

COMMITTEE OF THE CIVIL PROJECT

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MACRO-ECONOMIC POLICY, DEBT AND AID

Post-conflict Sudan will be deeply indebted and aid dependent. Experience of post-conflict transitions in Sudan and elsewhere indicates that appropriate economic policies and the correct sequencing of political and economic transitions are essential if the right outcome is to be achieved. Sudan should not rely on rapid and generous assistance from western donors: a transition to peace and democracy will probably see an increase in aid, but donors will insist on conditions before providing debt relief and major development assistance. Some of the basic principles for the post-transition economic arrangements will need to be agreed between the major parties, and possibly discussed with donors and creditors, before the political transition is negotiated. This issue paper will address some of the questions that arise.

Dimensions of the Problem

Assessing Sudan's economic performance is complicated by the unreliability of statistics. Many of the figures for government income and expenditure, inflation, growth and production are based on Sudan Government estimates, which are not always reliable. For example, official figures for defence expenditure are grossly understated. However, figures for debt, balance of payments, international financial flows and aid are much more accurate.

This section outlines some of the major elements of Sudan's current economic position.

Debt

Per capita, Sudan is one of the world's most highly-indebted countries. The debt burden is huge and completely unsustainable. Even though Sudan cannot borrow, because of arrears on the existing debt, Sudan's liability is increasing. Even the consolidated debt arrears themselves—totally about \$6bn—are unpayable.

Table 1
Sudan's external debt (World Bank estimates) (\$m)

	1992	1993	1994	1995	1996	1997	1998
Total med/long term	9,480	9,490	9,896	10,275	9,865		
Short term	5,047	5,424	6,042	6,368	6,214		
<i>of which, interest arrears</i>	<i>4,419</i>	<i>4,796</i>	<i>5,414</i>	<i>5,737</i>	<i>5,683</i>		
Total external debt	15,450	15,837	16,918	17,603	16,972	21,269	22,355
Total debt service paid	27	20	3	69	48		
% of debt service paid	5.3	4.6	0.5	9.4	5.2		

Sources: Economist Intelligence Unit Country Profile 1998-99, World Bank

Commentary:

Most of Sudan's debt was run up in the 1970s, and well over half the outstanding amount consists of the consolidated arrears on interest payments. Sudan is repaying only a very small fraction of the debt it owes, and its arrears are continuing to mount. No lender of any sort is prepared to lend money to Sudan at present.

A particular aspect of Sudan's debt crisis is its arrears to the IMF. In 1986, when Sudan was suspended from the IMF, the unpaid debt and arrears stood at about \$260m. In 1990, after repeated failure to pay arrears and implement agreed macroeconomic changes, the IMF declared Sudan 'non-cooperative'—potentially the first step to the unprecedented step of expulsion. Since then, Sudan's debt to the IMF has mounted to reach \$1.57bn by April 1999 (the largest arrears of any debtor to the IMF). Although this is a small part of Sudan's overall debt, it is particularly significant as (a) the IMF's statutes restrict its ability to forgive debt and enter into agreements with defaulters, and (b) the IMF also plays the role of international umpire for the acceptability of financial and economic arrangements—without the IMF's imprimatur, Sudan is very unlikely to achieve any debt forgiveness by major creditors.

In 1997, the Sudan Government reached an agreement with the IMF which involved paying \$4.5m per month against the arrears. Sudan has complied with this—so that virtually the entire debt service payments it has been making have been to the IMF, totally neglecting the other debtors. The IMF also insisted on some other economic policy changes. The Sudan Government has averted the danger of expulsion, and the IMF expressed its satisfaction at recent performance in debt repayment and economic reform. In September 1999 the IMF lifted its declaration of non-cooperation with Sudan. The next step, dependent on continued good performance on economic reform and debt repayment, may be reversing Sudan's suspension. But even with full status regained at the IMF, Sudan would be a long way from being eligible for further loans from the IMF, or indeed from any other major creditor. The arrears are simply too vast and the macroeconomic imbalances too huge for Sudan to be attractive to any lender.

Without a far-reaching agreement with creditors, including massive debt forgiveness, there is no realistic prospect of Sudan being able to pay off the arrears on its international debt, let alone the principal.

