

Research

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Global Political Insights

Tipping Point in Tripoli?

- **Libya is poised to become the third country in MENA headed for regime change this year.** Rebel forces claim to occupy much of Tripoli, heralding the end of Muammar Qaddafi's 42-year rule, though fighting in the capital continues and opposition control has not yet been fully established.
- **An end to conflict in Libya would be positive for accelerating the country's return to full oil production capacity,** which dropped from 1.6-m b/d to 100,000 b/d during the fighting, contributing to an increase in the Brent crude risk premium.
- **We estimate Libya could resume its full production capacity by the end of 2012 – but this depends in large part on its ability to manage a challenging political transition.** Restoring security on the ground will be vital if our forecast for resuming production is to be met. NATO will continue to provide air cover, and the presence of international peacekeepers in future seems likely. Support from regional powers will play a critical role in stabilising the country.
- **With few functioning state institutions, Libya faces daunting challenges.** In the short term, minimising score-settling between tribes, and rebels and regime elites will be necessary for limiting disruption during the transition.
- **Iraq's ongoing political and security challenges provide many lessons.** But Libya has a key advantage: the existence of the National Transition Council (TNC) prepared to take over the running of the country.
- **Regionally, Qaddafi's personal fate will be watched closely.** Facing trial at the International Criminal Court on charges of crimes against humanity would send a powerful message. Revolutionaries elsewhere may step up their own efforts, particularly in Syria and Yemen, though international military assistance in these cases is unlikely.

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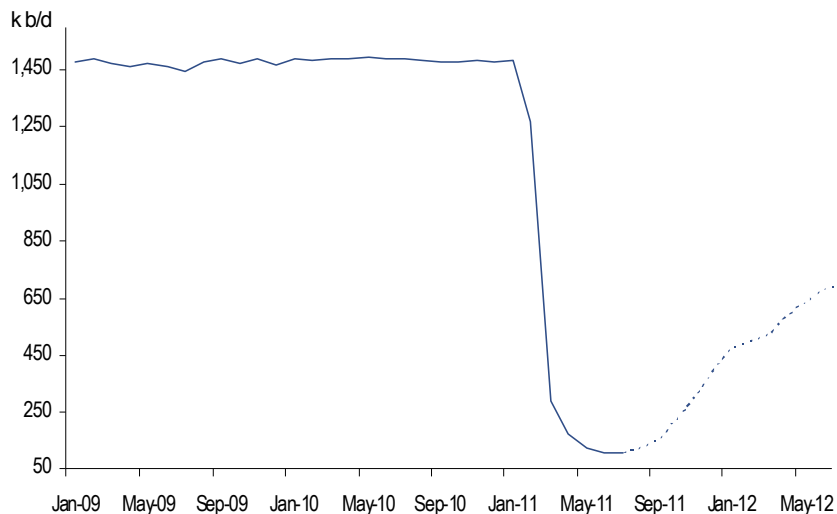
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Libya: Third Stop on MENA's Revolutionary Road?

Figure 1. Libyan wellhead production could reach 400-500-k b/d by end-2011



Source: CIRA estimates

With the news of rebel forces moving rapidly into Tripoli and the possibility of the defeat of Qaddafi after six months of armed conflict, the battle for regime change in Libya is nearing its end. In contrast to the mere weeks of street protests that saw autocrats removed in Tunisia and Egypt, the process of toppling Muammar Qaddafi, the region's longest-serving leader, has taken much longer. It has also been bloodier, prompting semi-reluctant NATO military intervention in the process. We take a moment here to discuss what this means for oil markets and for political stability, both within Libya and in the wider region.

An end to armed conflict would clearly be a positive step towards full-blown resumption of oil production. But markets may be getting ahead of themselves, as there are significant challenges ahead before sufficient volumes can be generated that would accomplish more than taking the edge off Brent premiums to WTI. Some of these challenges are on the technical side, but the key challenges are political.

