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Socialist People's Libyan Arab Jamahiriya 2004 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion.

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 2004 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 21, 2004, with the officials of the Socialist People's Libyan Arab Jamahiriya on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 4, 2005. 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.

- a staff statement of January 28, 2005 updating information on recent developments.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 28, 2005 discussion of the staff report that concluded the Article IV consultation.

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

Statistical Appendix

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

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SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Consultation with the Socialist People's Libyan Arab Jamahiriya

Approved by Lorenzo L. Perez and Anthony R. Boote

January 4, 2005

- Discussions for the 2004 Article IV consultation were held in Tripoli during October 9–21, 2004. The staff team comprised Messrs. Elhage (head), Abdoun, Bailen, and Ms. Farhan (all MCD); and Mr. El Qorchi (MFD).
- The mission met with Prime Minister Ghanem, Secretary of Finance El-Huwej, Secretary of Planning Jehaimi, Central Bank Governor Menesi, Deputy Governor Ekdara, Mr. Saif Al-Islam Qadhafi, son of the Libyan Leader, and other senior officials.
- At the conclusion of the last consultation on August 18, 2003, Executive Directors commended the Libyan authorities for the reforms taken since the freezing of the UN sanctions in 1999 and emphasized the need to implement key reforms as part of a medium-term policy framework. They noted that, in the short run, the reform agenda should aim at improving macroeconomic management, removing remaining trade restrictions, bringing domestic prices in line with world prices, and addressing explicitly in the budget the impact of price realignments on vulnerable groups and public enterprises. In a second stage, structural reforms that require longer technical preparations would need to be implemented. Directors also acknowledged the close collaboration with staff during the 2003 Article IV consultation mission and supported Libya's requests for technical assistance from the Fund.
- In June 2003, Libya formally notified the Fund of its decision to accept its obligations under Article VIII, Sections 2 (a), 3, and 4 of the Fund's Articles of Agreement. The standard review, by MFD and LEG, of Libya's exchange system is currently underway. The Libyan dinar is pegged to the SDR.
- Libya's statistical base suffers from important shortcomings in the quality, coverage, timeliness, and consistency of data that need to be addressed. All of these have hampered the staff's ability to conduct the relevant economic analysis and effective surveillance.
- Libya's relations with the Fund and the World Bank are summarized in Appendices I and II, respectively. Data issues are covered in Appendix III, and Appendix IV summarizes the main staff recommendations in the monetary area.
- The authorities intend to publish the staff report and issue a PIN following the conclusion of the consultation process.

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Executive Summary

Developments in 2003–04

In 2003–04, reflecting the favorable developments in the world oil market, Libya's fiscal and current account balances registered large surpluses. While oil production increased markedly, the nonhydrocarbon sector grew only modestly, and CPI inflation remained negative. Limited progress was made on structural reform, but the government did adopt laws to encourage private investment. Banking supervision was strengthened and a new draft law aiming at enhancing the role of the central bank is under consideration.

Views of the authorities

The authorities agreed with the staff that higher growth rates and diversification of the Libyan economy could only be achieved through deregulation, a significant scaling down of the dominant role of the public sector, and the development of the private sector. However, they indicated that, given Libya's political structure, their preferred approach to reform was a one-sector-at-a-time piecemeal approach. They expressed strong interest in having the Fund and the World Bank take the leading roles in assisting them in formulating strategies to reform the economy.

Staff appraisal

Libya's macroeconomic position is projected to remain strong over the medium term. However, projected growth rates under the current policy stance would not be sufficient to generate employment opportunities for the new entrants to the labor force. Given the complementarity of structural reforms, staff recommended the development of a comprehensive and well-sequenced economic reform program. The latter could focus in the short run on strengthening budgetary management, developing market-based monetary instruments, and restructuring the banking system. More profound structural measures that require significant technical preparation and consensus building could be gradually implemented at a later stage. Given its weak institutions and the serious human capacity constraints, Libya will need substantial technical assistance to undertake and implement such a reform program.

Staff stressed that a prudent fiscal policy will remain key to maintaining macroeconomic and financial stability. Although the fiscal position is projected to remain comfortable, the structure of the budget will need to be rationalized through streamlining of expenditures and improving the efficiency of the tax system. In this context, it is important to amend the new tax law as recommended by FAD, avoid extra-budgetary spending, strengthen expenditure management and control, reform the subsidy system, and increase transparency in government operations.

The central bank of Libya is urged to increase its reliance on indirect monetary management and implement MFD's recommendations on banking supervision and monetary policy operations. The appropriateness of the exchange rate level and regime will need to be monitored as structural and macroeconomic reforms progress. Also, greater efforts to address statistical deficiencies and improve the timeliness and quality of data are required.

Staff expressed its regrets that Libya will not be participating in the Heavily Indebted Poor Countries (HIPC) Initiative. It stressed that the success of the HIPC Initiative will require the participation of all creditors, including Libya.

I. Background and Recent Developments

A. Background

1. **Libya is generously endowed with energy resources, but has one of the less diversified economies in the Maghreb region and even among the oil producing countries**. In the early 1970s, Libya opted for a socialist state and a command economy. Investment was essentially state-driven and trade and price controls, along with subsidies, were widespread. Economic performance was severely constrained by stifling government interference in the economy and an unfavorable business climate. 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 the UN economic sanctions, following the Lockerbie bombing. The authorities were reluctant to initiate any economic reforms when the country was subject to sanctions.

2. **Since the freezing of the UN sanctions in 1999, Libya has been gradually implementing measures to reform and open its economy.** But, it is only since the lifting of the UN sanctions and all U.S. Libya-specific trade sanctions in September 2003 and September 2004, respectively, that the pace of reform has picked up somewhat, with the implementation of measures aimed at enhancing the role of the private sector in the economy. These reforms continue, however, to be implemented in an ad hoc and nontransparent manner, and their pace and effectiveness are affected by serious human capacity constraints.

3. **In recent years, Fund surveillance has focused on policies to overhaul the incentive and regulatory regimes, exchange rate and trade reforms, fiscal reform, monetary reform, as well as on improving the reliability of economic data**. The authorities unified the exchange rate in 2002, and in 2003 eliminated exchange rationing and import licensing requirements. Progress in other areas, however, has generally been limited, mainly as a result of weak institutions.

4. **The Libyan economy still remains largely state controlled and heavily dependent on the oil sector.** Three quarters of employment is still in the public sector and private investment is low (2 percent of GDP). Private sector activities are hindered by a complex regulatory regime, restrictive labor market practices, and a legacy of policy reversals. In 1999–2003, the oil sector contributed about 50 percent of GDP, 97 percent of the country’s exports of goods, and 75 percent of government revenue. Libya’s social indicators are favorable by Middle East and North Africa (MENA) standards (Table 1).

B. Political Developments

5. **A settlement related to the Lockerbie bombing was reached in August 2003, and in December 2003, Libya announced that it had agreed to reveal and end its programs**

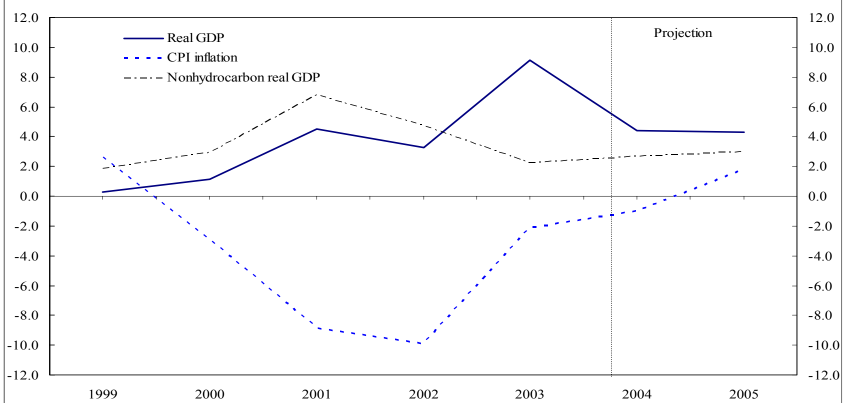
to develop weapons of mass destruction. Libya's relations with the U.S. have begun to normalize and ties with Europe and Asia continue to be strengthened.[1]

6. **The authorities have renewed their commitment to open up and liberalize Libya's economy.** They have expressed strong interest in having the Fund and the World Bank take the leading roles in assisting them in formulating plans to reform the economy and they have requested technical assistance from both institutions in their areas of expertise. The appointment of reformist figures at key ministerial posts since 2002 indicates support for economic reform by senior decision makers.

II. Developments in 2003 and 2004

A. Economic Developments in 2003

Figure 1. Libya: Real GDP and Inflation, 1999–2005
(Annual changes in percent)



Source: Libyan Authorities and Fund staff estimates.

7. **Real GDP grew by an estimated 9 percent in 2003, reflecting a 28 percent rise in oil production and a modest 2.2 percent increase in nonhydrocarbon activities (Table 2, Figure 1)**. While activity picked up in the trade, service and transportation sectors (5 percent), gains in agriculture and utilities remained modest (2–3 percent), and manufacturing declined (-5 percent) mainly as a result of increased competition from private sector imports. Public works and construction decreased by 7 percent, consistent with the drop in public investment spending. Deflation, as measured by the official Consumer Price Index (CPI), decelerated to 2.1 percent from 9.9 percent in 2002, mainly as a result of the disappearance in 2003 of the effects of the appreciation of the special exchange rate on the price of private sector imports.[2] Persistence of deflation in official statistics reflects in staff's view the fact that the current CPI, which according to the authorities is outdated and suffers from major shortcomings, covers essentially goods supplied by public enterprises whose prices have continuously declined in recent years as a result of increased competition from private sector imports.

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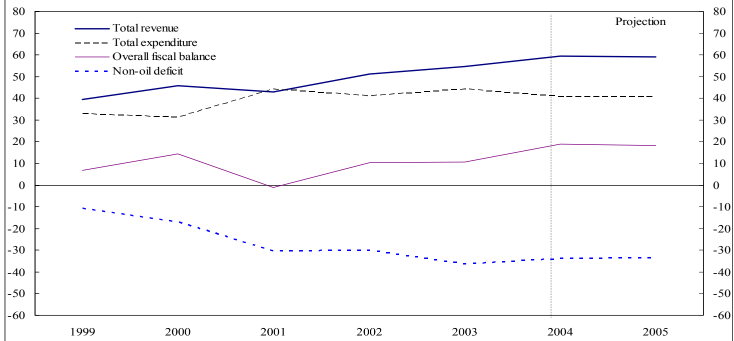
[1] A Euro 7 billion gas pipeline connecting Libya to Sicily (540kms) was inaugurated in October 2004. Staff has not received detailed information on this project, which started in August 2003.

[2] See footnote 8.

8. **The fiscal stance continued to be expansionary, with the non-oil fiscal deficit widening to 36 percent of GDP**[3] (Table 3, Figure 2). However, reflecting higher hydrocarbon revenues, which reached 47 percent of GDP, the overall surplus remained stable at about 10.5 percent of GDP. Non-oil revenue declined by 3 percentage points of GDP as a result of widespread tax evasion and low efficiency in tax collection. Capital expenditures were compressed to make room for the payment of one installment ($1.1 billion) of the Lockerbie settlement.[4] However, current expenditure, excluding the Lockerbie payment, remained high (30 percent of GDP).

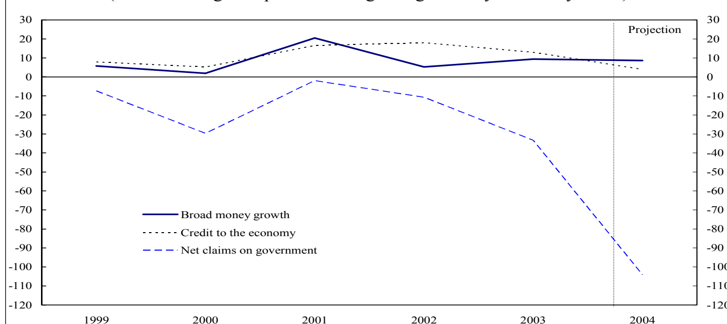
Figure 2. Libya: General Government Operations, 1999–2005
(In percent of GDP)



Source: Libyan Authorities and Fund staff estimates.

9. **Broad money increased by 9.4 percent** (Table 4, Figure 3). As a result of the improved fiscal situation, net banks' claims on the government declined sharply, whereas credit to nongovernment sectors increased by about 13 percent of end-2002 money stock, reflecting mainly credit extended to public enterprises.

Figure 3. Libya: Monetary Indicators, 1999–2004
(Annual changes in percent of beginning-of-the-year money stock)



Source: Libyan Authorities and Fund staff estimates.

