POLICY OUTLOOK

TRT WORLD research centre

Of Energy and Unity: Oil and Challenges to Libya's Political and Economic Future

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(SIPA Press - Anadolu Agency)

Libya has been a significant producer of crude oil since the 1960s. During this time, Libya became a significant player in international affairs, playing vital roles both throughout the region and globally. The hydrocarbons sector is the primary source of growth within the country and since the fall of the Gaddafi regime in 2011, commercial activities have been severely impacted by the frequent conflicts around oil infrastructure. This policy outlook examines the political economy of oil and gas in Libya, analysing how the country's ongoing conflict impacts the oil and gas industry.

Introduction

Libya ranks as the largest oil economy by proven oil reserves in Africa and one of the world›s wealthiest economies by proportion of oil reserves to population size.

The Libyan economy, understandably, depends heavily on hydrocarbon exports. According to the International Monetary Fund (IMF), oil accounts for over 90% of national fiscal revenue. Non-oil exports of goods and services represent less than 3% of overall GDP. As the oil sector is the primary source of growth within the country, commercial activities have been severely impacted by the frequent conflicts around oil infrastructure. This instability has been continuously ravaging the country's economy since the ouster of the Muammar Gaddafi regime in 2011.

The blockade of oil terminals from January 2020 until September 2020 by militias aligned with Khalifa Haftar further deepened Libya's economic crisis. Oil production plummeted from 1.14 million barrels per day in December 2019 to 100,000. According to Libya's National Oil Corporation (NOC), this has resulted in approximately $10 billion in financial losses.

These blockades seriously hampered industrial activity in order to force the internationally-recognised Government of National Accord (GNA) into meeting Haftar's demands.

Presently, Libya's oil production continues, however its export revenues have been frozen at the Libyan Foreign Bank since September 2020, pending a political agreement on distribution.

Libya's Oil Industry

Since gaining its independence in 1951, Libya has experienced different periods of politics, each of which has impacted the oil and gas industry.

Ronald Bruce St. John, the author of "Libya: From Colony to Revolution", wrote that «oil exploration in Libya began in 1955, and deposits in commercially viable quantities were first discovered in 1959 when American prospectors confirmed their location at Amal and Zelten, separate oilfields in Cyrenaica. The following decade witnessed dramatic increases in both production and revenues."

Libya has been a significant producer of crude oil since the 1960s. During this time, Libya became a significant player in international affairs, playing critical roles both throughout the region and globally.

From the 1970s to 2000s Libya's oil and gas industry established a conventional array of structures, companies and operators, all administered by NOC. With a population of only six million and significant annual oil revenues, amounting to $32 billion in 2010, the NOC was also the most important engine in Muammar Gaddafi's political-economic machine. However, the revolution that overthrew Gadhafi in 2011 brought major disruptions to the oil and gas sector.

