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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Outlook For Libya

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1971

INTELLIGENCE MEMORANDUM

THE ECONOMIC OUTLOOK FOR LIBYA

Introduction

1. On 1 September 1969 a small group of relatively unknown Libyan army officers staged a bloodless coup, replacing Idris's conservative regime with a radical and staunchly Arab-oriented one. The new government has budgeted for increased economic development, increased Libyan control of the economy, realigned government spending, and has negotiated large increases in oil revenues. These revenues, which will total more than $2 billion in 1971 and $3 billion a year later, may be used to finance development projects, increased arms purchases, or additional aid. Even so, a massive accumulation of reserves probably will be unavoidable. Thus the prospect is for an anomaly – and one with great potential for disruptive activities – a radical state with great uncommitted wealth.

Discussion

Economic Life Under the Idris Regime

2. From 1965 through 1968, the last full year of the Idris regime, Libya's economy grew explosively, almost entirely because of rapidly expanding oil production. Oil production increased an average of 29% annually, causing gross national product (GNP) to grow 17% annually. Domestic investment, almost entirely by the government and expatriate residents, was concentrated in public works and luxury housing. While this stimulated rapid growth in Libya's construction industry, it did very little to develop other sectors of the economy.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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3. Although per capita GNP grew rapidly, reaching more than $1,000 by 1968, most Libyans experienced little increase in their standard of living. Much of the income was repatriated by the oil companies, while some of Libya's share was merely added to reserves, which grew at a rapid rate. Corruption syphoned off considerable sums and rising ordinary government expenditures benefited mainly a handful of civil servants and wealthy natives and expatriates. Development spending was meager, mainly for public works and some infrastructure projects; the average Libyan benefited very little. Most expenditures, as well as rising consumer imports, flowed to the two major urban centers -- Tripoli and Benghazi -- the rural areas where nearly 40% of the Libyans live received almost no benefit.

4. In spite of rapid economic growth, the oil industry still accounts for about 80% of GNP, the remainder consisting mainly of primitive agriculture and service activities. Many Libyans are still nomadic. There is virtually no industry, and about 60% of food and agricultural raw material supplies for the roughly 2 million inhabitants are imported. Total imports are equal to about 27% of GNP.

5. Despite increased revenues, Idris did not expand defense expenditures significantly. The defense budget for fiscal year (FY) 1969 1/ was only $40 million or 4% of total expenditures. A government contract for substantial arms purchases in the United Kingdom was never implemented.

6. Idris made no attempt to use Libya's growing financial resources to influence events in other countries, either politically or economically. Despite repeated pleas, Libya gave only moderate aid to other Arab states. Under great pressure from his fellow Arabs, Idris did agree to an annual payment of $25 million to Jordan and $59 million to Egypt following the 1967 Arab-Israeli war and subsequently extended a few ad hoc loans and grants.

The RCC 2/ Takes Over

7. In marked contrast to the conservative, slow-moving Idris regime, the new RCC government is vigorously trying to achieve vague goals of economic growth and increased political esteem in the Arab world. The RCC, however, has directed its energies toward seemingly unrelated and even contradictory ends.

1. The Libyan fiscal year runs from 1 April of the previous year to 31 March of the stated year.
2. Revolutionary Command Council, the official name of the new government.

8. Initially, the new government sharply reduced domestic outlays by curtailing ordinary expenditures and scuttling some development projects started during the Idris regime. Although government spending was on the rise by mid-1970, 3/ it probably remained below the 1968 level. Efforts to eliminate corruption and a careful review of day-to-day spending continue to restrain ordinary expenditures. Although substantial sums have been nominally allocated to new industrial and agricultural investment, little has actually been spent to date because almost none of the planning and other preparatory acts have been undertaken. There probably has been some small increase in development spending, however, since several old infrastructure projects have been revived.

