

**FOR
AGENDA**

EBS/83/174

CONFIDENTIAL

August 16, 1983

To: Members of the Executive Board

From: The Acting Secretary

Subject: Sudan - Staff Report for the 1983 Article IV Consultation and
Review Under the Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Sudan and a review under the stand-by arrangement. Draft decisions appear on pages 28 and 29.

It is proposed to bring this subject to the agenda for discussion on Wednesday, September 14, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Yaqub, ext. (5)7134) or Mr. Nashashibi, ext. (73197).

Att: (1)

INTERNATIONAL MONETARY FUND

SUDAN

Staff Report for the 1983 Article IV Consultation
and Review Under the Stand-by Arrangement

Prepared by the Middle Eastern Department,
the Exchange and Trade Relations Department,
and the Fiscal Affairs Department

In consultation with the Legal Department, the
Research Department, and the Treasurer's Department

Approved by A.K. El Selehdar and Subimal Mookerjee

August 16, 1983

I. Introduction

The 1983 Article IV consultation discussions and review under the stand-by arrangement were held in Khartoum during the periods May 28-June 14 and July 19-25, 1983 and in Washington during the period July 4-6, 1983. The Sudanese representatives were led by the Minister of Finance and Economic Planning and the Governor of the Bank of Sudan and included senior officials from the Ministry of Finance and Economic Planning, other economic ministries, the Bank of Sudan, and public corporations. The staff members participating in the discussions during one or more of the three periods comprised: Messrs. M. Yaqub (Head - MED), K. Nashashibi (MED), P. Clawson (MED), J. Dodsworth (MED), S. Geadah (MED), S. Kawar (MED), R. Kibuka (FAD), and R. Pownall (ETR), Mrs. A. Yates (Secretary - MED), and Ms. B. Tveitan (Secretary - ADM). Mr. A.S. Shaalan (MED) participated in the Washington meetings, Mr. M. Hosny, the Fund's Resident Representative, assisted in the discussions held in Khartoum, and Mr. E. Mtei, Alternate Executive Director, attended some of the Khartoum meetings. Messrs. J. Hansen (IBRD) and T. Moe (IBRD) accompanied the mission that visited Khartoum during May 28-June 14, 1983.

On January 28, 1983 the Executive Board approved, in principle, a one-year stand-by arrangement for Sudan in the amount of SDR 170 million or 128.8 percent of quota (EBS/83/9, 1/11/83, and Sup. 1, 1/27/83, Sup. 2, 1/27/83, Sup. 3, 1/31/83, and Sup. 4, 2/22/83); it was to become effective upon determination that the projected gap in Sudan's external payments in 1983 would be covered through additional nonproject aid and debt relief. Following the meetings of creditors/donors the Executive Board concluded that enough new nonproject aid and debt relief had been pledged to cover the remaining balance of payments gap, and the stand-by arrangement became effective on February 23, 1983. So far, two purchases have been effected under the arrangement--SDR 68.0 million on March 3, 1983 and SDR 25.5 million on June 15, 1983. The phasing of remaining purchases is indicated in Table 1.

Table 1. Sudan: Purchases and Repurchases During Remainder
of Stand-By Period

	<u>Aug.-Sept.</u> 1983	<u>Oct.-Dec.</u> 1983	<u>Jan.-Feb.</u> 1984
	(In millions of SDRs)		
Purchases	25.5	25.5	25.5
Repurchases	9.3	12.0	7.2
Regular	(2.1)	(7.5)	(--)
CFF	(7.2)	(4.5)	(7.2)
Net purchases (excluding CFF repurchases)	23.4	18.0	25.5
Net purchases	16.2	13.5	18.3
Total Fund holdings of currency excluding holdings under CFF <u>1/</u>	597.6	615.6	641.1
Total Fund holdings of currency <u>2/</u>	712.6	726.1	744.4
	(In percent)		
Total Fund holdings of currency excluding holdings under CFF	452.7	466.4	485.7
Total Fund holdings of currency	539.8	550.1	563.9

Source: The Treasurer's Department and staff projections.

1/ These amounted to SDR 574.2 million as of July 31, 1983.

2/ These amounted to SDR 696.4 million as of July 31, 1983.

The Executive Board also approved on March 11, 1983 a purchase under the compensatory financing facility (CFF) equivalent to SDR 39.1 million (EBS/83/34, 2/11/83; and Sup. 1, 3/2/83, and Sup. 2, 3/8/83). As of July 31, 1983, outstanding use of Fund credit was equivalent to 427.6 percent of quota, or 335.0 percent of quota if purchases under the CFF are excluded. 1/

Sudan continues to avail itself of the transitional arrangements under the provisions of Article XIV.

II. Background

Sudan's external payments position was considerably weakened from about the mid-1970s by a combination of domestic and external factors. These included (a) slow growth in output, particularly of the principal export commodities, (b) rising public and private expenditures financed mainly by internal and external borrowing, (c) labor shortages due to migration of workers to the Arabian peninsula, (d) cost/price distortions arising from controls on prices of key commodities and on profit margins, (e) an overvalued exchange rate which reduced the profitability of exports and encouraged imports, (f) negative real rates of interest which discouraged financial savings, (g) rising international prices of Sudan's essential imports, particularly petroleum and sugar, and (h) growing burden of servicing external debt due both to a rise in international interest rates and a sharp increase in the extent of Sudan's indebtedness. By about mid-1978 the country was faced with a severe shortage of foreign exchange and a buildup of external payments arrears. To redress the unsatisfactory domestic and external performance, the Sudanese authorities have since then pursued corrective policies within the context of adjustment programs supported by the World Bank and the Fund. 2/ The initial thrust of the adjustment effort was concentrated on structural and institutional reform of the agricultural sector to provide incentives for higher output and on the budget in order to reduce recourse to domestic bank borrowing. A number of policy initiatives taken during the period 1978-81 contributed to an expansion in agricultural output and an improvement in the Central Government's financial position in the fiscal year 1981/82. 3/ However, the balance of payments situation remained weak in part because of a substantial worsening of the terms of trade between 1980 and 1982 and mounting burden of external debt payments. In spite of a rise in private and official transfers the country found it difficult to fully service its external debt obligations, the magnitude of which turned out to be much larger than the original estimates. 4/

1/ Details of Sudan's relations with the Fund are provided in Appendix I.

2/ The initial program with the Fund for a first credit tranche purchase, approved in June 1978, was followed by a three-year extended arrangement in May 1979, which was replaced by a one-year stand-by arrangement effective February 22, 1982. As mentioned before, the current stand-by arrangement became effective on February 23, 1983.

3/ Sudan's fiscal year covers July 1 to June 30.

4/ For a more detailed review of developments covering the period 1978-82, see EBS/83/9, pp. 2-13, and SM/82/174, pp. 1-5.

By about the time of discussions on the current stand-by arrangement (mid-1982) it became clear that no internal adjustment, consistent with social stability, would be feasible to service all the maturing external debt obligations and that domestic stabilization effort must be supported by additional nonproject aid and a restructuring of Sudan's foreign debt on a sustained basis. As mentioned before, in early 1983 Sudan's various donors/creditors pledged additional assistance and agreed to give debt relief in support of the stabilization program launched by the Sudanese authorities. The success of the program hinges crucially on the realization of the commitments made by the international community as well as on the seriousness with which the Sudanese authorities pursue their domestic adjustment policies. The aid and debt relief arrangements for 1983 as well as the latest projections of the outcome have been described in EBS/83/147 (7/14/83). The present report therefore concentrates mainly on an evaluation of Sudan's own performance in relation to the program targets.

III. The Current Stand-By Arrangement and Developments in 1982/83

The program supported by the current stand-by arrangement aimed in the first place to strengthen the external payments position by (a) providing encouragement to exports, particularly of agricultural products, (b) restraining the growth of imports while simultaneously redirecting their composition toward intermediate and capital goods and away from inessential consumer goods, and (c) increasing incentives for remittances by expatriate workers. In order to achieve the objectives of the program, specific real and financial targets were set for 1982/83 and 1983/84 ^{1/} to be backed by policy measures. More specifically it was projected that the economy will achieve a growth rate of 3.5 percent in 1982/83 (cotton output, the mainstay of the economy, was to increase by about 16 percent) and, in order to achieve a reduction in the rate of inflation to about 25 percent, monetary expansion was to be contained to about 28 percent and the overall budget deficit was to be lowered to about 7 percent of GDP. As the following review of performance indicates the authorities were not fully successful in achieving the specific targets set for 1982/83. ^{2/}

1. Real sector developments

In the last few years the Sudanese authorities took a number of policy measures to encourage production from the irrigated agricultural sector; these included increases in procurement prices, a restructuring

^{1/} The current stand-by arrangement covering the period February 23, 1983-February 22, 1984 overlaps the two fiscal years.

