

## OPPORTUNITIES FOR ESTABLISHMENT OF FINANCIAL MARKET IN LIBYA

A. Aljbiri

**Received: June 30, 2007**

### Abstract

ALJBIRI, A.: *Opportunities for establishment of financial market in Libya*. Acta univ. agric. et silvic. Mendel. Brun., 2007, LV, No. 6, pp. 9–16

The main purpose of this paper is to show the importance of financial markets to the Libyan economy. At present, the country is preparing to establish a financial market as a requirement of economic reform with its goal to achieve economic stability and improve the volume of investment, as well as raising the growth rate. As the analysis in this paper shows, there are achievements with respect to the financial indicators, but it is limited with respect to the volume of investment and the level of incomes. This leads to the importance of establishing the financial market which is one of the primary requirements to achieve these goals.

debt issues, preferred stocks, savings, treasury bills, Initial Public Offering (IPO)

In the 1990s, Libya underwent many important economic reforms, which are the base for the next stage with a different economic and political philosophy regarding the development of Libyan economy. In the economic sector, Libya has had a program of economic reform from 1999 with agreement of the international institutions (International Bank, IMF) for improvement of the missing infrastructure that the Libyan economy is suffering from and that brings Libya to a sharp economic crisis with financial, monetary and structural dimensions. Main causes include local, regional and international changes, which together led to a sharp decline in all economic indicators.

The reform program includes a package of monetary and fiscal policies, which will lead the economy to a free market and its mechanisms with related reform of the pricing structure, interest rate, floating exchange rate and minimizing the role of the state through the privatization policy to enable the private sector to lead economic development and achieve a high growth rate. It requires a huge structural reform in taxes, customs, laws and the financial sector by enabling savings to be used in the investment sectors.

Despite of the implementation of the economical reform program over many years, the results have been disappointing. There are many goals not yet achieved, especially in the aspects related to increasing the volume of investment, opening new productive job opportunities and increasing the level of income.

It is known that organized and flexible financial markets play a vital role in the mobilization of savings and hence to investment, also increasing activity in many different sectors of the economy thus increasing the growth rate. They also help to increase national and international savings. Success of the economical reform program depends on the existence of an active financial market which increases and expands the range of dealing with financial papers. Therefore the Public People Committee (PPC) issued decision No. (134/2006) concerning establishment of financial market in Libya.

### MATERIAL AND METHODS

This research paper describes the nature of the financial markets of various kinds and identifies the conditions necessary for their establishment, as well as

the requirements for their success related to other reforms. This research paper concentrates on the most important reasons for establishment of the financial market in Libya using analytical descriptive methodology of some monetary and financial indicators.

## RESULTS AND DISCUSSION

### Concept and Nature of Financial Markets

To understand financial markets, let us look at what they are used for, i.e. what is their purpose? Without financial markets, borrowers would have difficulty finding lenders themselves. Intermediaries such as banks help in this process. Banks take deposits from those who have money to save. They can then lend money from this pool of deposited money to those who seek to borrow. Banks usually lend money in the form of loans and mortgages. More complex transactions than a simple bank deposit require markets where lenders and their agents can meet borrowers and their agents, and where existing borrowing or lending commitments can be sold on to other parties. A good example of a financial market is a stock exchange. A company can raise money by selling shares to investors and its existing shares can be bought or sold.

Financial markets can be divided into different sub-types:

- A. Long-Term Capital Market: is the market in which longer-term debt (Generally those with original maturity of one year or greater) and equity instruments are traded (Mishkin, 2006).
- B. Short-Term Capital Market: facilitates short-term loans. It is the institution through which individuals and institutions with temporary surpluses of funds meet the needs of borrowers who have temporary funds shortages. Thus the money market enables economic units to manage their liquidity positions. Also one of the principal functions of the money market is to finance the working capital needs of corporations and provide governments with short-term funds (Rose, 1997).
- C. Primary versus secondary markets: the financial markets may also be divided into primary markets and secondary markets:
  - a. Primary markets. Primary market is a part of the capital markets that deals with issuing new securities. Companies, governments or public sector institutions can obtain funding through selling a new stock or bond issue. This is typically done through a syndicate of securities' dealers. The process of selling new issues to investors is called underwriting (Kerry, 1982). In the case of a new stock issue, this selling is called "initial public offering" (IPO). Dealers earn a commission that is built into the price

of the security offering, and it can be found in the prospectus. Principal function of this market is raising financial capital to support new investment in buildings, equipment and inventory.

