

SUDANREPORT

The Impact of the International Financial Crisis on the Economy of the Sudan

Medani M. Ahmed

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The Impact of the International Financial Crisis on the Economy of the Sudan

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Introduction

The ongoing international financial crisis has forced experts, economists, politicians, and decision-makers to assess what is happening and seek to understand the causes, extent and possible impacts of the crisis on the global economy and the economies of developing countries. The initial official response in the Sudan was slow and denied any serious effects on the economy. Later on, however, officials began to admit that there would be some negative effects on the economy and the newly formulated budget for fiscal year 2009 due to the decline in oil revenues. The main objective of this study is to carefully examine the mechanisms through which the economy of the Sudan is being affected. The analysis in section four will focus on the negative impact of the crisis by examining its anticipated effect on various aspects of the economy. Specifically, this paper will investigate the effects on the financial markets, agricultural development, and food prices as well as the fiscal, foreign trade, foreign investment, insurance, and security sectors. Finally, the study will attempt to provide some strategies to deal with the negative impacts of the crisis. Before addressing all the concerns mentioned above, section one will try to understand the causes of the crisis. Section two examines the extent and impact of the crisis on Advanced Developed Countries (ADC), whereas the third section analyzes the crisis' impact on Less Developed Countries (LDC).

1. Understanding the causes of the current international financial crisis

There are several important factors reported to have caused the international financial crisis¹. These factors are leverage, greed, fraudulency, contagion, recession, cecopathy², and the lack of strict monitoring of supervisory and regulatory institutions. Firstly, the leverage factor refers to a situation in which the managing directors of banks and investment companies have enormous leveraging power, allowing them to borrow the funds needed to finance their investments and contributing to the development and accentuation of the financial crisis. For many years before the crisis, high degrees of transparency, accountability, and auditing implemented by corporations and financial institutions had built confidence in the power of the banks, markets, and market-based institutions. Confidence has always been safeguarded by efficient monitoring, assessment, regulatory, and legal procedures concerning all global markets and transactions. In recent years, stringent regulatory and supervision measures on the markets for complex derivatives in USA and UK were absent, the matter which exposed the financial, banking, investment and economic institutions to risks, vulnerability, and bankruptcy and collapses in some cases.

¹ See World Bank. [2008] "Prospects for the Global Economy." Online. Available at: <http://web.worldbank.org/external/default/main?> Also, see Wikipedia. Online. Available at: G:\Literature on Financial crisis\Financial_crisis.htm.

² Torjorn K.A. Eljazon coined this term in 2008 [see footnote no.7]. The term defines a situation in which economic intelligence (i.e., the drive to maximize profits) crosses the line at an alarming rate. It is an area where profitability at all costs with no regard for one's moral values comes to the fore [see point six-below- in our analysis of the factors that have caused the international financial crisis].

Secondly, the greed factor describes the unrelenting drive of the directors of these institutions to earn huge profits and achieve their goals without being subject to supervisory procedures or prudent economic behaviour, further accentuating the crisis. Krishna Chandramamun, in support of the above argument, stated that the international financial crisis has been primarily caused by the excessive greed, recklessness, and leverage used by financial institutions in irresponsibly investing both their own and their clients' funds in high-risk stocks with no supervisory controls³.

Generally, it is widely believed that the systemic cause of this crisis is the opaque nature of the unregulated derivatives market, of which the so-called "sub-primes" are a subset. It is a market of unknown size, but is estimated to be anywhere between \$50 and \$70 trillion. It is structured in such a way that if only one or two key players fall, the entire system collapses. For example, the UK banks, RBS and Barclays, are estimated to have obligations of between \$2-3 trillion hedged with other derivative contracts, which in the event of a collapse would be worthless⁴.

One important example of the complete absence of regulation in the financial markets is the phenomenon known as Credit Default Swaps (CDS), which were created by banks to insure their own transactions when dealing with high-risk investments in a market believed to be worth \$60 trillion, an amount greater than the world's GDP. James Ferguson, a market analyst at Pali International, gives one useful definition of CDS. He described CDS as "a derivative to allow people to buy insurance on a trade. If I have a \$100 billion worth of bonds issued by US banks and suddenly I am really worried about their credit, I can go out and insure that position by buying credit default swap protection. For every credit default swap trade there are two people who transact the terms of the contract that state what one side will pay out in the event of a default of the underlying bond"⁵.

It is obvious from the above discussion that the feverish drive to maximize profits and exploit market opportunities has led some stock market companies, financial institutions, investment companies and banks not to adhere to some important principles of accounting and performance. This argument is supported by the Australian Prime Minister Kevin Rudd, who cited "ultra-capitalism" as the cause of the crisis, characterized by the elimination of regulation and a lack of compliance with proper banking procedures⁶. The result of these deviations has been the collapse of the world's largest banks, investment firms, corporations, and insurance and reinsurance companies. However, the greatest loss is that of confidence in these institutions in general, who are accused of being at least partially responsible for creating the crisis along with the real estate and housing sectors. Thirdly, the fraudulency factor refers to the behaviour of the managing directors of these institutions, who attempted to attract clients, depositors, and investors to their firms with misleading claims about their investment strategies with the prospect of large profits, and who subsequently embezzled the returns on their investments.

Fourthly, the contagion factor describes the effect of the crisis experienced by one institution in relation to others in their field. For instance, the problem that began in the real estate sector, when owners failed to pay their mortgage instalments on homes and other buildings, was transmitted to the stock market in the form of declining share prices, losses, and bankruptcies, thus creating a vicious cycle which has affected the real economy by producing a credit crunch and a slowdown in the demand for goods and services. This cycle of causation occurred between the financial markets,

³ See Krugman, P. [2008] "Moment of Truth". Online. Available at: <http://www.iht.com/articles/2008/10/10/opinion/edkrugman.php?d=1>

⁴ See the Sky News [2008]. Online. Available at : <http://news.sky.com/skynews/Home/Business/Credit-Default-Swaps-Vast-Unregulated-Market-Pours-Poison-Into-Global-Markets/Article/200810315122299?>

⁵ Ibid.

⁶ Ibid.

real economy sectors, and the US and global economies for one main reason, specifically, the high degree of globalization of the markets. Moreover, there is a high degree of interdependence, complementarity, and sensitivity, causing a ripple effect in even the smallest parts of the world. The information, technology, and communications revolution has facilitated global transactions between partners across the world, which minimize time and costs while maximizing profitability and strengthening international markets.

Fifthly, the recessionary factor refers to the vicious cycle between the battered stock markets and financial sectors on the one hand, and the slow growth in the real economy on the other. Finally, the cecopathy factor, a new psychological concept proposed by Torjorn K.A. Eljazon in 2008, defines a situation in which economic intelligence (i.e., the drive to maximize profits) crosses the line at an alarming rate. It is an area where profitability at all costs with no regard for one's word or moral values comes to the fore⁷.

Robert Zoellick, president of the World Bank, supports the argument that the financial crisis was caused by misconduct and misbehaviour of some people in the stock and financial markets, and as well banking system will produce catastrophic effects on developing countries. As a result, national solutions are becoming increasingly limited and cannot possibly solve the problems being faced⁸. International efforts, measures, and solutions are needed in dealing with the crisis. Zoellick argues that the onset of the crisis caused a "stunning" decline in global trade. He states that "The world economic outlook has weakened significantly, including developing countries. The food and fuel crisis of the recent year has now been supplemented by the blow of a financial crisis"⁹.

Furthermore, Zoellick says that "China is in a very good position to have a strong fiscal expansion, and the Chinese authorities talked about moving toward a strong fiscal expansion. The adjustment process will mean a loss of jobs in a lot of countries"¹⁰.

He notes that there is a sense that all financial institutions need some form of regulation, but it is a matter of degree and that the level of regulation will likely cause some pain¹¹.

A number of observers believe that the lack of strong regulatory procedures for the derivatives market was among the most important causes of the crisis in both the USA and UK.

Many people criticized Wall Street executives for the huge profits they earned, giving them the incentive to increase their risk in subsequent dealings. Wall Street issued about \$23.9 billion in bonuses in 2006, according to the New York State Financial Controller's Office¹². The whole financial system, from mortgage bankers to Wall Street risk managers, seemed to be based on short-term risk while completely forgetting their long-term obligations. Firms continued to increase their risk with no regulatory oversight and knew nothing of each other's exposure to either toxic or complex derivatives, showing unequivocal evidence that none of the senior bank officials had expected the crisis to occur¹³. Before concluding this section, it is important to briefly mention some other explanations for the cause of the crisis. Andre Gunder Frank and Immanuel Wallerstein

⁷ See Wikipedia [2008]. "Financial Crisis." . Online. Available at: G:\Literature on Financial crisis\Financial_crisis.htm.

⁸ See Jeff Fick and Alastair Stewart. [2008] "World Bank Sees Financial Crisis Crimping Trade in 2009". The Wall Street Journal .Online. Available at : G:\Literature on Financial crisis\NewsStory.aspx.htm.

⁹ Ibid

¹⁰ Ibid.

¹¹ Ibid.

¹² See Business Week. [2008] "The Financial Crisis Blame Game" . [October 18]. Online. Available at: G:\Literature on Financial crisis\pi20081017_950382_page_4.htm.

¹³ Ibid.

of World System Theories have systematically warned of the dangers of a potential financial crash that the capitalist economies are now facing. For these scholars the crash has come at the end of a long economic cycle which began after the oil crisis of 1973.

Hyman Minsky developed a theory stating that financial fragility is an intrinsic feature of capitalist economies, leading to a greater risk of financial collapse¹⁴.