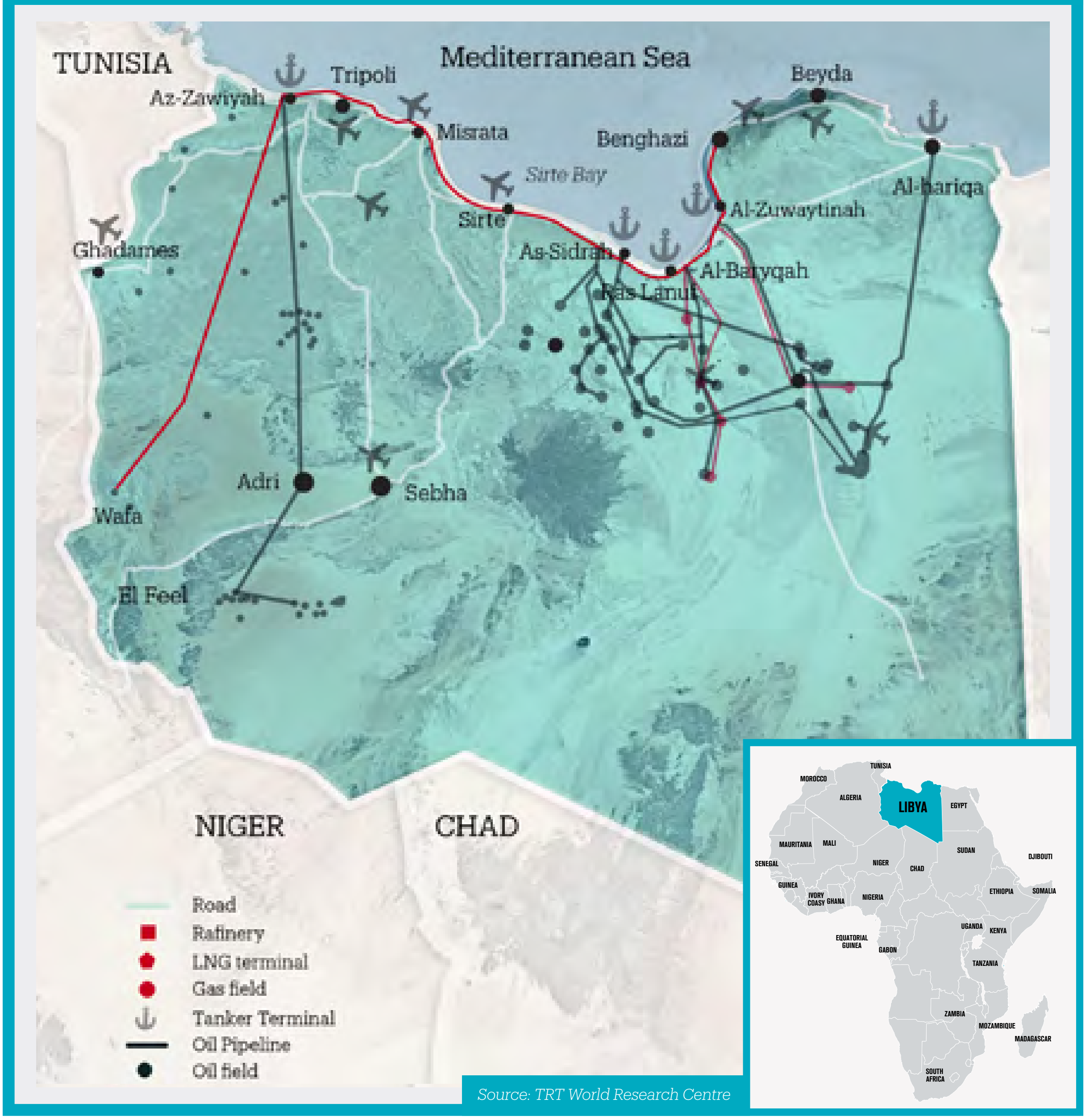
Libya has unique advantages as an oil producer, and its reserves remain significant. With over 48 billion barrels, or just under 3% of the world's total reserves, the deposit is Africa's largest. Libya also had substantial cash reserves and investments across the globe.

The country's position is also an important asset. Geographic proximity to the European market, particularly to the southern European ports, has been a tremendous advantage for Libyan oil vis-à-vis Middle Eastern oil producers, as a closer location to relevant ports has meant cheaper transportation costs.

Libyan oil is also easy to extract. The installation of production and transport infrastructure has historically been straightforward, connecting the oil-rich hinterland to several specific export terminals on the more inhabited coast. This pipeline structure is massive, meaning the capacity exists for a considerable production extension when it becomes available.

(Mohammed Elshaiky - Anadolu Agency)

Map of oil and gas fields and infrastructure



Source: TRT World Research Centre

The National Oil Corporation (NOC)

The National Oil Corporation (NOC) formed in 1970. Under the auspices of the Ministry of Petroleum Affairs, the NOC was authorised to negotiate with oil firms as part of its mission to carry out Libya's improvement plans in the hydrocarbon industry.

