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Central Intelligence Agency
Office of the Deputy Director for Intelligence

7 March 1986

NOTE TO: Deputy Secretary of State

John —

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Following up on our conversation at lunch today, attached are several items on Libya's current economic problems that I think you will find of interest. [redacted] 25X1

Note on the last page that we believe Libya has been exporting between 1.1 and 1.3 million barrels of oil a day. We believe this figure has dropped about 200 thousand barrels a day within the last two weeks. (I would be interested in knowing where the 900 thousand barrel per day figure came from.) [redacted] 25X1

If you would like more information, let me know. [redacted] 25X1

Regards,

Bob

Robert M. Gates
Deputy Director for Intelligence

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Libya: Economy Under Siege [redacted]

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The recent drop in world oil prices and US economic sanctions are the latest jolts to hit the Libyan economy. They come at a time of unprecedented popular discontent over Libyan leader Qadhafi's misguided economic policies and penchant for costly foreign adventures. The freeze on Libyan assets in US banks has deprived Tripoli of access to approximately $700 million, and closed off an important channel for revenues from the sale of Libyan crude. The sharp drop in oil prices—unless accompanied by an offsetting increase in liftings—will leave Tripoli even less maneuvering room to manage the economy this year. A dip in oil prices to $15 per barrel would confront Qadhafi with an unmanageable cash shortage unless he makes politically risky cuts in consumer imports or swallows his pride and borrows on the international market. Further reductions in imports almost certainly would increase the chances that the military will decide to move against Qadhafi. [redacted]

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Living With Less

Qadhafi's speech last September calling for a greater public sacrifice underscores growing concern in Tripoli over the poor state of the economy. Although oil revenues have stabilized at about $11 billion over the past two years, this is down by almost half from the 1980 level. Unlike previous speeches extolling revolutionary successes, the Libyan leader urged the people to eat camel meat and wild game rather than imported lamb and beef. Qadhafi's uneasiness is supported by recent statistics that suggest real GDP fell 2 percent last year, the fifth consecutive year of decline. Per capita GDP is now below the 1977 level and inflation is at a near-record 15 percent. [redacted]

Living conditions for the average Libyan continue to deteriorate. [redacted] shelves in most government-operated supermarkets are empty or poorly stocked except on traditional holidays. Food lines are longer and more contentious as people search for basic staples. Hoarding has become a way of life for most and a thriving black market has evolved, despite numerous attempts to control such activity. Moreover, the quality of health care and education—hallmarks of Qadhafi's revolution—has fallen off sharply. While few starve in Libya, most agree that Qadhafi's economic policies have failed. [redacted] 25X1

The government budget, foreign workers, and foreign contractors have all been casualties of the revenue squeeze. Development spending was down by 20 percent, and the administration budget had to be cut for only the second time since 1969. Actual spending levels probably are as much as 40 percent lower, however, based on import figures and press reporting. Moreover, [redacted] 25X1 [redacted] the expulsion of 150,000 foreign workers last year was intended to save $1 billion 25X1 worker remittances. To shore up Tripoli's foreign exchange position, payments to foreign suppliers were further delayed. The slowdown probably pushed Libyan commercial arrears to an estimated $4 billion, straining relations with several of Libya's leading trading partners, including Moscow. [redacted] 25X1

Nevertheless, work on priority development projects is continuing. [redacted] 25X1 [redacted] 25X1 state ministries decided last summer to finish those projects that were more than fifty percent complete and to cancel or delay others under the 1986-90 Plan, [redacted] 25X1 [redacted] 25X1 Exceptions to the decision include Qadhafi's priority Great Manmade River project, an iron mill at Misratah, and an aluminum smelter at Zuwara. Qadhafi also has attached increased 25X1 importance to agricultural development to limit dependence on Western food supplies. One benefit