- b. Secondary markets. They deal with securities previously issued. Its main function is to provide liquidity to security investor that is, provide a possibility to convert financial instruments into ready cash. However, Rose (1997) mentioned that the secondary market does not support new investment as the primary market do. Nevertheless the primary and secondary markets are closely intertwined.

Secondary markets provide the investors with two basic factors: the first factor is liquidity, and the second factor is possible profitability. Liquidity represents the possibility to sell the bonds and transfer them to cash, wither the profitability chance appears when the price of shares or bonds rises, so the holder can sell it for a better price, and achieve a capital gain.

### Creation and Development of Financial Markets

Nations move from the primary production to advanced industrial activities; the huge projects need a lot of capital for their financing. Because it is impossible to allocate these financial resources from one person or even a few people, it is necessary to establish stock companies to which a number of people can contribute through buying their publically traded stocks.

Governments issue public bonds, loans for financing their projects and development plans. In spite of the existence of markets in the society, they have been limited to selling and buying real goods. As well, the methods of selling and buying these goods used to be very simple, like barter.

Financial markets are considered new compared to other markets. They have been called a "Bourse" because of huge financial investments and using technology in this field. The name "Burse" refers to one of the most famous businessmen, whose name was "van den Bourse" and he was living in Bruges, Belgium. Referring to the history of international bourses, we find the first one was established in Antwerp in 1536, then other in Amsterdam 1806, London 1666, and Paris 1808. These cities were the most important financial centres in the Middle Ages. The Wall Street bourse in USA was the new bourse of the new world. In the Arabic world, many bourses were established. The Egyptian Bourse is the oldest bourse in the Middle East from 1890 and other bourses in Oman, UAE, Tunisia, and Saudi Arabia. (Shaied, 2005) We can say these bourses are new and emerging markets. We can also say that the idea of financial markets had been

developed in many stages to reach the current form, as follows (Arsalan, 2002):

- A. This stage is characterized by many banks and exchange offices and a relative increase in the standard of living, more investment of the individuals' savings in commercial, agricultural and real estate projects. This leads to an increase in commercial transactions and to projects, which need high amounts of capital.
- B. The second stage begins with the emergence of central banks. The commercial banks have absolute freedom in the first stage, but in this stage, the commercial banks do their classical work, accepting to discount the commercial papers and credit according to the instructions of the central bank.
- C. Then specialized banks appear for creditting (lending) in medium and long terms. These banks provide issuing medium and long-term instruments for financing the needs of businesses.
- D. Emergence of the money markets with increasing commercial papers' transactions, and certificates of deposits. This leads to merging of the monetary market with capital market.
- E. Merging the monetary markets with local financial markets, as well as international markets.

#### **Economic Functions of Financial Markets**

Financial markets contribute to achieving important economic goals, especially the following (Rasmiya, 1999):

- A. Increasing the growth rate of national economy: these markets encourage the investment of savings in general, and encourage the small savers to save, in particular. This helps to launch investment projects otherwise impossible due to lack of capital. This market helps to increase the investment rate, employment rate, and the growth rate as a consequence.
- B. Financial markets transfer the financial resources from categories, which have surplus (savers) to categories, who need resources (investors) to establish their investment projects. It reflects increasing the employment rate and improving the living standards in the society.
- C. Issuing financial papers (Debt issues) enables Governments to implement the planned monetary and fiscal policy. In addition, these tools (Treasury bills) are the main tools for financing the budget deficit in one hand, and managing the planned monetary liquidity on the other. The financial markets increase liquidity of financial assets easily, with good prices and at low costs.
- D. Financial market represents an indirect controlling authority on the efficiency of firms and projects as

their perceived efficiency is reflected in the price of their debt in the market.

- E. Financial papers assist to encourage savings from individuals and institutions, and draw the surplus of monetary liquidity, directing these savings towards investment instead of consumption.
- F. Financial and economic development: financial market works towards increasing the link with the external world by connecting the international financial markets, and encouraging foreign investment and technology transfer.
- G. Financial market shows a daily indication of the investment conditions and its direction. It is an indicator which reflects the solidity or weakness of the national economy and reflects performance level of economic sectors and the financial performance of the investment firms.

