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**Research Paper**

# Fuel Subsidy Reform in Libya: Policy Options and Analysis

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***ABSTRACT:-*** The objective of this paper is an analysis to policy alternatives suggested for reforming the current policy for subsidizing fuel products in Libya. The policy alternatives were analyzed against four criteria: effectiveness, cost, administrative and political feasibilities. Sources of secondary data including books, journals, newspapers and the internet were used to collect data needed for analysis. Analysis showed that the best alternative – among the Status Quo, Smartcard Project, Comprehensive Borders Protection, and Gradual Phasing out of Fuel Subsidies – was that of the Smartcard Project.

***Keywords:-*** Fuel subsidies, policy options, cost, effectiveness, political and administrative feasibility

## I. INTRODUCTION

Libya's budget is burdened by subsidies for fuel and food. Libya pays a large amount of money to subsidize fuel and keep it cheap for its people. This cheap fuel is being smuggled to the neighboring countries at an alarming rate. Libya also has to hire and train more border patrol agents along with enhanced technology in order to prevent or at least decrease smuggling. According to the International Energy Agency, subsidizing fuel cost the interim government about 8.5% of Libya's GDP in 2012, which takes up to $8.1 billion [1]. This paper proposes that the Libyan government should reform fuel subsidies over the course of three years in order to reduce fuel smuggling and increase savings from subsidies to be spent on other priorities including health, education, security and infrastructure.