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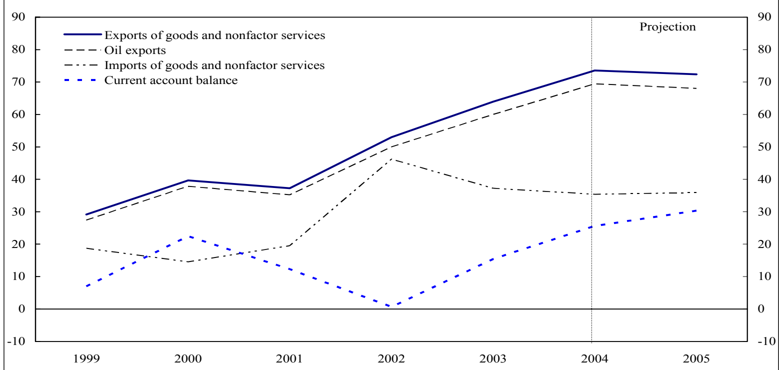
[3] This deficit is relatively high when compared to deficits in other oil producing countries. In 2003, the non-oil fiscal deficit as a percent of GDP was 22.5 percent, 21 percent, and 16.5 percent for the Gulf Cooperation Council countries, Algeria, and Iran, respectively.

[4] The total settlement amount is $2.7 billion; the remaining payment of $1.6 billion was expected to be made in 2004.

10. **The favorable developments in the oil market contributed to a significant improvement in the external current account surplus, which reached about 15 percent of GDP**. Oil export earnings increased by 47 percent to about $14.2 billion, and non-oil exports, mainly petrochemicals, also grew markedly. Imports declined by about 3 percent, consistent with lower capital expenditure and weak private sector demand growth (Table 5, Figure 4). Gross international reserves increased to about US$19 billion, equivalent to 22 months of 2004 imports.

Figure 4. Libya: External Sector, 1999–2005
(In percent of GDP)



Source: Libyan Authorities and Fund staff estimates.

B. Policy Developments in 2003–04

11. **Some progress was made on structural reforms in the last two years.** Measures taken include trade liberalization, allowing foreign investment in some sectors, the removal of customs duty exemptions enjoyed by public enterprises, and the reduction in import tariff rates. In addition, a privatization plan was initiated in January 2004, which involves the sale of 360 economic units, but excludes the utilities, the oil and gas sector, and the air and maritime transportation sectors. Thus far, 42 small units have been privatized and sold to domestic investors.

12. **In the money and banking area**, **banking supervision was strengthened**. A new draft Law on Bank Reorganization, Currency, and Credit has been submitted for discussion to the Basic People's Congress (BPC, Libya's local councils).[5] The draft law gives the Central Bank of Libya (CBL) greater responsibility in the conduct of monetary policy, including issuing its own securities. Also, the authorities have lowered interest rates across the board in an effort to encourage private sector demand for credit and developed a strategy to modernize the payment system.

13. **An Anti-Money Laundering (AML) draft law is still being considered by the General People's Congress (GPC, Libya's Parliament)**. Meanwhile, the CBL issued guidelines on implementing AML measures including requiring banks to designate controllers to report suspicious transactions. A Financial Intelligence Unit was established at the CBL to ensure that commercial and regional banks comply with the requirement to file suspicious transactions reports and create internal AML units, which will disseminate information and delineate the procedures to be followed in this area.

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[5] MFD's and the Legal Department's (LEG) comments on the draft law have been sent to the authorities.

14. **The authorities passed a new tax law in March 2004.** The new law reforms the general income tax, reduces the top marginal tax rate on wages and salaries, and increases exemptions. The corporate tax remains progressive, with rates varying from 15 to 40 percent, compared with 20 to 60 percent under the previous law.

15. **Libya has taken steps toward regularizing its relations with external creditors,** settling disputed claims with Italy's export agency[6] and creditors in Germany and the United Kingdom. Also, discussions are ongoing with other foreign creditors. These claims, on which no information has been made available to staff, pertain to disputed payments resulting from the imposition of UN sanctions on Libya. A new debt department has been recently established at the Ministry of Finance, with a view to developing an external debt database and strengthening external debt management procedures.

16. **On September 2, 2004, the authorities informed staff that Libya's participation in the HIPC Initiative failed to get the necessary political support for ratification**. They also indicated that Libya is preparing its own debt relief plan, which they intend to discuss directly with HIPC.[7]

C. Economic Developments in 2004

17. **Based on the latest World Economic Outlook (WEO) oil price assumptions,[8] large fiscal and current account surpluses are estimated to have occurred in 2004.** Real GDP growth is estimated at about 4.5 percent, reflecting a deceleration in growth of oil production to 7.5 percent, and a real nonhydrocarbon GDP growth rate of about 2.5 percent. For the year as a whole, the authorities expected a deflation rate of about 1 percent.[9]

18. **The overall fiscal surplus is estimated to have reached about 19 percent of GDP.** Oil revenue is estimated at 52.4 percent of GDP, reflecting significantly higher oil prices and production than in 2003. However, non-oil revenue is estimated to have declined by about 1 percentage point of GDP to 7 percent, partly owing to reduced tax revenue in connection with the new tax law provisions. Despite large increases in the wage bill (21 percent) and in capital expenditure (73 percent), total expenditure is estimated to have declined by 4 percent of GDP, mainly on account of a 7 percent of GDP drop in current extra-budgetary

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[6] According to the Italian authorities, Libya still owes about Euro 600 million to Italian firms.

[7] The authorities' intention is to approach their debtors on a bilateral basis, and discuss with them terms—that could be specific to each country—for the reimbursement of their debt to Libya.

[8] Under the December 2004 WEO assumptions, the average oil price for Libya in 2004 was estimated by staff to be $36.4 per barrel.

[9] The continued decline in the CPI in 2004, when there was only a modest growth in the supply of goods and a marked increase in wage payments, is an indication that the current index does not adequately measure actual inflation. The authorities have undertaken a new household survey in 2003, which is being used to prepare a new CPI.

expenditure.[10] The increase in the wage bill reflected mainly the new hiring of doctors and teachers.

19. **Broad money is estimated to have increased by about 8.5 percent.** Given the sustained improvement in the fiscal accounts, the government continued to be a net lender to the banking sector. Net claims on nonfinancial public enterprises and credit to the private sector are estimated to have increased only modestly. In May 2004, the government decided to use the foreign assets revaluation account at the CBL to buyback its outstanding domestic debt and part of the public enterprises debt to commercial banks.[11]

20. **The estimated strong external current account—a surplus of about 26 percent of GDP—reflects a 10 percent increase in oil export volume and a 29 percent increase in oil export price.** Nonhydrocarbon export growth is estimated to have remained robust, owing mainly to strong petrochemical exports. Imports are estimated to have grown by about 19 percent, consistent with import liberalization, a significant increase in capital expenditure, and high import prices.[12] Official reserves are estimated to have reached $24.6 billion, equivalent to about 27 months of projected 2005 imports.

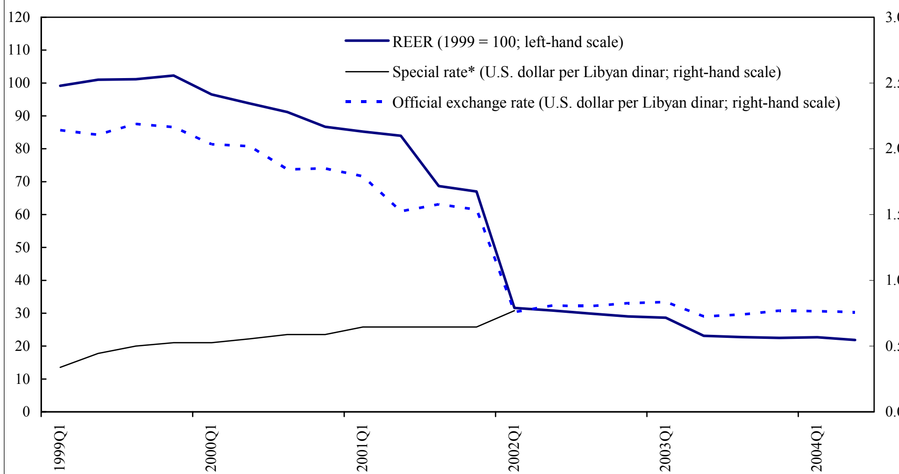
[10] The drop reflected mainly lower transfers to local governments.

[11] So far, the government has bought back LD 6.3 billion and LD 1.7 billion of its debt owed to the CBL and the commercial banks, respectively, and another LD 0.8 billion of the public enterprises' debt to the commercial banks. The government intends to buy back an additional LD 1 billion of public enterprises' debt to commercial banks in 2005. While the debt buyback from the CBL did not affect reserve money, the increase in liquidity resulting from the buyback from the commercial banks has been sterilized at the CBL. In view of the absence of the sale of foreign exchange, staff expressed reservations regarding these operations, stressing that the revaluation gains at the CBL were unrealized profits. Staff also recommended that the authorities do not follow up on their intention to buy back additional public enterprises' debt from the banks using the revaluation account, stressing that this operation should be part of a comprehensive public enterprises reform plan.

[12] About 60 percent of Libya's imports are from the euro zone area and Japan.

21. **In view of the existing price rigidities, it is difficult to assess the appropriate exchange rate level for Libya.** The authorities indicated, however, that the exchange rate market is functioning smoothly and no parallel market for the Libyan currency has developed since the unification of the exchange rate in 2002. Since the devaluation of the exchange rate in June 2003,[13] the Real Effective Exchange Rate (REER) has remained broadly stable and there has been no pressure on the exchange rate (Figure 5).

Figure 5. Libya: Exchange Rate Developments, 1999Q1–2004Q2
(End-of-Period)



Source: Libyan Authorities; and Fund staff estimates.
* In February 1999, the parallel market rate was legalized for some transactions and called the "special" rate. The exchange rate was unified in January 2002.

D. Medium-Term Outlook

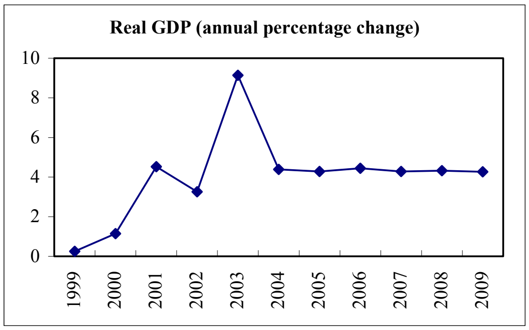
22. **Libya's medium-term outlook remains favorable and does not raise any sustainability concerns, on the expectation that world oil prices will decline only gradually and oil production will increase steadily to about 2.15 million barrels per day by 2009** (Tables 6 and 7, and Figure 6). During 2005–09, both the fiscal and external current account balances are projected to continue to register large surpluses averaging about 18 percent and 30 percent of GDP, respectively. However, without corrective measures, the non-oil fiscal deficit is expected to remain relatively large over the period, averaging about 33 percent of GDP, and real nonhydrocarbon GDP growth is projected to range between 3–3.7 percent. Projected growth rates would not be sufficient to generate employment opportunities for the new entrants to the labor force, which are expected to grow by about 3.5–4 percent per year over the medium term, as the current pace of government reforms will fall short of generating a sustained increase in investment and output.[14]

[13] The devaluation of the exchange rate was in line with staff's recommendations.

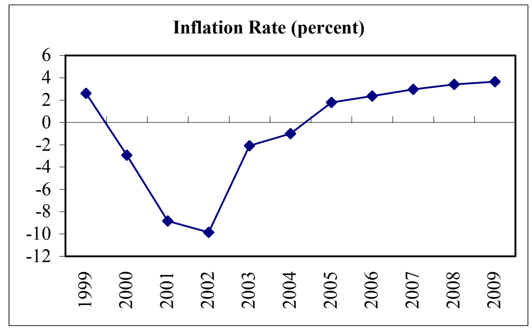
[14] Studies on countries in the MENA area show that, on average, for each 1 percent growth in the non-oil economy, employment increases by about 0.7 percent.