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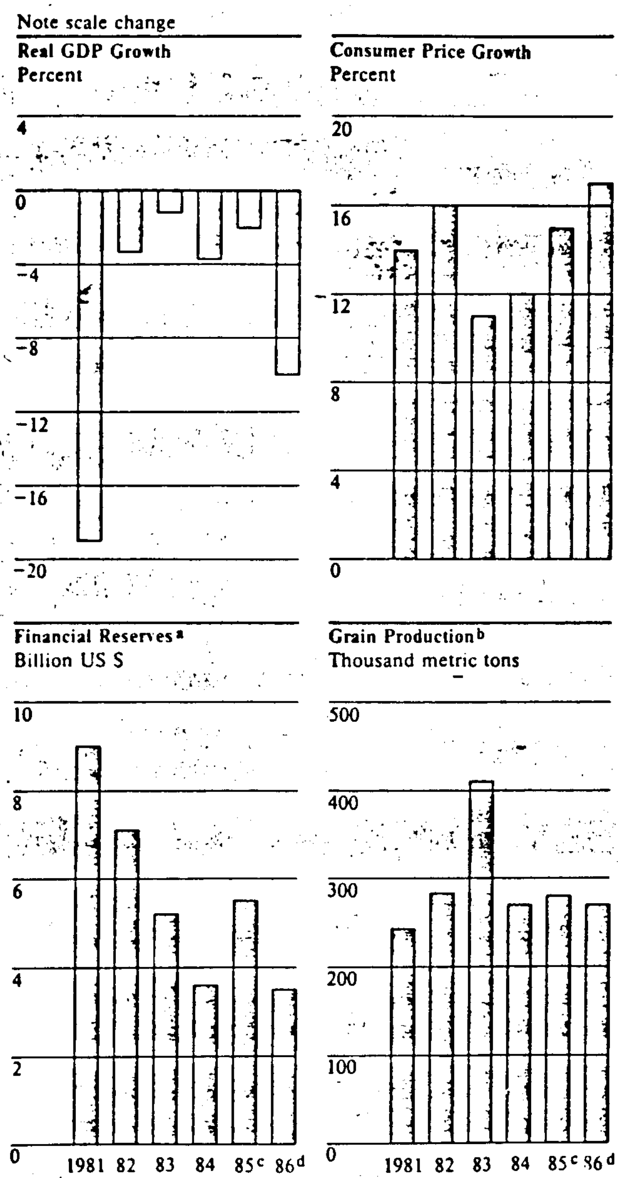
Libya: Economic Indicators, 1981-86



[a] End of period; excluding 3.6 million ounces of gold.
[b] Includes wheat and barley.
[c] Estimated.
[d] Projected.

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of the development slowdown has been that it limited the impact of the expulsion of foreign workers. 25X1

Defense spending also has felt the pinch. Military imports probably fell to $1.7 billion last year from their peak of almost $3 billion in 1982. Most of this decline reflects the completion of deliveries under existing contracts. Other defense-related spending has remained relatively stable. Qadhafi depends heavily on the military and security forces to stay in power and knows that they pose the greatest threat to his regime. As a result, further cuts in defense spending are not likely. 25X1

Qadhafi's draconian measures to stem the economic slide have had some positive effects. The sharp cut in imports and foreign workers, coupled with oil exports slightly above Libya's OPEC production quota of 990,000 b/d, probably produced a small surplus in the current account for the first time since 1982. These factors and delayed payments to foreign contractors helped push foreign exchange reserves to $5.5 billion by yearend—10 months of imports—from a low of $3.3 billion in January 1985. 25X1

US Economic Sanctions

The freeze on Libyan financial assets has had the greatest impact among the various US economic restrictions imposed last month. Libya lost access to as much as 13 percent of its foreign exchange reserves and has had increased trouble in servicing contract payments— 25X1
Moreover, Tripoli's attempts to circumvent US sanctions have met with limited success. Other Arab states so far have offered little more than vocal support. 25X1

The impact of US sanctions on the oil sector is small. We estimate that Libya continues to produce 1.1-1.2 million b/d of oil. While most US oil workers have left Libya, domestic oil workers and other foreign technicians probably can maintain

Political Strains of Austerity

For the most part, Qadhafi is a judicious political calculator. He has often been able to respond flexibly to his political and economic troubles, tactically changing course without losing sight of his revolutionary goals. When he perceives threats to himself or that his revolution is failing, however, Qadhafi's usually pragmatic decisionmaking can falter. We judge that Qadhafi is now in such a strained period, and flawed decisionmaking could well compound his economic problems. [redacted]