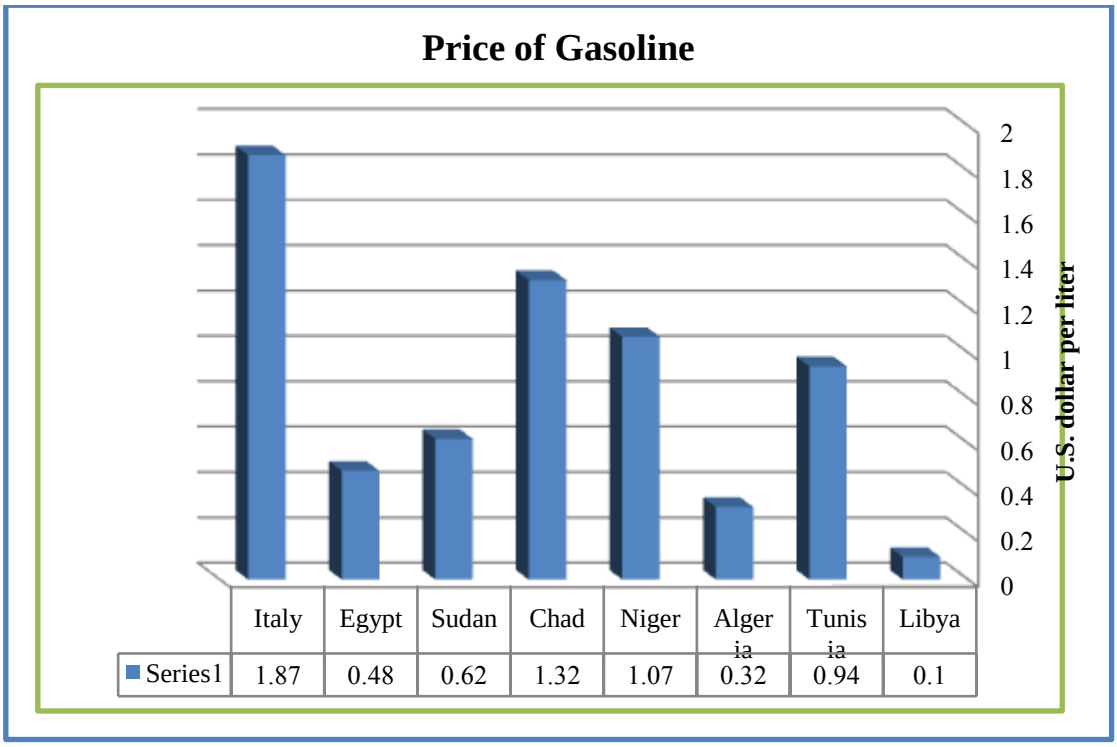
## II. STATEMENT OF THE PROBLEM

According to the IMF [2], subsidising fuel leads to inefficient energy consumption. It also distorts companies' investment as well as the public's use of energy. Low fuel prices encourage establishing fuel-based companies such as, petrochemical factories. These factories make full use of cheap fuel to build plants that cannot compete on the international level. Furthermore, fuel subsidies lead to capital-based industries rather than to labor-based ones. As a result this will not help the country to create new jobs. Fuel prices discrepancy between Libya and its neighboring countries encourages smuggling fuel out of the country, which means that this subsidy program benefits consumers and middlemen in neighboring countries rather than in Libya [3].

The Libyan gasoline price as of the writing of this paper is 0.10 US Dollars per liter compared to the current market price of 1.08 US dollars per liter. This invites entrepreneurs willing to break the law to make significant profits by exploring this arbitrage opportunity. It has been a practice to smuggle oil products to neighboring countries where it is sold for about ten times its cost in Libya. The amount of fuel smuggled increased dramatically in the chaotic aftermath of the Arab Spring. Prior to that, fuel smuggling was only a small-scale trade with only a few cars loaded with gasoline. It has now become a smuggling industry involving tanks and trucks run by militias. It's widely believed that some tribal conflicts on the border may be due to fighting over smuggling routes. Libyan fuel is being smuggled to Malta, Tunisia, Egypt, Algeria, Italy and Sudan. Libya now pays a large amount of money in terms of salaries and equipment in order to reduce fuel smuggling [4]. Another issue with smuggling is that it is usually associated with bribes to border agents and customs, which plays a role in distorting the whole country's security image. It helps to create an atmosphere of disorder and lawlessness, thereby leading to more serious violations and crimes to happen. The subsidy system is also a source of corruption. Government officials receive huge commissions from deals of buying subsidies [5].

Subsidies are distributed to citizens, foreigners and organizations without any limitations. The high income group, middle income group and organizations benefit considerably more compared to the low income groups on a per capita basis. Higher income groups and organizations have multiple motor vehicles, which get

the most benefit from the subsidy. They tend to have two or more cars while low-income groups have one car or no car at all. High and middle-income groups consume about 57 percent of fuel. The cost of subsidies is large and reduces the resources available for public expenditure priorities, including education, health and investment in infrastructure [2]. Moreover, A significant portion of fuel consumed is wasteful consumption. This overconsumption makes Libyan the biggest polluters of CO2 emission on a per capita basis in the region [6].
The graph below shows gasoline prices in Libya compared to its neighboring countries.




***Source:*** **Libyan Public Policy Formulation [6]**

## III. CRITERIA

Fuel smuggling in Libya is increasingly having negative effects on many aspects of Libyan's lives both within Libya and neighboring countries. The following criteria will be used to establish manageable solutions through: Effectiveness, Administrative Feasibility, Economic Feasibility, and Political Acceptability.

Libyan government has had difficulty reforming fuel subsidies. Subsidy reform can also be complex when it includes trying to reduce inefficiencies and production cost. However, many countries have succeeded in reforming their energy subsidies and conclusions can be drawn from their successes and mistakes.

