ERF Policy Brief

ERF-FDL Project on Stabilization, Adjustment and Growth in MENA

Post-conflict Reconstruction, Stabilization and Growth Agenda for Sudan

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About the authors

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In a nutshell

Main Reasons: for a collapsing Sudanese economy in the last 30 years:

- *Sudan is being characterized by civil war, political instability, and developmental failure;*
- *The heavy legacy of the former regime (1989-2018) kleptocratic practices "Tamkeen and political marketplace" led to state capacity erosion and intuitional failure;*
- *The partitioning of the country in 2011 and the loss of oil rents, led to sudden stop and its macroeconomic burden; the beginning of the end for the regime;*
- *The transitional government formed after the December Revolution of 2018 designed an ambitious reform plan aimed at stabilizing the economy and reintegration of Sudan into the international development community;*
- *2021 coup resulted in halting the transition to democracy, denying Sudan's access to international finance, and prevented debt relief through HIPC;*
- *The ongoing clashes between the Sudanese Armed Forces and the Rapid Support Force since April 2023. wreaked havoc on the economy and exacted untold humanitarian cost on the civilians;*
- *The war has a considerable cost, under the catastrophic-pessimistic scenario, it takes until 2051 for the GDP to return to its 2022 prewar Conversely, the prewar GDP level is restored by 2046. Alternatively, if the war come to an end in 2023, and a fully civilian led government is formed and pursued political and economic reforms, GDP is projected to recover in 2023.*

Opportunities for economic growth:

- *Rich natural resource base, geostrategic location and vibrant youth constituting 67% of the population.*
- *Support of international community for democratic transition which will unlock international finance for development.*

Introduction

The Ingaz regime strategy of Tamkeen and cronyism led to considerable distortion in the economy and weakened the state capacity which was directly reflected in service delivery, political and economic instability. Under the Comprehensive Peace Agreement (CPA) of 2005, a Government of National Unity was formed, led by the National Congress Party (NCP) and the Sudan People Liberation Movement (SPLM), in addition, to an SPLM-led Government of South Sudan. Unfortunately, in 2011, the country portioned into two parts as the former regime did not make conditions attractive for unity.

As a result, the loss of oil revenue led to a decline of imports by around 20% from 2010 to 2018. The secession also led to severe economic depression of about 17% in 2012, followed by unstable growth performance. In addition, Sudan economy witnessed a severe economic crisis in terms of high inflation driven by distorted macroeconomic practices, a declining of foreign reserve, high and unsustainable fiscal deficit, and high current account deficit.

The economic crisis resulted from the succession has, in fact, constituted an extreme case of what came to be known in the macroeconomic literature as the "sudden stops". Faced with a distorted macroeconomic condition. The Sudan Transitional Government planned fiscal, exchange rate and monetary reforms as the kernel of its economic recovery program including IMF's Staff Monitoring Program (SMP) agreement, which is critical for the rehabilitation the country into the international development community and for the HIPC initiative (Elbadawi, 2020).

More recently, Sudan has been embroiled in a destructive internal warfare between the Sudanese Armed Forces and the Rapid Support Force since April 2023. The outbreak of the destructive war suggests that the economic agenda for Sudan must be dominated by assessing its economic cost as well as the post-conflict reconstruction.

This policy brief presents the potential for future economic growth of the SMP-associated economic reforms and debt relief. It organized as follows; 1). the economic crisis inherited from the Ingaz regime; 2). the main tenets of the economic reform agenda of the transitional government (IMF- SMP); 3). the recent growth performance of Sudan during the last thirty years, compared to the growth of Ethiopia; and 4). justification for the "optimistic" growth scenario by demonstrating the tremendous growth potential of Sudanese agricultural development strategy, built around agro-industrial growth corridors.

"Sudden" Stops and Economic Collapse

adopted Tamkeen strategy manifested in massive purges of civil service, security institutions when loyalty replaced proficiency. The NIF transformed the civil war into a religious war. Cronyism in terms of building a new business class through using fiscal and monetary policy tools, including highly irresponsible inflation tax, privatization of SOEs at lower prices.