Sudan's debt is owed to a very wide range of creditors, including the IMF, other international financial institutions, Paris Club members, Arab countries, former eastern bloc countries, and commercial banks. Most of the debt consists of liabilities incurred in the 1970s plus interest arrears—which by now well exceed the original loans. The complexities of the loan arrangements in the 1970s meant that in 1978 the Ministry of Finance had to employ external consultants to track down all the agreements made by different ministries and individuals. Since then the situation has become more complicated by further layers of agreements on rescheduling and automatic sanctioning by donors because of non-payment of arrears. (For example, the US Government automatically prevents payments to certain debtors that have fallen behind in repayments.) This means that even if the Paris Club countries and the major multilateral institutions were to forgive Sudan's debt, the other debts would still be immense.

Some critics of the Sudan Government have campaigned for severe sanctions on Sudan including expulsion from the IMF. This is a mistaken approach. Any future democratic government will find itself encumbered by the legacy of such sanctions, which will be hard to reverse. Advocates for the Sudanese people would be better advised to begin preparing for how to mobilise major economic resources after a peace agreement and transition to democracy.

A symbolic action on the debt crisis would be to try to recover some of the money diverted and mis-spent by those who took out the debt. This would focus on investigating those in government during the relevant period and trying to discover whether any illegally acquired funds could be traced. While little money would probably be retrieved, this action might be a disincentive for future diversion of foreign loans.

Balance of payments

Sudan's balance of payments is in a disastrous state.

Table 2

Balance of payments (IMF, World Bank estimates) (\$m)

	1992	1993	1994	1995	1996	1997	1998
Goods: exports fob	213	306	524	556	620	624	614
Goods: imports fob	-810	-533	-1,045	-1,066	-1,340	-1,620	-1,968
Trade balance	-597	-227	-522	-510	-719	-996	-1,356
Current acc. balance	-506	-202	-602	-500	-827	-1,639	-1,996
Financial balance	316	327	276	474	137		
Errors and omissions	31	-83	345	89	728		
Overall balance	-159	42	19	63	38		
Foreign exch reserves	37.4	78.2	163.5	106.8	81.6		

Source: Economist Intelligence Unit Country Profile 1998-99, World Bank for 1997 and 1998 figures (incomplete)

Commentary:

These figures indicate that Sudan's trade balance and current account balance continue to worsen. The adjustment measures instituted by the Sudan Government in order to increase production for export do not appear to have succeeded in changing a continuing adverse balance of payments situation, as the increases in exports marked in the early and mid-1990s have not been sustained, and in any case they are more than offset by increases in imports, especially since 1997.

Unrecorded flows, especially remittances from Sudanese expatriates working abroad, constitute a major component of the Sudanese economy. Remittances outside the formal exchange system are the largest source of foreign currency and help to explain why the Sudanese economy still functions despite these disastrous statistics. This is why the figure for 'errors and omissions' is so huge. In the mid-1980s, the earnings of the approximately 350,000 Sudanese professionals working in the Arab countries was estimated at more than \$5 billion, equivalent to about 75% of Sudan's GDP at that time. The situation has not changed fundamentally since.

Oil revenues will substantially improve the balance of payments. Estimates for production (see below) suggest that oil income could narrow the deficit by \$350-450m in a two-three year period, and even create a modest surplus thereafter. (The medium- and long-term possibility that oil exports could overvalue the exchange rate and depress agricultural exports should not be overlooked.)

Sudan's reserves are entirely in foreign exchange, with no reserves at the IMF. These reserves represent between one and two months' worth of imports.

Growth

Sudan's economy is probably growing. But this is little reason for optimism as it is growing from a very low base. Many years of rapid growth will be needed if the country is to escape from poverty.

Table 3
Sudan's Growth in GDP

	1993/94	1994/95	1995	1996	1997	1998
Real change GDP	4.3	4.5	4.4	4.7	5.5	5.0

Source: IMF, Sudan—Recent Economic Developments

Commentary:

These figures, from the IMF, are considerably lower than Ministry of Finance estimates which are 7-12% growth, and cannot be considered reliable. These growth rates are very vulnerable to the slightest shocks, such as a poor harvest or fluctuations in remittance income. In the near future, the growth of—or disruptions to—the oil industry will be a major influence on growth rates.

Note that with population growth rates of approximately 2.5%, the above figures need to be adjusted downward to reflect real per capita growth.

Agricultural Sector

The agricultural sector is the backbone of the Sudanese economy. The following table indicates the basic trends, and also the great variability in production from one year to the next due to dependence on unreliable rainfall and other factors.

