Implications of the Economic Crisis in South Sudan

South Sudan is in the midst of an economic crisis. The economic situation in the country is often overlooked in the context of the humanitarian emergency and the fragile political and conflict environment; yet the worsening economic conditions in the country hold widespread implications for further political instability as well as the operating conditions for humanitarian organisations working in the country.

At independence in 2011 the country was debt-free. In addition, a relatively small population and lucrative oil revenues meant the government’s per capita spending was considerably greater than many of its regional neighbours. Thus beyond the critical state-building and nation-building challenges that the country faced at independence, there was a sense among external observers that the country did have good economic prospects. It had inherited an established oil industry, which augmented by untapped oil reserves, mining and agricultural potential left the country well-placed to pay for the massive investments required in health, education and physical infrastructure. Yet five years later the country has the world’s highest rate of inflation, its currency has lost more than 90 percent of its value and the government’s budget deficit for 2016/2017 is projected to be more than US$ 1.1 billion.

In May 2016 a team from the International Monetary Fund (IMF) visited South Sudan and warned that the deteriorating economic situation threatened further human suffering and the peace process. Yet following the crisis in July, economic indicators have worsened and so too has the likelihood of greater hardship and political instability. And while high levels of dysfunctionality in South Sudan is not uncommon, the converging factors of hyper-inflation and a critical shortage of government revenue threatens to undermine the basis of the patronage network at the heart of the governance system in the country. Moreover, experience from recent years has shown that political instability often manifests as conflict, which in turn results in attacks against civilians and displacement.

For humanitarians the current economic environment holds a number of risks, both in terms of a general deterioration of the humanitarian context but also from increased criminality and the unpredictability of unpaid armed men on organisational operations.

This briefing note will therefore examine the context of the country’s economic crisis and explore some of the potential political and conflict implications as well as the impact on international organisations operating in South Sudan.
Where Did It Go Wrong?

There are a number of factors driving South Sudan’s economic crisis, the most significant of which are the impacts of conflict and global oil prices on the government’s budget – and the resultant effects of a chronic shortage of hard currency in the economy. South Sudan is the most oil-dependent country in the world; with oil accounting for almost all exports, 60 percent of gross domestic product (GDP) and 98 percent of government revenue. Yet the oil shutdown in 2012 and the conflict that began in 2013 resulted in South Sudan’s oil output dropping to approximately 165,000 barrels per day (bpd) from a high of around 300,000 bpd. In addition to reduced output, declining global oil prices have decimated the government’s finances. At the beginning of 2013 oil was trading at more than US$100 per barrel and fell to US$30 in February 2016. But while oil prices have recovered somewhat and are currently trading a little below US$50 per barrel, a combination of reduced output, debt repayment and payments to Sudan have all but strangled the government’s earnings.

Most of Sudan’s and South Sudan’s proved reserves of crude oil and natural gas are located in the Muglad and Melut basins, which extend into both countries – yet approximately 75 per cent of the oil reserves are believed to lie within South Sudan’s Unity and Upper Nile states. Given that Sudan’s oil industry was largely developed during the civil war, oil exploration was for the most part limited to the south-central regions of the then unified Sudan and significant fields such as Block B in Jonglei were surveyed but exploration never took place. Sudan currently has two export pipelines pumping Dar Blend from Upper Nile and Nile Blend from Unity’s oil fields northwards to the Bashayer Marine Terminal on the Red Sea. Yet the pipelines that make-up Sudan and South Sudan’s economic lifelines are also tools for leverage and catalysts for conflict between the two countries.

