Libya's year zero
Finding opportunity as a country rebuilds
A report from the Economist Intelligence Unit

Contents

Introduction

Libya's rebels have pushed the regime of Muammar Qadhafi out of power, and are poised to take complete control of the country. This in itself is a monumental achievement, but it marks only the start of what is likely to be a long and fraught process of rehabilitation. The new leadership must rebuild a state that for decades was run on the whims of an authoritarian leader, determined both to monopolise and to hold on to power. There are few institutions that work, and even fewer that work to the benefit of the general population, so the challenge amounts to little short of building a functioning state from scratch. Views on what form that state should take are as diverse as the regional, ideological and sectarian interests making up its would-be architects, and these stake holders must be persuaded to support the process—or at least not to obstruct it—before it can even begin.

Libya is strategically placed, adequately supplied with talent and well endowed with natural resources. If the state-building exercise is successful, it can quickly become a stable and thriving economy, offering a range of opportunities to business investors both at home and abroad. But the challenges are numerous and substantial, and a post-Qadhafi dividend is not guaranteed.

This report spells out those challenges, and the business opportunities that would be the reward of success.

The first section of the report looks at the political outlook. The Economist Intelligence Unit identifies three scenarios, and attaches probabilities to each.

Scenario 1 (60% probability): According to plan - Elections to replace the National Transitional Council (NTC) with an elected government based on a new constitution take place more or less on schedule, although the election results in a weak government and parts of the country remain insecure.

Scenario 2 (30% probability): Permanent transition - The NTC struggles to overcome internal disputes and is distracted by security problems and by outbreaks of popular protest at its failure to deliver adequate services, and therefore fails to stick to its blueprint. The NTC becomes a *de facto* regime.

Scenario 3 (10% probability): Prolonged instability - The NTC loses control of security and fails to establish an effective interim government. Local groups including remnants of Qadhafi-era people's committees and Islamist militias take charge of different parts of the country, threatening the viability of Libya as a unified nation state.

The second section of the report starts from the assumption that our central scenario, that the NTC blueprint is adhered to, comes to pass. We then look at the implications and opportunities for business, sector by sector.

Part I: The political outlook

Scenario 1 (60% probability): According to plan

Elections to replace the National Transitional Council (NTC) with an elected government based on a new constitution take place more or less on schedule. The election results in a weak government and parts of the country remain insecure.

The Economist Intelligence Unit's central scenario is that the NTC will succeed in its mission to lay the basis of a new Libyan state governed by an elected parliament. The NTC has allowed a 20-month period for this to take place. We expect numerous delays and setbacks as a result of security issues and political disputes, but these will not be serious enough to derail the entire process. The effectiveness of governments, both interim and elected, is likely to be undermined by persistent infighting, and security will be compromised by the difficulty in disbanding militias.

One of the biggest assets the Libyans have as they work to create a new system of government is the appalling record of the ousted leader, Colonel Muammar Qadhafi. Over the past 42 years the Libyan people have been guinea pigs in a series of political and socio-economic experiments based on the eccentric whims of Colonel Qadhafi. The country has made progress in some fields, thanks to abundant oil export revenue and the efforts of a select band of dedicated technocrats—many of the founders of the NTC had been involved in recent initiatives spearheaded by Saif al-Islam Qadhafi, one of the Colonel's sons, to modernise the economy. However, the negative impact of Colonel Qadhafi's policies and actions far outweighs these advances, and means that Libya has squandered many of its advantages.

The awareness that Libya could have done so much better and that it now has a chance to rectify past mistakes inspires those who have stepped up to take responsibility for the country's future through involvement in the NTC. However, as the NTC tries to push ahead with its plans for the creation of a new political system, much will depend on the level of co-operation it can garner from other groups with a strong sense of entitlement, in particular those that were directly involved in the military campaigns. The NTC has set its face against purging everyone associated with the former regime and is seeking to maintain the integrity of functioning institutions such as the Central Bank of Libya and the National Oil

How the NTC envisages the creation of the new Libya

The transition period:

- The NTC is the highest authority in Libya and is responsible for legislating and setting policy.

- The NTC comprises representatives of local committees and establishes an interim government

- The executive committee implements policy set by the NTC.

Post-liberation period:

- Following the declaration of liberation, the NTC moves to Tripoli and forms a transitional government within 30 days.

- The interim government issues a law governing the election of a General National Congress (GNC) and calls the election.

- The GNC is elected within 240 days of liberation and comprises 200 elected members.

- The NTC is dissolved at the first session of the GNC. The GNC's members elect a head.

- The GNC appoints a prime minister, who nominates ministers within 30 days of its first session.

- The GNC selects a constitutional committee within 30 days of its first session. The committee submits a draft constitution within 60 days of its first meeting.

- The GNC approves the constitution. It is put to a referendum within 30 days of its approval by the GNC. If two-thirds of voters vote yes, it is passed by the GNC. If not, the constitutional committee revises it and puts it to another referendum within 30 days.

- The GNC issues an election law in line with the constitution within 30 days.

- Elections are held within 180 days of the election law,

- The GNC verifies the results of the election and the legislature convenes within 30 days. The GNC is dissolved during its first session.

- As soon as parliament holds its first session, the interim government is designated hukumat tayseer aamal (a government with powers only to manage day-to-day business) until the transfer of power to a permanent government in accordance with the constitution.

- The definition of head of state and the role of the office and the selection are (presumably) left to be decided by the constitutional committee.

Corporation (NOC). It has justified this approach on the grounds that the example of Iraq had shown the perils of unnecessarily creating internal enemies, but it has at the same time laid itself open to the charge of protecting its own interests, given that so many of the NTC membership had served the Qadhafi regime.

Pulling together

Our core scenario rests on the assumption that disputes between various factions and individuals can be managed. This will require continued co-operation between the various strands of Libyan society that took part in the anti-Qadhafi struggle and the successful integration of former regime loyalists into the system.

