70 percent of GDP. While bank credit to the private sector grew only modestly (about 3 percent), most of the private sector credit needs were met by the government through specialized banks.

On the external side, the widening of the current account surplus to 41 percent of GDP reflected mainly strong hydrocarbon exports, which increased by 48 percent to about US$29 billion. Imports grew 24 percent to some US$11 billion, boosted by increased domestic demand. Overall, gross international reserves rose to about 32 months of 2006 imports.

In 2005, the authorities continued to implement measures to reform and open up the economy. The government streamlined the customs tariff, and eased restrictions on external trade by downsizing the negative import list from 31 items to 17 items. The new tariff schedule has only two rates (10 percent for tobacco products and 0 percent for all other products), but all imported goods are now subject to a 4 percent service fee. In the meantime, the production and consumption tax was increased to 25–50 percent for imported goods and reduced to 2 percent for domestically produced goods. Also, the government created an investment fund (IF) to manage part of the government's oil revenues.

In the monetary and banking area, the authorities passed: (i) a new banking law which reinforces the independence of the CBL and gives it the authority to allow foreign banks to operate in Libya;

and (ii) an Anti Money Laundering (AML) law. As of August 2005, banks were granted autonomy to determine freely interest rates on deposits and to set lending rates within a band of 250 basis points above the discount rate (currently at 4 percent). The CBL also launched the privatization of Sahara Bank and recapitalized three commercial banks.

As regards structural reform, major progress has been made in simplifying business application procedures. In particular, a one stop-window has been established, and a 30-day limit has been set for application approval with the obligation for the administration to notify any refusal through a notary public. The privatization program and foreign investment's scope of activity have been broadened to include downstream activities in the oil, health, transportation, and insurance sectors. Also, joint ventures between Libyan and foreign investors are now permitted to benefit from the incentives of Law 5 related to domestic investment. Overall, a total of 216 enterprises have been slated for privatization, and 144 are to be liquidated. Thus far, 66 small enterprises have been sold.

Libya has taken steps towards regularizing its relations with external creditors. In 2004–05 disputed claims with creditors in Germany, Spain and the United Kingdom have been settled. Discussions with other foreign creditors are ongoing.

Following its withdrawal from the Heavily Indebted Poor Countries (HIPC) Initiative, Libya has developed its own debt relief plan. Rescheduling agreements were reached with a number of HIPC countries including Uganda, Tanzania, Benin, and negotiations with Nicaragua are ongoing.

Executive Board Assessment

Directors welcomed Libya's continued strong macroeconomic performance during 2004–05, which had benefited from favorable developments in the world oil market. Both the fiscal and external current account balances registered large surpluses, and international reserves increased considerably. Directors commended recent structural reform initiatives, including the streamlining of the tariff schedule, the partial liberalization of interest rates, and the broadening of the privatization program and the scope for foreign investments.

Directors stressed the importance of accelerating progress towards the establishment of a market economy and sustained growth and job creation in the non-oil economy, noting that reform efforts have so far suffered from the absence of a comprehensive medium-term plan that is consistently implemented. Accordingly, they urged the authorities to take advantage of the good opportunity afforded by Libya's comfortable financial situation to pursue their reform agenda vigorously, with the medium-term strategy prepared by staff at the authorities' request as a blueprint. Directors were encouraged by the authorities' recognition of the need to move forward along these lines. They stressed that successful implementation will depend on careful prioritization and sequencing, as well as effective coordination among institutions—in particular between the central bank and the ministry of finance—including through the establishment of a high inter-ministerial oversight committee.

Directors noted that improving budgetary management and implementing a prudent fiscal policy are key to maintaining macroeconomic stability. They recommended that control of fiscal policy be brought under the responsibility of the ministry of finance by unifying the government's budgets

and officially abolishing all extrabudgetary operations. The authorities should also persevere with the implementation of fiscal reforms, by strengthening expenditure management and control, streamlining the tax system, and modernizing and improving revenue administration. To ensure long-term fiscal sustainability, Directors urged the authorities to strengthen the management of Libya's oil wealth by replacing the existing Oil Reserve Fund and Investment Fund by a Savings and Stabilization Fund. The revenue and expenditure policies of such a fund should be governed by strict and fully enforced rules, and its performance should be periodically assessed.

Directors supported the authorities' decision to increase public expenditure on basic infrastructure and social services, in order to improve coverage of the population's basic social needs. They stressed, however, that such spending should take into account the economy's absorptive capacity, while institutional capacities and accountability should be strengthened in order to ensure increased efficiency. In particular, budget preparation, execution, and monitoring need to be considerably reinforced and budgetary discipline enhanced. Beyond this, Directors urged that all outstanding government arrears be eliminated and no new arrears be accumulated.

