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Submission to Foreign Affairs Select Committee inquiry: *British foreign policy and the 'Arab Spring': the transition to democracy*

Submission 2: Business Opportunities for British Companies

Contents

1. Executive Summary

This submission presents the issues discussed at a Royal African Society / Africa APPG and Libya-Analysis.com closed briefing held in the House of Commons on 7th December 2011 entitled: *'Business Opportunities for British Companies'*. The audience comprised Members of the UK Parliament and the speakers included: a former British ambassador to Libya with particular knowledge of the Libyan business climate, a leading authority on banking in Libya and an expert on British investments in North Africa. While it does not conclude with specific recommendations, **we believe the meeting raised a number of key issues of relevance** to the Foreign Affairs Select Committee's inquiry on *British foreign policy and the 'Arab Spring': the transition to democracy,* in particular those **related to the revival of the Libyan economy**, and we therefore urge the Committee to take these issues into account.

It was agreed that there is **great long-term potential for British business involvement in Libya, yet in the short term there are few opportunities and much uncertainty.** During the transition period the Libyans must address immediate political needs and only later, under an elected government, will massive project spending begin. In the short term, the health and reconstruction sectors are paramount, yet in the medium term the new regime will require similar areas of expertise to those sought by Gaddafi.

There is **surprising continuity in the current Libyan economic picture from the situation immediately before the crisis.**

2. Introduction

The Royal African Society is Britain's prime Africa organisation. Now more than 100 years old, its in-depth, long-term knowledge of the continent and its peoples makes the Society the first stop for anyone wishing to know more.

- We foster a better understanding of Africa in the UK and throughout the world - its history, politics, culture, problems and potential.
- We disseminate knowledge and insight to make a positive difference to Africa's development.
- We celebrate the diversity and depth of African culture.

In Parliament, the Royal African Society provides the administration for the Africa All Party Parliamentary Group (APPG), which was established in January 2003 by Hugh Bayley MP and Lord Lea of Crondall. With a membership of over 80 MPs and Peers, the group is one of the largest APPGs.

In addition to holding regular meetings, the Africa APPG has published a number of reports, most recently a submission to the Strategic Defence Review entitled *Security and Africa* and an inquiry into the impact of the Bilateral Aid Review on Africa due to be published during December 2011. The Government has responded to each of the Group's reports in broadly the same way that Ministers respond to Select Committee reports, and important changes in UK Government policy have resulted from this – for instance a quadrupling of our aid for people with HIV/Aids in Africa, a new Bribery Act and funding for Parliamentary capacity building in Africa.

Libya-Analysis.com specialises in helping British and American companies, politicians, and policy makers navigate the history, politics, and business climate of the new Libya. Its President, Jason Pack, is a researcher of Libyan History at Cambridge University. He writes about Libya domestic and international politics for the Wall St. Journal, the Guardian, and Foreign Policy. In September, he led a fact-finding mission to Libya to investigate the relationship between the militias and the central government.

The Africa APPG and Libya-Analysis.com co-hosted a series of parliamentary events entitled ***Libya in Transition: Implications and Opportunities for Britain*** during November and December 2011. This collaboration has benefitted from the Africa APPG's experience of Parliament and Libya-Analysis.com's expertise on Libya.

This submission discusses the issues addressed in the second roundtable briefing of the series, entitled ***Business Opportunities for British Companies***, which took place on the 7th December 2011. While it does not conclude with specific recommendations, we believe the meeting raised a number of key issues of relevance to the Foreign Affairs Select Committee's inquiry on *British foreign policy and the 'Arab Spring': the transition to democracy*, in particular those related to the revival of the Libyan economy, and we therefore urge the Committee to take these issues into account. In particular, the discussions are relevant to the following specific questions which are part of the Select Committee's inquiry:

- What forces are driving the movement for reform and reconstruction in Libya?

- What specific assistance can the British Government give to help Libya revive its economy? How can the British Government best work with its allies and through international institutions to support reform in Libya?

The opinions expressed in this submission do not reflect an official policy position of either the Royal African Society or Libya-Analysis.com, but rather the submission should be considered a discussion of relevant issues.

3. Key Issues

3.1. Frozen funds

The current situation in Libya has generated by far the largest amount of UN frozen assets in history, which have been extremely difficult to administer. The Libyans have not yet demonstrated to the IMF or to Alastair Burt, the UK Minister for Middle East and North Africa, that they are ready to absorb the unfrozen funds. Even when the Libyans improve their central financial system, **it may prove difficult to convince the international community's lawyers that the interim Libyan government has installed the necessary safeguards to ensure transparency and prevent corruption**.

The best solution to this impasse was presented as a partial release of funds in a Know Your Customer (KYC) compliant agreement with the Central Bank of Libya. The UK Financial Services Authority (FSA) would support this action. If the UK were to release half or a quarter of the Libyan funds frozen in Britain, this would allow the interim government to begin investing in the Libyan future. While certain Libyan Treasury officials and ambassadors have spoken against funds being unlocked at this stage, former NTC representative to Britain, Guma al-Gamati, has highlighted the urgent need for money in the country. It cannot be disputed that at present the interim authorities can barely pay salaries, and **do not possess sufficient funds for medical care, for tackling the unexploded ordnance problem, or reconstruction**.

