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**EBS/97/101**

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**June 11, 1997**

**To: Members of the Executive Board**

**From: The Acting Secretary**

**Subject: Sudan—Staff-Monitored Program—Report on Developments Through May**

Attached for the information of the Executive Directors is a report on developments through May of the staff-monitored program for Sudan.

Mr. Sundararajan (ext. 38573) or Mr. Shabsigh (ext. 35364) is available to answer technical or factual questions relating to this paper.

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INTERNATIONAL MONETARY FUND

SUDAN

**Staff-Monitored Program—Report on Developments Through May**

Prepared by the Middle Eastern and Policy Development  
and Review Departments

Approved by V. Sundararajan and T. Leddy

June 10, 1997

1. Pursuant to the Executive Board's consideration of Sudan—Staff-monitored Program for 1997<sup>1</sup> and the finding of the Board, as a whole, that the program was broadly of a quality that warranted monthly monitoring by the staff, the staff has conducted monthly visits to Sudan. The first monthly report on developments through April 1997 was issued for the information of the Executive Board (EBS/97/83, 5/14/97). Based on the second visit during May 19–25, 1997,<sup>2</sup> this note provides information on recent developments in economic performance and policies, compliance with the quantitative benchmarks through end-March 1997 (using actual data for end-March), and compliance with the structural benchmarks for May 1997.
2. Payments to the Fund through May were made as committed (for a total of US\$28.2 million during January–May, 1997). Payments to other international organizations totaled US\$1.2 million for the first four months of 1997.
3. Data and economic information have been reported to the Fund as specified under the staff-monitored program. Furthermore, the authorities have made progress, particularly in the fiscal area, in developing an information and reporting system to monitor more frequently key economic variables, including the quantitative benchmarks.
4. Against the background of mostly favorable developments in the agriculture sector<sup>3</sup> estimated real GDP growth remains broadly in line with the program projection of about

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<sup>1</sup>See EBS/97/45, 3/14/97, considered at EBM/97/29, 3/27/1997.

<sup>2</sup>The staff team comprised Messrs. Sundararajan (head), Shabsigh and Treichel (all MED), and Mr. Lin (PDR), and overlapped with the technical assistance mission by Mr. Abdel-Rahman, a consultant for FAD.

<sup>3</sup>See EBS/97/83, 5/14/97.

4.9 percent for 1997. Inflation continued to decline (led primarily by lower food prices) with 12-month inflation falling to 75 percent in April 1997, and further to 70 percent in May 1997, as compared to 114 percent in December 1996. The free (accounts-to-accounts) exchange rate was broadly stable, while the official dealer rate was depreciated by a cumulative 3 percent during May. As a result, the spread between the accounts-to-accounts and official rates narrowed to about 14 percent, in line with the reduction expected under the program.

5. As regards external sector developments, the trade deficit widened in the first quarter of 1997 as compared with the same period in 1996, owing to a weak export performance and a strong pickup in imports. Exports fell slightly as the sizable increase in cotton and nontraditional exports was offset by a sharp drop in gum arabic and sesame exports, reflecting a substantial weakening of international prices. Higher imports reflected a one-time increase in wheat and textile imports in February and some increase in machinery and equipment imports. Preliminary data for April indicate that, while exports remained flat as compared with the same month in 1996, imports fell sharply across-the-board. The trade deficit during the first four months was \$254 million as compared with \$222 million in the same period last year. Despite the deterioration in the trade balance, unexplained private capital inflows and errors and omissions remained large and covered most of the trade deficit during the first quarter, as in the previous years. The net international reserves of the Bank of Sudan (BOS) increased slightly (abstracting from valuation changes), and arrears continued to accumulate as actual payments were considerably smaller than debt service obligations. Net short term trade-related inflows were recorded at US\$10 million, while commercial banks' net reserves improved by US\$25 million.

6. The mission confirmed the monetary developments in the first quarter of 1997 as reported in EBS/97/83. Preliminary data for April point to an increase in the growth of broad money that was triggered by an increase in banking system's net domestic assets, the sources of which are still being investigated by the staff. To further contain credit growth, particularly to the private sector, the authorities, in mid-May, raised the share of customer financing under the Musharaka mode of finance<sup>4</sup> by five percentage points for all sectors. The authorities affirmed their commitment to carefully monitor monetary developments, particularly banks' financing of non-government sectors, and stand ready, if necessary, to raise in June the minimum rates under the Murabaha mode of finance, or reintroduce bank-specific credit ceilings when needed.

7. Budget revenues through April 1997 remained in line with program projections, despite a long holiday in April which resulted in a decline in fiscal revenue in April relative to

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<sup>4</sup> Musharaka and Murabaha are financing tools under the Islamic mode of finance. Under Musharaka, the bank and its customer contribute capital jointly to a particular operation and share the risks and profits according to a negotiated formula. Murabaha resembles most closely a repurchase agreement, under which the bank purchases commodities and sells them to the customer, typically in installments at a pre-negotiated price.

