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November 11, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Sudan - Report on the Formulation and Implementation
of the Government's "Program of Action"

The attached report on the formulation and implementation of the Sudanese authorities' "program of action," together with the paper on Sudan's overdue financial obligations to the Fund (EBS/87/231, 11/10/87), is tentatively scheduled for consideration by the Executive Board on Monday, November 16, 1987.

Mr. Dodsworth (ext. 4527) or Mr. El-Erian (ext. 7137) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

SUDAN

Report on the Formulation and Implementation
of the Government's "Program of Action"

Approved by S.H. Hitti and J.T. Boorman

November 10, 1987

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I. Introduction

For many years, the Sudanese economy has experienced a steady deterioration which has been reflected in declining per capita real income, investment and imports, intense inflationary pressures, balance of payments difficulties and a large build-up of external debt, including, in recent years, mounting arrears to the Fund. The poor economic performance resulted from various factors, including inadequate and inconsistent implementation of economic policies, prolonged drought and the continued civil conflict in southern Sudan. Fund management and staff have persistently maintained that the resolution of Sudan's economic problems requires strong and comprehensive reform measures adopted in the context of a medium-term strategy and implemented on a consistent and continuous basis with increased international financial support.

Given the fragile social and political circumstances, and in the context of a country living for many years beyond its means, any meaningful reform measures were to involve austerity and sacrifices which were politically difficult to undertake. Accordingly, the previous governments refrained from making serious and sustained efforts to address the difficult economic problems of the country and the consequent disenchantment of the international community, resulting in disruption in aid flows, added to the problem.

During the past two years, the political developments in Sudan culminated in the assumption of office, in May 1986, of a democratically-elected government which indicated that it accorded a high priority to addressing the problems of the economy. The Government's policy objectives, as expressed in its first-year "Salvation Program," were judged to be in the right direction; however, the authorities did not adopt a comprehensive package of corrective policies until July 1987 when a "Program of Action" was formulated and implementation was initiated (see Appendices I and II).

In contrast to earlier economic policies, the Program of Action comprised a comprehensive set of measures that were mutually reinforcing and consistent, and also attempted to address, in a medium-term framework, the deep-rooted structural problems of the economy. The policy package was viewed by the management and staff of the Fund as representing a decisive first step in the process of economic adjustment. The main elements of the Program were presented to Executive Directors during the Board review of Sudan's overdue obligations to the Fund on August 7, 1987. At that time, Executive Directors expressed a generally favorable response to the design of policies, but emphasized the importance of their timely and full implementation and the need for subsequent monitoring of developments in the economy. In this context, it was decided that a further review of Sudan's overdue obligations would be held within three months, which period was subsequently extended slightly to not later than November 16, 1987.

The present paper aims to describe the various elements of the Program of Action, its implementation so far, financial programming for the remainder of the fiscal year and the external payments gap that, under current policies, needs to be covered through debt relief and additional cash and commodity assistance. 1/

II. The Program of Action and its Implementation

The authorities' four-year development plan is still in the process of being specified in detail and will not be finalized until the beginning of 1988. However, in view of the urgency of the situation, the Program of Action was formulated within a broad medium-term framework aimed at achieving a sustained rate of economic growth, reducing the rate of inflation and moving toward medium-term balance of payments viability. The Program of Action emphasized production orientation of policies and structural reforms that are crucially needed to achieve the medium-term objectives. It is hoped that policy measures for the fiscal year 1988/89 (beginning on July 1) will be more firmly entrenched in the authorities' medium-term plan.

1. Real sector policies

One of the main objectives of the Program of Action is an expansion in output and the authorities have initiated policies aimed at improving efficiency of resource utilization and encouraging production both in agriculture and industry. In the first place, the Government's policies for agriculture are aimed at ensuring adequate production incentives by guaranteeing minimum/procurement prices for the major crops, securing the necessary production inputs for the public sector irrigated schemes, and improving the availability of imported inputs for the private sector. As regards domestic prices for agricultural output, the Government, on the basis of detailed cost structure studies, announced in October 1987 floor prices for groundnuts and sesame which will safeguard producer incentives both in the irrigated and rainfed sectors. In addition, the procurement price for gum arabic has been increased to a level which is expected to encourage production and reduce smuggling. 2/ These actions are to be supplemented during the period November/December 1987 by the announcement of a minimum price for sorghum (dura) and procurement prices for cotton and wheat, which will be established in consultation with the World Bank. Unlike the

1/ The Program of Action was prepared in July 1987 with the assistance of a Fund team; this was followed by discussions in Washington at the time of the Annual Meetings and a staff visit during the period October 23-28, 1987 to review the implementation of the Program of Action and to assist the authorities in setting quarterly financial benchmarks for the monitoring of developments in the remainder of the year.

2/ Details of the minimum/procurement prices that have been announced are contained in Appendix II, paragraph 11.

agricultural pricing policies in the previous years, when their financial burden was reflected in expansion of bank credit due to weak budgetary policy and overvalued exchange rates, in 1987/88 these prices are supported by an exchange rate adjustment and an explicit recognition of remaining subsidies. So far as the availability of inputs is concerned, the authorities have been involved in negotiations with various donors to match agricultural sector requirements with commodity aid commitments. They have also, as described more fully in Section II.4 below, instituted measures to allow private sector financing of imports from "own resources," which is expected to facilitate a substantially higher level of imports of both agricultural and industrial inputs.

The second major element of the Government's supply-side policies is the reform of the parastatal sector. There are 227 enterprises operating in all areas of the economy, most of them on a very inefficient basis. Parastatal reform is, thus, an immense undertaking, which will need to be implemented over many years. The reform program, being prepared in close consultation with the World Bank, is aimed at (i) addressing the problems of individual public sector corporations through rehabilitation programs, or, where entities are not considered viable in their present form, through their liquidation or privatization, (ii) rationalizing employment and management policies, (iii) improving the monitoring and financial accountability of enterprises, and (iv) adopting realistic and rational pricing policies.

In regard to individual corporations, rehabilitation efforts have been launched and the World Bank is actively involved in programs for a number of enterprises including Sudan Railways, the National Electricity Corporation, the Sudan Port Authority, the Sudan Gezira Board, four other agricultural corporations and the public sector sugar factories. Moreover, a study of ten additional public enterprises is soon to be initiated in the context of a World Bank credit. ^{1/} Under this program, the Government is to decide by September 1988 whether the corporations under review are to be retained, liquidated or privatized. In addition, the Government has announced its intention to abolish two agricultural entities, replacing them with a mixture of cooperatives and private enterprises, and has decided to divest itself of two corporations (sweets factories) by September 1988.

