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Libya's Transformation to an Islamic Financial System: Issues and Challenges

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Abstract

The Libya's revolutionary government after the Gaddafi regime legislated the prohibition of all dealings that involve interest (riba). Commercial banks were then obliged to convert to Islamic banking from January 1, 2015. This law was practically difficult to implement, which led to the extension of its implementation until 2020. This paper traces the origin of this transformation process right from the independence of Libya in 1951 to identify the motives, obstacles and underlying issues in the transformation process to Islamic banking. There is still no full-fledged Islamic bank operating in Libya because of these problems. Some of the key problems include inadequacy of a framework for Islamic banking and lack of skilled manpower in Libyan banks regarding Islamic banking products. Other problems are lack of knowledge about the theory and practice of Islamic banking among stakeholders and their unawareness and negative perceptions on Islamic banking system. The banks in Libya are also not willing to set strategies that will aid in a successful conversion due to resistance to change attitude especially among bank managers. Indeed, the current political, economic and social environment is in a dearth that seriously affect the progress of the transition program.

Key Words: *Libya, Islamic Banking, Transformation Process, Literature Review, Islamic Financial System*.

Introduction

Libya is a developing country located in North Africa on the south coast of the Mediterranean Sea, which is considered as the link between Africa and South Europe. It has an area of 1,759,540 square kilometers, which is the fourth largest country in Africa. It has a population of over five and a half million (5,673,000) (Libya State, 2006). Arabic is the formal language while English is limited to business and trade and some universities.

In the economic context, Libya as a developing country still depends on oil revenue as its sole source for income and development in the State since the sixties of the last century. After three decades of the strict economic and government control, recent years has seen attempts by the Libyan government to move towards an open market economy to encourage foreign investment. To achieve this purpose, the law no. 5 of *1997* came as a response to the Libyan intention towards moving to liberalization and economic that will pave way of creating an open market economy and privatization. This law encourages the foreign banks to investment in Libyan banking sector (Gait, 2009) although the state-owned banks are still dominated in more than 80% of the Libyan banking sector.

Currently, Libya has started adopting Islamic banking system. To meet this purpose, the Libyan legislator has issued serval laws to enable Islamic banking products in the country. However, until now there is no single fully Islamic bank in Libya. The operations are just limited to Islamic branches and windows.

The purpose of this paper is to present the Libyan financial system with special focus on the Libyan banking model which have passed many changes during the last four decades until the period of adopting Islamic banking methods. The paper also goes further to explore the problems facing the transformation to an Islamic financial system.

History of the Libyan Financial System

Libyan Economy (From 1951-1969)

Libya at the day of independence in 1951was one of the poorest countries in the world. Libyan people at that time gained a per capita income of less than US$50 per year. The economy was dependent on the agriculture and the aid from western countries such as USA and UK. This period was known as the period pre-discovery of petroleum (Gait, 2009). In the beginning of the sixties of the last century, oil was discovered Libya and this led to a quantum leap in the Libyan economy. St John states that since the discovery of oil in commercial quantities in the east of Libya's oil exports in 1959, there was significant increase from $40 million in 1962 to $625 million in 1967 within eight years of its first shipment (St John, 2008).

Since 1962, oil has become a key factor in economic growth of the sector in Libya where it became the main source of foreign currency in Libya as well as the financier of important sectors in the country such as education, health, imports of goods to Libya (Masoud, 2013). Therefore, oil revenue became the first cornerstone of the government plan for development in Libya between 1963-1968. Accordingly, Encyclopaedia of the Nations, 2007 confirms that the main aim of the Libyan development plan (1963-1968) was to improve major sectors such as the industrial sector and the agricultural sector. This impacted positively on the Libyan economic growth since the first plan for economic development in Libya and the growing of oil revenues contributed to increasing the contribution of other sectors such as agriculture and thus an increase in the income of the state. The value of total output of GDP increased from LYD277.000 million in 1963 to LYD1,194.000 million in 1968. On a percentage basis, this represented an increase of more than 330% between 1963 and 1968 (Gait, 2009).

Transition to a Socialist Economy (From 1970-1987)

The year 1969 saw significant changes in Libya where Gaddafi took power to rule Libya after they overthrew the royal regime in Libya, declaring a revolutionary government. Immediately, the Libyan new government, since 1970 started to change the economy from a capitalist-oriented to a socialist-oriented economy.

The revolutionary government implemented the socialist philosophy which is based on spending on the public sector and reduce economic freedom for individuals and their right to own properties. These policies were reflected clearly on the government's plans for development from 1976 to 1980 and from 1981 to 1985, which saw the expansion of the role of the public sector to the private sector account, and thus cancelled the private sector and the government became responsible for management of all economic activities in Libya (Alafi & Bruijn, 2010).

To implement the socialist economy policy, Gaddafi's government issued some laws to actualize this, such as Law 65 (1970) pertaining to merchants and commercial companies. The second paragraph clause 7 in this law imposes co-operative companies to put out their stock for public trading. Moreover, the law limited the role of stock exchange market and prevented the companies from the issuing stocks for public dealing as well as preventing individuals from commercial activities such as brokerage and identified penalties for non- compliance. Also, Law no. 87 of 1975 on the organization of operations by commercial agencies, limited commercial activities to public companies only. The aim of all these laws at that time was to reduce commercial activities and abolish the private sector and enhance government control in the economic activities in Libya and encourage internal trade only (Masoud, 2014).

The activities during this period and all companies operating in the State were fully controlled by the Libyan government. This also includes the nationalization of all companies in the oil sector and curtailed the role of foreign oil companies in Libya on behalf of the Libyan government. In addition, there was the abolition of the role of the private sector to contribute to the development of the Libyan economy (Khalifa, Edweib & Shafii, 2013).

Deregulation Programme (1987-2011)

The control of the Libyan economy by the government during the seventies and mid-eighties led to negative consequences for the economy of Libya whether at the macro level which the oil sector dominates on the economic performance in the country or at micro level. The economy suffered from low performance of public companies, despite the significant investments in public sector in the fields of industry and agriculture by the Libyan government in the seventies an eighties of last century. The investments have reached 40 billion LD between 1970 and 2000. The goal of these investments was to reduce the dependence on oil and creating a production base that would help to diversify national income sources. Instead of that, the public sector suffered from many problems, such as mismanagement of public companies, over employment of staff beyond necessity, the accumulation of losses and debts of domestic banks and the worst of that is failure to achieve the objectives of government which is to reduce dependence on oil revenues and diversify the sources of the national income. (Sheranna & Farhat, 2013). The situation became worse when oil prices crashed in the second half of the eighties. The worst scenario was when the United Nations in 1992 imposed economic sanctions on Libya due to the famous case of the Lockerbie bombing in 1988 (St. John, 2008). To reduce the economic loss at that stage, the government stopped public spending and froze the its plans for development and give more freedom to the private sector to invest in economic activities (Shareia & Irvine, 2014). To achieve that purpose the Libyan government passed some laws and regulations to encourage the private sector, and shareholders.