Qadhafi has increasingly surrounded himself with people whom he believes he can trust—relatives, fellow tribesmen, or young radicals committed to his ideology. [redacted] 25X1 25X1 *professional officials in key positions—particularly the security services—are being replaced by young extremists who have grown up under Qadhafi and are considered ideologically sound. Qadhafi also has staged rallies in tribal areas to convince both internal and external opponents that he continues to enjoy popular support. For example, this year, for the first time, Qadhafi celebrated the anniversary of his coup in the relatively secure city of Sebha. Instead of the usual displays of military units, he featured parades of Revolutionary Committee cadre. In our view, this relects Qadhafi's distrust of the Army's loyalty and was intended to demonstrate to his adversaries that the Libyan revolution would continue even if he were personally eliminated.* [redacted] 25X1

At the same time there has been increased infighting among senior officials as they prepare themselves for any succession struggle. [redacted] 25X1 [redacted] 25X1 *high-level officers, including Libya's number-two man, Abd al-Salam* 25X1 *Jallud, are building up their networks of clients and supporters. In our view, this jockeying for political position reflects a lack of confidence in Qadhafi's viability and threatens the unity of the regime.* [redacted] 25X1

Qadhafi's popular base will continue to erode as long as he responds to the challenges to his regime by closetting himself with a diminishing circle of loyal revolutionaries. Qadhafi is almost entirely dependent on the continued loyalty and competence of the Revolutionary Committees and the security services to preserve his position. At present, these institutions appear capable of protecting him. Nonetheless, political and economic trends in Libya are running against Qadhafi, and we assess his chances of surviving until 1987 as little better than even. [redacted] 25X1

production and possibly increase it by several hundred thousand barrels per day. [redacted] [redacted] spare parts are not a problem because stocks are adequate or can be aquired through non-US suppliers. Moreover, [redacted] completion of other Libyan development programs, including the Great Manmade River project, will be largely unaffected because of the substantial participation of West European and South Korean firms that can easily replace US firms. [redacted]

Outlook

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Soft oil market conditions pose the greatest threat to the economy and probably the regime. Tripoli loses $400 million annually for each one dollar decline in oil prices at the current export volume. 25X1 Conversely, every 100,000-b/d drop in oil exports costs the regime $730 million at the current $20 per barrel price. [redacted] 25X1

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Libya: Current Account Trends, 1981-86

Billion US $

	1981	1982	1983	1984	1985	1986
Current account balance	**−5.3**	**0.6**	**−1.0**	**−1.5**	**0.6**	**−1.0**
Trade balance	−1.3	4.3	3.5	3.1	4.1	2.5
Exports (f.o.b.)	15.2	13.6	11.9	11.2	11.0	8.8 [a]
Imports (f.o.b.)	16.5	9.3	8.4	8.1	7.0	6.3 [b]
Non-Communist	13.0	5.8	5.9	5.9	4.9	4.7
Military	0.8	1.1	0.6	0.4	0.5	0.5
Communist, nonmilitary	1.8	1.7	1.3	1.0	0.9	0.7
Soviet	0.3	0.3	0.4	0.2	0.1	0.1
Other	1.5	1.4	0.9	0.8	0.7	0.5
Communist, military	1.8	1.9	1.3	1.3	1.2	1.0
Soviet	1.2	1.0	0.7	0.8	0.7	0.6
Other	0.6	0.9	0.6	0.5	0.5	0.4
Net services	−3.6	−3.1	−4.2	−4.1	−3.3	−3.2
Freight and insurance	−2.0	−1.1	−1.0	−1.0	−0.8	−0.7
Investment income receipts	1.5	1.1	0.8	0.4	0.3	0.2
Other	−3.2	−3.1	−3.9	−3.6	−2.8	−2.7
Grants	−0.4	−0.5	−0.4	−0.4	−0.4	−0.3
Change in reserves	−4.1	−1.9	−1.8	−1.6	2.1	−2.0

[a] Projected, assuming average exports of 1.2 million b/d at $20 per barrel.
[b] Based on additional reductions in military- and project-related imports.

