The colonel's risky foray

Why Gaddafi is seeking to shrink the Libyan state

The maverick leader has re-engaged with the world but intends to create upheaval at home by devolving ministerial powers, write **Roula Khalaf**, **Andrew England** and **Heba Saleh**

Muammer Gaddafi is the eternal revolutionary. In his anti-imperialist days, he roused trouble by backing rebels and radicals abroad, a costly strategy that he eventually had to abandon. His reincarnation as a mainstream, more responsible member of the world community secured the survival of his regime but it also left him looking for a new cause. Now he appears to have found his next big revolution: upheaval at home.

As Libya has sealed its international rehabilitation – a procession of world leaders have knocked on Mr Gaddafi's door in recent weeks, including Italy's Silvio Berlusconi and the US's Condoleezza Rice – the colonel has turned against his own cabinet, in effect demanding its abolition.

Under a plan revealed in a speech in March and reiterated this month on the 39th anniversary of the coup that brought him to power, most ministries are to be disbanded. Instead, oil wealth is to be distributed directly to the people, leaving them to organise and run the economy. The shake-up recognises the failure of the quirky socialist-style system he put in place decades ago. His so-called Jamahiriya, or rule of the masses, was translated into a series of committees that are supposed to represent the people yet leave power concentrated in Mr Gaddafi's hands.

The problem, however, is that no one knows what the latest plan means in practice or how a new system might work. Many fear it is a recipe for chaos.

If Mr Gaddafi acts on his words, Libya will by the start of next year have only a few government institutions: security, defence, foreign affairs and energy. The rest, including education and healthcare, will become, as he says, the "responsibility" of the Libyan people. "Each one of you, prepare to take his portion of the wealth and spend it as you wish," he declared recently. "As long as money is administered by a government body, there would be theft and corruption."

Some Libyans hope the notoriously unpredictable leader's latest experiment will prove a momentary folly. Mr Gaddafi has a habit of announcing big decisions, then reversing them. He has in the past dissolved some ministries and moved others away from Tripoli, the capital. A decade ago, he ordered all retail outlets to close, in order to be replaced by government-owned stores, but later decided that the shops could reopen.