The NTC itself is a good example. It is a collection of individuals brought together by circumstances, and will become increasingly vulnerable to internal differences over time. The council members are drawn mainly from municipal administrators and lawyers active in their local areas. Because of the

NTC's origins in Benghazi, there is a perception in other parts of the country that the council has an eastern bias, despite ongoing efforts to widen its membership. The NTC executive committee is staffed mainly with technocrats who spent much of their career outside Libya, and includes a number of figures that were enticed back to their home country in the latter part of the Qadhafi era to take part in economic reform initiatives launched by Saif al-Islam. The chairman of the NTC, Mustafa Abdel-Jalil, who served as justice minister from 2007 until the February uprising, represents a self-styled moderate band of Islamism, akin to that of the Muslim Brotherhood in Egypt.

Mr Abdel-Jalil has urged Libyans to tolerate differences, and to steer clear of seeking to settle scores with people considered to have abused powers conferred on them by the former regime. There is a risk that this appeal to moderation will not satisfy more radical elements in the NTC and in its security apparatus, who might not be prepared to allow anyone tainted by association with the Qadhafi regime to play a part in building the new Libya. Mr Abdel-Jalil is also making a leap of faith in assuming the goodwill of the former regime elements that he is interested in rehabilitating.

The NTC has secured wide international recognition (although a number of states, including Russia, China and Algeria, have been reluctant to endorse what they plainly consider to be a front for Western liberal intervention), but it will be equally important for it to build up its domestic support. Among the challenges that it faces will be to deal with any political aspirations of military commanders directly involved in the fight against Colonel Qadhafi. The NTC will also need to ensure that discontent voiced by fighters about the allocation of defence and security posts following the liberation of Tripoli do not get out of hand.

A new model army

The NTC has sought to lay the foundations for a new unified army by setting up a military council. However, each Libyan city has its own security command structure, and more than 50 brigades that have sprung up as part of the liberation struggle continue to operate with varying degrees of autonomy. The head of the military council is Suleiman Mahmoud al-Obeidi, one of the first senior army commanders to defect after the February 17th uprising. He was based in the eastern city of Tobruk. His deputy is Khalifa Haftar, who had been on the revolutionary command council set up by Colonel Qadhafi after the 1969 coup. He defected to the US in the 1980s following his capture in Chad after leading Colonel Qadhafi's disastrous invasion of the African country in 1980, and returned to Benghazi to support the rebel military efforts.

The important role played by veteran Qadhafi-era military men in the rebel campaign has generated some friction. This spilled over into violence with the assassination in late July of General Abdel-Fattah Younis, the commander of NTC forces who was suspected by some of retaining residual links to the Libyan dictator. Ismail Sallabi, an Islamist militant who is in charge of security in Benghazi, has not concealed his opposition to the involvement of former regime officials in the NTC and its military structures.

The NTC also attracted sharp criticism for its initial decision to appoint a defected commander, Albarrani Shkal, as head of security in Tripoli. The general had taken part in the regime's siege of Misurata in March and April, before moving over to the rebel camp. His appointment was rejected by a brigade of Misurata fighters that took part in the operation to drive Qadhafi forces out of Tripoli, and

Al-Qaida "connection"—Qadhafi/MI6 propaganda slur?

The prominent role played by former members of the Libyan Islamic Fighting Group (LIFG) in the anti-Qadhafi campaign and in the post-liberation security arrangements has prompted questions about the risk of Libya becoming a new base of radical Islamism, akin to Taliban-era Afghanistan. In our view such fears are misplaced, and the assurances of figures such as Abdel-Hakim Belhaj that Libya's former Islamist militants are fully signed up to the project of creating a democratic civil state should be accepted.

Mr Belhaj has given details to the media about how he was the victim of a rendition operation conducted by US and UK intelligence services on behalf of the Qadhafi regime in 2004. This resulted in him being flown to Libya from Thailand. He said that during his incarceration he had been interviewed by UK intelligence officers, and that he had sought to communicate to them that he had been subjected to torture. He said that his captors put pressure on him to state that the LIFG had close links with al-Qaida, something that he refused to do, and he continues to deny that such links exist.

Mr Belhaj was released as part of an agreement negotiated in 2009 between Saif al-Islam al-Qadhafi and the LIFG in London. Mr Belhaj has acknowledged that he and other LIFG activists had participated in mujahideen operations in Afghanistan against Soviet forces, but he has stated that this is insufficient grounds on which to base accusations that the LIFG was "connected" to al-Qaida.

The other "connection" that has prompted suspicion in some commentaries is that between Mr Belhaj and Qatar. The Gulf Arab state played a significant role in supporting the anti-Qadhafi forces, and is said to have helped to train and equip some of the main fighting units. Some have made the leap to connect Qatar's hosting of radical Islamist figures, such as Youssef al-Qaradawi, and its association with Al-Jazeera television to some sort of sponsorship of an Islamist extremist takeover of post-Qadhafi Libya. We consider such fears to be exaggerated. The Qadhafi regime sought to play up the supposed association of the LIFG with al-Qaida for its own interests, and although there is evidence that many Libyans did take part in al-Qaida operations in Iraq and that one of al-Qaida's top officials is Libyan, the principal focus of the LIFG was on opposing the Qadhafi regime. As for Qatar, the notion that it is involved in a grand jihadi design to nurture Islamists in Libya stretches credulity.

who have remained in the capital since then. The NTC backed down, and Abdel-Hakim Belhaj, reputed to have been a prominent member of the Libyan Islamic Fighting Group (LIFG), has since emerged as the commander of the Tripoli military council. His deputy is Mehdi Harati, a Dublin-based Arabic teacher, originally from Tripoli, who developed into an able and inspiring leader of forces in the western Libyan campaign.

Government weakness

Our core scenario assumes that the interim authorities will be able to maintain sufficient basic security to allow the political process to move forward and for work on restoring oil production and rebuilding infrastructure to go ahead. The NTC has been prepared to acknowledge the role played by the UN and NATO in enabling the overthrow of the Qadhafi regime, but it is likely to insist that foreign involvement in maintaining security from now on is kept to a minimum. We assume that Islamist parties will emerge in the lead-up to elections but that they will compete with other tendencies within a broadly democratic framework rather than seeking to suppress them and impose a uniform system based on a fundamentalist interpretation of Islam. The representative bodies that will be created in accordance with the NTC's plan will have a diverse make-up, with some members emphasising tribal or regional allegiances and others identifying themselves on the basis of Islamist or Western liberal affiliation. The governments that stem from these assemblies will be under constant pressure to respond to the demands of diverse interest groups, and are consequently likely to find it difficult to implement policies in a decisive fashion.

