

What's it like to work on a Fragile State?

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The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management

Well, it did not start out that way!

- **Prosperity to Transition**
- **Transition to Fragile**
- **Fragile to Failed**

Libya - big country with small population



Ancient Libya

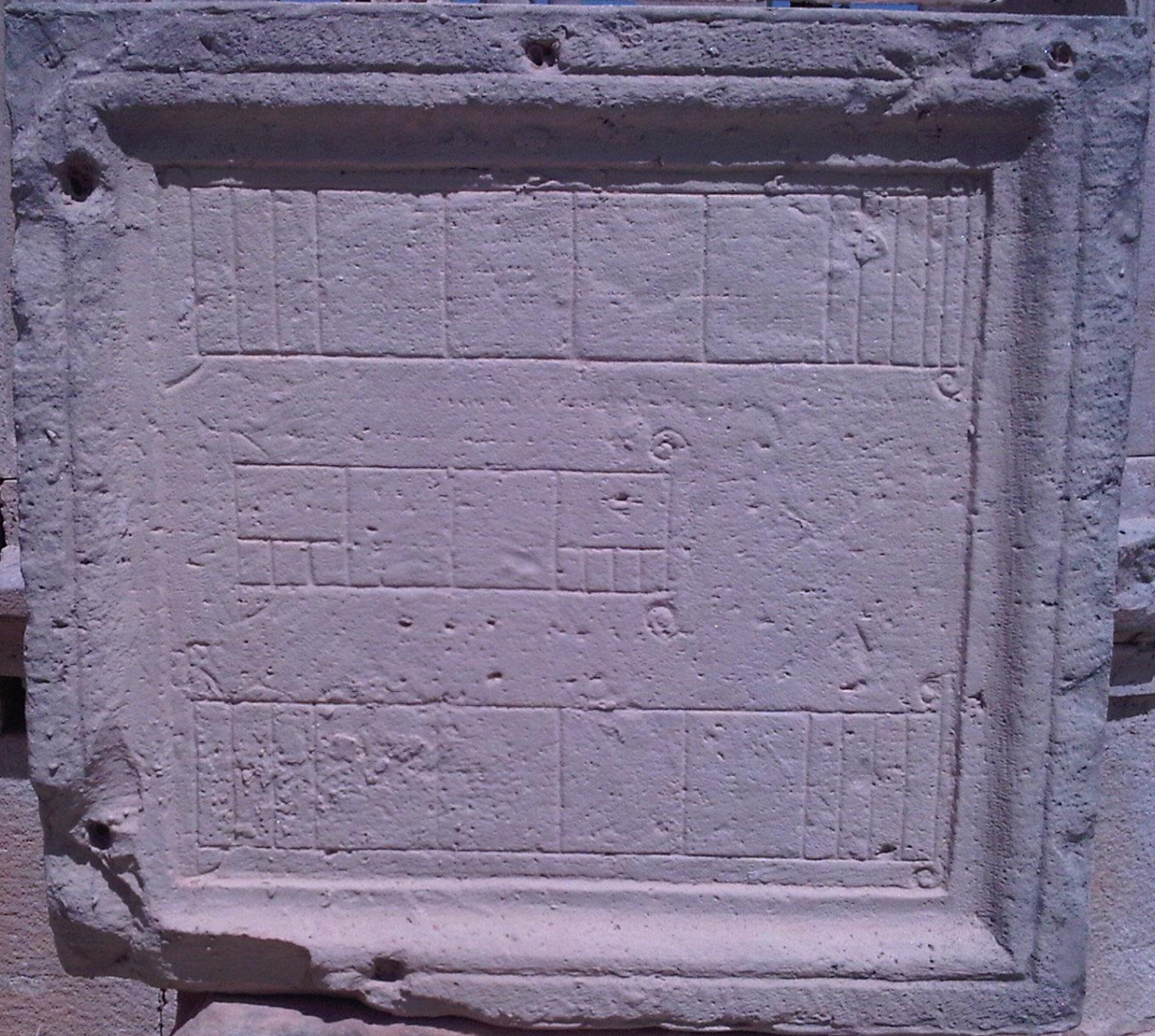


Libya before the Revolution

Leptis Magna



LENGTH MEASURES



Subrata: Incredible Roman heritage



Most of it still covered by sand



Over 2000 kilometers of pristine coastline



Dining among the Roman ruins



Meetings at picturesque Central Bank

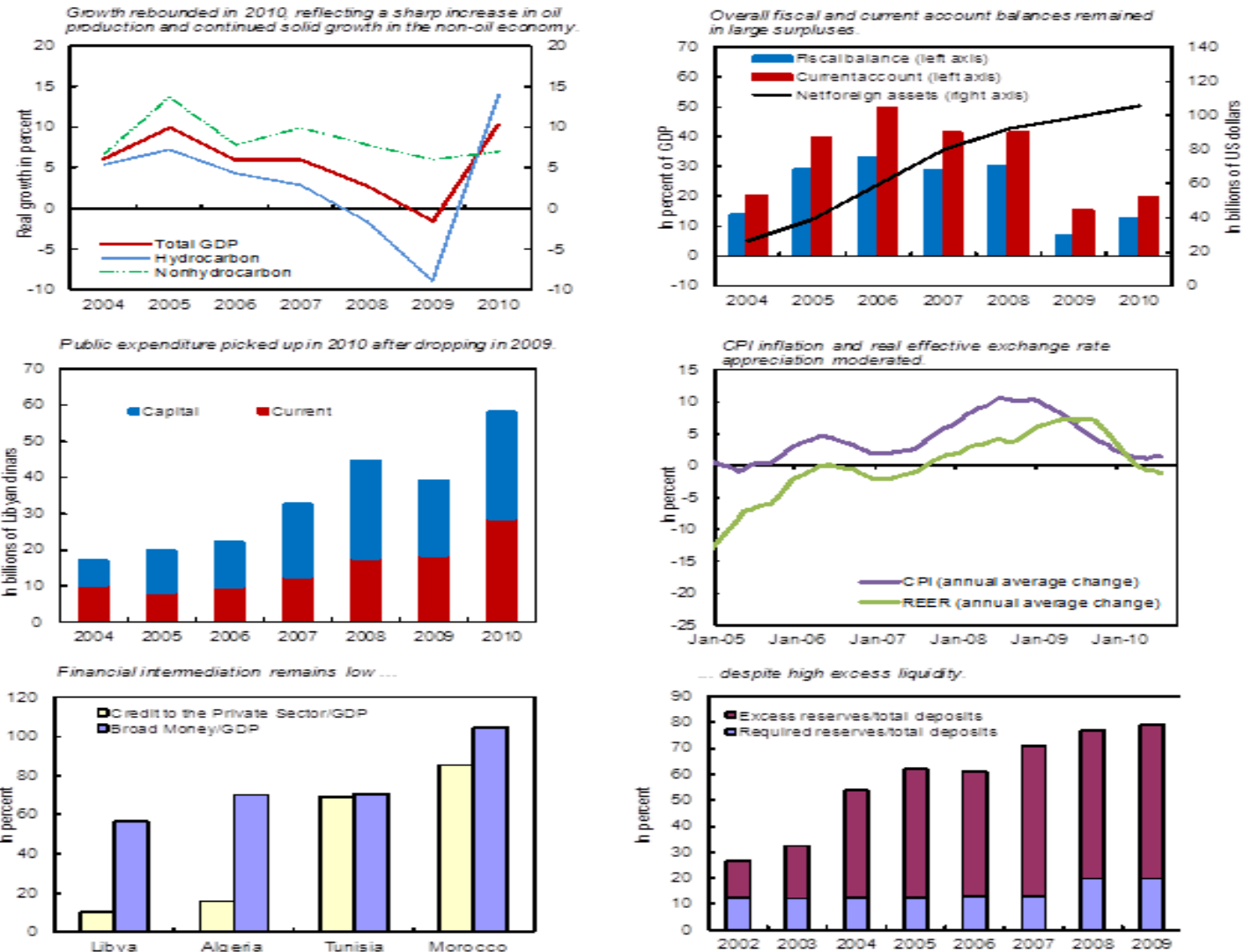


Before the Revolution: economic gains...