Accordingly, the People's Committee Decree 427 for the year 1989, pertaining to the application of collective ownership of economic units was introduced. This law aimed to transfer the public company owned by government to cooperative companies owned by individuals. Law 9 of the year 1992, on practising economic activities was also introduced. The second clause of this law stipulated that individuals can practise economic activities freely. The law also defined the value of stock owned by the decision makers in cooperative companies on the condition that they do not exceed 100 LYD, per the following regulations:

i. Individuals in cooperative companies with a capital that exceeds 0.5 million LYD may not own more than 12% of the total number of stock.
ii. Individuals in cooperative companies with a capital that exceeds 0.5 million LYD may not own more than 10% of the total number of stock, while limiting an individual's ownership of assets and branches to 15% of the total number of stock.
iii. Individuals in cooperative companies with a capital that exceeds one million LYD may not own more than 8% of the total number of stock, whereas an individual's ownership of assets and branches may not exceed 10% of the total number of stock.
iv. Individuals in cooperative companies with a capital that exceeds two million LYD, may not own more than 5% of the total number of stock, whereas the establishment of cooperative companies is not allowed except through public writing.

The law no.1 of 1993 replaced the previous banking law 1963. The law allowed the establishment of private commercial banks with capital not exceeding LYD10,000,000. Moreover, they allowed foreign banks to establish agencies and offices in Libya and allowed the foreigners to open accounts with foreign currencies (Masoud, 2013).

Similarly, the government launched the privatization program which was aimed at transferring the property of public sector companies to the private sector companies. This involved a three-wave privatization since the mid of 1980s that started with the concept Tashrukiyya. It is a collective ownership where some partners contribute capital and another partner contributes to working under the name of cooperatives. The reason behind establishing the Tashrukiyya system was to encourage the private sector in contributing in light industries in Libya at that time. The result of the first privatization wave was 102 public firms were privatized and 10,233 new private firms were created, according to Vandewalle (1998) in early 1990s. After the first wave of privatization, the Libyan government took further action to reform the economy towards the liberalization model and introduce the concept of Sharika Musahima, or joint stock company. The purpose of this company was to benefit from previous experience to private sector and share the burden of the state company with the government. In 2003, the Libyan government launched the third wave of the privatization which was considered as the biggest stage for privatization in the country. It adopted the concept of Al-Tamleek program which aimed to encourage the Libyan citizens to own public companies (Aboujdiryha, 2011). It is worth noting that the Libyan government also established stock markets in 2007 for more support in the reform of the Libyan economy toward liberalization and towards a more market-oriented economy.

Despite all these measures toward privatization and an open market economy under the offering non-oil sectors there were no significant results. According to IMF report of 2007, only 66 of the 360 state enterprises slated for privatization or liquidation had been sold, for example between the years 1999-2003, the 97% of total exports and 75% of government revenues come from oil and gas sector largely remained under the control of the Libyan government and decreased the contribution of private investment in GDP to only 2% (St John, 2008).

Other than the government that followed the implementation of the privatization program in 2002, it has been given a license to two private banks and a regional bank. In 2007, BNP Paribas has acquired 19% of the deserts of the state-owned bank with direct management control and an option to purchase additional shares up to 51 percent in 3-5 years. This was followed by Jordan's Arab Bank which invested in Wahda Bank in 2008 under similar conditions. In the same vein, the 100% privatization of Libyan Arab Airlines was achieved after it was split into three companies. Other companied privatized were the Brega Oil Marketing Company and public communications. By the end of 2007, seven companies (mostly banks) were listed with a market capitalization of LYD1.2 billion (IMF, 2008). Gaddafi's government continued to pursue privatization approach to companies and public and private sector support until 2010, then in 2011 the Libyan economy has witnessed a new phase which is the stage after Gaddafi from 2011 (Alafi & Bruijn, 2010).

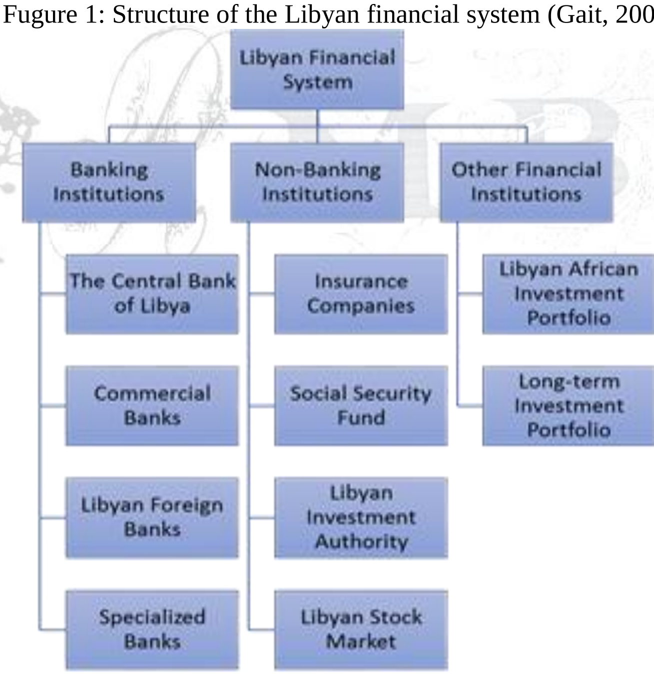
Structure of Libyan Financial System

The Libyan financial system has undergone changes during the last decades as result of political changes that happened in Libya. Notwithstanding, Libya, as a developing country has suffered from the lack of efficiency and active capital market. There was absence of a financial market for trading stocks and shares until 2004. The result of that was that the investment activities were majorly in the Real estate sector. Nevertheless, the Libyan financial sector witnessed a remarkable development in last ten years especially in the banking sector due to the privatization program by the Libyan government to encourage the private sector to invest and contribute to the development of the banking sector.

Despite the privatization program, there were also efforts to encourage foreign investment and the private sector to contribute to the development of the banking sector, which represents more than 81% of the assets of the Libyan financial sector (Troug & Sbia, 2015). Regarding market share of commercial banks in Libya, the assets of four state banks out of 16 commercial banks namely Al-Jumhouria bank, National Commercial Bank, Al-Wahda Bank, Al-Sahari Bank formed 80.7% of the total assets of the Libyan banking sector until the end of the second quarter of the year 2016 (Research Statistics Department CBL, 2016).

