Libya Looks to a Bright Future Post-Sanctions

Gawdat Bahgat
Director
Centre for Middle Eastern Studies
Indiana University of Pennsylvania

In late 2004 foreign ministers from the European Union (EU) and the Mediterranean region decided to name 2005 – the tenth anniversary of the Barcelona Process – the "Year of the Mediterranean." The goal was to further foster the economic and political cooperation between all involved states. Libya, a member of the Arab Maghreb Union and a founding member of the African Union, has taken decisive steps to consolidate its integration in the global system since 2003. This essay examines the emerging partnership between Libya on one side and the United States and the European Union on the other. Particular attention is given to the important initiatives the two sides took in 2005.

Libya's Dramatic Transformation

On 19th December 2003, an announcement was made simultaneously in Washington, London, and Tripoli that Libyan leader Muammar Gaddafi had promised to terminate his country's efforts to acquire and develop weapons of mass destruction and to fully cooperate with the international community in destroying them. This announcement was preceded by equally significant steps to end Libya's international isolation and pave the way for Tripoli to rejoin the global economic and political system. Most notably, Libya officially accepted responsibility for the 1988 Lockerbie bombing, carried out by Libyan intelligence officers, and agreed to pay financial compensation to the families of the victims of this terrorist attack.

To reward Tripoli for denouncing international terrorism and agreeing to adhere to the norms and rules of the nonproliferation regime, the decade-long United Nations sanctions were lifted. London re-established diplomatic relations with Tripoli that had been severed in 1984, and Washington substantially eased the economic sanctions it had imposed in the late 1970s and reinforced throughout the 1980s and 1990s. These concrete steps to normalize economic and diplomatic relations with Libya were followed by well-publicized direct contacts between Western leaders and Gaddafi. Energy partnership has been at the heart of these consultations.

Libya's Energy Outlook

Unlike Gulf producers such as Iran, Iraq, Kuwait, and Saudi Arabia, where oil was discovered earlier in the 20th century, oil in Libya was discovered late in the 1950s. Yet, in a short period of time, the oil discoveries were brought on-stream. Thus, by the late 1960s, Libya had become the world's fourth largest exporter of crude oil. The rush to raise production in Libya reflected not only the world's growing appetite for oil, but also certain advantages the Libyan oil sector enjoys. First, Tripoli holds huge proven oil reserves – estimated at 36 billion barrels, or 3.1 percent of world's total. Second, production costs are among the lowest in the world. Third, Libya produces high-quality, low sulphur "sweet" crude oil. Fourth, the proximity of Libya to Europe is a big advantage in terms of ease and cost of transportation.

Given these advantages, it is little wonder that American and European oil companies were heavily involved in exploring and producing oil in Libya. The country's oil production reached a peak of 3.32 million barrels per day (b/d) in 1970. This high level of production, however, proved unsustainable. Economic sanctions and political isolation took their toll. In 2003 Libya produced 1.488 million b/d – less than half of its production in 1970. This decline can be explained more by political factors than geological ones. From the outset, the post-1969 revolutionary regime had tense relations with the U.S. government and American oil companies operating in the country. Eventually, in the mid-1980s, these oil companies completely withdrew from Libya. For most of the 1990s, comprehensive international sanctions were imposed on Libya by the UN Security Council. Bilateral sanctions in the 1980s and multilateral ones in the 1990s deprived Libya's oil industry of the spare parts, new equipment, modern technology, management techniques, and foreign investment badly needed to maintain and upgrade its production capacity. Despite this hostile political environment, a competent Libyan National Oil Corporation (NOC) and a handful of European oil companies kept oil production going over the years, although at a level greatly reduced from that of the booming late 1960s.

Diplomatic re-engagement with Libya and the easing of sanctions have been followed by serious efforts by international oil companies to resume their oil exploration and production operations in the country. Since mid-2004, the entire Libyan hydrocarbon sector has seemed poised for promising development, fuelled by foreign investment.

Oil Partnership with the United States

U.S. oil companies have been involved in Libya's oil industry since the discoveries of Libyan oil in the late 1950s and early 1960s. Some of the largest oil fields were found in concessions held by independent U.S. companies. Marathon, Amerada Hess, and Conoco (now ConocoPhillips) formed the Oasis Group that, with the NOC, achieved world-class commercial oil discoveries in Libya's Sirte Basin in 1962. The outcome of this partnership was a steady and substantial increase in Libya's oil production. However, the ongoing political tension between Washington and Tripoli interrupted this mutually profitable partnership. In January 1986, then-U.S. President Ronald Reagan issued an executive order imposing unilateral sanctions against Libya. U.S. companies' assets in the country were put in "suspended animation." In order to protect their concessionary interests, five U.S. firms signed a Standstill Agreement with the NOC. Under this agreement, the U.S. companies retained the original rights and obligations in the fields they operated, while NOC became responsible for the development of these fields until the return of the U.S. firms.