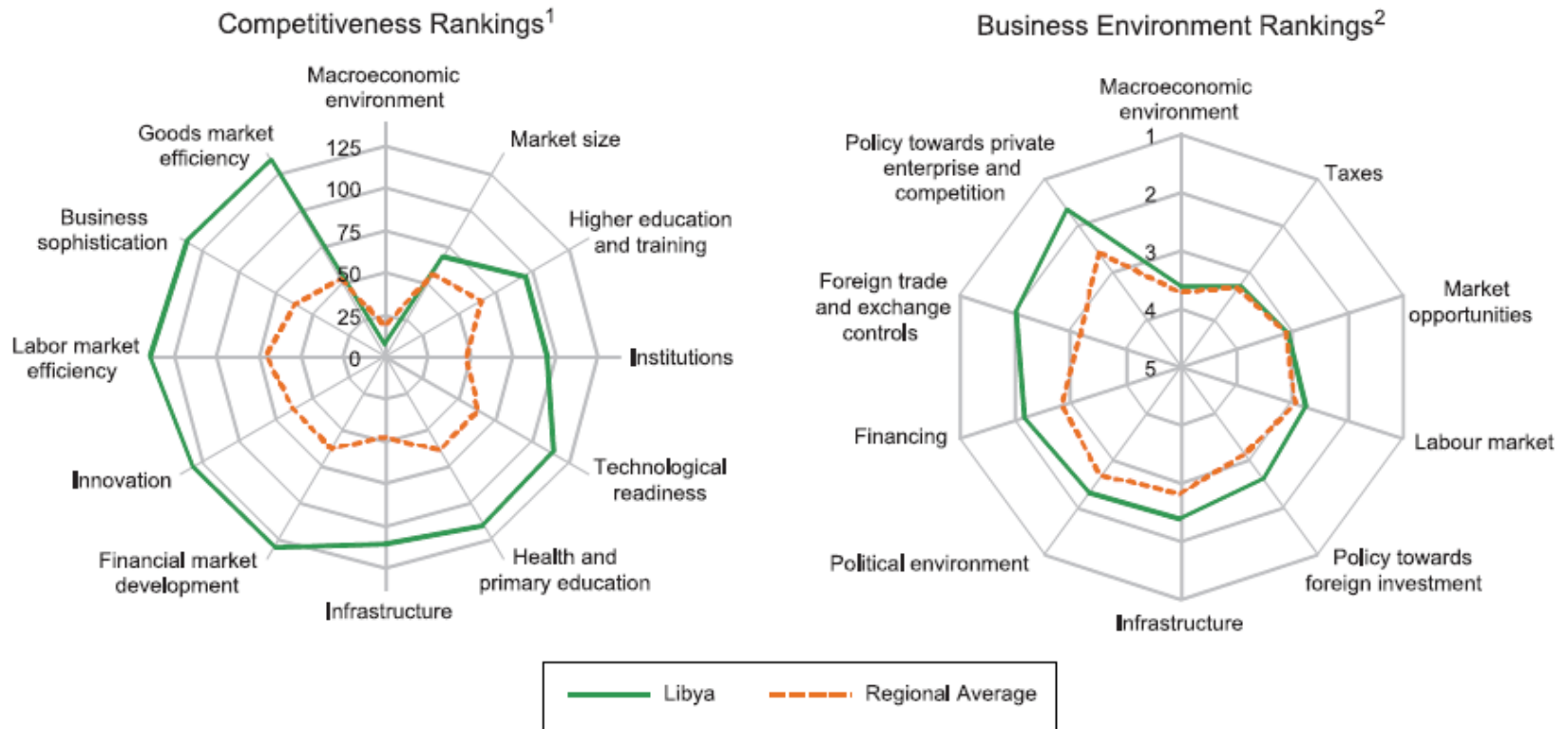
- Following the lifting of earlier UN sanctions in 2003, economic activity increased steadily for seven years.
- During 2004–10, average growth was about 5 percent, annual inflation averaged less than 4 percent, and **official foreign reserves increased from \$20 billion at end-2003 to \$170 billion at end-2010.**
- An ambitious public investment program.

...and a rich and growing economy.

Figure 1. Libya: Recent Macroeconomic Developments

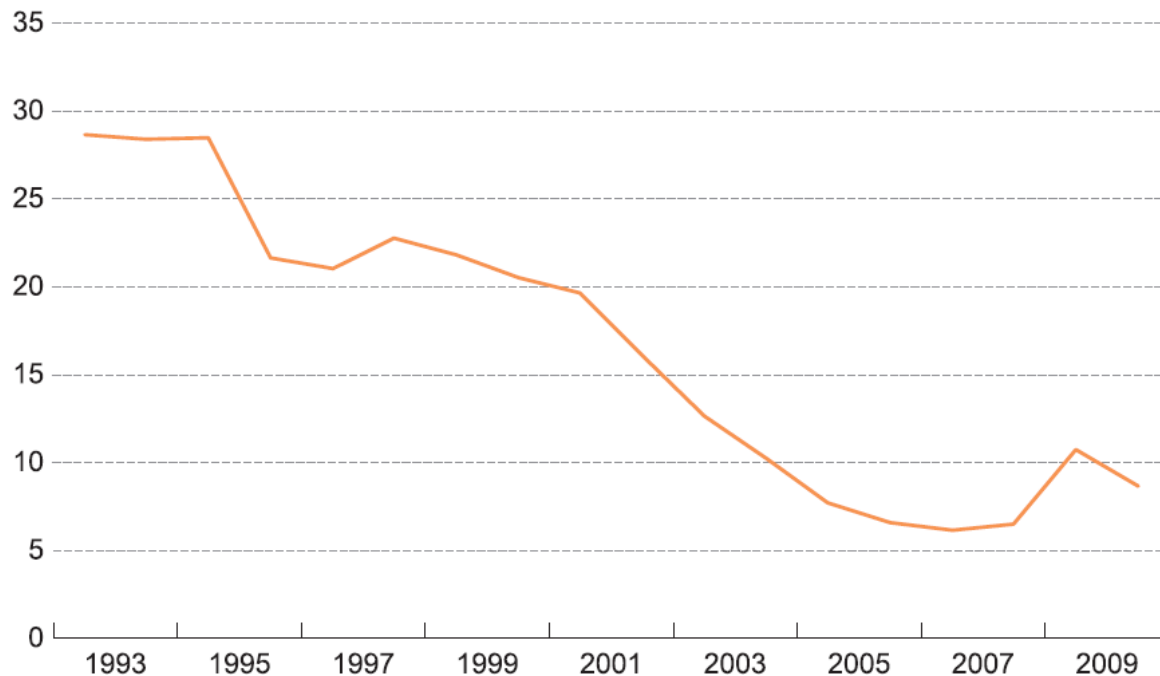


But, masking poor business conditions...



...heavy public sector presence in the economy.

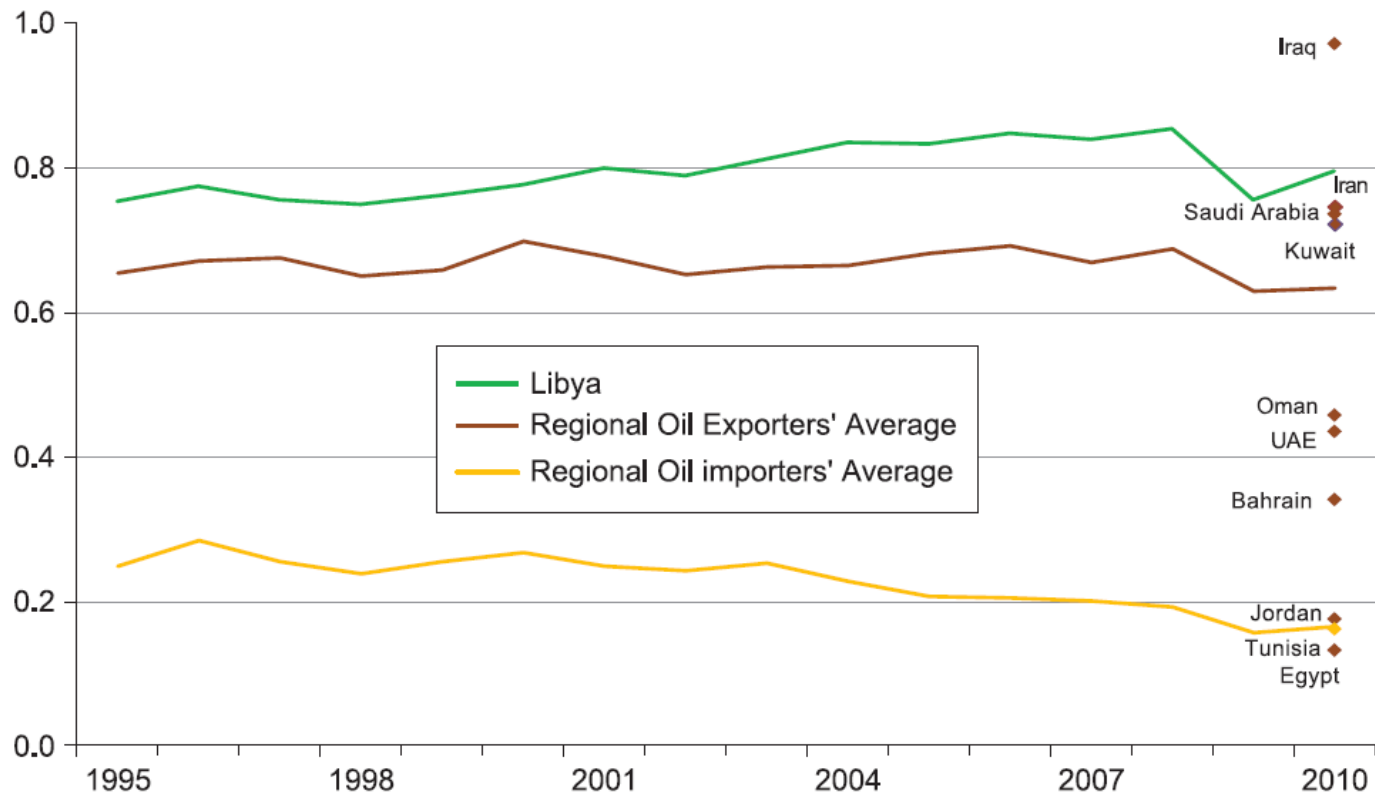
**Figure 14. Low Financial Intermediation Limits
Private-Sector Development**
(Credit to private sector as a share of GDP)



Sources: Country authorities; and IMF staff estimates.