^{2/} As indicated in Section IV, the authorities have decided to step up their effort in 1983/84 to partly compensate for the nonachievement of some of the targets in 1982/83, particularly the financial targets.

of financial relationships designed to increase production incentives, and rehabilitation of the physical capital of the various agricultural schemes. The outcome has been encouraging as reflected in a substantial expansion in yields and output of the irrigated agricultural sector since 1980/81. For example, in 1982/83, output of cotton rose by 29 percent (compared with the program target of 16 percent) reflecting a 24 percent increase in the average yield. However, the encouraging performance of the irrigated sector, reflecting responses to various policy initiatives, was more than offset by a sharp drop in production from the rain-fed areas, where yields are dependent on the vagaries of weather conditions. In the rain-fed areas, drought conditions in 1982/83 led to a fall in the output of dura (sorghum) (by 45 percent), groundnuts (by 29 percent), and sesame (by 42 percent). As a result, it is estimated that value added in the agricultural sector (including livestock) declined by nearly 8 percent in real terms in 1982/83 (Table 2).

In the manufacturing sector, aggregate output rose mainly as a result of an improvement in the production of sugar and cement owing to the completion of some rehabilitation work. However, many manufacturing industries, including nearly all textile factories, continued to operate below their capacity because of shortages of power, spare parts, and skilled labor. In the transport sector, action was taken to remove some of the existing bottlenecks primarily through the acquisition of new rolling stock for the Sudan railways and by an administrative reorganization of the railway system intended to increase local managerial responsibility and improve the efficiency of maintenance operations.

In the petroleum sector, the authorities have moved ahead with plans to develop petroleum reserves in southwestern Sudan. Construction of a pipeline to transport 50,000 barrels per day (b/d) (expandable to 100,000 b/d with additional pumping stations) is to start in late 1983 and is expected to be completed by mid-1985. Sudan's consumption of petroleum products was estimated at slightly more than one million metric tons in 1982 and is projected to increase by about 10 percent in 1983. The electric supply situation, which had been an important constraint on manufacturing operations, is expected to improve with expansion of some power stations, and household demand is expected to be restrained by the doubling of electricity rates in 1983.

In overall terms, the decline in agricultural production more than offset the growth in other sectors with the result that real GDP is estimated to have declined by about 2 percent in 1982/83 compared with the program's target of a 3.5 percent growth.

Table 2. Sudan: Output, Area, and Yield of Principal Agricultural Commodities, 1980/81-1983/84

(Output in thousand tons, area in thousand feddans, and yield in ton/feddan except as noted)

	1980/81	1981/82	Prelim. 1982/83	Proj. 1/ 1983/84
Irrigated sector				
Cotton				
Output (thousand bales)	544	854	1,101	1,225
Area	964	958	988	1,050
Yield (kantar/feddan)	2.10	3.27	4.04	4.23
Groundnuts				
Output	159	280	186	255
Area	199	411	232	300
Yield	799	681	802	850
Wheat				
Output	218	163	185	240
Area	437	354	236	300
Yield	499	460	784	800
Dura (sorghum)				
Output	154	279	224	270
Area	502	606	570	600
Yield	307	460	393	450
Rain-fed sector				
Groundnuts				
Output	548	441	315	390
Area	1,930	1,935	1,385	1,500
Yield	284	228	227	260
Dura (sorghum)				
Output	1,914	3,066	1,695	2,400
Area	6,454	8,652	7,961	8,000
Yield	297	354	213	300
Sesame				
Output	221	242	140	240
Area	2,011	1,971	1,230	2,000
Yield	110	123	114	120
(In percent)				
Growth of value added				
in agriculture	5.3	8.3	-7.6	10.0
Growth of real GDP	5.6	7.2	-2.0	4.4

Sources: Ministry of Agriculture and Irrigation.

1/ Staff projections.

3. Financial developments

The program had allowed an expansion of LSd 835 million in net domestic assets in 1982/83 on the assumption that about LSd 260 million of it would be offset by a reduction in the net foreign assets of the banking system so that money supply would increase by LSd 575 million (about 28 percent) in 1982/83 (Table 3). This rate of monetary expansion in combination with an improvement in the availabilities reflecting a 3.5 percent growth in real GDP was expected to lower the rate of inflation to about 25 percent in 1982/83. However, the disappointing output performance in 1982/83 was accompanied by a rather sharp expansion in money supply, which increased by about 37 percent. ^{1/} Under the combined impact of reduced output and higher growth in money supply, inflationary pressures have intensified. The cost of living index rose by 41 percent in the year ended March 31, 1983 compared with 24 percent in the corresponding period of 1981/82.

An analysis of the factors for monetary expansion shows that net borrowing of the Government from the banking system was within the sub-ceiling on Government for March 1983, and indications are that such borrowings may have been contained within the June ceiling as well (Tables 3 and 4). Similarly, credit to the public entities and private sector remained within the notional ceilings for March 1983. Expansion in money in excess of the program target, in spite of the fact that credit to the Government, public entities, and private sector was contained within the prescribed ceilings, is attributable to three factors: (a) the external sector turned out to be much less contractionary than assumed in the program; (b) revaluation at the new exchange rate of foreign currency deposits of residents, which constitute a part of money supply, inflated the stock of money immediately after devaluation; and (c) capital subscription for the newly created Export-Import Bank was paid out of the blocked account, which was treated outside the government (net) domestic borrowing in the definition of the ceilings.

^{1/} Revised series. Monetary data had been distorted since late 1981 by the inclusion in the money stock of the domestic counterpart of certain arrears on foreign payments and by improper classification of Bank of Sudan external liabilities relating to the major debt reschedulings effected since 1981. "Devaluation adjustments," relating to net foreign assets and rescheduled liabilities, following the 1982 devaluation had added to the problem. A revision of monetary statistics was carried out by a Bureau of Statistics team in April 1983 and by the May-June staff mission. For further details, see Sudan - Recent Economic Developments.

Table 3. Sudan: Changes in Domestic Liquidity, 1980/81-1982/83

Changes During the Period	1980/81	1981/82	Program 1982/83	Estimated 1982/83
(In millions of Sudanese pounds)				
Money and quasi-money	<u>489.5</u>	<u>349.0</u>	<u>575.0</u>	<u>700.0</u>
Impact of external sector	-101.9	-105.2	-260.0	-106.0
Foreign assets (net)	-101.9	-969.6	...	-923.0
Devaluation adjustment	--	558.6	...	556.0
Rescheduling account	--	305.8	...	261.0
Domestic credit extension	<u>607.4</u>	<u>506.7</u>	<u>835.0</u>	<u>835.0</u> ^{2/}
Claims on government (net) ^{1/}	<u>299.1</u>	<u>121.3</u>	<u>110.0</u>	<u>110.0</u> ^{2/}
Claims on public entities	131.5	204.4	310.0	304.0
Claims on private sector and specialized banks	172.8	237.9	405.0	) 421.0
Other items (net)	4.0	-56.9	10.0)
Blocked accounts (-)	<u>-16.0</u>	<u>-52.5</u>	--	<u>-29.0</u>
(Changes in percent) ^{3/}				
Money and quasi-money	46	23	28	37
Claims on government (net)	30	9	8	8
Claims on public entities	46	49	50	49
Claims on private sector and specialized banks	33	34	43	40 ^{4/}
(As percent of broad money at beginning of period) ^{2/}				
Impact of external sector	-10	-7	-13	-6
Domestic credit extension	57	33	41	44
Claims on government (net)	28	8	5	6
Claims on public entities	12	13	15	16
Claims on private sector and specialized banks	16	15	20	) 22
Other items (net)	1	-3	1)

Source: Bank of Sudan and staff estimates.

^{1/} Includes government domestic arrears, which were LSd 14.0 million on June 30, 1980 and LSd 105.8 million on June 30, 1981.

^{2/} Assumes that actual domestic credit extension is the same as that provided in the program ceilings.

^{3/} Because of the revisions in the monetary data, the percentage changes for 1982/83 for the program parameters, which have been estimated on the basis of the unrevised series, are not strictly comparable with the parameters of the revised series.

^{4/} Approximate.