Table 4
Sudan: Agricultural production

	1992/3	1993/4	1994/5	1995/6	1996/7	1997/8	1998/9
Sorghum							
Area ('000 feddans)	14,762	11,152	13,303	11,277	15,602	13,924	13,924
Prodn ('000 tonnes)	4,042	2,386	3,648	2,433	4,179	4,300	4,000
Millet							
Area ('000 feddans)	3,710	2,543	7,707	5,758	3,889	6,387	5,217
Prodn ('000 tonnes)	449	221	973	885	440	800	600
Groundnuts							
Area ('000 feddans)	1,298	1,858	2,113	2,580	2,251	3,043	3,152
Prodn ('000 tonnes)	380	428	714	738	815	800	980
Sesame							
Area ('000 feddans)	2,676	2,928	3,248	4,046	3,437	2,826	3,152
Prodn ('000 tonnes)	175	170	313	416	281	165	210
Cotton							
Area ('000 feddans)							
Prodn ('000 tonnes)							
Wheat							
Area ('000 feddans)	777	851	662	709	784	602	235
Prodn ('000 tonnes)	445	475	445	527	642	535	200

Source: IMF; 1997-9 figures from FAO; 1999 figures preliminary

Commentary:

These figures are from the Sudan Government but they are roughly in line with the FAO and US Department of Agriculture estimates.

Agriculture represents approximately 40% of Sudan's recorded GNP and is the largest proportion of the recorded economy. (If remittance income is included, it probably represents 30% and is in second place behind remittances.)

One of the interesting elements in these statistics is that the productive area has remained roughly constant over these years. There is neither a major crisis in agriculture, nor a massive expansion of agriculture. Production varies tremendously from one season to the next because of the weather. There is however a diversification away from the earlier heavy dependence on sorghum and cotton, towards a wider range of crops. The experiment with wheat production initiated by the current government in 1990 has not proved very successful.

Cotton production used to represent Sudan's major export. In the 1970s it provided more than 50% of Sudan's export revenue, and as recently as 1987 it provided \$176m worth of exports—37% of total exports. Various factors including neglect of irrigated schemes and the early 1990s drive for self-sufficiency in food production led to a sharp decline. By the mid-1990s cotton had dropped to under 20% of export revenue, and since 1996 it has provided a lower share than sesame. In 1998, cotton exports were valued at just \$96m, just 16% of exports.

Oil Sector

Sudan's oil production sector holds out the promise of helping to solve some of the country's economic problems. The known reserves consist of about 800 million barrels. The three main oil fields at Unity, Heglig and Adar have an existing capacity to produce more than 71,000 barrels per day, and peak output when all fields are fully operational could be as much as 300,000 b/d. There are also unexplored oil fields near Suakin. The oil pipeline to Port Sudan has a capacity of approximately 100,000 b/d. A second pipeline will be needed if the export capacity of the existing oil fields is to be met. In August 1999, Sudan exported its first 600,000 barrels.

With exports of 100,000 b/d, at current prices, Sudan will be earning \$350-450m per year in hard currency. Government revenue will probably start at around 40% of revenue, rising in proportion as output increases to a maximum of 70% or more. Most estimates indicate that the Sudan Government can hope to earn \$200-300m per year from oil.

The oil industry can be a mixed blessing, as a number of countries have found. Among the potentially adverse implications are:

1. Oil exports maintain the currency at an artificially high rate, making agricultural exports uncompetitive on the world market, and undermining the agricultural sector. (For example this has happened in Nigeria, where agriculture has stagnated, impoverishing farmers, and agricultural exports have virtually ceased, rendering the country entirely dependent on one export—oil.)
2. Extreme dependency on oil exports can leave a country vulnerable to fluctuations in the price. Sudden price drops can cause a sudden contraction in government budgets, a crisis of foreign exchange, etc.
3. The benefits of the oil production and export accrue to a very small section of the populace, especially the government, which therefore gain disproportionate power relative to the rest of the population. This can create friction between communities (the Ogoni in Nigeria is the classic case) and can undermine democracy.

4. Oil companies often respond to problems of crime and local instability by militarisation, including hiring mercenaries, supporting local militia groups, or paying protection money to armed groups active in the areas where they work. This has happened in Sudan before, as well as other countries including Colombia and Angola.
5. There can be problems of pollution. This is a particularly serious problem in Sudan because a major oil spill in the Nile would have immense consequences for populations living downstream. The Sudan Government and the oil industry should be liable for any such spillages and responsible for cleaning them up rapidly and effectively.
6. There can be tensions arising because of the alienation of land from local communities, both for drilling sites and pipelines.
7. Oil has a mystique: the rulers of oil-exporting countries suddenly believe they have inherited unlimited wealth, and lose their judgement about what is a sensible investment, how long the money will last, etc. Oil-rich countries have a tendency to show very bad economic decision-making.
8. The oil wealth has an unknowable impact on the investment decisions of Sudanese businessmen, especially expatriates in the oil-rich Gulf states. It is possible that the oil mystique may encourage Sudanese with money abroad to invest in Sudan once again. If so, this inflow of capital might have a larger net effect on the Sudanese economy than the oil itself. I.e. the oil might have its greatest effect indirectly, by creating a psychology of potential future wealth.