## IV. POLICY OPTIONS

### 4.1. Status Quo – Subsidizing Fuel

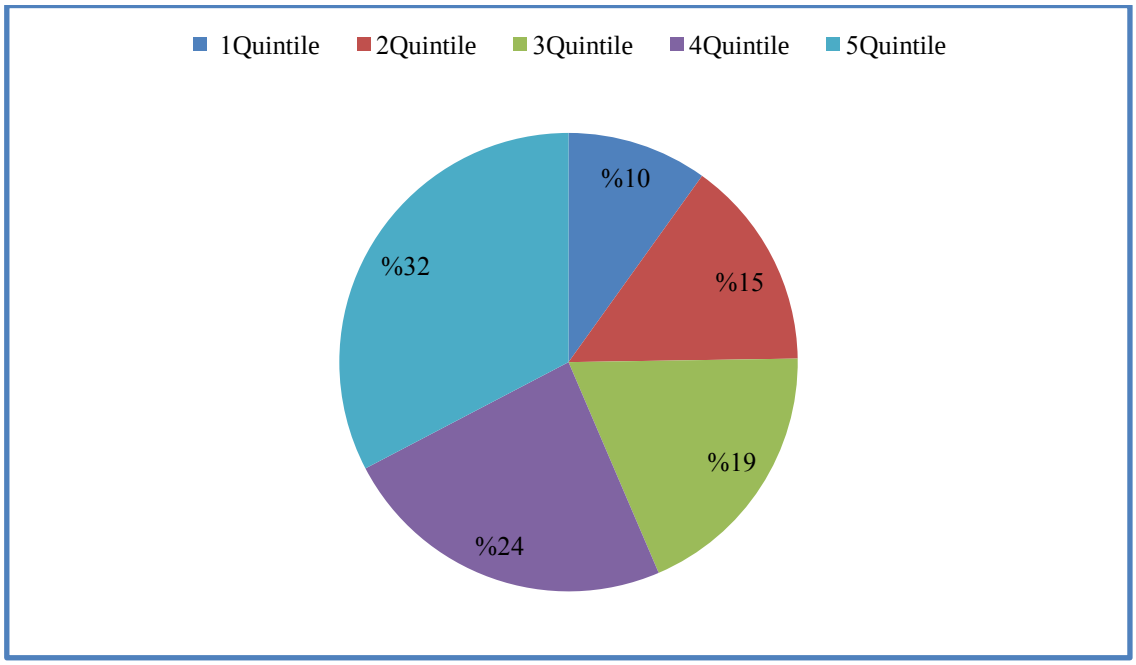
The 2012 budget allocates 8.1 billion dinar for fuel subsidies (8.5 percent of GDP). This subsidy program has been active since 1971 when there was no big discrepancy between the national and international fuel prices. International gas price is $1.08 per liter, while it's only ¢10 cents per liter in Libya. Subsidies, in general, are Libya's most important social safety net for the poor. The aim of the current policy is to help the poor with receiving services on a reasonable price and affordable cost [7].

#### 4.1.1. Effectiveness (Low)

The current policy adopted since 1971 proved to be ineffective, particularly in the aftermath of the Arab Spring. This policy boosted smuggling, caused shortage of gas and diesel over the past two years, and caused wasteful consumption [8]. Since national refineries are unable to fulfill the national consumption of fuel, Libya has to purchase fuel at the international price and sell it to the public at the cheap pump price. This puts more pressure on the fiscal budget.

Though it does keep oil products' prices down for the poor, the subsidy program is not targeting the low-income groups. Subsidies are distributed to the poor and rich as well as to Libyans, foreigners and organizations without any restrictions. In fact, high income groups and organizations benefit more than the poor,

because they tend to have more cars and thus buy more gasoline compared to low-income individuals [6]. The graph below shows that the two higher-income groups account for 57 percent of gasoline consumption.




***Source:*** **Libyan Public Policy Formulation [6]**

#### 4.1.2. Administrative Feasibility (Moderate)

The current program has been administered by the National Oil Corporation (NOC) since 1971 [6]. It has an administrative structure already in place. However, the current program is corrupted due to the lack of regulations and oversight [5]. In fact, it is against government's interest to keep funding the current policy. It has resulted in higher fiscal expenditures on fuels depriving other priorities from a higher share of the budget.

#### 4.1.3. Political Feasibility (Low)

Political support for the status quo seems to be relatively low. The government has already showed intention to reform the current program. Abdul Bari Al-Arusi, Libyan Oil and Gas Minister, declared that his ministry is discussing the removal of fuel subsidies by 2016 [9]. By the same token, Ahmed Lamin, Libyan Cabinet Spokesperson, said that the government plans to reform the subsidy program. Also many economists and educators support the government's decision to reform subsidies and work on raising awareness about program's inefficiencies and fuel wasteful consumption [8].