March. The drop in revenue in April was exclusively the result of a sharp decline in customs collection (reflecting the long holiday). Revenue from all other taxes and non-tax revenue performed better than projected (but not to the extent of offsetting the decline in customs revenue). The authorities continued to monitor expenditures closely to ensure that they remain within the limits of revenue and financing from the banking system permitted under the program. Preliminary data on net credit to government from the BOS show a small increase of SP 1.5 billion above the program ceiling for end-April. The deviation was caused inadvertently when effecting and recording the government's April payment to the IMF by the BOS, resulting in an increase in BOS's claims on government. This has been corrected, and the net credit to government reverted to below the program benchmark in early May. To prevent future oversights of this nature, the Ministry of Finance has streamlined the procedures for adjustments in its accounts at the BOS.

8. *The structural benchmarks for the month of May have been met as detailed in Table 2.* The authorities were assisted with FAD technical assistance in complying with some of the benchmarks.

9. In line with the understandings reached with the authorities during the April staff visit, the following measures were undertaken on May 15 aimed at strengthening exchange system reform: (i) liberalization of pricing and importation of jet/kerosene, and, in parallel with this measure, a reduction in surrender requirements to the BOS of all exports (other than cotton and gum arabic) from 30 percent to 25 percent; (ii) a reduction in the surrender requirement on cotton export proceeds from 100 percent to 40 percent, with the 60 percent portion being retained by exporters; and (iii) an increase in export retention from 50 percent to 55 percent for certain categories of export. The use of the official exchange rate for customs valuation became effective in May.

10. With regard to tax reform, the authorities reaffirmed their commitment to the introduction of the Value-Added Tax (VAT), for phased implementation during the 1998 budget. An interdepartmental committee that was in charge of planning and preparing the introduction of VAT completed its report ahead of schedule and submitted its recommendation to the Minister of Finance at end-April 1997. The mission reviewed the report and provided suggestions to the committee.

11. The mission reached understandings with the authorities, with support from FAD technical assistance, on a strategy for VAT implementation. Since the current constitutional arrangement in Sudan specifies how to collect and allocate the various categories of taxes between the central and the state governments, the implementation of the VAT at the national level could require amendments to the relevant constitutional decrees. To avoid the potential delay this would entail, the authorities have agreed to adopt a pragmatic strategy that would assure the prompt implementation of the tax reform.

12. The main element of this strategy is to adopt a two-track approach: (i) the VAT would initially be introduced at the federal level only, in close coordination with, and voluntary cooperation of, the states, and (ii) institutional and consultative steps will be identified and initiated to prepare, if needed, amendments to the relevant constitutional decrees that would ensure appropriate federal-state cooperation in taxation and tax sharing, and thereby facilitate the adoption of the VAT at the national level. The implementation of the VAT initially at the federal level is a feasible and appropriate strategy, in part because the federal government already collects most of the taxes on behalf of the states, based on an agreed revenue sharing formula. Also, preliminary discussions with the concerned government officials suggest that a federal level VAT with a revised revenue sharing formula could be introduced based on voluntary cooperation of states, and formal amendments to the constitutional decrees may not be needed at this time. This issue will be pursued further in future missions.

13. Against this background, the mission reached understandings with the authorities on a timetable for finalizing a study on the revenue effects of the VAT (by mid-June), identifying the administrative and organizational aspects of VAT implementation (by mid-July), finalizing the draft law on VAT (by end-October), and identifying the legal and procedural steps that are required to effect, if needed, amendments to the constitutional decrees on federal-state tax relations. More detailed operational steps to initiate phased implementation in 1998 and its appropriate timing, will be developed with the help of IMF technical assistance.

Table 1. Sudan - Quantitative Benchmarks

(In billions of Sudanese Pounds; except if indicated otherwise)

	1996	1997						
	Dec.	Jan.	Feb.		Mar.		Apr.	
	Actual	Actual	Estimate	Actual	Prog.	Actual	Prog.	Prel.
	revised 1/	revised 1/						
<b>Benchmarks</b>								
Ceiling on banking system's NDA 2/ 3/	989	44	25	-2	37	11	52	50
Ceiling on net credit to government 2/ 4/	589	10	20	10	28	26	35	37
Ceiling on new nonconcessional borrowing contracted or guaranteed by the government	--	--	--	--	--	--	--	--
Floor on NFA on the Bank of Sudan (in millions of US\$) 5/	-3,245	54	--	62	--	66	--	93
Payments to the Fund (in millions of US\$)	--	--	15.3	15.3	4.3	4.3	4.3	4.3
<b>Memorandum items</b>								
Reserve money 2/	649	-15	24	17	34	20	44	53
Central government revenue 2/	702	60	141	127	217	222	300	297

Sources : Bank of Sudan; and staff estimates.

1/ December 1996 and January 1997 were revised to correct for a misclassification of certain accounts in the Bank of Sudan's balances.