Table 4. Sudan: Performance Under Stand-By
Arrangement Borrowing Ceilings

(Cumulative Changes over June 30, 1982)

	March 31, 1983		June 30, 1983	
	Program	Actuals	Program	Actuals ^{2/}
<u>(In millions of Sudanese pounds)</u>				
Net domestic borrowing	610	593	835	...
Government (net)	95	78	110	...
Public entities	225	214	310	...
Private sector and specialized banks	300	266	405	...
Other items (net)	-10	35	10	...
<u>(In millions of U.S. dollars)</u>				
Nonconcessional public and publicly guaranteed external borrowing	--	--	--	--
Maturity of 1-5 years	--	--	--	--
Maturity of 1-10 years	--	--	--	--

Source: Bank of Sudan.

^{1/} After adjusting for the 21-day average level of the Government's current account balance with the Bank of Sudan head office.

^{2/} Likely to become available by the end of August 1983.

4. Budgetary developments

The principal fiscal development of the last few years has been the progressive reduction in the overall budget deficit from 9.8 percent of GDP in 1980/81 to an estimated 6.1 percent in 1982/83 which, in turn, has made possible a sharp reduction in recourse to domestic bank borrowing (Table 5). ^{1/} Bank credit financed about 6 percent of total government expenditures in 1982/83 compared with 8.4 percent in 1981/82 and 23.7 percent in 1980/81. In terms of its monetary impact, the contribution of the net bank borrowings by the Government to the increase in money supply in 1982/83 was about 6 percent compared with 28 percent in 1980/81.

^{1/} In view of the technical deficiencies of national accounts statistics, and sharp variability of real output in the rain-fed agricultural areas, which make no direct contribution to revenues, the short-term changes in ratios of various budgetary parameters to GDP should, however, be interpreted with caution.

Table 5. Sudan: Central Government Operations, 1980/81-1983/84

	1980/81	1981/82	Revised			Revised		
			Budget	Program	Estimate 1/	Budget	Estimate	Program
			1982/83			1983/84		
(In millions of Sudanese pounds)								
Total revenue	732.1	890.6	1,342.7	1,302.9	1,240.3	1,599.4	1,366.8	1,482.4
Tax	591.6	736.0	1,007.8	1,083.1	1,038.0	1,261.0	1,151.9	1,261.9 2/
Nontax	140.5	154.6	334.9	219.8	202.3	338.4	214.9	220.5 3/
Total expenditures	1,263.2	1,487.4	1,744.2	1,958.0	1,809.5	2,254.0	2,524.3	2,315.5
Current	844.3	975.1	1,202.0	1,416.7	1,186.5	1,547.8	1,818.1	1,609.3 4/
Of which:								
Interest on external obligations	(51.1)	(59.8)	(128.6)	(166.7)	(...)	(148.7)	(399.2) 6/	289.2 7/
Development	290.5	306.4	502.2	476.3	443.0	609.8	609.8	609.8
Equity	49.3	31.9	39.9	)	30.0	96.4	96.4	96.4
Other operations (net)	79.1	174.0	--	) 65.0	150.0	--	--	
Overall deficit	-531.1	-596.9	-401.5	-655.1	569.2	-654.6	-1,157.5 6/	833.1
Financing	531.1	596.9	401.5	655.1	569.2	654.6	1,157.5	833.1
External (net)	253.1	354.0	350.7	524.8 8/	...	621.2	621.2	678.7
Gross loans and grants	(...)	(...)	(567.6)	(695.8)	(534.4) 5/	(830.6)	(830.6)	(830.6)
Amortization	(...)	(...)	(-216.9)	(-294.0)	(...)	(-209.4)	(-208.9) 6/	(-151.9) 7/
Domestic	299.2	121.3	50.0	130.0	140.0	50.0	...	160.0
Banking system	(299.2)	(121.3)	(--)	(110.0)	(110.0)	(--)	(...)	100.0
Other	(--)	(--)	(50.0)	(20.0)	(30.0)	(50.0)	(...)	60.0
Residual, surplus (-)	-21.2	121.6	0.8	0.3	...	-16.6	536.3	-5.6
(As percent of GDP)								
Total revenue	13.5	13.3	14.4	14.0	13.3	14.2	12.2	13.2
Total expenditure	23.3	22.2	18.6	21.2	19.5	20.1	22.5	20.6
Of which:								
Current	15.6	14.6	12.9	15.2	12.8	13.8	16.2	14.4
Development	5.3	4.6	5.4	5.1	4.8	5.4	5.4	5.4
Overall deficit	9.8	8.9	4.3	7.0	6.1	5.8	10.3	7.4
External financing (net)	4.7	5.3	3.8	5.6	...	5.5	5.5	6.1
Domestic bank financing	5.5	1.8	--	1.2	1.2	--	...	0.9
Memorandum item:								
Overall deficit less interest on external obligations	8.8	7.6	2.9	5.3	...	4.5	6.7	4.9

Sources: Ministry of Finance; Bank of Sudan; and staff estimates.

1/ Staff estimates.

2/ Includes new measures in customs tax estimated to generate LSd 91 million and in excise taxes estimated to yield LSd 19 million.

3/ Includes LSd 5.6 million to be generated as profits on the wheat account.

4/ Reflects a reduction in outlays for subsidies for wheat and wheat flour (LSd 82.8 million) and for pharmaceuticals (LSd 16 million).

5/ The total payments on external interest and amortization is estimated at LSd 378.0 million; however, it has not been possible to accurately separate interest payments from amortization. Bank of Sudan data up to March 1983 indicated that interest payments constituted about one third of total debt service.

6/ Reflects debt relief for the second half of 1983.

7/ Assumes there will be LSd 110 million in external interest relief and LSd 57 million in external amortization (total debt relief of LSd 167 million) in the first half of 1984.

8/ Includes LSd 123 million that was expected to be provided as additional external assistance by the Consultative Group and/or Paris Club.

The improvement in fiscal performance has resulted from both expenditure adjustments and new revenue measures. Revenue measures, which were introduced prior to the approval of the present stand-by arrangement, included a change in the customs duty valuation basis, increases in various excise taxes, and the raising of certain rents and fees. Preliminary estimates for 1982/83 indicate that tax revenues increased by 41 percent and nontax revenues by 31 percent compared with 1981/82. However, this barely kept pace with the rise in prices and total government revenues as a proportion of nominal GDP remained unchanged at 13.3 percent. While taxes on international trade and on income and profits showed healthy increases, there is likely to be a small shortfall in total revenues compared to the program targets for 1982/83 due mainly to noncollection of excise taxes on beer, which resulted from temporary closure of the factories, and on sugar, where most factories experienced serious cash flow problems brought about by rising costs in the face of fixed output prices. In addition, a shortfall in nontax revenues is also expected.

Expenditures are also likely to be slightly below the program target mainly due to a lower level of subsidies for wheat, flour, and pharmaceuticals and a lower implementation rate for development expenditures, partly offset by a higher level of debt service payments compared with the program estimates. The large payments of debt service, despite the buildup of arrears in the latter half of 1982 and the substantial debt relief accorded by creditors at the beginning of 1983, was the result of the liquidation of certain past arrears not provided for in the budget and underestimation of current debt service payments in the program. The overall increase in government expenditures in 1982/83 is likely to be in the region of 22 percent, indicating progress in the expenditure control measures which have been emphasized over the past few years.

5. External developments

a. Balance of payments

Sudan's current account position, which had worsened in 1981/82 following a precipitous deterioration in the trade account, is estimated to have strengthened considerably in 1982/83 (Table 6). Export earnings rose by 48 percent paced by a more than doubling of cotton exports following the good performance of the 1981/82 harvest, but also reflecting a recovery in nearly all other agricultural exports with the notable exception of groundnuts. In addition to higher exports, there was a 7 percent decline in imports largely as a result of lower outlays for petroleum and sugar as well as a decline in the volume of other imports. Imports of petroleum and petroleum products declined mainly because of lower international prices. Imports of sugar fell in part because of lower international prices but also because import requirements were less than projected, because of a rise in domestic production. The lower volume of many other imports may be the result of the price effects of the depreciation of the free market rate of the Sudanese pound and shift from the old to the new official rate of the basis for customs duty valuation.