The structure of the Libyan financial system comprises of three categories of financial institutions. These are the non-banking institutions, banking institutions and other financial institutions like Libyan foreign investment companies (figure 1). These institutions are addressed briefly as follows:

Fugure 1: Structure of the Libyan financial system (Gait, 2009)



Non-Banking and other Financial Institutions

Non-bank institutions in Libya are those institutions that do not practice commercial activities of banks and do not have the license of commercial activities banking in Libya. They represent 19.3% the assets of the Libyan financial sector. It is useful briefly to give an overview about each of these institutions as follows:

Insurance Companies

During the period from 1951 to 1970, there were many insurance companies in Libya which offered all types of insurance such as fire insurance and life insurance. Most of those companies were foreign and only four Libyan companies were operating at that time. But since 1970, when the Gaddafi government moved out to national economy the nationalization of all these companies, he integrated them into two companies, known as the Libya Insurance Company and the Al-Mukhtar Insurance Company with 1 million LYD as capital to each. After then in 1980 Al-Mukhtar Insurance Company was integrated to the Libyan insurance company and increased the capital to 30millon LYD and Libyan Insurance Company continued as the sole insurance company until 1999 when the private sector could establish insurance companies. This began with the United Insurance Company 1999, African Insurance Company and the Al-Sahara Insurance Company in 2005 (Gait, 2009).

The number of insurance companies, according to the Central Bank of Libya are nine as at 2013 and were mostly listed on the Libyan stock market. The insurance sector now represents 16% of the shares traded in the Libyan Stock Market (The central bank of Libya, Economic Bulletin First Quarter, 2016,)

Social Security Fund

Libyan social security fund has been established in 1980 pursuant to the Social Security Act No. 13 of 1980 for social security. This fund aimed to provide protection for individuals and sponsorship in cases of old age, disability, illness, work injury, illness or protection for families when the breadwinner is lost or there is disruption in livelihoods. Also, it was aimed to provide aid for women in case of divorce and widowhood to help them in carrying family burdens in disaster and emergency situations and death. This fund served as a tool to protect and ensure the basic need of Libyan families. The sources of this fund depended on the monthly instalments deducted from salaries of employee and workers in economic sectors in Libya. Social security fund is considered as one the most successful social investment projects in Libya. The value of the social security fund investments at the end of 2011 amounted to 3,341.7 million LYD which was invested in services, hotels, real estate, and other forms of investment. The number of owned fund companies amounted to 3 companies, as total real estate owned by social security fund LD 9236 million (Central bank of Libya, 2011).

Libyan Investment Authority

Libyan investment authority was established in 2006 and started operations in the second quarter of 2007. Total assets of this institution at the end of that year reached over $ 35 billion (LIA), which is considered as sovereign wealth fund owned by Libyan state aimed to diversify and create new financial sources for wealth for new future generations in Libya by long-term investment globally. Foundation assets have recorded significant growth to about $64 billion in 2012 (Central bank of Libya, 2013).

Libyan Stock Market

Despite the spread of stock markets in middle east and north Africa long time ago, Libyan stock market has been established recently. The idea of establishing stock markets was the part of the plan of Libyan government move to liberalization and market economy. The General People's Committee issued law No. 134 in 2006, which allowed the establishment of stock markets in Libya with a capital of 400 million LYD, (Gait, 2009). In 2007, there were seven companies listed in the stock market, which included four banks, two trade companies and one insurance company. In 2013, there were 12 companies listed in main table of the Libyan stock markets. According to the CBL, banking sector was the main contribution of list (LSM) with seven banks. It represents 85.4% of the value of shares traded. The insurance sector has three companies and trading volume reached 13.89%. The investment and industrial sectors each has one company listed in the stock markets. It should be noted that the Libyan stock market has halted trading since 24/07/2014 because of the deteriorating security situation and the state of the political divide witnessed in Libya in recent times (Central Bank of Libya, 2014).

Libyan African Investment Portfolio

The Libyan African Investment Portfolio (LAIP) is an investment institution established in 2006, which totally was owned by the Libyan investment authority. This institution seeks to attract opportunities for investment in Africa to promote the diversification of Libyan income sources. This institution acquires all the share of Libyan African Investment Company (LAICO) which has investments in sectors such as agriculture, industry, hotels, real estate, trade, mining and telecommunications in 25 African countries. The Libyan African Investment Portfolio (LAIP) acts as one of the most important Libyan investment arms regionally and internationally. The assets and investments of this portfolio is estimated at US$4,205 billion (Central Bank of LIBYA, 2014).

Long-Term Investment Portfolio

The Long-term Investment portfolio was established in 1982. The purpose of establishing this portfolio is to invest a surplus of Libyan oil revenues for the benefit of the Libyan society and support financial stability and contribute to the diversification of income sources in Libya. It is considered acting as one acting as one of the investment arms of Libya internationally. In 2014, the value of the assets of this portfolio reached more than $10 billion (Central Bank of Libya, 2014).

Libyan Banking Sector

The history of Libya's banking sector centres upon the radical changes in the banking system that is associated with the changes in the political regimes in Libya. Since during the period when the Ottoman Empire occupied Libya until now, the banking system in Libya has witnessed many changes. The first bank established in Libya was the Ottoman Agriculture Bank in 1868, which aimed to support and develop agriculture. It was considered as the main income source of Libya at that time. Later another branch was opened in Tripoli. Moreover, between 1906 and 1911 two branches of the Ottoman bank were opened in Benghazi and Tripoli (Kumati, 2008).

In 1911, Italy occupied Libya, thus, many Italian banks opened branches in Libya. The first bank to open a branch Banco di Roma which started operation in 1907 to facilitate the Italy invaded colonials in Libya. After that, some Italian banks were established which include Banco De Napoli, Banco De Sicilia and the Bank of Italy. More so, the Italian Lira was the official currency traded in Libya at that time (Abouzkeh, 2013).

In 1943, the Italian-occupied colonial where defeated by allies where Britain and France took over the control of Libya. During this administration, Barclays Bank was established and on the eve of the Independence in 1951 until 1963 many foreign banks were established in Libya such as Arab Bank and then British Bank in 1963. The government issued law No. 4 which required that at least 51% of all banks in Libya must be owned by Libyan investors. After then in 1969 when Gaddafi took over, he nationalized all foreign banks in Libyan to be state owned banks which were named as National Commercial Bank, Gumhouria Bank, Sahara Bank Umma Bank and Wahda Bank, which formed most commercial banks in Libya at that time. By 1977, all private and foreign banks in Libya were revoked and replaced with state owned banks.