The current government is holding out oil exports as a possible economic salvation for the country. Oil will greatly ease the current government's cash-flow problems. Oil can also be mortgaged in order to buy on credit (and there is evidence that this is how the government is obtaining new arms supplies).

But the overall economic impact of oil exports should not be exaggerated. They cannot on their own solve the massive macro-economic imbalances that exist. In fact, without a comprehensive agreement with creditors, oil income would simply be an invitation for Sudan's creditors to ask for increased debt repayment. The vision of an oil bonanza also overlooks some of the potential negative consequences from the development of the oil industry. A future democratic government needs to have a long-term policy for the oil industry that maximises the benefit from oil production, and minimises the negative implications.

Inflation

Table 5
Sudan's inflation.

	1993/94	1994/95	1995	1996	1997	1998
Consumer prices	103.0	85.0	68.0	139.0	65.0	28.9

Source: IMF, Sudan—Recent Economic Developments

Commentary:

These figures are from the Ministry of Finance and cannot be considered reliable. In 1998 the government claimed that inflation was about 20%, which is unlikely to be accurate. However, it is certain that the hyper-inflation of 1990-2 has subsided somewhat.

Fiscal Performance

Table 6
Sudan Government Budget Revenue and Expenditure (LS million)

	1997
Total Revenue	1,073,900
Taxes	814,200
On income and profits	216,600
On goods and services	178,300
On international trade and transactions	419,300
Non tax revenue	259,700
Of which: public service charges and fees	64,100
Profits from public enterprises	49,500
Receipts from sale of public enterprises	700
Total Expenditure including interest arrears	2,868,000
Total Expenditure excluding interest arrears	1,206,100
Current expenditure	1,113,000
Of which: wages and salaries	334,600
Goods and services	329,100
Of which: defence	163,000
Overall balance including interest arrears	-1,794,100
Balance excluding interest arrears	-132,200

Source: IMF, Sudan—Recent Economic Developments

Commentary:

The above is based on Sudan Government figures which must be treated with caution. At the time, \$1=LS1,500. Official figures for defence expenditure cannot be considered reliable. In addition, no extra-budgetary expenditure was recorded.

These figures do however indicate:

1. Payment of interest arrears is the most substantial part of the Sudan Government's budget. In practice, the Sudan Government succeeds in (almost) balancing its books by simply not paying interest, and accumulating more arrears.
2. Capital expenditure has been almost eliminated from the budget. This has long-term implications for Sudan's infrastructure.
3. Even with the above stratagems, the Sudan Government is still running a year-on-year deficit.
4. Revenues from oil production (which do not figure in the table above) will ease the Government's crisis but not solve it.

Defence Spending

The big unanswered question from the above figures is the level of defence spending and its impact on the Sudanese economy. The last broadly reliable figures for defence spending are for the 1988/9 financial year, when the budget was \$570m, of which an estimated \$460m was met.¹ The military government presided over a major increase in military expenditure in 1989/90 and it is unlikely that expenditures have decreased subsequently. A rough figure of

¹ Source: International Institute for Strategic Studies.

\$1 bn is often cited as the cost of the war. At an exchange rate of LS1,500=\$1 for 1997, this implies approximately LS1,500,000m on defence—more than 50% of all government expenditure. Sources of finance for this include aid in cash and kind from supportive governments.

Much of the Government's war effort is supported by loans and gifts from friendly countries. These do not appear in official statistics, and the terms of any loans are not known. It is possible that the Sudan Government has been running up new debts which are not recorded, or mortgaging oil revenues, for the war effort.

The end of the war will see a reduction in defence spending. But it would be unwise to count on any substantial peace dividend, for the following reasons:

1. A peace agreement will bring substantial numbers of unpaid guerrilla fighters currently in the opposition forces onto the government's payroll, at least for a short period.
2. Disarmament, demobilisation and the reintegration of former combatants will be an expensive business.
3. Military aid in cash and kind that supports the current levels of military spending are unlikely to be translated into direct financial or development aid.
4. The macro-economic imbalances of the Sudanese economy are so adverse and so huge that any dividend will disappear into urgent demands for unpaid salaries, debt repayments, rehabilitation of capital infrastructure, etc.