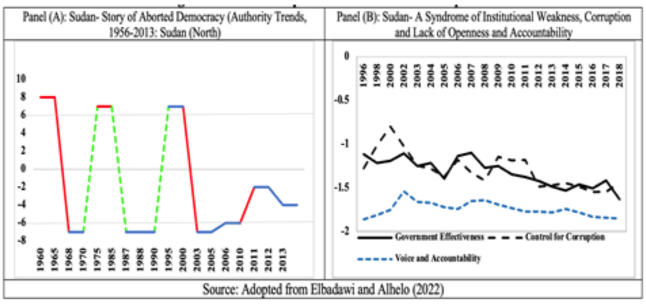
The former government dismissed around 73000 public sector employees under the so-called "public interest". As a result, state capacity has weakened, including regarding very basic functions, such as exercising monopoly over violence, much less delivering health and education services and other public goods. Moreover, this political ideology pushed the Sudanese politics into an "opportunistic social equilibrium", where the "political marketplace" was the main institution for political settlement.

Following the spilt of the NIF into NCP and Popular Congress Party which weakened the ideological base of the regime, Al-Bashir wielded full control over the state, aided by rents from the oil sector since 1999. Therefore, the oil rents-enabled "Centralized Political Market Place" was contributing to regime survival at the cost of squandered opportunity for transforming the economy (Elbadawi and Alhelo 2022).

The NCP government and SPLM signed the CPA in 2005 which led to the portioning of the country in 2011 with South Sudan retaining 75% of oil. The partitioning earmarked the unravelling of the Ingaz regime and its eventual collapse in April 2019. The regime grossly underestimated the tremendous impact of the loss of oil for the highly oil-dependent pre-secession economy, which could not be compensated by the gold sector. The loss in oil revenue led to severe economic depression of about 17% in 2012, followed by negative growth rates since 2018.

The overall loss of value-added amounted to more than 26% of GDP, of which about 19 percent of GDP in the oil sector. The official reserves plumped by 17% (US$0.5 billion), inflation rates increased to more than 50% as of 2019 (IMF, 2012). The ensuing economic crisis in the aftermath of the succession has, in fact, constituted an extreme case of what came to be known in the macroeconomic literature as the "sudden stops". In this context, the literature suggests that countries with

Figure 1: Institutional performance and dictatorship



fragile macroeconomic economic conditions prior to the onset of the “sudden stop”, are likely to be the most severely impacted. The ensuing impact on the cost of living caused considerable hardship for the remaining seven years of the regime, thus further eroding its fast-shrinking popular base.

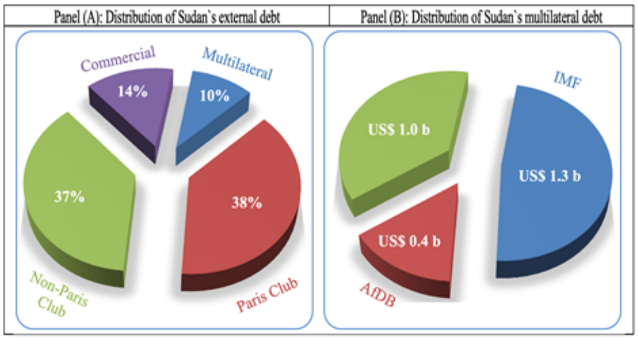
The Policy Framework for Re-Engagement and Debt Relief

As a result of the “Sudden Stops”, poor economic management, political marketplace, cronyism and kleptocracy, the economy has been contracted since 2018. Current account deficit stood at 10.5%, fiscal deficit widened to 10.8 % and international reserves reached a very low level of $190 million In 2020. Covid-19 reduced both domestic and external demand. Sudan had accumulated arrears to the major sources of development finance (see figure 2). The financial sector was undercapitalized due to macroeconomic mismanagement. Lacking access to finance, the budget deficit continued to be monetized, which resulted in two-digit inflation and a rapidly deterioration of the local currency.

The transitional government emphasized investment to enhance real sector productivity and proposed a sequence in which reforms to produce macroeconomic stability and a more efficient allocation of resources. The government’s stabilization program, articulated in the IMF-SMP, contained subsidy reform, increasing public revenue, exchange rate reform, control over state owned enterprises, financial sector reform including central bank independence, anti-corruption measures, and social protection measures e.g., Sudan Family Support Program (SFSP).