The establishment of a state-owned oil company allowed Libya to follow in the footsteps of other oil-producing economies, where control of such a revenue-generating resource lay with the government.

The NOC was responsible for implementing Exploration and Production Sharing Agreements (EPSA) with international oil firms (IOCs) and its own field development and downstream activities. Its members include the Sirte Oil Company and the Arabian Gulf Oil Company (Agoco). The NOC remains the primary body overseeing Libya›s oil and natural gas industry.

However, Libya has been politically split since 2014, with the Government of National Accord (GNA), led by Prime Minister Fayez al-Sarraj, controlling Tripoli and the north-west and territory held by eastern-based militias, including Haftar's Libyan National Army (LNA). This political crisis has resulted in two rival entities, two central banks and two national oil companies.

In December 2015, the Libyan Political Agreement (LPA), also known as the Skhirat Agreement, was signed to form a transitional government in order to resolve the country's political divide. As a result, the UN-backed GNA, which was created by the LPA, became the country's only internationally recognised executive body. However, political opponents have questioned the GNA's legitimacy. They gathered their political forces in what came to be known as the House of Representatives (HoR), a competing administration based in Tobruk in the northeast of the country.

Consequently, the HoR attempted to gain control over state finances by facilitating its own branches of the NIC and Central Bank of Libya (CBL).

However, five Western countries including the United States, the UK, Germany, France and Italy as well as Turkey refused to recognise the new executives appointed by Haftar and the HoR for the CBL and the NOC. Instead, they continued to support CBL governor al-Saddiq al-Kabir and NOC chairman Mustafa Sanallah, who had both been appointed before the institutional split and continued to be based in Tripoli.

However, Haftar accused the Tripoli government of mismanaging oil and gas revenues, abusing state funds and failing to carry out reforms to stabilise the economy. Thus, Haftar called for a leadership change in both the CBL and NOC. Haftar has consistently faced the problem of being able to control oil production, but not the oil revenues. Although he controls the majority of Libya's key oil infrastructure, he does not have access to the revenues that are housed at the CBL, nor does he have the reins of the NOC.

Gaining access to these oil funds has been at the heart of Haftar's plans to control eastern Libya. Despite Haftar's efforts, the GNA continues to have greater access to resources due to the presence of the CBL in Tripoli and the CBL's monopoly over access to foreign exchange.

According to the LPA, the UN-recognised government retains control of the Tripoli-based NOC and oversees state funds deposited in the Tripoli-based Central Bank. These are the two channels through which oil revenues can flow legally and the only two institutions recognised by the UN Security Council.

Dr Mamdouh G. Salameh, an international oil economist and visiting professor of energy economics at the ESCP Europe Business School in London, told TRT World Research Centre that: "Libya has been in a mess suffering from a destructive civil war since 2011. It has virtually become irrelevant to the global oil market since the civil war in 2011. The North African state is caught in a conflict between two rival authorities and their armed allies – one internationally recognised and the other a self-declared administration."

The Central Bank of Libya (CBL)

The political battle over control of Libya's primary economic institutions is critical for whoever wants to assert authority over the country. There are two economic players are of paramount importance: the NOC, which manages oil and gas production and exports, and the CBL, which gathers revenues from hydrocarbon sales.

As the hydrocarbons sector is the main source of growth in Libya, economic activities are negatively affected by the constant battle to control this oil wealth.

According to Dr Salameh, "in the absence of a central government capable of extending its authority all over the country, a truce currently maintaining a tenuous peace and divisions between the CBL and the NOC over the distribution of the oil revenue, one would expect both rivals to try to generate income in one way or another to sustain themselves. This explains the increasingly sophisticated revenue-generating schemes in the eastern part of the country including oil and gas illegally sold outside UN's approved channels with help from foreign powers supporting Haftar's Libyan National Army (LNA) and its allies."

