The Sudanese Struggle for Stability: Long-term Energy Security Hinges on Deeper Bilateral Political Progress

BILL FARREN-PRICE looks at the prospects for a resumption of oil exports from Sudan and South Sudan in the wake of September's peace agreement

The fledgling nation of South Sudan has had a tough first year, confronting head-on the realities of its geopolitical and economic reliance on its northern neighbour, Sudan, for access to international oil markets. South Sudan shut down oil production in January, following a dispute over tariff payments to Khartoum. September's peace agreement brokered in Addis Ababa has, on the face of it, laid the groundwork for a resumption of oil production and exports from the south. But traditional lifters of Sudan's high-quality crude will be as concerned with the sustainability of a resumption of oil exports as with the restart itself.

While both Sudan and South Sudan are for now bound together by their overlapping oil industry, a resumption of production from South Sudan and export via the north will be sustained only if there is further progress in bilateral discussions between the two countries over unresolved issues, in particular the future of Abyei and other disputed territories. Despite the improved diplomatic atmosphere between the two Sudans evident at a recent investment roadshow in Vienna, the narrowing of the political gulf between the two countries has been driven by the economic imperative of restarting oil exports, on which both are so reliant for state revenue. Juba's desire for economic independence will ultimately limit this marriage of economic convenience, while failures to contain rebel uprisings in Sudan's southern states could also put the industry in fresh danger.

This year's oil shutdown means that Khartoum and Juba have now experienced the challenge of maintaining currency stability and public spending after months of shuttered oil exports – and the experience has pushed both sides back together. South Sudan should be able to restart some oil production relatively swiftly once technical problems are overcome, but long export pipelines through Sudan are vulnerable to disruption, especially if fighting in the border zones, such as that seen in South Kordofan in recent weeks, continues. Achieving pre-crisis production levels of 450,000 b/d will be a challenge for the two Sudans if the Sudan People's Liberation Movement – North (SPLM-N) continues its campaign in Sudan's southern states and if Juba and Khartoum do not make progress beyond the September peace deal.

More Realistic Budgeting

Government officials are cautious about the oil restart. Sudan's Finance Minister Ali Mahmoud has said that projected revenue from the recent deal with South Sudan over oil transit fees will not be reflected in the 2013 budget, suggesting Khartoum is wary of delays to restart timelines. Before the early-2012 shutdown, South Sudan produced 340,000 b/d, of which 250,000 b/d derived from the Melut Basin Petrodar project and the rest from Blocks 1, 2 and 4. Sudan had assumed transit fees income of $36 per barrel in its original 2012 budget, but the collapse in revenue and the September agreement have encouraged a more realistic budgeting approach.

The stark economic challenge presented first by the South's secession in 2011, taking with it two-thirds of former Sudan's oil production, and the subsequent oil export shutdown in January this year, was outlined by the IMF after its recent Article IV consultations with Khartoum. The IMF pulled no punches, arguing that the division of the country had 'translated for Sudan into the loss of a sizeable portion of its economic potential and a daunting challenge of adjusting to a permanent fiscal and external shock'. Following on from the contraction of exports and imports forced by the loss of oil revenue in 2011, H1 2012 saw revenue undershoot by 30 percent with no parallel reduction in government spending, boosting money supply which, in turn, carried inevitable inflationary impacts. The reduction in Sudan's GDP has been significant: the IMF projects an 11 percent contraction for 2012 and a smaller decline in 2013.

So the incentives for a political breakthrough were strong and the deal brokered in Ethiopia between Sudan and its southern neighbour has covered important ground. The September 27 agreement was significant in establishing a new security regime between the two countries, with a demilitarised border zone and an agreed tariff for South Sudan's exports via Sudan's pipelines and coastal terminals. The two sides also signed bilateral agreements on cross-border trade, banking, pensions and citizenship issues, and the deal allowed the newly appointed Sudanese ambassador to Juba to take up his post. But the two sides failed to agree on a compromise position over the disputed Abyei region and other disputed territory issues, which South Sudanese officials alarmingly have described as a 'ticking time bomb for the conflict resumption in the near future'.

Oil Deal Agreed

In the end, the oil segment of the deal was straightforward, once Sudan's maximalist demand for a $36/b tariff had been discarded and once Juba had agreed to a one-off treasury transfer of just over $3 billion to the North. The oil element of the agreement was struck in early August and left South Sudan paying an average $9.48/b for transportation, transit and processing fees for oil shipped through the Petrodar pipeline (80 percent of South Sudan's production from Blocks 3 and 7) and output from the Greater Nile Petroleum Operating Company (GNPOC) fields in Blocks 1, 2 and 4. As expected, the oil agreement took the form of a temporary deal for three and a half years, with the option to negotiate lower, but not higher, tariffs at its conclusion, giving Juba the opportunity to investigate alternative pipeline plans during the interim.

Such alternative routes to the twin pipes through Sudan, exporting Nile and Dar blends, include a proposal for a 2000 km pipeline to Lamu in Kenya which, it is estimated, would take at least three years to build. Another possible plan would see a new pipeline laid to Uganda, potentially linking up with Tullow Oil's discoveries there and transporting the oil further to the Kenyan coast. South Sudan is also pursuing plans, in line with its push for economic independence, to construct small topping plants to meet the country's 20,000 b/d requirement for petroleum products and ultimately allow some product exports to neighbouring countries.

Damage sustained in April to the Heglig oil field central processing facilities has been partially repaired, allowing northern oil production to reach the Khartoum refinery, but more work is needed before the surface facilities can handle full output from the fields. The Heglig facilities, operated by the China and Malaysia-owned GNPOC, are also the focus of a claim by Khartoum for compensation following the South's military occupation in April. Meanwhile, the Petrodar consortium operating the Block 3 and 7 fields expects to bring some 180,000 b/d of its 250,000 b/d capacity back on-stream in 4–5 months, provided that restart operations for the waxy crude run smoothly.

Ultimately, the degree of success that both countries can achieve in maintaining oil production will depend upon efforts to resolve the outstanding political issues regarding Abyei and the remaining disputed territories. Sudan's control in South Kordofan state, which adjoins the GNPOC-operated blocks, and Blue Nile state is challenged by opposition militants under the banner of the SPLM-N, representing non-Muslim communities that found themselves in Sudan following South Sudan's secession in 2011.

Differences Remain

It is not easy to project a straightforward resolution to this additional complication. Khartoum has rejected an offer from South Sudan to mediate between Sudan and the SPLM-N on the grounds that it did not recognise the latter 'politically, organizationally and militarily'. It also called on South Sudan to break off all ties with the rebel group. The SPLM-N, for its part, says its goal is to topple the Khartoum regime.

Meanwhile, disagreements over rules for a future referendum in Abyei and the apparent inability of Khartoum and Juba to agree an interim joint administration for the oil-rich area appear to kick hopes for a comprehensive final political agreement between the two sides further down the road. South Sudan recently rejected a call from Khartoum for the Abyei issue to be solved by political means rather than a referendum. Sudan's view is that the outcome of a referendum would make Abyei part of one of the two countries. This result would therefore be rejected by one of them, leaving open the possibility of a further conflict.

Economics and the countries' shared oil industry will bind them together, but it will be difficult to sustain economic cooperation until all political issues are resolved. For now, that prospect is distant. Both countries remain heavily reliant on oil revenue and the September agreement has provided a platform for joint efforts to attract fresh foreign investment. A new round of oil exploration awards in Sudan may help in the medium term. But continued border skirmishes and the lack of will on both sides to resolve all outstanding political differences mean that oil flows will remain vulnerable to disruption. ■