Although euphoria is likely to prevail in the immediate aftermath of a confirmed rebel victory, the road to establishing new political authority under the TNC, maintaining social stability in a country divided along tribal lines and restoring security on the ground will be challenging. Stable leadership will be necessary for international oil companies and foreign personnel to return to aid construction efforts – both in basic services, and also in energy infrastructure, as well as before international development efforts can take place.

Colonel Qaddafi's highly personalised regime resembled a Central Asian-style 'cult of personality' more than the presidential republics found elsewhere in North Africa. Having been effectively isolated for several decades, international expertise on Libya is limited. The size of the middle class is small, and there is little in the way of civil society or a professional civil service. Libya has not had effective courts, police or military services or other institutions that would help maintain public order or facilitate a transition to rule of law. Avoiding score-settling between tribal groups and

revenge attacks against members of the old regime will require enormous discipline and control from the TNC.

The list of challenges, in short, is daunting, and not a little reminiscent of the situation in Iraq following Gulf War II, which saw armed militias fighting in the streets, undermining sectarian relations and creating a power vacuum that has yet to be completely overcome.

But there are some important differences between the Iraq and Libya cases that are in Libya's favour. First, Libya's regime change was not the product of foreign intervention, although NATO assistance to the poorly-equipped rebels has undoubtedly been critical to their success. The dynamics are therefore very different.

With this in mind, the recognition of the TNC by Egypt's transitional authority on Monday is important. Given the economic worries plaguing the international community's traditional donor states and limiting their willingness to dig deep to assist Libya with nation-building, the role of regional financial and security support from the GCC states will be crucial.

Libya's other advantage is the very existence of the TNC, a ready-made interim government that was not in place in Iraq and one that has been working for months with other countries to co-ordinate post-Qaddafi scenarios. The TNC leadership is comprised, among others, of some former members of the regime, which bodes well for avoiding the negative consequences of de-Baathification that so undermined the post-Saddam transition in Iraq. The composition of the TNC increases our optimism that members of the old elites and revolutionary fighters will be willing to collaborate on re-building the country. The country's small population, 6.4 million, large revenue generation potential and geographical proximity to Europe could also provide increased sources of support for a transition.

The list of challenges Libya faces is daunting and the potential for a return to conflict or counterrevolution remains high, as it does in all revolutionary scenarios. Nevertheless, there are many actors with an interest in helping Libya achieve a peaceful political transition – including several EU countries which rely on Libyan energy supplies – and resume its place as one of the world's most significant energy exporters. With this in mind, a call for the presence of regional or international peacekeeping troops is a likely next step. Preventing Libya's suspected stocks of chemical weapons from falling into the hands of terrorists will be a further argument for providing continued international security support.

Libya's oil sector

Libya claimed proved reserves of 46.4 billion barrels, or 3.4% of the world, as of end-2010. However, the state-owned National Oil Company's Director of Exploration stated that Libya had a total of 2 billion barrels of oil-in-place in November 2010 – very modest given its claimed proved reserves numbers. This suggests under-exploration (or inflated proved reserves numbers) and perhaps greater potential in the future.

Libya was the 12th largest crude oil exporter at the time, and exported over 90% of its production. However, its importance lies in the quality of its crude, which is light and sweet. Global demand growth has been increasingly concentrated in middle distillates, and further, the premium on middle distillate demand in emerging markets arises from its use not only as a transportation fuel, but also as a substitute for other fuels when they are not readily available in power generation. As

governments have regulated limits to sulphur content in diesel and other middle distillates, premium has been placed on light, sweet (that is, low sulphur) fuels.

Of the estimated 12.5-m b/d of production of crude oil that is light and sweet, African countries produce 42%; and of the African producers, Libya, along with Nigeria and Algeria, are the largest. Thus, the disruption to Libyan crude had a disproportionate effect on oil (particularly Brent) prices, relative to its oil production of around 1.6-m b/d before the uprisings.