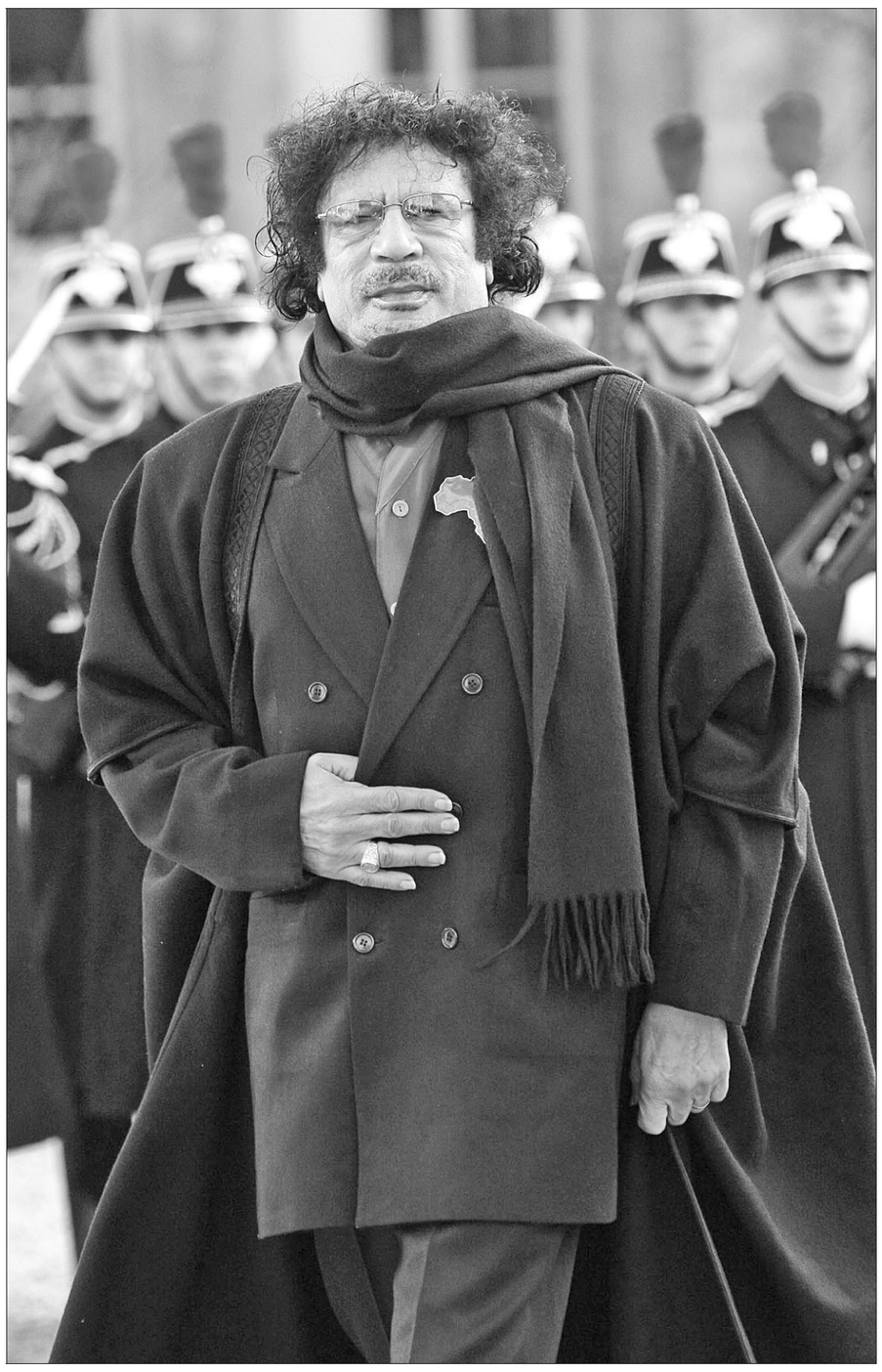
'What they're doing comes from the view that everything else has been tried but didn't work . . . It's a wild experiment'

More recently, his discourse has been more supportive of the private sector and of the free market. Yet that did not stop him from rounding up a dozen businessmen last year and locking them up for a week, in what analysts saw as warning to big business. Observers suspect that this time the colonel is determined to follow through with his plans, taking Libyans on another risky adventure. Mr Gaddafi himself expects his policies to create chaos "for a year or two", as he put it in his September speech.

"Gaddafi has a vision of permanent revolution and this guarantees his control," says George Joffe, a London-based expert on Libya. "His new plans also respond to pressure for change from the outside world and from his own elite. This is his own interpretation of what he thinks capitalism means – the market is people and people have to make their own arrangements."

With a population of only 5.8m and sizeable but underexplored oil reserves, Libya should be as prosperous as the small Gulf states of the Middle East. But a decade of international sanctions, the diversion of resources for the colonel's political causes and persistent mismanagement have left it with dilapidated infrastructure and a lethargic state-dominated economy.

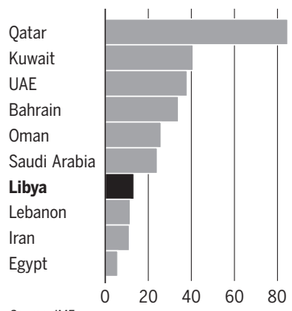
In 2006, with the encouragement of Seif-al-Islam al-Gaddafi, the leader's reform-minded son who had been instrumental in the rapprochement with the west, the government hired armies of consultants to recommend economic strategies. Michael Porter, the Harvard management guru, was also invited to Libya to offer his contribution. Mr Porter, once an adviser to Ronald Reagan as US president, helped to produce a 200-page document that called for prioritising tourism, agriculture and construction to diversify an economy in which oil and gas account for 70 per cent of gross domestic product. But Libyan observers say the slow pace of development has frustrated both Gaddafis, prompting the calls for a more drastic approach.