Figure 6. Libya: Baseline Medium-Term Scenario, 1999–2009

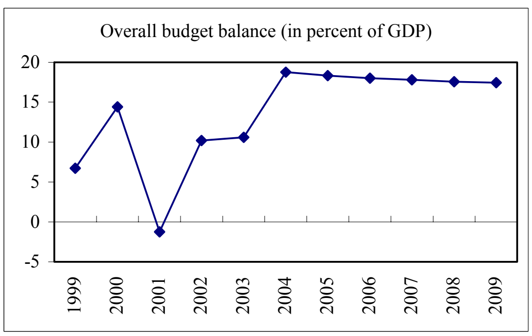
After a pick up in 2003, growth is expected to remain sluggish



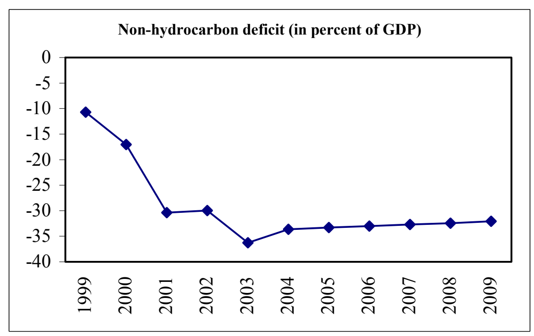
Inflation will pick up but will remain low



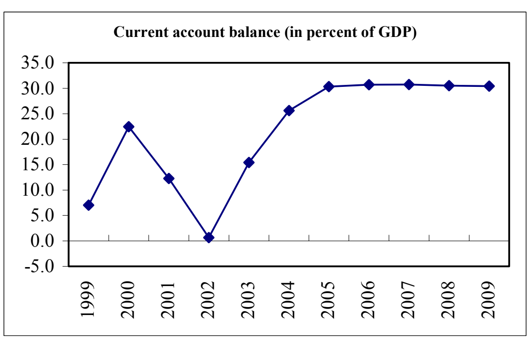
After increasing in 2004, the overall budget surplus will peak at 2005 and then decline gradually



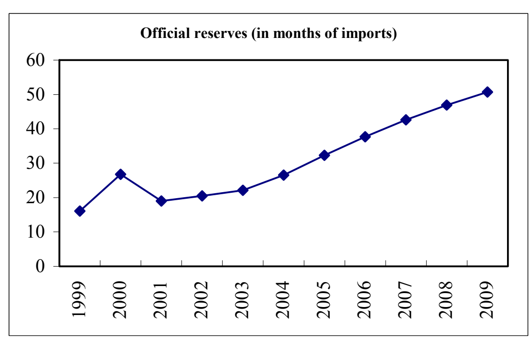
However, the non-oil fiscal deficit will remain high over time



The current account will remain in a large surplus over the medium term



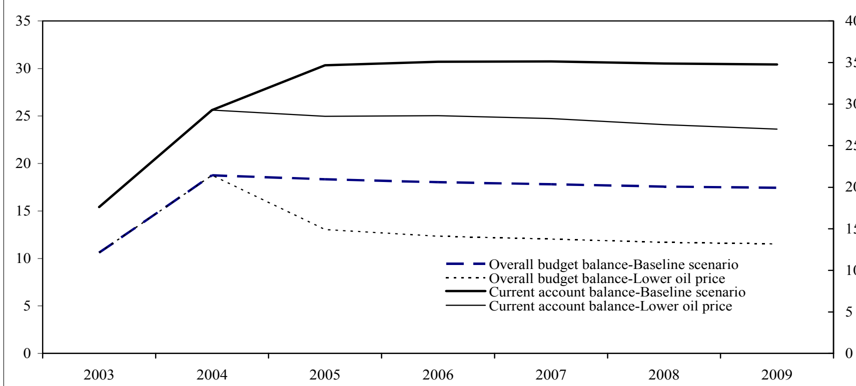
Gross official reserves will rise over time



Sources: Libyan authorities and Fund staff estimates.

23. **Although the medium-term outlook is based on historically high levels of oil price and production assumptions, the downside risks to the projected outlook are somewhat limited**. Indeed, on the assumption of an oil price that is $5 a barrel below the WEO spot price trajectory, staff estimates indicate that the fiscal and external current account would still record large surpluses during the entire projection period—on average 12 and 25 percent of GDP, respectively (Figure 7).[15] The build up of these surpluses reflects the limited absorptive capacity of the economy, particularly the projected low investment and growth levels resulting from the slow pace of reforms.

Figure 7. Libya: Sensitivity Analysis for the Medium-Term
(Oil Price lower by $5 every year), 2005–09
(In percent of GDP)



Source: Libyan Authorities and Fund staff estimates.

III. Policy Issues and Discussions

24. **Discussions took place at a time of an intense internal debate on how to reform the Libyan economy.** The authorities agreed with the staff that higher growth rates and diversification of the Libyan economy could only be achieved through deregulation, a significant scaling down of the dominant role of the public sector, and the development of the private sector. They indicated, however, that given Libya's political structure, their preferred approach to reform is a one-sector-at-a-time piecemeal one. They expressed strong interest in having the Fund and the World Bank take the leading roles in assisting them in reforming the economy. In this connection, they requested technical assistance from both institutions, including Fund's long-term resident advisors to assist them in developing and implementing reform agendas in the fiscal, monetary, and banking areas.[16] They are establishing an inter-ministerial economic team to coordinate policy design and reform implementation, and to follow up on Libya's technical assistance needs.

[15] Even a higher decline in the oil price ($12 below the WEO spot price trajectory) would still result in fiscal and external current surpluses averaging 2.2 and 14.1 percent of GDP, respectively.

[16] In December 2004, two Libyan advisors visited the Fund and the World Bank and discussed Libya's technical assistance needs in the financial and banking sector and statistics area.

25. **Staff indicated that Libya could benefit from the experience of other countries that succeeded in their transition from a centrally planned to a market economy**. These experiences stress that proper planning, coordination, and sequencing of policies are essential for the success of the reform efforts. In addition, the sustainability of reforms requires public support, which could only be achieved through a constructive dialogue with the civil society.

26. **Given the complementarity of structural reforms, staff recommended putting in place a comprehensive and well-sequenced macroeconomic and structural reform program that could serve as a blueprint to reforming the Libyan economy.** Staff suggested that in the short term, the authorities could focus on developing market-based monetary instruments, restructuring the banking system, liberalizing prices, strengthening budgetary management and procedures, and moving from price subsidies to a cash subsidy system. Preparatory work for these measures is at an advanced stage and the Fund has already provided technical assistance in the monetary reform area. More profound structural measures that require significant technical preparation and consensus building could be gradually implemented at a later stage (Box 1).

A. Fiscal Policy

27. **Fiscal policy continues to be shaped by the availability of oil revenues and the need to support employment and finance the subsidy system**. Several factors have markedly reduced the capacity of the authorities to conduct an effective fiscal policy. These include a lack of transparency of the budget process, considerable netting out of expenditure items, extra-budgetary revenues and expenditures, rigid rules, and the absence of medium-term planning. In addition, widespread tax exemptions continue to weaken the non-oil tax base.

28. **Staff stressed that a prudent fiscal policy will remain key to maintaining macroeconomic and financial stability**. It urged the authorities to avoid extra-budgetary spending and strengthen expenditure management and control in the period ahead. Staff recommended that the significant projected increases in oil revenues over the medium term be largely saved or allocated to finance structural measures to reform the economy, such as public enterprise and civil service reforms, and reform of the subsidy system.

29. **While staff has not had the opportunity to comment on the 2005 draft budget**,[17] it recommended that the authorities avoid extra-budgetary spending and that any budgeted increase in spending be directed to improve human capital and infrastructure, which have deteriorated significantly under the sanctions. Also, increased spending on health and education should be accompanied by reforms in these sectors. The authorities were advised to seek technical assistance from the World Bank in this regard.

[17] As of December 30, 2004, staff has not received any information on the 2005 budget.

Box 1. Libya: Required Economic Reforms

Phase 1 (1–12 months): Objective: Maintain macroeconomic stability, implement monetary reforms, finalize the plan to restructure public banks, establish appropriate relative prices, and improve overall transparency in economic management:

- Anchor the transition on macroeconomic stability by adopting a medium-term budget framework underpinned by sound management of the Oil Reserve Fund (ORF). Also, there is a need to develop an official law or decree, which clearly states the rules, purpose, and objectives of the ORF.
- Lift sectoral credit restrictions and allow interest rates to determine credit allocation. Gradually liberalize interest rates. Implement IMF's recommendations on improving the conduct of monetary operations and banking supervision.
- Finalize the plan to restructure public banks.
- Reassess the privatization strategy.
- Replace price subsidies by cash payments.
- Improve the economic database.

Phase 2 (12–36 months): Objective: Establish the institutional foundations for the efficient functioning of a modern economy:

- Accelerate the process of building up a sound investment climate, with strong institutions to support open markets and a level playing field for all investors. Measures include simplifying business entry, opening protected services to domestic and foreign investors, reducing regulatory ambiguity, strengthening the rule of law, and land reform.
- Restructure public enterprises and implement the privatization program.
- Restructure public banks and start to modernize prudential regulations and banking supervision in line with international best practices. Privatize public banks.
- Strengthen the social safety net to protect the vulnerable groups most affected by structural reforms.
- Consolidate and harmonize import duties and other taxes levied on imports. The number of tariff rates should be reduced from the current 20 to no more than five.
- Implement a comprehensive civil service reform.
- Develop an active money market with reliance on indirect monetary instruments

30. **Although the fiscal position is projected to remain comfortable over the medium term, the structure of the budget needs to be rationalized through streamlining of expenditures and improving the efficiency of the tax system.** On the revenue side, staff recommended that the authorities amend the new tax law approved by the GPC in March 2004, in line with FAD's recommendations (Box 2).

Box 2. Libya: Recommended Tax Reforms

FAD recommended a strategy aimed at simplifying the tax system, in order to improve its efficiency and make it more stable, transparent, and equitable. The strategy, which should be supported by tariff reforms and a reform of the tax and customs' administration, aims to:

- reform the general income tax; reduce the individual exemptions; and limit the rate schedule for individuals to three brackets: 15, 25, and 35 percent;
- simplify the corporate tax with a 35 percent flat rate, base corporations' payments on last year's income, and allow corporations to exclude domestic dividends from income;
- abolish the social solidarity tax, the Jihad tax, and the investment contribution tax;
- allow banks a tax deduction equivalent to the additional loan loss provision required by the central bank.
- ensure that tax incentives are not subject to administrative discretion, and that incentives for investment are not used as tax holiday;
- introduce the VAT by 2007; and
- facilitate privatization, by introducing appropriate rules for tax neutral corporate restructuring.

31. **On the expenditure side, the authorities were encouraged to reassess the 70/30 rule, and strengthen expenditure management and control**.[18] Staff recommended alternative approaches that could target specific sectors such as education or health without distorting the overall budget allocation. It stressed that further rationalization of spending, including within the context of reforming the civil service and the subsidy system, are needed to improve the efficiency of government spending. The authorities agreed with the staff that the 70/30 rule introduces a measure of rigidity into the budget process, particularly in view of the country's limited absorptive capacity.

32. **The authorities also agreed with the staff that the operations of the ORF should be reviewed to increase its transparency and accountability (Box 1)**.[19] Also, there should be regular and frequent disclosure and reporting on its inflows, outflows, and the investment of its assets, and the fund's accounts should be audited by an independent agency. The authorities agreed with staff's recommendations and stressed that the ORF should have both saving and stabilization functions.

[18] Budgetary oil revenues are allocated to capital and current expenditures according to a 70/30 fiscal rule. For more details on the structure of Libya's budget, see Country Report No. 03/327, Appendix V.

[19] The ORF is a government account managed by the CBL. It accumulates oil revenue in excess of the level determined by a budgetary oil price ($20 per barrel in 2004). Withdrawals from the ORF, mostly for current expenditures, take place on a discretionary basis. The ORF is not integrated into the budget and its operations are not transparent. There is a need for the CBL and the Ministry of Finance to agree on the nature and exact amount of the ORF holdings at the CBL.

33. **The authorities were in general agreement with staff's assessment of and recommendations on fiscal policy.** To that effect, they requested a Fund resident advisor at the Ministry of Finance that would help them develop an agenda for fiscal reform. FAD is of the view that a first step in this process would be to send a fact-finding mission to Libya to assess this request.

B. Monetary Policy and Financial Sector Developments

34. **Staff welcomed the authorities' intention to implement monetary and banking sector reform.** It stressed that current policies of direct controls on credit and interest rates are inefficient and make monetary policy increasingly ineffective in influencing macroeconomic goals. Even though progress is not yet tangible, the authorities are keen to develop a market-oriented monetary policy. While interest rates were reduced across the board in February 2004, the first change since 1994, rates are still controlled by the CBL. Furthermore, the current interest rate structure with a range of unchanged and low ceilings on lending rates reduces banks' ability to price in risk and discourages their lending activity. The authorities are concerned that, if they liberalize lending rates, interest rates would increase and adversely affect economic activity.

35. **Staff stressed the importance of further easing interest rate controls, with the aim of full liberalization.** It emphasized that the current weak demand for loans and the abundant bank liquidity offer a window of opportunity for initiating gradual interest rate liberalization without leading to higher lending rates. At the same time, directed credit allocation should be phased out. Without these reforms, financial markets will not be able to deliver efficient allocation of credit, which is needed to jump-start private sector activities and increase the overall efficiency of the economy.

36. **Staff urged the authorities to continue implementing the recommendations of the 2001 and 2004 MFD technical assistance missions** on banking supervision and monetary policy operations (Appendix IV). With the intended move toward indirect monetary management, it recommended the establishment at the CBL of a monetary policy committee responsible for key policy decisions, and the strengthening of daily monetary policy management.

37. **The authorities agreed with staff on the urgent need to reform the predominantly state-owned banking system.** They indicated that they have stepped-up efforts to improve banking supervision and arrange workouts of nonperforming loans, which stood at 26 percent of total loans at end-August 2004. They are aware that a more efficient and market oriented banking system is needed if Libya is to succeed in reforming its economy. They intend to restructure and privatize public banks, and allow foreign banks to operate in Libya, and have asked the Fund and the World Bank to assist them in this endeavor.