#### **REASONS FOR ESTABLISHING THE FINANCIAL MARKET IN LIBYA**

Preparation for establishment of the financial market in Libya is considered a requirement of the economic reform program, after implementing a package of structural economic reforms, in order to achieve the goal of economic stability, improving investment conditions and increasing the growth rate.

Stability policies have already reached some achievements according to the financial indicators, but these achievements are still limited therefore it is important to establish the financial market as one of the primary requirements for encouraging investments. Also the nature of the economic reform program implies establishing a financial papers market for the following reasons:

#### **Increasing the Growth Rate**

There is no doubt that achieving high stable growth rates requires removing the obstacles to growth. Lack of sufficient capital for financing the special investment projects and plans of social and economic developments are the important obstacles. This is the importance of establishing financial markets, which work to expand financial resources and increase savings and then allocate between competing investment activities so as to increase overall investment, and raise the standard of living, employment rate, and GNP.

*I: Developing of GDP growth rate in Libya (market prices)*

Indicator	2002	2003	2004	2005
Growth rate	3.3	9.1	4.6	3.5
Inflation rate	-9.9	-2.1	-2.2	2.5

Source: report of international Monetary Fund

Tab. I shows that the performance of Libyan economy was satisfactory during the years of study for several reasons, especially an increase in the oil price by 31% and increase in the oil production by 5.6%, which projected into a growth rate in (real) GDP by 4.6% in 2004 and decreasing the customer prices by (-2.2%). Performance of the economy still had proportional solidity in 2005, when its real growth rate of GDP was 3.5% and the inflation rate still low (2.5%). Such a low rate reflects the economic performance of the Libyan economy since removing the international sanctions, after 10 years, in 2003 and 2004.

### Increasing the Role of Private Sector in Economic Development

The goal of the economic reform program is to enable the private sector to manage economic development and to increase its role in enhancing the capacity of investment and employment. In the past, the private sector had a limited role with its investment as low as 2% of GDP. In future it will be expanded because of the policy to reduce the role of state in economic activities by privatization in public projects. Such programmes are coherent with the spread of glo-

balization and growing number of free market economies. The private sector depends on two main sources for financing its needs:

- A. Governmental Financing: through its financial institutions and specialized banks like Real Estate Bank, Agricultural Bank and Housing Bank.
- B. Banking Sector: this sector does not have sufficient capacity to offer credits for private sector, because of its weak capital base. Borrowers face difficulties with loans' repayment due to the absention basis of active financial intermediates what limits the banking services provided and doesn't enable to develop these services towards the needs of private sector. In addition, the principle of belief in activities and facilities financed by the loans (considering that the interest is forbidden, according to the Islamic law Shariah) complicates the situation even more. Simply, the commercial bank sector, which presumably mainly lent to the government, in the past, will have difficulties financing the new emerging private sector due to an inadequate capital base of the banks and unproven creditworthiness of potential borrowers.