Table 6. Sudan: Balance of Payments, 1980/81-1982/83

(In millions of U.S. dollars)

	1980/81	1981/82	Estimated 1982/83
Exports	478.9	381.2	563.3
Cotton	182.0	69.4	173.5
Other	296.9	311.8	389.8
Imports	-1,631.4	-1,884.7	-1,742.5
Petroleum	-393.0	-494.8	-439.6
Sugar	-183.6	-158.5	-52.5
Other	-1,054.8	-1,231.4	-1,250.4
Trade balance	<u>-1,152.5</u>	<u>-1,503.5</u>	<u>-1,179.2</u>
Services	-48.8	-65.1	-38.2
Receipts	328.5	503.0	534.4
Payments, of which:	-377.3	-568.1	-572.6
Interest	(-105.2)	(-190.2)	(-169.2)
Transfers (net)	426.6	523.5	734.6
Private	304.6	350.0	430.0
Official	122.0	173.5	304.6
Current account	<u>-774.7</u>	<u>-1,045.1</u>	<u>-482.8</u>
Official capital	412.8	587.7	320.0
Receipts	499.0	685.0	491.0
Payments	-86.2	-97.3	-171.0
Allocation of SDRs	<u>11.0</u>	<u>--</u>	<u>--</u>
Errors and omissions	<u>148.1</u>	<u>130.9</u>	<u>...</u>
Overall balance	<u>-202.8</u>	<u>-326.5</u>	<u>...</u>
Monetary movements (increase -)	<u>202.8</u>	<u>326.5</u>	<u>...</u>

Sources: Bank of Sudan, Ministry of Finance and Economic Planning, and staff estimates.

There was also a sharp rise in official and private transfers, in part reflecting disbursements out of the supplementary pledges made during the January 1982 Donor Group meeting and the January 1983 Consultative Group meeting. Consequently, the current account deficit fell to less than one half of its previous year's level. The improvement in the current account was, however, largely offset by a sharp reduction in net official capital inflows. The latter in some respects resulted from the growth of official transfers reflecting the growing inclination of Sudan's bilateral aid donors to provide help in the form of grants in place of loans. However, the inflow of loans to finance development projects appears to have also been held back by delays in project implementation. 1/

b. Foreign exchange market 2/

Sudan has a dual exchange market with an official exchange rate that has remained unchanged at LSd 1.30 = US\$1 since the devaluation effected in November 1982, and a free market rate which has depreciated from about LSd 1.75 = US\$1 in December 1982 to about LSd 1.98 = US\$1 at the end of July 1983. On February 27, 1983 four commercial banks were licensed to operate in the free market along with the foreign exchange dealers. In March 1983 seven additional banks were given similar licenses. At the same time, in order to widen the coverage of the market, all private sector imports (except for pharmaceutical) were required to be financed from the free market and, on the receipts side, 25 percent of all export proceeds were to be sold to banks at the free market rate. 3/ During the following four months the free exchange market has been in a state of flux as a number of institutional changes were made in succession imparting uncertainty and instability to the market. For example, on May 18, 1983 the foreign exchange dealers' licenses were suspended and they were requested by the authorities to re-apply for licenses after having incorporated their business. No licenses have so far been issued. Delay in relicensing the dealers resulted in a reduction in the supply of foreign exchange in the free market and encouraged the emergence of a third, "unofficial" market. The free market exchange rate stood at about LSd 1.87 = US\$1 in May 1983 while the third market rate depreciated to about LSd 2.05 = US\$1. An attempt by a group of commercial banks to depreciate the free market rate to about the level of the third market rate resulted in a temporary suspension in May 1983 of their licenses to

1/ Because of the sizable adjustments to the monetary data mentioned earlier, there is a high probability of significant errors in the data on "monetary movements." The margin of error is also quite large in balance of payments data, as reflected in the "errors and omissions" entries for the past years. An estimate of overall balance of payments position for 1982/83 has therefore not been attempted. It is hoped that in the period ahead further work by the staff and a technical assistance expert will make it possible to reconcile the monetary and balance of payments data.

2/ For a description of the exchange system, see report on Recent Economic Developments.

3/ The remaining 75 percent to be surrendered to the Bank of Sudan at the official rate.

deal in foreign exchange; their licenses were reinstated on July 7, 1983. The authorities indicated their intention to initiate the process of relicensing the exchange dealers before July 31, 1983 and to allow the free market to operate without undue official interference.

In addition to the multiple rates, payments arrears and a bilateral payments agreement with a member country are the major exchange restrictions subject to approval under Article XIII of the Articles of Agreement.

IV. Targets and Policies for 1983/84

In the light of developments in 1982/83, and in particular the excessive monetary expansion and higher than projected price increases, the Sudanese authorities have decided to adopt a much tighter financial posture during 1983/84. The revised targets for 1983/84 and supporting policies are set out below.

1. Production policies

It is projected that a recovery in agricultural output of the rain-fed areas in combination with continued expansion in production in the irrigated agricultural and in manufacturing sectors will generate a 4.4 percent growth in real GDP in 1983/84.

To encourage the production of agricultural exportables and import substitutes, the authorities will give highest priority in allocating credit and foreign exchange resources to the requirements of the public agricultural entities. The focus of policy will continue to be on the stimulation of cotton production, traditionally the principal contributor to export receipts. The improvements in financial returns to cotton farmers during the two previous years have had a salutary effect on yields. For the 1983/84 growing season, the authorities intend to raise again the domestic procurement prices for the various cotton varieties to reflect the rising international prices and the impact of the effective depreciation of the Sudanese pound. It is also intended to expand the area under cultivation by about 11 percent with the help of the machinery and equipment and the fertilizer and insecticides procured under World Bank Agricultural Rehabilitation loans. Furthermore, fuel and input constraints which have affected recent production performance in some of the smaller irrigated schemes are being alleviated through ongoing expansion of fuel storage capacity and arrangements with aid donors to have more commodity aid provided in the form of essential agricultural inputs. An important ingredient in rationalizing the structure of rewards to farmers has been the levying and collection of land and water charges on the various crops according to their different watering requirements in order to ensure that the cost is recovered from all crops and not from cotton alone. This system, which was put into general application at the start of the 1981/82 season, at first encountered collection difficulties in respect of the crops that were sold directly by tenants. For the

coming agricultural season, the management of the various schemes will strengthen their collection ability through more effective control over the marketing of crops and by preventing growers of crops other than cotton from planting their next cycle of crops until they have settled the due charges. 1/

To encourage greater productivity in sugarcane growing and sugar refining, the Government has recently increased the factory gate price paid to sugar produced at the Kenana estate and at the other sugar refineries. 2/ These increases will improve the cash flows of the refineries and permit more systematic equipment maintenance and higher wages for cane cutters, thereby contributing to higher capacity utilization. From a longer-term standpoint, further increases in output (and in some cases even the maintenance of present levels) would require substantial capital investment for modernization and upgrading of equipment. The Sudanese authorities are presently engaged, with the support of the World Bank and other lenders, in rehabilitating some of the irrigated agricultural schemes and sugar refineries.

2. Pricing policies

In an attempt to suppress the growing inflationary pressures in the economy, the Sudanese authorities had since the mid-1970s controlled the prices of key consumer goods and instituted controls on the profit margins of retailers and a review process for authorization on price increases by domestic manufacturers. 3/ Since late 1979, however, the authorities have shown more flexibility in allowing price increases. 4/ The prices of nearly all consumer goods, including the essential goods, have been either administratively increased or allowed to rise in response to international price movements and exchange rate changes. Electricity and water rates were doubled in May 1983. The prices of bread were increased by amounts ranging from 41 percent to 69 percent as of July 8, 1983, thereby eliminating the budget subsidy. The subsidy on pharmaceutical products arising from their pricing on the basis of the exchange rate prevailing before the November 1982 devaluation (LSd 0.90 = US\$1) will be eliminated before August 15, 1983.

1/ Since all cotton is marketed by the public sector, the tenants cannot evade the payment of charges.

2/ The increases raised the procurement price for Kenana sugar from an estimated LSd 400 per ton to LSd 537 per ton for the first 150,000 tons and to import equivalent--currently about LSd 554 per ton--for production in excess of that, and for sugar procured from the other four refineries from LSd 250 per ton to LSd 400 per ton.

3/ Administrative delays in evaluating cost developments as well as the use of a rate of exchange that did not correctly reflect free market developments contributed to cost/price distortions in the manufacturing sector.

4/ At present, price controls at the retail level are confined to a few essential consumer and producer goods. The principal affected commodities and services are: petroleum and products (excluding chemicals and lubricants), sugar, wheat and flour, construction steel and timber, cement, and public utilities.

All budget subsidies have been removed with effect from the fiscal year 1983/84. For the period ahead, the Sudanese authorities are committed to adjusting the prices of consumer goods sold by the public sector to ensure that no budgetary subsidies re-emerge. The authorities have also undertaken to simplify and expedite the procedure for reviewing and approving price increases by domestic manufacturers and to allow manufacturers to use the free market exchange rate for the valuation of imported inputs for purposes of cost calculations.