A constraint on the implementation of parastatal reform policies has been the lack of information on financial and production aspects of public entities' operations. In order to address this problem, a comprehensive data base is now being established within the purview of a strengthened Central Bureau for Public Enterprises which will provide the Government with information and recommendations concerning specific

^{1/} For more details see "Public Enterprises and Economic Management Project" (Report No. P-4434-SU) approved by the World Bank Executive Board in May 1987.

enterprises. These actions are to be reinforced by measures aimed at rationalizing existing labor laws, orienting decision-making processes toward commercially based criteria, and revising pricing policies. The authorities are holding in November 1987, in consultation with the World Bank, an "Action Planning Workshop" which will provide recommendations as to the implementation of specific measures. It is expected that an understanding on such measures will be reached with the World Bank by January 1, 1988.

The third major element of the supply-side policies is the revitalization of private sector production and investment activities. In this field, the authorities will issue, in the context of the Four-Year Development Plan, detailed guidelines which will clearly delineate the role of the private sector. The objective of these guidelines will be to reduce the institutional and policy uncertainties which have for some years hindered the development of the sector. The authorities have also decided to review the 1980 "Encouragement of Investment Act" and revise the provisions governing private sector investment incentives.

These actions are to be supplemented by the rationalization of the current price and profit regulations. ^{1/} In the past, the pervasive and rigid imposition of these regulations have adversely affected the production and investment performance of the private sector. In particular, the profitability of these enterprises was undermined by unrealistic costing practices, including the use of an accounting exchange rate overvalued in comparison with the rate at which the transactions were effected, long delays in the consideration of requests for price adjustments, and the provision of inadequate profit margins relative to the prevailing inflationary environment. Consequently, the regulations tended to limit the incentive and capacity for investment and maintenance of capital in the private sector. At the same time, in many cases the regulations failed to insulate consumers as intended, benefiting instead trading intermediaries. The reform of the regulatory environment has been recognized as an extremely important area both for private sector development and for the efficient operation of other economic policies. It is an area, however, which involves complex and politically sensitive issues that will need to be addressed in a phased manner. The authorities have undertaken in the current year to improve the efficiency of administering these controls by adopting more realistic costing procedures for production and imports, and making an allowance in costing for a return on capital which takes into account the prevailing inflationary environment. The authorities have also taken action to expedite requests for price increases more promptly and these are now completed within a two-week period.

^{1/} A detailed analysis of the coverage and operation of these regulations is contained in Appendix I of SM/86/38 (2/26/86).

2. Budgetary policies

The authorities' budgetary policies for 1987/88, as outlined in the Program of Action, are designed to contain expenditures, expand revenues and reduce borrowing from the banking system. For the containment in expenditures, the Government has already taken measures to eliminate extrabudgetary operations, which in the past accounted for a significant part of total spending, and to reduce waste. In addition, and despite trade union pressures, the Government is committed to maintaining a freeze on nominal wages in the public sector in the remainder of the fiscal year, except for minimum wages and transportation allowance. Provisions for increased expenditures resulting from the October 1987 devaluation (equivalent to 10 percent of current expenditures or LSd 480 million) were incorporated in the Program of Action to accommodate increased domestic currency costs of government imports and some wage adjustment. The authorities are currently contemplating a 10-30 percent graduated wage increase for employees earning less than LSd 200 (US\$44) per month and an increase in transportation allowance of LSd 20 per month effective from January 1, 1988; these adjustments will involve outlays estimated by the staff, of some LSd 70 million which can easily be accommodated within the above budgetary provisions. However, a more generalized wage increase would jeopardize the budgetary and monetary targets for the current fiscal year.

In addition to the tight control on expenditures, the authorities' Program of Action includes new revenue measures that will raise an additional LSd 932 million in the current fiscal year. ^{1/} Of this amount, some LSd 200 million was raised by measures announced in the 1987/88 budget which included imposition of an import surcharge (defense tax), higher excise duties on domestically produced cigarettes and increased import duties on cigarettes. These measures were supplemented in September-October by (i) increased excise duties on cement, (ii) a restructuring of the rate and base of customs tariffs, (iii) the reimposition of certain regional and local taxes, and (iv) increases in the prices of benzine and sugar.

^{1/} The authorities' measure of revenue generation includes the gross receipts from higher benzine and sugar prices while increased petroleum, wheat, and pharmaceutical subsidies, reflecting less than complete pass through of the exchange rate action, are included on the expenditure side. It should be noted that the offsetting of the petroleum and sugar receipts against the subsidies reduces the estimate for total budgetary revenues and leads to a corresponding reduction in total expenditures. This results principally from the reduction in net receipts from petroleum to LSd 149 million as compared to LSd 496 million in 1986/87. Thus, projected budgetary revenues and expenditures would amount to 8.5 percent and 20.6 percent of GDP, respectively, compared to 9.8 percent and 21.9 percent of GDP, respectively, as presented in the Program of Action.

A detailed evaluation of these measures by the staff during the October mission led to the conclusion that their yield will be about LSd 100 million less than what was intended in the Program of Action due to inadequate or partial implementation of some of the previously expected measures. To compensate for this, the authorities have decided to increase, by November 15, 1987, the price of sugar for soft drink producers and confectioners and, by January 1, 1988, import duties and excise duties on certain products and rates of stamp duty (see Appendix II, paragraph 6). With the introduction of these additional measures the revenue target of the Program of Action is expected to be achieved. In addition, the Government intends to issue securities at remunerative rates to raise LSd 20 million from the nonbank public during the year.

A determined effort to contain expenditures, and the realization of anticipated revenues, will enable the Government to hold the fiscal deficit (commitment basis) to the targeted 12 percent of GDP. This, in combination with the anticipated increase in aid inflows, should make it possible for the Government to contain domestic bank financing within the target of LSd 800 million set for 1987/88 (2 percent of GDP), which will represent a significant improvement over 1986/87 (LSd 1,315 million equivalent to 4.5 percent of GDP).

While the authorities have taken steps to strengthen the budget during this year, the achievement of a sustained reduction in the fiscal deficit and domestic bank borrowing will require more fundamental policy actions designed to change the structure of the budget. On the revenue side, despite the introduction of discretionary measures over the past several years, the revenue/GDP ratio has tended to decline, reflecting the narrowness of the tax base and its inelasticity with respect to changes in output and prices. For the authorities to move from the situation where new measures are required each year just to maintain the existing revenue/GDP ratio, the coverage of taxes needs to be substantially broadened and the system made more responsive to changes in prices and output. This would be facilitated by the introduction of, inter alia, a current payments system for income tax purposes, the conversion of specific taxes to an ad valorem basis, the expansion of regional taxation, particularly to bring local production activities in the tax base, and more flexible pricing of public utilities. In addition, improvements in tax administration, parastatal reforms and the channeling of underground activities back into the formal economy through liberalization of controls will go a long way in raising government revenues. On the expenditure side, the Government will need to embark on a program of civil service reforms in order to contain wage outlays; there is also a need to adopt policies to eliminate, in a phased manner, the budgetized subsidies on bread, pharmaceuticals and petroleum products.