He argues that firms choose between three types of financing according to their tolerance for risk: these are hedge finance, speculative finance, and Ponzi finance (the most fragile). He explained that financial fragility levels move in conjunction with business cycles. For instance, after a recession in which firms lose much of their liquidity, they choose only hedge finance, the safest type of financing, and as the economy grows and expectations for profits rise, they choose speculative finance. As an example of Ponzi finance, firms believe that profits alone will not always cover the interest payments on their debts, expecting interest rates to increase in the future in order to repay their loans.

Consequently, firms borrow money to facilitate more investment, with lenders ready to loan money without a full guarantee of success. Though lenders know that firms may face problems in repaying their loans, they believe these firms may be able to refinance these loans from higher than expected profits. Thus, according to Minsky, Ponzi finance is an important factor in contributing to the crisis.

¹⁴ See Wikipedia . [2008]. "Financial Crisis". Online. Available at: website: G:\Literature on Financial crisis\Financial_crisis.htm.

2. The extent and impact of the crisis on ADCs

In the USA, during the first week of October 2008, we witnessed a plunge in stock prices and losses amounting to 8-10% of their value for many consecutive days with a sharp decline in the price of some stocks of up to as much as 40%. The real estate market collapsed, auto sales declined, and retail stores faced difficulties as credit froze. Banks stopped lending to both their customers and other banks due to a loss of confidence not only in their ability to repay their loans, but also as a precautionary measure to ensure solvency. The meltdown of the stock market fuelled recessionary pressures in the real economies of the USA, Europe, and Asia. Prices plunged in many international stock markets, leading to panic and the hasty sale of stocks due to the fear of continued price drops, thus causing a further deterioration of the market.

A decline in the demand for commodities, especially durables, has become the norm in many global economies. Capital financing has eroded, leading to fears of a deep recession followed by a long depression as workers are laid off in the face of the persistent crisis.

With regard to another aspect of the global economy, industrial production dropped in September 2008, underscoring the plight of the troubled auto industry with the manufacturers of furniture, construction materials, and other goods also impacted by the collapse of the housing market. The US Home Price Index for 2008 fell by 17.7% as compared to 2007. A rapid decline in housing prices has triggered the mass sale of homes and property amid falling stock prices and a shrinking credit supply. Rising mortgage rates contributed to an increase of 182% in mortgage failures in the USA in November 2008¹⁵. The construction sector has been affected as well, with Citicorp and Citibank losing about \$71 billion due to their purchase of high-risk construction stocks¹⁶. General Motors lost 45% of its sales and incurred losses of \$4.5 billion by November 2008 with Chrysler and Ford losing 35% and 30% of their sales, respectively.

It should be noted that the biggest car companies in USA, GM, Chrysler, and Ford have had difficulty producing smaller, more inexpensive cars that could compete internationally due to their high fixed operating costs. The state-owned China Export/Import Bank offered Chevrolet about \$1.45 billion for overseas expansion to improve the quality of their exported cars, whereas Changan, one of Ford's two joint venture partners, indicated that it might buy Volvo, which has been a money losing company for GM¹⁷.

In response to fall in sales and big losses in profits, the automakers did lay off many workers and sought a bailout of \$25 billion from the US government. It should be mentioned that the chief executives of the GM, Chrysler and Ford companies travelled to Washington to ask for \$7.5 billion to be used to finance \$25 billion in loan guarantees that had been promised in a 2007 energy bill. The reason for demanding bailout was to enable the companies to produce new car versions that more –energy efficient¹⁸.

The second bailout request amounted to \$100 billion; an economic stimulus that included \$25 billion for the automakers, which would come out of the \$700 billion set aside for banks and other financial firms. Senator Harry Reid, a Nevada Democrat who is the majority leader, proposed the

¹⁵ CNN. [2008] World Business Report[November 10].

¹⁶ CNN. [2008] World Business Report[November 7].

¹⁷ See Daniel Schafer. [2008] The Financial Times[December 10].

¹⁸ See The New York Times.[2009] credit crisis-The essentials. Online. available at :http://topicsnytimes.com/topics/reference/timestopics/subjects/c/credit_crisis/index.html?

bailout plan. The Bush government opposed the plan and asked congress to rewrite the terms of the loan guarantees to make companies performing properly, not just building new cars¹⁹. The bailout was not passed and instead, the three companies were asked to provide a plan of how they are going to use the cash injection and how they will return profitability. Many other attempts were made to pass the bill but the congress failed to act. The Bush administration proposed using some of the \$700 billion stimulus plan to rescue the car companies. About \$17.4 billion were promised to be given as a rescue to the three companies, but with tough conditions. The conditions were not different from the ones advanced by the Senate Republican plan, which demanded the companies to reduce their debts by two thirds, through debt-for-equity swaps and become competitive through cutting labour cost and benefits²⁰.

The US logistics group FedEx slowed its 2009 outlook while Texas Instruments warned that its profits will not increase in 2009²¹. American Insurance Group (AIG) was also negatively affected by the financial crisis, DHL suffered huge losses, forcing the company to lay off about 9,500 employees, and the Circuit City Company filed for bankruptcy²². In the stock market, \$30 billion in 4-week US treasury bills were sold at a discounted rate of 0% for the first time, whereas the 3-week bills traded at 0.1%. Moreover, flat panel screen manufacturers have also witnessed a rapid decline in the price of flat panel TVs and computer monitors in Europe and the USA, slowing expansion plans and leaving parts of their factories idle because of a sharp drop in demand in the second half of 2008²³.

Even more importantly, unemployment topped 400,000 in the ailing labour market, and Donald Khan, vice chairman of the Federal Reserve, said that “given the likely drawn-out nature of the prospective adjustments in housing and financial markets, I see the most probable scenario as one in which the performance of the economy remains sub-par well into 2009 and 2010”²⁴. The most recently released employment statistics in the USA indicate that the unemployment rate has reached 6.5%, up from 4.5% in 2007²⁵. It is expected that 3 million people will lose their jobs by the end of 2008 and will need to be retrained to compete for other jobs²⁶. Ben Bernanke, chairman of the Federal Reserve, urged lawmakers in the USA to weigh the effect of a stimulus package of \$700 billion on the US budget deficit, which has tripled in fiscal year 2007/2008 to \$455 billion²⁷. Treasury Secretary Henry Paulson said that the government’s purchase of ailing bank and company stocks represents an investment in the future by generating the capital needed to reduce the budget deficit. As soon as the banks show signs of recovery and begin to perform normally, the government will sell these stocks to get out of the market.

Indeed, the \$700 billion bailout proposal would allow the government to purchase toxic assets from the biggest banks, to strengthen their balance sheets and to restore confidence and trust in the financial system. Congress did some amendments on the plan and put some measures for oversight. On September 29, 2008. The House rejected the bailout plan and as a result the Standard & Poor’s 500- stock index lost 9%, the highest loss in a single day since October 1987. With introduction of many tax breaks and compromises, the Senate passed the revised bailout plan and the House also passed by a vote of 263 to 171²⁸.

¹⁹ Ibid.

²⁰ Ibid.

²¹ Op.cit.

²² CNN. World Business Report [November 10].

²³ See Robin Kwong. [2008] The Financial Times [December 10].

²⁴ See the website: <http://news.yahoo.com/s/sp/0081016>.

²⁵ CNN. [2008] World Business Report[November 7].

²⁶ Ibid.

²⁷ Ibid, October 21, 2008.

²⁸ See The New York Times.[2009] credit crisis-The essentials. Online. available at :http://topicsnytimes.com/topics/reference/timestopics/subjects/c/credit_crisis/index.html?

In the UK, about 1,790,000 people were laid off in August 2008, with this figure expected to reach 2 million by the end of 2008. Forty percent of jobs in construction and industry have been lost, with unemployment causing a substantial drop in consumer spending. As a result, the demand for goods and services has declined rapidly with a strong fear that the level and intensity of poverty and hunger might increase²⁹. The British Central Bank estimated that international banking losses could reach about \$2.6 trillion, creating a huge loss of capital for both owners and investors³⁰. United Kingdom Prime Minister Gordon Brown has expressed strong fears that the world is indeed facing a prolonged recession with a sharp decline in domestic demand and a depreciation in the value of the assets of most companies and banks, thus lowering the GDP growth rate of most major western countries³¹.

The British government announced a rescue plan of \$63 billion to provide capital for ailing banks through the purchase of troubled stocks in order to rebuild confidence in the banking system. Three troubled banks benefited from the rescue plan, namely HBOS, Lyons Scotland, and TSP³². Germany has suffered greatly from the effects of the financial crisis as well, as many banks and corporations collapsed and declared bankruptcy. For example, Volkswagen suffered from a slowdown in sales and became the first German automaker to seek capital from the government's \$650 billion bailout plan. BMW and Daimler have said they may also apply for funds from the rescue plan due to a decline in the demand for their product³³. In France, six banks were negatively affected by the crisis which forced the government to act quickly to save them from bankruptcy. The government injected \$14 billion into the three banks that stood to gain the most from the rescue plan. Of the total financial rescue package, Credit Agricole received \$3 billion, BNP Paribas \$2.55 billion, and Societe Generale \$1.7 billion³⁴. In Iceland, the overall economy is expected to grow by only 0.1% in 2008, with most of its banks badly affected by the crisis and the government forced to adopt a rescue capitalization plan of \$206.1 billion.

In November 2008, Japan's government officially admitted that it was entering a recession with a number of major corporations, especially automakers, facing a decline in the demand for cars in the USA and Europe. For instance, Honda's sales have slowed considerably, sharply reducing its revenues and profits. The Japanese government launched its own bailout, reducing the interest rate to a five-year low of 0.3% and injecting \$277 billion in the form of short-term credits for families to boost spending and increase the demand for goods and services³⁵. Sony plans to close 5-6 of its factories, reduce investment, and cut 8,000 jobs (which amounted to 5% of its total employment), in order to mitigate the sharp slump in consumer demand for electronics. Additionally, Sony was negatively affected by a weak euro and raised its prices to offset the loss of revenues³⁶.