External Financial Flows

Table 7

Sudan: Total Receipts: Development Assistance plus Foreign Direct Investment (\$m)

	1993	1994	1995	1996	1997	1998
<i>Countries</i>						
France	43.9	6.1	37.3	-19.0	-46.9	
Germany	26.4	24.2	16.5	24.3	5.1	
Italy	4.0	-6.4	3.7	3.0	0.4	
Japan	15.2	20.6	16.3	9.3	2.7	
Netherlands	34.6	29.2	31.3	12.7	20.8	
Norway	4.6	5.7	11.4	10.7	7.6	
United Kingdom	15.0	25.7	10.9	9.6	9.9	
United States	20.0	32.0	8.0	16.0	17.0	
Total DAC Countries	198.0	161.0	158.3	86.8	33.8	
Total Arab Countries	1.8	0.2	0.6	-	-	
<i>Multilateral</i>						
African Devt Bank	4.7	1.9	18.1	14.7	1.1	
African Devt Fund	16.6	12.5	22.0	6.2	0.4	
European Commission	33.4	33.1	21.7	23.5	21.2	
IDA	69.7	7.6	-	-	-	
UNDP	15.9	10.0	6.7	7.7	11.1	
UNICEF	32.4	40.2	31.9	28.5	29.0	
UNHCR	15.8	14.9	9.8	9.2	8.2	
WFP	90.9	110.7	2.4	18.7	32.4	
Arab Agencies	2.2	-1.5	-	-	-	

Total Multilateral	293.0	240.3	123.2	126.9	102.7	
<i>Total, EU members + EC</i>	<i>175.9</i>	<i>124.5</i>	<i>132.5</i>	<i>61.1</i>	<i>19.1</i>	
Total	492.8	401.5	282.1	213.6	136.5	

Source: OECD, Geographical Distribution of Financial Flows to Aid Recipients

Commentary:

These figures show a quite catastrophic decline—in fact a collapse—of international financial flows to Sudan. (Direct military assistance is excluded.) It is worth comparing these figures with the flows that occurred in the 1980s. The same source (OECD) gives the following figures:

Table 8
Sudan: Total receipts (aid plus FDI), 1980s (\$m)

	1983	1985	1987
EEC + member countries	251	291	291
USA	158	346	103
Multilateral agencies	122	204	173
Arab countries	363	215	231
Others	68	73	104
Total	962	1,129	902

Source: OECD, Geographical Distribution of Financial Flows to Developing Countries

Current levels of financial flows to Sudan are therefore less than 20% of what they were a decade ago. In addition, a substantial portion of this assistance is handled by WFP and UNICEF and is in the form of humanitarian assistance under OLS, delivered to Southern Sudan.

Table 9
Sudan Government: Aid receipts (\$m)

	1993/4	1994/5	1995	1996	1997
Cash and Commodity Aid	69.3	40.7	43.8	32.9	15.0
Budgetary inflows	18.7	16.7	15.6	8.6	0.0
Non-budgetary inflows (all WFP)	50.6	24.0	28.2	24.3	15.0
Project Aid	18.8	11.6	10.6	7.8	4.1
Budgetary inflows	12.8	5.9	6.0	2.9	0.1
Of which: Germany	5.6	0.5	1.8	0	0
Iran	5.0	0	0	0	0
Af Devt Fund	2.7	2.6	2.6	2.7	0
EEC/EDF	4.5	2.4	1.3	0	0
Non-budgetary inflows (all UNDP)	6.0	5.7	4.7	4.9	4.0

Source: IMF, Sudan—Recent Economic Developments

Commentary:

These figures do not match the OECD figures given above. This is because the second set of figures is based on Sudan Government statistics, using different accounting periods and methods, and also excluding assistance not handled by the government (which of course includes OLS-Southern Sector and much NGO assistance). However, they give an indication

of the extent of financial, commodity and project assistance that is given to the Sudan Government by major donors.

Sudan now receives some of the lowest per capita aid flows in Africa, at about \$4 per head for all financial flows.

These figures, combined with the debt figures given above, show that Sudan is totally dependent financially on donor assistance for recovery. There is no prospect of Sudan achieving any form of financial rehabilitation or growth without massive donor financing.

