

# Risk and Reward in South Sudan

Investment Potential in the World's Newest Country

On July 9, 2011, South Sudan celebrated its long-awaited independence from Sudan, with which it had engaged in over 50 years of political and economic conflict and two devastating civil wars. On its path to sovereignty, **South Sudan has boasted an average GDP growth of 9% over the past five years**, spurred largely by its natural resources. In addition to vast oil reserves, South Sudan has largely unexploited agricultural, mineral, and infrastructure industries that may now flourish in the wake of independence. Furthermore, the lifting of US-led sanctions on South Sudan's non-petroleum sectors has piqued the interest of many Western investors. Despite the resource wealth of the world's newest country, barriers to prosperity remain. Tensions

between Khartoum and Juba have risen steadily throughout 2011 and at least 2,300 people have been killed (mostly South Sudanese at the hands of Sudan-backed militias), prompting fears of ethnic cleansing. Additionally, **South Sudan's bureaucracy, limited human capital, and poor infrastructure have the potential to complicate investment** and slow development.

In the face of such adversity, what does the future hold for investment in South Sudan? How will emerging opportunities and persistent challenges affect investors' outlooks? Ergo spoke to experts on investment and security in South Sudan to answer these questions.

## EFFECTS OF INDEPENDENCE ON OIL

Although the petroleum industry is the primary recipient of foreign direct investment in South Sudan – accounting for 80% of all investment over the last decade – Western firms will find it difficult to make inroads for two reasons. First, **the oil industry has already been cornered by Chinese state-owned enterprises CNPC and Sinopec.** The Chinese government plays a special role in sustaining its relationship with South Sudan by supporting infrastructure and development projects, including Juba's brand new soccer stadium and roads throughout the country. Second, **American firms are still restricted by Washington's sanctions regime against Khartoum.** Although the US Treasury Department lifted sanctions against South Sudan upon independence, it left in place prohibitions on the petroleum industry as Khartoum and Juba will continue sharing oil revenue in the near future. To its credit, the South Sudanese government has announced vague intentions to construct a pipeline through Kenya in order to cut ties with the North, yet there have been no concrete signs of progress.

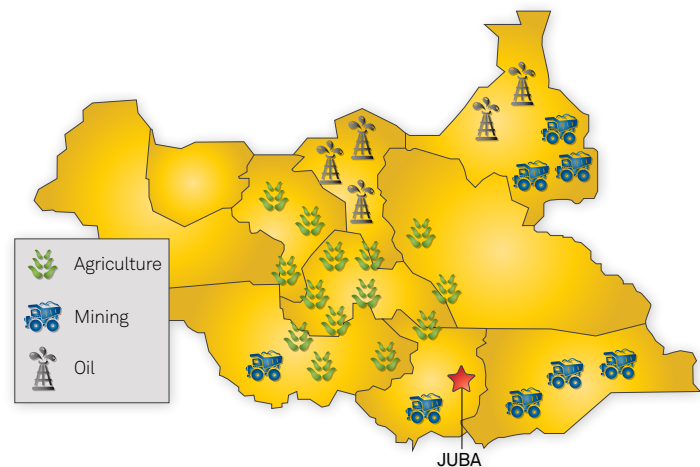
## INVESTMENT IN OTHER SECTORS

With such a murky future for the petroleum industry, many investors are turning to other staples of developing economies and investing in more reliable sectors. In particular, agriculture, mining, and infrastructure are three industries that will benefit from investment in newly independent South Sudan.

Sudan has an arid desert climate, but **South Sudan is located on a large fertile plain with abundant sunshine and natural irrigation.** As much as 80% of the country's land is arable, compared to only 7% in Sudan and 33% in neighboring Kenya. Jarch Group, an American investment firm, purchased a 70% interest in a plot of South Sudanese farmland the size of Rhode Island. Egyptian private equity firm Citadel Capital is also investing in agriculture with a 260,000 acre plot in Unity State. Citadel's investment focuses on sugar, corn, cotton, wheat, sunflower, and sorghum, the majority of which will be delivered to domestic South Sudanese markets. Despite the recent uptick in agricultural investments, only 4% of South Sudan's arable land is currently farmed and myriad opportunities remain for investors to enter the market.

South Sudan's mineral wealth is also drawing great interest from investors as the breakaway republic has large untapped reserves of gold, iron ore, limestone, uranium, and diamonds. However, Alex Kenyi, the Managing Director of South Sudan Mineral Exploration, warns that while Western companies remain overly cautious about security issues, Chinese firms are not hesitating to enter this market and could quickly dominate it. Furthermore, Kenyi notes that the **mineral reserves are mostly in the safe southern states, far removed from the conflict zones near the northern border.**

Locations of Key Industrial Activity, South Sudan



As **South Sudan currently has only 40 miles of paved road in the entire country**, investors should also expect infrastructure to grow tremendously. Ambrose Peter Atipo, a Uganda-based legal advisor to investment projects in South Sudan and the greater East African region, foresees “increased and systematic infrastructure development at a grand scale, particularly through the building of fully fledged modern cities.” In February 2011, construction began on a US-funded tarmac road from Juba to Gulu, Uganda, which will reduce travel time between the cities from eight hours to only two and a half. In Gulu, the route will connect to existing roads and provide South Sudan with much-needed access to the port city of Mombasa, Kenya.