An estimated $4.5 billion external finance was required with only $490 million forecasted from disseminating of Tamkeen asset recovery. To qualify for Highly Indebted Poor Countries (HIPC), an Upper Credit Tranche (UCT) SMP was implemented. Sudan had been in debt distress for nearly four decades. Sudan’s

Figure 2: Structure of external debt



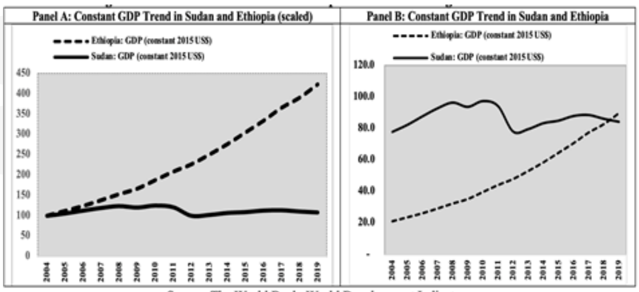
nominal debt stock was initially estimated at USD $50 billion as of December 31, 2019 and after reconciliation it was estimated at $56.3 billion, or 199 percent of GDP at the end of 2019.

At the HIPC Initiative completion point Sudan was expected to receive full and irrevocable reduction of debt. Due to the 2021 coup, the required bilateral agreements with Paris Club members was not executed, and negotiations with non-Paris Club bilateral creditors and private (London Club) creditors not meaningfully started. As a result, Sudan’s debt remains unsustainable. In addition to a massive loss of life and public infrastructure, the ongoing conflict has destroyed many assets in the private sector, including hospitals, telecommunication networks and banks. Post-conflict economic growth will require: 1) higher productivity-enhancing investments, 2) Reliance rely on more on-budget resources to spur a private sector takeoff, 3) Investment in transportation networks, energy, and telecommunications, 4) investment in human capital, 5) policy reengineering to make markets contestable by ensuring the competitive neutrality of the government including State Owned Enterprises, 6) scaling of capital required for Sudan’s recovery, 7) accelerate move to digital finance, including non-bank financial intermediation, and 8) credibility and capacity building.

Growth and Investment Tradions

Comparison between Sudan and Ethiopia reveals extremely divergent growth experiences. While the Sudanese economy stagnated for 15 years, the Ethiopian economy more than quadrupled. In less than one generation, the Ethiopian economy bridged the gap of more than $60 billion that separated it from the Sudanese economy in 2004. Similarly, while per capita income of the Sudanese remained stagnant for 15 years, Ethiopia’s income per capita increased by nearly three times, which allowed the latter abjectly poorer Ethiopia to reduce the income gap from nearly a fifth of

Figure 3: A tale of two countries – Ethiopia and Sudan divergent growth path



Source: The World Bank, World Development Indicators.

the Sudanese per capita income in 2004 to a half in 2019 (See Figure 3). It's apparent that the Ethiopian elites, decided to build "economic legitimacy" or "gamble on development" as a basis for regime survival in power. Instead, the elites of the Ingaz relied on oil and gold-financed kleptocracy to hold on to power

Growth and Investment Transitions

The paper employed the Long Term Growth Model (LTGM) as an analytical framework, the analysis considers three distinct scenarios: two catastrophic scenarios (long-duration civil war - one "pessimistic" with only limited post-conflict reforms, and another "optimistic," with robust reforms). Instead, the third is a peaceful renaissance scenario. To establish a baseline, we consider a 20% decline in GDP for the year 2023 and a corresponding 10% decrease in the capital stock due to the prevailing conflict.

The conflictive catastrophic scenarios

Under the two catastrophic scenarios, it is evident that GDP exhibits different post-conflict growth patterns. In the catastrophic-pessimistic scenario, GDP experiences a decline of -2% in 2024, gradually reaching 0% growth by 2037, and eventually expanding to 4.5% by 2050. Consequently, it takes until 2051 for the GDP to return to its 2022 level. Conversely, in the catastrophic-optimistic scenario, GDP shows more favorable growth, starting at -2% in 2024, progressively increasing to 0% by 2037, and then rising further to 8.7% by 2050. As a result, the prewar GDP level is restored by 2046. In terms of GDP per capita (GDPPC), the projections indicate a similar pattern. In the catastrophic-pessimistic scenario, GDPPC experiences a decline of -4.7% in 2024, gradually improving to -1.9% by 2037, and eventually reaching a growth rate of 2.7% by 2050. In the catastrophic-optimistic scenario, GDPPC starts at -4.7% in 2024, progresses to -1.9% by 2037, and then accelerates to a growth rate of 6.9% by 2050.