Trajectory of the conflict

Libya's relationships with major oil consumers had been improving with the lifting of sanctions in 2003-04. Many hoped that the Qaddafi leadership was becoming increasingly progressive, and might gradually rejoin the international community. However, conflict began in February 2011 with protests in Benghazi in the east, which quickly spread. When Qaddafi forces used lethal force on protesters, uprisings spread throughout the country and opposition support consolidated.

Libyan oil is bought on the Brent benchmark, and given the particular importance of light, sweet crude, this drove a further wedge between WTI and Brent prices, which made the WTI-Brent spread widen. Libya was producing around 1.6-m b/d as unrest began, which fell to under 100-k b/d, while exports effectively stopped. Later, the IEA responded with the 60 billion barrel Strategic Petroleum Reserve (SPR) release on 23 June, which helped ease oil prices somewhat.

Oil prices were also impacted indirectly as these developments in the wider Arab Spring context alarmed other oil producers in the region, who increased their breakeven budgets, effectively attempting to gain their citizens' support through increased social spending.

Challenges to restarting oil production are partly technical...

As a rule-of-thumb, post-disruption supply is usually not as high as pre-disruption supply. It could take until end-2012 to recover Libya's full production capacity, from whenever the current crisis is resolved, depending on the scale of damage to infrastructure, international sanctions being lifted, and international oil companies and foreign personnel feeling assured enough to return.

Libya's NOC and the international oil companies will need to work in partnership to repair infrastructure, and bring production back towards levels before the crisis. Production recovery is likely to differ basin by basin. The major Sirte basin in eastern Libya is mature and complex and may take longer – it accounted for around two-thirds of Libyan production – while the newer, less complex fields such as the Murzuk and Pelagian Shelf basins in western Libya may take less time.

...but mostly political

The TNC has an incentive to boost oil revenues as soon as possible: it will soon need to pay salaries, restore public services and start the process of rebuilding the country. The TNC's capacity to maintain order on the ground and control over the population is not clear, but these conditions would have to be present before IOCs such as ENI, Total and others would re-enter the country.

The TNC has shown encouraging signs of democratic inclinations, including publishing an interim constitution that acknowledges the rights of the minority Berber population, but tribal factionalism will not evaporate overnight. The mysterious killing of the rebel military chief is one manifestation of these challenges. The potential for tensions between Islamists and secular forces is also significant in

Libya as in Egypt and Tunisia; the interim constitution gives a role for Islamic law, but also puts limits upon it.

Outlook and risks

We are cautiously optimistic about the prospects for Libya's political transition, though we do not minimise the risks. We see the return of Libyan crude to the market sooner than expected, and continue to see Libya as able to produce 200-k b/d by mid-September, rising to around 500-k b/d by year-end, and nearing full flows by end-2012.

A quicker return to higher levels of Libyan supply would be bearish for Brent prices, and should help close the WTI-Brent spread, even as Cushing stocks in the US Midwest remain high without a real pipeline solution, though they are on a downward trend. Risks to the upside could transpire if the success of the rebels in Libya emboldens other uprisings in the region.

The countries most immediately likely to see renewed momentum as a result of the developments in Libya are Syria, where protests are now moving to the major cities and international pressure on the Al-Assad regime is mounting, and Yemen, where the momentum has slowed. Revolutionaries in both countries will take heart from the Libyans' success after months of fierce combat.

Qaddafi's personal fate will be watched closely in the coming days and weeks. Regional leaders will note with interest whether he and his sons are tried on charges of crimes against humanity at the International Criminal Court.

After a spate of examples of unpopular military interventions by Western countries in recent years, the positive role of NATO forces in supporting the Libyan rebels could encourage liberal interventionists to call for NATO action elsewhere. Even so, we think that the current isolationist mood in the US and challenges of the sovereign debt crisis make further Western military interventions unlikely, with the notable exception of international peacekeeping troops who could be called upon to help maintain order on the ground. NATO has offered to continue to provide support in the form of air combat patrols until remaining Qaddafi forces surrender. While there remain many risks, Libya's end game has begun, and is unlikely to be reversed.

Appendix A-1

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