9. In contrast to relatively low spending for domestic economic and social purposes, Tripoli has been more than liberal in spending for the foreign aid and defense programs. Aid to other Arabs more than doubled during the RCC's first year and reached at least $300 million in the 12 months ending March 1971. Two large contracts, one with the USSR for arms and the other for arms and aircraft with France, have been signed, and additional arms contracts have been sought with other, mainly Western, suppliers.

10. One major RCC policy objective has been to gain control of the country's economic assets. Thus far, these efforts have been concentrated in the non-oil sector. The sizable Italian community, which owned and operated most of the country's few modern farms and scores of small businesses in Tripoli, was summarily expelled in July 1970 and their property, worth more than $300 million, confiscated. Banks, insurance companies, hospitals, newspapers, and assorted private firms have also been either nationalized or Libyanized. 4/ The regime has ordered the complete Libyanization of the non-oil sector by 2 May 1971, after which all foreign firms outside the oil industry must limit their ownership to 49% of no more than three firms.

11. Although still small, RCC participation in the petroleum industry has increased. Through the Libyan National Oil Company (Linoc), the fledgling state oil company, the government is at least nominally involved in all aspects of the industry. Linoc's producing wells are limited to a small field relinquished by Phillips Petroleum, but the company is exploring for oil under a joint venture with French companies. Linoc markets its own

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3. The budget for FY 1971 was announced in May 1970.

4. Private firms are Libyanized when majority ownership is transferred to the state or private Libyan citizens.

small production and has sold some royalty oil. 5/ All domestic distribution facilities, nationalized in 1970, are owned and operated by Linoc. The company also holds a majority interest in a handful of firms providing services to the oil industry and has recently completely nationalized one such company.

12. The RCC's greatest success has been sharply increasing revenues from foreign-owned oil companies. Through a series of agreements in September 1970 and again in April 1971, the RCC obtained significant concessions from oil companies and established itself as a formidable bargaining force. These negotiations were conducted with advice from the Algerians and a leading Middle East oil consultant. 6/

13. Conducting the first round of negotiations at a time of tanker shortages and sharply rising demand for oil in Western Europe, the RCC threatened to cut off all Libyan exports and did order selective cutbacks that reduced output 20% from the peak of 3.7 million barrels per day achieved in May 1970. 7/ Occidental Petroleum, an independent US company with virtually all its producing assets in Libya, was the government's prime target. Its output was reduced by 50%, and further reductions were threatened. Unable to obtain either oil or financial support from other oil companies, Occidental acceded to most Libyan demands. The other companies soon followed suit. After this settlement had been reached, the RCC continued to restrain output and, although production has increased, it is still below the record achieved in May 1970.

14. The second agreement was negotiated in the context of larger OPEC discussions 8/ in which Libya represented countries supplying oil directly to the Mediterranean. 9/ The RCC was able to obtain gains several times as large as in the earlier agreement.

15. The two successive agreements guaranteed Libya greatly increased revenues for years to come. The negotiated increase in the posted price 10/

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5. Royalty oil is oil taken by the state in lieu of royalty payments made in cash.

6. Abdallah Tariqi, former Minister of Petroleum and Mineral Wealth in Saudi Arabia.

7. At that time, Libya supplied almost 30% of Western Europe's oil imports.

8. Organization of Petroleum Exporting Countries through which the oil producing countries have presented a united front in dealing with foreign oil companies.

9. Similar negotiations had been conducted by Persian Gulf producers and were settled on 14 February 1971.

10. The posted price is the price upon which taxes and royalties are based.

from \$2.210 to \$3.447 a barrel and other adjustments will raise government revenues by about \$0.90 per barrel. If the production rates of December 1970 of 3.19 million barrels per day are maintained, government oil revenues will rise by 140%, from \$1.3 billion a year in FY 1970 to \$3.1 billion a year (see Table 1) by FY 1973.