Finally, this bleak situation can best be described by the general population's lack of confidence in stock markets, banking institutions, automakers, real estate companies and most importantly, in the managing directors of investment firms. According to John William, confidence in the future economic outlook has been quickly eroding in the second half of 2008. Financial directors have greatly reduced their earning and spending forecasts for 2009, while considerably raising job layoff figures. Indeed, the credit crunch has caused many companies to experience difficulty in renewing

²⁹ Ibid.

³⁰ CNN. [2008] World Business Report[November 8]

³¹ CNN. [2008] World Business Report[October 22].

³² Ibid. October 17, 2008.

³³ See Robin Kwong. [2008] The Financial Times [December 10].

³⁴ CNN. World Business Report[November 21].

³⁵ CNN. [2008] World Business Report, [October 17].

³⁶ See Robin Hardies. [2008] . The Financial Times, [Wednesday, December 10].

Neil Dennis and Michael Mackenzie gave an estimate of 16,000 jobs cut by Sony and a reduction of investment in the face of the global financial crisis. See The Financial Times, *ibid*.

their lines of credit. As most banks started to hold loan offerings, the cost of credit rose dramatically by 177 basis points in the USA and by 106 basis points in Europe³⁷.

³⁷ See John William. [2008]. The Financial Times. [December 10]

3. Impacts on LDCs

The World Bank Global Forecasting Model reveals that a 10% decline in additional business fixed investments in 2008 will yield an additional 7% decline in US imports, causing serious effects in the demand for exports from US trading partners. US imports are expected to sharply decline, negatively affecting such close trading partners as Mexico, whose exports would decline by 9% in a worst-case scenario, and China, whose exports would be reduced by 3%. Exports from the European Union are expected to decline by 2.5%, with many East Asian and Pacific Rim countries which export advanced technological products experiencing a reduction in exports relative to the baseline³⁸.

Generally speaking, developing countries with large deficits in their current accounts balance will be affected the most by the crisis, with developing countries which depend on external financing for their investments and growth being impacted as well. In fact, as the unfolding financial crisis worsens the prospects for growth in developing countries will be negatively affected in the short run due to the enormous turmoil in global stock markets. According to the World Bank, growth in the developing countries declined from 7.8% in 2007 to 6.5% in 2008, with countries that depend on foreign capital flows experiencing the greatest negative effect. The World Bank also stated that despite strong production growth at the aggregate level, higher oil and food prices have reduced real income and worsened conditions for the poor in the urban areas of developing countries³⁹.

China is considered to be the country least affected by the global crisis, although it was announced that a drop in its GDP growth rate reached 9% in the third quarter of 2008 as compared to 12% for the same period the previous year. Corporations most affected were the ones that were strongly connected to international markets. For example, the electrical appliances manufacturer Baillinda in Shenzhen was forced to shut down, causing a loss of 1,500 jobs. More recent information from government statistics in China estimate that at least 67,000 factories across all sectors closed in the first half of 2008⁴⁰. India has also been badly hurt by the crisis. The stock market there has lost half its value, and a decline in the demand for exports has reduced revenues and slowed the GDP growth rate by 2.5%, bringing it down to 6-7%, with the handicrafts sector the most seriously affected.⁴¹ South Korea has also been hit hard by the financial crisis due to the negative effect on its exports from the sharp decline in global demand. The government there injected \$10.8 billion in tax reductions for companies affected by the crisis, while Argentina moved quickly to nationalize its Pensions Fund, valued at \$30 billion, with the objective of protecting pensioners and retaining large cash balances to ease their liquidity shortage⁴².

Arab stock markets, especially the Gulf markets, have dropped sharply with investors sustaining heavy losses. It is estimated that the Gulf stock markets have lost 65% of their value. Additionally, there is bad news for the African countries which have depended on exports as their main source of revenue, especially the export of commodities whose prices will continue to fall as the recession worsens, increasing the trade and budget deficits. The International Labour Organization (ILO) warned that almost 20 million people will be unemployed by the end of 2009 with many observers

³⁸ See the World Bank [2008]. Online. Available at website: <http://go.worldbank.org/H7UB58YP01>.
See World Bank.[2008] "Prospects for the Global Economy". Online. Available at website:<http://web.worldbank.org/external/default/main?>

³⁹ Ibid.

⁴⁰ See Jonathan Birchall. [2008] The Financial Times.[December 10].

⁴¹ CNN. [2008] World Business Report,[November 10].

⁴² CNN. [2008] World Business Report, [November 3].

expecting cuts in humanitarian aid, a further deterioration of conditions, and widespread starvation for those living in poverty⁴³.

3.1 African economic performance during the crisis

In 2007 and the years prior to the crisis, Africa achieved a relatively strong growth rate of 6.1% (led by South Africa with the continent's highest growth rate), with per capita GDP increases of 4.1% for all countries. The growth was impressive and shared by both oil and non-oil producing countries. However, Angola's growth performance has been the highest in Africa for the period from 2004-2007, with a growth rate of 22.9% in 2007, and Nigeria attaining the second highest growth rate of about 6%, attributable to their oil, communications, and financial sectors⁴⁴.

Central Africa's growth performance was much lower, amounting to 3.3%, driven by expansion in public investment. Gabon achieved strong expansion in both manganese and forestry production, though oil production in both the Republic of Congo and Guinea was low due to serious technical problems.

Growth performance in Western Africa was lower than in Southern Africa, though almost the same as the central region, about 3.2% in 2007. Some countries in the regions, especially the Republic of Congo and Equatorial Guinea, were badly affected by the decline in oil production with Eastern Africa showing impressive growth, owing to good agricultural, industrial production, and its performance in the service industries. In Kenya economic performance improved in 2007, whereas in Tanzania the agricultural, mining, tourism, and manufacturing sectors spearheaded growth. Ugandan growth was enhanced and propelled by an increase in the supply of electricity and strong private sector contributions to the national economy. Most countries in the region witnessed accelerated consumer price inflation in the first quarter of 2008, fuelled by higher food, energy, electricity, and transportation costs⁴⁵.

⁴³ CNN[2008], World Business Report [October 15].

⁴⁴ See World Bank [2008] .Online. Available at website: <http://web.worldbank.org/external/default/main?>

⁴⁵ Ibid.

4. Impact of the crisis on the Sudanese economy

There are many factors related to the crisis that will affect the Sudanese economy. The effect on different sectors will vary in degree depending upon the extent of openness and integration with global markets in both financial and economic terms. One can postulate a number of scenarios through which the economy will be impacted:

The more local financial institutions depend on foreign investors and capital, the more they will be vulnerable to the negative effects of the crisis;

The more the economy is dependent on the export of primary products such as raw materials, oil, and minerals, the more they will be prone to fluctuations in the price of these commodities and the negative external shocks caused by falling demand; and

The more the economy's local currency is pegged to the dollar or euro, the more it will be affected by variations in these currencies, as the evolving financial crisis deteriorates over time.

4.1 Impact on the fiscal sector: Budgetary effects

Since 2000, the central government's budget has started to depend increasingly on oil revenues as its main source of financing for service delivery and development, as well as for other administrative, security, and military activities. In 2006, oil revenues comprised 60% of total revenues, with this figure likely to increase in the coming years. The remaining 40% of revenues come mainly from indirect and direct taxes, with a small share on returns from parastatals and sales generated by privatized institutions. Because of oil exports, the share of revenues in GDP has increased steadily from 15.8% in 2001 to 19.6% in 2005 and to 20% in 2006. (See Table 3.)

Table 3: Government budget for the period from 2000-2006

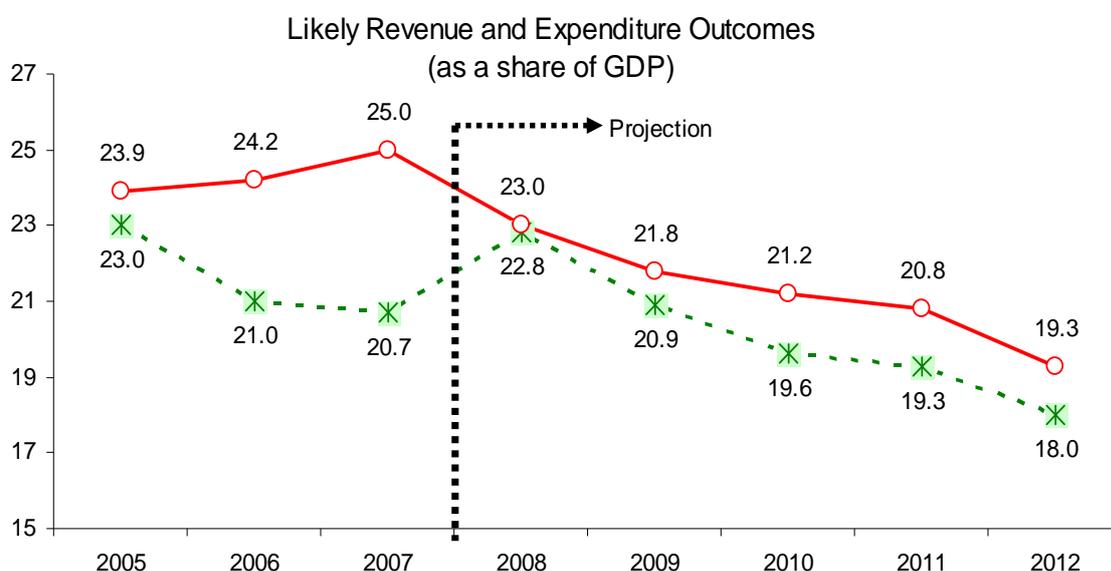
ITEM/ YEAR	Total expenditures as % of GDP	Revenues as % of GDP	Budget deficit as % of GDP
2000	11.9	11.2	0.7
2001	12.4	10.8	1.6
2002	13.4%	12.2%	.001
2003	16.5%	15.8%	.007
2004	22.5%	20.9%	1.6%
2005	22.3%	19.6%	2.7%
2006	24.2%	19.97%	4.2%

Source: Bank of Sudan, Annual Reports for the Period 2000-2006.