38. **Staff discussed with the authorities the main features of the draft law on bank reorganization, currency, and credit**, currently under preparation. The draft law, which is

intended to give the CBL greater responsibility in the conduct of monetary policy, raises issues that are a source of concern, mainly the composition of the proposed Board of the CBL, which would comprise representatives of three ministries with voting rights. Moreover, the draft law does not remove existing interest rate ceilings. Staff stressed that these provisions are not consistent with the principle of central bank autonomy. The authorities are reviewing the comments sent to them by MFD and LEG.

39. **Staff recommended that the authorities proceed with the planned reforms in the area of AML/CFT** and encouraged the implementation of AML/CFT measures in line with international practice in order to address vulnerabilities to money laundering and terrorist financing. The authorities were urged to seek staff's comments on the draft AML/CFT law before its adoption by the government.

C. Exchange Rate and Article VIII Issues

40. **Staff discussed with the authorities the importance of continued assessment of the level of the exchange rate.** It stressed that adjustments to the peg should occur as needed to absorb shocks and avoid a sustained real appreciation that would be harmful to competitiveness. Given the current features of the Libyan economy, in particular, the absence of well-developed financial markets, including a formal exchange market and the lack of adequate monetary instruments to manage liquidity, staff believes that the current exchange regime is appropriate. However, the exchange rate level and regime will need to be monitored as structural and macroeconomic reforms progress.

41. **With regard to Libya's acceptance of the obligations of Article VIII**, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement, the standard review, by MFD and LEG, of Libya's exchange system is currently underway. Staff stressed that, should the review identify any exchange restrictions, the authorities will need to eliminate them.

D. Trade Reform

42. **Staff welcomed the recent simplifications in Libya's trade regime**, including abolishment of licenses, lowering of tariff protection, and elimination of import duty exemptions granted to public enterprises. However, despite these measures, effective trade protection remains relatively high (Box 3).

43. **WTO accession negotiations will place a high demand on administrative resources.** In this connection, the authorities have formed a working group to undertake a thorough review of all laws, regulations, and policies that affect international trade and investment, and to prepare the Memorandum of the Foreign Trade Regime before the start of the negotiations for full membership in 2005. Staff recommended that, in order to speed-up the process, Libya could seek technical assistance from the World Bank, whose experts have prepared similar documents in other countries.

Box 3: Libya's Trade Regime

Libya's trade regime remains among the most restrictive in the world. In 2003, the simple average tariff rate was 21.8 percent, with tariff rates ranging between zero and 425 percent, and there is a substantial dispersion of tariffs within product categories. Besides import tariffs, the trade protection system includes a discriminatory consumption tax (between 10 and 50 percent) on goods that are consumed but not produced in Libya (while a production tax on local production ranges between 2 and 5 percent); and a regional and social solidarity tax of 15 percent of the import tariff. In addition, there are import bans on 31 items.

Some progress was made in 2004 to liberalize Libya's trade regime. Tariff rates were reduced—the maximum rate to 100 percent—resulting in a decline in the simple average tariff to 17.8 percent, and some state import monopolies were eliminated. The authorities intend to keep the import bans only for religious, health and ecological reasons, which would involve less than ten products, and replace the remaining bans by tariffs.

Further action is needed to improve Libya's trade regime. The consumption tax and regional and social solidarity tax should be integrated into the tariff rate structure, tariff protection should be limited to few items and reduced gradually overtime, and the number of tariff bands should be reduced from the current 20 to no more than five. Also, the remaining state import monopolies should be phased out and customs procedures should be simplified and made consistent with international standards.

E. Pricing and Subsidy Policies

44. **The authorities described their plans to reform the subsidy system**, the cost of which has increased by about 85 percent in 2004 to about 3.5 percent of GDP.[20] Staff recommended that the authorities' plan to replace the current price subsidy system with cash subsidies be accelerated, and that the latter be well targeted and limited to the vulnerable segments of the population. While agreeing with staff's recommendation, the authorities indicated that, for political reasons, the subsidy amount would be distributed equally among all Libyans.

45. **Staff noted that implicit subsidies would also need to be addressed.** They are sizable and are channeled to the economy mainly through fixed low consumer prices, in particular for petroleum products and electricity. In this connection, staff welcomed the increase in electricity prices in July 2004, and encouraged the authorities to increase gradually domestic petroleum product prices. Staff recommended that all implicit subsidies be budgeted and gradually reduced over time.

F. Deregulation and Privatization

46. **The pace of reforms has progressed recently.** Obstacles to private sector activity that were in effect for a long time are gradually being lifted. Staff welcomed the liberalization of foreign investment in some sectors and the creation of the Libyan Foreign Investment Board, acting as a one-stop-shop for foreign investors. However, while the state

[20] This excludes all implicit subsidies, but includes extrabudgetary spending on food subsidies.

has begun to withdraw from economic activity, the regulatory and institutional framework that supports the transition to a market economy suffers from major deficiencies.

47. **Staff welcomed the reduction in the number of state import monopolies.** State-owned companies now face competition from the private sector, which can freely import or produce goods that were previously under public monopoly. While price and profit margin controls still remain in a number of markets, the authorities stressed that enforcement of these controls is almost non-existent; accordingly, they were urged to abolish them. A limited number of goods, which the authorities feel are not sufficiently exposed to competition, could remain under a temporary pricing formula; however, the number of these goods should be gradually reduced and eventually eliminated.

48. **The authorities are committed to privatizing most state-owned public enterprises.** However, their strategy remains constrained by two main objectives: (i) protecting employment; and (ii) broadening the ownership base to avoid concentrated ownership. In this connection, staff encouraged the authorities to reassess their strategy and implement measures along the lines recommended by the World Bank. The latter include, among other things, (a) enacting a privatization law that would give the privatization agency an independent legal existence and an explicit mandate, and allow investors to acquire a significant share of capital and have corporate control over the privatized companies; and (b) basing the sale process on competitive bidding.

G. Other Issues

49. **Staff expressed its regrets that Libya will not be participating in the HIPC Initiative** under a multilateral framework which is providing considerable debt relief to HIPC, and urged the authorities to reconsider their decision. The authorities are aware that the comparability of treatment clause in Paris Club debt relief agreements requires the debtor country to seek from all other official bilateral and commercial creditors debt relief terms comparable to those obtained under the Paris Club. However, they indicated that the legislative structure in Libya requires approval from the BPC before Libya's participation in the HIPC Initiative could be considered for ratification. The authorities informed staff that the BPC did not support Libya's participation in the Initiative and, for that reason, decided to withdraw from it and are preparing their own debt relief plan instead.

50. **The authorities agreed with the staff that a concerted effort is needed to address data deficiencies in Libya (Appendix III).** Staff discussed with the authorities how the fundamental flaws of the Libyan data system can be addressed, and recommended that Libya participate in the General Data Dissemination System (GDDS) and appoint a national coordinator to that effect. The authorities reiterated their request (made during the annual

meetings in October 2004) for a multi-sector technical assistance mission from the Fund's Statistics Department.[21]

IV. Staff Appraisal

51. **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.** In 2003–04, Libya's macroeconomic performance was strong, with large fiscal and external surpluses reflecting the favorable developments in the world oil market. While staff welcomes the adoption of measures aimed at encouraging foreign investment and enhancing the role of the private sector in the economy, the pace and effectiveness of these reforms remain limited in part because their implementation is done in an ad hoc and nontransparent manner. Staff encourages the authorities to speed up the transition to a market economy, by easing government control on the economy and shifting progressively the economic decision-making to the private sector, while allowing free competition on a level playing field.

52. **Staff believes that the authorities' one-sector-at-a-time piecemeal approach to reform would limit the pace and efficiency of the envisaged reforms.** Libya needs strong and sustained economic growth to meet the demands of its rapidly growing labor force, which requires high investment in both physical and human capital, as well as an efficient use of available resources. This can only be achieved through the implementation of a comprehensive and well-sequenced reform program.

53. **Priority structural reforms that could be launched in the short run** could focus on monetary and financial reforms, price liberalization, budgetary management and procedures, and subsidy system reform. Further reform steps to create a conducive environment for economic activity, including a vigorous privatization program and the building-up of a sound business climate, that require significant technical preparation and consensus building could be implemented at a later stage. In this context, the authorities are urged to reassess their privatization strategy and implement measures along the lines recommended by the World Bank.

54. **Improving budgetary management and control and implementing a prudent fiscal policy are key to maintaining macroeconomic stability**. There is a need to strengthen the budget system and integrate extra-budgetary operations in a consolidated budget under the responsibility of the Ministry of Finance. In view of the large non-oil fiscal deficit, it is important to broaden the non-oil tax base and streamline spending. To achieve this objective, the authorities need to strengthen tax policy as recommended by staff and reassess the 70/30 rule to better take into account the country's absorptive capacity and avoid procyclical expenditure. Given the human capacity constraints at the Ministry of Finance, Libya will need substantial technical assistance to undertake these reforms.

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[21] The multi-sector mission from the Fund's Statistics Department is currently scheduled for June 2005.

55. **The authorities' plan to replace the current price subsidy system with a cash subsidy should be accelerated.** Staff recommends that the new subsidy be well targeted and limited to the vulnerable segments of the population. It is also important that the authorities tackle the issue of the implicit subsidies. Staff welcomes the recent increase in electricity prices and encourages the authorities to increase gradually domestic petroleum product prices.

56. **Staff strongly urges the authorities to increase transparency and accountability in the operations of the ORF**. This should be done through the enactment of a law that clearly states the ORF's rules, objectives, and the agency that controls it. Also, the ORF's accounts should be regularly reported and audited by an independent agency.

57. **It is crucial that the authorities carry through their stated intention to reform the monetary and banking sector**. For that purpose, the authorities are urged to incorporate in the new law on bank reorganization, currency, and credit MFD and LEG comments. In particular, the new law should clearly give the CBL full autonomy in the conduct of monetary policy. In this regard, urgent steps are needed to develop indirect monetary policy instruments, including the gradual liberalization of interest rate and the elimination of directed credits. It is also important to strengthen bank supervision and to ensure adequate asset classification and provisioning, in line with international best practices. Staff strongly supports the intention of the authorities to restructure and privatize public banks, allow foreign banks to operate in Libya, and their request for technical assistance from the Fund to reform Libya's financial and banking sector.

58. **Determining the proper exchange rate for the Libyan dinar is difficult in the current economic conditions.** However, the relatively modest increase in the demand for foreign exchange and the absence of pressures on the exchange rate following the implementation of current account convertibility and the increased liberalization of the external trade are indications that the current rate of the Libyan dinar is broadly appropriate. Nevertheless, the authorities should be prepared to revalue the peg as necessary in response to market forces, while taking into consideration the need to preserve the economy's competitiveness. Also, exchange rate policy will need to be kept under review as structural and macroeconomic reforms progress.

59. **Despite the recent simplifications in Libya's trade regime**, effective trade protection remains high. The required reforms include the integration in the tariff rates of the taxes levied on imports, the streamlining of the tariff structure, gradual reduction in tariff rates, and the abolishment of the remaining state import monopolies.

60. **Staff urges the authorities to reassess their decision to withdraw from the HIPC Initiative.** It stresses that the success of the HIPC Initiative will require the participation of all creditors, including Libya.

61. **The authorities need to increase their efforts to improve Libya's statistical database**, whose shortcomings seriously affect the capacity of the government to assess

economic and financial conditions and the ability of staff to conduct effective surveillance. Staff encourages the authorities to look to the GDDS as a framework for statistical development and appoint a national coordinator to that effect.

62. **In the period ahead, staff intends to intensify policy dialogue with the authorities** with a view to assisting them in the development and implementation of an economic reform program. In this regard, staff will develop a technical assistance program in support of Libya's economic reforms.

63. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

GLOSSARY

AML	Anti Money Laundering
BPC	Basic People's Congress
CBL	Central Bank of Libya
CPI	Consumer Price Index
FAD	Fiscal Affairs Department
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
GPC	General People's Congress
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank of Reconstruction and Development
IFC	International Finance Corporation
IMF	International Monetary Fund
LEG	Legal Department
MCD	Middle East and Central Asia Department
MENA	Middle East and North Africa region
MFD	Monetary and Financial Systems Department
MIGA	Multilateral International Guarantee Agency
OPEC	Organization of Petroleum Exporting Countries
ORF	Oil Reserve Fund
PDR	Policy Development and Review Department
REEF	Real Effective Exchange Rate
TA	Technical Assistance
WEO	World Economic Outlook
WTO	World Trade Organization

Table 1. Libya: Demographic, Social, and Human Development Indicators, 1997–2002

	Units	Libya						MENA 1/
		1997	1998	1999	2000	2001	2002	2002
Demographic indicators								
Population	Millions	4.94	5.04	5.14	5.24	5.34	5.45	306.5
Aged 0–14	Percent of total	37.0	36.1	35.2	33.9	33.5	33.0	108.0
Aged 15–64	Percent of total	60.2	61.2	62.2	62.7	63.1	63.5	185.6
Aged 65 and above	Percent of total	3.1	3.2	3.3	3.4	3.5	3.6	12.2
Age dependency 2/	Ratio	0.75	0.73	0.71	0.69	0.68	0.66	0.7
Urban population	Percent of total	86.3	86.7	87.2	87.6	87.9	88.2	68.9
Social indicators								
Total labor force	Millions	1.41	1.44	1.47	1.50	1.53	1.57	105.3
Male	Percent of total	78.3	77.9	77.4	76.9	76.4	76.0	73.4
Female	Percent of total	21.7	22.1	22.6	23.1	23.6	24.0	26.6
Life expectancy at birth	Years	70.2	...	...	71.5	...	72.3	69.6
Male	Years	68.3	...	...	69.3	...	69.9	68.0
Female	Years	72.2	...	...	73.8	...	74.9	71.4
Infant mortality rate	Per thousand live births	...	...	...	17.0	...	16.0	36.7
Immunization rate								
Measles	Percent of under 12 months	91.0	92.0	92.0	92.0	93.0	91.0	93.1
DPT	Percent of under 12 months	96.0	95.0	94.0	94.0	94.0	93.0	92.4
Education indicators								
Adult illiteracy rate (ages 15 and above)	Percent of total	76.7	77.8	78.8	79.9	80.8	81.7	73.8
Male	Percent of Male	88.7	89.4	90.1	90.8	91.3	91.8	83.0
Female	Percent of Female	63.4	65.0	66.5	68.1	69.3	70.7	64.5
Human development indicators								
Human development index (HDI) 3/ 4/	Index	...	0.760	0.770	0.772	...	0.794	0.725
Gender-related development index (GDI) 4/ 5/	Index	...	0.738	0.748	0.753	...	...	0.676

Sources: World Bank's World Development Indicators, 2002 and UNDP's Human Development Report, 2002.

1/ Middle East and North Africa (MENA) (16 countries): Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Oman, Saudi Arabia, Syria, Tunisia, West Bank and Gaza, and Yemen.

2/ Population under the age of 15 and over the age of 65 as a share of the total working-age population.

3/ Human Development Indicators measures average achievements in basic human development in one simple composite index. Its value ranges from zero to 1.

4/ The MENA region for HDI and GDI refers to 16 countries: Algeria, Bahrain, Egypt, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, the UAE, and Yemen.

5/ Gender Development Index (GDI) measures achievements in the same dimensions and uses the same variables as the HDI does, but takes account of inequality in achievement between men and women.

Table 2. Libya: Basic Economic and Financial Indicators, 2000–05

(Quota = SDR 1,123.7 million)
Population (million):5.6 (2003)

	2000	2001	2002	Est. 2003	Prel. 2004	Proj. 2005
	(Annual percentage change, unless otherwise specified)					
National income and prices						
Real GDP 1/	1.1	4.5	3.3	9.1	4.4	4.3
Real non-hydrocarbon GDP 1/ 2/	3.0	6.8	4.7	2.2	2.7	3.0
Nominal GDP in billions of Libyan Dinars	17.7	18.1	24.6	30.3	38.0	39.2
Nominal GDP in billions of U.S. dollars 3/	34.5	30.0	19.3	23.6	29.0	31.0
Per capita GDP in thousands of U.S. dollars 3/	6.6	5.6	3.6	4.3	5.1	5.4
CPI inflation	-2.9	-8.8	-9.9	-2.1	-1.0	1.8
	(In percent of GDP)					
Central government finances						
Revenue	45.7	43.1	51.1	54.8	59.5	58.9
Of which: Hydrocarbon	31.5	29.1	40.2	46.9	52.4	51.6
Expenditure	31.3	44.3	40.9	44.2	40.8	40.6
Of which: capital expenditure	10.2	10.0	13.6	9.3	12.9	12.8
Overall balance (deficit -)	14.4	-1.2	10.2	10.6	18.8	18.3
Non-hydrocarbon balance (deficit -)	-17.0	-30.4	-30.0	-36.3	-33.6	-33.3
	(Changes as a percent of beginning of the year money stock)					
Money and credit						
Money and quasi-money	1.9	20.5	5.3	9.4	8.6	12.6
Net credit to the government	-29.7	-1.9	-10.7	-33.3	-104.1	-46.6
Deposit rate (1-year deposits, in percent)	5.5	5.5	5.5	5.5	4.5	...
	(In billions of U.S. dollars; unless otherwise indicated)					
Balance of payments						
Exports, f.o.b.	13.5	11.0	9.9	14.7	20.8	21.9
Of which: hydrocarbons	13.1	10.6	9.7	14.2	20.1	21.1
Imports, f.o.b.	4.1	4.8	7.4	7.2	8.6	9.3
Current account balance	7.7	3.7	0.1	3.6	7.4	9.4
(As percent of GDP)	22.5	12.3	0.6	15.4	25.6	30.3
Overall balance (deficit -)	6.5	1.3	0.3	3.1	5.7	6.6
(As percent of GDP)	18.8	4.5	1.6	13.2	19.7	21.1
Reserves						
Gross official reserves	13.1	14.1	15.0	18.9	24.6	31.2
(In months of next year's imports of GNFS)	26.7	19.0	20.5	22.1	26.5	32.3
Exchange rate						
Official exchange rate (LD/US$, period average)	0.5	0.6	1.27	1.28	1.31	...
Official exchange rate (LD/US$, end of period)	0.5	0.7	1.21	1.30	1.27	...
Special market rate (LD/US$, end of period) 4/	1.8	1.6	...	...	...	...
Spread = special rate/official rate (LD/US$, end of period)	3.3	2.5	...	...	...	...
Libya crude oil production (millions of barrels per day)	1.351	1.316	1.200	1.534	1.650	1.750
Libyan crude oil price (US$/bbl)	27.0	23.3	24.4	28.2	36.4	35.7

Sources: Libyan authorities and Fund staff estimates and projections.
1/ Growth rates are related to GDP at factor cost.
2/ Up to 2002, data reflect the authorities' estimates, which in staff view could be over-estimated. For 2003 onwards, data are staff estimates and projections.
3/ At official exchange rate prior to 2002.
4/ The previous parallel market, and was legalized for some transactions in February 1999.

Table 3. Libya: Consolidated Fiscal Operations, 2000–05

	2000	2001	2002	Est. 2003	Prel. 2004	Proj. 2005
	(In millions of Libyan dinars)					
Total Revenue	8,075	7,814	12,572	16,614	22,646	23,116
Hydrocarbon, *of which*	5,557	5,286	9,872	14,228	19,929	20,245
Oil Reserve Fund	3,130	1,719	2,119	8,607	11,179	9,150
Nonhydrocarbon	2,518	2,528	2,700	2,386	2,717	2,872
Budgetary Revenue	4,729	5,802	9,847	7,308	10,830	13,309
Hydrocarbon budget allocation	2,427	3,567	7,753	5,621	8,750	11,094
Nonhydrocarbon Tax Revenue	2,061	2,056	1,150	725	840	881
From tax administration	475	524	771	340	372	391
Taxes on international trade	1,586	1,531	379	385	468	491
Nontax revenue	241	179	944	962	1,239	1,334
interest from Oil Reserve Fund	161	166	348	0	115	582
Extrabudgetary Revenue	3,346	2,012	2,725	9,307	11,816	9,807
Reserve Fund allocation	3,130	1,719	2,119	8,607	11,179	9,150
GMR Revenue	216	294	606	699	637	657
Total expenditure and net lending	5,528	8,038	10,063	13,396	15,510	15,927
Total expenditure	5,528	8,038	10,063	13,396	15,510	15,927
Current expenditure	3,721	6,226	6,724	10,564	10,612	10,924
Administrative budget	3,044	3,537	4,183	4,228	5,327	5,445
Expenditure on goods and services	2,801	3,161	3,684	3,499	4,132	4,325
Wages and salaries 1/	1,999	2,297	2,546	2,812	3,403	3,573
Other purchases of goods and services	802	863	1,139	688	729	752
Interest Payments	0	75	0	0	66	0
Subsidies and other current transfers	243	301	499	728	1,129	1,120
Food Subsidies	130	140	431	480	850	813
Other current transfers	113	161	67	248	279	307
Extrabudgetary current expenditure	677	2,689	2,541	6,336	5,285	5,479
Oil Reserve Fund 2/	121	2,193	1,966	5,636	4,545	4,716
Defense	556	496	575	700	740	763
Capital expenditure	1,807	1,813	3,339	2,832	4,898	5,003
Development budget	1,541	1,539	2,936	2,204	4,190	4,273
Extrabudgetary capital expenditure	266	274	403	628	708	730
GMR 3/	266	274	403	628	708	730
Overall balance	2,547	-224	2,509	3,218	7,136	7,190
Overall balance, excluding Oil Reserve Fund revenue	-583	-1,943	390	-5,389	-4,043	-1,961
Nonhydrocarbon balance	-3,010	-5,510	-7,363	-11,010	-12,793	-13,055
Domestic Financing 4/	-2,940	-223	-1,281	-4,273	-7,136	-7,190
Statistical discrepancy	393	447	-1,229	1,055	0	0

Table 3. Libya: Consolidated Fiscal Operations, 2000–05

	2000	2001	2002	Est. 2003	Prel. 2004	Proj. 2005
			(In percent of GDP)			
Total revenue	45.7	43.1	51.1	54.8	59.5	58.9
Oil revenue, *of which*	31.5	29.1	40.2	46.9	52.4	51.6
ORF	17.7	9.5	8.6	28.4	29.4	23.3
Non-oil revenue	14.2	13.9	11.0	7.9	7.1	7.3
Tax revenue	11.7	11.3	4.7	2.4	2.2	2.2
Nontax revenue	2.0	2.2	5.2	5.5	4.9	5.1
Total expenditure	31.3	44.3	40.9	44.2	40.8	40.6
Current	21.1	34.3	27.4	34.8	27.9	27.9
Budgetary	17.2	19.5	17.0	13.9	14.0	13.9
Extrabudgetary 2/	3.8	14.8	10.3	20.9	13.9	14.0
Capital	10.2	10.0	13.6	9.3	12.9	12.8
Budgetary	8.7	8.5	11.9	7.3	11.0	10.9
Extrabudgetary	1.5	1.5	1.6	2.1	1.9	1.9
Overall balance	14.4	-1.2	10.2	10.6	18.8	18.3
Overall balance (excl. Oil Reserve Fund revenue)	-3.3	-10.7	1.6	-17.8	-10.6	-5.0
Nonhydrocarbon balance	-17.0	-30.4	-30.0	-36.3	-33.6	-33.3
Gross domestic debt	43.3	42.1	31.1	25.2	0.0	0.1
Memorandum items:						
Nominal GDP	17,668	18,148	24,583	30,338	38,036	39,214
Nonhydrocarbon GDP	10,905	11,480	11,755	11,647	11,336	12,202

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

1/ Net of income taxes and includes the contributions to the social security fund.

2/ ORF expenditure for 2003 and 2004 includes payments for the Lockerbie settlement of LD 1,388 million and LD 2,095 million, respectively.

3/ Includes current and capital expenditures.

4/ Data for 2004 do not include the government's debt buyback operation.

Table 4. Libya: Monetary Survey, 2000–05 1/

	2000	2001	2002	2003	Prel. 2004	Proj. 2005
	(In millions of Libyan dinars)					
Net foreign assets	5,410	6,921	14,743	21,952	28,680	36,878
Central bank	5,834	7,933	15,895	22,837	29,479	37,677
Foreign assets	7,419	9,606	19,193	27,757	35,477	43,958
Foreign liabilities	1,585	1,673	3,298	4,921	5,998	6,281
Deposit money banks	-423	-1,012	-1,152	-885	-799	-799
Foreign assets	461	620	778	793	927	927
Foreign liabilities	884	1,633	1,930	1,678	1,727	1,727
Net domestic assets	4,826	5,414	-1,755	-7,739	-13,242	-19,500
Domestic credit	9,211	10,712	11,620	8,973	-5,252	-11,594
Net claims on government	1,135	940	-377	-4,707	-19,497	-26,686
Central bank claims 2/	7,288	7,151	7,010	7,012	1,015	1,015
Governments' deposits with central bank	7,563	7,763	8,588	12,964	20,100	27,289
Commercial banks' claims 2/	1,766	1,811	1,811	1,811	373	373
Governments' deposits with commercial banks	355	259	609	566	785	785
Claims on the rest of the economy	8,076	9,772	11,996	13,680	14,245	15,092
Claims on nonfinancial public enterprise 2/	4,245	5,164	7,320	9,075	9,368	9,984
Claims on private sector	3,639	4,482	4,525	4,405	4,626	4,857
Claims on specialized banking institutions	94	50	82	77	97	97
Claims on nonbank financial instit.	98	76	70	123	154	154
Other items (net) 2/	-4,385	-5,298	-13,375	-16,712	-7,990	-7,906
Broad money	10,236	12,335	12,987	14,213	15,438	17,378
Money	7,243	8,271	8,894	9,184	10,509	...
Currency in circulation	2,699	2,560	2,614	2,780	2,737	...
Demand deposits (other than government)	4,543	5,712	6,281	6,404	7,772	...
Quasi-money	2,993	4,063	4,093	5,029	4,929	...
Memorandum items:						
Net claims on the government excl. SSF	1,604	1,381	101	-4,173	-18,986	-26,175
	(Annual rate of change in percent) 2/					
Broad money	1.9	20.5	5.3	9.4	8.6	12.6
Money	1.1	14.2	7.5	3.3	14.4	...
Quasi-money	3.9	35.8	0.7	22.9	-2.0	...
Net claims on government	-72.4	-17.2	-140.0	1150.2	5.0	5.0
Claims on nonfinancial public enterprises	13.2	21.7	41.8	24.0	3.2	6.6
	(Percent change over beginning broad money stock) 2/					
Net foreign assets	34.6	14.8	63.4	55.5	53.0	53.1
Domestic credit	-24.4	14.7	7.4	-20.4	-100.1	-41.1
Net claims on government	-29.7	-1.9	-10.7	-33.3	-104.1	-46.6
Claims on the economy	5.2	16.6	18.0	13.0	4.0	5.5
Claims on nonfinancial public enterprises	4.9	9.0	17.5	13.5	2.1	4.0
Claims on private sector	0.1	8.2	0.3	-0.9	1.5	1.5
Other items (net)	-8.3	-8.9	-65.5	-25.7	61.4	0.5
	(As percent of GDP)					
Domestic credit	52.1	59.0	47.3	29.6	-13.8	-29.6
Net claims on the government	6.4	5.2	-1.5	-15.5	-51.3	-68.1
Broad money	57.9	68.0	52.8	46.8	40.6	44.3
Nominal GDP (in billions of Libyan dinars)	17.7	18.1	24.6	30.3	38.0	39.2

Source: Central Bank of Libya.
1/ Data include the local ("regional") banks.
2/ In 2004, data reflect the government's debt buyback operation.