16. The early actions taken by the RCC caused a slowdown in economic activity and considerable unemployment among skilled and semi-skilled workers. Uncertainty pervaded the non-oil sectors of the economy, and construction activity declined by 17% in 1969 as projects were suspended. The subsequent expulsion of the Italian community reduced commercial activity, at least temporarily. Some increase in government spending under the new budget revived the construction industry, but in general the non-oil sectors of the economy remain depressed. Almost nothing has been done to improve the lot of the natives outside the two major urban areas. Growth in the all-important oil industry declined to only 6.8% in 1970, when the government restrained production as a bargaining lever in negotiations. Growth in GNP apparently was a modest 5.5%, compared with 23% in 1969. In recent months, economic activity has begun to quicken. Formerly Italian-owned shops were reopened by new Arab owners and construction activity has picked up. The virtual cessation of oil investment, however, has prevented complete recovery to the pre-coup level.

Financial Outlook for 1971

17. Libya's already huge financial reserves are almost certain to increase in the future. In February 1971 the country's gold and foreign exchange holdings were \$1,688 million, enough to finance 30 months' imports at the 1969 level. Even this is understated, however, because a high percentage of imports in 1969 were used to expand the oil industry, and new investment has since slowed dramatically. Oil revenues are expected to increase from \$ 1.6 billion in FY 1971 to \$2.3 billion in FY 1972 and to \$ 3.1 billion in FY 1973, even allowing for no increase in production. 11/ Although the FY 1971 budget allocated very large sums to development, and the government has committed substantial amounts for arms purchases, the prospective revenues far exceed likely spending. Libya almost certainly will increase expenditures when it sees potential economic gain, but opportunities during the next year or so will be limited. In FY 1972, revenues are likely to exceed expenditures by some \$1. , billion,

11. Being genuinely concerned over possible exhaustion of reserves and now assured of a high inflow of revenue, Libya may well continue to hold oil production at present levels. So far, at least, Libya has given no indication of any relaxation in production controls.

Table 1

Oil Revenues, by Fiscal Year

Million US $

	1969 a/	1970 b/	1971 b/ c/	1972 b/ d/ e/	1973 b/ e/
Taxes due on prior year's production f/	782	753	674	523	401
Revenues due on current year's production		538	874	1,780	2,688
Of which:					
Due to permanent increase in posted price g/				1,571	2,393
Due to temporary Suez allowance g/				48	87
Due to temporary freight allowance g/				56	103
Total oil revenues	*782*	*1,291*	*1,548*	*2,303*	*3,089*

a. Last full year of the Idris reign; figures are as reported by the Idris government.
b. CIA estimate. Based on a posted price of $2.447 per barrel for 40° API crude oil, average production costs of $0.35 per barrel, and production of 3.19 million barrels per day in 1971 and 1972.
c. Effective September 1970, the posted price was raised from $2.21 per barrel to $2.53 per barrel and scheduled to escalate 2¢ annually the first of every year. The tax rate was raised from 50% to 55%.
d. Effective 20 March 1971, the posted price was raised to $2.447 per barrel and scheduled to escalate 2¢ on 1 January 1972.
e. Including retroactive royalty and tax payments of $105 million.
f. Beginning in FY 1970, oil revenues were placed on a new schedule which was designed gradually to place oil tax payments on a current basis by FY 1973. Previously, companies had paid taxes in one lump sum payment in April of the year following the actual year of production. Does not allow for the currently minor royalty payments made in kind.
g. The $3.447 per barrel posted price effective 20 March 1971 is the sum of a $3.197 per barrel permanent posted price and a $0.25 per barrel freight allowance, $0.12 of which is the result of the Suez Canal closure and $0.13 of abnormally high world tanker rates. When the Suez reopens, and/or tanker rates fall, the posted price will be adjusted accordingly.

and the balance-of-payments surplus in FY 1972 will probably be about $1.6 billion, which will about double foreign exchange reserves.