Income Distribution

There are no reliable figures for inequality in Sudan. However there are extreme regional and class disparities in income and wealth. One of the main factors for this is the earnings of Sudanese expatriates in the Arab countries, whose remittances are directed primarily to the major urban areas. These remittances are not controlled by the state. In addition, they dwarf official flows of aid and export revenue. One consequence of this is that Sudan is far richer than official figures show. Another is that the government has no real control over the exchange rate for the Sudanese pound/dinar.

In the mid 1980s it was estimated that, accounting for unrecorded remittances, the income of Khartoum was approximately equal to 50% of the Gross National Income. The income of the Southern regions was estimated at approximately 4-6% of the national economy. Equality is unlikely to have improved in the intervening years.

Sudan is akin to two economies: an entrepot enclave economy in Khartoum and one or two other major towns, and a rural hinterland. These two economies function in such radically different ways that policies aimed at assisting Sudan may help one and damage the other. Usually it is the metropolitan enclave that benefits and the rural area that suffers. Urban bias in economic policy has been a historical factor in the Sudanese economy throughout the 20th century.

One of the ironies of the Sudanese economy is that during the 1970s and '80s there was massive export of capital and accumulated investment abroad, amounting to an estimated \$20 billion by 1985 alone. This amount will have increased in the intervening period, and the unmistakable signs of capital flight are still evident in Sudan. This means that, if the private ownership of capital abroad is included, Sudan is actually a *creditor* country—private Sudanese assets abroad are greater than official international debt. The resources for resolving Sudan's macroeconomic problems lie in the hands of Sudanese citizens—if they are willing to use them.

Future Prospects of the Sudanese Economy

The Sudanese economy is caught in an immense structural crisis. The modest stabilisation of the economy in recent years (if official figures are to be trusted) only reflects the fact that the current government has found a means of living under the current circumstances, postponing the major decisions for the future. There is no prospect of a major turnaround in the Sudanese economy unless four necessary conditions are met:

1. The country is at peace.
2. The burden of external debt is almost entirely lifted.
3. A major programme of post-conflict rehabilitation and reconstruction is implemented.

4. Sudanese expatriates begin to invest in Sudan.

Oil revenues will ease some of the government's liquidity and hard currency problems. But it cannot resolve the major structural problems of the Sudanese economy.

Strategies to Address the Debt Burden

The complexity of Sudan's debt—the high number of different creditors, the high number of different kinds of agreements, the multiple rescheduling, and the violation of many of the terms of initial loan agreements and rescheduling agreements—will make systematic action to eliminate Sudan's debt extremely difficult. For example, even if the major western donors were to forgive their bilateral debts, Sudan could still be faced with unpayable debts to former eastern bloc countries and Arab countries.

Possible approaches to Sudan's debt problem include:

1. *Debt rescheduling.* Sudan has already rescheduled most of its official bilateral and multilateral debt many times, both by formally renegotiating the terms, and by the informal mechanism of simply not paying what is due. The IMF is constitutionally forbidden from dealing with a country that has run up arrears, but in the case of Sudan it has found various ways around this problem. However, the IMF is the least forgiving of Sudan's creditors and will not be ready to forgive the debt (and probably neither would it allow a generous donor to pay off Sudan's IMF debt). So the IMF debt, at the minimum, will have to be rescheduled. Sudan's debt to the IMF is in the region of \$1 bn—small in comparison with the total debt burden, but still too much for the country to pay at present.
2. *Debt cancellation.* Ultimately, most of Sudan's debts will have to be written off. The complexity of Sudan's debt and the complex interests of creditors make this a slow and difficult process.
3. *Debt swap.* The use of Sudan's debt to western donors and financial institutions to finance local development initiatives and other projects is an attractive proposition. The proposal made below is that the debt should be converted to local currency and used as a component of a post-conflict trust fund.

A concerted and comprehensive approach is needed. Sudan needs a creditors' task force to address these issues. One of the challenges of the democratic forces in Sudan is to begin to work on educating the members of such a task force. This could put Sudan on the 'fast track' for the highly-indebted poor countries initiative.

Strategies for Aid and Macro-Economic Issues

Sudan's aid donors will face a major dilemma when the country becomes a full, acceptable member of the international community once again. There are two major strategic options for aid-givers:

1. To prioritise the macro-economic imbalances in the economy, including overcoming the debt problem, the balance of payments problem, and the government deficit. This is

essential if the long-term problems of the Sudanese economy are to be overcome. But the sheer level of resources needed for successful adjustment are so great that it will be a long and uncertain process.

2. To prioritise rehabilitation, reconstruction and development, to enable the standard of living of Sudanese citizens to be improved in the short-to-medium term.