Table 5. Libya: Balance of Payments, 2000–09

(In millions of US dollars; unless other indicated)

	2000	2001	2002	2003	Prel. 2004	Projections 2005	2006	2007	2008	2009
1. Current Account	7,745	3,682	123	3,642	7,429	9,406	10,008	10,530	10,962	11,491
A. Goods and Services	8,661	5,310	1,307	6,309	11,071	11,312	11,755	12,130	12,369	12,694
a. Goods	9,379	6,160	2,443	7,464	12,254	12,574	13,066	13,498	13,803	14,199
Exports (fob)	13,508	10,985	9,851	14,664	20,844	21,903	22,731	23,607	24,439	25,419
Hydrocarbon sector 1/	13,057	10,565	9,668	14,175	20,137	21,100	21,875	22,695	23,466	24,383
Other exports	450	420	184	489	707	803	856	913	973	1,036
Imports (fob)	-4,129	-4,825	-7,408	-7,200	-8,590	-9,329	-9,665	-10,109	-10,636	-11,220
b. Services	-718	-850	-1,137	-1,155	-1,183	-1,263	-1,311	-1,369	-1,434	-1,505
Debit	890	1,033	1,539	1,597	1,669	1,796	1,898	2,013	2,142	2,283
Credit	172	183	402	442	485	534	586	644	708	778
B. Income	-429	-899	-404	-994	-1,368	-1,321	-1,195	-1,028	-814	-589
Direct investment income 2/	-1,143	-1,575	-1,254	-2,137	-2,579	-2,703	-2,802	-2,907	-3,006	-3,123
Other investment income	714	676	850	1,143	1,212	1,381	1,607	1,879	2,191	2,535
Government sector	420	528	748	1,022	1,085	1,249	1,469	1,735	2,041	2,378
Private sector	291	142	110	122	127	132	138	144	150	157
C. Current transfers	-487	-728	-780	-1,673	-2,274	-584	-552	-572	-593	-615
General government 3/	0	0	0	-1,174	-1,756	-50	0	0	0	0
Private	-487	-728	-780	-499	-518	-534	-552	-572	-593	-615
Oil sector	-20	-24	-13	-14	-20	-21	-22	-22	-23	-24
Other sectors (workers transfers abroad)	-467	-705	-767	-485	-498	-513	-531	-549	-570	-591
2. Capital and Financial Account	-149	-977	89	-167	-1,330	-2,852	-3,060	-3,285	-3,528	-3,790
Direct investment	43	-308	281	79	-193	-470	-517	-569	-626	-688
Portfolio investment	-706	-1,358	72	-607	-907	-1,552	-1,629	-1,711	-1,796	-1,886
Other investment	514	690	-264	361	-230	-831	-914	-1,005	-1,105	-1,216
3. Errors and Omissions and Other Capital	-1,097	-1,368	101	-353	-400	0	0	0	0	0
4. Overall Balance	6,499	1,338	314	3,122	5699	6554	6,948	7,246	7,435	7,700
5. Reserve items	-6,499	-1,338	-314	-3,122	-5699	-6554	-6,948	-7,246	-7,435	-7,700
Memorandum items:										
Official exchange rate, LD/US$ (pa)	0.51	0.61	1.27	1.28	1.31	...	...	...	...	...
Official exchange rate, LD/US$ (eop)	0.54	0.65	1.21	1.30	1.27	...	...	...	...	...
Gross official reserves (in billions of US$)	13.1	14.1	15.0	18.9	24.6	31.2	38.1	45.3	52.8	60.5
Gross official reserves, in months of next year's imports of GNFS	26.7	19.0	20.5	22.1	26.5	32.3	37.7	42.6	46.9	50.7
Current account balance (in percent of GDP)	22.5	12.3	0.6	15.4	25.6	30.3	30.7	30.7	30.5	30.4
Overall balance of payments (in percent of GDP)	18.8	4.5	1.6	13.2	19.7	21.1	21.3	21.2	20.7	20.4
Nominal GDP (in billions of US$, pa)	34.5	30.0	19.3	23.6	29.0	31.0	32.6	34.3	35.9	37.8

Source: Central Bank of Libya; and staff estimates and projections.
1/ Includes foreign partners' oil share.
2/ Includes partner's profit remittances from oil investment.
3/ For 2003 and 2004, includes payments for the Lockerbie Settlement of $ 1,076 million and $ 1,624 million, respectively.

Table 6. Libya: Illustrative Medium-Term Scenario, 2000–09

	2000	2001	2002	Est. 2003	Prel. 2004	Projections 2005	2006	2007	2008	2009
	(Assumptions)									
Crude oil production (in millions of barrels/day)	1.35	1.32	1.20	1.53	1.65	1.75	1.85	1.95	2.05	2.15
Hydrocarbon exports (in billions of US$)	13.1	10.6	9.7	14.2	20.1	21.1	21.9	22.7	23.5	24.4
Libyan crude oil export price (US$ per barrel)										
(based on WEO assumptions of December 2004)	27.0	23.3	24.4	28.2	36.4	35.7	34.7	34.0	33.3	32.8
	(In percent of GDP; unless otherwise indicated)									
CPI (percent change)	-2.9	-8.8	-9.9	-2.1	-1.0	1.8	2.4	3.0	3.4	3.7
GDP deflator (percent change)	24.9	0.1	31.5	16.0	23.4	-1.6	-0.1	0.2	0.1	0.5
Real GDP growth rate at factor cost (in percent)	1.1	4.5	3.3	9.1	4.4	4.3	4.4	4.3	4.3	4.3
Real nonhydrocarbon GDP growth rates,										
at factor cost (in percent)	3.0	6.8	4.7	2.2	2.7	3.0	3.5	3.5	3.7	3.7
Total revenue, *of which:*	45.7	43.1	51.1	54.8	59.5	58.9	58.5	58.0	57.6	57.2
Hydrocarbon revenue	31.5	29.1	40.2	46.9	52.4	51.6	51.1	50.5	50.0	49.5
Total expenditure	31.3	44.3	40.9	44.2	40.8	40.6	40.4	40.2	40.0	39.8
Current	21.1	34.3	27.4	34.8	27.9	27.9	27.4	27.1	26.8	26.4
Capital	10.2	10.0	13.6	9.3	12.9	12.8	13.0	13.1	13.3	13.3
Overall budget balance	14.4	-1.2	10.2	10.6	18.8	18.3	18.0	17.8	17.6	17.4
(excluding the ORF revenue)	-3.3	-10.7	1.6	-17.8	-10.6	-5.0	-4.1	-3.4	-2.8	-2.3
Non-hydrocarbon balance (deficit -)	-17.0	-30.4	-30.0	-36.3	-33.6	-33.3	-33.0	-32.7	-32.4	-32.1
	(In millions of U.S. dollars; unless otherwise indicated)									
Exports, f.o.b., *of which:*	13,508	10,985	9,851	14,664	20,844	21,903	22,731	23,607	24,439	25,419
Non-oil exports	450	420	184	489	707	803	856	913	973	1,036
Imports	-4,129	-4,825	-7,408	-7,200	-8,590	-9,329	-9,665	-10,109	-10,636	-11,220
Current account balance	7,745	3,682	123	3,641	7,429	9,406	10,008	10,530	10,962	11,491
(In percent of GDP)	22.5	12.3	0.6	15.4	25.6	30.3	30.7	30.7	30.5	30.4
Official reserves	13,051	14,139	15,029	18,899	24,598	31,152	38,100	45,346	52,780	60,480
(In months of next year's imports of GNFS)	26.7	19.0	20.5	22.1	26.5	32.3	37.7	42.6	46.9	50.7

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

Table 7. Libya: Indicators of External Vulnerability, 2000–05

(In percent of GDP; unless otherwise indicated)

	2000	2001	2002	Est. 2003	Prel. 2004	Proj. 2005
Financial indicators						
Net domestic debt of general government	3.1	2.0	-3.9	-17.4	-53.3	-70.0
Broad money (percent change, 12-month basis)	1.9	20.5	5.3	9.4	8.6	12.6
Private sector credit (percent change, 12-month basis)	0.1	23.2	0.9	-2.6	5.0	5.0
31-day treasury bill yield	…	…	…	…	…	…
31-day treasury bill yield (real)	…	…	…	…	…	…
External indicators						
Exports of G&S (percent change, 12-month basis in US$)	88.0	-18.4	-8.2	47.3	41.2	5.2
Imports of G&S (percent change, 12-month basis in US$)	-12.3	16.7	52.7	-1.7	23.5	8.8
Terms of trade (percent change; 12-month basis)	58.0	4.4	76.4	2.8	-2.4	…
Current account balance	22.5	12.3	0.6	15.4	25.6	30.3
Capital and financial account balance, *Of which:*	-8.4	-53.8	3.6	-5.5	-35.0	-72.7
Inward portfolio investment (debt securities etc.)	…	…	…	…	…	…
Other investment (loans, trade credits, etc.)	…	…	…	…	…	…
Inward foreign direct investment in the form of debt or loans	…	…	…	…	…	…
Gross official reserves (in millions of US$)	13,051	14,139	15,029	18,899	24,598	31,152
Central bank short-term foreign liabilities (in millions of US$)	3,217	2,789	2,597	3,784	...	...
Central bank foreign currency exposure (in US$)	…	…	…	…	…	…
Short-term foreign assets of the financial sector (in US$)	…	…	…	…	…	…
Short-term foreign liabilities of the financial sector (in US$)	…	…	…	…	…	…
Foreign currency exposure of the financial sector (in US$)	…	…	…	…	…	…
Official reserves in months of imports of goods and services	31.2	29.0	20.2	25.8	28.8	33.6
Official reserves in months of next year's imports of goods and services	26.7	19.0	20.5	22.1	26.5	32.3
Official reserves to broad money (M2) (in percent)	68.9	74.5	140.0	172.9	201.9	226.5
Total short-term external debt to reserves (in percent)	…	…	…	…	…	…
Total external debt, *Of which:*	...	...	...	...	...	...
Public sector debt (in millions of U.S. dollars)	…	…	…	…	…	…
Total external debt to exports (goods and services)	…	…	…	…	…	…
External interest payments to exports (goods and services)	…	…	…	…	…	…
External amortization payments to exports (goods and services)	…	…	…	…	…	…
Official exchange rate (per US$, period average)	0.51	0.61	1.27	1.28	1.31	1.26
REER appreciation (official exch. rate) (-) (annual change)	-15.3	-22.8	-56.7	-22.5	...	…
REER appreciation (parallel exch. rate) (-) (annual change) 1/	40.7	13.2	…	…	…	…
Financial market indicators						
Stock market index	…	…	…	…	…	…
Foreign currency debt rating	…	…	…	…	…	…
Spread of benchmark bonds (basis points; end of period)	…	…	…	…	…	…

Sources: Libyan authorities; and Fund staff estimates.
1/ The exchange rate was unified in January 2002.