Scenario 2 (30% probability): Permanent transition

The NTC struggles to overcome internal disputes and is distracted by security problems and by outbreaks of popular protest at its failure to deliver adequate services, and therefore fails to stick to its blueprint. The NTC becomes a de facto regime.

The ability of the NTC to push through its political plans will depend on a number of key factors, in particular its own internal cohesion, the maintenance of security without oppression and the delivery of basic services in a satisfactory fashion. On all these counts, there are significant risks of failure. The NTC, or the dominant faction within it, could resort to authoritarian measures under the pretext of ensuring stability, and increasingly take on the trappings of a permanent successor to the Qadhafi regime.

There is plenty of room for doubt whether the inheritors of post-Qadhafi Libya will be able to accomplish the task of building a new government and political system along the lines that they have planned. The shambolic state of the system left behind by Colonel Qadhafi is in one sense an advantage, given that the task of dismantling the institutions of the former regime should be relatively easy. However, it also means that there is much more scope for conflict over the shape of the new institutional framework. The NTC has proposed an inclusive approach, giving people associated with the Qadhafi regime the opportunity to continue working for the benefit of Libya. This could provoke opposition from radical elements demanding a more decisive break with the past and even questioning the basis on which the NTC has taken charge of Libya's destiny.

The main threat to Libya's stability is likely to stem from the difficulty in forming a national security force in which all citizens have confidence. The war against the Qadhafi regime was carried out by many different armed groups, which have acquired a strong sense of their regional identity and of the role that they played in the campaign. There is a risk that if the new national army being established by the NTC attempts to disband some of these self-styled brigades, armed clashes could break out. One way around this would be to involve the UN in a supposedly impartial role in helping to maintain order. However, there is likely to be strong opposition to the overt presence in Libya of any outside military forces—European and Arab special forces did play an important part in the anti-Qadhafi campaign, but in a largely covert way, providing training and acting as spotters for NATO air crews, rather than being directly engaged in combat on the ground.

The NTC, through its national military council and city- and region-level commanders, could be pushed towards taking an authoritarian approach in seeking to suppress militia activity. This could result in the outbreak of protest demonstrations, particularly in areas where people perceive that they have been discriminated against by the NTC. Persistent protests and outbreaks of violence would make it increasingly difficult for the NTC to make progress with its plans for elections and for the creation of new institutions, and it may have to resort to drastic revisions to its plans, with a much longer timeline.

Another variant of this scenario would entail the NTC pushing ahead with elections with inadequate preparation and with low levels of participation. Faced with the risk of the process collapsing, senior members of the NTC would renege on their pledge not to seek elected office, and the elections would merely consolidate the rule of the NTC government, but without the benefit of popular legitimacy.

Scenario 3 (10% probability): Prolonged instability

The NTC loses control of security and fails to establish an effective interim government. Local groups including remnants of Qadhafi-era people's committees and Islamist militias take charge of different parts of the country and the viability of Libya as a unified nation state comes increasingly into question.

The NTC has passed a number of tests in its prosecution of the military campaign against the Qadhafi regime and in its management of affairs in the east of the country during the war. However, tougher challenges lie ahead that could place intolerable pressures on the unity and effectiveness of the NTC. Armed groups may well resist efforts by the NTC to gather up unauthorised weapons, and clashes could break out between rival militias—including rump Qadhafi loyalist forces, radical Islamists and tribal or regional groups. This could result in the establishment of semi-autonomous enclaves in parts of the country and the emergence of separatist tendencies.

There is a risk that Libya could degenerate into a low-level civil war as a result of a failure to build national institutions capable of overriding sectional interests. There have already been some instances of clashes between rival brigades that fought in the Tripoli campaign and then returned with their weapons to their home areas in the Nafusa mountains, and the assassination of General Abu Bakr Younis in July set an ominous precedent for such an extreme method of settling scores. The situation would be exacerbated if tribal groups or former regime military units retaining some allegiance to Colonel Qadhafi were to remain at large. Ultimately, this could lead to the fragmentation of the country.

We consider this scenario to have a very low probability because of the powerful interest that Libyans have in retaining a functional unitary state. The NTC has already established a solid basis for a new Libyan state, and has overwhelming international support. This means that it will have control over the proceeds of Libya's oil export revenue (past and present), which gives it immense powers of patronage, which would be denied to any breakaway faction.

Part II: Economic policy and opportunities for business

The opportunities presented by post-Qadhafi Libya will be similar in many respects to those that businesses pursued during the latter part of the Qadhafi era, as the regime tried to make up for decades of stagnation by opening up to private investment. The initial focus of a new government will be on diverting state funds to finance reconstruction. Once this is under way, it will introduce reforms to enable the private sector to operate more effectively than under the highly restrictive Qadhafi regime. The NTC has not formally outlined its policies in this area, except to state that it will try to create "effective economic institutions to eradicate poverty and unemployment". Restoring oil production will be a priority, but the new government is also likely to devote considerable attention to repairing and upgrading infrastructure and investing in housing, as well as filling in the gaps in the regulatory system, which have made it impossible for the development of a healthy private sector.

The post-conflict reconstruction effort will provide ample early opportunities for foreign companies that have already established a presence in the country, as well as for new entrants to the market. Beyond this, a new government is likely to revive schemes that the previous regime was unable to complete, and to introduce new ones. Progress on these will depend on how successful the NTC and future governments are at building a more transparent and efficient institutional framework.

Decision-making may for some time remain fragmented and ineffective, as experienced technocrats who served under the Qadhafi regime clash with new political elites over the direction of policy. Institutions associated with the old order are likely to be wound down, and it will be some time before they are replaced. This absence of structure is likely to affect the new government's capacity to implement decisions, formulate budgets and dispense funds in the medium term.