### II: Structure of loans of commercial banks in Libya [%]

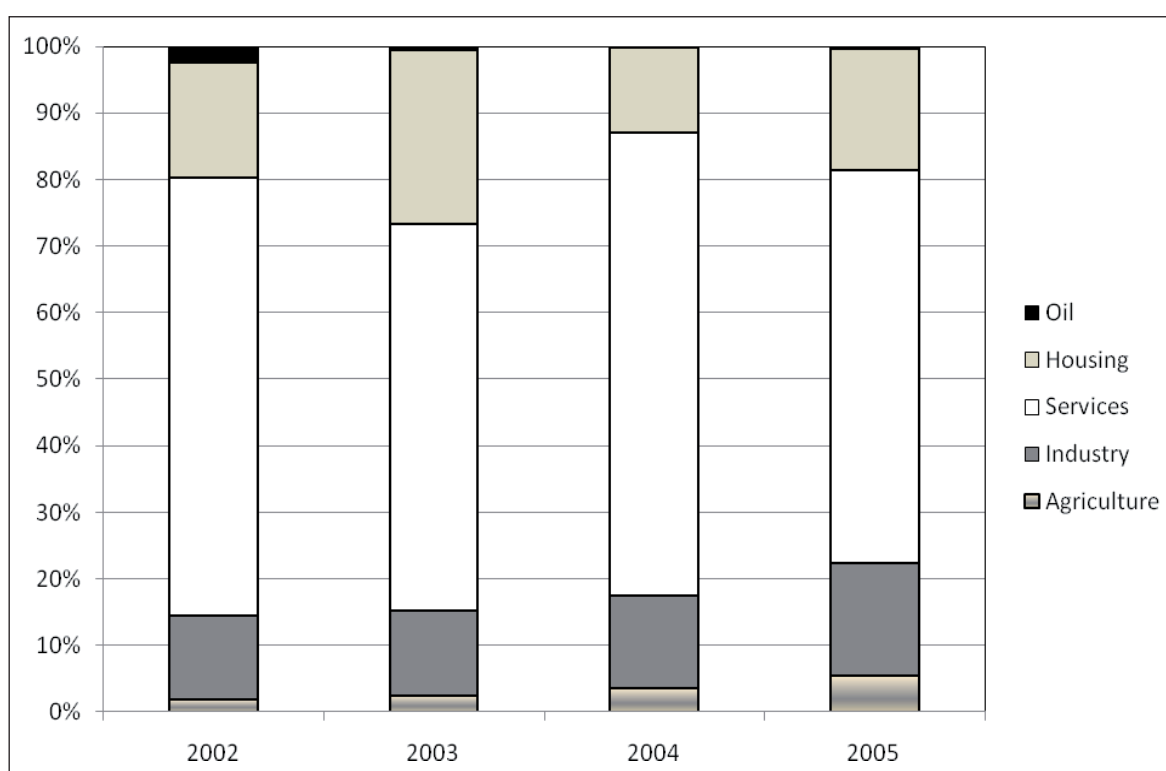
Year/ sector	2002	2003	2004	2005	Medium period
Agriculture	1.87	2.41	3.6	5.5	3.34
Industry	12.58	12.9	13.8	16.8	14.2
Services	65.8	58.09	69.61	59.06	63.14
Housing	17.36	26.14	12.8	18.3	18.65
Oil	2.4	0.45	0.19	0.34	0.77
Total	100	100	100	100	100

Source: Economic bulletin, Central bank of Libya

Therefore, the individuals and projects use other alternatives like: informal financing outside the banking system or they can use the Islamic banking system by other methods, according to Islamic law (Musharakah, Mudharbah, and Murabahah). On the other hand, we find the majority of financing by commercial banks concentrated in commercial activities, but other sectors, like agriculture and industry, which are important sectors creating increasing investment and added value, have little bank financing. Tab. II shows the commercial banks financing by economic sectors.

Fig. 1 shows that an average of 63% of bank loans in the period 2002–2005 were to the commercial and service sectors whilst the other sectors had a low rate

of bank financing. The agricultural sector did not reach 3.37%, industry 14.2% and housing 18.65%. the situation is presented in figure N(2) above. These rates reflect an inefficient allocation of available financial resources leading to increased economic loss and opportunity cost to the economy and imbalance between short-term commercial credit and long-term investment credit. This structural imbalance in the commercial banks' activities needs to be addressed by distributing its resources to real economic activities, which serves the long-term economic goals and emphasizes the importance of establishing the financial markets which work to enhance the savings and managing it towards different investments.



1: Loans of the commercial banks in Libya

### Limits of Libyan Banking Sector

Financial and banking institutions play a major role in developing the financial intermediaries and increasing the saving and investment awareness of public and then enhancing the local savings and re-allocating it among sectors and different investment activities. It is known that the developing countries, including Libya, have limited local savings and poor investment awareness of majority of individuals

in the society, on the other hand. The major savings are from small category. Thus we can say that there are huge financial resources represented in the small savings which do not find their way into the financial system. We can know the capacity of these financial institutions for attracting the savings, its allocation and investing in different investment sectors, as shown in the table (III).