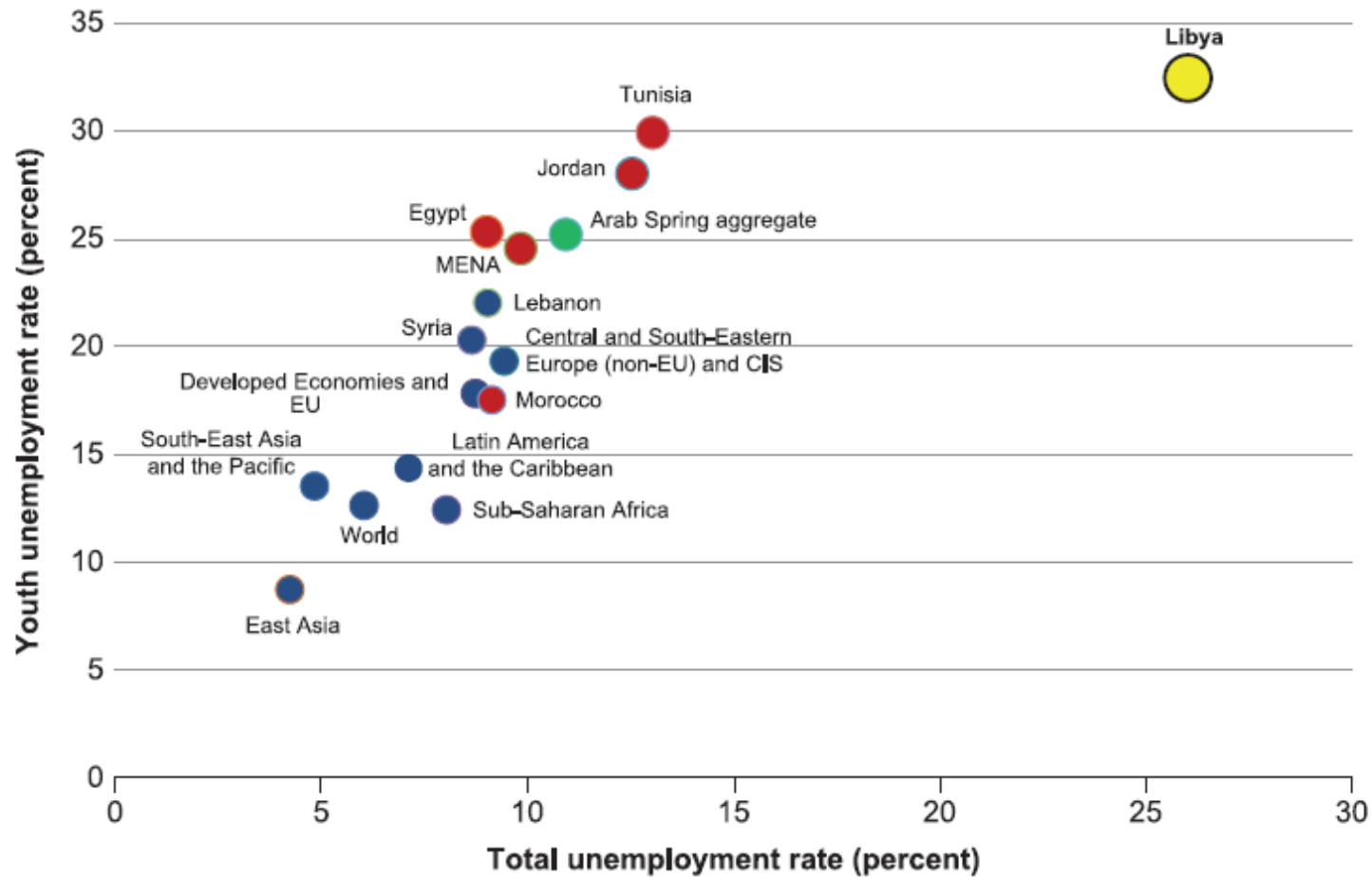
...relying mostly on hydrocarbons...

Figure 10. Libya Exports Almost Nothing but Hydrocarbons
(Export concentration index, 1 = maximum concentration)



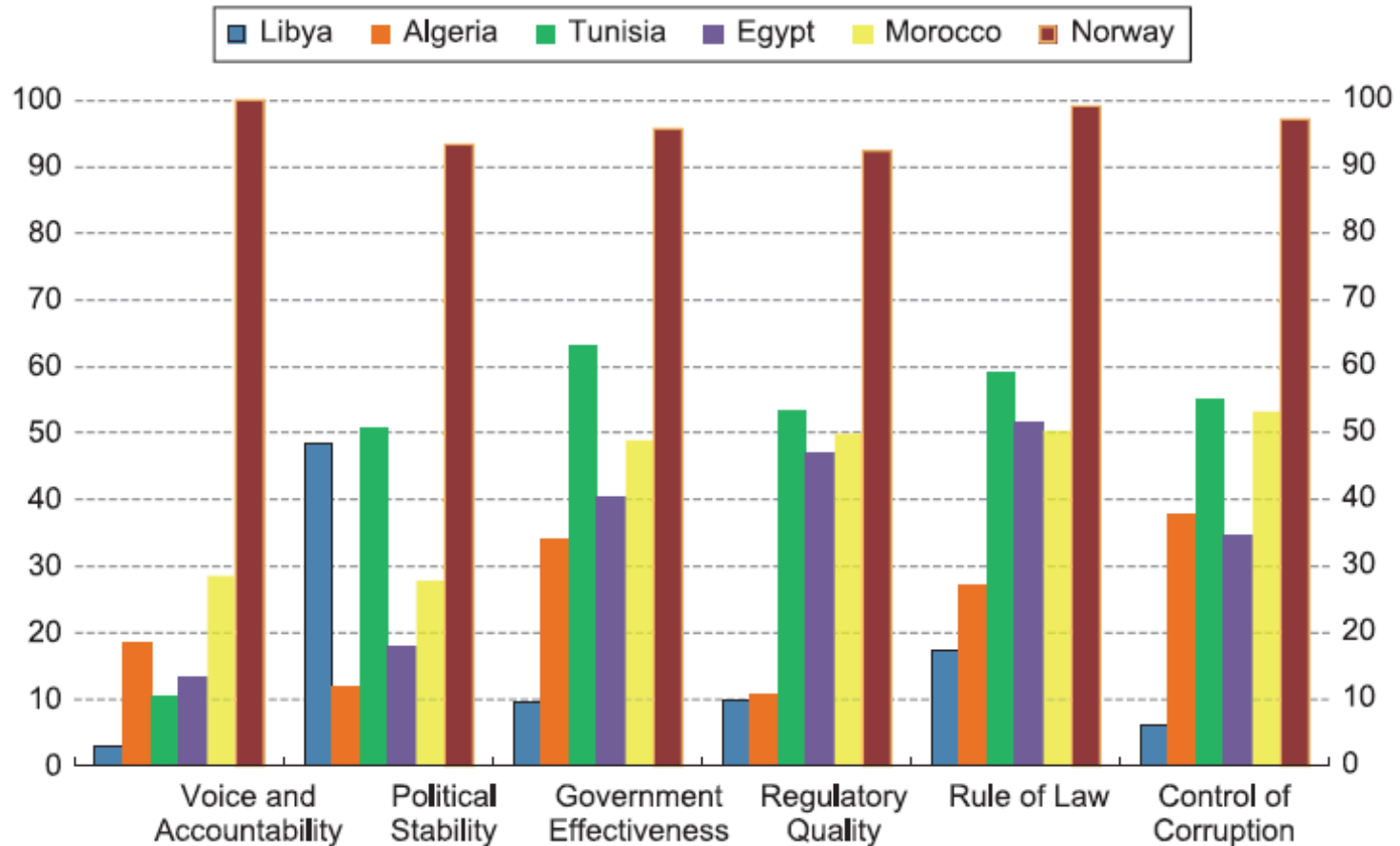
Source: United Nations Conference on Trade and Development.

...with high and sustained unemployment...



Sources: Ministry of Labor and Capacity Building; International Labour Organization; and IMF staff calculations.

...and stark political and institutional failures.



Source: Worldwide Governance Indicators, World Bank, 2011.