The battle over the control of oil proceeds continues unabated. Controlling this huge hydrocarbon resource is a principal driver of conflict among Libyan groups, with many competing to secure a share of the benefits.

Oil exports resumed in September 2020 after an eight-month blockade imposed by Haftar›s camp in January 2020 was lifted. According to a Middle East Economic Survey (MEES) report, the oil blockades are estimated to have cost some $11bn last year, with the CBL burning through $7.3bn in foreign currency reserves to plug the gap.

Haftar's LNA have reportedly allowed Libyan oil facilities to start operating again. Conditions for this reopening included guarantees for 'a fair distribution of revenue'. Haftar and other detractors claim that inequality is the norm when it comes to revenue distribution in the country. They argue that Libya's oil revenues are not distributed fairly over the three historical regions, Tripolitania, Cyrenaica and Fezzan, thus, accusing the Tripoli central bank of favouritism and corruption.

For Dr Salameh, "at the start of the civil war, there were complaints that Tripoli got the lion's share of the oil revenues at the expense of the eastern part of the country. While these complaints could not be verified thoroughly at the time, the division between the NOC and the CBL over the distribution of the oil revenue lends some credence to these allegations. Therefore, a fair distribution of the revenue should be an integral part of any peaceful settlement of the civil war."

For other experts, these claims are ascertained for political purposes. Guma El-Gamaty, a Libyan academic and politician who leads the Taghyeer Party, commented: "Unfortunately, these grievances have been exploited by Haftar's camp for political gain, helping him impose the oil blockade under a populist narrative, which actually, in turn, caused grave economic damage and hardship for the entire Libyan population, leading to almost $10 billion in revenue losses during the eight-month blockade period in 2020 alone."

Aydin Calik is the North Africa Editor at Middle East Economic Survey (MEES). In an interview with TRT World Research Centre, he stated that "under Gaddafi at least, Libya's west was favoured, even though roughly two-thirds of Libya's oil output is located in the east. So, there are also historical grievances to consider. There is an unequal distribution of wealth across the country. Revenues are not being spent on development and rebuilding the country [...] And it is without a doubt that a lot of Libya's oil revenues have been squandered and wasted over the past decade. But right now, the fight over oil revenues has to do with power. It is not guided by a sense of fairness."

Since September of last year, the NOC no longer transfers oil revenues to the CBL. The NOC stated that the revenues would be kept in its accounts at the Libyan Foreign Bank (LFB) until a final agreement is reached between Libyan rivals on wealth distribution and financial oversight.

According to Al Gumaty, these developments exacerbate divergences even more. For him, "the conflict in Libya is now shifting to control over revenues from oil production, further complicating a resolution to the Libyan divide. While oil has long impacted the overall dynamics of the conflict, the recent feud over control and management of oil revenues may prove a major obstacle to a final political settlement."

Libya's economic challenges

Before 2011, Libya was exporting approximately 1.8 million barrels of oil a day as well as considerable amounts of natural gas. The struggle that tore the country apart in 2011, damaging port cities, drilling stations and refineries, had a devastating impact on the economy. Since 2011, Libya has not only descended into violence and social breakdown but has also come to be influenced by numerous militia groups who have taken advantage of the political instability.

Internal Political Competition

Libya continues to suffer from interlinked political and economic crises, which weaken state institutions and damage the economy. Haftar's LNA continues to undermine the legitimate government, seeking to harm where it hurts most: oil revenues. Armed groups regularly fund their activities through illegal oil sales. These increasingly sophisticated revenue-generating schemes capitalise on the weakness of state authorities across the country. As a result, the UN-backed government's efforts to impose authority across the country have been systematically jeopardised.

In this context, Dr Salameh stated that the internal feuds "impact Libya's economy adversely by depriving it of badly needed funds in a country where the oil revenue represents over 95% of export earnings and 60% of GDP according to the International Monetary Fund (IMF). Politically, this helps entrench the status quo and the division in the country."