Despite the rising share of revenues as a percentage of GDP, the government has not succeeded in expanding its fiscal capacity or increasing revenues from taxation, owing to several structural problems that have handicapped the expansion of production capacity and real income, thus limiting its revenues from taxes. The government has increasingly depended more on the indirect taxation of consumables and imports, placing a burden on the general population and increasing poverty in the country.

The World Bank has predicted that oil production in the Sudan will decline as a result of technical problems, and expects oil prices to fluctuate in the range of \$80 per barrel in the medium term and \$70 per barrel in the long term because of the negative impacts of the crisis. The Energy Information Administration (EIA), the statistical arm of the US Department of Energy, expects oil consumption to decline by 50,000 barrels per day in late 2008 and by 450,000 barrels a day in 2009. The expected average price per barrel will be \$51 in 2009⁴⁶. The World Bank predicts that the ratio of revenues to GDP will decline from 22.8% in 2008 to 20% in 2010 and to 18% in 2012, whereas expenditures will decline from 23% in 2008 to 19.3% in 2009 and reach even lower levels in 2010. (See Figure 2.)

Figure 2: Projection of revenues and expenditures



Source: See World Bank and IMF (2008); also see Deepak Mishra's (WB Senior Economist to Sudan and Ethiopia) public lecture entitled "Global Crisis and Impacts on the Sudan", Faculty of Economic and Social Studies, University of Khartoum, November 5, 2008. Notes: Red line indicates expenditures. Green line denotes revenues and grants.

A sharp decline in budget revenues, especially from oil, will have disastrous effects on the budget and economy. The government's ability to secure funding to improve living standards and to finance and implement development projects will be seriously jeopardized. The greatest negative effect will be felt by the Government of Southern Sudan (GOSS), which depends on the central government for more than 90% of its budget. GOSS will be unable to compensate for the sharp drop in oil and non-oil revenues, causing serious political tensions among salaried workers (who constitute more than 80% of current spending), fostering insecurity and an environment of conflict. In other words, there is a grave threat to the Sudan's Comprehensive Peace Agreement (CPA) and the Abuja and Asmara Peace Agreements if Sudanese oil revenues are endangered or suffer a decline. In fact, any sharp decline in oil prices, which have dropped from a record high of \$147 per barrel in 2007 to below \$50 per barrel in December 2008, would decimate the budget and render it incapable of delivering services and implementing development projects. Governments in the

⁴⁶ See Chris Flood. The Financial Times, December 10, 2008.

Sudan have a long history of an unwillingness and inability to curb public expenditures for various political, security, social, and economic reasons.

Transparent , efficient, flexible, and reliable Public Financial Management (PFM) and Fiduciary Assessment (FA) systems will need time to be established and implemented. Fiscal discipline and prudence cannot be easily attained from the expenditures side, and the failure to mobilize revenues through sound taxation and management will require institutional reforms and a substantial capacity building effort. The result will be an expanded budget deficit, creating pressure on the public and central banking systems while increasing the amount and level of internal debt and inflation⁴⁷ .

4.2 Impact on resource distribution among tiers of government

Since the colonial era of 1898-1956, most remote regions in the Sudan have suffered from severe sustained underdevelopment. These can be summarized as follows:

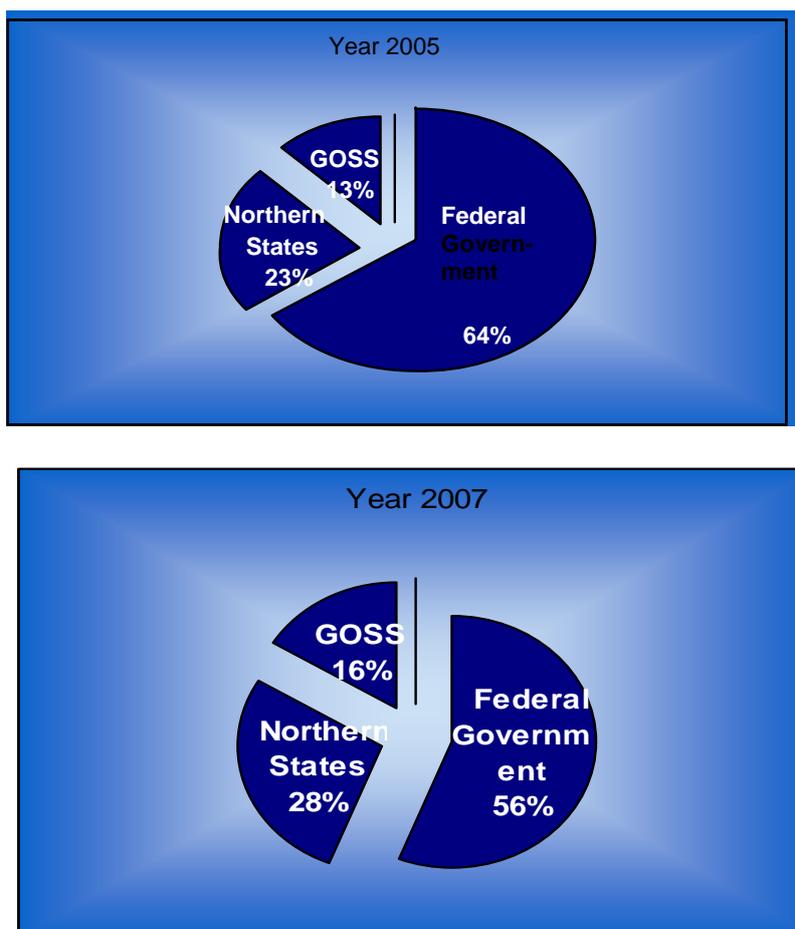
- Low investment in agricultural activity and sub-sectors in most regions, resulting in low production and a deficiency in the supply of food products for local consumption and export.
- Low investment in human capital, and research and development, has seriously reduced the productivity of farmers and deprived them of the use of modern agricultural technology.
- Limited financial banking capabilities and credit supplies have seriously handicapped the development of agriculture, industry, service, and infrastructure projects, which have reduced the chances of maximizing profits from the activities in these sectors, thus creating a long tradition of an unprofitable and unrewarding economy.
- Underdeveloped small markets and a lack of modern marketing know-how and skills have limited production and handicapped the realization of values. This situation has been exacerbated by a lack of information and access to the market for rural farmers and small producers, and the limited information that is available has been monopolized by a few wealthy producers.
- Slow institutional and organizational development and a lack of transparency, accountability, and credibility have constrained growth, wasted public resources, and frustrated agricultural development.
- Low organizational and management capacities have undermined the various governments' efforts to mobilize internal resources to achieve the expected delivery of services and development projects.
- A lack of sound and efficient PFM systems and FA capabilities have caused an enormous waste of resources and slowed development opportunities.
- Inappropriate and sometimes erratic fiscal, monetary, and credit policies have created macroeconomic instability and have failed to succeed in curbing inflationary pressure and enhancing economic growth and development.
- Political unrest and civil strife have produced misery, poverty, underdevelopment, and chaos in many remote regions, especially in the southern and eastern regions of Darfur. Since gaining independence in 1956, the Sudan has experienced many social and political upheavals that have frustrated efforts to achieve development and a reasonable standard of living in some regions.
- Worst of all, there is a lack of a strong political will to expedite positive change and development at home and a failure to keep promises and commitments to implement the desired economic, institutional, legislative, and political reforms.

⁴⁷ The 2009 budget estimated that internal debt would amount to 6% of GDP.

This section argues that the direct transfer of financial resources from the federal government to GOSS and the Northern States is essential for economic, social, and political development and for reversing the symptoms of underdevelopment mentioned above. Unfortunately, the funds transferred from the central government to the different states and regions in the Sudan have constituted only a small percentage of the budget.

Direct transfers to the states expressed as a ratio of total government spending has been low for the period from 1980-2004, not exceeding on average of 10% of total government expenditures, indicating that fewer resources have been transferred to assist states in coping with their rising obligation to provide services such as education, health, water, and sanitation. With the implementation of the Comprehensive Peace Agreement (CPA), more resources have been transferred to the southern and northern states from the National Revenue Fund. In 2005, the first year of the CPA, the transfers to the southern government amounted to more than 13% of total federal government revenues, while the Northern States received slightly more than 23%, and the federal government 64% of total revenues. In 2007, more resources were transferred to the Northern States and Southern Sudan, amounting to 44%, whereas the federal government's share declined to 54% of total revenues. (See Figure 3 below.)

Figure 3: Government Transfers to the Northern States and Southern Sudan, 2005-2007



Source: Joint Report of the GNU and GOSS, Sustainable Peace through Development, Oslo, Norway, May 6-7, 2008.

Due to constitutional and institutional agreements made by the CPA, the Fiscal and Financial Allocation and Monitoring Commission (FFAMC) was established to perform some vital duties concerning resource and wealth sharing in the Sudan. The Presidential Decree No. 35 of 2006 (which repealed Presidential Decree No. 41 of 2005), specifies these duties included in the following list⁴⁸ :

Ensure transparency and fairness in regards to the allocation of nationally collected funds to the GOSS and the states;

- Monitor and ensure that equalization grants from the National Revenue Fund (NRF) are promptly transferred to the respective levels of government;
- Guarantee the appropriate utilization and sharing of financial resources;
- Ensure that revenues allocated to areas affected by conflict are transferred in accordance with the agreed formula;
- Safeguard transparency and fairness in the allocation of funds to GOSS and the states according to the established ratios and percentages stipulated in the Constitution;
- Ensure that the funds allocated to the war-torn areas are promptly transferred;
- Propose formulae and criteria for the distribution of resources; Review and update the basis, proportions, and criteria for the allocation of revenues between the central and state governments, and the allocation of revenues across the 15 Northern State governments at least every three years; and
- Ensure the use of the allocated resources by the concerned bodies for the specified purposes specified.