3. Financial policies

a. Introduction

Since monetary expansion in 1982/83 exceeded by a significant margin the program target for the year, a considerably more restrained target for monetary growth had to be established for 1983/84 in order to achieve the financial objectives of the program. The monetary growth target for 1983/84 has been set at 18 percent compared with the original program target of 26 percent; achievement of this target in combination with realization of the projected 4.4 percent growth of real GDP can be expected to reduce the rate of inflation to about 20 percent in 1983/84.

The target for expansion in the net domestic assets of the banking system in 1983/84 was established on the assumption that the monetary impact of the external sector would be neutral. Given the permissible rate of monetary and credit expansion worked out on the above basis, indicative targets for the expansion of credit to the public entities and to the private sector were established on the basis of their seasonal pattern of requirements and their present liquidity. Ceilings for the expansion of the net domestic assets of the banking system for the periods ending September 30 and November 30, 1983 and subceilings on the expansion of net domestic borrowing by the Government are shown in Table 7.

b. Credit control measures

The credit program for 1983/84 entails a significant reduction in the pace of credit expansion to the public entities and private sector and its successful implementation will require adoption of additional measures. For this purpose, the following measures are to be taken before August 15, 1983. To absorb the excess liquidity of commercial banks, the Bank of Sudan will (a) impose a 10 percent reserve requirement on all bank deposits and (b) instruct banks to transfer the counterpart of all customer payments of local currency against foreign settlements to a blocked account maintained with the Bank of Sudan. To rationalize the extension of bank credit to the private sector, the Bank of Sudan will (a) issue specific directives to banks establishing priorities in credit allocation, (b) prohibit the extension of credit to purchase land and real estate and credit on personal guarantee, (c) increase margin requirements for the opening of letters of credit for nonessential imports, and (d) raise margins for advances against pledging of certain goods. Moreover, the Bank of Sudan will strengthen enforcement of quantitative credit ceilings for individual banks by increasing penalty rates and improving the inspection mechanism.

Table 7. Sudan: Credit Targets for 1983/84 and Ceilings on Credit Expansion, September and November 1983

(In millions of Sudanese pounds)

	Cumulative Change over June 30, 1983		
	Sept. 30, 1983	Nov. 30, 1983	June 30, 1984
Net domestic assets <u>2/</u>	<u>224</u>	<u>297</u>	<u>470</u> <u>4/</u>
Claims on Government (net) <u>3/</u>	40	55	100 <u>4/</u>
Claims on public entities <u>4/</u>	112	148	125
Claims on private sector and specialized banks <u>4/</u>	72	94	245
Other items (net) <u>4/</u>	--	--	--

1/ These changes have been established on the assumption that the outstanding stock of money as of June 30, 1983 would be LSd 2,600 million (compared with the actual money stock of LSd 2,455 million on March 31, 1983). Any excess (or shortfall) of the actual level over the assumed level for June 30, 1983 would reduce (increase) by the same amount the permissible expansion in net domestic assets for the period July 1, 1983 to June 30, 1984. In such a case, the overall ceilings for September 30 and November 30 would each be adjusted so as to maintain their present proportions in the total change in net domestic assets. The sub-ceilings on net credit to the Government will, however, not be affected.

2/ "Devaluation adjustments" made to foreign assets (net) on account of the November 1982 devaluation were estimated at LSd 556.1 million at the end of March 1983 and at the end of June 1983. Any change in this account from the June 30, 1983 level will be treated as a part of changes in net domestic assets in the calculation of ceilings for September and November 1983. Additionally, the "devaluation adjustment" relating to the "blocked accounts" was estimated at LSd 186.8 million at the end of June 1983. This amount shall remain unchanged.

3/ Claims on Government (net) for the purpose of monitoring the September and November ceilings will be worked out as follows:

a. For the derivation of claims on Government (net) from the monetary survey, the existing "blocked accounts" will be treated as a part of the deposits of the government sector in June, September, and November 1983.

b. Changes in claims on Government (net) derived from the monetary survey, as above, will be adjusted on the basis of the average government position with the Bank of Sudan headquarters. This average government position will be established as the midpoint of the 21 working days around the end of the month.

4/ Indicative target.

Credit to the public entities (which is extended only by the Bank of Sudan) will be subjected to increased supervision and more frequent reviews to ensure that amounts drawn by each of the public entities are consistent with their genuine requirements and output programs as agreed with the Bank. Additionally, the activities of the Cotton Public Corporation, which is responsible for the marketing of cotton, will be monitored more closely to ensure that seasonal credit which is extended at harvest time is effectively retired in the ensuing marketing season. While discussing the credit control measures the staff had pointed out to the authorities the implications for the economy and for credit demand of maintaining a structure of negative real interest rates and had stressed the importance of increasing nominal interest rates. The Sudanese authorities, however, felt that the role of interest rates in allocation of resources is rather limited in the economic, social, and religious context of Sudan.

c. Budgetary measures

The staff's projections of central government revenues and expenditures for 1983/84 had indicated that, without additional measures, the overall deficit for the year would amount to LSd 1,158 million (10 percent of projected GDP) (Table 5). These calculations allowed for the debt relief already secured in 1983 but did not allow for likely relief in 1984. On this basis, and taking into account disbursements out of committed external assistance and bank financing allowed under the credit ceilings, aggregate central government operations implied an unfinanced gap of LSd 436 million. It was agreed that this gap should be filled through domestic effort of a magnitude that would, inter alia, demonstrate the country's determination in the implementation of the program and achievement of its objectives. Accordingly, while it could be expected that substantial debt relief would materialize in 1984 (the 1983 relief was estimated at LSd 372 million), the authorities committed themselves to the mobilization of LSd 274 million (2.4 percent of projected 1983/84 GDP) from domestic nonbanking sources. This effort, together with the permissible LSd 100 million of borrowing from the domestic banking system, would reduce the gap to about LSd 162 million.

The supplementary domestic resource mobilization effort of LSd 274 million was apportioned into LSd 214 million of revenue generating/expenditure reducing measures and LSd 60 million of nonbank domestic borrowing. The additional budgetary effort includes elimination of budgetary subsidies on wheat and wheat flour through raising the price of wheat to domestic millers by 57 percent (from LSd 230 per ton to LSd 360.4 per ton) and of flour to bakeries by 61 percent (from LSd 305.2 per ton to LSd 492.5 per ton) as of July 8, 1983; these increases will eliminate the budgetary subsidy that was calculated at LSd 82.8 million in 1983/84 and in addition generate a net profit of LSd 5.6 million on wheat/flour transactions. Moreover, the authorities are to implement the following measures on or before August 15, 1983. (1) Eliminating preferential duty status for spare parts and raw materials imported by certain industries; these changes are expected to generate on an annual basis about LSd 40 million in additional revenues. (2) Increasing the additional customs duty affecting a wide range of

imported goods by 3 percentage points, to 13 percent; this is calculated to yield LSd 51 million in the current fiscal year. (3) Improving the administration of the excise tax by posting excise department personnel in factories and applying a form of "capacity taxation" for some of the taxable goods; this is estimated to yield LSd 15 million in additional revenues. (4) Reinstating the full 15 percent excise tax on sugar produced by the four nationally owned sugar mills; this measure is projected to yield an additional LSd 4 million in the current fiscal year. (5) Eliminating subsidies on pharmaceuticals which is estimated to generate LSd 16 million in expenditure savings.

With the various measures fully in place, central government operations including interest on foreign obligations are projected to result in a deficit of LSd 833 million (7.4 percent of GDP) which would be financed to the extent of LSd 679 million (6.1 percent of GDP) from net external sources, LSd 100 million (0.9 percent of GDP) from the domestic banking system, and LSd 60 million (0.5 percent of GDP) from domestic nonbank sources.

d. Exchange and trade policies

A study of the appropriateness of the official exchange rate was recently undertaken by the staff. Its principal conclusion was that on the basis of the current cost structure of major agricultural crops, current agricultural yields, prevailing world prices, and present arrangements for surrendering export receipts (75 percent to be surrendered at the official rate of LSd 1.30 = US\$1 and 25 percent to be surrendered at the free market rate which currently is LSd 1.98 = US\$1), the effective export rate provides enough financial incentives for raising the production of export crops. However, excess demand in the economy, capital flight, institutional changes introduced in the market, and speculative factors have continued to exert pressure on the free market rate leading to a growing divergence between the two rates, which, in turn, has contributed to the misallocation of resources and the encouragement of export smuggling. The authorities recognize the need to narrow the differential between the free market rate and the official rate and have decided to take a number of initiatives including restraints on overall credit expansion, increased restrictions on credit for imports, and more effective enforcement of existing bans on certain luxury imports. In addition, it is hoped that the recent reinstatement of bank dealings in the free market and the expected relicensing of foreign exchange dealers will increase the supply of foreign exchange and enhance confidence in the market.