#### 4.1.4. Economic Feasibility (Low)

Libya spent over $50 billion on fuel subsidies between 2002 and 2012. The cost of subsidies increased from the average of 2 percent on national GDP to approximately 13 percent in the last couple of years – one of the world's highest levels [6]. Gasoline spending in Libya is very distorted, particularly when compared to its development. These distortions can have severe impacts on long-term growth. The subsidy program puts a huge burden on the budget and decreases spending for health, education and infrastructure.

### 4.2. Smart Card Project

Libyan citizens enjoy cheap prices when buying motor fuel, much of which is smuggled into Tunisia for resale at higher prices. The government could limit those costs by introducing a smart card system like the one recently adopted by the Egyptian government. In Egypt the project is targeting low-income individuals. However, in Libya its purpose is to provide an equal transfer to each individual.

Libyan citizens would be issued cards with their personal data for buying fuel, which would be swiped at petrol stations to gather consumption data. This project would enable the government to limit the amount of fuel bought. Once the smart card system is active, consumers would be able to buy a limited amount of subsidized fuel, and would need to pay a normal, market price for any extra amount of fuel needed. The system proposes that about 50 liters per week would be available to every consumer at the subsidized price and anything extra fuel needed would be paid for at market price [8].

#### 4.2.1. Effectiveness (High)

The smartcard project aims to curb the smuggling of subsidized fuel and thus helping to rationalizing Libya's subsidies for oil products. If it is efficiently implemented, it would then have the potential to decrease the fiscal expenditure. It would also reduce and nationalize fuel consumption and circumvent widespread corruption as well as allow Libya to decrease spending while still protecting the poor. It would also have direct benefits to demolishing the black market particularly smuggling [8]. Another advantage of this policy is that prices would be the same for 50 subsidized liters per week for each individual which would help to prevent inflation.

#### 4.2.2. Administrative Feasibility (Low)

The administrative feasibility of this alternative is relatively low. Libya lacks the administrative resources necessary to operate this alternative. Libya has already adopted the smartcard project and announced that it would launch in August 2014 [8], which wasn't the case. The decision seemed very ambitious as political split and the ongoing state of lawlessness are paralyzing legislation and decision-making process.

The smartcard project requires a degree of bureaucracy to distribute the cards and to supervise implementation. It also requires providing smart-card machines to gas stations, training to a significant number of gas stations' workers and building a database of companies and depots for fuel distribution. Moreover, the implementing agency has to ensure safety to the implementing staff as they may be targeted by smuggling militias hoping to vandalize the project. What makes it hard for the project to be implemented is that Libya has very poor technological infrastructure. All government administrations are still rooted on paper-based service systems. For instance, national IDs and driving licenses are not smart cards.

#### 4.2.3. Political Feasibility (High)

Political support for the smartcard project seems to be high. The Libyan government has already adopted the plan. The government wants to pull the carpet from under smugglers' feet to make their illegal business ineffective [8]. It also wants to ensure that only Libyans benefit from fuel subsidies. Therefore, approximately 500,000 foreigners, as of the writing of this paper, living in Libya would have to pay the market price. Prior to 2011 Arab Spring [10], there were about 2.5 million foreign nationals living in Libya.

#### 4.2.4. Economic Feasibility (Moderate)

The cost of this alternative is relatively moderate. Libya, although has the monetary resources to fund this project, it has other spending priorities. Other priorities include, but not limited to: education, health, infrastructure and security. However, once the project enters into force, Libya is expected to save up to $650 million annually in subsidy costs by cutting out smuggling [8].