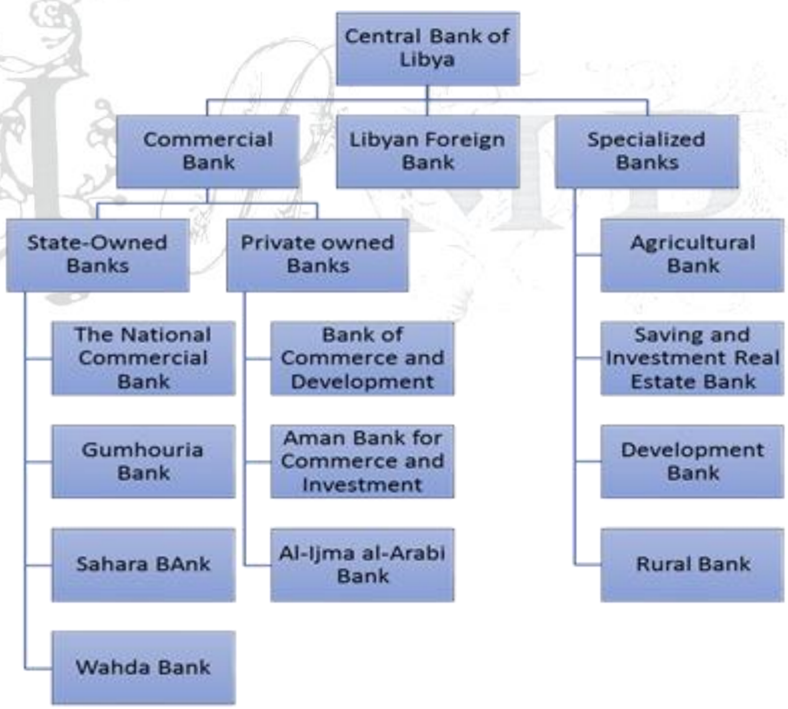
In 1993, the law No 1 reflected a major change in government policy toward banking sector. This law allowed the establishment of private banks in Libya, which was prohibited since 1977. Thus, a group of private banks were established and the first was Development and Commerce Bank in 1996, then Alsaraya

Bank and the Mediterranean Bank followed in 1997 and in 2003, Al-Ejma Al-Arabi Bank was established. Later Wafa Bank was established in 2004. In 2005, the law No.1 was replaced the banking law of 1993. The new law gave major power to CBL, which was unprecedented in the history of Libya. This allowed the CBL to be an independent authority of the government. CBL had the power to administer the monetary policy, supervise all commercial banks operating in Libya to promote economic activities (Abouzkeh, 2013).

In 2013, law No.1 issued by the revolutionary government (Libyan General National Congress) which replaced the Gaddafi regime came and prohibited all dealings in interest (riba). Commercial banks were then obliged to convert to Islamic banking from January 1, 2015. However, the implementation of this law is still yet to be made due to many obstacles that include poor experience and inefficiency in the field of Islamic banks with commercial banks. Moreover, there are problems of the deteriorating economic and security situation and the state of the political divide in Libya.

The banking institutions acting as the first financial institutions had operated in Libya whether by foreign colonized countries or by a Libyan government. But as noted earlier, since 1970 Libya had an independent banking system due to nationalisation of all banks and made all banks fully state-owned banks until 1993 where private banks where then established. Also, the role of the Central bank of Libya was further enhanced to supervise commercial bank which was also part of the Libyan legislation and law. (Figure 2).

Figure 2: The structure of Libyan banking system



Central Bank of Libya

By 1951, when Libya had its independence, there was no central bank. The Libyan Currency Committee was given the responsibility to perform the roles of a central bank. On 26 April, the National Bank was established which replaced the Libyan Currency Committee with a capital of 1,000,000 pounds. It served as the central bank and had a sole right to issue currencies on behalf of the federal government and supervision in commercial bank activity in Libya (Kumati, 2008). In 1963, bank of Libya replaced National bank and practiced the same authority as sole body to issue the local currency in Libya and oversee the commercial banks. The bank was later renamed as the central bank of Libya and its function was limited to local currency management and managing the country's reserves of gold and foreign currencies also acting as a banker of local commercial banks. Moreover, it oversees the activities of commercial banks to protect the rights of depositors and shareholders. But because of lack of the tool to impact on the monetary policy the effort of the CBL focused on the minor things such as control over the work of banks and providing information services to state-owned banks Technology. The banking law no 1 (2005) has come to give unique power to CBL which was earlier considered unprecedented. It determined the duties and responsibilities of CBL. Also, the CBL will be operated under a patronage of the secretariat of the General People's Congress (GPC). According to the article 5 of the law, the duty and responsibilities of CBL are as follows:

1. Issuing the Libyan currency and maintaining its stability within Libya and abroad.
2. Managing the government's reserves of gold and foreign exchange.
3. Regulating monetary policy and supervising currency conversion transactions within Libya and abroad.
4. Regulating credit and banking policy and supervising its implementation within the framework of government policy.
5. Achieving the goals of economic policy in terms of stabilising the general level of prices and maintaining the soundness of the banking system.
6. Managing the liquidity of the national economy.
7. Regulating and supervising the foreign exchange market.
8. Providing advice to the government on matters related to general economic policy
9. Acting as a Banker of the state which represents the financial agent of a state within its duties to maintain revenues and accounts of expenditures. It also provides banking service to the public institutions such as administering letters of credit on behalf of customers. Furthermore, it also represents the state and administers regional and international agreements regarding financial and monetary matters between Libya and other countries. It is also plays the role of supervision function in all financial institutions, commercial banks, and specialized banks (Kribat, 2009 and Central bank of Libya, 2016).

Libyan Commercial Banks

Although banking institutions in Libya have been established earlier in middle of the nineteenth century, there were foreign banks established by colonial powers, Ottoman empire, Italy and Britain, such as the Banco di Roma that was established in 1907, the Bank of Napoli, the Bank of Italy and the Banco di Sicilia in 1913 and the Barclays Bank in 1943. The actual beginning to Libyan commercial banks was in 1963 when the government decided that all commercial banks in Libya must be Libyan joint-stock companies owned by Libyan government or Libyan citizens at least 51% of shares pursuant to law No 4 of 1963. Later in 1970 and for implementing the national policy for all financial institution in the country the Banking Law No.153 of 1970 was passed. It states clearly that all Libyan banks must be fully owned by Libyan government and revoked the private banking sector. After that, the banking law NO 1 of 1993 was issued which allowed private sector to established private banks in Libya that was prohibited since the seventies of the last century (Gait, 2009).