The current mechanism for regulating the uses of unfrozen funds, the Temporary Financing Mechanism (TFM), is seen as fostering corruption within the NTC. There is speculation that Libyans in the financial sector do not wish for the unfrozen funds to be released into the hands of the TFM Advisory Committee which consists in the most part of the Finance, Oil, Economy and Health Ministers of the Interim Government and that **it is wise to wait until Libya has an elected government before the majority of funds are released**.

3.2. Conducting business during the transition period

No one should doubt the long-term prospects inherent in the Libyan market: the capital expenditure plans for infrastructure under Gaddafi were approximately $240 billion for the years 2008-13, and **the need for infrastructure is no less great now**, with spending particularly needed to get oil fields functioning. **Months ago former NTC PM Mahmoud Gibril spoke about $400 billion** in project spending from 2012-17.

However **the new administration is not in a position to sign long-term contracts**, as Libyan cabinet ministers do not want to commit their successors or enter contracts that might be undone by the future administration. Companies planning missions to Libya in January must be aware that there is **little scope for new business interests to become settled at such an uncertain time politically**.

The **key immediate Libyan infrastructure investment needs**, crucial for Libya's economic recovery, **are power, water, housing and transport. However the medical sector remains the interim government's top priority for political reasons.** There have been protests for medical aid and pensions for fighters, and the government is likely to address these before turning to repairing damaged infrastructure.

At the moment, British businesses dealing with the interim authorities are focused on the medical, de-mining and reconstruction sectors. **The Libyan authorities see the involvement of other sectors as a nuisance**. Indeed other European countries prematurely sent missions to Libya, which adversely affected their relationship with the new cabinet. Britain has been patient, for example the oil and gas mission arranged for January 2012 has been postponed.

The temporary nature of the interim authorities means that many of the **Ministers that British companies would meet during missions to Libya at the moment will not be in power next year**. It was argued that the existence of the interim authorities only postpones discussions about the distribution of power by either seven months or two years. An example of the ways in which the authorities will change is that there are no overt Islamists in the current ministerial list, other than the Minister for Religion. **Many aspiring politicians are not yet involved**. The Islamists will presumably bide their time and enter the political process at the most opportune moment.

Currently the **role of the Embassy, in terms of business, is to present British business interests, connecting with middle management and mapping out the situation** ready for businesses to move in later. The work that the UKTI is doing in Benghazi involves fending off horizontal missions when **highly-focused vertical missions are more useful.** Despite the changing of the political guard, it is worth establishing contacts now as middle management technocrats are unlikely to change.

3.3. Nature of the private sector in Libya (foreign and domestic)

The British private sector should be able to flourish under the new Government although entirely foreign-run businesses will not be allowed. Employment of local staff and joint ventures will be the norm for British companies, similar to the old Libyan business climate. Historically, companies have seen Libya as a long-term market and have entered it seeking to build relationships first and profit further down the line. However, the UK and U.S. private sectors are more risk averse since the economic downturn and few corporate boards are willing to use this approach in Libya at this time. Therefore, it was argued that **Libyan companies will need to pass tests of trust** before British companies will agree to work with them.

The nature of the **Libyan private sector** is also an issue, as many private sector companies are still essentially state run. Ostensibly private companies are often owned by the old Libyan business families, for example the mogul Hosni Bey -- owner of the largest private holding company in Libya HB Group -- also controls the al-Sayara Trade and Investment Bank even if it appears that it has other ownership. Often **examining the so-called nascent private sector reveals essentially state-run companies or companies controlled by the same few tycoons connected to the old regime**.

3.4. Banking

It was argued that most of the business available in the banking sphere will remain in the **public sector -** Islamic banking and trade finance. **Sharia finance will certainly grow in Libya** although it will not necessarily be compulsory for international banks, despite President Abdel-Jalil's prior pronouncements. **Recent events have made Libyan trade opportunities seem more risky to UK banks**. As a high-risk environment, **the premiums to be made in Libya by foreign banks are higher** than in lower risk countries like Tunisia. **At present Libyan banks are not issuing credit**, one reason the economic recovery is so sluggish.

Many Libyan bankers have been well trained by banks such as Barclays and HSBC, and their systems are generally respectable, for example they have an optical fibre clearing system. There is therefore little need for international consultants; rather there is **a risk that an influx of international banks causes unemployment** amongst qualified Libyan professionals. Banks will encounter challenges as money comes in, and **manoeuvrability will be limited by public ownership**. Tajara li-Tanmia is the biggest private bank in Benghazi, and others will follow its lead by diversifying as they accumulate services.