3. Monetary and banking policies

The authorities' budgetary policies for 1987/88 will contribute to a decline in government recourse to bank credit. This, in combination with lower net credit extended for stockpiling of dura and oilseeds, will provide increased scope for financing the genuine productive credit needs of the parastatal and private sectors, and, at the same time, help moderate the rate of monetary expansion from the high levels of the recent past. The authorities, with the assistance of the staff, have projected the credit requirements of the various sectors of the economy on the basis of a detailed analysis that took into account, inter alia, the scope for immediate financial efficiency gains in the parastatal and commodity stockpiling activities, the projected expansion in domestic economic activity, and the impact of price increases including those emanating from the devaluation of the Sudanese pound. On the basis of this analysis, the authorities seek to reduce the expansion in net domestic assets from 45 percent in 1986/87 to 19 percent in 1987/88. Such a reduction, which is to be achieved without compromising credit requirements of the productive sectors of the economy, will contain money supply growth to 23 percent in 1987/88, as compared to 34 percent in 1986/87 and to an estimated 44 percent in the absence of policies. ^{1/}

A major factor affecting the process of financial intermediation in Sudan has been the September 1984 implementation of institutional changes, which was introduced without adequate preparation, and the subsequent uncertainty regarding the Government's intentions as to the future institutional set up. The resulting uncertainty has adversely affected the process of financial intermediation. After evaluating various options, the authorities decided to maintain the Islamic banking system. The authorities believe that, under the Sharia laws, there is no inconsistency between Islamic banking principles and the protection of the real value of financial assets. Accordingly, the authorities introduced on November 1, 1987 a "compensatory rate system" within the existing Islamic banking principles. Under this system, all banking institutions are able to attract deposits and provide advances on the basis of a compensatory rate, which is determined on the basis of (i) the change in the average of the available previous three months consumer price index for higher salaried employees relative to the comparable period a year earlier, and (ii) a mark-up of three percent per annum. On this basis, the compensatory rate, applicable as of November 1, 1987, is 25 percent per annum, and a corresponding structure for minimum rates on deposits and maximum rates on advances has been specified (for details see paragraph 8 of Appendix II). A circular has been issued by the Bank of Sudan to the commercial banks detailing the operation of the system and the structure of rates. These rates are to be reviewed every quarter by the Bank of Sudan and adjusted in light of changes in the rate of inflation. At the same time, a comprehensive review of the inflation index will be undertaken in order to improve its coverage and timeliness.

^{1/} See Table III in Appendix I.

The changes undertaken by the authorities should remove institutional uncertainty and pave the way for more efficient financial intermediation in the medium term. However, the current insufficient profitable investment opportunities available to banks, in combination with excessive liquidity in the banking system and quantitative credit regulations, will tend to continue to limit the role of the new rates in mobilization of additional deposits by banks. In fact, the pace of amelioration in the process of financial intermediation will remain contingent on progress in other areas of the economy. The authorities' adjustment strategy incorporates measures to revitalize private sector activity, reform parastatal entities, and relax quantitative credit controls. This, in combination with measures to reduce excess liquidity in the banking system, will gradually increase the banks' incentives to mobilize financial savings. However, the Sudanese authorities have cautioned that, even in these circumstances, the beneficial impact on savings and investment of positive real rates on savings/charges on borrowing may remain modest.

4. External sector policies

An important aspect of the authorities' Program of Action is the reform of the exchange and trade system. In the past, the authorities were reluctant to take any comprehensive actions in this area believing, in particular, that past devaluations were largely ineffective, in addition to being unpopular. Notwithstanding this, the authorities recognized the importance of providing adequate export incentives and, accordingly, did adjust a number of export rates in 1986/87. However, these adjustments were not accompanied by supportive actions on import rates and/or real resource mobilization; consequently, the increased incentives were undermined by the inflationary impact of the credit-financing of the price support policies.

The staff has held extensive discussions with the Sudanese authorities on the issue of exchange rate adjustment and, in this context, has carried out detailed analyses of the cost structure of Sudan's exports. Independent cost calculations were also undertaken by the Sudanese authorities. While the authorities' computations, carried out in the context of the formulation of the Program of Action, indicated that the bulk of the traditional exports would be profitably moved at a rate in the neighborhood of LSd 4.00 per U.S. dollar, those of the staff, which took explicit account of anticipated increases in costs during the fiscal year, suggested that a higher rate would be necessary. After reviewing the staff's analysis, as well as the budgetary and price implications of exchange reform, the authorities adopted on October 3, 1987 an initial unified rate of LSd 4.50 per U.S. dollar, 1/ representing a 44 percent devaluation of the official

1/ All rates were unified with the exception of the rate applicable to the bilateral payments agreement with Egypt which is LSd 3.25 per accounting dollar. The authorities have indicated that this rate would be revised in the context of the annual renegotiation of the agreement, which is to be held in January.

rate and a 29 percent devaluation of the trade-weighted average rate. This new rate can be expected to move the bulk of the traditional export commodities without explicit or implicit subsidies. The Government does recognize the dynamic nature of the cost structure in the country, and of international market conditions, and has indicated that it intends to follow a flexible policy with regard to the maintenance and strengthening of export incentives.

In the context of the unification of the exchange rates, the authorities have also ensured a full pass through into prices of the exchange rate action with the exception of sensitive commodities representing some 25 percent of the projected imports for the current fiscal year: bread, pharmaceuticals, gas oil, fuel oil, kerosene and LPG. The resulting subsidies have, however, been explicitly incorporated into the budget.

In addition to the adjustment in the exchange rate, the authorities have taken steps to liberalize the import finance and trade regulations. Specifically, measures were adopted in early August allowing "own-finance" imports of a wide range of agricultural and industrial inputs and essential consumer commodities. Under this system, importers are allowed to utilize their own foreign currency resources--whether held domestically or abroad or acquired from the free market--to finance the importation of commodities for which licenses have been provided by the Ministry of Commerce. The list of such commodities has been revised on three occasions resulting in an expansion of its coverage. The system provides an additional avenue for financing imports and encouraging remittance inflows, and, according to preliminary indications, the scheme has had an encouraging response.

5. Monitoring of developments in the remainder of the fiscal year

The timely implementation of the measures specified in the Program of Action needs to be accompanied by effective monitoring of economic and financial developments in order to make any further policy adjustments that are necessary for the achievement of the objectives. In order to facilitate monitoring of developments in the remainder of the fiscal year, the authorities have specified, with the assistance of the staff, a set of quarterly financial benchmarks (Table 1 of Appendix II). These benchmarks cover credit extension to the major sectors of the economy, and have been derived on the basis of detailed analyses of the relevant variables including the seasonal pattern of budgetary revenue and expenditures, the expected disbursements of already committed aid, the seasonality in trade and domestic activities--particularly as related to the agricultural cycle, the expected disposal of stocks of cotton, dura, and oilseeds, and the seasonality of the working capital requirements of parastatal entities. The authorities will examine the adequacy of policies in the light of actual developments in relation to the benchmarks.