III: Deposits in commercial banks (Million Libyan Dinars)

Year	2001	2002	2003	2004
Total deposits	7 984.4	8 340.5	9 567.2	11 268.7
Currency uses outside banking system	2 559.6	2 613.9	2 763.5	2 612.7
The rate of currency to total deposits	32%	31%	28%	23%

Source: Economic bulletin, Central bank of Libya

In the Tab. III it is observed that there was a small increase in the deposits in the banking system (from 7984.4 Million Dinar in 2001 to 11268.7 in 2004). This small increase was due to lower interest rates which slowed the rate of increase in savings, and it represents a weakness in applying the banking policies. This small increase does not reflect the real indicator of the efficiency of banks for attracting the savings from individuals and firms. Economists and

financial analysts are using the known financial indicators to assess the efficiency of banks and financial institutions for attracting savings. The most important indicators is "the rate of currency outside the banking system to the total deposits".

Tab. III also indicates the improving capacity of banks to enhance the individuals' and institutions' savings in the period 2001–2004.



### Conditions for Success of the privatization Policy

The privatization process needs a developed capital market to mobilize savings and enable them to be used in different fields of investment.

The experience of many countries applying economic reform program shows that the existence of financial markets is an important condition for success in privatization programs enabling an objective assessment of firms' assets and setting realistic prices of the stocks which are offered for registration or in the secondary markets.

The privatization policy in Libya is considered one of the components of the economic reform program which PPC has issued in the decision No. 69, year 2001 for privatization of the public firms. PPC enables the Public Property Institution (PPI) to implement this task, which is assistance to transfer the public firms to private property, for increasing productivity and profits and focused on transferring ownership to local entrepreneurs. A number of large enterprises on the privatization list will be available for foreign investors, such as: cement, glass, steel and airline firms. There is a program prepared by PPI and plan begins in 2004 for 5 years to transfer and reform 361 public projects to the private sector. So far, only 65 state-owned companies have been transferred to the private sector, most of them small and medium sized, they have mainly been from the agricultural and some industrial sectors. There is only privatized one big company, which is the Arabic Cement company, worth an estimated \$500 million. At present, there is privatization of a flourmill, which is worth an estimated \$211 million. The plan of PPI on the privatization process was divided into three stages, beginning with the small firms and then, the medium sized and finally the big firms, the value estimates range from \$50.000 million to 3 billion dollars. It should be said that the first stage is almost finished. Meanwhile, PPI is preparing studies of all the major public enterprises privatization of which will require an active financial market.

### Enhancing the Foreign Investment

To increase foreign investment in Libya requires suitable investment conditions and an attractive in-

vesting environment backed by developed infrastructure such as, electricity, water supply, sewerage, streets and highways, ports, airports, and transport network. Other requirements include political stability, stable exchange rate, and a successful economic policy to reform the imbalances in the economy.

For enhancing the foreign investment, the state has implemented many procedures in the form of the economic reform program.

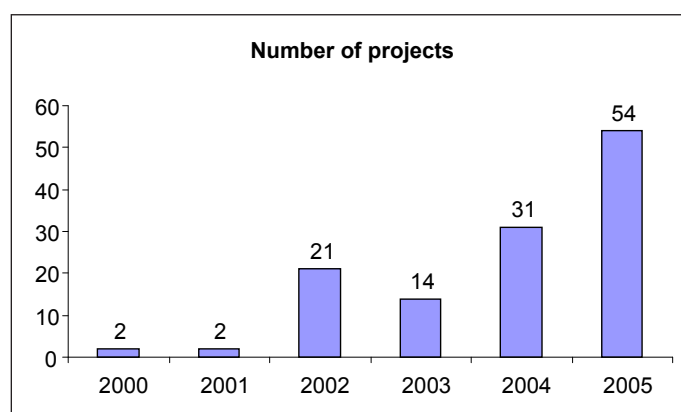
In the last years, there was a wide promotion campaign, which included meetings and conferences with different international institutions to enhance the international investment in the field of oil and gas, and in new sectors, like tourism. As the result, the flow of international investment was USD 700 million in 2003, but in years 2004–2005, the international investment ranges between 6–7 USD billion, after minus records in many recent years.