The Libyan government is looking for assistance with asset management for the Central Bank (CBL). It was proposed that the **Libyan Investment Authority (LIA) is likely to continue its old investment patterns in Britain** and elsewhere until a confusion over which institution has the authority to control the money is resolved. The CBL sees the Libyan Investment Authority as an arm of itself, which is contested by the finance ministry under Hasan Zaghlam and the LIA's old leadership. The CBL's claim to authority comes from its position as the original source of the investment capital, but the law establishing the LIA states that it is not under the Central Bank’s control. Al-Sadiq Omar al-Kabir is currently the head of CBL but it is unclear how much longer he will hold this post. Internationally respected former CBL head Farhat Omar Ben Gdara is unlikely to make a comeback as he is too closely connected to the old regime. **To date no one knows how the interim authorities are planning to reconstitute the LIA**, who it will be accountable to, and what investment strategy it is likely to pursue.

A 2005 McKinsey study led to the appointment of Rothschilds as over-seer to the **opening of banks with foreign capital of at least $50 million.** Only Unicredit of Italy succeeded in doing this; HSBC was never granted a license, perhaps because they lacked ‘proximity’ to the Gaddafi family. In May 2007, HSBC opened and worked with the authorities until Tim Gray, the Canadian manager on the ground, had to leave during the revolution.

Experts familiar with the Libyan banking system feel that it has not fundamentally changed, nor will it until an elected government comes into office.

3.5. Oil

Libya has few prospects of revenue except from hydrocarbons and the investment profits from its sovereign wealth funds. For example the agriculture sector is in a state of disarray, as Gaddafi's ideological aim to make Libya self-sufficient in terms of food led to massive inefficient project spending.

Gaddafi did not destroy the oil fields during the months of battle as he appears to have believed he would win the conflicts and regain the support of the Libyan people. Zawaya is an example of a town which is in ruins while its oil refineries and pipelines remain intact. All efforts are being made to restore production levels, with **impressive success** so far – certain sources report nearly **800 000 barrels a day as a production figure**, which is almost half of the previously recorded level of 1.7 million barrels under Gaddafi. The proposed target of **3 million a day, the level reached during the 1970s, is unobtainable in the medium term** however, as such a target will take at least three years of political stability and enormous foreign investment.

Expectations for production rates vary considerably – the BBC World Service reported that Zuwara oil complex is highly functional and could get the country ready to produce two million barrels a day in the first quarter of next year, but **such rapid progress is not necessarily taken seriously by oil analysts**, despite the fact that post-Gaddafi Libya has so far exceeded all expectations. The oil companies working under Gaddafi are now trying to address shortages and damaged infrastructure. This can be seen as a practical demonstration of **business relationships enduring throughout the turmoil**. It is quite apparent with ENI.

In summation, there is **remarkable continuity between the current Libyan economic picture with that before the crisis.** In the short term, the health and reconstruction sectors are paramount, while in the medium term the new regime will require similar areas of expertise as those sought by Gaddafi.

3.6. Potential destabilising influences

A number of potentially destabilising influences were discussed.

It was noted that the reforms implemented during the so-called '**reform process' of 2003-2010 to stimulate economic progress are now derelict**. The few functional or semi-functional institutions created by the reform process -- such as the Economic Development Board and Libyan Investment Authority -- are now without staff and in a state of administrative limbo. Ministers have no staff or ministerial machines – the old Gaddafian adage 'lijan fi kuli makan' (Committees everywhere) is applicable – and **decisions are taken by committees and stake holders -- i.e. wealthy and powerful Libyans**, many with ties to the old system.

To help prevent inefficiency and corruption, the commercial law sector was suggested as an area where the UK could become more involved, as previous British work in this sphere has successfully influenced Libyan legislation.

It could be argued that **the Libyan economy has reverted to a stage of scarcity, barter, and personal networks**. Moreover, Libya's economic recovery could be impeded by **'the fifth column' elements of Gaddafi supporters and family members abroad** who have access to many assets previously hidden away. These vast monies and control of many of

Libya's quasi-state business **could be used to sabotage the Libyan economy and enrich the old elites.** There is a concern that if the wrong people who were technocrats under the old regime are allowed to remain influential **corruption and nepotism will continue**.

Unexploded ordnance is a grave safety concern. Britain and Scandinavian countries in particular are needed to assume their historic roles in demining in Libya.

4. Summary

The primary difference between before and after the revolution from a business point of view is the **increased goodwill that exists between Libyans and the members of the NATO-Alliance countries**. To capitalize on this goodwill, the experts recommend **a light touch**. Britain's approach should now be **reactive not proactive**. British government officials **should listen very carefully to the Libyans** and relay their stated needs to appropriate members of the private sector. Despite short term difficulties, there are many reasons for optimism.

In many Arab Spring affected countries, a crony-capitalist system has been brought down. In contradistinction, in Libya Gaddafi's quasi-socialist model has failed. This leaves the possibility of wide spread support for the emergence of an Islamic-capitalist system.

Drafted by Jason Pack and Roisin Blake of Libya-Analysis.com and Victoria Crawford of the Royal African Society on 12.12.11.