[redacted] 25X1

A *$20 per barrel* oil price probably would have little impact on the economy during the next year if current export levels can be maintained. Assuming no change in imports, Tripoli would face a projected current account deficit of roughly $1.5 billion this year. Such a shortfall could be sustained by drawing down accessible foreign exchange reserves. [redacted]

An average price of *$15 per barrel* would force Tripoli to make some difficult choices. Tripoli would face a projected current account deficit of $3.0-3.5 billion this year, equal to about 70 percent of available foreign exchange reserves. Hefty import reductions, however, almost certainly would hit both civilian goods and military equipment as well as priority projects. Any increased popular dissatisfaction could generate renewed coup plotting and force Qadhafi to rely even more heavily on his security forces to remain in power. [redacted] 25X1

A steep drop in oil prices also limits Qadhafi's ability to purchase support by reordering economic priorities and channeling the savings into the consumer sector. In response, he could step up oil production to boost export revenues and purchase basic commodities to ease mounting tensions over living standards. An increase of 140,000 b/d in oil exports at $20 per barrel would boost revenues by the amount of import reductions last year. Such volume, however, would be difficult to sustain under current market conditions without depressing prices further. [redacted]

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LIBYA: Impact of US Oil Sanctions

US sanctions have disrupted some Libyan oil exports by increasing marketing difficulties, but they have had little effect on oilfield or refinery operations. [redacted] 25X1

[redacted] Libyan oil production may have fallen by as much as 200,000 barrels per day in the last two weeks, to about 1 million b/d. The drop in oil output is largely the result of the soft oil market, however, not production problems. Libya is attempting to sell oil previously handled by the US companies by aggressively negotiating netback pricing deals, primarily with Mediterranean refiners, but sales in the current glutted oil market will be difficult without severe price discounts. Libya also appears to be increasing exports of refined products to replace lost crude sales. [redacted] 25X1 25X1 25X1

[redacted] US companies in Libya are complying with the law and have stopped all liftings. [redacted] the US restrictions have delayed some petroleum-related projects but caused no serious disruption in oilfield operations. [redacted] US service companies and most US technicians are being replaced by firms and personnel from the UK, France, and West Germany. Oil equipment sales and services disrupted by the US sanctions will continue to be replaced by foreign companies with comparable capabilities because service opportunities elsewhere are declining. [redacted] 25X1 25X1 25X1 25X1 25X1

The freeze on Libyan financial assets has prevented Tripoli from collecting some $150 million for oil sold in December. [redacted] Libyan leader Qadhafi recently told petroleum officials not to extend the deadline for making payments, putting the oil companies technically in default of their contractual obligations. [redacted] 25X1 25X1 25X1

Libya's increasingly tough posture toward the US producing companies probably suggests Tripoli now realizes they must be replaced. [redacted] Libyan oil officials have stopped communicating with US oil producers except through telex messages—suggesting Libya wants documentation for legal proceedings against the US producers. Firms from several countries, including Argentina, Austria, Italy, and Hungary, are interested in taking over US oil concessions in Libya. With US companies unable to sell their assets to foreign firms or subsidiaries, however, Libya will try to buy out the US concessions on attractive terms; nationalization probably would be a last resort because it might prompt US retaliation and damage Tripoli's reputation with foreign companies. [redacted] 25X1 25X1

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Next 3 Page(s) In Document Denied

Briefs

Energy

OPEC Production Update

OPEC crude oil output averaged 17.3 million b/d in January, a 1.1-million-b/d decrease from December levels. Weak oil demand caused Saudi production to drop about 600,000 b/d, which may indicate that companies are not picking up all the oil they are entitled to under netback contracts. Nigeria and Libya also had trouble marketing their oil. 25X1

OPEC: Crude Oil Production, 1985-86

Million b/d

	Quota	1985		January 1986[a]
		Year	December	
Total	**16.0**	**16.4**	**18.4**	**17.3**
Algeria	0.66	0.7	0.6	0.7
Ecuador	0.18	0.3	0.3	0.3
Gabon	0.14	0.2	0.2	0.2
Indonesia	1.19	1.2	1.3	1.3
Iran	2.30	2.3	2.4	2.3
Iraq	1.20	1.5	1.7	1.7
Kuwait[b]	0.90	1.1 (0.9)	1.1 (1.0)	1.2 (1.0)
Libya	0.99	1.2	1.3	1.1
Nigeria	1.30	1.5	1.6	1.3
Qatar	0.28	0.3	0.3	0.3
Saudi Arabia[b]	4.35	3.5 (3.3)	4.9 (4.7)	4.3 (4.1)
UAE	0.95	1.1	1.2	1.2
Venezuela	1.56	1.6	1.6	1.4

[a] Estimated.
[b] Amount in parentheses excludes production from the Neutral Zone, whose output is divided between Saudi Arabia and Kuwait and included in their country quotas; the Neutral Zone has no production quota of its own.

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