Consequently, achieving convergence with the GDPPC level of 2022 is not realized until 2050 due to the positive population growth that reduces GDPPC growth. If we extend our simulation, the pessimistic scenario takes until 2075 to reach the GDPPC level of 2022, whereas the optimistic scenario achieves it by 2056. A pivotal question to ask at this juncture, is how costly a long-duration civil war might be for Sudan, relative to a modest counterfactual peaceful growth scenario.

A very conservative assessment would be to assume a stagnant economy at the 2022 GDP level, with a zero annual growth. Another still conservative scenario would be to assume annual growth of 4% during the post-2023 period. Under the first approach and assuming comprehensive reforms after the war (as in the catastrophic-optimistic scenario), the cost of the war amounts to 195 billion USD, which is nearly six times the size of the GDP in 2022. Conversely, with limited reforms after the war (as in the catastrophic-pessimistic scenario), the cost rises to 236 billion USD, approximately seven times the size of the GDP in 2022. However, if we consider the loss compared to the GDP level that would have been reached with 4% growth, the estimates become even more alarming. In the optimistic scenario, the cost of the war amounts to 2.2 trillion USD (or more than 66 times the country's GDP in 2022), while in the pessimistic scenario, the cost exceeds 4.5 trillion USD (or more than 136 times the GDP in 2022, and bearing in mind that convergence is not achieved until 2100, which is where our LTGM simulation concludes).

The peaceful renaissance scenario

The peaceful renaissance scenario envisions the war coming to an end in 2023, as part of a robust political settlement, leading to a transformative civil-democratic transition. This scenario is grounded in fundamental changes (ending the militarization of the Sudanese politics, building a unified political, professional arm forces. It involves implementing security reforms in line with international standards.

Furthermore, a national conference for peace would be convened. The scenario also entails putting an end to the devastating Sudanese syndrome, and embarking on a comprehensive social, political, and economic renaissance, guided by a social contract inspired by the “iconic” principles of the “glorious” December Revolution. According to such a situation, by 2030, we anticipate investment reaching the average level seen in Ethiopia between 2004 and 2019.

Additionally, TFP growth to align with the 90th percentile TFP growth observed in countries classified as low income (LI) by the World Bank. From 2043 onwards, TFP growth is projected to increase further, eventually surpassing its initial trajectory by an additional percentage point by 2050. Furthermore, we envision significant improvements in male and female Labor Force Participation (LFP), with both reaching the 75th percentile of their 2019 values for Low Income countries. Additionally, reforms in HC are introduced to stimulate HC growth, yielding a considerable boost (detailed in the table summarizing these assumptions). Under this scenario, GDP is projected to experience robust growth, increasing from 5.6% in 2024 to approximately 10% by 2030 to 2050. Concurrently, GDPPC is forecasted to rise from 2.9% to 7% by 2030, reaching 8.6% by 2050. These optimistic growth rates indicate a rapid recovery. By 2029, GDP is estimated to surpass its 2011 level, followed by GDP per capita in 2033. By 2050, GDP is projected to be more than seven times higher than its 2011 value, while GDP per capita is expected to be around 3.5 times higher. As depicted in the graph, the initial investment required to achieve a growth rate of 9.8% is notably high, surpassing 45% in 2024.

However, the investment needed gradually declines to around 40% between 2030 and 2043. Subsequently, with the acceleration of TFP and the consequent increase in the marginal product of capital (MPK) due to the implemented reforms the required investment begins to decrease. By 2050, the investment needed reaches approximately 33.5%. This trend is primarily driven by the significant increase in MPK until 2030, when most of the reforms are assumed to take place.

Furthermore, another increase in TFP growth is anticipated from 2043, contributing to the decline in the required investment. In fixed 2021 dollars, the simulated investment ratios come to about $186 billion for the first ten years of the growth profile (2024-2033). As equation 3 above makes clear, financing such a hefty level of investment requires large national savings, enabled by robust fiscal and other economic reforms; substantial debt relief, but also new preferably concessional borrowing for financing the much need social programs in education, health, and social protection. However, FDI will likely be the main source of finance, attracted by the growth prospects of huge agricultural potential of the Sudanese agriculture.