For enhancing the investment and employment together, there are many other decisions and acts, e. g. the act No. 5, year 1997, which includes a number of incentives for investors. These include:

- A. Five-year exemption of customs duties on equipment and materials to set up a project, and on raw materials, components, or spare-parts.
- B. Five year tax exemption of income taxes from the first day of production if profits are reinvested –extendable for further three years.
- C. Exports exempted from excise taxes and fees.
- D. The right to own land for use, rent, or building for the needs of the project.
- E. The right to open a foreign currency account.
- F. The right to re-transfer uninvested foreign capital abroad.
- G. A guarantee that projects will not be nationalized or frozen by the government.

### Projects of investment according to law N (5) for 1997

Approval of investment projects according to Law No. (5) of 1997 regarding attraction of foreign capital to be invested in different projects has reached 124 projects. See the Fig. 2 below.



2: Number of investment projects in Libya

The state has established Misratah city as a free trade zone for activation of national capital in many investment fields and attracting more foreign capital. Establishing the financial market in Libya will also attract investments of Libyan citizens living abroad – there are many Libyan citizens abroad who have significant savings seeking good investment opportunities inside Libya that the financial market can provide.

### CONCLUSION

This paper demonstrates the importance of financial market for a national economy and describes the most important factors for establishing financial market in Libya. Libya goes through comprehensive structural

reforms and is converting to free market economy. Establishment of financial market is considered one of the necessary conditions to support the Libyan economy, and develop its financial system. Establishment of this market will only be possible as a part of special reforms of the banking and financial sector.

The paper focuses on the most important reasons to establish the financial market in Libya by analysing of some financial and economic indicators. Results confirm the necessity to establish this market, which has a vital role in allocating resources and savings towards investments, their activation in different economic sectors, increasing the growth rate, enhancing the local and foreign investment, and success of economic reform program.

### SOUHRN

#### Příležitosti pro ustavení finančního trhu v Libyi

Hlavním cílem tohoto příspěvku je demonstrovat význam finančního trhu pro Libyjskou ekonomiku. V současné době Libye připravuje založení finančního trhu jako součásti požadovaných ekonomických reforem s cílem dosažení ekonomické stability, zvýšení objemu investic a zajištění ekonomického růstu. Jak ukazuje analýza v tomto příspěvku, dochází ke zlepšení hodnot finančních indikátorů, ovšem dosud nedošlo ke zvýšení objemu investic a výše příjmů. Toto demonstruje potřebu založení finančního trhu jako jednoho z hlavních předpokladů k dosažení uvedených cílů.

emise dluhopisů, preferenční akcie, úspory, pokladniční poukázky, první veřejná nabídka akcií (IPO)

### REFERENCES

- ARSALAN, M. A.: Financial market. 1<sup>st</sup> edition. Egypt: Faculty of trade and management, University of Aden, 2002.
- COOPER, S. K., FRASER, D. R.: The Financial Marketplace. 1<sup>st</sup> edition. USA: Addison-Wesley-Longman Publishing, 1982. 500 p. ISBN 0-201-00196-9
- MISHKING, F. S.: The economics of money, banking, and financial markets. 7<sup>th</sup> edition, USA: Addison-Wesley, 2006. ISBN 0-321-37312-X
- RASMIYA, G.: Markets-capital-institutions. 1<sup>st</sup> edition. Egypt: Trade faculty, Elskandriya University, 1999.
- ROSE, P. S.: Money and Capital Markets Financial institutions and instruments in a global marketplace. 6<sup>th</sup> edition. USA: Richard D Irwin, 1997, 722 p. ISBN 0-256-15239-X

- SHAIED, A. M.: Market Management and Financial institutions. 1<sup>st</sup> edition. Egypt: AL Mansura University, 2005
- CENTRAL BANK OF LIBYA. Economic Bulletin [on-line]. c2006, [quot. 2007-06-01]. <http://www.cbl.gov.ly/en/listview/index.php?cid=78>.
- INTERNATIONAL MONETARY FUND. Staff Report for the 2005 Article IV Consultation [on-line]. c2006, [quot. 2007-06-01]. <http://www.imf.org/external/pubs/ft/scr/2006/cr06136.pdf>
- LIBYA FOREIGN INVESTMENT BOARD [on-line]. c2006, [quot. 2007-06-01]. <http://www.investinlibya.com/enmain.htm>.

#### Address

Atia Milad Aljbiri, MSc., Ústav financí, Mendelova zemědělská a lesnická univerzita v Brně, Zemědělská 1, 613 00 Brno, Česká republika