Favoured nations

If Libya is able to break with the past and push ahead with new projects, a number of countries are likely to emerge as the main beneficiaries. South Korean firms are well established in the country. Having spent years waiting patiently for the Qadhafi regime to deliver on its promises, their perseverance may be about to pay off. French and Italian firms are likely to receive a boost from their governments' support for the NTC from early on in the conflict. Mustafa Abdel-Jalil, the chairman

Qadhafi's thin investment legacy

Starting in the late 1990s, Libya turned its attention to attracting foreign investment. Law No. 5 of 1997 opened up new sectors to foreign investors and allowed complete foreign ownership of companies registered under the law. In addition, it provided incentives such as exemptions from customs duties and corporate income tax on foreign investment projects. The law was amended by Law No. 7 in 2003/04, which governed foreign investment specifically in the tourism sector.

The regime's efforts to encourage investment culminated in Law No. 9 of 2010, which annulled previous legislation. The new version, like its precursors, aimed to build up Libyan technical expertise and transfer knowledge and technology as well as to diversify the economy, and applied to national, foreign or joint-venture capital. Projects established under the law would benefit from exemptions on income tax and stamp duty for five years.

of the NTC, has indicated that Egyptian companies will be called upon to help rebuild the country. Tunisian firms may find themselves in a similar position.

Libya's new start offers an opportunity for the emergence of a viable home-grown business sector, too. The Qadhafi regime made some halting efforts to open the economy to private business and foreign investment during the tenure of Shokri Ghanem as prime minister (2003-06), and under the influence of Saif al-Islam. However, the results were meagre owing to the corrosive influence of the Qadhafi family and its cronies, the lack of consistency in economic policy and the chronic under-development of the financial sector. As a result of the Qadhafi regime's policies, Libyans with a flair for business and finance tended to pursue their careers outside the country. There is now a good chance of a reverse brain drain—already evident in the make-up of the NTC and in the important role played by foreign-born Libyan young people in the rebel armies.

Oil: The switch-on

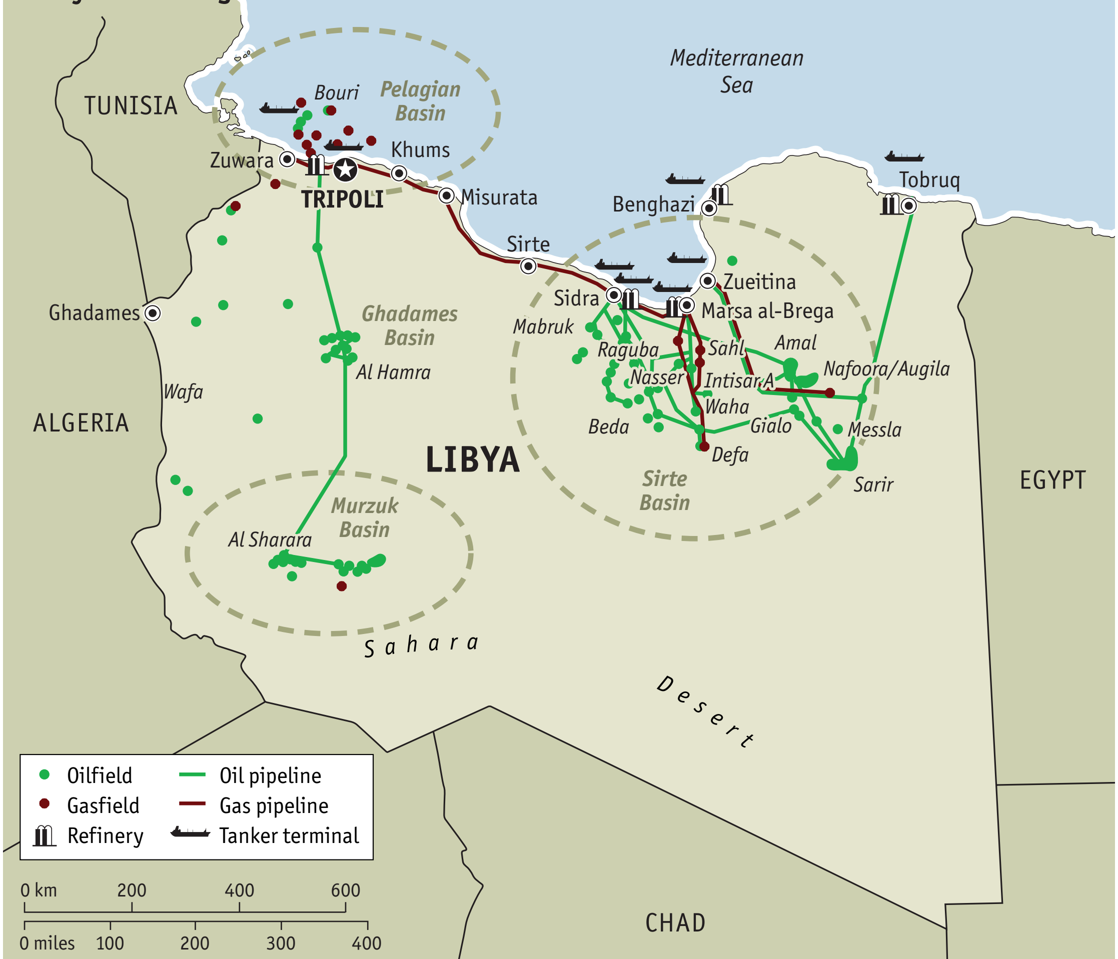
Cranking oil production back up will be largely a matter of turning idle equipment back on and dealing with any minor problems that arise. Most of the work will be managed by the state-owned National Oil Corporation (NOC), with the help of oilfield services companies expected to return to the country and establish new work camps in the desert and on offshore platforms (most of the existing camps have been destroyed). Foreign oil companies with production-sharing agreements with the NOC will also be involved, but they will have to establish the commercial basis for any additional investment that they are required to make before committing fully to resumed operations. The pace and extent of the oil sector's recovery will depend on a number of factors, in particular the physical state of the production facilities, the effects on older fields of being left idle for more than six months, and the ability of Libya's new political leaders to agree on how the oil sector is to be run.