Commercial banks in Libya can be state owned bank or banks owned by shareholders or enterprises owned by companies called bank holding companies which can be defined as "institutions which accept deposits, make business loans and offer related service" (Kumati, 2008). The Libyan Banking Law No. 1 of 2005 has defined a commercial bank as "any company that ordinarily accepts deposits in current demand accounts or time deposits, grants loans and credit facilities and engages in other such banking activities". Pursuant to this law, all banks were presumed to be joint-stock companies with capital paid of at least 10,000,000 LYD, whereas the value of each share must not exceed 10LYD which can be held by Libyan citizens or by public and private bodies. In terms of shareholders, they have the right to entrant vote based on their shares in the banks, which must not exceed 4%. Each commercial bank should have a board of directors consisting of between five and seven members. They will be selected by the General Assembly with the function of determining the remuneration of the Board of Directors. The Chairman of Board of Directors will be selected by members of boards of directors. He will be appointed as General Manager of the Bank according to the recommendation made by 2 members of boards of directors (Kumati, 2008).

According to the central bank of Libya, there are 16 commercial banks in addition to the Libyan foreign banks with 520 agency and branches spread all over Libya. The number of employees in the Libyan banking sector until the end of 2014 are 19,138 employees. The Libyan commercial banks are divided into six banks fully or majorly owned the by central bank of Libya with foreign partnership. There are two banks that are jointly owned by the state and foreign partners, which are Al-Wehda Bank and Sahara Bank. Foreign partners like Arab Bank of Jordan and the French BNP Paribas own only 19% of the share of capital and management in Al-Wehda and Sahara Banks respectively. Four state-owned banks are dominated by Libyan banking sector operation which are Jamahuriya Bank, National Commercial Bank, Sahara Bank and Wahda Bank. On the other hand, private banks are seven, four of them owned by Libyan citizens and three private banks jointly owned by the foreign partners (Central Bank of Libya, 2014) (See table 1).

Table 3: Capital ownership of commercial banks operating in Libya (Source: Hawashe, 2016)

No.	Name of the bank	Capital Ownership		
		Public Sector %	Private Sector %	Strategic Partner %
1.	Al-Jumhoria Bank	83.0	17.0	0.0
2.	National Commercial Bank	85.0	15.0	0.0
3.	Al-Wahda Bank	54.0	27.0	19..0
4.	Al-Sahari Bank	59.0	22.0	19.0
5.	North Africa Bank	82.0	18.0	0.0
6.	Al-Waha Bank	90.0	0.0	0.0
7.	Bank Alaman for Commerce and Investment	0.0	60.0	40.0
8.	Al-Wafa Bank	0.65	99.3	0.0
9.	Assaray Trade and Investment Bank	0.0	100.0	0.0
10.	First Gulf Bank	50.0	0.0	50.0
11.	Al-Mutahed Bank for Trade and Investment	3.0	57.0	40.0
12.	Arab Commercial Bank	0.0	100.0	0.0
13.	Bank of Commerce and Development	17.0	34.0	49.0
14.	Mediterranean Bank	0.0	100.0	0.0
15.	Al-Ejmaa Al-Arabei Bank	0.0	100.0	0.0

State-Owned Banks

State-owned banks are those banks that are fully owned or majorly by the Central Bank of Libya. Most of them were established in 1970 to reflect a policy of nationalizing the Libyan banking sector which was adopted by the government at that time. Nowadays state owned banks have dominated in almost ninety percent of Libya´s banking sector assets. Each of these banks have a capital base of at least 10 million Libyan Dinars. These banks will be discussed individually.

a. Gumhouria Bank

The Gumhouria Bank is a result of nationalization of the Barclays Bank, pursuant to the banking law No.1 of 1970. Since that time, it became a fully owned state bank. In 2008, Gumhouria Bank merged with Ummah bank under the name of Gumhouria Bank. Since that time, it became the biggest commercial bank in Libya and one of the ten biggest banks operatng in North Africa with a budget of up to 8 billion LYD. The bank has 146 branches and agencies across Libya, which is why it is considered as the biggest bank with highest number of branches across a country. The number of employees in this bank are up to 5807. Moreover, Gumhouria Bank, acts as a leading Islamic bank in Libya. The bank has 15 branches and 48 Islamic windows for Islamic banking services and it dominates more than 50% of the market share of Islamic banking operation in Libya (Gumhouria Bank, 2016 and Gait, 2009).

b. National Commercial Bank

National Commercial Bank was established as a joint company in Libyan with a capital of 500 million LYD under the provisions of Law No. 153 of 1970, issued on 22-12-1970. The bank's assets represent 16% of the assets of Libyan commercial banks. Since its inception, the number of branches of the bank amounted to 64 branches across Libya. It is one of the banks active in Islamic finance in Libya along with Gumhouria Bank. National Commercial Bank has 67 Islamic windows across Libya and acquired more than 25% of the market share of Islamic banking operation in Libya (National Commercial Bank 2016).

c. Sahara Bank

Sahara Bank was established in 1964 before the nationalization process in 1970. Before nationalisation, the bank was owned by Banco di Rom, Banco di Sicilia and Bank of America, along with Libyan investors which hold 51% of its shares (Kumati, 2008). Later it became a fully state-owned bank until 2008 when BNP Paribas bank acquired 18% of the total share as a foreign partnership along with CBL. This bank has many branches and agencies around Libya. It has started to offer Islamic finance services, with 1 branch and 6 Islamic windows for Islamic banking operations which represent almost 4% total share of Islamic banking operations in Libya (Central bank of Libya 2016).

d. Wahda Bank

Wahda Bank is state-owned bank established according to law (153) in the year (1970). This bank was a result of the merger of five working Banks which are the African Arab Bank, Bank of North Africa, Al-Kafela Bank, Al-Nahda bank and Commercial Bank. The assets of this bank represent 13% of total asset of libya commercial banks. CBL owns 87% of the total share and 13% acquired by foreign partnership which is Arab Jordan Bank (Wahda Bank, 2016). According to the reports of the CBL, Wahda Bank has 2 branches and 6 Islamic windows which represents more than 10% total of the share of Islamic banking in Libya,

Private Commercial Banks

Private commercial banks in Libya were established because of the Banking Law No.1 of 1993 which allowed individuals and the private sector to establish private banking in Libya for the first time since 1977. In 1996, the Bank of Commerce and Development was the first bank that operated as a private bank in Libya. Later about eight private banks were established in Libya but their contribution in Libyan banking operation is still limited. In the same context, the total share of assets of all private banks did not exceed 12% of the total share of assets of Libyan commercial banks. There most successful private commercial banks are Bank of Commerce and Development (BCD) which is the first private bank that was established in Libya and the most successful private bank, then Aman Commerce and Investment Bank and lastly Aljma Alarabi Bank which is considered as more competitive to Bank of Commerce and Development.