LIBYA: FUND RELATIONS
(As of November 29, 2004)

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

II. General Resources Account:	SDR Million	Percent of Quota
Quota	1123.70	100.0
Fund holdings of currency	728.20	64.8
Reserve position in Fund	395.51	35.2

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	58.77	100.0
Holdings	471.54	802.32

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements: None

VI. Projected Obligations to Fund: None

VII. Exchange Rate Arrangement

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. Following the gradual appreciation of the special exchange rate while simultaneously depreciating the official exchange rate, on January 1, 2002, the authorities unified the exchange rate and pegged it 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.

VIII. 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.

IX. Article IV Consultation

Libya is on a 12-month consultation cycle. The last Article IV staff report (SM/03/258) was discussed by the Executive Board in August 2003. The 2004 Article IV consultation discussions were held in Tripoli in October 2004.

X. Technical Assistance

1. February 1985: STA mission in monetary statistics.
2. September 1985: STA mission in price, trade, and non-oil production statistics.
3. March 1990: STA mission in money and banking and balance of payments statistics.
4. February 1998: STA multisector statistics mission.
5. August 2001: MAE mission in monetary operations, banking supervision and payment system.
6. December 2003: Two-week course on financial programming (INS and MCD).
7. February 2004: FAD mission on strengthening tax policy and revenue administration.
8. May 2004: MFD mission on monetary policy operations and introduction of financial instruments and markets.

LIBYA: RELATIONS WITH THE WORLD BANK GROUP

Prepared by the World Bank Staff

(As of November 16, 2004)

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. A World Bank economic report on Libya was issued in October 2004.

2. In 2000, the Libyan authorities invited the Bank Group to the "International Conference on Development and Investments in Libya," held in Tripoli. A mission visited Libya in February 2001 and presented a study on Regional Capital Markets at the Summit for African Heads of State.

3. An annual Framework for Technical Cooperation was signed on January 28, 2002, for Bank technical assistance in the area of Payment Systems. A World Bank mission visited Tripoli in April 2002 and presented a document on a "Vision of the Future National Payment Systems" to key Libyan stakeholders.

4. A Bank mission, led by the Director of the Maghreb Department, visited Libya in April 2004. The purpose of this mission was to re-establish the dialogue with the Libyan authorities, assess their demand for Bank services in the context of the reform process that was launched recently, and renew the general framework for a two-year cooperation agreement. It was agreed that the Bank would prepare a Country Economic Report, with the aim of providing the necessary background for the cooperation program with the Bank, while assisting the authorities in the design of an economic program for transition to a market-led economy integrated with the rest of the world.

5. The main economic mission for the Country Economic Report visited Libya from June 26 to July 8 2004. The mission consulted with various ministries and administrative departments. The work of the mission mainly focused on the following areas: macroeconomic performance, public finance management, investment climate, public enterprise reform, trade policy and customs administration, financial sector reform, and social protection. The preliminary Country Economic Report was sent to the government for consideration.

6. As a result of the April 2004 mission, several Bank missions took place in June/July 2004: a mission on Small and Medium Enterprise development; a Social Security mission that resulted in a Concept Note and a draft agreement; and a transport mission whereby an Aide Memoire was sent to the Government for comments. A follow up is expected from the Libyan officials on these activities.

LIBYA: STATISTICAL ISSUES

1. Libya's database suffers from shortcomings that seriously affect the capacity of staff to conduct effective surveillance. Among these are: (i) weaknesses in the conceptual and compilation procedures underpinning the collection of statistics in the various sectors; (ii) deficiencies in data quality, coverage, periodicity, and timeliness; (iii) lack of consistency of data across sectors; and (iv) with the exception of monetary and balance of payments data, lack of a data reporting system to the Fund in order to update MCD's operational data base between missions. The above issues are compounded by specific institutional weaknesses affecting data quality and timeliness, in particular the lack of interagency cooperation, the proliferation of agencies with unclear and often overlapping responsibilities, and the continuous reshuffling of responsibilities among agencies. Participation in the Fund's General Data Dissemination System (GDDS) would help to address these problems. Libya will be invited to attend the regional GDDS Metadata Development Workshop in Abu Dhabi, scheduled for February 27–March 9, 2005 organized by the IMF's Statistics Department.

2. The February 1998 multisector STA mission examined the conceptual and compilation procedures for national accounts, price indices, foreign trade, money and banking, and government finance. The mission prepared a short-term action plan including recommendations to enhance the quality of the data.

3. The following sections outline the current status of data compilation and reporting by sector:

- **In the area of national accounts statistics,** some progress has been achieved with the compilation of GDP estimates by economic activity through 2003, based on the 1968 *System of National Accounts* (1968 SNA). However, the compilation process is hampered by the poor quality of data, the lack of staff resources, high staff turnover, and significant delays in the receipt of basic data from various sources, including from government agencies. The main weaknesses identified by the 2004 Article IV mission are as follows:

    - There is a need to develop a plan for a gradual implementation of the 1993 System of National Accounts (1993 SNA);
    - In view of the world oil prices of recent years and the projected oil prices over the medium term, the 1997 base year for the compilation of the GDP at constant prices has become obsolete, underestimating the oil sector's contribution to GDP growth and overestimating the non-oil sector's growth

- At end-October 2004, there are no data on economic developments in 2004, and data on agricultural output for 2003 are not yet available.[22] This emphasizes the need to improve data collection and develop a system of quarterly national accounts.
- The growth of the oil sector is derived from National Oil Company (NOC) exports that are recorded in the BOP and do not include the partners' share. The value added of the oil and gas sector should be based on total crude oil output, including the partners' share, the sales to the local refineries, and total sales of natural gas (both domestic sales and exports).
- The value added related to the production of refined products should be derived directly from the consolidated accounts of the refineries and should not be included in the non-oil GDP.
- The growth of the value-added of government services is determined using as a proxy the increase in the size of the civil service. This estimation could be improved by using the increase in the average base salary, which captures the changes in qualification, experience, and number of employees, the three main determinants of the value-added of government services in real terms; since there has been no salary increase in Libya since 1981, the base salary index is a volume index.
- The nonexistence of a producer price index (PPI) and volume indices makes the estimation of sectoral growth rates very uncertain. There are no volume indices for agriculture, industry and construction, and no instruments to measure real growth in the other sectors (transportation, commerce, and nongovernment services). Also, the CPI is not an appropriate deflator to derive value added at constant prices.

- **In the area of prices:** The current CPI is based on weights derived from the 1992–93 household budget survey. It has a 1999 base year and is compiled for 2000 onwards. The authorities provided the mission with monthly CPI data covering the period through June 2004. The 2004 Article IV mission stressed the need to:
    - accelerate the production of the new CPI, based on the 2003 household survey, as the current CPI does not seem to measure adequately actual consumption inflation.
    - compile a producer price index (PPI)—a recommendation of the 1998 STA mission.

[22] The agricultural sector's growth in 2003 and its projected growth for 2004 are both based on the long-term trend performance (1990–2001).

- **In money and banking statistics,** while the timeliness and quality of monetary data reported to the IFS have improved, some deficiencies remain, mainly related to the persistently high level of unclassified liabilities. The CBL implemented most of the recommendations of the 1998 STA mission, including (i) the review of the analytical presentation of accounts to separately identify nonresident accounts according to the residency rather than nationality criterion; (ii) the collection of data from the newly created banks, and accounts for the various institutions (deposit money banks, other banking institutions, offshore banks, and nonbank financial institutions), and the separate identification of the government's Social Security Fund; and (iii) the design of new call report forms. The CBL has also consolidated the balance sheets of the regional banks with the commercial banks. The Article IV mission recommended including the remaining private banks in the consolidated balance sheet of commercial banks that is reported to the Fund.

- **Regarding fiscal data,** the Libyan fiscal information system remains fragmented and inconsistent with international standards, since it has been designed for administrative reporting under the government finance law, rather than for purposes of providing timely statistical information for economic planning and analysis. None of the recommendations of the 1998 STA mission has been implemented and no fiscal data is reported to the Fund between missions. The following are the main weaknesses identified by the Article IV mission:

  - The existence of three budgets (central government administrative budget, the subsidies' budget, and the development budget) that are not consolidated in one presentation complicates economic analysis and management.
  - There are weaknesses in the conceptual and compilation procedures underpinning the collection of statistics (such as misclassification of expenditure items). A coherent methodological framework for data compilation is needed.
  - There are no data on the breakdown of line items in the presentation of the budget (be it the budget law or its execution). For example, revenue from the tax administration is lumped in one line item, rather than having a breakdown for income tax, corporate tax, stamp duty, etc.
  - There are substantial inconsistencies between sectors, in particular, between data on budget execution and monetary data on net bank claims on government.

  - **As for balance of payments data,** the authorities reported to STA in 2000, and recently in 2004, annual data for publication. However, the authorities do not use STA's standardized reporting form, and the reported data suffer from deficiencies, mainly on account of (i) generally unclear methodology; (ii) outdated surveys as sources for primary data; (iii) lack of component detail; (iv) lack of comprehensive coverage for trade data; and (v) methodological flaws in the compilation of the financial account. The following are the main weaknesses identified by the Article IV mission:

- Total hydrocarbon export receipts should include foreign partners' exports.
- Investment income should include both total investment income obtained by the foreign partners of the National Oil Company and the investment income of the nonhydrocarbon sector.
- The capital account should register as a capital inflow/outflow the net transactions of commercial banks with non-residents. This information,—which should be consistent with the monetary survey—would reduce the errors and omissions in the capital account.

The CBL should use the information available in customs and the Ministry of Finance, as well as the information on changes in international reserve assets and liabilities of the CBL and commercial banks, available in the monetary survey, to develop preliminary quarterly estimates of the balance of payments.

Libya: Core Statistical Indicators
(As of November 29, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Gov. Balance	GDP/ GNP	External Debt/Debt Service
Date of Latest Observation	Nov. 2004	Sept. 2004	Sept. 2004	Sept. 2004	Sept. 2004	Sept. 2004	June 2004	2003	2003	June 2004	2003	Nov 2000
Date Received	Nov. 2004	Nov. 2004	Nov. 2004	Nov. 2004	Nov. 2004	Nov. 2004	Oct. 2004	Oct. 2004	Oct. 2004	Oct. 2004	Oct. 2004	Nov. 2000
Frequency of Data	M	M	M	M	M	M	M	A	A	A	A	…
Frequency of Reporting	M	M	M	M	M	M	M	A	A	A	A	…
Frequency of Data	M	M	M	M	M	M	M	A	A	A	A	…
Frequency of Reporting	M	M	M	M	M	M	M	A	A	A	A	…
Source of Update	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Directorate of Statistics	Central Bank	Central Bank	Secretariat of Finance	Secretariat of Planning	Central Bank
Mode of Reporting	V/e-mail	V/e-mail	V/e-mail	V/e-mail	V/e-mail	V/e-mail	V/e-mail	V	V	V	V	V
Confidentiality	No	No	No	No	No	No	No	No	No	No	No	No
Frequency of Publication	M	M	M	M	M	M	M	A	A	A	A	...

M = Monthly; A = Annual V = Staff visit or the annual Article IV consultation mission. U = Unrestricted; C =confidential.

STAFF'S RECOMMENDATIONS IN THE AREA OF THE MONETARY AND FINANCIAL SECTOR

- Develop a liquidity forecast to prepare the ground for a more pro-active use of monetary operations.

- Phase out any remaining directed credits imposed on commercial banks, and create an environment that would facilitate market-based decisions and enhance competition.

- Liberalize interest rates gradually. First, liberalize interbank rates completely. Subsequently, apply a single, maximum deposit rate, rather than a large number of rates depending on size and maturity; and give banks full freedom to operate up to that limit. Likewise, impose only one, maximum lending rate. After some months of operating in this way, consideration could be given to full liberalization, perhaps removing the maximum deposit rate before that on lending rate.

- Start the preparatory work for the issuance of CBL bills, including planning infrastructure changes (auction mechanism, a registry, an issuance program, secondary market), ahead of the change in the law, so that issuance could begin very soon after the legal change.

- Pursue efforts for privatization, which should aim at attracting qualified and strategic categories of investors with proven track record in banking activity.

- While awaiting privatization, state-owned banks should be allowed to operate independently from the CBL or any other authority. Their management should benefit from a normal incentive structure and be accountable for their banks' performance. This requires a clear strategy, effective governance, and new managerial structure.

- Establish a Monetary Policy Committee, which could assess the appropriate level and structure of banking sector liquidity and take key policy decisions. This committee should be supported by a Monetary Policy Executive Unit to undertake day-to-day operations on the basis of policy decisions taken by the Committee.

- Ensure that the central bank has effective autonomy in conducting its operations, both de facto and de jure. The composition of the Board of the central bank should reflect the independence of the central bank from the government.

- The national payment system project must be given full priority and support from the CBL's Executive management. Training of staff from all concerned parties is key for the reform's success.

- In addition to rules-based supervision, the CBL should develop risk-based supervision.

Statement by the IMF Staff Representative
January 28, 2005

1. This statement provides information on recent developments in Libya that has become available since the staff report was circulated to the Executive Board on January 5, 2005. The new information does not change the thrust of the staff appraisal.

