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An assessment of the states and institutions well placed to provide significant financial relief to Sudan

Analyst's note. 'Well placed' is taken to mean financially *and* politically able to provide relief; 'significant' is taken to mean in a timely manner *and* of a magnitude sufficient to make a difference to the failing Sudanese economy.

1. The current risk profile of Sudan will deter many lenders from issuing new loans and the conditions imposed by international financial institutions (IFIs) may discourage Sudan from seeking new, non-concessional finance. As such, **debt relief will most likely be the dominant form of any financial relief provided to Sudan.**
2. There are five key groups of Sudanese creditors: international financial institutions, Paris Club members, non-Paris Club members, commercial lenders and supplier companies.
3. The **International Monetary Fund** (IMF) is critical to facilitating a comprehensive debt relief programme for Sudan. The **Islamic Development Bank** and **Arab Monetary Fund** may also provide debt relief on comparatively less onerous conditions and fast track resumption of financing services.
4. **Austria, United States, Denmark, United Kingdom, Italy, France** and **Belgium** are Sudan's largest Paris Club creditors. However, the recently renewed US trade sanctions, concerns over ongoing border conflict and Khartoum's interference in aid delivery, suggests Paris Club creditors are likely to impose constitutional, political and human rights reform conditions on debt relief – conditions that are likely to be challenging for the current Sudanese government to satisfy.
5. Of the non-Paris Club creditors, it is **Kuwait, Saudi Arabia** and, to a lesser degree, **China** that will likely influence both Paris Club negotiations and the overall level of debt relief delivered. New and existing Gulf state creditors may be willing to issue bilateral loans instead of debt relief if they consider economic stability in Sudan advantageous to regional power balance and necessary to secure long term agricultural and industrial opportunities.
6. **Commercial lenders** will be influenced by the direction of Paris Club negotiations and opportunities to litigate recovery for loan default.
7. Due to the diverse nature and number of **supplier companies,** it is unclear what position individual suppliers would take on debt relief.

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Sudan's economy faces potential collapse. Unsustainable external debt, significantly reduced government revenues, rapidly escalating inflation, rising rural and urban poverty and youth unemployment, and a growing balance of payments deficit suggests urgent measures are required to avoid economic collapse and increasing political instability.

The Sudanese government has attempted to stabilise the economy through negotiations to reduce external debt, expansion of gold export, maintenance of self-imposed structural adjustment programmes and implementation of IMF austerity measures. Economic stabilisation programmes have attempted to discourage new, non-concessional financing, focusing Khartoum's attention on managing existing debt.

Secession and external debt

The Sudanese government established oil production in 1999, and achieved consistent GDP growth through the 2000s. However, Sudan lost 70-75% of its oil reserves when South Sudan succeeded in 2011, leading to a sharp decline in government revenue. Economic hardship became particularly pronounced in early 2012 as oil production halted due to pipeline transit fees and border security disputes.

In September 2012, the African Union brokered a Cooperation Agreement between Sudan and South Sudan. Under the Agreement, Sudan continues to retain all existing external debt. Both nations will participate in creditor outreach to assist Sudan to become eligible for the IMF/World Bank Enhanced Initiative for Heavily Indebted Poor Countries (HIPC). If Sudan does not achieve HIPC milestones by July 2013, it will trigger a negotiated debt apportionment between the two countries.

Achieving timely economic stability requires Sudan to receive substantial and urgent debt relief through international mechanisms, such as the Paris Club and the HIPC initiative and negotiations with non-Paris Club creditors. To date, most IFIs and creditor nations have not re-established new financing facilities for Sudan; although there are limited exceptions, including a reported offer from Qatari emir Sheikh Al-Thani to purchase $2 billion in Sudanese government bonds for currency stabilisation purposes.

Sudanese officials have highlighted international acceptance to cancel the country's external debt, particularly after the signing of the Cooperation Agreement. However, Khartoum authorities have also expressed disappointment in the negotiations: on 29 September 2012, Sudan's foreign minister, Ali Ahmed Karti, told the UN General Assembly that international promises to cancel Sudan's debt were 'gone with winds'.

Key creditors

Sudan's external debt is **$43.7 billion,** including an estimated $30 billion in arrears and overdue interest payments. Sudan owes money across five key groups of creditors, shown in Table 1 overleaf in order of significance.

It is those of Sudan's creditors with the largest exposures and highest interest rates that are best placed to provide financial relief. However, there are a complex set of variables that may determine the *likelihood* of well-placed creditors providing debt relief, including alignment with national interests or regional geopolitical strategy, technical or procedural barriers embedded in debt relief mechanisms, existing investment or trade relations and historical political relations.

Table 1. Sudan's key creditors by type (including percentage exposure to total Sudanese debt).

Type of creditor	Key players	Percentage
International financial institutions	International Monetary Fund, Islamic Development Bank and Arab Monetary Fund	14%
Paris Club members	Austria, United States, Denmark, United Kingdom, Italy, France and Belgium	32.9%
Non-Paris Club members	Kuwait, Saudi Arabia and China	36.3%
Commercial lenders	Pomgrad Split, Habib Bank Limited, Namco Anstalt and Africa Alfa Fund	12.8%
Supplier companies	Predominantly Chinese companies	4%

Debt relief initiatives for Sudan must be comprehensive to be effective and require systematic donor coordination. Creditors will seek equal treatment, despite important differences in their political interests and approaches to debt relief. However, Sudan's strained relationship with the international community poses a challenge to systematically coordinating debt relief procedures.