6. Balance of payments, cash flow and external aid requirements

Sudan's external payments prospects in 1987/88 continue to be characterized by a low level of export earnings relative to import requirements, and massive external debt obligations. While the implementation of the Program of Action in 1987/88 and its reinforcement in the subsequent period will lead to improvements in the country's balance of payments over the medium term, the nature of the imbalances and prevailing circumstances are such that the economy will require a substantial amount of external assistance for many years to finance the necessary imports and meet its external debt obligations. In effect, the availability of significant international financial assistance in the coming years in support of domestic policies is essential for progress toward longer-term balance of payments viability, whereby dependence on exceptional external assistance could be eliminated. The medium-term balance of payments projections made by the staff, and included in previous documents circulated to the Board, provide some indication of the order of magnitude and the time path for such assistance. ^{1/} As far as 1987/88 is concerned, projections made jointly by the staff and the authorities are contained in Tables 2 and 4 of Appendix II. These projections indicate a financing gap before external assistance of around US\$5.3 billion. Expected disbursements of aid in the pipeline would reduce the financing gap to some US\$4.7 billion, of which US\$3.1 billion could be covered if Sudan were to obtain debt relief from bilateral creditors and commercial banks along the terms granted in 1984 and 1985. The residual gap of US\$1.6 billion incorporates debt servicing obligations to the Fund, including arrears, of US\$0.8 billion.

The authorities, assisted by the staff, have attempted a quarterly external cash flow, detailing the phasing and timing of export receipts, import requirements and disbursement of already committed aid (see Table 4 in Appendix II for details). In addition, as the external gap is dominated by debt service obligations and arrears, the phasing of the covering of the gap is highly dependent on the availability of additional aid and debt relief and the associated debt service payments. For illustrative purposes, it is assumed that debt restructuring and complete clearance of Fund arrears would take place at the latest by the April-June quarter of 1987/88. In order to accomplish this objective, it would be desirable if such normalization could begin with reductions in Fund arrears as soon as possible. Accordingly, in addition to covering the quarterly gaps indicated in the Table, resources would need to be mobilized for effecting payments to the Fund.

^{1/} See for example Section V of SM/87/12 (1/8/87).

III. Staff Appraisal

The deteriorating condition of the Sudanese economy in recent years has been the result of both adverse exogenous factors and a lack of political determination to deal with the country's serious economic problems within a comprehensive adjustment strategy. Against this background, the formulation and implementation of the "Program of Action" by the authorities represents an encouraging and important first step in addressing the country's difficult economic and financial problems. The authorities' Program of Action, which has been formulated in a broad medium-term framework, comprises a set of policies in the areas of production, demand management and the exchange and trade system, that are expected to have a mutually reinforcing impact on the economy. The policies, however, will need to be further strengthened and broadened over the medium term to bring about the desired restructuring of the economy that will permit the achievement of sustained economic growth and balance of payments viability.

The staff has evaluated the implementation of policies so far and concluded that the authorities have, in accordance with the Program of Action, announced incentive-based prices for a number of agricultural commodities, adjusted prices of benzine and sugar, contained budgetary expenditures, revised the structure of rates of return on savings and of charges on borrowing, and reformed the exchange system. In assessing the budget, the staff identified a revenue shortfall in comparison with the target of the Program of Action reflecting inadequate and partial implementation of the revenue measures. However, the authorities intend to take steps to compensate for this shortfall, as indicated in Appendix II. Moreover, in order to monitor developments under the Program of Action, quarterly benchmarks for net government borrowing and credit to the parastatal and private sectors have been specified for the remainder of the fiscal year which will enable the authorities to identify any slippages and take compensating measures in a timely manner. The authorities are also in the process of initiating specific measures in the areas of parastatal reform and the revitalization of private sector production and a World Bank mission is currently in Khartoum to assist the authorities in preparing a schedule of such actions. Work is also proceeding, in close collaboration with the World Bank, on the detailed preparation of the Government's Four-Year Development Plan. In the context of their medium-term plan, the authorities intend to discuss with the staff in early 1988 an economic and financial program for 1988/89.

While the staff welcomes the implementation of policies under the Program of Action, it needs to be emphasized that the effort must be sustained and intensified in the period ahead. In particular, the staff has emphasized the importance of restructuring of the government budget to permit an increase in the revenue/GDP ratio so as to close the wide gap between revenues and expenditures. This can only be attained through a significant broadening of the tax base, improving the responsiveness of revenues to changes in output and prices, pursuing realistic pricing policies, reforming the parastatal sector, and

substantially freeing the private sector from controls. Steps will also be required to further tighten government current expenditures, and measures will need to be taken to siphon off excess liquidity from the economy and the banking system. The staff has also emphasized, and the authorities have indicated their recognition of, the need to closely monitor developments with respect to the existing exchange and trade arrangements, particularly in respect of maintaining competitiveness of exports and developing means of extending the "own resources" system of importation.

For Sudan's domestic adjustment efforts to achieve the objective of sustained growth in the context of reduced internal and external financial imbalances, they need to be initially supported by substantial and timely international assistance to finance import requirements and normalize external debt relations, including the settlement of the overdue financial obligations to the Fund. In this context, Directors have consistently supported the view that all aspects of Sudan's economic and financial problems, including its external debt obligations, need to be addressed within a comprehensive solution. The Program of Action was indeed based on such a comprehensive approach, and it was clear that the resolution of the arrears problem would require substantial additional assistance and debt relief. Management and staff have been assisting the Sudanese authorities in various ways to mobilize the necessary external financial assistance, including the holding of informal meetings of Executive Directors representing Sudan's major donors and creditors, a briefing of Ambassadors and local donor representatives in Khartoum, and other bilateral contacts. These efforts with donors and creditors are continuing and will be reinforced by discussions in some national capitals ahead of a meeting of the "Heads of Delegations" of the Consultative Group for Sudan which is scheduled to be chaired by the World Bank in Paris on December 2, 1987. This is to be followed, providing satisfactory understandings are reached with the World Bank and the Fund on the medium-term plan and an economic and financial program for 1988/89, by a full Consultative Group meeting for Sudan, tentatively scheduled for April 1988.