The authorities have indicated that the appropriateness of the official rate, and in particular its adequacy for providing the required incentives for the production of exportables, as well as the developments in the free market, will be kept under review and that further institutional and policy adjustments will be considered, if necessary.

e. External debt and debt service policies

To alleviate the heavy burden of external debt service and to maintain an orderly pattern of payments, the Sudanese authorities negotiated formal debt rescheduling arrangements covering 1983 with their principal creditors, made ad hoc arrangements for the settlements of other claims, and approached certain of their smaller creditors with proposals for debt rescheduling. ^{1/} Since the beginning of the year, every effort has been made to meet the obligations of the 1983 reschedulings and the authorities' record in this respect has been commendable.

The magnitude of Sudan's external debt and annual debt servicing obligations, however, is such that it is not realistic to expect an orderly servicing of those obligations without significant relief extending for a number of years. Without debt relief, debt service obligations would exceed proceeds from exports during each of the coming five years (Table 8). Recognizing this, the authorities have set in motion the machinery for requesting a rescheduling covering 1984. For this purpose, the Fund and the World Bank have been asked to assist the authorities in preparing the ground for a rescheduling of obligations falling due in 1984. Preparations have begun on the economic and financial programs that will serve as a basis for seeking supplementary assistance and debt relief from donors and creditors. Tentative plans are to convene the Consultative Group for Sudan in mid-December and to hold another round of debt rescheduling with the principal creditors soon after that. On this basis, the authorities indicated that they would reach an agreement on a new stand-by arrangement prior to the meetings of the donors and the creditors even though the current stand-by arrangement may still be operative.

^{1/} The relief negotiated with bilateral creditors generally followed the format established by the Club of Paris. As reported in SM/83/54 (Report on Renegotiation of Sudan's External Debt, 3/15/83) the rescheduling by the Club of Paris consolidated (a) arrears outstanding at the beginning of 1983, (b) all principal payments falling due in 1983, and (c) one half of interest payment falling due in the year into a 16-year loan with a 6-year grace period. Relief along the same lines was accorded by Saudi Arabia and Kuwait. Earlier, arrangements were made with Iraq and Eastern bloc creditors to reschedule certain obligations and to pay others in local currency, and proposals were made to the United Arab Emirates and Qatar to reschedule obligations already in arrears and falling due in 1983. The relief accorded by the commercial banks specified a maximum payment for 1983 and deferred the remainder of obligations falling due in the year to 1984. Ad hoc arrangements have been made with various suppliers to either effect payments in local currency or to roll over obligations. As of June 15, 1983 the major unresolved debt service issue pertains to obligations to two bilateral creditors with whom political relations are strained.

Table 8. Sudan: External Public Debt Service Obligations, 1984-88

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988
A. Debt service on disbursed debt	<u>976.2</u>	<u>1,118.2</u>	<u>1,117.1</u>	<u>1,068.9</u>	<u>986.5</u>
Bilateral	<u>633.6</u>	<u>637.7</u>	<u>569.6</u>	<u>517.1</u>	<u>480.5</u>
OECD countries	<u>243.3</u>	<u>215.8</u>	<u>200.2</u>	<u>158.7</u>	<u>153.2</u>
Club of Paris I ^{1/}	(86.6)	(85.5)	(80.8)	(32.0)	(29.9)
Club of Paris II	(29.2)	(18.5)	(18.3)	(33.8)	(46.9)
Club of Paris III	(56.3)	(56.3)	(56.3)	(56.3)	(56.3)
Other	(71.2)	(55.5)	(44.8)	(36.6)	(20.1)
OPEC member countries	347.4	386.7	326.2	319.9	298.2
Eastern bloc countries	25.4	23.2	20.8	17.9	14.3
Other countries	17.5	12.0	22.4	20.6	14.8
Multilateral	<u>193.4</u>	<u>225.2</u>	<u>264.0</u>	<u>289.1</u>	<u>263.0</u>
IMF	<u>146.8</u>	<u>177.7</u>	<u>216.1</u>	<u>242.6</u>	<u>216.3</u>
Use of resources ^{2/}	(135.0)	(159.4)	(195.5)	(222.1)	(195.8)
Trust Fund	(6.9)	(13.4)	(15.7)	(15.6)	(15.6)
SDR charges	(4.9)	(4.9)	(4.9)	(4.9)	(4.9)
World Bank	11.9	12.8	13.2	11.8	12.0
IBRD	(7.1)	(7.1)	(7.1)	(5.5)	(5.5)
IDA	(4.8)	(5.7)	(6.1)	(6.3)	(7.0)
Other	34.7	34.7	34.7	34.7	34.7
Financial Institutions	<u>149.2</u>	<u>255.3</u>	<u>283.5</u>	<u>262.7</u>	<u>243.0</u>
Commercial bank rescheduling	113.2	219.3	247.5	226.7	207.0
Other	36.0	36.0	36.0	36.0	36.0
B. Debt service on debt yet to be disbursed ^{3/4/}	<u>96.5</u>	<u>173.5</u>	<u>219.5</u>	<u>267.5</u>	<u>357.7</u>
Total	<u>1,072.7</u>	<u>1,291.7</u>	<u>1,336.6</u>	<u>1,336.4</u>	<u>1,344.2</u>

Sources: Data provided by the Sudanese authorities, IMF Treasurer's Department, IBRD Debtor Reporting System, and staff estimates.

^{1/} Includes minor amounts rescheduled by Ireland (not a Club member) under terms of the Club of Paris 1979 rescheduling.

^{2/} Includes servicing of a possible stand-by arrangement to be approved in late 1983.

^{3/} Excludes servicing of potential use of Fund resources after 1984 and of borrowing by the White Nile Petroleum Corporation to finance the proposed oil export pipeline; this latter borrowing will be serviced directly from export proceeds.

^{4/} Assumes US\$450 million of annual disbursements from official assistance and an average US\$100 million in suppliers' credits.

4. External payments prospects in 1983 and in 1984

The slower pace of imports that was manifested in the second half of 1982 and the first half of 1983 is expected to continue during the second half of the year. The trend will be reinforced by the more restrained domestic financial policies and by the price effects of the continuing depreciation of the free market rate. In addition, it is expected that imports of sugar will be considerably lower than projected, due to the higher domestic production. On the export side, the program target of US\$675 million in total receipts represented an increase of 38 percent over 1982. Much of this increase was expected to result from cotton though groundnuts and sesame were also expected to make larger contributions. It now appears likely that there will be a small shortfall in export receipts in 1983 from what was projected in the program, mainly reflecting reduced groundnut and sesame production, as well as a decline in export receipts from dura, due to lower prices. The latest projections indicate that the trade balance is likely to show a slightly larger deficit than first projected; however, performance should still show a considerable improvement over 1982 (Table 9).

As explained earlier, an important element in covering the initially projected unfinanced external gap in 1983 was the additional aid disbursements out of pledges made at the January 1983 meeting of the Consultative Group and the relief from debt service obligations given by creditors. The staff had initially estimated that external assistance (grants and official capital receipts) in 1983 would be about US\$850 million compared with US\$1 billion in 1982. The latest available information indicates that the overall level of assistance is likely to be realized, though there have been considerable changes in projected disbursements between types of assistance (grants and loans) and between different donors. The prospects are that project and commodity grants and commodity loans will be larger than previously expected, offset by a shortfall in project loans. With the substitution of grants for loans, the current account balance in 1983 is likely to be in line with the program target despite the shortfall in exports and a higher level of external interest payments. The balance of payments is expected to record a small overall deficit in 1983. Consequently, on the basis of the availability of maximum net financing from the Fund of about US\$154 million, the increase in working balances will turn out to be much lower than the program target.

The tentative staff estimates indicate a further improvement in the trade account in 1984. Earnings from cotton and other agricultural crops are projected to increase by about 23 percent compared with only a 2 percent increase in imports. The growth of cotton exports is predicated on a considerable increase in shipments from the 1982/83 crop, the realization of another good crop in 1983/84, and a strengthening of international demand that will permit a higher level of prices. The growth in other exports is expected to come mainly from a recovery of groundnuts from the very depressed level of 1982/83 when availability was curtailed by the crop failure in the rain-fed areas and to continued expansion of livestock exports. The growth of imports is expected to be broadly in line with the rise in international prices. However, the composition is expected to change in favor of intermediate and capital goods.