Revolution February 2011: violent protests erupted, escalating rapidly into full-fledged conflict

- The UN Security Council imposed sanctions on Libya on February 26, 2011. [UNSCR1970.pdf](#)
- March 17, 2011: a mandate for limited foreign military intervention and a freeze on Libya's foreign assets.
- UN General Assembly on September 16, 2011 recognizes the National Transitional Council (NTC) as the government of Libya. [UNRecognition1](#)
[UNRecognition2](#)
- UNSCR 2009—September 2011:
[Resolution 18](#): Requesting IMF/Bank help: a First!
- IMF Fact Finding Mission—October 2011
- October 23, 2011: the NTC declared liberation; and
- [November 22, 2011: a transitional government was announced.](#)

The World meets at the UN in NY



Including France..and recognizes NTC as the new government



United Nations Security Council Resolution 2009 (2011)

18. *Requests* the International Monetary Fund and the World Bank to work with the Libyan authorities on an assessment of Libya's public financial management framework, which would recommend steps to be taken by Libya to ensure a system of transparency and accountability with respect to the funds held by Libyan governmental institutions, including the LIA, LNOC, LAFB, LAIP and Libyan Central Bank, and *further requests* that the Committee be informed of the results of that assessment;

We find ourselves on a 4 am flight from Malta to Tripoli, October 2011



Not a comfortable ride



Arriving into Chaos



Having to ride in an armored vehicle!



Witnessing the destruction...



...of Nato's Air and Sea Missiles...



...on Khadafy's compound...

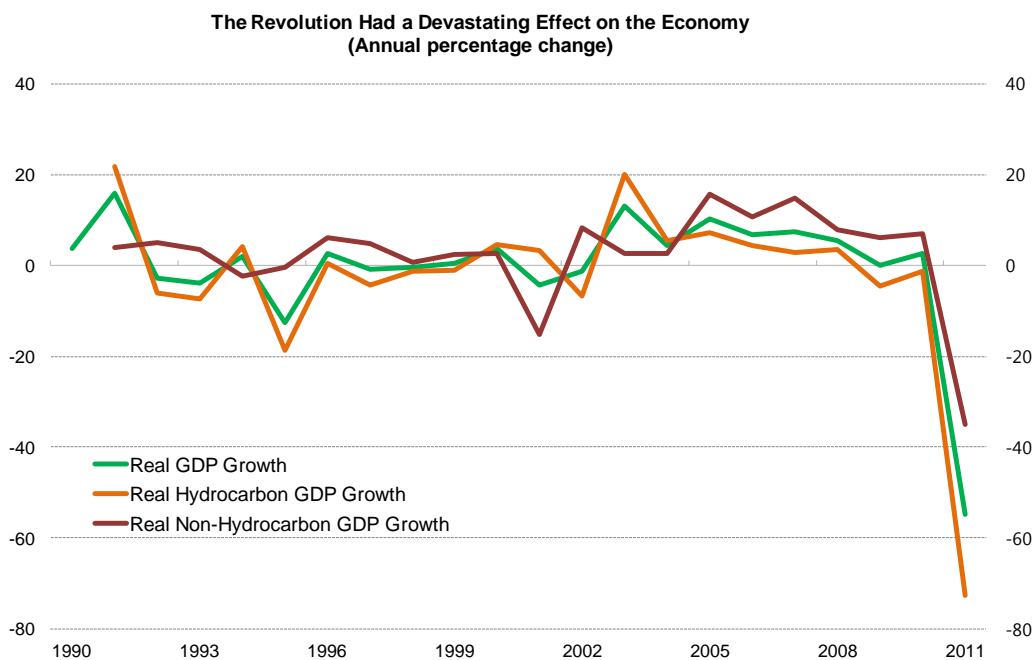


...and his lair in Tripoli...but, he had retreated to Sirte



The conflict and international sanctions lead to a collapse in economic activity.

- Real GDP is estimated to have contracted by 60 percent in 2011.
- Due to the fall in hydrocarbon exports, the budget was in a large deficit and the current account surplus was reduced sharply.
- The budget deficit was 27.0 percent of GDP in 2011, compared to a budget surplus of 16.2 percent in 2010. Similarly, the current account surplus narrowed from 19.8 percent of GDP in 2010 to 1.3 percent in 2011.

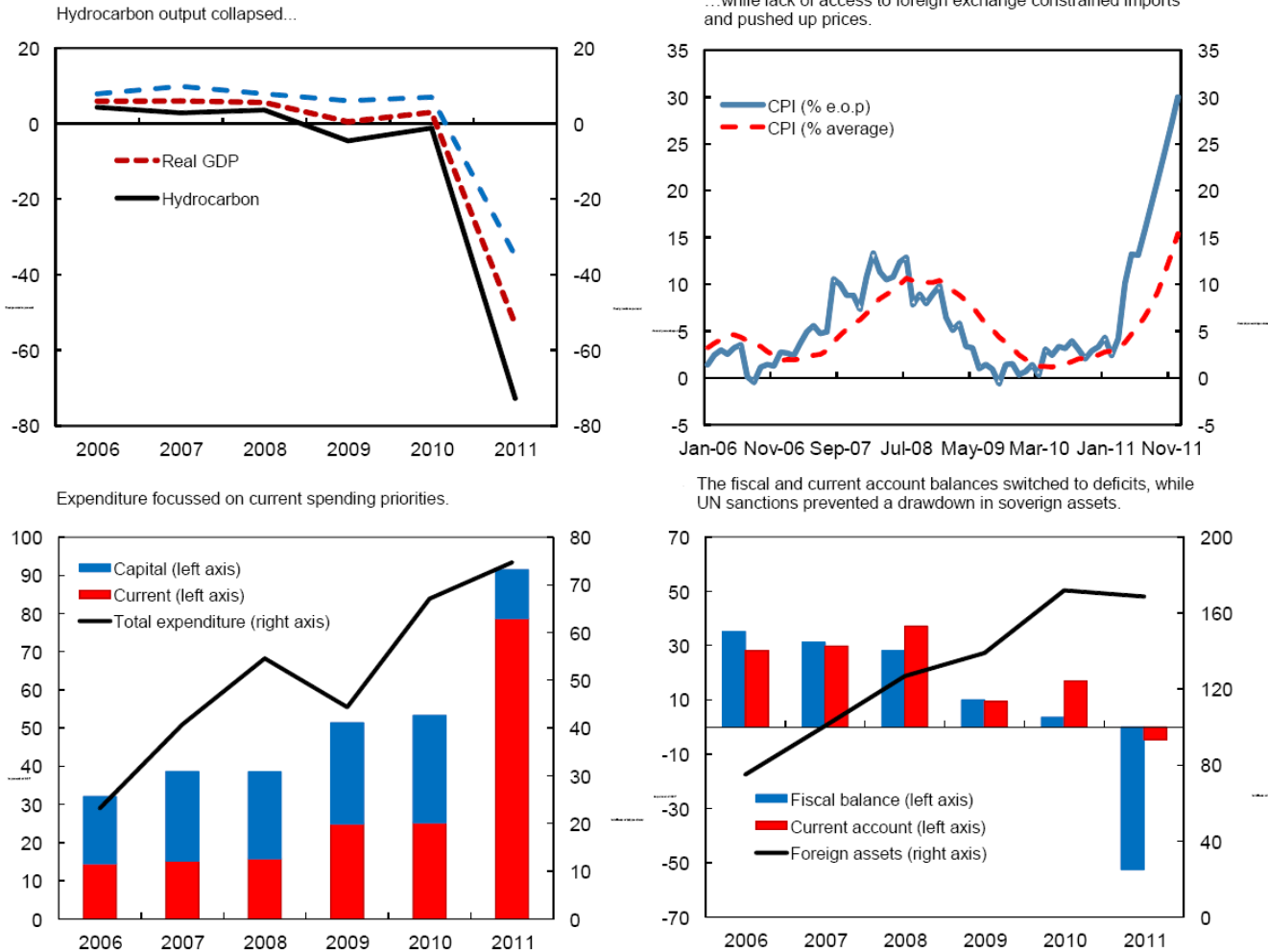


Sources: Country authorities; and IMF staff estimates.



Collapse in pictures

Figure 1. Libya: Recent Macroeconomic Developments



Source: Libyan Authorities; and Fund staff estimates.

The conflict had adverse consequences across the board

- The financial situation of the public sector was precarious: government financing expenditures by borrowing from the Central Bank of Libya (CBL) and by drawing down deposits at the CBL.
- The money supply increased due to monetization of the budget deficit.
- Although cash in circulation doubled, demand for cash increased even more, resulting in a shortage of liquidity in the banking system.
- The CBL responded by imposing a limit on cash withdrawals by individuals.

Confidence in the resource-backed currency helped mitigate the economic impact

- The CBL was unable to provide adequate foreign exchange to the market.
- Accordingly, the currency traded on the parallel market at about two-thirds of its official value, contributing to inflation, which peaked at 29.7 percent in September 2011.
- **Most of the UN sanctions were lifted on December 16, 2011,** allowing the CBL to provide foreign exchange liquidity to banks which helped normalize banking operations.

An economy in **transition**: Libya at a historic juncture

- Looking beyond the revolution, the authorities faced the twin and immediate challenges:
 - stabilizing the economy, and
 - responding to the aspirations of the revolution

Revolution also unleashed potential
for diverse and inclusive growth:

A Norway on the Mediterranean?

Our plan of Action: Working with Government, CSOs, IFIs to



If only we could help the country handle short-term challenges

- Manage the political transition; and
- Exercise budget discipline, while
- Maintaining macroeconomic stability.