The heyday of the Libyan oil industry was in the late 1960s, with production peaking at 3.4m barrels/day (b/d) just after Colonel Qadhafi seized power on September 1st 1969. There was a sharp decline thereafter, partly attributable to nationalisation, and production fell further during the 1980s after the Libyan leader clashed with the US and the UK over his involvement in terrorism and the pursuit and murder of exiled dissidents. Production picked up in the 1990s with increased activity by foreign firms, and there was another spurt after UN and US sanctions were lifted in 2003 and 2004, respectively. However, the award of dozens of exploration concessions over the past six years has not yielded many notable successes, and there seems little prospect of Libya ever regaining the production levels of the pre-Qadhafi era.

The workhorses of the Libyan oil industry are still the big fields discovered in the early days in the 1950s and 1960s in the Sirte basin in central and eastern Libya. One of these is Sarir, the first field to get back on stream after the fall of Tripoli. It was discovered in 1961 by BP (UK), and is now operated by the Arabian Gulf Oil Company (Agoco), a Benghazi-based wholly owned subsidiary of the NOC. Nouri Berrouin, an Agoco official, was chosen by the National Transitional Council (NTC) to take charge of the NOC after the defection of Shokri Ghanem in June. The appointment has already prompted speculation about a shift in the centre of NOC operations to the eastern city from Tripoli. Agoco's fields were producing about 400,000 b/d, or one-quarter of Libya's total output, prior to the anti-Qadhafi uprising.

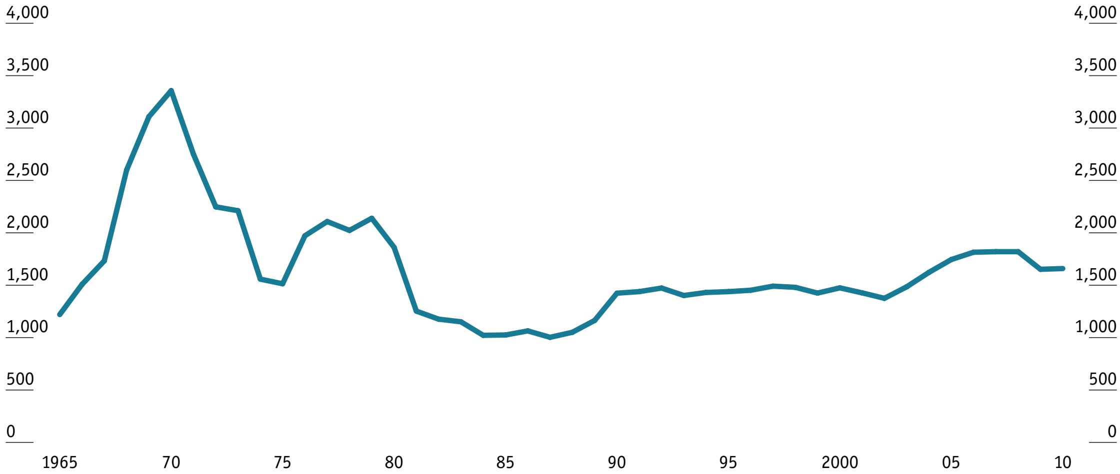
Also in the Sirte basin are fields operated by Waha Petroleum, in which three US companies

Libya's oil and gas infrastructure



Source: Wood Mackenzie.

Underachiever
(Libyan oil output under Qadhafi; '000 b/d)



Source: BP *Statistical Review of World Energy*.

(ConocoPhillips, Marathon and Hess) hold 41% in total. These fields reached peak production of over 1m b/d in the 1960s, but their output capacity has now declined to about 350,000 b/d. The US partners resumed their direct involvement in Waha operations in 2005 after a 19-year absence owing to sanctions.

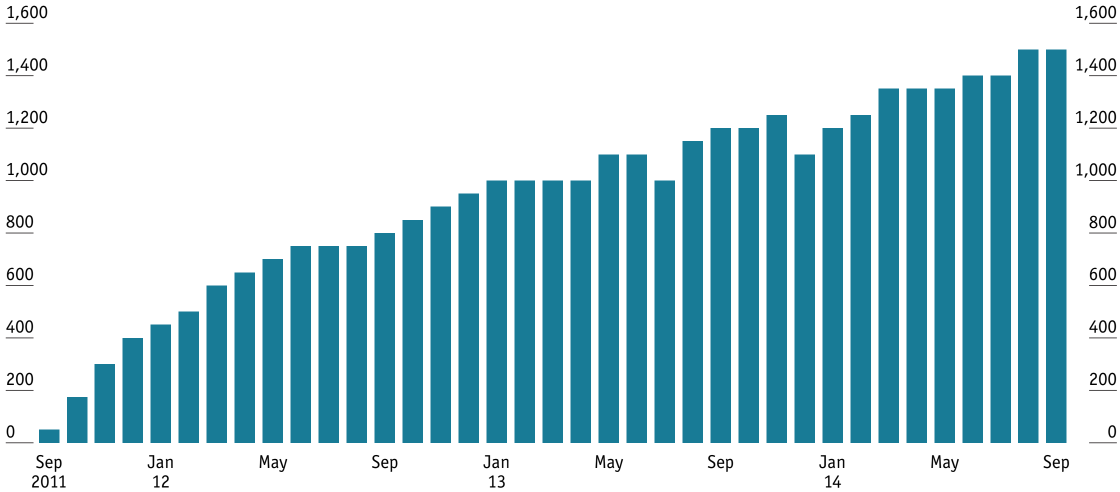
The other main producers in the Sirte basin are NOC joint ventures with, respectively, Suncor of Canada, Wintershall of Germany, Occidental of the US (a partner in Zweitina Oil Company) and Eni of Italy, as a partner in Sirte Oil Company. Altogether, the Sirte basin accounts for about two-thirds of Libya's oil production. However, the fields in this region are mature, and many of them require enhanced production techniques, such as water or gas injection, to sustain their output. The large size of these fields suggests that resuming production will be straightforward, but that regaining previous capacity will take time and investment, much of it by the foreign partners.