This issue paper suggests that both priorities need to be addressed at the same time. Resources need to be directed to both correcting the macro-economic problems and post-conflict rehabilitation. To some extent, the two problems can be coordinated. Some of the external debt should be swapped for local currency that can be utilised as part of a proposed post-conflict rehabilitation trust fund.

The Sudan Government will be faced with major dilemmas also—that successive governments have failed to resolve over the years. The basic problem is that the government needs to obtain the confidence of *both* the international financial institutions *and* Sudanese expatriates with money and assets abroad, and it has no control over either one.

1. In order to gain the confidence of the IMF and other donors, the government must implement adjustment and austerity measures including devaluing the currency and cutting expenditure.
2. In order to gain the confidence of Sudanese expatriates remitting money, to encourage them to use official channels or even to invest in Sudan, the government needs to demonstrate a stable economy with good prospects for the future.

As the analysis of Sudan's macro-economy shows, when remittance income is included, the normal IMF prescriptions are not very appropriate to the Sudanese context. The main macroeconomic problem in Sudan is not government profligacy or indiscipline, or lack of exports. Instead it is lack of confidence in the country's economic prospects by Sudanese entrepreneurs, who prefer to use informal currency markets and to invest abroad. Austerity measures concentrate on the relatively less important problem of government finances, and do not address this problem. In fact, austerity measures can be counterproductive, because they can increase the determination of those in the informal currency market to obtain the best possible exchange rate, evading any governmental controls or regulations, and reduce entrepreneurs' readiness to invest in Sudan. The effectiveness of any measures such as devaluation and reductions in public expenditure are therefore much reduced.

When adjusted to reflect unrecorded financial flows, the Sudanese economy remains remarkably resilient. The public debt is balanced (at the minimum) by private assets held abroad. The problem lies less with the Sudanese national economy than with the Sudanese *state*. It is the crisis in the state that has created the economic crisis, and the remedies for the state's financial crisis have unfortunately worsened many aspects of the economic difficulties.

The solution to Sudan's fundamental economic problem is ultimately political: it is *investor confidence*. A democratic government will need to have the confidence of Sudanese entrepreneurs to create a new environment of confidence and investment. The democratic leadership in Sudan—which has massive resources currently outside the country—will have to lead the way in restoring this confidence.

Meanwhile, one of the problems that will face a democratic government in Sudan is ensuring the resumption of aid flows. In this respect it will face several specific problems:

1. Donors have wound down their commitments to Sudan (excepting humanitarian aid) and it will be difficult in the current environment of declining official aid to restore former levels of assistance.
2. Ongoing assistance programmes are mostly humanitarian assistance, with the exception of a few relatively minor agricultural rehabilitation and development programmes administered by UNDP. These programmes are often ineffective and have been heavily influenced by the current government's ideology and political-military strategy. But simply halting them would run the risk of creating vacuums where people are currently dependent on aid, and interrupting the small existing aid pipeline.
3. Sudan's default on many loans has left it under legislative sanction by a number of donors. The only way to remove these sanctions is to repay the debt, or at least the arrears. Research is needed into the different aspects of Sudan's debts and what action is needed to overcome these constraints.
4. The current Sudan Government austerity programmes have won cautious approval from the IMF. The 1986-9 democratic government failed to demonstrate the same rigour—for example it was ready to give way on economic policy decisions in the face of popular protest or parliamentary opposition. The IMF will be pleased with any peace agreement, because of the economic drain caused by the war, but will not necessarily be more favourably disposed to a democratic government, simply because it is democratic. Any new government will need to prove its neo-liberal economic credentials by not making fundamental alterations to the current policies on fiscal restraint, liberalisation, and debt repayment.
5. Some well-meaning critics of the current government have campaigned for sanctions on Sudan on account of issues such as terrorism, slavery and human rights abuses, and have welcomed measures taken against Sudan by the IMF. This can be counterproductive because removing legislative sanctions or reversing IMF decisions can take years. (Executive sanctions, such as those currently imposed by the US, can be removed much more easily.) Friends of Sudan should not push for any legislative sanctions.

Creating the conditions for a resumption of aid flows and a strategy to address Sudan's macro-economic crisis will require the active cooperation of all Sudan's political forces with one another and with the aid donors. Meanwhile the future Sudan Government will need to do its utmost to create a conducive environment for this cooperation.