A Program of Action of the Government of Sudan
Relating to its Economic and Financial Policies

August 3, 1987

1. The Government of Sudan is currently engaged in a serious attempt to deal with an extremely difficult economic situation which is the consequence of many years of economic mismanagement as well as adverse factors including devastating drought conditions, continuing civil unrest in the South, and large inflows of refugees from neighboring countries. When the present Government assumed power in May 1986, the underlying problems of the economy had reached alarming proportions. Per capita real income and consumption had fallen to levels substantially below those prevailing a decade earlier, the capital stock had been depleted, national savings had declined sharply, and fixed investment was being almost entirely financed by a net resource transfer from abroad and recourse to domestic bank borrowing. The government finances and parastatal operations had been neglected to the extent that a greater part of the current expenditures of the budget and financial losses of parastatals were being financed by bank credit. In the external sector, the country had accumulated a foreign debt of about US\$10 billion, including arrears of US\$2.6 billion, and an extremely precarious foreign exchange situation prevailed.

2. During its first year in office, the democratically-elected Government accorded a high priority to redressing the economic problems that it inherited. The main thrust of its Economic Salvation Program, launched in October 1986, was to regenerate growth in production by the adoption of supply-oriented policies while, at the same time, implementing financial policies to generate more revenue and to bring about discipline in government budgetary operations. The Government also embarked on a series of structural reforms and increased incentives, which helped to promote output in 1986/87, and are expected to continue to have favorable effects. However, the country has experienced further compression of imports, shortages of essential consumer and producer goods, strong inflationary pressures, and it has been unable to fully meet its external obligations. To tackle these continuing problems, the Government has resolved to boost its efforts in both the supply enhancement and demand containment areas. The intensification of the Government's efforts to deal with Sudan's economic problems will be guided by a medium-term national economic recovery plan expected to be completed by the end of 1987. The major objectives of this plan are: (i) to ensure a sustained growth in output which will allow increases in per capita income and consumption, and increase the availability of essential goods; (ii) to moderate the rate of monetary expansion which, in combination with improved supplies, will reduce progressively the underlying rate of inflation; and (iii) to achieve greater self-reliance by improving the external payments position and reducing, over time, dependence on foreign aid.

3. To achieve these objectives, the Government intends to implement a strong and comprehensive package of adjustment measures beginning in 1987/88 aimed at both increasing domestic production and curtailing growth in nominal aggregate demand. On the supply side, policies have been introduced in the area of allowing the private sector to use its own foreign exchange resources for the importation of essential inputs together with removing protection from a number of inefficient industrial plants. In addition, other policies will be introduced in the current fiscal year to maintain price incentives in agriculture, ease the present constraints on industrial production, improve the efficiency of parastatal operations, and initiate a comprehensive action plan to encourage private savings and investment. Building upon the policies of the previous year, the Government intends to ensure that there is full encouragement of agricultural production during the 1987/88 season. To this end, the Government will maintain its policy of announcing procurement prices for cotton and gum arabic and minimum floor prices for dura, sesame, and groundnuts at levels which will give adequate incentives to producers. In the irrigated subsector, the Government will continue its incentive system to encourage early picking of cotton and will review financial relations between the tenants and the agricultural schemes with the aim of increasing collections of land and water charges and progressing toward the goal of full cost recovery in the major agricultural schemes.

4. One of the major elements of the Government's program is the reform of the parastatal sector which is being undertaken with the technical assistance of the World Bank. The parastatal reform program will, in the current year, be focused on the rehabilitation of individual enterprises, improving management efficiency and labor productivity, and introducing more realistic pricing policies and commercially-oriented decision making within the public enterprises. The Government also intends to make decisions during the year concerning the retention, liquidation, or privatization of some individual enterprises, as appropriate. Before January 1, 1988, the Government intends to prepare and review with the World Bank staff a comprehensive action plan designed to address the structural problems of the parastatal sector, and in particular, improve productive efficiency of the enterprises to initially facilitate the repayment of seasonal loans and advances from the banking system and ultimately to generate surpluses for net capital formation and to provide a fair return on past government investment.

5. The contribution of the private sector to Sudan's economic development has been far below its potential for some years. The Government is committed to creating conditions to encourage the revitalization of the private sector and is concentrating on creating a climate of confidence which will help promote private savings and investment. Its action plan has the following main components:

(i) In the context of the four-year national recovery program, the Government intends to announce in the current fiscal year a comprehensive policy on the role of the private sector in Sudan. This

will involve, as an initial step, introduction of a comprehensive revision of the laws and regulations governing private investment so as to, inter alia, ensure the provision of adequate returns for investors. The Government will also be providing infrastructural support to the private sector which will include the strengthening of the Investment Bureau.

(ii) To promote private sector investment, the Government intends to implement a range of policies that will increase remittance inflows from Sudanese nationals working abroad. Aside from the adoption of an appropriate exchange rate policy, the Government intends to launch joint ventures and provide support in the identification of viable projects.

(iii) The Government is aware that for private sector savings to be mobilized and for efficient and productive investment to be undertaken, a major reform of the banking system will be required. In this context it is recognized that the haphazard changes in the banking system since September 1984 have impeded banks from playing their proper role in the economy, impeding their intermediation function and necessitating extensive administrative actions in allocating credit. The Government plans to address these problems in three major ways: first, by removing the prevailing institutional uncertainties through the introduction of a "compensatory rate" system in which the rate of return would reflect the rate of inflation and normal bank charges; for this purpose, a draft law will be submitted to the Constituent Assembly prior to October 1, 1987. This change will be introduced within the existing system of Islamic banking. Second, following the institutional reforms, the Government will review the structure of charges on loans and returns on savings in order to encourage savings and promote efficient allocation of resources. Third, our intention is to gradually reduce the present excessive administrative regulation of credit and replace it by relying on the conventional instruments of credit control. In the present circumstances, however, overall credit ceilings for the private sector will continue to be necessary.

(iv) One of the major factors which has adversely affected the past performance of the private sector has been the application of price and profit regulations which, not only has severely limited this sector's capacity for investment, but also has contributed to the growth of a large underground economy. The Government believes that, although in present circumstances, price and profit regulations are needed for several strategic or socially sensitive goods, actions have begun to be taken to moderate the adverse effects of such regulations. In the current year, the Government has already embarked upon a program aimed at achieving the following: (a) the inclusion of a full and realistic costing of all inputs in price determination; (b) a reasonable return on capital given the inflationary environment; and (c) price decisions to be made promptly.

6. The Government is aware that the beneficial impact of the supply-enhancement policies will be negated if actions are not taken to remove

the constraints on production arising from shortages of foreign exchange, and to moderate the underlying rate of growth in domestic absorption and inflation. Accordingly, the Government intends to introduce a major reform of the exchange rate system and introduce measures to contain growth in monetary expansion.