The other main production areas are the Murzuk basin, about 1,000 km south of Tripoli, where Eni and Repsol (Spain) have been producing about 400,000 b/d in total from fields brought on stream since 2000, and two offshore fields, Bouri (Eni) and Al-Jurf (Total of France), which together produced about 95,000 b/d. Restoring these fields may well be easier than in the east as most of the production equipment is of more recent vintage.

Our projection sees a relatively swift increase in output to 1m b/d by the end of 2012, but with slower progress thereafter, given the likelihood of some temporary falls in production as new equipment is installed. We do not expect production to recover to 1.6m b/d until 2015. Mr Berrouin has offered a more optimistic scenario, saying that 1m b/d production could be attained in five to six months and that Libya is likely to be producing 1.5m b/d at end-2012.

We assume that there is unlikely to be any oil produced from newly discovered and developed fields until the second half of the decade. Dozens of companies secured exploration concessions in the EPSA4 bid rounds in 2005 and 2006, but successes have been rare. Verenex (Canada) was one of the

Libyan oil output projection
('000 b/d)



Source: Economist Intelligence Unit.

Libyan oil output, 2009 (b/d)

Operator	Production
Arabian Gulf	400,000
Waha	330,000
Repsol	260,000
Eni	260,000
Sirte	90,000
Wintershall	90,000
Suncor	75,000
Zweitina	55,000
Total	50,000
OMV	1,000
Total	1,611,000

Source: Central Bank of Libya.

exceptions; after it struck oil, it tried to sell its concession to China National Petroleum Corporation, but the NOC exercised its right of pre-emption and bought the licence for a lower price. The BP signed a separate exploration deal outside the EPSA4 framework, but has yet to start drilling. The part UK-owned Royal Dutch/Shell Group has also signed an agreement with the NOC, but with the emphasis on natural gas production and processing.

Foreign companies investing in restoring oil production will have to negotiate terms with the NOC for reimbursement for these additional costs. There is a risk that this could lead to disputes that might hold up progress with the restoration work. Another major issue for the Libyan oil sector will be creating a system of public accountability for the allocation and spending of oil export revenue.

Finance: Opening the safe

Even for a country not known for transparency, the state of Libya's financial affairs is particularly murky. Nowhere is this more apparent than at the Libyan Investment Authority (LIA), the country's sovereign wealth fund. Established in 2006, the fund was one of the most opaque of its kind. Now, the LIA's estimated assets of around US$65bn offer a vital financial resource to the NTC, as long as it can untangle the fund's sprawling portfolio.

The most recent information available about the LIA comes from a leaked management report that covers the fund's performance at the third quarter of 2010. This glimpse at the LIA's portfolio confirms the widely held impression that the fund was not an astute steward of the country's oil wealth. Around US$2bn was lost on equity derivatives and US$1bn on stakes in hedge funds, private equity firms and other alternative investment vehicles. The report complains of lacklustre performance at several funds—especially in light of steep management fees—and suggests halving the LIA's US$4.5bn alternatives portfolio, presumably at a loss, in order to "guarantee capital preservation".

The LIA's equity portfolio, worth US$7.2bn at the time of the report, features stakes in a wide range of blue-chip companies in Europe, the largest of which is an investment in a beleaguered Italian bank, UniCredit, now probably worth far less than the US$1.3bn disclosed in the report. Additional equity stakes abroad—including more shares in UniCredit—are held directly by the Central Bank of Libya via its Libyan Foreign Bank subsidiary, which reported assets of around US$16bn at the end of 2010. The stockmarket turmoil of recent quarters will not have been kind to Libya's equity holdings, given that perhaps one-quarter of its portfolio is exposed to shares of hard-hit financial firms. Once the freeze on most of these stakes is lifted, it will not be an auspicious time to sell, to the extent that Libya's new regime can afford to be patient when it comes to maximising its investment returns.

More encouragingly, the LIA's bond portfolio, worth US$3.2bn, is packed with US treasuries, which have rallied so far this year. The fund's sizeable cash pile, worth more than US$20bn, or just over one-half of the LIA's financial assets, is another source of welcome liquidity for the NTC, subject to complex logistics of releasing the funds from the asset freezes imposed by the countries in which many of the deposits are held.

Given Colonel Qadhafi's dwindling resources during the worst of the fighting, the fate of the LIA's

The people's portfolio
(Investment performance of Libyan Investment Auuthority in selected asset classes, as of Q3 2010)

Source: Libyan Investment Authority.

assets not subject to sanctions remains a mystery (as does the Central Bank's store of nearly 150 tonnes of gold). The fund controlled subsidiary businesses worth nearly US$25bn as of the third quarter of 2010, including everything from real estate to manufacturers to farms. Many of these ventures are based in Sub-Saharan African countries that did not impose freezes on Libyan assets. Still, the extent of the former regime's attempts to repatriate any these investments—many are uneconomic vanity projects financed by Colonel Qadhafi in his guise as the pan-African "King of Kings"—is unclear.

It is safe to say that Libya's haphazard investment strategy under Colonel Qadhafi left the NTC with less—potentially much less—than the LIA's last publicly available report suggests. The new regime is investigating the fund's transactions, which may lead it to pursue restitution from the many international banks that structured loss-making investments for the LIA, including BNP Paribas, Société Générale and Credit Suisse, among others.

This could complicate the development of Libya's financial sector. Whatever the success of the NTC in freeing state funds in the short term, the need for financing to aid reconstruction in the long term is undeniable. Foreign banks remain keen on the country, given the scope for growth.

Liberalisation of Libya's banking industry began only in 2005. Since then, halting progress has been made on opening up the sector to private and foreign players. BNP Paribas, Arab Bank and Banco Espírito Santo purchased minority stakes in local commercial lenders starting in 2007. In 2008 a number of international banks were allowed to open representative offices in the country, of which there are now 19. The prospect of new banking licences, which allow foreign banks to establish and control operations, although they are restricted from owning a majority of a bank's share capital, led many international banks to express interest in 2010, although in the end only UniCredit was awarded a licence. In its call for bids in February 2010, the Central Bank of Libya claimed that "the entire banking system will be in private hands by 2011".

The NTC suggests that it will honour the banking licences issued by the previous regime. Its commitment to privatisation of the country's concentrated, state-dominated financial sector will be closely watched by bankers around the world. For all of the risks of doing business in Libya, it represents one of the few remaining untapped markets for an industry struggling to grow.