Muammer Gaddafi on a visit to France: he accepts his plan to end the government's involvement in functions such as education and healthcare will create chaos 'for a year or two' Alphafrance

Middle East GDP per head

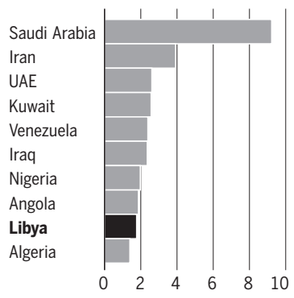
$'000 (2008 estimate)



Source: IMF

Opec oil production

Average for first half of 2008 (million barrels per day)



Sources : MEES

A main problem, businessmen say, is the inability of the system to transform itself, because Mr Gaddafi has built a weak state topped by inept cronies from the early days of the revolution who continue to have extensive access to the leader. Many of these officials, according to a western observer, "are incompetent, have no idea of leadership and do not know how to delegate". But as north Africa's wealthiest nation, it can no longer blame western powers for its predicament. Its emergence out of the diplomatic wilderness comes at a time of high oil prices, providing the means to back an economic transformation.

Over the past three years, a series of measures have raised hopes that Libya may engineer a relatively stable transition away from a command economy. As oil prices have risen and Libya has accumulated higher revenues – net foreign assets are likely to reach $100bn (£56bn, €70bn) this year, up from $40bn in 2005 – the government also set up a sovereign wealth fund with about $50bn in capital. The central bank meanwhile launched a privatisation programme, selling stakes in two local banks to foreign institutions and merging others.

At a time when other oil producing countries have grown more resistant to foreign investment, Libya has welcomed back the international oil majors as it seeks to raise production from a current 1.8m barrels per day to 3m b/d in five years. BP has been working on a $900m gas exploration deal and Eni recently agreed to renegotiate its contracts, giving Tripoli a greater share of profit. Oil executives say they do not expect Mr Gaddafi's plans to affect the industry, which would continue to be managed by Libya's National Oil Company.

Investment in tourism too has started, with at least three five-star hotels planned (there is only one in Tripoli today). Dubai's Emaar Properties, the regional real estate giant, is planning to develop a whole new city near the capital.

But business complains that the administration is dysfunctional, because no one dares to take the initiative or make decisions. Projects that are launched are often not followed through. Internal regime politics complicate matters. Reformers around Seif Gaddafi have been locked in a power struggle with the old guard, many of whom have financially benefited from his father's rule. Seif himself is said to be facing increasing competition for power from his brother Moatassim, the head of security.

Some analysts suggest that the idea of a government overhaul was influenced by the ambitious Seif as a way of getting rid of top officials he believes to have blocked reforms. But Seif's efforts at reforming the system without having an official position within it are seen as another sign of weakness. An exasperated Libyan describes him as a well-intentioned "dreamer" who wants to introduce a degree of liberalisation but who "is not day-to-day in the kitchen, which is a problem".

Adding to the confusion, Seif announced late last month that he was retreating from politics. Strangely, he declared that the creation of "new institutions" meant he would no longer need to intervene in affairs of state.

"Reforms will start by a new administration structure and end with a popular contract which will keep the Jamahiriya system in place but with a new form that is different from the bad initial one," he said. But political analysts play down his exit, suggesting that it was designed to put pressure on the old guard and strengthen Seif's position within the regime.

As rivalries play themselves out at the top, businessmen and analysts are waiting for the outcome of deliberations by various committees, which have been charged with interpreting Mr Gaddafi's new demands and figuring out how the country will work and how a wealth distribution system will operate.

According to Khaled Sakr, head of the International Monetary Fund's mission to Libya, only $4bn has been included in the budget for direct distribution to Libyan citizens this year. He says he would be more alarmed about the implications for inflation and the quality of expenditure if the much larger amount originally announced – $20bn-$25bn – were being disbursed.