And plan for medium-term policy challenges

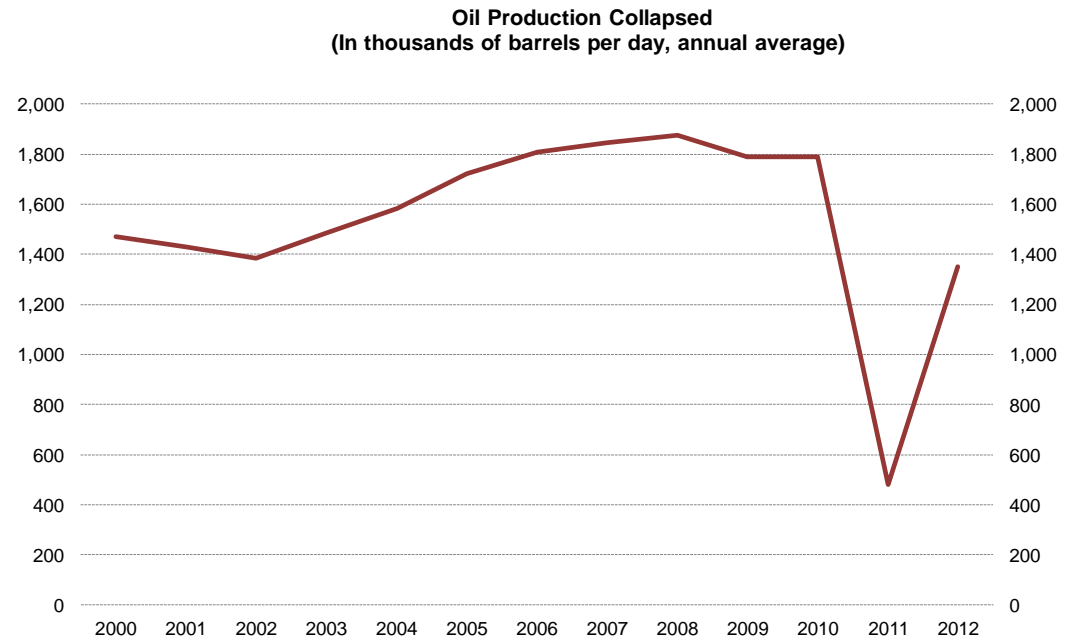
- Capacity building, including sound institutions for managing public resources;
- Improving the quality of education;
- Rebuilding infrastructure;
- Developing financial sector;
- Reducing hydrocarbon dependence; and
- Putting in place an efficient social safety net.

Setting up a governance framework

- Linked to transparency and accountability, which would promote
 - private sector-led development,
 - job creation, and
 - inclusive growth

In transition: economic activity rebounded strongly in 2012

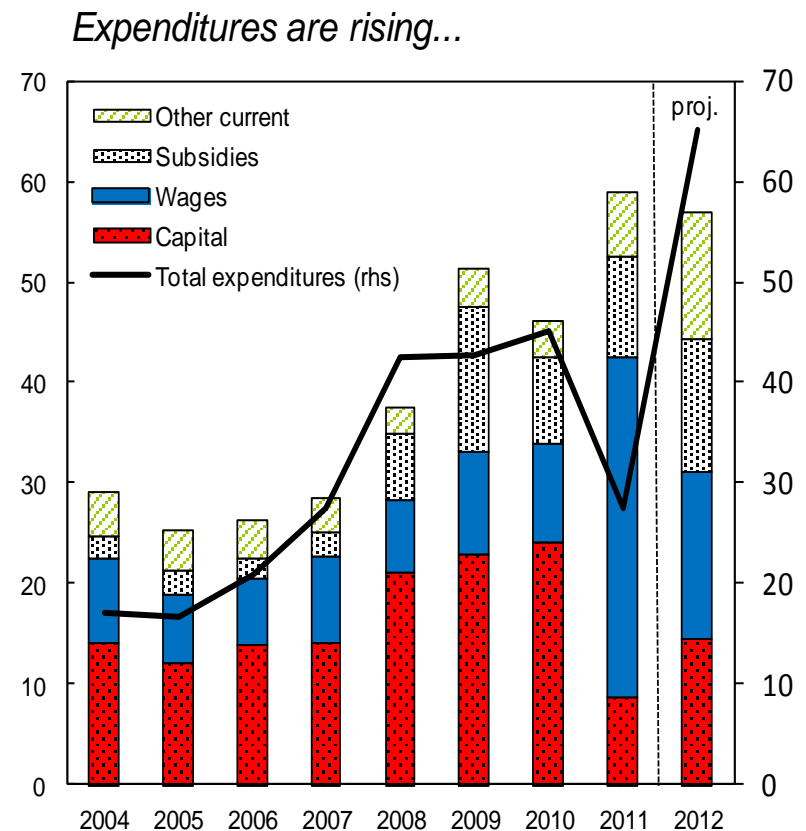
- Crude oil production reached the pre-conflict level, while reconstruction expenditure and the release of pent-up private demand facilitated a recovery in non-hydrocarbon sectors.
- Increased hydrocarbon exports led to a fiscal surplus of 14.2 percent of GDP and increased the current account surplus to 21.9 percent.
- The normalization of imports continued to contain consumer price inflation, despite the upward pressure on prices arising from supply bottlenecks.



Source: U.S. Energy Information Administration; and IMF staff estimates and projections.

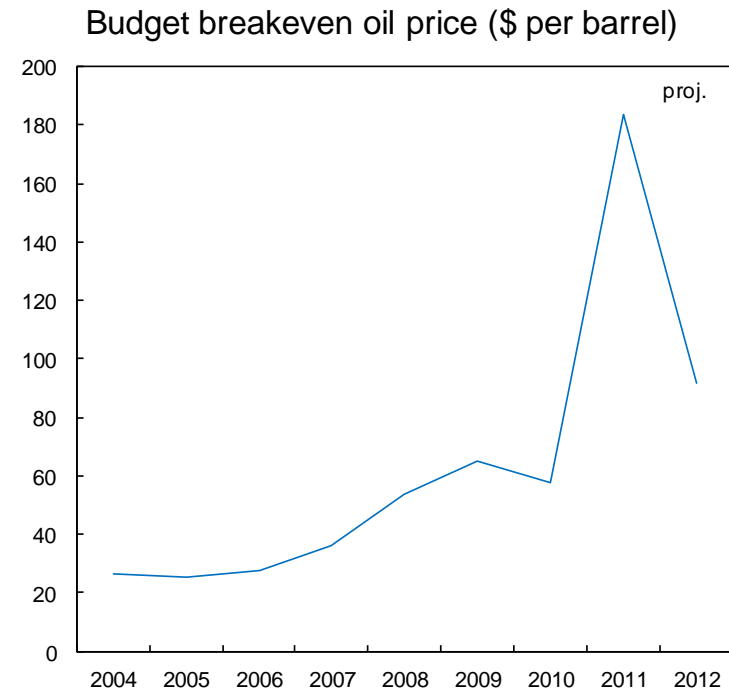
Fiscal discipline needed to support macroeconomic stability

- In 2011, current expenditures increased significantly, primarily due to policies to increase public sector wages and employment, as well as to raise subsidies.
- In 2012, capital spending remained constrained by limited execution capacity, while current spending on wages and subsidies increased to 30 percent of GDP.
- Although Libya could afford elevated current spending in the short term, the level of recurrent spending was inconsistent with appropriate budgetary prioritization and led to a damaging appreciation of the real exchange rate.



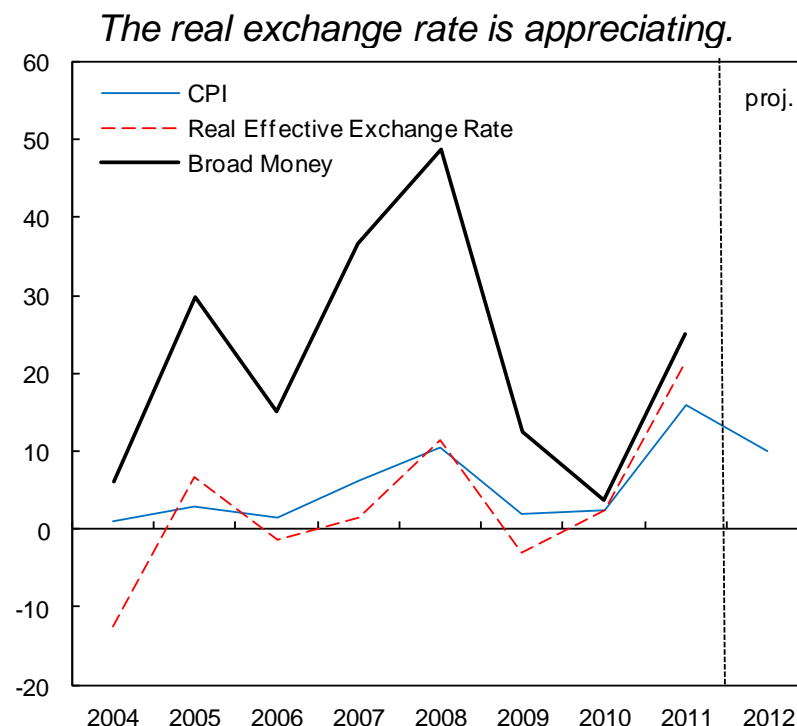
Unchanged fiscal policies eroded Libya's wealth...