In the following two decades, the Standstill Agreement has survived the extreme political tension between the two states. Since the mid-1980s, the NOC and its subsidiaries have maintained production at these fields, albeit at much lower levels. With the lifting of UN sanctions in 2003 and the easing of U.S. sanctions, American oil companies were allowed to resume their operations in Libya.

Exploration Licences

Libya is eager to increase its oil production. Indeed, the NOC announced that it wants to produce 2 million b/d by 2007. In order to achieve this goal Tripoli acknowledges its need of foreign investment to modernize its energy infrastructure. In early 2005 Libya held an exploration licence round. International oil companies showed great interest in the country's largely un-explored and under-utilized hydrocarbon resources. Four factors have heightened foreign investors' interest in Libya's oil: high oil prices; certainty of proven reserves; availability of new acreage that had been off the market for years; and scarcity of opportunities to explore for oil in other parts of the world.

More than 120 companies had applied for the auction acreage. Of the 15 blocks, 9 are onshore and 6 offshore. Three U.S. companies – Occidental Petroleum Corp., ChevronTexaco Corp., and Amerada Hess International Ltd. – won interests in 11 of the 15 permits. Other successful bidders hail from Australia, Algeria, India, Brazil, Indonesia, and Canada.

These licences are based on an exploration and production-sharing agreement (EPSA). Prior to 1973, foreign oil companies worked in Libya under concession arrangements. Since then the EPSA has become more common. Under an EPSA, the government, through the NOC, retains exclusive ownership of oil fields while signatory oil companies are considered contractors. Three rounds of EPSA contracts were held – one in 1974, another in 1980 and a third in 1988, with some differences regarding recovery of development and production costs. EPSA contracts usually involve an initial exploration period, during which companies assume exploration costs and risks and are required to invest specific sums in exploration. If a discovery is made, the EPSA continues in force for a set period (usually 20 to 30 years); output is divided between the NOC and the contracting company. The 2005 licensing round was based on a more attractive model called EPSA-IV. Under this revised formula, contracts are awarded on the basis of competitive bidding, instead of closed-door negotiations. International companies carry all exploration and appraisal costs, as well as training costs for Libyan nationals, during a minimum exploration period of five years. Thereafter, capital expenses for development and exploitation, as well as operating expenses, are borne by the NOC and the investor according to their primary agreement. The hope is that the EPSA-IV will attract more international oil companies to Libya.

Relations with Europe

Libya enjoys a unique relationship with Europe. These special ties are based, at least in part, on historical experience and geographical proximity. Several European countries have extensive trade relations with Libya; nearly all Libyan oil is sold to European countries, including France, Germany, Italy, and Spain. Furthermore, European oil companies maintained their Libyan operations after their U.S. rivals left in the 1980s.

Prospects for continuing close cooperation between Europe and Libya remain strong, given the growing European dependence on imported oil and gas supplies and the European policy of diversifying its suppliers. For the past two decades, the North Sea's oil and gas deposits satisfied a big proportion of European energy needs. The North Sea currently seems to have passed its peak; it can no longer fulfil the widening gap between Europe's rising oil and gas consumption and its declining production. As such, Europe is growing more dependent on foreign supplies. Russia, Norway, and Algeria already are major energy providers to the EU, and the EU is now showing great interest in Libya. Libyan oil and gas can be shipped easily to Italy and Spain, and from there to the rest of Europe. Indeed, Italy and Spain are positioning themselves as potential gas conduits to northern Europe.

Since the early 2005 Libya's natural gas exports to Italy have increased. The NOC is a partner with the Italian company Agip in a joint venture called the Western Libya Gas Project (WLGP). The goal is to produce 10 billion cubic meters a year over a 20-year period. Most of this gas will be exported to Italy via the Green Stream pipeline that was inaugurated in late 2004 to connect Libya and Italy through Sicily. This is the first such scheme to utilize Libya's

THE EURO-MEDITERRANEAN IN FEMISE ACTIVITIES

2005 was a pivotal year for the Mediterranean as a region. Ten years after the Barcelona Process, which created an innovative framework for north-south co-operation, Euro-Mediterranean co-operation is changing direction, or at least, is modifying its framework with the implementation of the European Neighbourhood Policy. It is without doubt a transition which is creating opportunities and challenges. This point of view is supported in the recent reports published by FEMISE (Euro-Mediterranean Forum of the Economic Institutes).