Power and water: Turning on the taps

Libya's electricity and desalination infrastructure provides a good indication of the stagnation that came to be associated with the Qadhafi regime. Many of the country's power plants are more than 20 years old, with the oldest at Tripoli West dating back to 1976. The excessive bureaucracy and unpredictable decision-making that characterised Qadhafi's Jamahiriya (State of the Masses) system meant that plans to build new plants were frequently changed or cancelled. If the new government does not get to grips with the challenge of ensuring adequate utilities provision, it could be storing up trouble for the future.

An important decision will be whether to maintain the existing structure, or try to create new bodies. In 2009 Colonel Qadhafi abolished a ministry, the General People's Committee for Electricity, Water and Gas, during one of his whimsical cabinet reshuffles. The long-established General Electricity Company of Libya (Gecol) was given responsibility for the power sector and effectively elevated to the position of a ministry. A new Ministry of Utilities took over the water and gas portfolios and subsumed the General Desalination Company (GDC), which had, since its establishment in 2008, been overseen by Gecol.

In 2008 Libya had installed power-generating capacity of around 6,200 mw and desalination capacity of 190,000 cu metres a day. According to MEED, a Middle East information provider, the government planned to boost power capacity by 13,000 mw by 2020 and to raise desalination capacity to 2.1m cu metres/day by 2015. Even more ambitiously, both Gecol and the GDC planned to diverge from the engineering, procurement and construction model they had used until then and instead solicit the help of private developers to build much of their future infrastructure as independent power and water projects. This did not get off the ground, and private infrastructure investment will not be feasible in the current conditions owing to the political risks that will be perceived by would-be developers.

Despite Libya's shortcomings, a handful of foreign companies have established a presence in the market. Sidem (France), a leader in the field of thermal desalination, has traditionally dominated the Libyan desalination industry. In 2009, however, the GDC announced that all future projects would use reverse osmosis technology. That year Hyflux (Singapore) signed a Memorandum of Understanding with the GDC to build a desalination plant in Tripoli with a capacity of 500,000 cu metres/day and a plant in Benghazi with a capacity of 400,000 cu metres/day, both using reverse osmosis. However, the schemes, which were also intended to be Libya's first independent water projects, were stillborn. Instead, Hyflux went on to sign a conventional engineering, procurement and construction contract for a 40,000 cu metres/day plant at Tobruk in November 2010 with the utilities ministry.

Foreign firms have also built Libya's power infrastructure. They include Alstom (France), Switzerland-based ABB, Bharat Heavy Electrical (India), Deutsche Babcock (Germany), US-based Westinghouse and Technopromexport (Russia). Since the lifting of the previous round of international sanctions in 2003/04, South Korean companies have become particularly active. Their biggest breakthrough came in 2007 with the long-delayed award of contracts on the 1,400-mw Tripoli West and Al-Khaleej (Gulf Steam) power plants.

The contracts on Tripoli West went to Daewoo Engineering & Construction, Doosan Heavy Industries & Construction and Hyundai Engineering & Construction. Hyundai, Doosan and a Turkish company, Gama, also won contracts for the Al-Khaleej project.

Construction on the two plants was severely delayed, however. While the Al-Khaleej plant was eventually allocated a budget, contractors on the Tripoli West scheme were left waiting. In August 2009, MEED reported that Gecol had asked the contractors on the project to lower their prices and was planning to sell the plant to Oasis IP, a UK-Abu Dhabi joint venture, after completion, making it Libya's first independent power project.

The new government would appear to have little option but to try to revive most of these contracts, and to devise a satisfactory system for assuring payment.

Perhaps the only success story that can be attributed to the Qadhafi regime in the utility sector is the Great Man Made River Project. Construction on the massive transmission system, which carries water from aquifers in the desert to the coast, began in 1984. While desalination plants provide most of Libya's drinking water, the underground river, made of 4-metre-diameter pipes, supplies water for agriculture. Supplies to Tripoli were cut during the conflict, possibly by Qadhafi forces. A lack of fuel has also affected pumping stations.

It is not clear whether electricity and desalination plants were damaged in fighting, but fuel shortages mean that they have not been operating at their normal capacity. This has resulted in frequent power cuts and UNICEF warned in late August that Tripoli was facing a dangerous water shortage. Humanitarian organisations have resorted to shipping and trucking fresh water in from neighbouring countries. Libya's power interconnections with Tunisia and Egypt have also served it well. According to Egypt's electricity minister, Hassan Younis, Egypt provided Benghazi and the east of Libya with 30% of its power during the conflict.

Telecommunications: Reconnected

The telecoms sector offers some major potential opportunities for post-Qadhafi development in Libya, as there is a strong case for it to be opened up to a wide range of new stakeholders. The Qadhafi family monopolised the sector. Mohammed Qadhafi, one of the deposed leader's sons, chaired the Libyan Post, Telecommunications and Information Technology Company (LPTIC), effectively a ministry, which in turn owned the country's two mobile-phone providers, Libyana and Al-Madar. In January 2011, Reuters, a news agency, reported that both companies were planning to list 2-5% of their shares on the Libyan stockmarket by the end of April. The privatisations had been discussed for years, but no progress was ever made. Libyan rebels in Benghazi set up a new mobile network—Free Libyana—in the east of the country after they were disconnected from Tripoli.

Libya's telecoms and information technology infrastructure is relatively poor, but the previous regime had attempted to make improvements. In January 2010, Ericsson (Sweden) announced that it had won a contract to become the main power supplier for Aljeel Aljadeed for Technology—an affiliate of LPTIC, which was established with the aim of modernising Libya's technology and telecoms sector. Under the deal, Ericsson would power next-generation networks across Libya as part of Aljeel Aljadeed's so-called 123 initiative, which was to allow users access to voice, TV and Internet on the same broadband connection.