It is not clear yet, however, how much will be allocated for next year or what form it will take: cash, shares in companies or a combination of both. Business says the uncertainty is slowing the workings of government even more than usual. They complain that the confusion imposed by the leadership could prove another lost opportunity for Libya. "What they're doing is nonsense – it comes from the view that everything else has been tried but didn't work," says one businessman who has worked in Libya. "Maybe it's a revolution on the revolution and it keeps everyone on their toes but it's a wild experiment."

Dirk Vanderwalle, a professor at Dartmouth College of the US and a Libya specialist, says the leader's latest revolution is, above all, a sign of the regime's inability to create a modern state responsive to the needs of its citizens. "Libya needs a much stronger state that actively adjudicates between citizens and channels money in a meaningful fashion throughout the economy. But he [Mr Gaddafi] says, 'let's just simply hand it over to the people' without ensuring it's done fairly or equitably, and without accountability."

From the 'third universal theory' to 'we cannot go on like this'

In 1977, Muammer Gaddafi created his own theory of government to consolidate his revolution. Choosing neither capitalism nor communism, he came up with the "third universal theory", which he detailed in his famous *Green Book*, and turned his state into a Jamahiriya, which means "the rule of the masses".

A form of socialism with Islamist overtones, the Jamahiriya system purported to give real power to the people by establishing, at least in appearance, a direct democracy.

In reality, however, the system allowed neither political parties nor elections. It created a complicated structure that ensured Mr Gaddafi – whose title is Guide of the First of September Revolution – ruled unchallenged.

Under his unique style of government, Libyans are represented through local congresses, each of which sends a representative to the General People's Congress. This body is supposed to act as a legislative assembly, but it has no real power and is used simply to confirm Mr Gaddafi's decisions.

Day-to-day decision-making meanwhile resides in the so-called General People's Committees, the equivalent of a cabinet, with its secretaries acting as heads of ministries. More substantial power has in the past resided in revolutionary committees, headed by people close to the leader and with young, zealous members. The power of these committees, often described as the regime's watchdogs, was curtailed in the 1980s, however, after they faced mounting accusations of abuse.

Now Mr Gaddafi is turning against his own system. In March, he said the General People's Committees had failed to manage resources and satisfy Libyans' needs. "We cannot go on like this, especially when the price of oil has reached more than $100 per barrel," he said.

The cabinet, he concluded, must be dissolved. Instead, Libyans would form "real people's committees". They would be given the cash so they could allocate funds for infrastructure, education and health – and in this way ensure that the money was well spent.

Russia lays down the law for a world in need of its wares

The Kremlin is taking an increasingly assertive line with its trading partners – and there is little they can do about it

Russia has never been big on adopting international standards. While most of Europe had brought in the Gregorian calendar by the end of the 18th century, it took Russia until after the Bolshevik revolution of 1917 to fall into line.

But since last month's Georgian crisis, Moscow has taken a string of actions that look to many like a deliberate abrogation of international economic rules. In quick succession, it held up streams of Turkish trucks at customs posts, announced it would suspend commitments made as part of its application to join the World Trade Organisation, banned poultry imports from 19 American companies and declared it would "review" the trade privileges it currently extends to Ukraine.

Anders Aslund at the Peterson Institute for International Economics in Washington, a critic of the current Kremlin, says: "Russia has been breaking agreements at the rate of about two a day."

Ministers insist they are not turning their backs on the world. Dmitry Medvedev, Russia's president, said this week that Moscow – the only big trading power outside the WTO – still wants to join the club. But trade officials and experts are not confident that Russia is prepared to make the sacrifices necessary. Moscow, they say, has a distinctly mixed record of binding itself with rules that constrain trade and investment dealings with foreigners.

When it emerged from the Soviet era in the early 1990s, Russia rapidly started collecting the badges of international economic respectability. Under Boris Yeltsin, president from 1991 to 1999, it agreed a flurry of bilateral treaties protecting foreign investors and signed the Energy Charter Treaty, which aims to guarantee security of investment and supply for oil and gas. In 1993 Moscow started the long and tortuous process of applying to join the WTO.

But even before Mr Yeltsin was replaced by Vladimir Putin, there were signs that the drive to end decades – indeed, centuries – of relative economic isolation was hitting potholes. The Russian parliament, or Duma, refused to back several of the bilateral investment treaties, including one with the US, and did not ratify the ECT.