a. Bank of Commerce and Development

The Bank of Commerce and Development was established as a joint-stock company in 1995 and started operations in 1996 with a capital of LYD 9.000 million in the city of Benghazi. It is the second largest city in Libya at that time. This bank was the first private bank that was established in Libya since the seventies of last century according to the banking law No1, 1993 which allowed individuals and private sector to establish private banks (Kumati, 2008). Currently, this bank has 32 branches around Libya. Moreover, the total assets of this bank amounts to almost 2 billion USD with 820 employees (Bank of Commerce and Development 2016). Bank of Commerce and Development entered a strategic partnership with Qatar National Bank which acquired 49% of the total equity capital in this bank (Central Bank of Libya, 2014).

b. Aman Commerce and Investment Bank

Aman Bank for Commerce & Investment was established in 2003 in the city of Tripoli as a Libyan shareholder company owned by the private Libyan sector with 10 million LYD pursuant to Banking Law no. 1 of 1993. Currently, Aman bank increased its capital to 100,020,000 LYD. Portuguese Banco Espirito Santo has owned 40% from the total share of Aman bank as a foreign partner to private Libyan banks. The foreign bank has a right to appointment four members of the Board of Directors alongside with three Libyan Board members including the Chairman (Aman Bank, 2016).

c. Aljma Alarabi Bank

Alijmae Al-arabi Bank was established in 2003 as a private bank fully owned by the Libyan private sector in the city of Benghazi with a capital of 1 million LYD. The bank has three branches and nine agencies across Libya. In terms of Islamic banking, the bank still limited its operations to only one branch yet to be established (Alijma Al-arabi Bank, 2016).

Libyan Foreign Bank

Libyan Foreign Bank is considered as Libyan joint stock company which was established by the Law No (18) of 1972. It operates as an offshore bank and practices business in various banks abroad through a series of contributions to the management of the institutions. The nature of these banks is that their operations are outside Libya but still they can operate in Libya via their units in Libya called the Libyan Dinar Unit. The purpose of this bank is to serve as a wholesale bank. The capital base of the bank stood at 7 billion USD, which the actual amount paid was 3 billion USD. The bank however is totally owned by the Central Bank of Libya.

Specialised Banks

These banks specialize and practice one type of banking activity rather than exercise the normal commercial banking activities. According to the Banking Law No.1 of 2005:

“A specialized bank whose main purpose is to finance and grant credit for specific activities, and whose basic activities do not include the acceptance of demand deposits, shall not be considered a commercial bank” (Gait, 2009).

Currently there are four specialized banks in Libya which are Agriculture Bank, Saving and Real Estate Investment Bank, Development Bank and lastly, Rural Bank. The task of these banks to finance diversified development projects whether in industry field or agriculture and real estate as well as give servicing loans. Moreover, the Rural Bank cares about financing individual’s activities and families who have a limited income in various economic fields (Central bank of Libya, 2012). These four specialized banks will be discussed briefly as follows:

a. Bank of Agricultural

Agricultural Bank was established in 1959 with a capital of LYD1,000 million. Initially it was called National Bank of Agriculture. It is considered as the oldest specialized bank in Libya according to the law. The aim of this bank is promoting agricultural sector by providing short and long-term loans to Libyan farmers to promote agricultural activities (Gait, 2009). The total value of loans granted by the bank in the year 2011 was more than 113 million LYD. Long-term loans accounted for 67% of the total loans granted by the bank (Central Bank of Libya, 2014).

b. Saving and Real Estate Investment Bank

Saving and Investment Real Estate Bank was established pursuant to Law No.2 in 1981 with 100 million of capital. The purpose behind establishing this bank is to finance real estate activities and provide loans whether to the corporate or individual for the investment in real estate by building and renting of houses (Gait, 2009). In 2011 the number of mortgages granted by the bank amounted to about 5745.7 million LYD (Central Bank of Libya, 2014).

c. Development Bank

The Development Bank was established pursuant to the Law No.8 1981 as a specialized bank with a capital of LYD100.000 million. It is fully owned by Libyan state. The aim of this bank is to develop the various Libyan areas and create jobs and raise the standard of living of the inhabitants of these areas to ensure stability. The bank has 27 branches around Libya, and 571 employees (Development Bank2016). The number of loans granted by the bank in 2012 was 51.4 million (Central Bank of Libya, 2014).

d. Rural Bank

This bank was established in 2002 and fully owned by the Libyan government with a capital of 100 million LYD. The objective of the rural bank is to improve and develop the rural areas in Libya by providing loans to support industrial and services sectors in these areas to ensure the contribution of rural areas is obtainable in developing Libyan economy (Gait, 2009). The number of loans granted by the bank since its inception is more than 150,000 loan with a total value amounting to 624 million as the share of the service sector. More than 40% of total loans and 28% for livestock breeding and the remainder is distributed between the agricultural, industrial and fishing sectors (Central Bank of Libya, 2014).

Banking Laws and Regulations in Libya

Since Libya's independence, the banking system has seen many changes that led to revising the banking laws that were enacted for more than fifty years. Naturally, these laws reflect the nature of the political and economic changes in Libya. As mentioned before, the early banking institutions in Libya were established by various foreign colonies like Ottoman empire and Italy. There was no actual Libyan banking system even after the Libyan independence in 1951. The first banking law in Libya was in 1957, which gave powers to the Ministry of Finance to organize and save cash reserves as well as oversee and control of commercial banks that normally is a unique function of the Central Bank. This is because Libyan government at that time had contractual and financial obligations with the British government (Kumati, 2008). But the actual beginning of the Libyan banking system was with the issuance of the Libyan banking law No.4 of 1963. This law stated clearly that all commercial banks that were operating in Libya at that time must become Libyan joint companies and the Libyan government and Libyan citizens must own at least 51% of the total shares. Due to this law, many of the foreign banks became national Libyan banks such as the Banco di Roma became the Umma Bank and the Banco di Sicilia became the Sahara Bank (Gait, 2009). Also, this law aimed to determine the objectives of CBL, which promotes sustained growth in the economy and maintains monetary stability in Libya in accordance with the government's general economic policy for the country (Kumati, 2008).