Armed groups rely on various illicit activities and commercial practices to support their activities, including corruption, extortion, confiscation of private properties, smuggling of oil-refined products and capital flight to foreign countries.

For Calik, "state weakness, in general, has allowed the public-wage bill to balloon from an already high point under Gaddafi to over 60% of total spending. Many of those who get salaries do not even work or are at the very least underemployed. Libya's private sector remains tiny compared to the oil sector. But state weakness has also allowed some militias to access hard currency at the official rate to profit from the gap between the official and black-market exchange rates. In other words, state weakness has allowed the pillaging of the state's resources."

Matt Williams, from the NGO Action on Armed Violence, observed that the conflict has become multi-layered. In his view, "instead of becoming a replica of Qatar or Dubai, Libya has been plagued by the rise of organised crime and a surging black market, spurred on by overlapping refugee crises and conflict, and expressed in several forms: drug trafficking, artefacts smuggling, petroleum trafficking, human trafficking and arms smuggling."

Smuggling

Smuggling is another key issue in Libya. Since Gaddafi's toppling, there has been a consistent and open competition for the control of smuggling routes, which has contributed to the outbreak of localised conflict. For instance, Trans-Saharan smuggling routes have evolved from passageways for the informal trade of licit goods, to conduits for the smuggling of weapons, drugs, fuel, counterfeit cigarettes and even people. The criminal activities and corruption associated with trafficking undermine domestic stability in Libya.

(Hazem Turkia - Anadolu Agency)

These criminal activities have increasingly harmed Libya's economy. Local armed groups have compensated for the state's failure to provide resources, services and, most notably, security to the population, especially in the east of Libya.

According to UNSC resolutions, oil facilities, production and exports should fall under the exclusive control of the Tripoli-based NOC. However, Haftar has reportedly tried to sell oil and gas through other channels. According to some media reports, United Arab Emirates (UAE) officials have engaged in secret talks with Haftar to sell Libya's oil outside of the UN's approved channels.

According to Calik, "Haftar has tried to sell Libya's oil outside of UN-approved channels and failed. And right now, I don't see any new development that would allow Haftar to sell oil independently. The NOC is one of the very few institutions that bind the west and east together. If its monopoly on oil sales is broken, then the task of stitching back Libya would be much more difficult."

A similar outlook is shared by Dr Salameh. For him, "Haftar needs to get his hands on regular financial resources to maintain the unity of his LNA and its allies. I am sure he receives financial support from foreign powers supporting his operations inside Libya, but he seems to need increasingly bigger funds, hence the stories about him trying to sell some of Libya's oil illegally in addition to blackmailing the NOC with threats to block oil exports if he does not get more funds."

Oil Blockade

In January 2020, eastern tribes and militias supported by the LNA halted exports from five key oil terminals, which drastically reduced the country's crude production, aiming to choke the GNA of considerable revenues.

Mustafa Sanalla, Chairman of the NOC, said that «the blockade has inflicted a lot of damage on the Libyan oil sector from both a budgetary and technical perspective, with severe repercussions for future output capacity." According to Dr Salameh, "Since the start of the civil war, many major producing oilfields, oil infrastructure and oil export terminals have spent the majority of their time idle without proper maintenance with some of the infrastructures badly damaged. Other than the loss of oil export revenue, there is a much heavier price to pay in the form of repairing some of the badly damaged infrastructures and replacing some of the irreparable ones costing hundreds of millions if not billions of dollars."

Crude production in Libya was slashed from more than 1.1 million barrels per day before the blockade to around 70,000-120,000 barrels. This sharp decrease was due to the frequent production interruptions caused by the pro-Haftar group.

Following the blockade, the NOC accused the UAE of instructing eastern militias to impose a blockade of oil routes. This blockade appears to have been encouraged by Haftar's external supporters, mainly the UAE and Russia, as an opportunity to put extra economic pressure on the authorities in Tripoli.