On the economic front, for which the network is most particularly responsible (with the support of the European Commission, renewed in 2005 for another 4 years) the great lesson of recent months has been the capacity of the Mediterranean partners to overcome up until now the increase in petrol prices, one of the major economic shifts in 2005. The considerable price rise has not so far had the negative impact that was feared, at least on current deficits. This year again, revenue from tourism and the remittances by workers abroad have helped avoid serious imbalances, which shows that the resilience capacity of Mediterranean countries has grown over the last decade. Nevertheless the fact remains that this shift will noticeably affect the budgetary situation in as much that the price of petrol or other primary materials are the most often subsidised or controlled in order to protect disadvantaged populations. This policy allows a certain social equilibrium to be maintained, but there is a price. In fact therefore, the financial needs of Mediterranean countries have increased, whereas the international situation is less favourable, marked by uncertainties in developed countries (fear of property market bubbles, increase in American and European interest rates, among others) and dynamic input in the region does not always reach the necessary levels, especially in terms of job availability. A completed transition through a consolidation phase bears witness to the relative stability of Mediterranean economies, into a phase where changes must be more noticeable and influential upon the daily lives of participants.

It is in this context, within which FEMISE considers that the EU has a key role, that the Commission has modified its Mediterranean policies by putting in place the Neighbourhood Policy. This policy is a unilateral offer by the EU which, to sum it up briefly, offers its neighbours in Mediterranean countries the chance to share in the *acquis communautaire* (the body of EU law accumulated so far), that is to say a sub-assembly of some 2000 directives which are the bedrock of the EU. This adapted sub-assembly is defined as "an approximation of the *acquis*", that is to say a contextualised adaptation, which would offer the Mediterranean countries a stake in the internal market, which is at the heart of the European proposition. FEMISE will place this question at the centre of its research programme for 2006, asking some 70 members of the network to conduct an academic reflection on the main economic directions that both the established and new members must take in order to give the southern countries a better foothold in the Union. The primary objective will be to direct the development of Mediterranean partners towards stronger growth, and above all towards employment creation within the multilateral framework of the partnership, now made complete by the Neighbourhood Policy. The idea is that the diffusion of specific elements of the *acquis communautaire* and the opening up of Southern economies will boost the behavioural and institutional changes necessary for this heightened dynamism. This must however be carried out n a sustainable manner, that is to say without causing major macroeconomic imbalances or causing poverty to increase, an essential factor in maintaining social cohesion and confidence in the European offer. Such a transition is not without consequences and it will be essential to forecast requirements for support and technical assistance, so that these are available for Mediterranean partners to use. Assistance of this nature for neighbours is at the very heart of the European project and it must combine the Association Agreements with the most recent dispositions of the Neighbourhood policy. The question of the relationship between the Barcelona Process and the Neighbourhood policy have been at the core of recent investigations by FEMISE, in considering that Neighbourhood policy is complementary to the European offer and must consolidate the partnership and not take its place. Studies by FEMISE show firstly that the concept of profound integration is not an appropriate theoretical reference and that continuing to use such a reference may lead to new disappointments. Secondly, their studies show that interdependence between Europe and the Mediterranean is in fact undeniable. This was taken into account by the Barcelona process, but in an incomplete manner, and it must therefore fall to the Neighbourhood Policy to develop this concept. The essential here will be to work out a regional vision together, because it is so important to be aware of the socio-economic consequences arising from the adoption of a significant number of European directives in the Mediterranean basin. This regional vision includes also those regional institutions, for negotiation or arbitration, which would be necessary to perform.

Further information:
Femise Annual Report 2005,
www.femise.org

Frederic Blanc
Director of studies, Institute of the Mediterranean – FEMISE

vast untapped gas reserves. It is also the biggest foreign investment in Libya's energy sector since UN sanctions were suspended in 1999, and it further cements Agip's strong relationship with the NOC.

To sum up, in the mid-2000s, Tripoli relations with both Washington and Brussels have substantially improved. Economic and diplomatic relations have been restored. The Council of the European Union lifted the arms embargo that had been in effect since 1986 and decided that a technical mission to Libya should be conducted to examine arrangements for combating illegal immigration. The Council also decided that an act of solidarity with those infected with HIV/AIDS at the Benghazi Hospital be implemented as soon as possible. The Council finally decided to closely follow the human rights situation in Libya and negotiate a fisheries agreement with Tripoli. These issues are likely to dominate relations between the two sides in the rest of the decade.