Later in 1970 the revolutionary government issued the banking law No.153 of 1970 which aimed to nationalize all commercial banks operating in Libya to be fully state-owned banks. The result of the implementation of this law by the year 1977 is that all the private and foreign banks were abandoned in favour of the public bank sector and yet still the public-sector banks dominated the banking activity in Libya.

Later the banking Law No. 1 of 1993 was issued to meet the new government policy which stipulates move to liberalization and open market economy. The aim of this law was to organize the banks, cash and credit system in Libya. Addition to this feature is that it allowed to establish private banks in Libya since 1969. Moreover, it encouraged foreign banks to operate in Libya. The result of this law was the establishment of many private banks in the country (Abouzkeh, 2013).

Banking Law No. 1 of 1993 was replaced by No. 1 of 2005. This law has three chapters with 121 articles. These chapters deal with the functions of the central bank, commercial banks, and penalties respectively. This law aimed to regulate business of the banking sector including CBL, specialised banks, and commercial banks. Article 5 stipulated the duties and responsibilities of CBL which is regulating and supervising the credit and banking policy, issuing the Libyan currency, management of reserves Gold and foreign exchange for the country. Moreover, article 7 stipulated the duties of CBL in controlling and monitor all activities of commercial banks operating in the country as well and controlling and regulating the relationship among commercial banks in Libya. Article No 65 defined the commercial banks as:

“Any company that ordinarily accepts deposits in current demand account or time deposits, grants loans and credit facilities, and engages in other such banking activities according to the provisions of paragraph (II) of this article shall be considered a commercial bank"

Also, Paragraph (II) of Article 65 identifies the commercial banks' activities as follows:

1. The cashing of cheques made out to and by customers.
2. Services relating to documentary credits, documents for collection, and letters of credit.
3. Issuance and management of instruments of payment including monetary drawings, financial transfers, payment and credit cards, traveler’s checks, etc.
4. Sale and purchase transactions involving monetary market instruments and capital market instrument to the credit of the bank or its customers.
5. The purchase and sale of debt, with or without the right of recourse.
6. Lease financing operations.
7. Foreign exchange transactions in spot and forward exchange markets.
8. The management, coverage, distribution, and transition of banknote issues.
9. The provision of investment and other services for investment portfolios, and the provision of investment trustee services, including the management and investment of funds for a third party.
10. Management and safekeeping of securities and valuables.
11. Provision of trustee or financial investor services.
12. Any other banking activities approved by the Central Bank of Libya. According to this law, all commercial bank must exercise these activities (Barghathi, 2014)

After the revolution of 17 February in 2011, due to increased pressure from the Libyan society to embrace Islamic banks, on July 2012, the National Transitional Council issued the law No. 46 on the amendment of banking Law No. 1 of 2005. The aim of this amendment is to enable Islamic banks to operate effectively within Libyan banking system. The new Banking Law No. 46, 2012 did not make any essential changes to law No 1 of 2005, instead it added nine duplicated Articles (i.e.100/1-100/9) regarding Islamic banking business in Libya (Hawashe, 2016).

Article (100/1) defines an Islamic bank as the bank which is established according to the activities of Islamic banking in terms of deposits from saving, forms of Islamic finance and investment or other services rendered by such banks. This is to acquire economic and social benefits in accordance to the approval of the central Shari'ah supervisory body.

Moreover, this article has defined some terms relevant to Islamic banking such as, Islamic banking branches as branches established by the conventional banks. Therefore, such banks must have separate capital and financing such that the funds are not co-mingled with the usurious assets of the conventional banks and must also be controlled by a special body for Islamic banking.

Article (100/3) stipulates that Islamic Banks may be licensed the practice of Islamic banking activities do the following banking businesses:

1. Accepting deposits from customers for current accounts
2. Acceptance of funds of investors in the joint investment accounts.
3. To finance economic activities that do not contradict with the provisions of Sharia and Islamic operations, using the legitimate contracts, such as Mudharaba, Musharaka, Murabaha sale and other contracts proposed by the legitimate bodies of commercial banks and approved by the Central Shari'ah Board of the Central Bank of Libya.
4. Using of funds of customer's in the accounts of joint investments with the Islamic Bank's resources according to joint mudarabah or investing in a dedicated investment account as agreed with the client.

Article (100/5) states that Islamic banks are subject to the provisions of the central bank of Libya like the conventional banks except where the rules contravene the Shari'ah law. The Board of the Central Bank of Libya puts controls governing the business of Islamic banks, which includes standards and controls needed for transferring the conventional bank into an Islamic bank or to open branches and windows for Islamic banking.

Article (100/6 and 7) focuses on the role of Shari'ah boards like in CBL or in the commercial bank that practices Islamic banking activities. Article (100/6) provides that the Central Bank of Libya shall appoint a central Shari'ah body that is composed of five specialist members of the law and the jurisprudence of Islamic transactions in addition to three other specialists in the areas of law, economics and banking. Its decisions shall be binding on all Shari'ah boards in all Libyan banks to exercise Islamic banking activities.
Article (100/7) stipulates that all banks practising Islamic banking must have a Shari'ah board consisting of three members specialized professional in Shari'ah, law banking and experienced in the jurisprudence of transactions. They shall be appointed the general assembly of the bank for three years and may be appointed again (Libya, 2012).

The banking law no. 46 is a quantum leap in the history of Libyan banks towards the adoption of Islamic finance in Libya. This law has paved the way towards the issuance of law no. 1 of 2013 on stopping the dealings in usurious transactions in the Libyan commercial banks. According to articles 1 and 2 of the law No 1 2013 it is made clear and explicit to stop all transactions in riba, whether by individuals or legal entities.

Article 6 of the Act provides the imposition of sanctions on violators of this law that may lead to imprisonment of at least two years and a fine of up to 10,000 LYD. Article 7 stipulates the period for the beginning of the implementation of this law on individuals and corporate bodies is from 01/01/2015 (Libyan law no 1, 2013).

Islamic Banking in Libya

Despite the widespread Islamic banking phenomenon around the world and especially in the Middle East and North Africa, Libya recently started showing interested in Islamic banking. Before 2011, there was little of attention and support from the Libyan government toward Islamic banking. The first preparation to start to Islamic banking in Libya was in 2009, where the Central Bank of Libya issued guideline number 9, which allows banks to deal with banking products that are compliant with the provisions of the Shari'ah, like Murabaha, Mudaraba and Musharaka, or other formulas that are developed. By that time many Libyan commercial banks have started operations Islamic banking such as Wahda Bank,Sahara Bank and Jamahiriya Bank which is the biggest commercial bank operating in Libya.