Post-Conflict Reconstruction

Much of Sudan has been ravaged by the war, especially Southern Sudan, the Nuba Mountains and Southern Blue Nile. Even before the war, these areas were poor and marginalised. With current levels of assistance—or even increased levels—the quality of life in these areas is not going to improve quickly. Sudan and its donors need to investigate creative ways of providing essential resources for rehabilitation and reconstruction to these areas.

The history of post-conflict reconstruction after the first civil war has important lessons. The failures of rehabilitation, resettlement and reconstruction during the 1972-83 period contributed to the outbreak of war again. Some of these failures included:

1. High-technology capital-intensive projects that had a high failure rate.
2. Failure to consult local inhabitants before beginning work on major developments such as the Jonglei Canal, giving rise to many fears—some of them founded, some unfounded.

3. Failure to implement agreed development projects in the Southern Region, such as the Mangala and Melut sugar factories.
4. Erroneous assumption that the war-affected areas would quickly begin to generate tax revenue for the Southern Regional Administration.
5. Control over Southern Regional budgets in Khartoum, and failure to provide monies as promised, leading to the undermining of the Southern administration, the decay of local government, and the flight of many Southern civil servants to Khartoum in search of their pay.
6. Failure to provide adequate livelihoods for former combatants, including their resettlement on poor-quality agricultural schemes.
7. Inadequate attention to intra-regional fairness in allocation of welfare and development projects.
8. Entrusting much welfare and development work to unregulated international NGOs which tended to concentrate their efforts in certain areas, exacerbating intra-regional inequalities and jealousies, and undermining the capacity of local government.
9. Aid projects became a means of politicians bribing the people to ensure they were re-elected, rather than a means of addressing the needs of the South. Decision-making over development was secretive and often corrupt.

Many of the same problems have been encountered by the Southern leaders who signed the 1997 Khartoum Agreement with the Government of Sudan.

Some but not all of these problems can be overcome with new modalities for rehabilitation assistance. One option is a trust fund for post-war reconstruction. The whole of Sudan needs reconstruction, but the war-affected areas need it most, because even the most basic infrastructure has disappeared.

Political considerations dictate that a single country-wide trust fund would not be acceptable. Southern Sudanese in particular would object to any funds for the rehabilitation of the South being administered through Khartoum, based on their experience of the broken promises of the past. This implies that special arrangements need to be made for the conflict-affected areas.

This paper therefore proposes three trust funds:

1. A Post-Conflict Rehabilitation Trust Fund for Southern Sudan. It should have the aim and budget to undertake the rehabilitation of basic social and economic infrastructure across the South. The Trust Fund should be administered jointly by the interim Southern administration and a consortium of donors headed by the World Bank. The Fund should be based in Southern Sudan, bypassing Khartoum. Funds should be allocated directly by the donors. A rehabilitation plan should be agreed between donors and the interim administration in advance, and implementation should be jointly monitored. The Fund could have a mandate for a minimum of six years.
2. A Post-Conflict Rehabilitation Trust Fund for the war-affected areas of Northern Sudan (i.e. Nuba Mountains, Southern Blue Nile and the Eastern Region). This would have a similar structure and mandate as the Southern Sudan trust fund and would have offices in Damazin, Kassala and Kadugli.
3. A National Transitional Rehabilitation Trust Fund. This would differ from the first two in that the funds would be administered by the government, according to a plan for basic rehabilitation agreed with the donors.

An important aspect of such Trust Funds is that their operations should be transparent, and that decisions should be made in a public and accountable manner. The assistance provided by such Trust Funds should be conditionality-free. The only criteria should be the effectiveness of the programmes and projects themselves, the transparency of decision making and the fairness of allocation of resources.

Implications

Sudan is facing enormous macro-economic difficulties. The economic crisis cannot be resolved without peace and a transition to democracy—but peace and democracy alone will be far from enough to solve the problems. The current Sudan Government is deluding itself if it believes that oil revenues can resolve the problems, in the absence of a comprehensive peace. But a future democratic government must not believe that the western donors will rush to assist it without also exacting their conditions. The experience of most countries recovering from conflict is that international aid is slow and meagre, and that high expectations are quickly disappointed. It is much easier to mobilise resources for an emergency famine relief operation than for long-term reconstruction.

Sudan will need a comprehensive and long-term approach to its economic problems. Sudan will also need to enter into a partnership with its donors and creditors in order to resolve these problems: the degree of indebtedness and macro-economic imbalance is such that Sudan itself cannot possibly mobilise the resources needed to dig itself out of the current economic hole it is in. This will mean a surrender of much sovereign power over economic decision-making, but this is the high price that will have to be paid for the errors of the past.