Several countries, including Egypt, France, Russia and the UAE, have supported Khalifa Haftar and the LNA out of concern for their own economic and geostrategic interests. However, the UAE, in particular, has taken a proactive role in empowering Haftar and facilitating his control over eastern Libya, providing crucial support for his offensive against the GNA.

The UAE's strategy towards Libya is motivated by a variety of interests, which vary from economic concerns to ideological worries related to movements associated with the Arab Spring. The UAE believes that Haftar is a workable ally in these endeavours. Haftar is also important to the UAE in their efforts to secure access to Libyan resources, including oil, gas, and gold. It is worth noting that the UAE has been accused of using Libya's frozen assets in its banks and selling Libya's oil money to support Haftar's military operations, as a senior Libyan official revealed recently.

Foreign mercenaries

Control over Libya's oil resources is a primary motivator for several of the countries currently engaged in the conflict. Libya's fragmentation at political and security levels has effectively led to an open fight for its energy resources. As a consequence, even external forces have been able to blockade oil ports and fields.

Since June of 2020, mercenaries from the private security firm Wagner, a company with reported ties to the Kremlin, have acted to secure Libya›s largest oil field, El-Sharara, and its most prominent oil-exporting port, Sidra. The Kremlin's assistance to Haftar has allowed him to maintain a blockade of the country's exports and a large Russian military presence in both Sirte and Al Jufra has reportedly preventing the UN-backed government from taking back the 'oil crescent region' by force.

For Dr Salameh "the presence of foreign mercenaries is a by-product of the civil war and the increasing involvement of foreign powers in Libya's internal affairs. Only a peaceful settlement or a prevailing of the authority of the Government of National Accord (GNA) in Libya with more powerful support from the UN Security Council or (Turkey's military support as a last resort) could lead to the removal of mercenaries from the country."

The continuing insecurity and presence of mercenaries are also detrimental to the oil industry. For Calik, "the more insecurity around oil facilities, the less likely important maintenance and development work can be carried out. Libya's oil infrastructure is in dire need of refreshing, but years of chaos following the 2011 revolution has prevented this to a large extent. Foreign oil and gas services companies and foreign workers are also much less likely to come to Libya to work with a continued risk of fighting."

Undermining the central bank

According to the World Bank 2020 report, the central banks' division has diminished normal central bank functioning and has severely impacted the financial sector. Control over monetary and fiscal policy is critical. The eastern branch continues to print money and issue bonds without the central authority's approval. Such practices weaken the global markets' confidence in Libya's currency and the CBL's ability to manage monetary policy.

In this context, Russian state-owned company Goznak has been accused of printing Libyan dinars and delivering them to the eastern-based Central Bank of Libya (CBL), which is not recognised by the international community. In 2020, Malta seized US$ 1.1 billion worth of Libyan dinar notes that were printed in Russia and bound for eastern Libya.

According to a Wall Street Journal report, a series of cash infusions has helped fund Haftar's operations. In April of last year, 100 tonnes of Russian-manufactured Libyan banknotes were delivered to the eastern-based CBL. The inflow of Russian-printed Libyan dinars over the years has only exacerbated Libya's economic challenges.

In 2019, the rival bank in eastern Libya sold bonds worth more than $23 billion to fund its state wages. This income also contributed to raising funds to cover the LNA's offensives. This move effectively bypassed the central bank in Tripoli and caused financial difficulties for the UN-backed government. Reuters reported that eastern Libya›s debt compounds an estimated 65 billion dinars in existing debt, further increasing inflation and putting local banks at risk.

According to Aydin Calik, "the billions of dinars in debt the eastern body has racked up through private banks and the central bank in the east is a problem because it will need to be paid back [or addressed] in some way. The only way this appears likely is through the unification of the central banks and the two rival entities, which would mean the eastern debt would be swallowed up by a unified Libya. However, a unified Libya is far from certain. Furthermore, western Libya also has considerable debts. The Tripoli Central Bank has throughout the oil blockades been forced to draw on its foreign reserves to keep the country running".