It is evident from the information in this section that enormous progress has been made in increasing the amount of transfers to the Northern States and Southern Sudan due to the CPA, APA, and ESPA, with transfers amounting to about 46% of total revenues in 2007. The Fiscal Financial Allocation and Monitoring Commission (FFAMC) has targeted 50% of total government expenditures for transfer from the central government to the southern and northern states in the 2008-2009 budgets. The substantial amount of transfers to the Northern States and to GOSS has produced enormous effects on the level of service delivery and improved economic and social conditions that have enhanced the life of both the people and the investment environment.

It must be mentioned that the transfers have had especially positive effects on the social and economic life of Southern Sudan. Despite delays in service delivery and the slow implementation of development projects in the south, many positive results have taken place. For example, the volume and quality of economic and social services have been steadily improving; infrastructure projects have been built; and institutional, administrative, security, and monitoring structures established. There are new opportunities and incentives for creating economic and investment activities with the population poised to benefit from them. As a result of these changes, consumption is expanding and the demand for goods and services increasing, thereby stimulating the local economy while expanding imports from neighbouring countries. All these changes and successes are a direct result of the achievement of peace, stability, and an increase of financial resources to Southern Sudan. They are also strong indicators of the extent to which improvement and development can be attained in the future.

However, the challenges facing the country generally and the states in particular are formidable and enormous. Sustaining peace is the fundamental requirement for solving social, economic, and political problems, with the transfer of financial resources to the southern and northern states crucial in helping to solve the social and economic problems of the future. The government also

⁴⁸ Michael Bell and Rory Riordan. [2007] "Building on the Successes of the Fiscal and Financial Allocation and Monitoring Commission". FFAMC, Khartoum, Sudan.

needs to allocate funds to reduce the vulnerability of the poor to disease, unemployment, natural disasters, economic crisis, harvest failures, disability, and maternal and infant mortality. Reducing the risk of epidemics such as HIV/AIDS and malaria via public health programmes should be a top priority, in addition to the construction of dams to reduce the risk of flooding. Indeed, increased spending on these critical services and activities is important for achieving MDGs in the Sudan. Another way to help the poor is through increasing the direct transfer of central government funds to invest in education, particularly the education of girls, to give them the skills necessary to produce new products and raise their technical and entrepreneurial capabilities. Hopes for transferring financial resources to the northern and southern states will be badly affected if oil revenues experience a sharp decline due to the negative effects of the crisis on the global demand for oil.

4.3 Impact on foreign trade

Since 1974, the Sudan's capacity to productively use its export yields has been systematically below one⁴⁹. (See Table 1.) The case of the Sudan clearly demonstrates an inability to use export yields to strengthen production export capacity. The ratio rose from 0.6 in 1990 to 0.72 in 2005, with an average of 0.7 for the period from 1990-2005.

Table 1: Balance of trade, 1999-2005

Year	Value of exports*	Percent-age change	Value of imports*	Percent-age change	Trade balance in US \$	XGS / MGS**
1999	780.1	31.0%	1414.9	-26.5%	-634.8	0.55
2000	1806.7	131.6%	1552.7	9.7%	254.0	1.16
2001	1698.7	-6.0%	2300.9	48.2%	-602.2	0.74
2002	1949.1	14.7%	2446.4	6,3%	-497.3	0.79
2003	2542.2	30.4%	2881.9	17.8%	-339.7	0.88
2004	3777.8	48.6%	4075.2	41.4%	-297.5	0.92
2005	4824.3	27.7%	6756.8	65.8%	-1932.5	0.72

Source: Annual Reports of the Bank of the Sudan, various issues for various years.

*: Figures of the value of exports and imports for the years 1970-1989 in million Sudanese pounds and for the period 1990-2001 in million US dollars. **: If the ratio XGS/MGS is >1, this denotes the ability of the country to more efficiently use foreign resources to generate foreign currency and vice versa.

This table shows the Sudanese economy in need of urgent structural reform to strengthen its productivity base and export capacity. With more openness, the economy is faced with a challenge to maximize the benefits of international trade while minimizing the costs and losses associated with price fluctuations in oil and primary products. Since 1992, the government has implemented a wide range of economic liberalization policies, privatization of parastatals, and free trade policies. As a result, the degree of openness to the global economy has increased enormously, reaching 38% in 2005 and 43% in 2007. With an increased dependence on oil as its main source of export revenue (oil constituted 90% of the total value of exports in 2006), the country has become more vulnerable to external oil price variations.

The sudden upsurge of oil prices in 2007-2008, from below \$50 per barrel to a record high of \$147 per barrel in early 2008, has helped the country to increase its export returns enormously and

⁴⁹ The measure of foreign resource use for enhancing export capacity is given as the value of exports (XGS) divided by the value of imports (MDG). If the measure is higher than one, it indicates the country's ability to use export revenues to enhance production, and if it is below one, it indicates the inability to productively use the export returns.

finance the purchase of a continuously expanding level of imports. In response to the rapid rate of growth in GDP, more and more imports are being used in capital sectors. For the period from 1990-2003, capital goods constituted an average of 50.9%, consumer goods 36.9%, and intermediate goods 12.2%. In 2006, capital goods increased to 53.3%, consumer goods declined to 34.9%, and intermediate goods dropped to 11.9%. (See Table 2.)

Table 2: Imports by end-use 1990-2006

YEAR	Consumer goods	Intermediate goods	Capital goods	Total
1990	62.9%	8.7%	28.4%	100.0
1991	49.8%	7.75	42.5%	100.0
1992	41.8%	9.2%	49.0%	100.0
1993	36.6%	10.9%	52.5%	100.0
1995	35.5%	13.9%	50.6%	100.0
1996	35.7%	17.9%	46.4%	100.0
1997	39.4%	14.0%	46.6%	100.0
1998	31.0%	10.9%	58.1%	100.0
1999	36.5%	11.9%	51.5%	100.0
2000	28.7%	18.1%	53.2%	100.0
2001	32.2%	8.4%	59.4%	100.0
2002	30.2%	11.2%	58.6%	100.0
2003	19.6%	16.0%	64.4%	100.0
Average 90-02	36.9%	12.2%	50.9%	100.0
2004	45.0%	10.4%	44.6%	100.0
2005	39.6%	14.2%	39.6%	100
2006	34.9%	11.9%	53.3%	100

Source: Bank of Sudan, Annual Reports, 1990-2006.

The high percentage ratio of capital goods to total imports reflects the rising demand for imports created by the rapidly growing oil, construction, and service sectors. The crisis has had varying effects on the Sudanese economy. Since the country depends on oil exports as its main source of revenue, a decline in the price of oil will result in falling exports, a worsening of the trade balance, the balance of payments, and the budget deficit. In reality, the sharp decline in oil prices from \$149 to below \$40 per barrel in late December 2008 will certainly have a serious effect on oil revenues, exerting strong pressure on the Sudanese pound to fall. The negative effects will also be felt in the monetary, fiscal, and development sectors of the economy.

4.4 Impact on foreign direct investment

The period from 1990-2008 witnessed a substantial drop in the volume of investments in the Sudan due to a number of factors. The country has suffered from mounting external debt problems with staggering debt burden indicators⁵⁰. The magnitude of Sudanese debt amounted to \$15.3 billion in 1990, \$19.4 billion in 1996, \$28.2 billion in 2006, \$31 billion in 2007, and \$34 billion in 2008. A breakdown of the external debt by category shows that principal debts constituted 51.5% in 2001, but declined to 45.4% in 2006. The contracted interest value was 20.9% of the total debt volume in 2001, declining slightly to 20.3% in 2006. The delayed interest constituted 27.6% of total debt in 2001, but increased steadily to 34.3% in 2006⁵¹. Debt sustainability is difficult to achieve given the

⁵⁰ Medani M. Ahmed. [2008] "External Debts, Growth and Peace in the Sudan: Some Serious Challenges Facing the Country in the Post-Conflict Era" . SR 2008: 1. Chr. Michelsen Institute (CMI), Norway.

⁵¹ Ibid.

economic and political situation, both locally and globally. Most debt burden indicators for the Sudan are substantially higher than the internationally defined benchmarks. The ratio of NPV of external debt to the average of three successive years' worth of exports of goods and services has declined from 1,186 % to 914 % to 707 % between 2003-2005. These percentages are higher than the threshold for meeting the sustainability criteria which is 150%. Despite the fact that the percentage has been falling for three years, it is still considerably higher than the threshold, and the Sudanese debt situation is systematically unsustainable using this measure or benchmark.

The NPV of external debt to government revenue declined from 950 % to 670 % to 510 % between 2003-2005. These percentages are also more than double the threshold in 2005, and debt is unsustainable using this indicator⁵².

The Sudan was technically qualified to join the HIPC in 1996 based on the debt unsustainability criteria advanced by the World Bank and the IMF, as most of its debt burden indicators were much higher than the level required by the HIPC Initiative. Yet because of purely political factors (the Southern Sudan War and later the Darfur problem), the country was delayed entry to the HIPC. The Sudan was unable to reach an agreement with the IMF, the World Bank, or western donors in solving its debt problem in 1990 due to US economic sanctions and poor relations with Europe following the coup of 1989 in the Sudan. The US sanctions and the European economic boycott have deprived the country of exercising its economic rights set forth in the Lome and Cotonou agreements, making it difficult to arrive at any debt agreement with the aforementioned organizations. As a result, the Sudan's creditworthiness has been seriously damaged, and the flow of private foreign investment and aid virtually stopped for the period from 1990-1995. Foreign Direct Investment (FDI) declined to zero during the same period, but increased slowly in 1996 to reach \$138.9 million, rising to \$ 392 million in 2000, increased to \$ 574 million in 2001 (a rate of growth of 46.4%), sharply climbed to \$ 713 million in 2002, nearly doubled in 2003 scoring \$ 1,349 million (a rate of growth of 89.2% in 2002-2003). It further rose to \$ 1,511 in 2004 and then hit a record high of \$ 2,304 million in 2005 (with an increase of 52.5% in 2004-2005).