Agricultural transformation

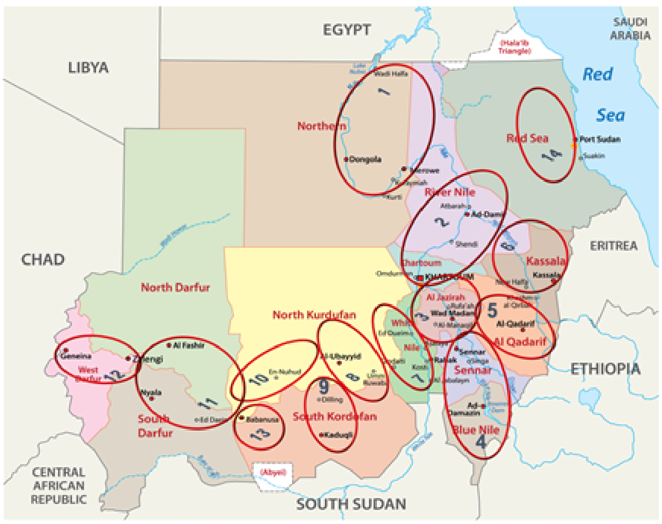
Despite the significant of the agricultural sector, Sudanese agro-industrial sector remains backward, beset with low productivity, weak linkages to modern agro-industry, while most of the farming community continues to languish in poverty and poor access to basic services. This due to the acute undercapitalization of the sector, as can be seen in the low levels of fertilizers use.

Therefore, for Sudan to achieve the miracle growth depicted under the peaceful renaissance scenario, we propose an Agro-industrialization strategy that will add value for agricultural products, maximize the return from agriculture, provide employment opportunities, modernize life and link Sudan’s agriculture and industry to regional and global markets. Implementing this strategy, requires substantial investment to upgrade the infrastructure layer to support large-scale agro-industrialization.

The paper proposed fourteen agro-industrial corridors (Figure 4), accounting for the overall richness and diversity of Sudanese agricultural resource base and strengths and opportunities of each area, bearing in mind the necessity of stimulating growth, poverty reduction and food security in the different regions of the country.

From the perspective of this paper’s LTGM growth model, under the peaceful, renaissance scenario, the proposed agro-industrial corridors would absorb most of the required investment. $165.5 billion out of $186 billion (FDI required to support the assumed 9.8% “miracle” annual rate of growth for the first decade (2024-2033), could be accounted for by FDI inflows for financing modernization and structural transformation of

Figure 4: Proposed agro-industrial corridors



the Sudanese agriculture, as part of a renewed interest on investing in Sudan as a "breadbasket" for the Arab world and Africa. The $165.5 is broken down into $14.6 operating capital ($3.9 billion for industrialization and $10.7 billion for agriculture) and $141.9 billion as fixed cost ($58 billion for land reclamation, $22.7 for irrigation and $61.2 for manufacturing) (Mahgoub, 2022).

Moreover, given the critical role of infrastructure as a main catalyst for development and economic growth, transforming the Sudanese agriculture as premised in the above strategy would also require further economy-wide investment in transport; renewable and nonrenewable energy; and, information and communication technologies. Sudan's infrastructure is in massive need for new implementations, rehabilitation of decaying installations and preventive maintenance to support the proposed vision of a vibrant and integrated growth corridors, especially in the energy and transport sectors. Improved telecommunication coverage and introduction of advanced IT technologies will propel efficiency and productivity. For example, the Transitional Government's Ministry of Transportation presented an infrastructure investment plan totaling almost $30 billion to donors and investors at the Paris Conference in 2021, covering rehabilitation, maintenance and new projects in sea ports, river navigation, railways, highways, and air transport.

The main policy recommendations

Key interventions to catalyze transformation of Sudanese economy Post-conflict Reconstruction, Stabilization and Growth:

- Immediate cease fire and resolution to the current armed conflict to realize the "peaceful renaissance" scenario that could lead to "miracle" growth
- Restore the path to democratic transition to unlock international development finance including HPIC, IDA etc.
- Social contract with political and economic tenets: not only electoral legitimacy, but also economic legitimacy
- Design financing and policy package that target urgent post-conflict reconstruction; moving fiscal policy and structural reforms from austerity to growth
- Secure $186 billion in the next decade to support the assumed 9.8% "miracle" annual growth for the first decade (2024-2033)
- Utilize $165.5 from FDI inflows for financing modernization and structural transformation of the Sudanese agriculture by strengthening its linkages with agroindustry as part of a renewed interest on investing in Sudan as a "breadbasket" for the Arab world and Africa
- Implement agro-industrial growth corridors as a development strategy with shared ownership by the government and the private sector
- Economy wide investment in transportation network, renewable energy, telecommunication and digital technologies to power economic growth

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