Prospects for unifying the economy

In a turn of events, Libya's warring parties signed an agreement in October to stop fighting, which has triggered a peace process that could lead to elections on December 24th, 2021.

The unification of vital institutions, including the CBL, and establishing a single exchange rate across Libya have been critical objectives of the U.N.-led process to resolve the economic problems obstructing a political solution to the conflict.

According to the United Nations acting envoy in Libya, Stephanie Williams, the U.N.-led process aims to develop important economic reforms and restore public confidence in the management of Libya's economy.

Following the peace talks in December of 2020, the Board of Directors at the Central Bank of Libya met for the first time in five years and agreed to unify its exchange rate. This positive step is intended to stabilise the Libyan currency and combat corruption.

As stated by Dr Salameh, "there is no doubt that there is a heavy demand on the CBL for a share of the oil revenue. [This request] comes from both the GNA and the Haftar-led LNA and its allies. While the NOC is recognised internationally as responsible for oil production and the receipt of the oil revenue, the CBL is the authority entrusted with the dispersal of the funds. Without the NOC releasing the oil revenue to the CBL to provide funds for both rival governments and support the Libyan economy, the current truce could be breached with Haftar's LNA resuming its blockade of the export terminals and the production facilities."

Tunisian President Kais Saied and UN Deputy Special Representative for Political Affairs in Libya, Stephanie Williams attend an opening session of the Libyan Political Dialogue Forum in Tunis, Tunisia on November 9, 2020. (Yassine Gaidi - Anadolu Agency)

Additionally, he expressed that "both the NOC and the CBL should join hands to persuade the warring factions to reach a permanent settlement to end the civil war in Libya and create a strong central accord government with authority over the entire country and equitable distribution of the oil revenue to the benefit of all Libyans. The warring factions should be made to understand that a continuation of the civil war is transforming a giant oil producer to a mere footnote to the global oil industry with billions of lost revenues."

For Calik, "UN-backed peace talks have so far failed to advance past the initial setting of elections for December 2021. Delegates have not managed to agree on a transitional government leading up to the elections. And the longer the impasse, the more chance that something could go wrong on the ground. It is important to note that Haftar did make oil revenue distribution a key requirement of allowing a restart of oil exports and production. The recent reconvening of the central bank of Libya board of directors was a good step, however. The board agreed to devalue the dinar and pledged to meet again to address other economic issues. This is no doubt a good development, but further progress is tied to the wider political process."

Conclusion

The offensive on Tripoli in 2019 and the blockade of the country's main oil ports and terminals in January of 2020 created the most serious humanitarian, political and economic crisis experienced in Libya since Gaddafi was toppled in 2011. The result of this ongoing conflict and political fragmentation has been deeply destructive to the country's financial development, causing new challenges and aggravating old ones.

Haftar has tried to use the oil blockade as leverage against the UN-backed GNA, however, his strategy failed. Instead, the sole outcome has been further socio-economic hardship.

The Libyan economy has always been tied to the evolving political situation in the country. Thus, the current political talks could build momentum to unify the country's economic institutions. However, the complex interlocking of often conflicting interests both within Libya and outside of the country could easily threaten this process.

The current reconciliation talks in Geneva under the United Nations› sponsorship have contributed to increased optimism about a restart for the Libyan economy. Meanwhile, the fraught question of dividing oil revenue among parties continues to be the main obstacle.

The political turmoil has weakened the country's economy, which has led to a deterioration in living conditions. Libyans now face issues that include increasingly frequent electricity outages, a shortages of dinar banknotes, and high inflation.

Libya requires broad economic reform to respond to its people's needs. The subsequent steps must include the reform of the economic institutions, functional unification, removal of quasi-parallel institutions in the east of the country, and transparency in oil wealth distribution.

(Hazem Turkia - Anadolu Agency)