Investment has been growing annually, on average, at 82.3% for the period 2000-2005, making the Sudan one of the highest foreign investment receiving countries in the Arab world in the same period. Foreign investment in the Sudan has been going mainly to the oil, agriculture, construction and transportation sectors.

In 2006 more efforts were being made to attract Arab investors, especially from the Gulf States, in the areas of the banking, oil, energy, agriculture, industry, infrastructure and other sectors. In November 2006, an important investment promotion conference for the Gulf investors was held in Khartoum, organized by the ministry of Investment and ministry of Finance and National Economy⁵³.

The reason for the upsurge in the FDI from 2000-2006 was the ability of the government to establish strong strategic partnerships with China, Malaysia and India and to renew its economic relationship with most of the Arab funds and governments, convincing them to invest in strategic infrastructure projects such as the Merowe and Rouseris Dams. FDI has increased from \$5 billion in 2007 to more than \$7 billion in 2008⁵⁴. Ironically, the enormous increase in FDI occurred while US economic sanctions were being strengthened and Sudanese debt sustainability was deteriorating. Some Arab governments (Jordan, Egypt, UAE and Saudi Arabia) invested in

⁵² Ibid.

⁵³ Ibid.

⁵⁴ Ibid.

agricultural projects to produce wheat, maize, vegetables, fruits, and fodder in the River Nile, White Nile, Sinnar, and Blue Nile States.

There were many factors behind the influx of Arab investment in the Sudan. Firstly, the Arab countries have been suffering from a huge food supply deficit, and the Sudan, with its abundant fertile land, has always been regarded as the breadbasket for the Arab world. Secondly, there has been a mounting distrust and risk associated with Arab investment in US and European stock markets, with investors losing vast sums during the crisis. Thirdly, there is a greater realization among Arab investors that investing in the real economy of the Sudan and other Arab countries is safer and more rewarding, both materially and strategically, in comparison to investing in US government securities and toxic stocks in the west. Western governments have imposed political pressure on Arab governments to undertake serious and unpopular reforms, making them fearful of taking any action in regard to investing in these markets.

Positive results of Arab investment in the Sudan are going to be endangered if there is a sharp decline in oil revenues, with a number of negative factors working against such investment⁵⁵. Such a decline will create a credit crunch, forcing investors to keep their portfolios in their own countries to finance liquidity needs⁵⁶. This situation will also cause Arab oil-producing countries to implement tight budgetary and monetary policies to meet spending commitments at home, thus resulting in less foreign aid, support and investment. As oil prices continue to drop sharply, more financial resources will be needed to meet domestic budget spending with less capital available for investment in the Sudan. A reduction in the financial surplus will make the Sudan less able to borrow and repay its debts, decrease its creditworthiness, and create an unfavourable environment for investors as risk and uncertainty rise and the prospects for profit-making decline.

4.5 Impact on security and economic growth

The main assumption of this section is that stability, peace, and security have been crucial in achieving and sustaining economic growth in the Sudan over the last decade. Another assumption is that economic stability has encouraged investment in oil production and exploration, making the oil sector the driving force behind growth in the country. A third assumption is that a decline in oil revenues would negatively impact the growth prospects of the Sudan in the intermediate and long term.

4.5.1 Maintenance of peace and security is vital for sustaining economic growth

Peace and security are essential for sustaining economic growth and development in the Sudan for a number of reasons:

- Strengthening production activities and maximizing returns on investment, thus raising and sustaining economic growth rates;
- Attracting foreign investment to create the opportunity to reduce production costs and risks while continuing to maximize profits;

⁵⁵ The rising amount of oil revenues in Sudan since 2000 has been used as an effective guarantee for external borrowing and FDI, and has enormously improved the Sudan's financial creditability among Arab and Asian investors and donors.

⁵⁶ There are unofficial reports estimating the Arab financial losses resulting from the international financial crisis to be about \$350 billion.

See Al-Ray Al-aam Daily News paper ,[2008] No.4034.[December 20],Khartoum , Sudan. The paper quoted international news reports made by Mr. Badr Omer, Executive General of the UN Economic and Social Committee for West Asian countries, who made the above estimate of the Arab world losses in the international financial crisis].

- Creating competition among producers to spark production initiatives, which will enhance their ability to endeavour into new economic sectors and activities in order to maximize profits and returns;
- Providing appropriate chances to strengthen institutions and institutionalize behaviour in economic projects to support economic growth and development in the country;
- Creating opportunities to undertake long-term policies for the planning and implementation of development projects to enhance interdependence, integration, and the promotion of mutual dependence between various regions and sectors;
- Providing essential requirements to enable various social and economic groups to benefit from their labour through the maximization of production activity, creating common bonds for economic and social cooperation in the country. This will improve the population's real income and living conditions, resulting in a reduction of poverty and deprivation; and
- Creating an appropriate environment for the mobilization of resources and development, and the opportunity to maximize returns within the context of a well-designed comprehensive development strategy.

In practice, the Sudanese experience has shown that the maintenance of peace and security are crucial for the achievement of a high economic growth rate, especially when done in coordination with other appropriate economic policies. Conversely, a lack of peace and security will create a negative production and investment environment characterized by shrinking consumption, unreliable and inefficient service delivery systems, unemployment, and poverty. This will lessen material gain and increase social distrust, conflict, crime, social upheaval, displacement, and capital impoverishment.

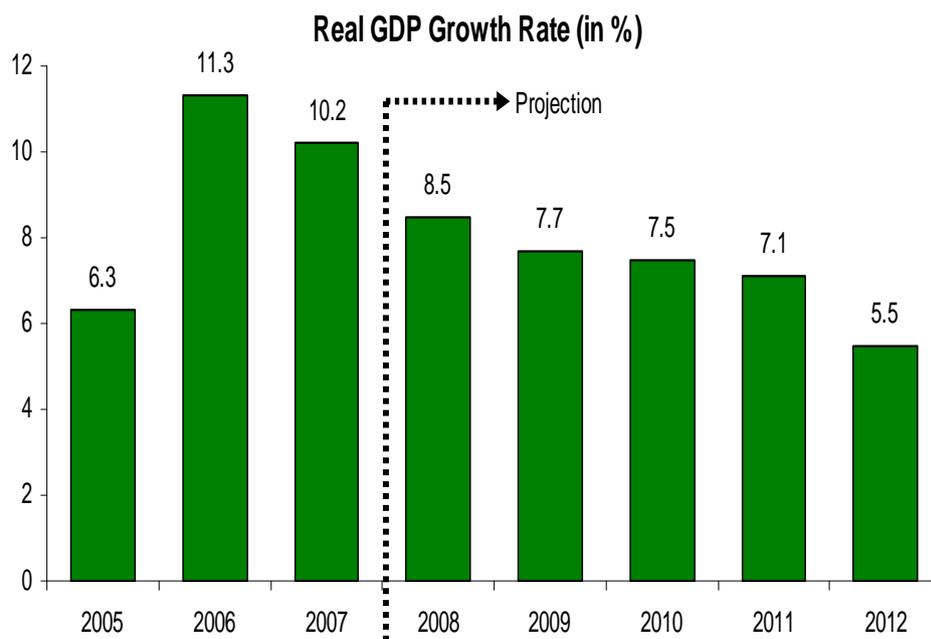
The Sudan implemented a wide range of economic, social, and political reforms in the 1990s. It has undertaken trade liberalization, privatization, banking reforms, and an anti-inflationary policy aimed at reducing the money supply and growth rates. These reforms were coupled with even tougher fiscal regimes to manage economic demands through the control of expenditures and an increase in revenue generation. The outcome of these policies was a drastic reduction of inflation from a record high of 130% in 1996 to single digits in 2006. As a result, GDP growth rates increased from 6% in 1997 to a record high of more than 10% in 2007. The rapidly growing oil, construction, and service sectors have been the prime movers of economic growth in the country because of their high profits and returns on investment in relation to other sectors. The oil sector has been especially successful in "crowding out" scarce local resources, monopolizing foreign resources and routing them away from traditional service and agricultural sectors, thus resulting in a rapid deterioration in their productivity and return on capital. The traditional sectors of agriculture and livestock still have the potential for growth in employment and income if more resources are invested to provide essential infrastructure and technical and human capabilities, coupled with market access and funding for small farmers and livestock feeders in the rural areas.

To sustain the growth of per capita income and reduce poverty in the Sudan, there is a need to coordinate the various government investment, fiscal, and credit policies and to focus on increasing the amount of resources and capital allocated to these productive sectors. These policies should also emphasize the improvement of public resource management at all tiers of government. At the budgetary level, there is an urgent need to undertake and develop effective mechanisms to monitor and control revenue generation and government spending with the objective of achieving greater public accountability and transparency. The proposed reform policies should allow the Ministry of Finance and National Economy to better control and manage resources in the country. The efforts to minimize off-budget revenue generation via the levying of taxes, rates, and duties, and prohibiting off-budget spending at all levels of government are crucial in helping to conserve scarce resources and eliminate waste and misuse of these resources.