Since Mr Putin's succession, Moscow's enthusiasm for international trade and investment rules has diminished sharply. Investment treaties tailed off abruptly, while Russia adopted a new model for its treaties that gave foreign investors much less protection than the Yeltsin-era version. The Kremlin also exploited ambiguities in existing treaties to argue that Russia itself has the power to determine whether or not its government's actions constitute "expropriation" of foreign investors' interests.

Some irate investors are trying to hold Moscow to account. After the Russian government in 2004 in effect seized the assets of the oil giant Yukos, Europe-based shareholders launched the largest investment arbitration claim in history. Their lawyers argue that according to the rules of the ECT, the treaty applies even though it was not ratified. (US shareholders have no such recourse, since the US is not itself an ECT signatory.)

But experience suggests that collecting on any award might prove difficult. After Franz Sedelmayer, a German businessman, had property seized in St Petersburg, an arbitration panel ruled he was owed compensation in 1998. Russia refused to pay and it took nearly a decade of legal wrangling before he got a court to seize Russian government assets abroad. Emmanuel Gaillard, head of international arbitration at the law firm Shearman and Sterling in Paris, represents European shareholders of Yukos. He says: "Russia has a terrible record in compliance . . . They want to get the benefit of treaties without the obligations."

Vladimir Chizhov: 'We don't need these talks any more than the EU'

Russia's application to join the WTO was encountering problems even before the Georgian crisis. Each of the organisation's 153 existing members has the right to block new entrants. Trade diplomats say that Tbilisi in particular has been making things difficult, retaliating for blocks that Moscow imposed on Georgian exports two years ago by preventing meetings of the official working party on Russia's accession.

Mr Putin says that Russia will not join the WTO if the price is too high and has threatened to suspend import quotas of poultry and other produce agreed as part of its accession negotiations.

Moscow has further signalled it might revoke bilateral trade privileges for Ukraine, arguing that since its neighbour recently joined the WTO, all members of the group can use Ukraine's privileged access to the Russian market as an export platform. There is little that Kiev can do about this. Despite various attempts to bind the former Soviet states into a unified free trade area, Russia and its immediate neighbours are still covered by an ad hoc patchwork of weak trade arrangements. Mr Aslund says that with the exception of Russia's economic union with Belarus, these deals are "essentially meaningless". Unlike most bilateral and regional trade pacts, they have little binding force or recourse to dispute settlement through arbitration.

All of this has left international investors and governments singularly short of statutory instruments to stop Russia throwing its weight around in the trade arena. When the EU suggested that it might stop negotiations over renewing a "partnership agreement" with Moscow – an arrangement Mr Aslund dismisses as of mainly symbolic value in any case – Vladimir Chizhov, Russia's permanent representative to the EU, was blunt. "We don't need these talks or this new agreement any more than the EU does," he told reporters. "It is more a self-punishment for the EU."

Moscow's 13-year application process to join the WTO was encountering problems even before the Georgian crisis

High world energy and food prices have put Russia, a big net exporter of both, in a powerful negotiating position. One of the EU's key demands during Russia's WTO entry talks is for Moscow to promise not to limit or tax its commodity exports – hardly a sign of strength from Brussels.

Masha Lipman of the Carnegie Moscow Center says: "If we envision Russia's trading partners saying we are no longer importing from you, and no longer exporting to you, of course Russia would suffer, but this is totally inconceivable."

Christopher Roberts, senior trade analyst at the law firm Covington and Burling, says: "The Russians have always been a great deal better than the Europeans at interfering in trade. If the Europeans try it, their traders are up in arms."

Mr Medvedev said this week that Russia had no wish to be an outcast. "We don't need any confrontation or isolation," he said. "We had enough of it for decades." But unless Moscow's hand is forced by turbulence in its banking system or by a collapse in the demand for oil, the price of acquiring all the badges of international propriety may be more than it wants to pay.

Alan Beattie and Charles Clover