Table 9. Sudan: Balance of Payments, 1982-84

(In millions of U.S. dollars)

	1982	1983		1984 Proj.
		Stand-By Program	Revised Projection	
Exports	489	675	635	780
Cotton	(124)	(238)	(237)	(296)
Other	(365)	(437)	(398)	(484)
Imports	-1,780	-1,800	-1,790	-1,832
Petroleum	(-472)	(-469)	(-473)	(-500)
Sugar	(-91)	(-60)	(-20)	(--)
Wheat and flour	(-76)	(-99)	(-100)	(-110)
Other	(-1,141)	(-1,172)	(-1,197)	(-1,222)
Trade balance	<u>-1,291</u>	<u>-1,125</u>	<u>-1,155</u>	<u>-1,052</u>
Net services, of which:	7	-82	-105	-531
Interest	(-199)	(-157)	(-180)	(-571)
Private transfers	400	430	430	450
Current account (excluding official transfers)	<u>-884</u>	<u>-777</u>	<u>-830</u>	<u>-1,133</u>
Official transfers	283	270	318	315
Current account (including official transfers)	<u>-601</u>	<u>-507</u>	<u>-512</u>	<u>-818</u>
Official capital	648	514	431	29
Receipts	(719)	(584)	(552)	(440)
Payments	(-71)	(-70)	(-121)	(-411)
Errors and omissions	-270)))
Overall balance	<u>-223</u>	) <u>7</u>	) <u>-81</u>	) <u>-789</u>
(- indicates deficit)))))
Memorandum item:				
Net Fund financing		150	154	...
Changes in working balances (- indicates increase)		-157	-73	...

Sources: Bank of Sudan, Ministry of Finance and Economic Planning, and staff estimates.

Transfers are expected to grow relatively slowly in 1984, mainly due to a moderation in the growth of private remittances as a result of the slowdown of activity in the Arabian peninsula. If interest obligations are effected as currently scheduled, the current account deficit would widen.

It is difficult to make meaningful medium-term balance of payments projections for Sudan due to a number of uncertainties. However, the balance on goods, services, and private transfers can continue to improve during 1985-88 provided that there is (a) a steady progress in capital stock rehabilitation, (b) continued reduction in constraints on the availability of imported inputs and electricity, and (c) pursuit of appropriate domestic pricing and demand management policies to encourage exports and curtail inessential imports. With these elements in place, it should be feasible to maintain the present level of agricultural yields and bring in additional acreage under cultivation and to contain the growth of imports. Moreover, the external payments position should begin to improve after 1985 with the start of petroleum exports.

5. Performance criteria

Performance criteria for the remaining period of the stand-by arrangement include (1) limits on the change in net domestic assets of the banking system and on net domestic borrowing by the Central Government during the periods ending September 30 and November 30, 1983 (Table 7), (2) prohibition from contracting, at any time during the period, new non-concessional public and publicly guaranteed external debt in maturities exceeding one year but less than ten years except insofar as this results from the rescheduling of previous debts, and (3) the standard injunctions on trade and payments restrictions with the exception of certain arrears; arrears would be allowed in the case of debt servicing obligations to those creditors with whom debt relief arrangements have already been made but where implementation agreements have yet to be finalized.

VI. Staff Appraisal

During 1982/83, Sudan's economic and financial performance improved in a number of areas but weaknesses continued to be experienced in others. The most significant improvements were (a) the continued expansion in output of the irrigated agricultural sector, (b) the elimination of most of the budgetary subsidies and the achievement of most of the budgetary targets for 1982/83, and (c) the improved performance in servicing maturing debt obligations. The most disappointing aspects were (a) the decline in real GDP, although this was largely due to the uncontrollable weather factor, and (b) the excessive monetary expansion with the consequent acceleration in the rate of inflation.

The policies followed in the last few years to reduce cost/price distortions in the irrigated agricultural sector and to increase incentives to farmers have had a salutary effect on productivity and output; in particular the production of cotton nearly doubled during the past two seasons. The staff believes that attainment of further improvement requires a strengthening of the management of the irrigated schemes and major investments for the rehabilitation of their capital. There is also a need to reverse the outward migration of traditional farmers; however, it is contingent on a sustained period of rising incomes on the farm and further progress in improving the social and economic infrastructure in the rural areas.

The contribution of the manufacturing sector to national output has remained small and performance of the manufacturing industries is hampered by the inadequate availability of imported inputs, the unreliability of electric supply, and the deterioration of the capital stock. Production of sugar and cement has expanded recently through concerted effort of the authorities, but there is a need to broaden the industrial base, in particular steps should be taken to improve the output of the textile units, which continue to operate well below capacity.

The staff is aware that the structural weaknesses in Sudan's economy cannot be rectified at too fast a pace except possibly by a compression of internal consumption that may not be socially and politically acceptable. However, in order to effect the level of investment needed to raise output so as to improve living standards, Sudan must steadily increase the rate of domestic savings, particularly in the public sector which plays a dominant role in the economy.

In seeking to mobilize resources for the public sector, the Central Government has over the past three years implemented several revenue-generating measures. However, these have merely kept pace with rising prices and the rising expenditure requirements in certain specific areas such as those of the southern region, national defense and security, and external debt service obligations. Consequently, there has been little generation of savings in the public sector; reliance on external assistance and domestic borrowing even to finance the current budget deficit has continued, although there has been an encouraging trend toward reduced

bank borrowing. The staff is of the view that the thrust of future policy adjustments for the generation of resources in the public sector should be toward an improvement in the efficiency of, and greater price flexibility for, various public sector industries and services and public producing entities. In addition, the authorities need to continue the groundwork for improved reporting and control of expenditures. There is substantial liquidity in the private sector and policy measures should be devised to channel it to productive investments and to tap it for the public sector through new instruments.

The growth of domestic liquidity during 1982/83 exceeded the program targets even though the credit ceilings were observed up to March 1983. Some of the liquidity growth stemmed from factors attributable to the November 1982 devaluation and a less contractionary impact of the external sector than what was assumed in the program. However, there are areas where vigilance could produce better results. For 1983/84, the targets for monetary and credit expansion are very restrained compared with the actual outcome in the last few years. Achievement of these targets will crucially depend on control of credit to the public entities and the private sector. It should be noted that, unlike in the past when net bank borrowing by the Government was the main factor contributing to monetary expansion, credit to the public entities and to the private sector has become the principal engine of expansion since 1981/82. While the staff fully supports the priority being given to the producing and trading public entities in the allocation of credit, it recommends at the same time that their financial operations be scrutinized more thoroughly than in the past. The efficiency of nonfinancial public entities that incur losses should be improved through various measures, including adjustment in prices. Similarly, long-term investments of the public entities should increasingly be financed through internal savings and through the development budget. Efforts are also required to ensure that short-term credit of the public trading entities is retired at maturity; this is particularly important in the case of the Cotton Public Corporation. As regards borrowing by the private sector, the staff welcomes the adoption of new credit control measures, in particular the introduction of reserve requirement on deposits and increase in the margin on letters of credit for imports. However, maintenance of an interest rate structure that yields negative real interest rates encourages unnecessary bank borrowing. While appreciating the authorities' viewpoint that there are social and religious factors restricting the use of interest rate policy, the staff would like to stress the importance of a realistic structure of interest rates for the conduct of the credit and monetary policies.

Sudan's external payments situation has strengthened with the recovery of exports, the reduction in imports, and the mobilization of additional external assistance. In the staff's judgment, a sustained growth of exports requires a concomitant expansion in imports of intermediate and capital goods and achievement and maintenance of financial stability. Moreover, by following appropriate pricing, interest rate, and exchange rate policies, Sudan can expect to retain and ultimately attract capital flows and also continue to provide the necessary price incentives to

encourage production of exportables and contain the demand for inessential imports. It is also clear that domestic adjustment must be supplemented on a sustained basis by external concessional assistance and debt relief. Without debt relief, debt service obligations are projected to exceed Sudan's medium-term debt repayment capacity.

The staff is satisfied that the official rate in combination with the provision that 25 percent of the export proceeds can be sold at the free market rate provides adequate incentives for agricultural exports at the present time. The staff has also been assured by the authorities that measures to broaden the free market will be initiated before August 31, 1983 and that the market will be allowed to operate without undue official interference. This is likely to lead to a lessening of the divergence between the official and the free market rates. The authorities have also indicated their willingness to keep the system under review in consultation with the staff. In view of the above, the staff recommends approval of the multiple currency practice.