2. **Oil price**. After the issuance of the staff report, the WEO oil price projections were revised upward. The upward revisions are particularly significant for 2005 and 2006; the increases are \$3.5 and \$2 per barrel, respectively. As a result, both the fiscal and external current account balances are projected to register, on average, surpluses that are larger than reported in the staff report, by about 2.5 percent of GDP per year during 2005–06.

3. **Lockerbie settlement**. In 2004, only \$1.1 billion was paid and not \$1.6 billion as indicated in Tables 3 and 5 and Footnote 4 of the staff report. The authorities informed the staff that the remaining \$540 million will be paid after the U.S. has removed Libya from the list of countries that sponsor terrorism.

4. **Policy developments**. The General People's Congress (GPC) held its annual meeting during January 8–12, 2005. The issues that were debated included, among others: (i) the privatization of state-owned economic units; (ii) the 2005 budget; (iii) the new draft Banking Law; and (iv) the Anti-Money Laundering (AML) law. Only partial information has been communicated to the staff on the outcome of the GPC meeting, but the staff was told that the 2005 budget law, and the banking and the AML laws were approved by GPC. The staff has not received copies of the approved banking and AML laws.

5. **Fiscal issues**. Only limited information on the 2005 budget was made available to the staff. The information provided by the authorities includes: (i) a new budget oil price of \$26 per barrel, compared to \$22 in staff's projections for 2005; (ii) total non-oil budgetary revenues of 7 percent of GDP, compared with staff projections of 5½ percent of GDP; and (iii) total budgetary expenditure of 38 percent of GDP, compared with staff projections of 27 percent of GDP. However, data on projected oil budgetary revenues and extrabudgetary spending are missing, which complicates the analysis of the authorities' budget. A preliminary assessment of the available information regarding the 2005 budget, combined with staff's projected oil revenue and extrabudgetary expenditure would result in a consolidated budget surplus of about 13 percent of GDP, compared to 22 percent of GDP in the revised staff projections based on the January 2005 WEO oil prices. While the staff has not had the opportunity to discuss the 2005 budget with the authorities, it has strong reservations on the authorities' budgeted increases for nonoil budgetary revenues and nonwage budgetary expenditures. Indeed, in the staff's view, the projected 30 percent increase in non-oil revenue is unrealistic in the absence of any revenue enhancing measures; and the limited absorptive capacity of the Libyan economy renders the 85 percent increase in the development budget optimistic. A staff team is scheduled to visit Libya in February and will clarify all these issues with the authorities.

6. **Monetary issues**. The staff has also been informed that many of its recommendations have been incorporated in the new banking law. Under the new law: (i) the composition of the seven member Central Bank of Libya (CBL) board includes only one representative from government ministries; (ii) the CBL has been given the authority to issue regulations related to monetary and banking issues; (iii) foreign banks are allowed to open branches in Libya; and (iv) more emphasis is put on improving banking supervision. Also, the Governor of the CBL has now the authority to establish a monetary policy committee responsible for key policy decisions; commercial banks have been given permission to lend to foreign companies investing in Libya; and interest rates on commercial banks' deposits held at the CBL have been unified at 2.5 percent and only paid on deposits held for more than three months.

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700 19th Street, NW
Washington, D. C. 20431 USA

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

On January 28, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Socialist People's Libyan Arab Jamahiriya.[1]

Background

The Libyan economy remains largely state controlled and heavily dependent on the oil sector. Since the lifting of the UN and U.S. Libya-specific trade sanctions in September 2003 and September 2004, respectively, the pace of economic and structural reforms has picked up somewhat, with the implementation of measures aimed at enhancing the role of the private sector in the economy. However, these reforms continue to be implemented in an ad hoc and non-transparent manner.

In 2003, real GDP grew by an estimated 9 percent, reflecting a 28 percent rise in oil production and a modest 2.2 percent increase in nonhydrocarbon activities. Deflation, as measured by the official Consumer Price Index, decelerated to 2.1 percent from 9.9 percent in 2002.
The avorable developments in the oil market contributed to a significant improvement in the external current account surplus, which reached 15.4 percent of GDP. Gross international reserves increased to about US$19 billion, equivalent to 22 months of 2004 imports.

[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.

The fiscal stance continued to be expansionary, with a non-oil fiscal deficit widening to 36 percent of GDP. However, reflecting higher hydrocarbon revenues, the overall consolidated surplus remained stable at about 10.5 percent of GDP. Non-oil revenue declined by 3 percentage points of GDP as a result of widespread tax evasion and low efficiency in tax collection. While capital expenditures were compressed to make room for the payment of one installment (US$1.1 billion) of the Lockerbie settlement, current expenditure, excluding the Lockerbie payment, remained high at 30 percent of GDP.

Broad money increased by 9.4 percent. As a result of the improved fiscal situation, net banks' claims on the government declined sharply, whereas credit to the economy increased by about 13 percent of beginning-of-the-year money stock, reflecting mainly credit to public enterprises. Reform measures in the money and banking area included a further strengthening of banking supervision. Also, the authorities have lowered interest rates across the board in an effort to encourage private sector demand for credit, and developed a strategy to modernize the payment system.

In 2004, economic and financial conditions continued to be favorable. Real GDP growth is estimated at about 4.5 percent, reflecting a deceleration in growth of oil production to 7.5 percent, and a real non-oil GDP growth rate of about 3 percent. For the year as a whole, the authorities expected a deflation rate of about 1 percent.

The overall fiscal surplus is estimated to have reached about 19 percent of GDP, with oil revenue estimated at 52.4 percent of GDP. However, non-oil revenue is estimated to have declined by about 1 percentage point to 7 percent of GDP, partly owing to reduced tax revenue in connection with the new tax law provisions.

Broad money is estimated to have increased by about 8.5 percent in 2004. Given the sustained improvement in the fiscal accounts, the government continued to be a net lender to the banking sector. On the external front, the current account surplus is estimated to have reached about 26 percent of GDP, while official reserves are estimated at $25 billion, equivalent to about 27 months of projected 2005 imports.

Some progress was made on the reform front. Measures taken include the adoption of laws to encourage domestic and foreign private investment, the adoption of a new tax law, the removal of customs duty exemptions enjoyed by public enterprises, the reduction in tariff rates, and the preparation of a new banking law that gives the Central Bank of Libya greater independence in the conduct of monetary policy. In addition, a privatization plan (not including the utilities, the oil and gas sector, and the air and maritime transportation sectors) was initiated in January 2004, which involves the sale of 360 economic units. Thus far, 42 small units have been privatized. In September 2004, the authorities withdrew their participation in the Heavily Indebted Poor Countries (HIPC) Initiative on grounds of lacking political support for ratification. They indicated that Libya is preparing its own debt relief plan, which they intend to discuss directly with the HIPC.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Libya's good macroeconomic performance in 2003–04, reflecting the favorable developments in the world oil market. The fiscal and external current account balances registered large surpluses, and international reserves rose sharply. Directors commended the authorities' increased efforts, since the lifting of the international sanctions, to reform the economy, including through measures to encourage foreign investment, enhance the role of the private sector, and liberalize the exchange system and external trade.

Directors observed, however, that much remains to be done to transform Libya's economy into one that is market-based. They emphasized that Libya's large surpluses present a good opportunity to speed up economic reforms while maintaining macroeconomic stability, and they looked forward to the early establishment of the inter-ministerial economic team to coordinate policy design and reform implementation.

Directors stressed that proper planning, coordination, and sequencing of policies in the context of a comprehensive reform program will be essential for the success of the reform efforts. Such an approach will help support the high levels of investment in physical and human capital, and the efficient use of available resources required to achieve economic diversification, strong and sustained growth, and to meet the demands of the rapidly growing labor force. In this connection, Directors encouraged the authorities to reassess their one-sector-at-a-time approach to reform, although it was recognized that the pace of reform will need to carefully take into account institutional and capacity constraints. They suggested that Libya could benefit from the experience of countries that have succeeded in the transition from a centrally planned to a market economy.

Directors supported the view that the reform process should focus in the short term on developing market-based monetary instruments, restructuring the banking system, liberalizing prices, strengthening budgetary management and procedures, and reforming the subsidy system. Other reforms to create a conducive environment for more efficient economic activity, including a vigorous privatization program and the building-up of a sound business climate, require significant technical preparation and consensus building to ensure their successful implementation over a longer period.

Directors considered that improving budgetary management and expenditure control in the context of a prudent medium-term fiscal framework is key to maintaining macroeconomic stability. To control the large non-oil deficit, they highlighted the importance of strengthening the non-oil tax base, including by reducing tax exemptions, and of streamlining spending.
In addition, the authorities should integrate all extra-budgetary operations into a consolidated budget under the responsibility of the Ministry of Finance, and move toward greater budget transparency.

Regarding oil revenues, Directors recommended that the substantial oil windfall projected over the medium term be largely saved, or partly used to finance human capital investment and structural reform measures, including restructuring public enterprises and the civil service. They also emphasized the need to address the rigidities arising from the mechanical distribution of oil revenues between capital and current expenditures. Directors called for the clarification of the status of the Oil Reserve Fund, and increased transparency and accountability in its operations, including through regular reporting on its accounts and their audit by an independent agency.

Directors encouraged the authorities to expedite their plan to replace the current price subsidy system with a cash subsidy, to be limited to the most vulnerable segments of the population. It will also be important to tackle the issue of implicit subsidies, and in this context, Directors welcomed the recent increase in electricity prices and recommended that the authorities gradually raise domestic petroleum product prices to international levels. The introduction of targeted social assistance would help cushion the effects of these reforms on the poor.

Directors welcomed the authorities' commitment to reform the monetary and banking sector. Key priorities will be to give the Central Bank of Libya (CBL) greater operational independence in the conduct of monetary policy, and for the CBL to increase its reliance on market-based monetary instruments, gradually liberalize interest rates, and eliminate directed credits. Directors also stressed the importance of strengthening bank supervision and ensuring adequate asset classification and provisioning, in line with international best practices. They commended the authorities' intention to privatize public banks and allow foreign banks to operate in Libya. Directors noted that there appeared to be no indication of pressure on the exchange rate. Going forward, the authorities should be prepared to adjust the peg as necessary in response to market developments and keep exchange rate policy under review as reforms progress, to help ensure the competitiveness of the non-oil sector.

Directors welcomed the authorities' commitment to privatize most state-owned enterprises, and urged them to enact a privatization law that would give the privatization agency an independent legal status and an explicit mandate. They encouraged the authorities to seek assistance from the World Bank in this area. Directors also pointed to the need to start the preparatory work to reform the regulatory and institutional framework to support the transition to a market economy.

Directors welcomed Libya's efforts to re-integrate itself into the global economy. In this connection, they urged the authorities to reassess their decision to withdraw from the HIPC Initiative.

Directors called on the authorities to increase their efforts to address the weaknesses of Libya's statistical system and to improve the timeliness and quality of economic, financial, and budget data. They encouraged the authorities to consider participation in the Fund's General Data Dissemination System (GDDS), as a useful framework for statistical development.

Directors welcomed the authorities' close collaboration with the Fund staff. In view of Libya's severe human resource constraints and weak institutions, they supported the authorities' request for technical assistance from the Fund in support of the country's economic and financial reforms, with due regard given to their absorptive capacity. They noted the importance of strengthened efforts to ensure the effective implementation of technical assistance recommendations.

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. The Staff Report for the 2004 Article IV Consultation with the The Socialist People's Libyan Arab Jamahiriya is also available.

Libya: Basic Economic and Financial Indicators, 2000–04

(Quota = SDR1,123.7 million)
Population (million): 5.45 million (2002)
Per capita GDP: US$4,121 (2003)

	2000	2001	2002	2003	Proj. 2004
	(Annual percent changes)				
National income and prices					
Real GDP	1.1	4.5	3.3	9.1	4.4
Real nonhydrocarbon GDP	3.0	6.8	4.7	2.2	2.7
CPI inflation	-2.9	-8.8	-9.9	-2.1	-1.0
	(In percent of GDP)				
Central government finances					
Revenue	45.7	43.1	51.1	54.8	59.5
Expenditure	31.3	44.3	40.9	44.2	40.8
Overall balance (deficit -)	14.4	-1.2	10.2	10.6	18.8
Nonhydrocarbon balance (deficit -)	-17.0	-30.4	-30.0	-36.3	-33.6
	(Annual percent changes, unless otherwise specified)				
Monetary Indicators					
Broad Money	1.9	20.5	5.3	9.4	8.6
Deposit rates (1 year-deposits, in percent)	5.5	5.5	5.5	5.5	4.5
	(In billions of dollars, unless otherwise specified)				
External Sector					
Exports of goods	13.5	11.0	9.9	14.7	20.8
Imports of goods	4.1	4.8	7.4	7.2	8.6
Current account balance	7.7	3.7	0.1	3.6	7.4
(As percent of GDP)	22.5	12.3	0.6	15.4	25.6
Gross official reserves	13.1	14.1	15.0	18.9	24.6
(In months of next year's imports)	26.7	19.0	20.5	22.1	26.5

Sources: Libyan authorities and IMF Staff estimates and projections.