Prospects for Development Spending

18. RCC interest in expanding economic development spending is clearly demonstrated by the FY 1971 budget, which calls for $560 million in new investment, or $170 million more than that actually spent by Idris in FY 1969. Unlike the previous regime, which tended to spend primarily on infrastructure and public works, much of the RCC budget is directed to industry and agriculture. Libya's ability to increase investment spending by much in the short run, however, is doubtful. The problem is that the government has not developed a comprehensive plan for economic development, and none seems to be in the offing. The only clue to the RCC's development thinking is a vague outline in the FY 1970 budget. Identifiable industrial projects are limited to a handful of small processing plants and four petroleum-related installations. 12/ Contracts for the petroleum plants have not been let thus far nor have detailed plans or even feasibility studies been made. Although plans for the Kufra Oasis project and a few other minor projects have been made, budget allocations amount to only $16 million. Moreover, the dearth of skilled managers and technicians, which has increased under the RCC, will hamper implementing development spending. Many technocrats present under Idris have been purged, and most Westerners have left. Many Egyptians have entered Libya to replace Westerners, but they are concentrated in the security forces, health services, and education. Moreover, distrustful of foreigners, the RCC has resisted technical assistance from either the West or the East and has shown some reluctance to admit large numbers of other Arabs. Palestinians, in particular, are not welcome in large numbers.

Prospects for Expanded Foreign Aid

19. Libya's foreign aid spending probably will depend largely on the political leverage such assistance could be expected to yield. Disillusioned with past results, the RCC recently has reduced aid expenditures sharply. Hussein's treatment of the fedayeen prompted the RCC to end aid to Jordan, while Syrian restoration of Tapline 13/ is believed to have led to a stoppage of aid to that country. Khartoum payments to the UAR continue, but ad hoc aid to Egypt appears to have ceased since Sadat began peace overtures to Israel. Some recent payments to the fedayeen have been

12. A small refinery, an ammonia plant, a methanol plant, and a carbon black plant.

13. The curtailment of oil shipments through Tapline had enhanced Libyan bargaining power during the oil negotiations.

made, and the Libyans have indicated a willingness to give additional aid, but only if the guerrillas provide adequate accounting and justification. Additional aid will depend, in large part, on the status of the war with Israel. Under conditions of tension but no hostilities, Libya probably will continue Khartoum payments to Egypt and perhaps extend some ad hoc assistance. An all-out war effort against Israel would cause a dramatic rise in Libyan aid while a negotiated peace might cause such assistance to terminate. In the absence of renewed Arab-Israeli fighting, the only likely cause of significant aid increases would be within the framework of the tri-partite federation. 14/ But the amount Libya would provide would not likely be large in terms of the country's revenues (see Table 2).

Potential Arms Purchases

20. Unaffected by financial restraints for a number of years, Libyan arms expenditures have been determined by RCC desires. The RCC is currently seeking approximately \$700 million of arms. Two contracts totaling \$500 million were signed with France (\$400 million) and the USSR (\$100 million) [redacted] 25X1

Longer Term Prospects

21. Although the Libyan government will have increased opportunities to increase development spending in the next few years, and its military and foreign aid outlays may remain high, it will be hard put to spend more than half its foreign exchange income.

22. If the RCC manages to organize a development program, it could, in the next few years, overcome shortages of skilled and even slightly skilled labor by hiring foreigners, while at the same time importing the necessary equipment. However, the RCC probably will not carry its Pan-Arab sentiments so far as to risk a dilution of Libya's national identity. 15/ To date, it has restricted the entry of non-Arabs and Palestinians and

14. The alliance of the UAR, Syria, and Libya.

15. Some willingness to accept Egyptians more readily could result from the embryonic union of Libya, Egypt, and Syria, but this is uncertain.

Table 2

Allocation of Libyan Revenues in FY 1972

	Million US $
Total revenues	*2,543*
Oil	2,303
Non-oil	240
Anticipated expenditures	1,200
Ordinary	560
Development	400
Aid	100 a/
Arms	140
Surplus	1,343

a. Including only Khartoum payments to the UAR and fedayeen subsidies.

restrained the inflow of other Arabs to avoid this contingency. Until this policy changes, labor shortages will severely constrain economic development. Substantial expenditures could also be made on welfare, following the example of Kuwait, but unlike that of Kuwait, the Libya regime is strongly inclined toward a conservative social policy and is unlikely to undertake large-scale welfare spending. In any event, Libya will be unable to increase either welfare or development expenditures greatly in the next two or three years because of the inevitable lags between planning and implementation.