- An analysis of spending trends under the assumption of unchanged policies indicated that the budget balance will be in deficit from 2014.
- Similarly, the oil price at which the budget was balanced increased from \$58 per barrel in 2010 to \$91 per barrel in 2012 and was poised to exceed \$100 per barrel from 2013.



...and its competitiveness

- With a pegged exchange rate, higher prices caused the real exchange rate to appreciate.



But, let us not forget what we are dealing with, an economy where:

- Oil dominates everything
- No Constitution and No Institutions!
- Not even Land Registry!
- High Unemployment, especially among the youth
- Country awash with arms!
- Mission work is challenging and downright dangerous!
- 14 Missions with very little protection, if any.....

Pre-deployment



In transit



Last meal?...



That's what an armored car looks like!







Winter in Libya

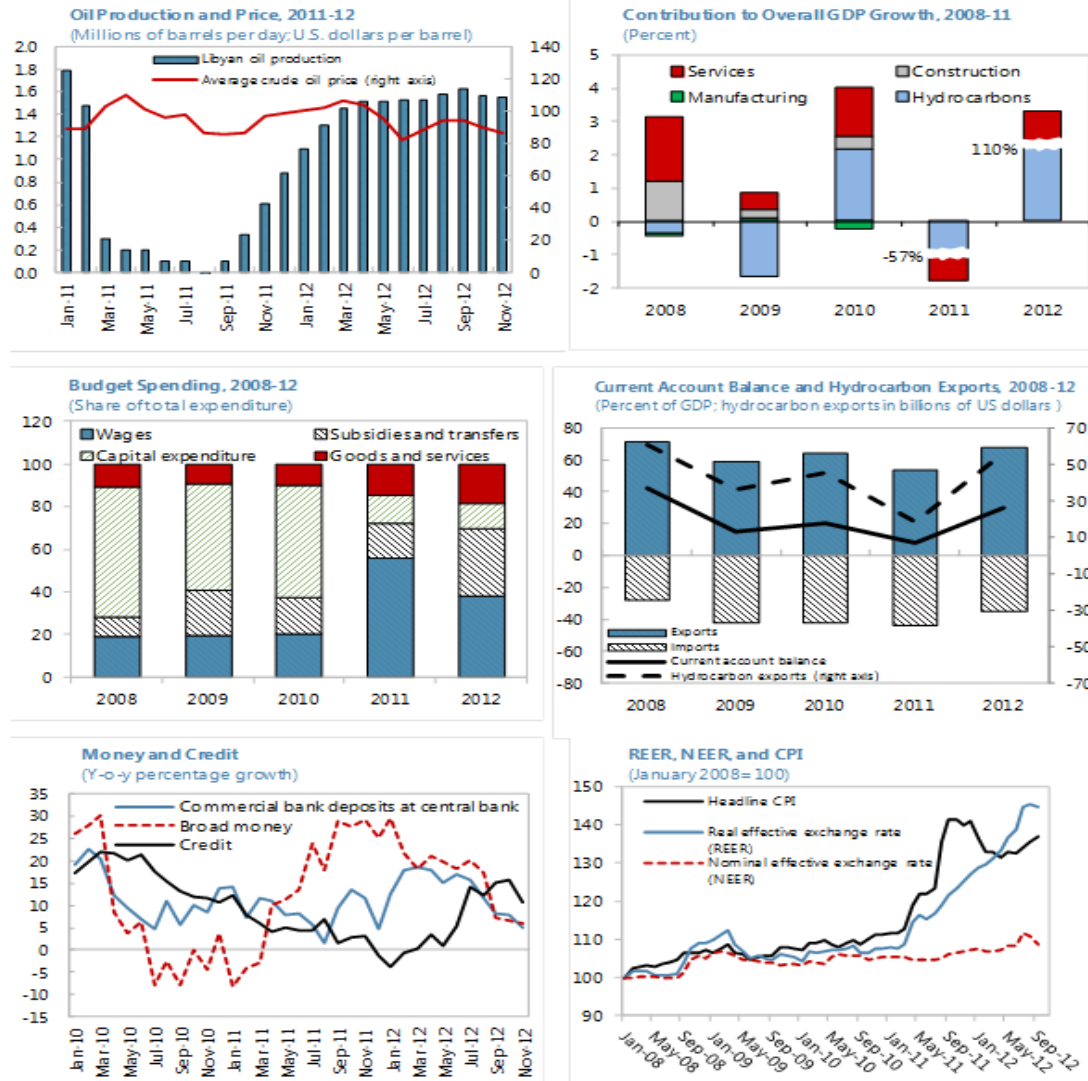


Post-deployment



Fleeting pictures of days of plenty

Figure 1. Libya: Context and Recent Developments



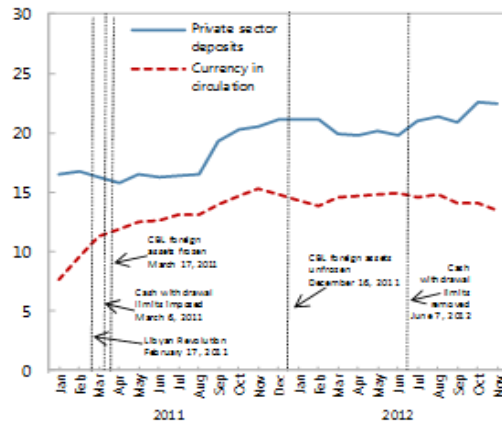
Sources: IEA, Central Bank of Libya, national authorities; and Fund staff estimates.

But, with worrisome signs

Figure 2. Libya: Recent Monetary Developments

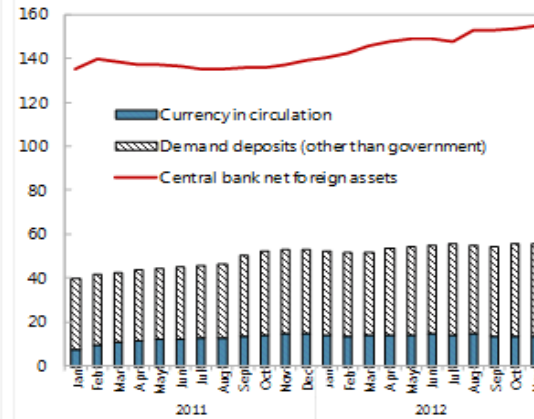
Private Sector Deposits and Currency in Circulation
(Billions of Libyan dinar)

Money doubled during the revolution.



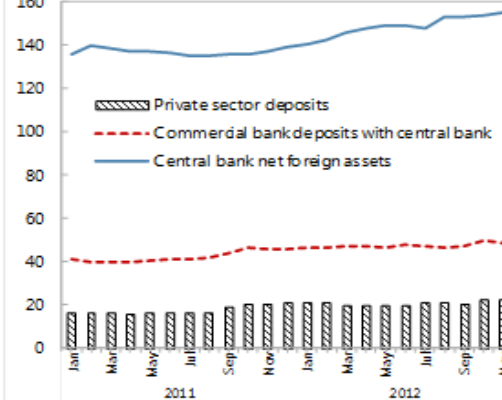
Central Bank Net Foreign Assets, Currency, and Demand Deposits
(Billions of Libyan dinar)

Money is covered by foreign assets



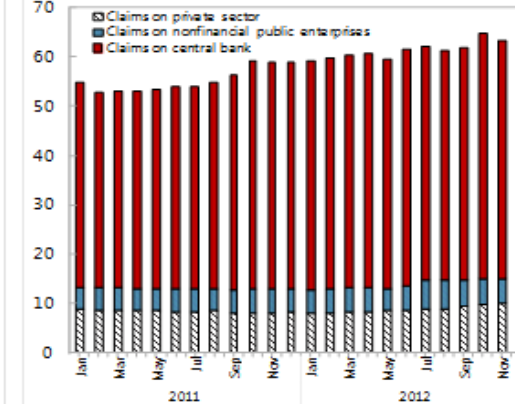
Commercial Bank Deposits and Central Bank Foreign Assets
(Billions of Libyan dinar)

Reserves for private sector bank deposits are ample.



Commercial Bank Claims on Private Sector, Nonfinancial Public Enterprises, and Central Bank
(Billions of Libyan dinar)

Bank assets are primarily at the central bank.



Source: Central Bank of Libya.

From a country in **Transition** to a **Fragile State**

- Fragile, but is it by design?
- Continued political uncertainty
- Delays in normalizing the security situation leading to
- Disruptions in oil production, while
- Throwing money at the problem led to
- Hemorrhaging of spending, while facing further
- Oil price drop and production disruptions

What does a Fragile state mean?

Ever seen “Ground Hog Day?”