Under the terms of the Comprehensive Peace Agreement (CPA), the SPLM was to share power with the National Congress Party (NCP) in a Government of National Unity from 2005 up to the referendum on South Sudan’s independence in 2011. Despite the provision of autonomy for the south, and the formation of the Government of Southern Sudan (GOSS) which was allocated half of the revenues generated by southern production, there was intense jockeying for power between the two parties over oil. The tensions were focused on a number of issues that ranged from un-demarcated borders – thus not allowing for the division of the oil fields between north and south – to the SPLM not being given access to any of the information relating to oil production and existing contracts. The atmosphere of mistrust between the SPLM and their NCP partners in the unity government were further heightened by a report by the advocacy group Global Witness which claimed that the government had under-reported the volumes of oil produced in the southern oil blocks. Thus while GOSS itself lacked oversight and was frequently guilty of fiscal mismanagement and corruption, the overriding sentiment in Juba to emerge from that period was that Khartoum could not be trusted.
At the time of South Sudan’s independence – and despite the fact that negotiations with Sudan on a number of issues including transit fees for the use of Sudan’s oil pipelines were unresolved – the oil continued to flow. Indeed, Juba estimated revenue of US$3.2 billion from oil sales in the final six months of 2011. Then in December 2011 claiming non-payment of transit fees, Khartoum seized US$850 million in oil revenue and began diverting South Sudanese oil to its own refineries. South Sudan responded in February 2012 by shutting down all of the country’s oil wells and effectively stopping oil exports. This was a key decision that laid the groundwork for the current crisis. The World Bank said at the time that the government was not aware of the economic implications of the shutdown, and despite an austerity programme it still needed to borrow heavily from oil companies against future sales of oil. The details of these deals have never been made public, but the shutdown in 2012 created a blueprint for government responses to future disruptions in oil production during the conflict and began a cycle of crippling oil-backed debt. The IMF reports that the government has increasingly resorted to collateralizing future oil sales to secure foreign loans, often at high interest rates. The IMF estimates that a US$1 billion line of credit was extended to South Sudan by oil companies operating in the country. In addition, it is believed the government has also borrowed from financial institutions – likely also secured against future oil revenues and at high interest rates.

A further significant dimension of the 2012 shutdown was the deal that eventually agreed with Khartoum. Against the advice of the industry, Juba agreed to pay US$11 per barrel for the use of the pipeline plus an additional US$15 per barrel as part of a US$3 billion compensation payment to Sudan for lost oil income. The key mistake was agreeing to pay a fixed fee rather than a sliding scale linked to international oil prices. So while the shutdown in 2012 made the country vulnerable to low global oil prices and accrued debt (either as cash repayments or future oil deliveries), the conflict that erupted in 2013 radically reduced the country’s oil output.

Within days of the conflict starting in December 2013, strategically important oil fields such as Adar Yale and Palogue in Upper Nile and Unity and Thar Jath fields in Unity state became areas of heavy fighting. Production has since recovered in Upper Nile, however the extent of the damage and the continuing instability has meant that South Sudan is still not producing any oil from its most valuable oilfields in Unity state. Though output levels in Unity oilfields were already in steep decline even before the conflict began in December 2013. From a peak of 288,000 bpd in 2004 they fell to below 125,000 at the time of South Sudan’s independence in 2011. This was largely due to over-production during the interim period after the signing of the CPA in 2005 when the government in Khartoum – fearing southern independence – attempted to increase output. And while recovery rates (the percentage of available oil pumped out) can be improved, this would require massive investments of an estimated US$300 million per field – and oil companies will be reluctant to make further investments in such an unstable environment. In addition to South Sudan’s current production being barely half what it was at its peak, the Dar Blend oil from Upper Nile (which is still being exported) is discounted between US$5 to US$11 per barrel due to its highly acidic content.
Thus the World Bank estimates that when the international oil price is at the current level of US$50, factoring in the discounts on Dar Blend, payments to Sudan, payments to oil companies and servicing debt, South Sudan only earns US$9 per barrel – by far the lowest price for crude in the world. But despite these reduced earnings, the overwhelming significance of oil within the economy means it will remain for the time being the fulcrum around which any economic growth and development will emerge. As such it is also worth considering how revenue is spent. The Stockholm International Peace Research Institute (SIPRI) estimates that in 2014 the government spent more than 60 percent of its overall net revenues on the military, and has steadily increased its expenditure on arms from US$945 million in 2013 to US$1.3 billion (thus far) in 2016 – including the purchase of two L-39 fighter jets in July 2016.