23. Given these constraints on development and welfare spending, Libya will probably have balance-of-payments surpluses of nearly $1.5 billion a year in 1972 and 1973. As shown in Table 3, even rapid increases in civilian imports (50% in three years), combined with payments on the large arms contracts already made or expected and continuation of Khartoum payments, would give this result. Even a level of per capita imports equal to that of Kuwait -- an extremely unlikely development -- would still leave a surplus of more than $1.0 billion in 1972. This assumes

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Table 3

Projection of Major Balance-of-Payments Items by Calendar Year

Million US $

	1968 a/	1969 a/	1970	1971	1972	1973
Oil revenues b/	768	970	1,460	2,490	2,910	2,300
Local expenditures by oil companies	170	316	110	110	110	110
Imports and net services						
Military	-98	-26	N.A.	-140	-140	-140
Non-military	-652	-760	-700	-810	-940	-1,080
Foreign aid	-85	-122	-350	-60	-100	-100
Other	51	1	50			
Reserve accumulation	154	379	570	1,590	1,840	1,090
Total reserves	*539*	*918*	*1,488 c/*	*3,048*	*4,888*	*5,978*

a. Reported.
b. Based on constant output and terms of new agreements. Figures are adjusted to reflect rescheduling of revenue payments.
c. Adjusted to reflect soft currency holdings reported as reserves.

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constant oil production. Under these circumstances, imports for use in the oil industry would be small. If oil production increased, foreign exchange earnings would be further raised, but a small part would be spend on increased imports for the oil industry.

24. The chances are good, therefore, barring large new foreign aid, that Libyan foreign exchange reserves could rise to more than $6 billion by the end of 1973. This amount exceeds Japan's current reserves by about 20% and is equal to about 40% of present US reserves. For a regime committed to raising its prestige, especially in the Arab world, and willing to use its economic muscle to gain political advantage, the potential for using this wealth to cause problems for the West is considerable indeed. The RCC could finance military expenditures in other more populous Arab countries such as Egypt. It could finance insurgencies that served its political purpose. Going beyond the Arab world, the Libyans could support Black African movements against Portugal or South Africa. Perhaps more serious would be their leverage in the world's financial markets, such as a threat to unload a substantial portfolio of UK securities. Libya could also demand that the US government convert large amounts of dollar holdings into gold. On the other hand, the RCC may eventually plan to take over the assets of the oil companies operating in Libya.

Conclusions

25. In its first 18 months in power, the present Libyan government halted expansion of oil production, delayed or canceled many investment projects, and expelled numbers of foreigners. The effect of all this has been a marked economic slowdown, which may be temporary. But the government also has successfully bargained for a massive increase in revenues. Libya's annual foreign exchange revenues, already more than $1 billion, will double in the next two years, even if oil production remains constant.

26. The expected increase in revenue far exceeds any likely growth in foreign exchange expenditures for civilian and military imports. Libya cannot use or maintain substantially more military equipment than it has already contracted for. Development spending will rise, but Libya's absorptive capacity is limited by a severe shortage of skilled labor, and the regime shows no signs of accepting large-scale immigration. Welfare spending could raise imports of consumer goods, but the regime's social ideology appears to preclude massive welfare programs. Libya could increase its aid to other Arab states, but past experience shows that it will carefully weigh the political benefits it can expect to receive in return. In summary,

the regime will be likely to have a balance-of-payments surplus of more than $1.5 billion this year and almost $2 billion in 1972.

27. Surpluses such as these could raise Libya's foreign exchange reserves to about $6 billion by the end of 1973, or more than the level of Japan's current reserves. The potential for disruptive action by an ideologically motivated government with such wealth and few domestic needs is vast, ranging from direct support of Arab military action against Israel to using its financial leverage to force political concessions from the West.