Sudan's statistical base remains in need of improvement and the Fund, in addition to other international organizations, has strengthened its technical assistance with the hope that in due course it will provide a firmer basis for economic analysis and economic decision making.

It is recommended that the next Article IV consultations with Sudan be held on the standard cycle.

The following draft decisions are proposed for adoption by the Executive Board:

1983 Consultation

1. The Fund takes this decision relating to Sudan's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Sudan, in the light of the 1983 Article IV consultation with Sudan conducted under Decision No. 5392-(77/63) adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Sudan's exchange system gives rise to multiple currency practices. The Fund notes that Sudan is taking steps to narrow the divergence between the official and free market rates with a view to unifying the two markets in due course. In the circumstances of Sudan, the Fund grants approval for the multiple practice arising from the existence of the dual market as described in EBS/83/174 (8/16/83) until February 22, 1984.

Review Under the Stand-By Arrangement

1. Sudan has consulted with the Fund in accordance with paragraph 4(b) of the stand-by arrangement for Sudan (EBS/83/9, Sup. 1, 1/27/83) and paragraph 4 of the letter of the Minister of Finance dated January 5, 1983 annexed thereto in order to review policies and to establish performance criteria subject to which purchases may be made by Sudan during the remaining period of the arrangement.

2. The attached table setting limits on the expansion of net domestic assets of the banking system and the increase in net claims on Government during the periods ending September 30 and November 30, 1983 shall be annexed to the stand-by arrangement for Sudan, and the letter of January 5, 1983 shall be read as supplemented by this table.

3. Sudan will not make purchases under the stand-by arrangement that would increase the Fund's holdings of Sudan's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

During any period in which the data at the end of the preceding period indicate that:

(i) the limit on net domestic assets described in paragraph 16 of the Statement annexed to the letter of January 5, 1983 and in the attached table, or

(ii) the limit on net claims on the Government described in paragraph 16 of the Statement annexed to the letter of January 5, 1983 and in the attached table,

has not been observed.

Sudan: Credit Targets for 1983/84 and Ceilings on
Credit Expansion, September and November 1983

(In millions of Sudanese pounds)

	Cumulative Change over June 30, 1983		
	Sept. 30, 1983	Nov. 30, 1983	June 30, 1984
Net domestic assets <u>2/</u>	224	297	470 <u>4/</u>
Claims on Government (net) <u>3/</u>	40	55	100 <u>4/</u>
Claims on public entities <u>4/</u>	112	148	125
Claims on private sector and specialized banks <u>4/</u>	72	94	245
Other items (net) <u>4/</u>	--	--	--

1/ These changes have been established on the assumption that the outstanding stock of money as of June 30, 1983 would be LSd 2,600 million (compared with the actual money stock of LSd 2,455 million on March 31, 1983). Any excess (or shortfall) of the actual level over the assumed level for June 30, 1983 would reduce (increase) by the same amount the permissible expansion in net domestic assets for the period July 1, 1983 to June 30, 1984. In such a case, the overall ceilings for September 30 and November 30 would each be adjusted so as to maintain their present proportions in the total change in net domestic assets. The sub-ceilings on net credit to the Government will, however, not be affected.

2/ "Devaluation adjustments" made to foreign assets (net) on account of the November 1982 devaluation were estimated at LSd 556.1 million at the end of March 1983 and at the end of June 1983. Any change in this account from the June 30, 1983 level will be treated as a part of changes in net domestic assets in the calculation of ceilings for September and November 1983. Additionally, the "devaluation adjustment" relating to the "blocked accounts" was estimated at LSd 186.8 million at the end of June 1983. This amount shall remain unchanged.

3/ Claims on Government (net) for the purpose of monitoring the September and November ceilings will be worked out as follows:

a. For the derivation of claims on Government (net) from the monetary survey, the existing "blocked accounts" will be treated as a part of the deposits of the government sector in June, September, and November 1983.

b. Changes in claims on Government (net) derived from the monetary survey, as above, will be adjusted on the basis of the average government position with the Bank of Sudan headquarters. This average government position will be established as the midpoint of the 21 working days around the end of the month.

4/ Indicative target.

Sudan: Relations with the Fund 1/

Date of membership: September 5, 1957.

Status: Article XIV.

Quota: SDR 132 million. The proposed maximum quota is SDR 169.7 million.

Fund holdings of Sudanese pounds:

	<u>SDR</u> <u>Millions</u>	<u>Percent</u> <u>of Quota</u>
Total, of which:	696.4	527.6
Credit tranches	92.2	69.8
EFF	123.2	93.3
SFF	168.6	127.7
CFF	122.2	92.6
EAR	58.3	44.2

SDR position: Holdings were SDR 60,041 or 0.12 percent of net cumulative allocation of SDR 52.19 million.

Trust Fund loan disbursements (first and second periods): SDR 70.4 million.

Direct distribution of profits from gold sales (July 1, 1976-July 31, 1980): US\$11.4 million.

Gold distribution: 61,619.962 fine ounces.

Exchange system: Sudan has a dual exchange system. The official market with a fixed rate of exchange of LSd 1 = US\$0.77 (US\$1 = LSd 1.30) handles all public sector transactions and some private sector trade and services transactions. The free market with a fluctuating rate handles remaining private sector transactions. At the end of July 1983, the free market stood at US\$1 = LSd 1.98.

Technical assistance: The Fund has a resident representative stationed in Khartoum. A member of the FAD panel of experts is assigned to the Ministry of Finance to advise on expenditure reporting and control as well as the accounting of aid disbursements. A member of the CBD panel of experts is assigned to the Bank of Sudan to advise on bank supervision.

1/ As of July 31, 1983.

Article IV consultation:

Article IV consultation discussions were held in May 1982. The staff reports (SM/82/174 and SM/82/179) were discussed by the Executive Board on September 22, 1982.

The Executive Board's decision concluding the Article IV consultation (Decision No. 7204-(82/125)) was as follows:

1. The Fund takes this decision relating to Sudan's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Sudan, in the light of the 1982 Article IV consultation with Sudan, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that the spread between the official and free market exchange rates has widened in recent months, and encourages Sudan to take steps to unify the exchange markets at a realistic rate.

Sudan: Selected Economic and Financial Indicators

	Actuals 1980/81	Program 1982	Estimated Actuals 1982	Program 1983	Revised Projections 1983
(Annual percent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	6	2	5	4	1
GDP deflator	28	25	30	25	31
Consumer prices	30	25	27	25	30
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	-18	30	8	38	30
Imports, c.i.f.	22	--	5	1	1
Non-oil imports, c.i.f.	14	-4	-2	1	1
Export volume	-24	24	18	40	35
Import volume	-5	-7	8	1	-1
Terms of trade (deterioration-)	-2	-12	-8	-1	-5
Government budget <u>1/</u>					
Revenue	26	34	22	46	39
Total expenditure	36	21	18	32	22
Money and credit <u>1/</u>					
Domestic credit <u>2/</u>	37	31	22	30	21
Government <u>2/</u>	30	11	9	9	8
Private sector <u>2/</u>	33	34	34	43	40
Public entities <u>2/</u>	46	70	49	50	49
Money and quasi-money <u>2/</u>	46	26	23	28	37
Interest rate (annual rate, one year savings deposit) <u>2/</u>	9.1	12.0	10.0	15.0	15.0
(As percent of GDP unless otherwise specified)					
Central government budget deficit <u>1/</u>	10	8	9	7	6
Domestic bank financing	5	2	3	1	1
Foreign financing	5	8	5	6	5
Balance of payments current account deficit					
Including official transfers	9	11	10	10	9
Excluding official transfers	11	13	15	13	14
External debt <u>2/</u> <u>3/</u> <u>4/</u>	...	...	123	...	121
Debt service ratio <u>4/</u> <u>5/</u>	24	50	12	19	26
Interest payments <u>4/</u> <u>5/</u>	13	28	9	13	16
(In millions of U.S. dollars)					
Overall balance of payments (deficit-)	-203	-177	-223	7	-81
Gross official reserves (months of exports) <u>2/</u>	less than 1	less than 1	less than 1	less than 1	less than 1
External payments arrears <u>2/</u> <u>3/</u>	1,500	1,000	2,250	...	...

1/ Fiscal year ending June 30.

2/ End of period.

3/ Partly estimated.

4/ Inclusive of use of Fund credit.

5/ In percent of exports of goods and services.