The HIPC initiative and the Paris Club impose challenging debt relief procedures that require a significant investment of time. Current HIPC case studies suggest a 12 to 30 month timeframe for existing mechanisms to start delivering formal debt relief, which may not be timely enough to address the pressing economic crisis that will continue in the absence of new finance.

International financial institutions

Sudan owes approximately 14% of its debt to IFIs, including the International Monetary Fund (approximately 3.9%), the International Development Association (IDA, approximately 3.7%), Arab Fund for Economic and Social Development (approximately 2.2%) and the African Development Bank (approximately 1.2%). These institutions have provided both concessional and non-concessional loans over the last three decades.

IFIs have diverse memberships and specific institutional procedures for arrears clearance and debt rescheduling, reduction or cancellation. Debt relief is often conditional on Structural Adjustments Agreements. Beyond demonstrating economic thresholds, Sudan will need to comply with IMF reform programmes, including austerity measures and development of a Poverty Reduction and Growth Strategy.

Khartoum officials have suggested that self-imposed structural adjustment and privatisation reform through the 1990s and 2000s will make compliance with IMF or IDA reform conditions easily achievable. Though partially true, complying with IMF reform programmes may challenge the National Congress Party's power base. Deeper cuts to fuel subsidies and rationalisation of sub-national funds may disrupt President Omar al-Bashir's patronage networks beyond Khartoum. Forced reductions on security and defence expenditure may further catalyse a weakening of al-Bashir's relationship with the Sudan Armed Forces and increase vulnerability to internal challenges. Beyond purely economic adjustment measures, the IMF and IDA may impose conditions on governance reform that the al-Bashir regime would find politically unpalatable.

Due to the IMF's fundamental role in coordinating international debt relief initiatives for Sudan, compliance with IMF conditionality will become an important benchmark for well-placed creditors.

If the current Sudanese government cannot satisfy IMF and IDA conditions, other IFIs including Islamic Development Bank, Arab Monetary Fund, OPEC Fund for International Development and International Fund for Agricultural Development may be better placed to provide debt relief.

Some IFIs have already provided Sudan with alterative debt rescheduling mechanisms in order to re-establish financing portfolios. The International Fund for Agricultural Development agreed with Khartoum to defer repayments for three years. The Arab Fund for Economic and Social Development provided Sudan with $350 million of concessional loans in early 2011.

Paris Club members

The Paris Club is a voluntary, informal group of 19 permanent creditor nations that coordinate official debt relief for developing and heavy indebted nations. The Paris Club evaluates debt relief on a case-by-case basis, considers implementation of IMF reform programmes, and seeks consistency in debt renegotiations with creditors.

Paris Club creditors take account of how Sudan treats all creditors. Paris Club creditors may be unwilling to provide debt relief if Sudan continues to repay debts held by non-Paris Club members such as China, Kuwait and Saudi Arabia. Historically, non-Paris Club bilateral creditors have only provided 34-39% of agreed Paris Club debt relief.

A number of Paris Club members made public pledges to provide debt relief to Sudan in 2011 following the secession of South Sudan. Germany initiated discussions with Khartoum on debt for development swaps. The United Kingdom signalled an intention to cancel $1.2 billion in Sudan government debt as part of its aid budget. Canada also indicated that it may soon consider Sudan eligible for debt forgiveness. Japan, as an important importer of Sudanese cotton, indicated an intention to forgive $40 million. Russian officials have also indicated that $5 million of debt relief is possible. However, while individual member states may express intentions to provide specific nations with debt relief, Paris Club principles require consensus, and so promised relief may fail to materialise.

Paris Club creditors account for approximately 32.9% of Sudan's debt. Major creditors include Austria (approximately $2.2 billion), Denmark (approximately $1.3 billion), Italy ($1.2 billion), France ($1.1 billion) and Belgium (approximately $1 billion).

Several Paris Club creditors are predominantly concerned with aid effectiveness and humanitarian assistance. These creditors are likely to be concerned about ongoing interference of Khartoum in aid delivery, continued escalation in border conflict and what they deem excessive government spending on defence and security.

It is possible that a small minority of EU creditors may not entertain debt relief without some form of regime change or transitional government and may be concerned about the precedent of providing debt relief to a government whose head of state has an outstanding International Criminal Court arrest warrant. Some EU countries may therefore opt to negotiate debt for development swaps as opposed to direct debt relief. (This is significant as three European states alone – Austria, Denmark and Belgium – account for 40% of total Paris Club debt exposure.)

These countries may also be mindful of commitments to achieve 0.7% Official Development Aid/Gross National Income targets by 2015. Considering the age and risk associated with the debt, countries such as Austria may choose to provide debt relief grants to Sudan (taking account of aid target objectives and unlikelihood of debt recovery from Sudan).