7. On the external side, the Government has decided to unify the exchange rates at a level that is consistent with the need to strengthen the production and export incentives. The rate will apply to all foreign exchange transactions both on the payments and receipts side and, as a general principle, the price level will be allowed to adjust fully to reflect changes in the exchange rate. However, in the short run we intend to protect prices of certain specific essential commodities in order to enhance the prospects for social acceptability of the contemplated adjustments in the exchange rate and to moderate the impact on the cost of living and cost of production. Accordingly, the prices of bread, pharmaceuticals, gas oil, fuel oil, kerosene, LPG, and diesel will be left unchanged. The subsidy involved in maintaining the domestic prices below the import cost at the new exchange rate will be incorporated in the budget and financed from the budgetary resources (Table I). The medium-term aim, of course, is to adjust prices to reflect full cost recovery so as to gradually reduce and ultimately remove the burden of price subsidies on the budget.

8. To support the exchange rate policies, the Government intends to implement monetary and fiscal measures to limit the overall growth in domestic liquidity in 1987/88 to 23 percent compared with 34 percent in 1986/87. To achieve the desired monetary expansion in the current year, substantial budgetary effort will be called for. Accordingly, the Government has decided to implement additional fiscal measures (equivalent to almost 3 percent of GDP on an annual basis). These measures include increases in prices of benzine products and sugar, and higher collections from import duties, excise taxes on cement, and a number of other taxes (Table II). While the increases in prices of essential commodities, in combination with the exchange rate reform, will add to the pressure for a generalized wage and salary adjustment, the Government intends to postpone any such consideration to the 1988/89 budget and intends to contain within 10 percent of the originally budgeted expenditures (excluding foreign interest payments), the increased cost of foreign exchange in the budget and any allowance for adjustment in the minimum wage.

9. In tackling the problem of weak government finances, the authorities intend to establish policies within a medium-term framework which will (i) substantially raise the revenue/GDP ratio to generate a current account surplus, (ii) expand the public investment program in consultation with the World Bank, (iii) reduce budgetary dependence on foreign assistance, and (iv) contain the need for domestic bank financing to the safe limits dictated by consideration of containing the rate of inflation to a moderate level.

Table 1. Sudan: Central Government Operations
(In millions of Sudanese pounds)

	1986/87 Prel. Est.	1987/88 Revised Policies
Total revenue	2,742	3,225
Of which: Revenue from petroleum price differences before new policies	(496)	(455)
Expenditure (excluding interest)	5,015	7,288
Current expenditure	(3,813)	(5,285)
Petroleum subsidy with new policies	(...)	(412)
Pharmaceutical subsidy with new policies	(...)	(36)
Increase in wheat operations subsidy with new policies	(...)	(39)
Development expenditure	(1,202)	(1,517)
Deficit (excluding interest)	<u>-2,273</u>	<u>-4,063</u>
Debt servicing	-474 ^{1/}	-18,406
Deficit (including debt service)	<u>-2,747</u>	<u>-22,468</u>
Financing		
Foreign	1,222	20,606
Project aid	509	726
Cash and commodity aid	713	1,119 ^{2/}
Additional cash and commodity aid and debt relief	...	18,762
New fiscal measures	...	932
At time of 1987/88 budget	...	200
Proposed new measures	...	732 ^{3/}
Of which: Petroleum price increase	(...)	(103) ^{3/}
Self financing units	65	110
Domestic financing	1,460	820
Borrowing from banking system	1,460	800
Borrowing from private sector	--	20
(In percent of GDP)		
Revenue	9.4	9.8 ^{4/}
Expenditure (excluding debt servicing)	17.2	17.1
Foreign financing net of debt servicing	2.6	5.2
Additional cash and commodity aid	...	44.0
Additional debt servicing ^{5/}	...	42.6
Additional external budgetary financing net of additional debt servicing	...	1.4
Additional fiscal measures	...	2.2 ^{3/}
Domestic bank financing	5.0	1.9

1/ Cash basis. Total scheduled obligations falling due amounted to LSd 2,052 million.

2/ In the pipeline as of July 22, 1987 and does not include the recently reported Saudi Arabian commitment.

3/ Nine months yield from the proposed measures except for the cement price adjustment. The annualized yield from the new fiscal measures is equivalent to some 3 percent of GDP.

4/ Including new revenue measures.

5/ Including arrears and excluding the initial budgetary estimate of LSd 250 million of debt service payments.

Table II. Sudan: Fiscal Measures to be Implemented
on or before October 1, 1987 1/ 2/

(In millions of Sudanese pounds)

	Est. Revenue Yields	
	Annual	9 months <u>3/</u>
1. New excise duty on cement at the rate of LSd 100 per ton	66	56
2. Increase in import duties: With the expansion in the base following the exchange rate change, the adjustment in the rates on dutiable imports will be such as to yield the cited amount. It implies that with the present average duty of 45 percent, the new average duty rate will be maintained at 36 percent.	433	325
3. New tax measures, imposed at the regional government level, on date trees, live- stock, agricultural produce and buildings	13	10
4. Average increase of 20 piastres in sugar price for the entire domestic consumption	253	190
5. Increase in price of super and normal benzine:	137	103
Normal from LSd 7.50 to LSd 9.50 per gallon	(127)	(95)
Super from LSd 8.50 to LSd 10.50 per gallon	(10)	(8)
6. Measures to be specified at the time of the Annual Meetings	66	49
Total	<u>968</u>	<u>732</u>

1/ Does not include LSd 20 million in revenue generated by the issuance of interest bearing securities by the Government to the nonbank public, at least LSd 5 million of which to be issued before December 31, 1987.

2/ For cement corresponds to 10 months from September 1, 1987.

3/ The 9 months of the fiscal year from October 1, 1987.

10. The fiscal actions described above will be supplemented by steps to contain the credit available for public producing and trading entities. As mentioned in paragraph 4 above, the Government has decided to introduce far-reaching reforms in the parastatal sector. While this will strengthen the entities' financial position over the medium term, such reforms are unlikely to reduce their dependence on the banking system in 1987/88. In addition, the public entities' overall credit requirements will increase because the cotton sector will not benefit from as large a reduction in stocks as in 1986/87 when large stocks were disposed of. Consequently, it is envisaged that credit to public entities may rise by about LSd 830 million compared with LSd 526 million the previous year (Table III). In respect of stockpiling operations, the Government will ensure that the large credit financing (about LSd 870 million) for sorgum and oil seed operations in 1986/87 will not be repeated in the current fiscal year. In fact, a large part of the carry-over of these stocks has already been sold and will be shipped during the next few months. In addition, the Government intends to take appropriate action to permit a larger private sector participation in marketing these crops. Consequently, the credit financing of this subsector will decline sharply. The Government also intends to take steps to ensure that credit extended to the private sector is not used for speculative purposes. Nevertheless, in order to ensure that the envisaged growth of private sector activity is not impeded by inadequate financing availability, the genuine credit needs for production as well as trading purposes will be met, resulting in recourse by the private sector to bank financing of some LSd 580 million. This, in combination with the measures in the fiscal area cited earlier, will permit a reduction in domestic liquidity growth to 23 percent of the money supply as of June 1987.