Similarly, to organize and guide the issuance of products and services for Islamic banking, the Central Bank of Libya issued guideline number 9/2010 on the rules and regulations to provide alternative banking products compliant with the provisions of Shari'ah for the operations of commercial banks in Libya. The guideline gave the necessary procedures for opening new branches for Islamic window and the requirements for Shari'ah supervisory of the respective banks (Khafafa & Shafii, 2013).

However, with the change of the Libyan political system in 2011, Islamic banking saw a growing interest in Libya and thus, the government issued several laws to support Islamic banking industry in the country. One of the important law was the law number 46 of 2012, which was an amendment of the previous law on commercial banking operations. The law added one chapter for specifically for the operation of Islamic banking.

Table 2: The statement of the turnover of Islamic banks in operating banks in relation to credit portfolios and the market share of each bank as at 30/06/2016. (Source: Central bank of Libya, 2016)

	Banks	**Branches of Islamic banking**	**Windows of Islamic banking**	**% of windows of Islamic banking in banks**	**The size of the bank Financial recruitment according to the Islamic modes of financing**			**The size of Credit portfolio of the bank**	**Islamic finance to the total credit portfolio ratio**	**Market share**
					Murabahah	**Musharakah**	**Total**			
1	Al-Gumhouria	15	148	52.75%	2,400,432,921.00	570,343,784.00	2,970,776,705.00	8,829,813,052.00	33.64%	56.78%
2	National Commerce Banks	0	67	21.68%	1,384,523,818.00	0	1,384,523,818.00	4,494,726,424.00	30.80%	26.46%
3	Al-Wehda	2	6	2.59%	551,286,018.00	0	551,286,018.00	2,147,830,693.00	25.67%	10.54%
4	Al-Sahari	1	6	2.27%	208,981,398.40	0	208,981,398.40	1,847,812,610.00	11.31%	3.99%
5	North Africa Bank	1	48	15.86%	25,610,268.80	0	25,610,268.80	852,953,840.00	3.00%	0.49%
6	Al-Muttahid for Training and Investment	1	10	3.56%	80,822,699.00	0	80,822,699.00	119,753,215.00	67.49%	1.54%
7	Al-Waha	1	0	0.32%	10,447,983.80	0	10,447,983.80	190,674,665.00	5.48%	0.20%
8	An-Nuran	2	0	0.65%	0	0	–	–	–	–
9	Al-Ejma Al-Arabi	1	0	0.32%	0	0	0	209,964,954.00	0.00%	0.00%
Total		**24**	**285**	**100.00%**	**4,662,105,107.00**	**570,343,784.00**	**5,232,448,891.00**	**18,693,529,453.00**	**27.99%**	**100.00%**

The final regulation by the Parliament was that the law no. 1 of 2013, which prohibits usury in all financial dealing in Libya, whether for individuals or corporates. Banks were given grace period to fully prepare before January, 2015 after, which legal action will be taken.

To meet increased demand on the Islamic banking facilities in Libya, Gumhouria bank opened many branches and banking windows to offer Islamic banking products and services. Yet, currently in this bank, the Islamic banking services are heavily Murabaha contracts. (El-Wafi & Riyny, 2012). Many banks followed Gumhouria bank and opened branches and windows to offer Islamic banking services in Libya. For instance, National Commercial Bank, Sahara Bank, Wahda bank and North Africa bank. (See appendix 4).

The Reality and Size of Islamic Banking in Libya

The Central Bank of Libya supervises and controls the conventional banks that engage in Islamic banking through branches and windows of Islamic banking subsidiaries in commercial banks through the Department of Islamic Banking Superintendency of Banks and cash management. The number of banks that have been granted permission to establish branches or Islamic banking windows or convert bank branches has reached nine, which are all commercial banks operating in Libya as at 30th June 2016.

The Islamic banks and Islamic windows across Libya were spread all over the country. The Gumhouria bank requested for a lion share Islamic banks and windows with 15 branches and 48 windows which comprises about 52.7% of the total Islamic bank branches in Libya. The second bank operating Islamic window is the National Commercial banks with 67 window, which represents 21.6%. North Africa banks had only one branch with 48 windows comprising 15.8% followed by United Trade banks and investment with only one branch and 10 windows, representing 3.5%. Next is Wahda bank with six window and two branches (2.5%) and then Sahara bank with six windows and one branch (2.2%). Bank of Noran had two branches (0.6%) and Waha and Al-Ijma Al-Arabi with only one branch for each bank (0.3%).

The financing products of the Islamic banks are limited to Murabaha products such that about 91% of the products are based on Murabaha. Musharaka accounts for only 9%, which is offered by Gumhouria bank only. It should be noted that the Central Bank of Libya reports that there are five Islamic banks under formation in Libya currently.

Conclusion

This paper has so far presented the economic and financial system of Libya, which was seriously affected by political changes since the colonial period and before the discovery of oil in the 1960s. The economy passed through stages of nationalism and because of the economic reforms that followed, the nation moved to a system of open market system for development of the economy. However, the Libyan economy is still government-controlled and it completely depends on oil revenues. In terms of its financial system, it is still small and being controlled by the Central Bank of Libya.

Moreover, the Libyan financial system faces several challenges and issues such as the absence of a body for securities exchange for the last four decades which effected the development of the Libyan banking system. In fact, the Libyan financial system in general and particularly the banking sector has suffered from the domination of the public sector which acquires more than 80% of the operations of the Libyan banking system and the absence of the effective role to private sector and foreign investment. Similarly, the domination of the Central Bank of Libya by having the power to control credit and interest rate also contributed to the drawback of the system. Also, most Libyan investments are performed outside the country instead of utilizing such opportunities to support and develop the economy and financial system.

However, the sudden introduction of the Islamic banking system in Libya in 2013 after a long period of its absence will certainly be coupled with several problems that will need to be addressed. In fact, there is still no full-fledged Islamic bank operating in Libya because of these problems. Some of the key problems inherent in this transition include inadequacy of the framework for Islamic banking and lack of skilled manpower in Libyan banks regarding Islamic banking products. Other problems are lack of knowledge about the theory and practice of Islamic banking among stakeholders and their unawareness and negative perceptions on Islamic banking system. The banks in Libya are also not willing to set strategies that will aid in a successful conversion due to resistance to change attitude especially among bank managers. There is also a lack of product development and innovation and lack of staff training. Indeed, the current political, economic and social environment is in a dearth that seriously affect the progress of the transition program.

Nevertheless, it can be observed that the problems are enormous, which a study like this could not be able to cover everything. Further study should focus on devising ways to improve the perceptions, awareness and knowledge of Libyan banking stakeholders towards Islamic banking and finance by investigating the determinants of these variables.

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