2/ Outstanding stocks in December 1996; cumulative changes through April 1997.

3/ Banking system's NDA was revised to reflect the correct valuation adjustment.

4/ Excluding changes in government deposits.

5/ Change in stocks over end-December level converted into US dollar at end-of-period official exchange rate. The increase in NFA in January-April, 1997, reflects primarily the impact of the appreciation of the US dollar against the SDR.

Table 2. Sudan: Status of End-May Structural Benchmarks

Benchmarks	Implementation
May Payment to the Fund of US\$ 4.3 million.	Received on May 14, 1997.
Adjustment in domestic petroleum prices to eliminate any remaining subsidization and ensure the budgeted contribution.	Domestic petroleum prices remain higher than international prices.
Adoption of an agreed timetable specifying the preparatory steps to introduce effectively the value added tax for phased implementation in the context of the 1998 budget.	Understanding has been reached on a timetable of specific steps.
Statistical reporting	Observed



Table 3. Sudan: Selected Economic and Financial Indicators, 1994-95/1997 1/

	1994/95	1995	1996		1997	
				Staff Mon. Prog.	March Actual	April Prel.
(Annual changes in percent)						
National income, prices and exchange rate						
Real GDP (at factor cost)	4.5	4.4	4.7	4.9	...	...
Consumer prices (month on year ago month)	57	71	118	65	90	75
Consumer prices (period average)	85	68	133	59	...	...
Official exchange rate end of period (LSd/US\$)	524	838	1,460	...	1,525	1,525
Real effective exchange rate						
(period average: depreciation -)	-18.4	-22.9	-0.4	...	2.6 3/	2.2 3/
(end period: depreciation -)	-39.7	-24.2	14.5	...	5.8 3/	0.9 3/
Central government operations						
Total revenue	117.6	75.5	92.0	81.2 2/	31.7 3/	33.4 3/
Total expenditure (including interest arrears)	88.5	95.7	142.7	32.5 2/	11.4 3/	15.03 3/
Expenditure (excluding interest arrears)	69.9	87.7	107.9	35.9 2/	...	...
External sector						
Exports, f.o.b.	-16.1	31.8	11.6	0.5	-1.4 4/	-1.0 4/
Imports, c.i.f.	-16.6	19.1	25.9	-5.8	16.7 4/	7.3 4/
(In percent of GDP)						
Central government operations						
Total revenue	9.4	8.7	6.9	7.5	...	...
Total expenditure (including interest arrears)	22.0	24.0	23.9	19.0	...	...
Expenditure excluding interest arrears	11.1	12.1	10.3	8.4	...	...
Overall deficit (on an accrual basis)	-12.7	-15.3	-17.0	-11.5	...	...
Overall deficit (on a cash basis)	-1.7	-3.2	-3.4	-0.9	...	...
Primary deficit	-0.9	-2.3	-2.4	-0.2	...	...
Balance of payments and external debt						
Current account deficit	-20.1	-20.8	-25.0	-22.7	...	...
Exports, f.o.b.	6.0	7.8	8.1	7.7	...	...
Imports, c.i.f.	14.4	17.2	20.2	17.9	...	...
External debt	263.9	272.0	267.5	263.7	...	...
External interest due	13.1	12.9	13.5	13.4	...	...
External debt paid 5/	0.9	1.0	0.7	0.8	...	...

Table 3. Sudan: Selected Economic and Financial Indicators, 1994-95/1997 1/

	1994/95	1995	1996	1997		
				Staff Mon. Prog.	March Actual	April Prel.
(Annual changes as percent of beginning stock of broad money)						
Money and credit						
Domestic credit	18.6	32.7	59.3	17.2	2.2 3/	2.7 3/
Net credit to the central government	5.5	22.0	31.9	6.9	-0.7 3/	-0.1 3/
Claims on nongovernment sector	13.1	10.7	27.5	10.4	2.9 3/	2.9 3/
Money and quasi-money	54.2	74.2	65.3	33.8	10.0 3/	13.5 3/
Velocity (GDP/average M2)	7.6	7.5	10.6	12.5	...	...
(As percent of total current account receipts, unless otherwise indicated)						
Total external debt service						
Commitment basis	215.1	160.6	185.5	181.1	...	...
Actual payments 5/	11.6	9.7	8.0	8.5	...	...
Memorandum item:						
Nominal GDP (annual; in billions of Sudanese pounds)	3,050	4,179	10,203	17,008	...	...

Sources: Fund staff estimates and projections based on information provided by the Sudanese authorities.

1/ Starting in 1996, all official accounts moved from a fiscal year (July-June) to a calendar year basis.

2/ For the purpose of comparison with the 1996 outcome, revenue and expenditure figures include LSd 145 billion.

3/ Cumulative change during 1997.

4/ Change during 1997 over the same period in 1996.

5/ Including payments of arrears to the Fund and burden sharing refunds.