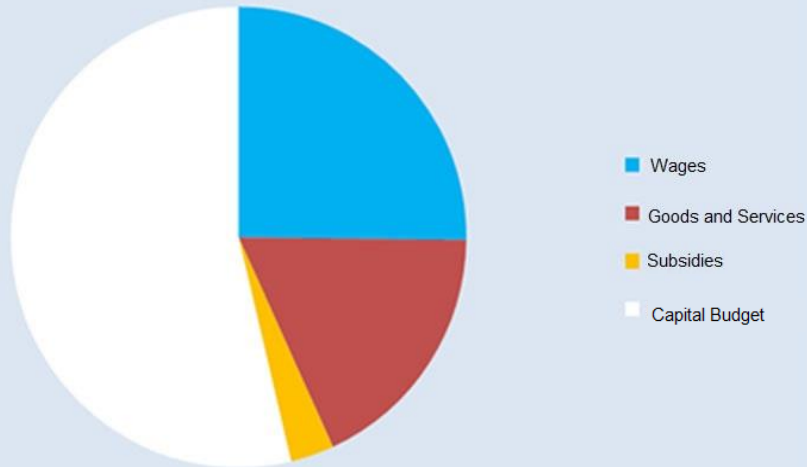
- Fragile means a new official every time you visit the country...you keep repeating the same conversation!
- That means there is no continuity...
- Current officials really have no power, no mandate, nor political will to make the tough decisions,
- Preferring instead to placate immediate demands by throwing money at the problem...hoping it would go away...especially if the disgruntled are carrying guns!
- Even at the expense of long term, but
- It doesn't go away...the demands get worse
- And you start to run out of money!

For our purposes, fragility translates to

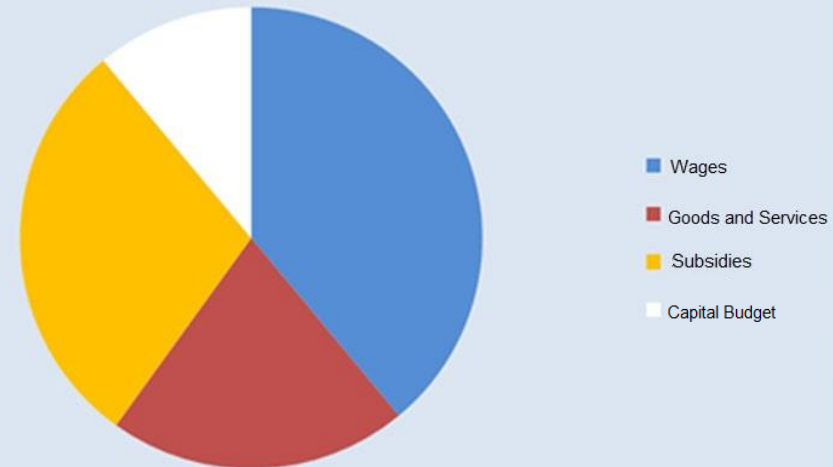
- Country awash with guns and arms of all kinds...
- With No army or policy force
- A Country 11 times the size of France!
- Weak central government, with centralized fiscal authority facing decentralized demands
- **No capacity to deliver**, that means
- Problems in **communicating** vision and strategies; in the **execution** of plans;
- And, in getting resources and funding fast enough to the where it is most needed,
- Again, is it by design? “Neopatrimonialism?”

The changing budget structure

2010 (46.5b)

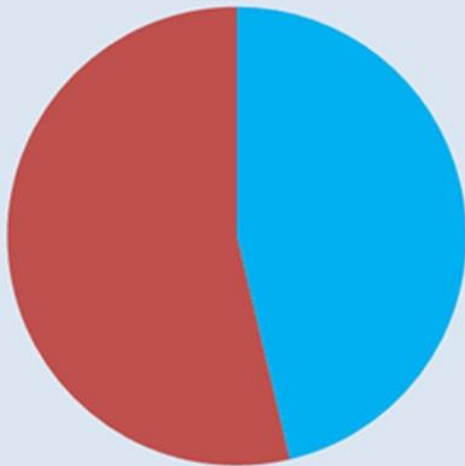


2013 (62.5b)



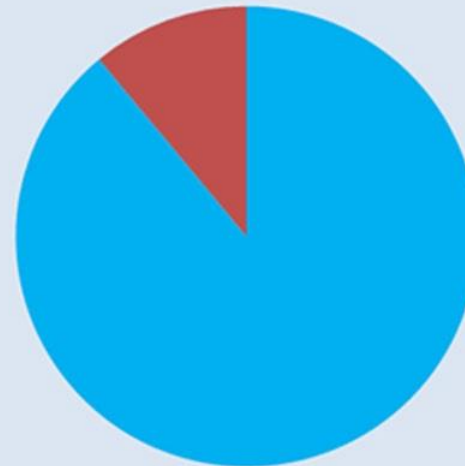
Total recurrent vs. total capital

2010



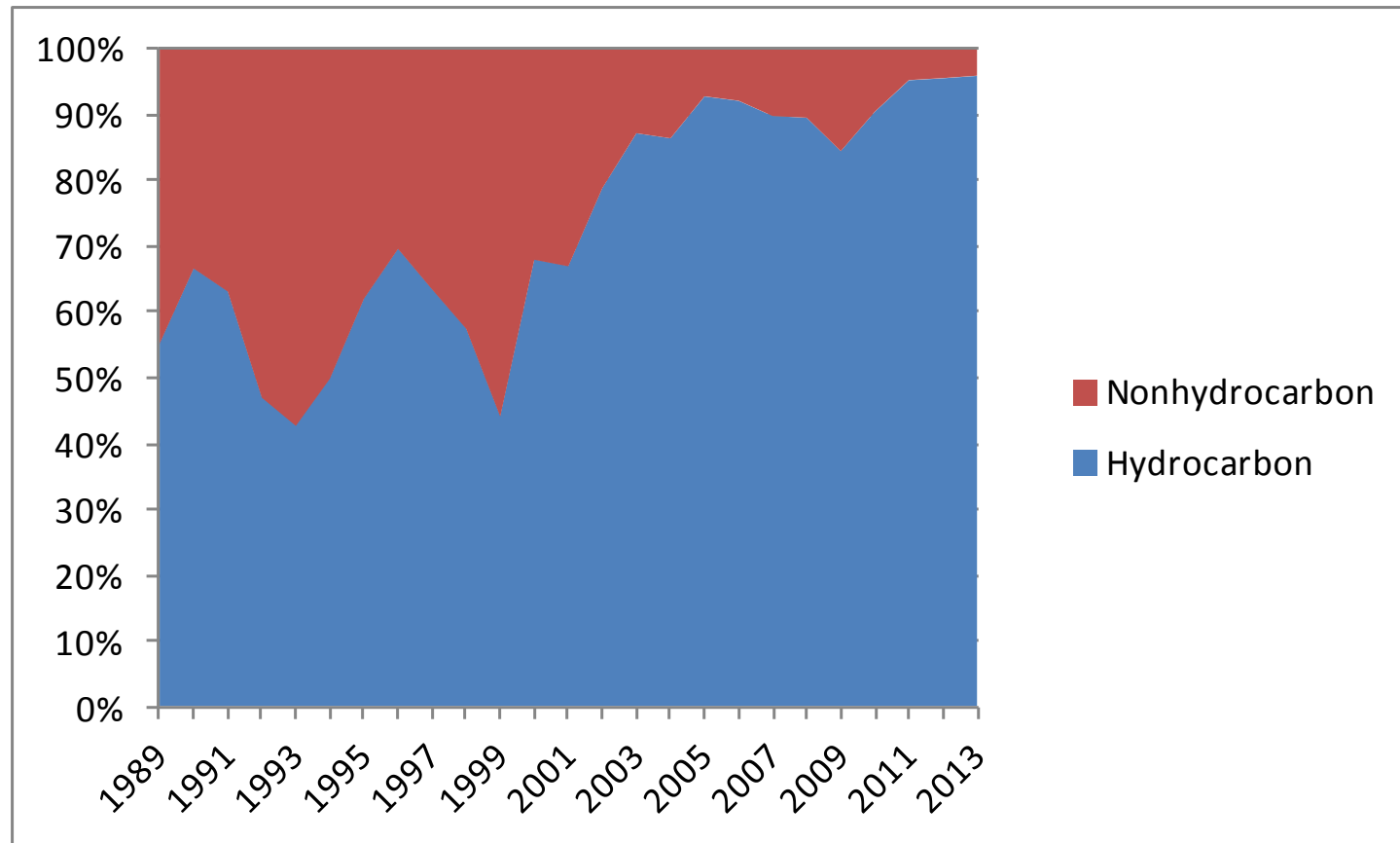
■ Total Current Expenditure
■ Capital Budget