Directors welcomed the partial liberalization of interest rates by the CBL, as well as the new banking law, which strengthens the central bank's independence and grants the CBL authority to allow foreign banks to operate. They encouraged the authorities to move to indirect monetary management, starting with full interest rate liberalization. Other required reforms include eliminating directed credit, reactivating the interbank money market, and strengthening banking supervision in line with international best practices. Directors considered the restructuring and modernization of the banking sector to be key to the development of the financial sector. They urged the authorities to implement a strategy for the restructuring of the state-owned banks, in line with staff recommendations, including the establishment of an independent bank restructuring agency that would take over ownership of public commercial banks.

Directors noted that Libya is well served by the current exchange rate regime pegging the Libyan dinar to the SDR, and that the current rate of the dinar is broadly appropriate. Going forward, due consideration should be given to adjustments in response to market developments, while preserving the economy's competitiveness. Over the longer-run, Directors recommended that exchange rate policy be kept under review as structural and macroeconomic reforms progress.

Directors welcomed the progress made in reforming the trade regime, and encouraged the authorities to terminate the remaining state import monopolies. They recommended that import taxation be streamlined by integrating all taxes and fees on imports in the tariff rates, which would be gradually reduced at a later stage. Directors encouraged the authorities to accelerate preparations for WTO accession discussions, and to seek technical assistance from outside experts in this endeavor.

Directors underscored that economic diversification will require a sustained effort including, in particular, enhancements to the government's privatization strategy, and improved conditions for foreign investment. They urged the authorities to enact a privatization law that will give the privatization agency a legal status and an explicit mandate. As regards foreign investment, Directors recommended replacing the current positive list with a clear and streamlined negative list, and removing the US$50 million floor on investment that, de facto, disqualifies most foreign

investments in the non-oil sector. They also encouraged the authorities to gradually streamline the subsidy system.

Directors welcomed Libya's recent decision to participate in the Fund's General Data Dissemination System (GDDS) and to use the latter as a framework for statistical development. They encouraged the authorities to undertake a thorough restructuring of Libya's statistical system, giving priority to the establishment of a National Statistical Council and the creation of a National Statistical Agency.

Directors welcomed the authorities' close collaboration with the Fund staff. They stressed that, in view of its severe human resource constraints and weak institutions, Libya will need further significant technical assistance to advance its economic reform agenda. In this regard, Directors welcomed Libya's decision to cover most of the cost of the country's required technical assistance.

Directors welcomed Libya's intention to participate in the financing of the Exogenous Shocks Facility and the progress made in improving relations with external creditors. They encouraged the authorities to reconsider Libya's withdrawal from the HIPC Initiative and integrate its debt relief plan in the multilateral framework of the latter.

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: Basic Economic and Financial Indicators, 2000–04

(Quota = SDR1,123.7 million)
Population (million): 5.67 million (2004)
Per capita GDP: US$5,271 (2004)

	2001	2002	2003	2004	Prel. 2005
	(Annual percent changes)				
National income and prices					
Real GDP	4.5	3.3	9.1	4.6	3.5
Real nonhydrocarbon GDP	6.8	4.7	2.2	4.1	4.6
CPI inflation	-8.8	-9.9	-2.1	-2.2	2.5
	(In percent of GDP)				
Central government finances					
Revenue	43.1	51.4	54.4	59.1	73.0
Expenditure and net lending	44.3	41.2	44.6	44.0	41.2
Errors and omissions [2/]	-2.5	5.0	-4.4	-2.4	-0.7
Overall fiscal balance	1.2	5.2	14.2	17.5	32.6
Nonhydrocarbon balance (deficit -)	-27.9	-35.1	-33.1	-33.6	-35.3
	(Annual percent changes, unless otherwise specified)				
Monetary Indicators					
Broad Money	11.1	10.9	8.1	9.2	28.6
Deposit rates (1 year-deposits, in percent)	5.5	5.5	5.5	4.5	4.5
	(In billions of dollars, unless otherwise specified)				
External Sector					
Exports of goods	10.9	9.7	14.5	20.6	30.1
Imports of goods	4.8	7.4	7.2	8.8	10.9
Current account balance	4.1	0.6	5.0	7.3	16.0
(As percent of GDP)	13.8	2.9	21.5	24.2	40.8
Gross official reserves	14.1	15.0	19.5	25.6	39.3
(In months of next year's imports)	19.0	20.5	21.9	23.9	31.5

Sources: Libyan authorities; and Fund staff estimates.
2/ Correspond to fiscal operations (net) not captured in available fiscal data.