The United States had initially expressed a desire to assist Sudan achieve debt relief objectives in 2011 and secure 'conflict resolution and democracy, not regime change'. In 2012, the US Treasury requested $250 million to cover the estimated cost of forgiving all of Sudan's outstanding US debt, on the expectation that Sudan could reach the HIPC decision point by 2013. (Sudan's total US debt stands at $2.1 billion, taking into account the original loan plus interest and arrears.) The proposed budget allocation would depend upon Khartoum satisfying congressionally imposed conditions related to human rights and state sponsorship of terrorism.

In addition to strict debt relief conditionality, the United States recently renewed Sudan trade and investment sanctions. Renewal of sanctions means active barriers to bilateral debt relief by the United States and constrains the voting of US executive directors to the IMF and African Development Bank.

The United States has also retained Sudan on its State Sponsor of Terrorism list despite a continuing intelligence partnership between Khartoum and Washington and the noticeably reduced level of US criticism of Sudan over human rights violations during the Obama administration.

Recent events may reinforce a hardened US posture. On 24 October 2012, Israeli forces attacked the Yarmouk arms factory in Khartoum, on the basis it was thought to be providing contraband weapons to Hamas on behalf of Iran. The subsequent docking of Iranian warships in Sudanese ports served to further underscore Israeli allegations.

It remains unclear whether extension of sanctions and hardening on debt reduction conditionality represents a change in US diplomacy towards Khartoum. The extension of sanctions may have been a short-term measure adopted more to manage the current US-Israeli relationship and US-Iranian containment than as a tool to actively punish al-Bashir's government.

Non-Paris Club members

A substantial proportion (approximately 36.3%) of Sudan's debt is owed to creditor nations outside the Paris Club. Major creditors include Kuwait (approximately $6 billion), Saudi Arabia (approximately $3 billion) and China (approximately $2.2 billion); others include India, Turkey, United Arab Emirates and Oman.

Gulf state financing in Sudan is partially motivated by a desire to address internal, creditor nation food supply deficits by building agricultural modernisation in the 'Arab world's breadbasket'. More than 76% of the registered capital in non-oil investment is attributable to Gulf state investors. For example, Kuwait has continued providing substantial loans for and investment in dam construction despite the current economic conditions. However, there is no consolidated motivation for Gulf state investment.

Debt exposure to the Gulf states cannot be solely explained by the financing of agricultural projects. Hostility from the United States towards Gulf state investment post 9/11, common language and cultural ties and a need to find alternative investment opportunities in North African countries where US interests were not dominant have also been important drivers.

Saudi and Kuwaiti appetites for debt relief will take account of specific regional power balances and Sudan's relationship with Iran, whereas other Gulf states may instead focus on economic objectives or shaping internal political dynamics. In December, Iranian ships docked in Sudan for the second time, suggesting growing political and military relations between National Congress Party conservatives and Tehran. This could possibly lock Sudan out of a 'Red Sea alliance' and deny it access to some Gulf Arab state financial assistance.

China has high stakes in security and stability in Sudan in order to protect and maintain diverse Chinese infrastructure development and investment. During Sudan's civil war in the 1990s, the Chinese National Petroleum Corporation (CNPC) secured significant oil production rights at a time when North American and European companies were divesting commercial interests. In 2009, prior to secession, over 58% of Sudanese exports were destined for China – mostly in the form of oil – with bilateral trade running at over $8 billion. China's economic interests also extend to transport and energy generation infrastructure development with a significant role in dam construction.

With a significant proportion of oil production blocks now located in South Sudan but oil pipeline networks traversing over 1,600 kilometres across Sudan, China and its state owned oil companies must strike a delicate balance. Security in production and delivery of oil requires cooperation of both Sudan and South Sudan. China will need to demonstrate commitment to relations with Sudan, while equally showing South Sudan that it can have a balanced approach to both countries.

Commercial lenders

At the height of the civil war, Sudan's options for financing and loans became limited as many IFIs and Western states withdrew access to concessional financing in light of systematic human rights abuses. As such, commercial lenders providing finance with high interest rates (upwards of 15%) became an important source of financing for Sudan.

The al-Bashir government has outstanding debts owed to a range of commercial lenders totalling over $4 billion dollars (approximately 12.8% of total), with a large component of penalty interest and arrears. These debts are often resolved via a form ancillary to the Paris Club called the London Club. Some of these lenders include Pomgrad Split, Habib Bank Limited, Namco Anstalt and Africa Alfa Fund. A number of commercial creditors have pursued legal judgments against Sudan totalling $133 million in claims. Claims may continue unless there is a strong, coordinated and inclusive push from Paris Club creditors for debt relief.

Supplier companies

In addition, private and state owned companies exporting to Sudan can provide the government lines of credit to purchase imports. Of the current Sudanese debt load, 4% is made up of debt owed to supplier/importer companies in this way.

This debt is owed to a large and diverse pool of companies, with the largest proportion based in China.

There is no mechanism similar to the London Club through which Sudan is able to negotiate collectively with commercial creditors of this sort. Due to the diverse nature and number of suppliers, it is unclear what position individual suppliers would take on debt relief.