4.5.2 Prospects for growth in the future

The World Bank has predicted that Sudanese oil revenues will decline to about \$80 per barrel in the medium term and \$70 per barrel in the long term, slowing economic growth from a record high of 10.2% in 2007 to 8.5% in 2008, 7.7% in 2009, and 5.5% in 2012⁵⁷. (See Figure 1.)

Figure 1: Projection of GDP growth for the Sudan, 2008-2012



Source: See World Bank and IMF (2008); also see Deepak Mishra's (WB Senior Economist to Sudan and Ethiopia) public lecture entitled "Global Crisis and Impacts on the Sudan", Faculty of Economic and Social Studies, University of Khartoum, November 5, 2008.

Indeed, there is a great danger that the Sudan will not be able to achieve high growth rates in the future due to a decline in oil revenues, affecting the central budget's service delivery projects. A sharp decline in oil prices will reduce export earnings and affect the flow of investment, which has traditionally used oil revenues as an incentive to encourage development activities in the country, resulting in a slowdown in the anticipated growth in foreign investment. The greatest effect on the growth rate of the real economy will be seen in the unemployment rate of graduates and unskilled labourers in the rain-fed agricultural areas of the Sudan. The drop in GDP growth rates, coupled with a decline of investment in the economy, will cause a rise in both unemployment and poverty levels.

4.6 Impact on the monetary sector and the economy

The economy has been sagging under the weight of very high inflation rates for the period from 1980-2000. The rates have increased to 33%, 42% and above 80% for the years 1982/83, 1985/86

⁵⁷ The 2008 budget predicts that GDP growth rate will be about 6%, even lower than the World Bank projections mentioned above.

and 1988/89, respectively⁵⁸. In the 1990s, the annual average rate of inflation increased from 44.6% in 1990 to a record high of 130.3% in 1996 before coming down to 16.1% in 1999. The overall average for the period from 1990-2001 was 66%⁵⁹. In the face of a substantial rise in the cost of living, trade unions have succeeded in raising wages through political pressure, labour strikes, and work stoppages. Output lost due to labour strikes for the fiscal year 1988/89 was estimated to be more than one billion Sudanese pounds. The absence of sound income and wage policies based on efficient labour production increases has contributed to an economic decline in the Sudan. There has been strong evidence to suggest that successive devaluations of the official value of the Sudanese pound, relative to the US dollar, have contributed significantly to the rising cost of domestic production without reducing the volume of imported commodities⁶⁰. These devaluations have failed to create an increase in the supply of Sudanese exports and succeeded in fuelling the enormous and devastating inflationary pressures in the country. Investment in the domestic and productive sectors has declined, economic growth has slowed, and the standard of living in the middle and poor classes has deteriorated.

The Central Bank of Sudan (CBS) has taken a leading role in maintaining macroeconomic stability and stabilizing prices through a tough policy of inflation control following the expansionary fiscal policy adopted by the Ministry of Finance and National Economy (MFNE) in the early 1990s. This strategy has also meant a reduction in government spending, control of the expansion of credit, and a strong curbing of the money supply. It has encouraged direct foreign investment in oil, the banking system, electrical generation, industry (sugar and some limited heavy industrial plants), and infrastructure projects. The laws to encourage this type of investment were amended several times to provide unprecedented fiscal and non-fiscal concessions and incentives. The elimination of both the internal and external balance of payment deficits should be viewed as important policies to relieve pressure on the local currency and enhance macroeconomic stability and growth for the period from 2000-2008.

A sharp decline in oil revenues, as a result of the worsening recession in the developed countries, will produce enormous negative effects on all other sectors of the economy and drastically reduce the flow of hard currencies to the Sudan. This will devalue the local currency and prevent the country from importing capital goods and consumables. It will also exacerbate the scarcity of goods and services as the government starts to depend mainly on deficit financing, internal borrowing, and an increase in taxes to generate more revenues for the financial, service delivery, and administrative sectors. The combination of high taxation and inflationary pressures will have a serious impact on both the people and the economy. Living standards will decline and production will be threatened as more capital flight through banks and unofficial channels takes place in response to the declining real value of assets and profits. With a drop in production, growth rates will decline as more private and foreign investors are discouraged to invest in the Sudan, creating a vicious cycle of low production, consumption, and income. A difficult situation will result in which huge deficits in commodities and services, along with higher rates of inflation and runaway deficit financing, cause a downward economic spiral and an extremely volatile monetary situation. As a result, development will slow and economic insecurity prevail.

4.6.1 Inflationary effects re-emphasized

There will be some internal factors generated by the financial crisis that will fuel inflationary pressures in the Sudan. Oil and minerals constitute a substantial share of the Sudanese government

⁵⁸ Ahmed, Medani M.[1993] "Economic Crisis of the 1980s in the Sudan: An Overview of the Main Indicators and Structural Causes" . *Egypt/Monde Arabe* No. 15-16 3e et 4e trimesters (Sep.-Dec.). Cairo, Egypt. Pp. 27-38 {in French}.

⁵⁹ Bank of Sudan.[for number of years] Annual Reports, Khartoum, Sudan.

⁶⁰ Ibid.

Also see Ali, A.A.[1985] Sudan Economy in Disarray. Khartoum and London: Ethica and KUP.

revenues, approximately 60-65% of total revenues in 2007-2008. A reduction in oil prices will decimate the budget and render it incapable of delivering services and establishing development projects, making both deficit financing and internal borrowing an inescapable combination for many African governments. Governments in the Sudan do not have a good record of being willing or able to curb public expenditures for obvious political, security, social, and economic reasons, with reliable PFM and FA systems not properly functioning in many tiers of government. Fiscal discipline and prudence are not easily attainable from the expenditures side, and the failure to mobilize revenues through sound tax generation and management will require institutional reforms and a substantial capacity building effort that will take time to expedite. The result will be an increasing budget deficit arising from an expansionary fiscal policy, adding inflationary pressure on the money supply and nationwide banking system.

4.7 Effect of a depreciated dollar and euro on the Sudan's economy

The negative effects of a depreciated US dollar are more notably felt by the USA's trade competitors in Europe and Japan as we will see in this section, followed by a look into its possible effect on the Sudan. The USA has been keeping the dollar weak in relation to the value of the euro and the yen, as this monetary policy generates a positive effect on the US economy by making its products more competitive compared to European and Japanese products. This situation has disrupted competition in the global trade system, and Europe has openly opposed the US dollar depreciation policy. The undervalued dollar has allowed the USA to pay less for foreign investments, resulting in some Chinese and Arab investors financing the USA's \$10 trillion debt. Through its weak dollar, the USA has been exporting inflation via the appreciated euro to the rest of the world. This depreciation will increase the risk of augmenting inflationary pressures in countries with fixed exchange rate regimes whose currencies are linked to the dollar. The rapidly falling dollar runs the risk of exacerbating inflationary pressure in the US economy, heightening interest in investing in the commodities market, and pushing commodity prices to even higher levels. The weak dollar will increase uncertainty about the yields of financial markets, fuel inflationary expectations in the both the USA and abroad, and force commodity prices to rise sharply⁶¹.

The Sudan, fearing both US economic sanctions and the loss of banking deposits and transactions in US dollars, has decided to peg its local currency to the euro rather than the dollar. The financial crisis has caused a depreciation of the euro in response to the meltdown in European stock markets, as well as a sharp decline in demand and a deep recession. Many Sudanese banks and export earnings declined as the value of the euro fell sharply. The Sudan is now faced with a important challenge: Should it link its pound with a group of foreign currencies instead of the euro, or should it float its pound freely against other currencies and be subject to the daily market forces of supply and demand? It seems the ideal choice is to peg its pound to a group of carefully chosen foreign currencies to offset any cyclical variations in one single currency.

4.8 Stock and money market effects on the economy

The impact of the crisis on the Sudan will be restricted because of the small number of transactions and limited size of the Sudanese market, which has no direct link to regional or international financial markets and no foreign investors or companies. There is however a narrow window

⁶¹ See the World Bank. [2008] "Prospects for the Global Economy". Online. Available at the website: <http://web.worldbank.org/external/default/main?>

through which the Sudan may be affected, specifically the few companies that are registered in both the Sudanese and Gulf states' stock markets. The Gulf markets have been severely impacted and unofficial estimates put the losses as high as 65% of their value. It is widely believed that foreign investors in these markets were forced to withdraw a substantial amount of their investments in order to compensate for this loss and to meet the need for liquidity at home. The Sudanese telecommunications company (SUATEL) is one example of a Sudanese company registered in both markets that expects to be only slightly affected by the crisis.

Many observers believe, however, that the paper money market in the Sudan, if strongly supported and given fiscal incentives to grow and prosper, will be able to generate enormous capital to finance development projects and service delivery in the country. Both the paper money and stock markets could give substantial financing to the productive sectors and become a major source of funding for development in the country with Government Musharaka Certificates (Shahama) and the development securities entitled "Sarih" as potential sources of revenue generation for the economy.

4.9 Effect of food prices and agricultural development on the value chain strategy

It has been observed that there is a strong link between increased oil prices and high food prices. Using DSA prices applied to the case of the Sudan, the World Bank says that there are two scenarios for oil-food price associations; one occurs when oil prices rise above the \$50 benchmark and the other when they drop below \$50. With the higher price, a 1% increase in oil prices will increase food prices by 2.1%, whereas a lower oil price scenario shows a 1% decrease in oil prices, reducing food prices by about 0.42 %⁶².

The food supply has been affected by drought and crop failures and by a shift to using maize and other food products in the production of biofuels in the industrialized countries⁶³. The rising price of fertilizers has increased production costs for small farmers, causing a sharp drop in the food product supply chain with a sharp increase in food and energy prices over the past few years, contributing to a drop of the real incomes of the poor and raising the rate of inflation in a growing number of countries. Moreover, the stocks of several major food companies are at record low levels, raising the possibility of an upward turn in food prices should a major crop failure occur in 2008.