11. The adjustment policies for 1987/88 will enhance the economy's ability to mount a sustained drive over the medium term toward increased export- and import-substituting production, and a reduction in our dependence on foreign aid. However, in view of the deep-rooted nature of our structural problems, the expansion in our net foreign exchange earning capacity in the first year will be limited. Accordingly, the provision of essential consumer goods and production inputs critical to our adjustment efforts, as well as the regularization of our external financial relations with creditors and a modest increase in our international reserves needed for working purposes, will require substantial additional support from the international community, estimated at some US\$4,845 million (Table IV), in the form of debt relief and cash and commodity aid on highly concessional terms.

Table III. Sudan: Changes in Domestic Liquidity

Changes during period	1986/87	1987/88	
	Prel. Est.	Revised Policies	Existing Policies
(In millions of Sudanese pounds)			
Money and quasi-money <u>1/</u>	<u>2,326</u>	<u>2,144</u>	<u>3,989</u>
Impact of external sector	<u>-752</u>	<u>385</u> <u>2/</u>	<u>-170</u>
Domestic credit expansion	<u>3,078</u>	<u>1,759</u>	<u>4,159</u>
Claims on Government (net)	1,460	800	2,056
Claims on public entities	526	829	919
Claims on private sector and specialized banks	317	578	499
Dura & oilseed stock financing	868	117	395
Fund accrual	109	-565	170
Other items (net)	-202	--	120
(As percent of broad money at beginning of period)			
Money and quasi-money <u>1/</u>	<u>34.0</u>	<u>23.4</u>	<u>44</u>
Impact of external sector	<u>-11.0</u>	<u>4.2</u> <u>2/</u>	<u>-2</u>
Domestic credit expansion	<u>45.0</u>	<u>19.2</u>	<u>45</u>
Claims on Government (net)	21.3	8.7	22
Claims on public entities	7.7	9.0	10
Claims on private sector and specialized banks	4.6	6.3	5
Dura & oilseed stock financing	12.7	1.3	4
Fund accrual	1.6	-6.2	2
Other items (net)	-2.9	--	1

1/ Excludes the effects of valuation changes on the local counterpart value of foreign currency deposits in 1987/88.

2/ After netting out the change in other items over the period.

Table IV. Sudan: Balance of Payments

(In millions of U.S. dollars)

	1986/87 Prel. Est.	1987/88	
		Revised Policies	Existing Policies
Exports, f.o.b.	492	654	632
Imports, c.i.f.	-911	-1,285	-847 <u>1/</u>
Services (excluding interest)	-80	-75	-75
Private transfers	250	260	200
Current account (excluding interest)	<u>-249</u>	<u>-446</u>	<u>-90</u>
Debt service <u>2/</u>	-245 <u>3/</u>	-4,777	-200 <u>4/</u>
Other <u>5/</u>	-149	--	-149
Change in reserves (-: accumulation)	204 <u>6/</u>	-60 <u>7/</u>	-- <u>6/</u>
Foreign assistance <u>2/</u>	<u>439</u>	<u>5,283</u>	<u>439</u>
Cash and commodity aid	...	258 <u>8/</u>	258 <u>8/</u>
Project aid	...	181	181
Requirements of additional aid (including debt relief)	...	4,844	...
<u>Memorandum item</u>			
Arrears outstanding at end of period	3,597	--	4,577

1/ Derived on the basis of financing available.

2/ Not equivalent to the corresponding estimates in the budgetary accounts due to coverage differences.

3/ Cash basis. Obligations falling due (including the Fund) totalled US\$1,068 million.

4/ Derived on the basis of projected budgetary debt service and trade-related obligations.

5/ Includes net private capital outflows.

6/ Excludes changes in accrual Fund accounts.

7/ Excludes net changes in the Fund position which are taken into account in debt servicing.

8/ In the pipeline as of July 22, 1987 and does not include the recently reported Saudi Arabian commitment.

12. As is evident from the previous paragraphs, the policy package for 1987/88 incorporates substantive adjustments in the exchange rate, increases in a number of socially sensitive key prices, a significant increase in the burden of taxation as reflected in a large revenue generation effort, a further containment of government expenditure in real terms, and a marked reduction in the growth of domestic liquidity. The effects of these decisive and difficult measures will test the tolerance limit of our people. While we are determined to sustain and reinforce these reforms, we would like to ensure adequate supplies of at least those commodities whose prices are to be increased prior to the action in order to enhance availabilities simultaneously with price adjustment. In view of the current poor domestic availability of major commodities and the prevailing fragility in the socio-political environment, we would expect a portion of the international support required during 1987/88 to be made available immediately in order to establish the preconditions for the successful and irreversible implementation in prices of benzine and sugar. On the production side, policies for 1987/88 will require, inter alia, the provision of inputs for production of the major agricultural and industrial commodities, the promotion of private sector productive activity through the alleviation of shortages of imported inputs and improvements in the overall environment, and the rehabilitation of the capital stock in the parastatal sector. We would, therefore, like to discuss with the donor community the provision of the necessary foreign financing as soon as possible so as to improve utilization of industrial capacity, increase productivity in the parastatal sector, and ensure continued growth in agricultural production.

13. The Government of Sudan is committed to meeting all its legitimate external payments obligations and, in this context, the policies proposed for 1987/88 explicitly aim at normalizing the country's relations with creditors, including the settlement of the overdue obligations to the Fund. However, as noted earlier, the structure of the economy's external indebtedness is of such burdensome proportion that it is impossible for sufficient resources to be generated domestically to meet the foreign obligations. Accordingly, our efforts in this area will require international support in the form of debt forgiveness and debt restructuring along highly concessional terms by commercial banks, Paris Club members, and other bilateral creditors. We would also need additional concessional resources to meet those obligations which cannot be rescheduled. In this regard, we give the highest priority to the working out of an acceptable financial agreement with the donor community that will help us to clear the arrears to the Fund. Upon clearance of such arrears, or having made firm arrangements for this purpose, we would like to hold discussions with the Fund for the use of its resources.

October 28, 1987

Dear Mr. Camdessus,

While your staff will be reporting to you in fuller detail the outcome of our discussions during their current visit, I thought that I should summarize in a note (attached) the main elements of policy implementation as a supplement to the Sudan Government's previous "Program of Action".

I would like to reiterate that the implementation of the Program of Action and its reinforcement as indicated in the present note is to be followed by a second phase of evolving a medium-term program and defining in specific terms the policies and program of action in 1988/89. Thus, while we are continuing and in certain ways intensifying our adjustment policies, for our efforts to be successful, they would need to be supported by substantial international assistance. In this respect, your personal interest and encouragement has been most appreciated and your continued support is of the utmost importance for the mobilization of necessary external resources.