2013

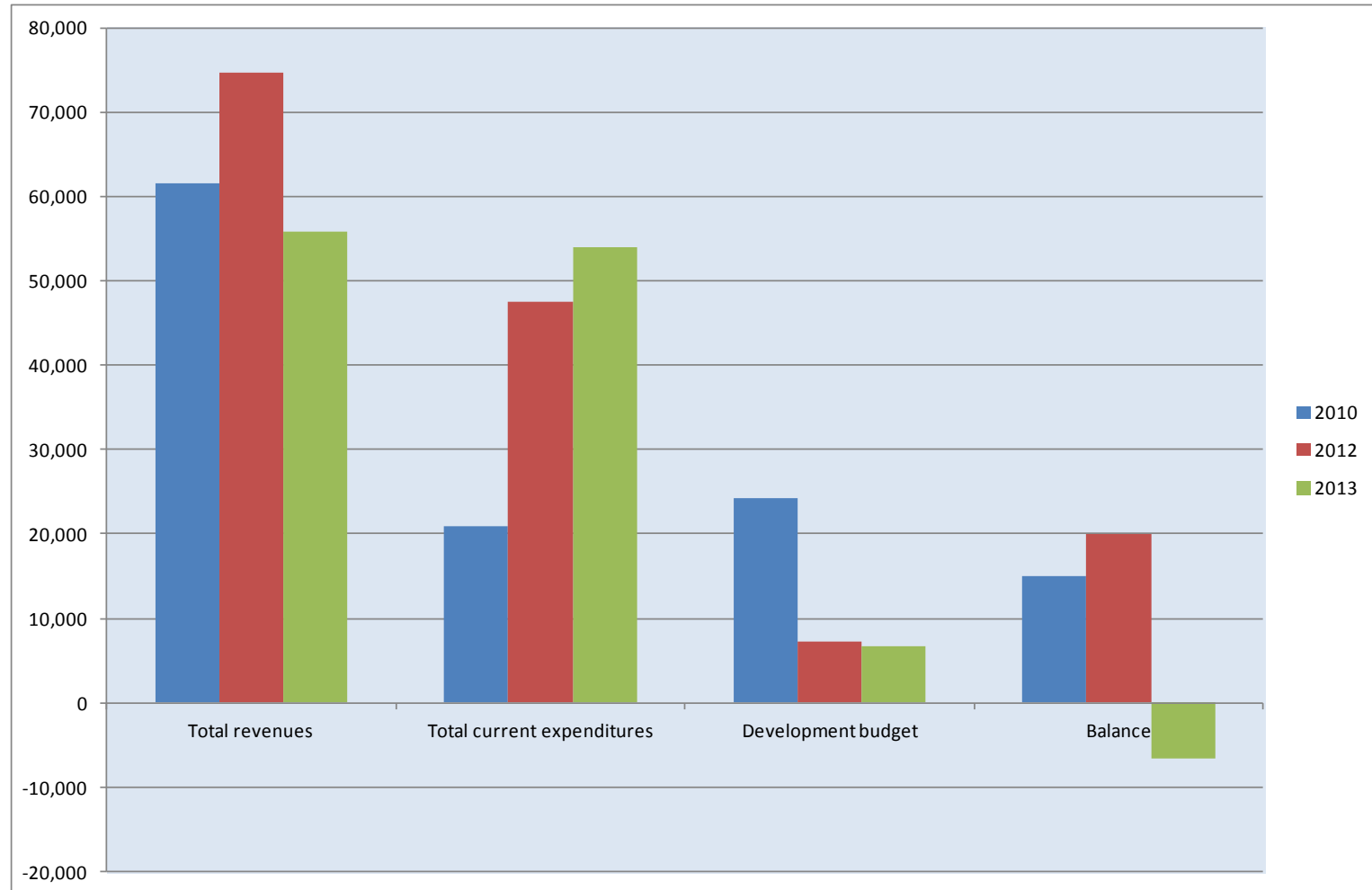


■ Total Current Expenditure
■ Capital Budget

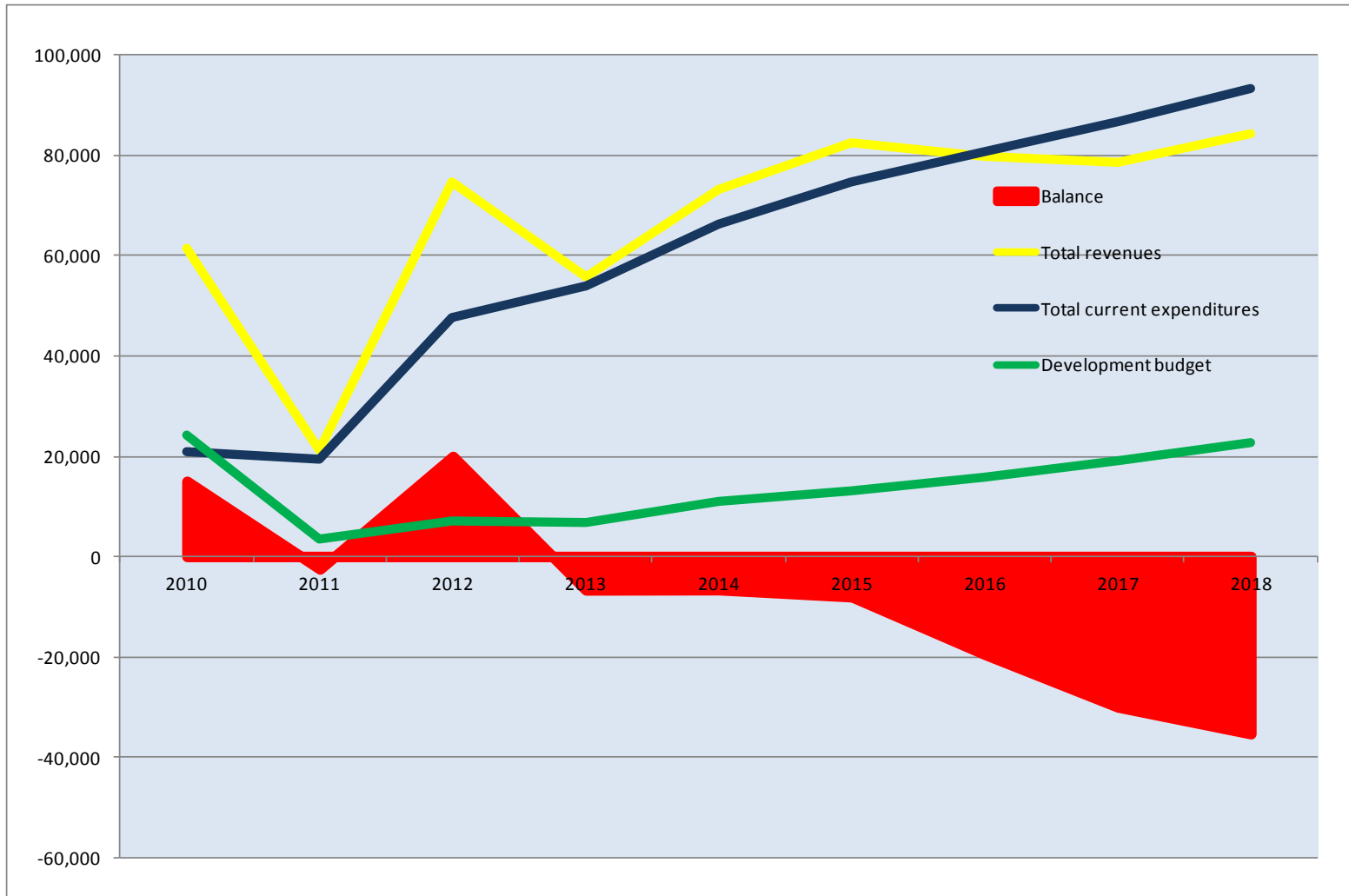
Changing revenue structure



Fiscal deficit as early as 2013



And a disturbing medium-term outlook



And if pictures are not enough to convey the dire situation...

- Wages and subsidies were growing faster than revenues, leaving less space for development spending and rendering public finances unsustainable, even at higher revenue levels
- A large deficit emerging in 2013, widening further as spending accelerated
- Total financing needs through 2018 to exceed **100+ billion LYD**

Emergency... Triage is needed

- Emergency Budget Committee to deal with the Hemorrhage...but, important to
- Bring every stakeholder into the committee
- Can't do anything about the oil revenue
- So focus on nonoil revenue and spending
- But, we first need to admit we have a spending addiction problem!
- Too dangerous to meet in Libya...so, Tunisia

And budget guys into the morning



Last day in Tunisia, with the team, and as mission chief



From Fragile to **Failed** State

Civil strife escalates with factional fighting across the country!

- Not every story has to have a happy ending...
- But, that depends on your time horizon (remember the *alleged* quote by Chairman Mao regarding the French Revolution?)

Nevertheless, there are policy and life lessons to be learnt by everyone

- First, remember that we all want to live in dignity and shared prosperity
- Power corrupts and Absolute Power.....
- Fragility is also endogenous
- Advice should always be in context
- Temporary Problems Warrant Temporary Solutions!
- Political will is important
- Communication is also paramount, especially in uncertain times
- In situation of uncertainty there is a need for rules versus discretion
- Institutions are very important, but
- Very difficult to build institutions when oil is already there....
- Resource curse is alive and well! So, institutions should come first
- Money is not everything and may even make things worse: Libya & Somalia
- Is there a successful case of building institutions in an already resource rich country?
- Final lesson is the First Lesson: **Irrespective who we are or where we come from or are going to..we all want the same thing: what is best for ourselves and our loved ones.**



The 2014
**FUNDWIDE
AWARDS**



Peace

Thank You