**It is not going to be smooth sailing, [but] if all goes well and peace is achieved, investors are not going to run away.**

- Joseph Shikwati  
Director, IREN Kenya



## REGIONAL INTEGRATION

Regional integration – particularly in the form of investment from neighboring countries and blocs – will also act as a major driver for South Sudan’s economic development. There is already talk of South Sudan joining the East African Community (EAC), an intergovernmental organization comprised of Kenya, Uganda, Tanzania, Rwanda, and Burundi. Membership would bring South Sudan **greater political coordination with its neighbors and enable economic integration** through the EAC’s customs union and the recently-announced Greater Free Trade Area which would link together several regional African unions. Joseph Shikwati, Founder and Executive Director of Nairobi-based think tank IREN Kenya, believes, “There is no way that South Sudan would want to remain a little island outside of this Cape Town-to-Cairo trade initiative.”

## CHALLENGES AHEAD

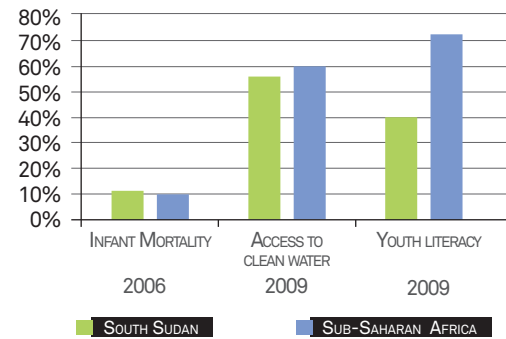
Despite these opportunities, optimism surrounding South Sudan’s future must be tempered with the reality on the ground. There remain several significant impediments to investment, including overregulation, poor human capital, and infrastructure concerns.

In its January 2011 report Doing Business in Juba, the World Bank described **a complex and burdensome regulatory environment** in South Sudan and ranked the country 159th (out of 183 countries worldwide) on its Ease of Doing Business index. In particular, the World Bank identified getting credit, protecting investors, trading across borders, and closing a business as key areas for deregulation.

Another obstacle will be human capital. Khartoum's brutal rule left South Sudan's population of roughly 8.2 million with social, economic, and health hardships. For example, literacy among 15-24 year olds trails the rest of Sub-Saharan Africa by nearly half. Additionally, 83% of the population lives in rural areas and many lack familiarity with industrialized work. **These figures do not bode well for investors seeking highly skilled labor in South Sudan**, although they potentially present opportunities for growth in education and development.

Additionally, South Sudan's weak infrastructure could further hinder progress. The country's aforementioned dearth of paved roads makes **transport of goods, trade with neighbors, and domestic security a constant challenge**. During rainy seasons, the country's dirt roads become impassable, making ground transportation unreliable. South Sudan's electrical grid – which relies on only a few generators to power the entire country – is also a limiting factor for economic development. The lack of electricity most directly affects the manufacturing and services sectors, as operations are difficult to sustain without a guaranteed electricity supply.

South Sudan - Key Development Indicators



Sources: Sources: South Sudan Centre for Census, Statistics and Evaluation, UN Statistics.

## ERGO'S VIEW

There is little doubt that independent South Sudan faces a bumpy road ahead. After 50 years of hardship and strife, this nascent republic's business landscape is not without its obstacles, but it is rich with rewards for intrepid and informed investors.

Chinese firms, based on their indifference to risk and their warm political relations with both Juba and Khartoum, have already saturated the petroleum industry. Barring major changes – such as the Kenya pipeline finally coming to fruition – **Western firms are unlikely to break China's firm grip on the energy sector**. Nonetheless, investors should recognize the benefits that the petroleum industry could bestow on government revenues, and thus development.

No matter the prospects for South Sudan's oil industry, Western companies could miss out on promising opportunities if they paint the country's security situation with broad strokes. **Agriculture, mining, and infrastructure all come with much lower security risks** and should be evaluated independently of whatever conflict persists near the northern border. Although regulatory, labor, and infrastructure challenges remain, the newly independent government has professed its commitment to development, and an open economy can help resolve these problems.

Going forward, one thing is certain: South Sudan has a more promising future than Sudan. Weighed down by a corrupt patronage system, in the crosshairs of human rights prosecutors, and bereft of the plentiful resources of the South, Sudan is faced with bleak and uncertain prospects for near-term growth and development. **Experts foresee a bright future, but they do not expect change to happen overnight**. Ambrose Peter Atipo explains: "Rome was not built in a day; Southern Sudan will not necessarily be built in a year."