In November 2009 Paris-based Alcatel-Lucent strengthened its presence in the market, with the award of two major contracts for telecoms infrastructure work. The first was an extension to its existing contract to install an optical fibre system in the east of the country from LPTIC. The first phase of this project entailed installing 4,400 km of optical fibre; the second phase involved adding 2,800 km to the system. Alcatel-Lucent was also selected by Aljeel Aljadeed to deploy a IP/MPLS (multi-protocol label switching) backbone in eastern Libya, which would significantly enhance broadband access.

According to the International Telecommunication Union, Libya had 1.23m fixed telephone lines in 2010, up from 605,000 in 2008. Mobile-phone subscriptions increased to 172 from 0.76 per 100 inhabitants over the same period. The number of Internet users rose to just 14 from 0.19 per 100 inhabitants in 2000. Broadband penetration remains very low with just 72,800 users in 2010.

Tourism: A missed opportunity

With 2,000 km of Mediterranean coastline and some of the world's most spectacular Roman ruins, Libya has the potential to become a prime tourism destination. It has so far failed to attract all but the intrepid tourist, however. Despite the country's much-lauded opening up to the West in the middle of the last decade, most tourists will have continued to think of it as a hostile and perhaps uninteresting place. They would not have been entirely at fault–it was notoriously difficult for those seeking to enter the country to get a visa. Even if the Qadhafi regime had sought to change this perception of Libya, it would not have been able to accommodate large numbers of tourists. A shortage of hotel rooms and a lack of any leisure facilities made the country an unlikely destination. Libya's alcohol-free status also acted as a deterrent.

In theory, the Qadhafi regime encouraged investment in tourism. Law No.7 of 2004 (which amended Investment Law No. 5) dealt specifically with the sector. The legislation allowed companies licensed under the law to be wholly foreign-owned and exempted investors from some duties and taxes. Both Law No. 5 and Law No. 7 were annulled by Law No. 9 of 2010 on investment promotion. But tourism development has remained slow. Gulf developers dabbled with the idea of investing in Libya several years ago, but their efforts came to nothing. In 2006 Dubai-based Emaar Properties announced that it had teamed up with the Zowara-Abou Kemash Development Zone, chaired by another of Colonel Qadhafi's sons, Saadi Qadhafi, to transform the area into a tourism, industrial and commercial zone. In the same year, another UAE company, Tameer Holding, said it would invest more than US$20bn in a project, which would involve building residential, commercial and tourism facilities outside Tripoli.

Such projects may not have been possible under the previous regime, but there is significant scope for progress under a new government. Libyans returning from the diaspora could play an important part in invigorating the hospitality industry. Foreign investors, particularly from the Gulf, will recognise opportunities in such an underdeveloped market. Qatar, which provided invaluable support to the National Transitional Council throughout the Libyan conflict, will be in a strong position when it comes to pitching ideas to the new government and companies like Qatari Diar and Barwa Real Estate are likely to benefit.

Conclusion

In the early days of the post-Qadhafi regime, business opportunities will be concentrated in oil and infrastructure as the new administration works to get the vital oil export business back on stream, and to repair the damage done during the conflict. Further down the line, other areas of the economy will become increasingly open to investment. The pace of that opening, the extent of the opportunities and the ease with which they can be pursued will all depend on which of our scenarios turns out to be the most accurate. If, as we expect, power is passed to an elected government staffed with able technocrats and supported by a wide range of interests more or less according to the NTC's timetable, the opportunities will be substantial, and the business challenges confronting potential investors will be on a par with those commonly faced in fast-growing emerging markets.

Access analysis on over 200 countries worldwide with the Economist Intelligence Unit

The analysis and content in our reports is derived from our extensive economic, financial, political and business risk analysis of over 203 countries worldwide.

You may gain access to this information by signing up, free of charge, at www.eiu.com.

Click on the country name to go straight to the latest analysis of that country:

Countries covered in this report

- Algeria
- Chad
- Egypt
- Iraq
- Libya
- Qatar
- Tunisia
- Singapore
- South Korea
- Sweden
- UAE

G8 Countries

- Canada
- France
- Germany
- Italy
- Japan
- Russia
- United Kingdom
- United States of America

BRIC Countries

- Brazil
- Russia
- India
- China

CIVETS Countries

- Colombia
- Indonesia
- Vietnam
- Egypt
- Turkey
- South Africa

Or view the list of all the countries.

Further reports are available from Economist Intelligence Unit and can be downloaded at www.eiu.com.

Should you wish to speak to a sales representative please telephone us:

Americas: +1 212 698 9717

Asia: +852 2585 3888

Europe, Middle East & Africa: +44 (0)20 7576 8181

Media Enquiries for the Economist Intelligence Unit

Europe, Middle East & Africa

Grayling PR
Angelina Hunt
Tel: + 44 (0)20 7592 7932
Mobile: + 44 (0)7850 311 441
Sophie Kriefman
Tel: +44 (0)20 7592 7924
Ravi Sunnak
Tel : +44 (0)207 592 7927
Mobile: + 44 (0)7515 974 786
Email: allgraylingukeiu@grayling.com

Americas

Grayling New York
Ivette Almeida
Tel: +(1) 917-302-9946
Ivette.almeida@grayling.com
Katarina Wenk-Bodenmiller
Tel: +(1) 646-284-9417
Katarina.Wenk-Bodenmiller@grayling.com

Asia

The Consultancy
Tom Engel
+852 3114 6337 / +852 9577 7106
tengel@consultancy-pr.com.hk
Ian Fok
+852 3114 6335 / +852 9348 4484
ifok@consultancy-pr.com.hk
Rhonda Taylor
+852 3114 6335
rtaylor@consultancy-pr.com.hk

Australia and New Zealand

Cape Public Relations
Telephone: (02) 8218 2190
Sara Crowe
M: 0437 161916
sara@capepublicrelations.com
Luke Roberts
M: 0422 855 930
luke@capepublicrelations.com

LONDON
26 Red Lion Square
London
WC1R 4HQ
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

NEW YORK
750 Third Avenue
5th Floor
New York, NY 10017
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
E-mail: newyork@eiu.com

HONG KONG
6001, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

GENEVA
Boulevard des Tranchées 16
1206 Geneva
Switzerland
Tel: (41) 22 566 2470
Fax: (41) 22 346 93 47
E-mail: geneva@eiu.com