Reduced Revenues

Despite the oil industry having little apparent impact on the daily lives of most South Sudanese, the consequences of reduced national earnings from oil are being felt through unpaid salaries for civil servants and ever-increasing prices for goods in the markets. South Sudan currently has the highest rate of inflation in the world (at the time of writing estimated to be more than 700 percent). The Crop and Livestock Information System for South Sudan (CLIMIS) notes the prices for basic foodstuffs at markets in Juba are between 323 percent and 723 percent higher than at the same time last year. This hyper-inflation is essentially the result of significant increases in the supply of South Sudan Pounds (SSP) not supported by accompanying GDP growth. While a number of factors accentuated inflationary pressures – such as reports that the government printed money to pay salary arrears and the flight of dollars from the country following the fighting in July – the decision to float the SSP in December 2015 was a significant event.

At independence in 2011 the value of the SSP was tied to the US dollar at a rate of 2.96 SSP – a relatively common practice for countries heavily dependent on a single export commodity. However, as oil production reduced, so too did the supply of US dollars – and inflation increased. This inflation created a parallel market rate for foreign exchange, and by December 2015 dollars were trading on the black market for 18.50 SSP – thus creating significant market distortions. These multiple exchange rates also created opportunities for well-connected people to buy dollars at the official rate and sell them for profit on the black market. The decision by the Bank of South Sudan (BoSS) in December 2015 to scrap the fixed exchange rate to a floating system effectively devalued the currency overnight. The move was advantageous in that it meant oil revenues earned in dollars equated into more SSP and it was hoped that a better functioning exchange market would reduce dollar shortages and attract investors. The underlying challenges remained however, and combined with ongoing political uncertainty, it became apparent that BoSS had neither the monetary policy tools nor experience to manage inflation and the depletion of foreign reserves.
The continued shortages of dollars during the first months of 2016 steadily undermined the broader economy, affecting food and fuel imports (despite exporting crude oil the country has no refining capacity). The rising cost and limited availability of fuel meant many businesses could not afford to run generators that powered machinery, irrigation or computers. Even large investors such as SABMiller-owned South Sudan Beverages\(^1\) closed their US$100 million plant in April 2016 due to a lack of available dollars – following the devaluation of their SSP reserves with the currency flotation, buying inputs in dollars and selling their products in SSP became unsustainable.

In August 2016 the Ministry of Finance ordered all government agencies to close their accounts with commercial banks and re-open accounts with the BoSS – an indication many believe of looming bankruptcy and an attempt to consolidate any remaining assets. The shortage of dollars following the crisis in July became critical as the BoSS began limiting the amount of dollars commercial banks could access. In turn, commercial banks are now restricting dollar withdrawals and not allowing transfers between banks and are not accepting cheques from other banks. For INGOs operating in South Sudan inflation is complicating organizational planning as programme budgets are quickly outdated and the banking restrictions are making it more difficult to access dollars or pay suppliers and national staff. International organisations operating in South Sudan may soon need to consider radical options such as bringing dollars into the country to meet operational costs – and thus further increasing operational risks.

The unfolding economic crisis in South Sudan therefore threatens further hardships for the country’s long-suffering people, a crisis of governability and a number of challenges for international organisations operating in the country. Particularly a marked rise in criminal activity – no doubt driven by the most noticeable dimensions of the economic crisis such as the severe disruption of markets and the unavailability of basic commodities. Many INGOs are reevaluating their security considerations after an increase in the number of compound robberies – which in places such as Rumbek have affected almost every international organization operating there. In addition to the growing risks of criminality directed towards INGO staff, compounds and warehouses, the confluence of the economic crisis with growing anti-western sentiment means that not only are there more robberies, but they have the potential to be more violent.

**Political Implications**

Any governance system based on personal loyalties to individual leaders within a complex system of power relationships and set against a backdrop of ethnic identity politics is not likely to produce robust institutions capable of weathering economic hardship. So the fact that South Sudan’s existing governance structures essentially comprise a patronage network of semi-institutionalised resource transfers makes

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1 Manufacturing beer brands White Bull, Nile Special and Club Pilsner as well as Club soft drinks
the country particularly vulnerable to economic shocks. Moreover, given the existing fragility of the political and conflict environment in South Sudan, the extent of the economic crisis has significant political and potential conflict implications.