### 4.3. Comprehensive Border Protection Project

Libya's border control is very weak and fragmented, allowing the smuggling of oil products, weapons, goods and people to flourish. Much of Libya's 2,702 miles of international borders with Tunisia, Algeria, Niger, Chad, Sudan and Egypt remain vulnerable to illegal smuggling. The main issue with fighting fuel smuggling is that Libya has very long borders with its neighboring countries. Libyan borders are about 2,702 miles long, most of which are borders in the desert [11]. The main goal of this alternative is to train and hire new border guards and to equip them with new technology and tools needed to prevent smugglers from crossing the borders. Their main tasks are to apprehend individuals trying to enter or leave Libya illegally, stemming the flow of smuggled fuel.

This policy alternative proposes that Libyan Borders Patrol increases both number of trained agents as well as enhanced technology. Bakrania (2014) said that Border Patrol only detect and apprehend about 10 per cent of major illegal fuel smuggling, indicating that 90 percent of fuel smuggling might pass through the border [12].

This policy alternative upholds that Border Patrol adopts a three-tiered border enforcement strategy like the one implemented in the U.S [13]. The alternative is to form a line watch, a roving patrol and checkpoints. The majority of agents are to be assigned to line watch operations responsible for deterring and turning back smugglers. Roving patrol will be smaller in number and will be deployed behind the line watch to detect and arrest those making it through the first layer. The third layer are checkpoints located on major Libyan highways at about 50 miles inland from the border. This will permit them to be far enough inland to detect and apprehend illegal fuel smugglers.

#### 4.3.1. Effectiveness (Moderate)

The Comprehensive Border Protection project is not a novel strategy. This project is being implemented in the U.S., but it has not been highly effective. In its annual report [14], the Department of

Homeland Security indicated that they only detected and apprehended 30 percent of major illegal activities in 2009, indicating that approximately 70 percent may have made its way inside the U.S. The three-tiered strategy would contribute to the Libyan Borders Patrol's ability to apprehend smugglers and seize smuggled fuel as well as drugs and weapons. However, the amount of fuel smuggled and the weaponry smugglers have are far beyond Borders Patrol's ability to detect and apprehend.

Moreover, it is difficult to apply this alternative because border areas are inhabited by tribes that live on both sides of the borders. Tribes such as, Tabu and Tuareg have close ties to kin in Algeria, Niger and Chad and Awlad Ali tribe inhabit both Libyan and Egyptian border areas [12]. It is very common for those tribes to circumvent border checkpoints, which leads to cross-border smuggling of fuel, weapons and goods.

#### 4.3.2. Administrative Feasibility (Low)

By analogy with the three-tiered strategy implemented over the U.S.'s 6,000 miles [13], the Libyan government should employ as many as 7500 agents for its 2,702 miles. The Libyan government would find it difficult to influence developments on its border areas without a functioning security sector. Moreover, Libyan Borders Patrol Administration has to increase both training for agents and enhanced technology.

This policy option is limited in scale due to administrative barriers it faces. Therefore, it would expect some resistance during implementation. For instance, a sizable number of Borders Patrol troops are engaged in tribal and regional conflicts [12]. When receiving training and enhanced technology, those troops may employ their training and technology to support their tribes or regions instead of patrolling the borders.

#### 4.3.3. Political Feasibility (Moderate)

The Libyan government has already made some attempts with its neighboring countries to engage in cross-border security cooperation. However, a number of challenges do exist. The main political issue with maintaining border security is closely related to the government's current struggle to control the armed groups and to integrate them into the security sector. The interim government failed to establish control over the armed groups. This led to creating security brigades combined of both official and non-official agents, and unclear lines of authority and tenuous allegiance to the government [12].

#### 4.3.4. Economic Feasibility (Low)

Implementing this alternative is very expensive. The government has to pay both one-time payment in terms of training and enhanced technology as well as guards' monthly salaries. These sort of jobs carry high risks, and therefore require higher salaries. A drawback in this alternative is that the overall spending cost would be much higher than the other alternatives.