Food prices rose dramatically for the period 2005-2008, with an increase of 12% in 2006, 24% in 2007 and 50% in 2008. There are a number of reasons for the decline in grain production, which according to the World Bank started in 2006. In 2007, wheat prices followed as "the cropland for wheat has been diverted to feedstock for biofuels using maize and soybeans in the United States, and rapeseed and sunflowers in wheat exporters such as Argentina, Canada, and Europe"⁶⁴. Rice prices remained low in 2007, but tripled in the first quarter of 2008 due in part to an increase in the shift of demand from wheat to rice and because of policy changes that included export restrictions and import increases needed to build reserves⁶⁵.

⁶² See Deepak Mishra [2008] (WB Senior Economist to Sudan and Ethiopia) public lecture entitled] "Global Crisis and Impacts on the Sudan" . Faculty of Economic and Social Studies, University of Khartoum.[November 5].

⁶³ A moderate drought in major producing countries resulted in an average of a 2% reduction in global food production from normal trends.

⁶⁴ Ibid.

⁶⁵ Ibid.

Many observers expected food prices to fall, which will generate some positive effects on living conditions of the poor by lowering the cost of consumption while improving both the quality and quantity of their food. In reality, the effect of the price decline has not been reflected in lower costs in the Sudan and other developing countries due to a lack of communication between the international and local levels. It should be noted that this is attributable to many factors, including the rigidity of sectoral arrangements and performance, the inflexibility of institutions, trade barriers, and the fiscal policies used to maximize revenue generation without the accompanying sensitivity to consumer benefits and gains.

High food prices have created pressures and the opportunity for the Sudan to look into the potential gains of implementing a food production and agribusiness value chain strategy. The effects of the strategy will be felt in many other fields, such as:

- The construction of a reliable and efficient transportation and railway network;
- Electrical power plants in rural areas;
- Improved communication and information capacities for ports and distribution channels;
- The modernization of marketing facilities that will enhance farmer's capacity building, know-how, and expertise in areas of modern farming;
- An increase in the amount of investment for the research and development of technology and extension services;
- The development of regional banking and financial systems for the implementation of the strategy; and
- The creation of an expanded labour market for young Sudanese university graduates.

There is a great potential to maximize values from the horizontal and vertical integration of all sectors and regions in the Sudan and at every level of the value chain strategy:

- Potential for a sustained food supply at affordable, competitive prices for Sudanese consumers;
- Potential for maximizing returns on capital investment;
- Potential for strengthening sectoral and regional complementarities in the area of commodity production;
- Potential for bio-fuel production which will be financially rewarding for the Sudan, which has an enormous supply of crop by-products, non-foodstuffs and waste (e.g. production of sugar cane, sorghum, peanuts and other crops). The bio-fuel production schemes for energy and electricity generation will increase returns on investment as witnessed by the success of the Kenana sugar factory;
- The phenomenon of rapidly rising food prices should remind and alert the government of the challenges and interventions needed for the achievement of agricultural development. The failure to achieve agricultural development means a continued dependence on foreign food aid and relief in many parts of the country. There is an urgent need to exercise a strong political will to honour commitments made at various times to swiftly implement the long-awaited agricultural transformation;
- The provision of micro-finance for small farmers and projects is important, but it will not adequately finance the agribusiness portion of the strategy, which will require a mobilization of substantial financial resources for its various activities. The provision of essential production inputs such as technology, research, extension services, and infrastructure are necessary for policy formulation and harmonization.

4.10 Effect of the insurance sector on the economy

There is a need to examine the main characteristics, production size, and links between insurance and other sectors, as well as the insurance sector's contribution to the Sudanese economy. Generally, the higher the degree of interdependence between international insurance companies, stock markets and the global economy, the greater the impact of the crisis on national insurance companies and the economy. The real estate and construction industries have been impacted the most by the drop in housing prices, which has led to an enormous decline in the stock prices of Wall Street investment companies and their global counterparts. This in turn has led to a collapse in the share prices of insurance and reinsurance companies, causing bankruptcies and failures of staggering proportions in the USA and Europe. A notable example was the loss of \$79 billion incurred by both Citibank and Citigroup due to their investments in high-risk real estate stocks.

There has been minimal investment by foreign insurance companies in the Sudanese market and minimal Sudanese investment in foreign companies and markets. As a result, the links between Sudanese insurance companies and foreign insurance firms are not strong. Some international reinsurance companies were badly affected by the financial crisis, both in the UK and USA, which has had a negative effect on the Sudanese insurance industry. No one knows the full extent of these effects, showing the need for a detailed study of the insurance sector. An examination of the financial characteristics and performance indicators of these companies is urgently needed to assess the challenges they face and to proffer some policy recommendations. This will strengthen their contribution to the national economy while protecting their capital and financing capacities within the framework of a nationally designed rescue and support plan. The Ministry of Finance and National Economy and the Central Bank of the Sudan have to coordinate their varied fiscal and monetary policies to encourage the development and advancement of the insurance sector.

5. Sound fiscal and monetary policies

There is a need for sound fiscal and monetary policies to offset the impacts of the global financial crisis in the Sudan:

- In the aftermath of the crisis the government should attempt to design and implement an objective budget based on the price of oil per barrel to prevent any future loss of government revenues. The government should also look into finding alternative revenue sources to compensate for the decline in revenue. The easy choice is to raise VAT and other taxes and tariffs, though this will negatively affect the standard of living while increasing the tax burden and accentuating the plight of the poor and fixed income groups in society.⁶⁶
- Another alternative is to depend on Shahama and Sarih to generate substantial revenues for the budget due to their high rate of return and the support of the government against any defaults.
- The Sudanese money market should be developed, strengthened and encouraged to supply capital. Currently, there has been little consideration given to its activities and role in the Sudanese economy.
- The challenge facing the government has always been to choose policies that are pro-poor, pro-growth, and pro-macroeconomic stability. The coordination between fiscal and monetary policies is crucial in achieving macroeconomic stability and sustaining growth and development.
- In order for the Ministry of Finance and National Economy and the Central Bank of the Sudan to formulate the appropriate fiscal, economic, and monetary policies, there is a need to establish Policy Analysis Centres (PAC). These centres could be the think tanks of the country and supply important policy recommendations to support its decision-making capacity, enhancing its effectiveness in different policy aspects.
- On the expenditures side, some serious fiscal measures need to be undertaken to rationalize and prioritize expenditure outlays for essential economic and social objectives. Budget credibility and a strict adherence to approved plans of spending with efficient, objective financial guidelines and laws must be carefully followed. There should also be expenditure commitments at every level with a corresponding release of cash balances to meet target spending. These reforms can only be implemented if the proper PFM and FA systems are installed for revenue generation, expenditure assignments, allocations, and disposition levels at all tiers of government.
- The government must choose a sound, effective, and desirable exchange rate policy that does not discourage exports, but works to maintain stability in the balance of payments.

5.1 Export promotion strategy

The country should attempt to strengthen its export production capacity through the careful design and implementation of export-based production activities in all strategic sectors such as agriculture, oil, and mining. The adoption and use of modern technology in production, distribution and marketing activities, coupled with a well-planned and executed infrastructure, would allow the country to maximize its return on exports.

⁶⁶ The government has already increased VAT from 10% to 12% to 15% in 2007/2008 budgets to compensate for a decline in oil revenues.

5.2 Other strategies

There are a number of other strategies the Sudan should adopt to reduce the negative effects of the crisis. Externally, there should be an attempt to establish a joint strategic economic cooperation with Arab and African neighbours. These strategic partnerships should aim at producing agricultural and industrial goods using the regionally integrated value chain strategy, targeting the most cost-effective methods of production, and constructing the necessary infrastructure to allow local producers to compete in global markets and interact with their partner countries.

- The Sudan's relationships with China, India and Malaysia should be strengthened and expanded to include the transfer of advanced technology. These countries have substantial technical capacities and are eager to secure a steady supply of oil and mineral resources to meet the needs of their rapidly growing economies. Training and capacity building programmes are essential for the transfer of know-how and technology to the Sudan.
- The Central Bank of the Sudan should design and launch a financial rescue plan to protect banks and companies affected by the crisis after completing a study of these institutions. The capitalization and injection of credit into the banking system is vital and should be implemented quickly to offset any drops in liquidity.
- An immediate measure that needs to be undertaken by the CBS is to fully guarantee all of the banks' deposits to enhance and strengthen confidence in the banking system within the country.
- The CBS must establish an early warning system to detect any elements of loss, failure, or default and move with haste to protect the banks from collapse.
- As inflation has been a genuine financial problem facing the economy since the 1980s, there is a need for the continuous monitoring of all the factors that cause inflation, particularly the factors that affect the demand for money in the Sudan.
- Reliable monitoring and evaluation systems must be established for the supervision of banks and brokerage firms to ensure their compliance with financial laws and procedures. Strict measures need to be taken to limit the power of bank directors when lending to private investors and/or in the execution of financial transactions. Experience has shown that the relaxation of these measures by some officials has caused the failure and collapse of many banks.
- Therefore, there is an urgent need to carry out reforms in many economic, financial, and administrative institutions to upgrade their efficiency, improve the overall investment environment within the country, and remove any negative perception by foreign investors that may prevent them from investing in the economy.
- There is an urgent need to implement employment-generating economic policies in order to lower level and extent of unemployment that might be caused by the crisis. The government has to encourage national and foreign investment in agriculture and industry, especially in the labour-intensive textile, agribusiness and agri-industrial sectors.

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Research addresses main challenges to peacebuilding in Sudan, with a particular focus on (a) the political economy of the transition, including institutional and governance issues, and (b) the role of third party engagement and issues related to the management and coordination of aid. The programme is multidisciplinary and combines macro level studies with research in selected localities and states. It covers basic and policy-oriented research as well as competence building.