At the heart of Salva Kiir’s political strategy in the period immediately following the signing of the CPA was the notion of the ‘big tent’ in which all opposition was brought into the SPLM. While touted as an expression of national unity, it was in fact a useful mechanism for entrenching his position in a fractious environment of diverse ethnic and regional loyalties as those within the ‘tent’ could expect to be allowed access to state coffers. Indeed, it is now widely accepted that vast amounts of oil revenue were diverted to key individuals while increasingly smaller amounts were funnelled into an immense network of patronage payoffs. According to a report by the South Sudanese auditor-general, over US$1 billion in oil revenues were unaccounted for during 2005 and 2006, and in 2012 it emerged that there was no financial reporting of what happened to non-oil revenues that were collected in taxes by the national government or states for two consecutive years. Billions more were feared missing between 2007 and 2011, and millions of dollars were also reportedly smuggled out of South Sudan in bags across borders to unknown destinations. In June 2012, Salva Kiir famously accused current and former senior government officials of stealing at least US$4 billion in state funds.

It is thus apparent that central to South Sudan’s governance model is the idea that it is not so much power that is corrupting, but rather it is corruption that is empowering. By investing their wealth in the expansion of kinship networks, leaders were able to strategically cultivate their local bases of support. As such, President Kiir’s 28 states decree can also be seen as mechanism for widening the patronage network; and the August 2015 peace agreement, which was based on a principle of power-sharing, was by implication a wealth-sharing deal that re-opened opposition access to state salaries and business opportunities. Though while growing the network by creating new states in the context of an economic crisis might seem counter-intuitive – given the dwindling resources that can be fed into the system – it does also create space for local authorities to expect some form of government funding. Even infrequent payments are better than none, and local leaders will also be empowered to raise revenue locally. A broader political consideration also underpinning the 28 states is that the allocation of land – and cities such as Malakal – are themselves evidence of patronage payments that appear to advantage Dinka communities.

At the centre of the ‘big tent’ initiative was the absorption of various militias such as the South Sudan Defence Forces (SSDF) into the SPLA – though often still loyal to individual commanders and defined by their ethnic identity. What this meant was the new country’s army was essentially an assemblage of diverse groups held together by ensuring the loyalty of individual commanders. So it is little surprise that at independence more than half of the country’s total budget was spent on the military – with as much as

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2 Described by Bruce Bueno de Mesquita in his book *The Dictators Handbook*
80 percent going towards salaries. It is also worth noting that the SPLA appeared to be exempt from the austerity cuts of 2012 - implying that the threat of unpaid soldiers was the reason for the concession.

The current economic situation therefore has the potential to radically undermine an already fragile environment. There are indications that the rising cost of living coupled with the government’s failure to pay salaries has exacerbated tensions within the military and among the broader population. And in addition to the threat of unpaid police and soldiers it is also worth considering that given the political context in which elites both survived and fuelled factionalism by channelling money through patronage networks, diminishing available resources threatens the very foundations of the governance system. A shrinking patronage network means that “capture” or retention of the centre of power is essential for controlling access to dwindling state resources. In this context we can expect new tensions and fissures within the ruling faction of the SPLM to emerge as the economic situation worsens.

There are few prospects for an improvement in the current economic environment. The government is unlikely to convince international donors to support it given its record of mismanagement, ongoing tensions with the international community over the deployment of a Regional Protection Force and recent reports from the UN Panel of Experts on military expenditure and the Sentry report on corruption. Moreover, while the resumption of oil production in Unity and an increase in global oil prices would do doubt help, it will not be enough – because repayments of existing debt through oil transfers will likely not translate into meaningful increases in government revenue. Moreover, the US Energy Information Administration (EIA) believes that the country’s production cannot recover to its 2011 average level production, at least in the near term, because of permanent damage to infrastructure and natural decline – particularly in the mature fields in Unity state. The cycle of instability in Unity will continue to deter investors from upgrading infrastructure or exploring new fields given the current abundance of cheaper, easier to access oil on global markets. Thus the economic problem is not one that will go away, and the full effects of the government’s policies of mortgaging the future while simultaneously buying the support of well-armed fractured communities is likely still to be felt.