### 4.4. A Gradual Phasing Out of Fuel Subsidies

The large amounts of money spent on subsidizing fuel continue to grow since the aftermath of the Arab Spring due to smuggling. Gradual phased cuts would enable individuals and industries to adjust their consumption and to minimize the impact of higher prices. By doing so, gas and diesel prices will go up and be similar to the neighboring countries. As a result the fuel smuggling industry would end, as it would not be profitable.

#### 4.4.1. Effectiveness (Moderate)

Phasing out subsidies would ensure that national wealth is not lavished on inefficient industry or wasteful consumption. On the other hand, this policy would make fuel prices go up. Any dramatic increase in fuel prices may provoke social unrest and inflation. It could also lead to stagflation where inflation is coupled with high rates of unemployment, taking into account that there is a sizable number of people work in the subsidy program including, contractors, fuel providers, depots and also some gas stations' workers. Those employees would lose their jobs due to expected less fuel purchases. The IMF [2] and many economists warn Libya that any unplanned cuts in subsidies would lead services to skyrocket. By the same token, removing subsidies would raise other services' prices such as, public transportations [5].

#### 4.4.2. Administrative Feasibility (Moderate)

The administrative feasibility of this alternative is medium. The government has to gradually phase out subsidies. Any cut in fuel subsidies has to be a phased cut. Some economists [6] suggest a three-year period and a three-tiered plan to implement this alternative. The implementing agency has to develop an action plan that finishes in three years taking into account that any dramatic increase in fuel prices would lead to public rage and unwanted financial consequences.

#### 4.4.3. Political Feasibility (Moderate)

Subsidized oil products are significantly important to the low income. Gas and diesel shortages over the past two years have impacted bakers, farmers, teachers, doctors and even ambulances trying to reach the injured or the sick [7]. The political feasibility of this alternative appears to be medium. The government is working on a plan to reform the subsidy program. It would be highly acceptable if the public are informed about the disadvantages of the current subsidy program and how the new system would benefit a long-term economic growth. However, there are concerns that any unplanned action could lead to negative financial and security consequences.

#### 4.4.4. Economic Feasibility (Low)

In terms of cost, this alternative is relatively cheaper than other alternatives. In fact, the government would save money after implementing every phase of the plan. A cutback in fuel subsidies could increase the fiscal space accessible for priority spending, including infrastructure, education and health. Moreover, this plan could be implemented by regular employees in the energy sector without costing the government any money other than the existing employees' salaries.

## V. CONCLUSION

A successful policy requires a thorough scrutiny of household spending data and elaboration of an appropriate reform strategy. While there are pros and cons to each policy alternative, it seems that the most feasible option is the **Smartcard Project**. It is very effective in decreasing fuel smuggling and increasing long-term economic growth as well as it is politically and economically feasible.

The Evaluation Matrix below summarizes the above mentioned policy alternatives. The matrix uses a scale of low, moderate and high as well as the ordinal numbers 1, 2 and 3 respectively to evaluate each alternative in light of the outlined criteria. The overage is calculated in order to determine the best option.

**Table 1: Evaluation Matrix**

| Options / Criteria | Smartcard Project | Comprehensive Borders Protection | A Gradual Phasing Out of Subsidies | Status Quo (Subsidizing Fuel) |
|---|---|---|---|---|
| **Effectiveness** | HIGH (3) | MODERATE (2) | MODERATE (2) | LOW (1) |
| **Administrative Feasibility** | LOW (1) | LOW (1) | MODERATE (2) | MODERATE (2) |
| **Political Acceptability** | HIGH (3) | MODERATE (2) | MODERATE (2) | LOW (1) |
| **Economic Feasibility** | MODERATE (2) | LOW (1) | LOW (1) | LOW (1) |
| **Summary** | (2.25) | (1.5) | (1.75) | (1.25) |

This paper recommends the Libyan government to adopt a well-targeted communication scheme to elaborate the cost of subsidies, illustrate how subsidies mainly benefit the high-income groups and organizations, and demonstrate how the resulting fiscal savings would be spent in order to mitigate the inflationary impact.

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