I would like to also reassure you that we are equally concerned about Sudan's overdue obligations to the Fund, and I am hopeful that during the coming period a cooperative and coordinated effort will be made for increased international assistance and debt relief and debt forgiveness that will also allow us to clear the arrears to the Fund.

Allow me to assure you of my highest consideration,

/S/ Bashir Omar M. Fadlalla
Minister of Finance and Economy

Attachment

Mr. M. Camdessus
Managing Director
International Monetary Fund
Washington, D.C.

October 28, 1987

Implementation of the Program of Action
by the Government of Sudan

1. The present Government had prepared in July a program of policy action for the fiscal year 1987/88 without waiting for the finalization of the medium-term plan for economic growth and stabilization. This reflected the Government's determination to make a prompt and decisive beginning in addressing the enormous economic and financial problems that it had inherited reflecting a long period of past economic mismanagement. Fund management endorsed the "Program of Action" as a decisive first step for the resolution of the country's difficult economic and financial problems, and the international community in general, and the Fund Executive Board in particular, reacted positively to the comprehensive nature of the policy package. However, some reservations were initially expressed, based on the track record of the Nimieri government, about the present Government's resolve to promptly and fully implement the Program of Action, and about its ability to sustain those actions in the event of an unfavorable reaction in the country. By now the Government has demonstrated its resolve by adopting all the measures and by standing firm in the face of opposition to the policy measures implemented on October 3, 1987.

2. The Government, soon after the implementation of the October measures, invited a Fund mission to Khartoum and reviewed with it the actions that have already been taken, the reinforcement measures that are contemplated further for 1987/88, financial programming for the remainder of the year, and the progress of work on the medium-term plan of economic development. This note briefly summarizes some aspects of the implementation of policies.

Exchange rate

3. It should be recognized that the Government took a bold step in unifying the exchange rate which was accompanied by full pass-through of the impact on prices, except for a few sensitive commodities whose subsidization was fully budgetized.

4. As has been stressed several times by the Government, the main thrust of the policy reform is toward the expansion of production with exports as the leading sector. Accordingly, the Government has given the highest priority to the strengthening of production incentives, particularly for exports. One of the main elements is the maintenance of an exchange rate at a level that ensures attractive price incentives for export production without explicit or implicit subsidies. Before the exchange rate adjustment, the Government had carried out extensive studies of the cost structure for various export commodities and concluded that most of the traditional exports were price competitive at a rate much lower than that indicated by similar studies by the Fund

staff. However, keeping in view the production orientation of the strategy, the Government took account of the Fund's staff calculations in determining the exchange rate adjustment of October 3, 1987. It may be added that, being fully aware of the changing nature of the cost and price structure in the country, the Government is determined to follow a flexible policy with regard to the maintenance and strengthening of export incentives.

5. The Government also introduced in August a system of "own resource" financed imports which has acted as a "safety valve" for remittance inflows and availability of essential imports that were crucially needed in the economy but could not be financed at the official rate due to the scarcity of foreign exchange. There are more than 40 commodities that can be imported under the scheme, including industrial and agricultural inputs, building materials and basic foodstuffs, and the response so far has been encouraging.

Fiscal measures

6. The Government has taken a series of measures to eliminate extrabudgetary operations, impose discipline on the entire public sector, minimize waste, and contain the growth in current expenditures. This has been done in spite of the burden on the budget of the continued civil unrest in the southern part of Sudan. Along with these expenditure control measures, new taxes were introduced in the beginning of the 1987/88 fiscal year. As part of the package of policy reform, and in continuation of the taxation measures taken at the beginning of the year, the Government took further fiscal measures on October 3, 1987 that were to yield LSd 968 million on an annual basis (3 percent of GDP). These included an increase in excise duty on cement, higher import duties and regional taxes, and increases in the prices of benzine products and sugar. A closer scrutiny of these measures, and a rather conservative estimate of their revenue yield by the Fund mission, has led to the conclusion that the actual yield could be about LSd 100 million less than that anticipated in the Program of Action. Accordingly, the Government has decided to introduce additional revenue measures on or before January 1, 1988, whose revenue yield in the remaining part of the fiscal year is given below.

Estimated Revenue Yield
(In millions of Sudanese Pounds)

By November 15, 1987:	
Increase in sugar price for soft-drink producers and confectioners	30
By January 1, 1988:	
Increase in import duties including those on iron, steel and glass products, electrical goods, spare parts and wood	22
Increase in excise duties, including those on soft drinks, tires, batteries, and other domestic manufactures	34
Increase in rates of stamp duty	7
Nontax revenue measures	<u>5</u>
Total	98

7. On the expenditure side, a provision of LSd 480 million was made in the Program of Action to accommodate the effects of the exchange rate adjustment on government expenditures, and of possible increases in wages that could be given on a selective basis to low income civil employees, to compensate for recent price increases. While postponing consideration of any general salary adjustment to 1988/89, the Government is at present contemplating graduated wage increases of 10-30 percent of the basic salary of less than LSd 200 per month (US\$45), and supplementing the transportation allowance by LSd 20 per month for all eligible government servants, both to be effective on January 1, 1988. The total cost of these measures is estimated at LSd 56 million, an amount well within the expenditure provision made in July 1987 for this purpose.

Compensatory rate system

8. In September 1984, the banking system was restructured on the basis of Islamic principles. Since then various instruments, like Musharaka and Murabaha, have been used in replacement of fixed interest rates. The present Government approved legislation on September 30, 1987 to introduce another instrument of Islamic banking designated as the "Compensatory Rate System" to be available to all banks and savings

institutions. The compensatory rate, which will be specified by the Bank of Sudan, consists of (i) a component which ensures the maintenance of the real value of the deposit/loan by compensating for the rate of inflation, and (ii) a markup of 3 percent. On this basis, a compensatory rate of 25 percent per annum, being the mid-point of the lending and deposit rates, will be put in place on November 1, 1987 with the following specification of the rate structure for deposits and advances. Provisions have been made for a review, to be held at least every quarter, of the appropriateness of the compensatory rate.

(In percent per annum)

Lending rate	27.0
Deposit rates	
Demand deposits	--
Fixed deposits	
3 months	20.0
6 months	21.0
9 months	22.0
12 months	24.0
Savings deposits	20.0
Deposits of pension and provident funds	20.0

9. While the new instrument will add flexibility to the system and ensure the emergence of a structure of returns on savings and charges on borrowing that is positive in real terms, it must be recognized that the role of the rate of return/charges in the mobilization of additional savings and allocation of loanable funds remains limited in the conditions prevailing in Sudan. This is due to relatively under-developed banking habits and institutional framework, the small size of financial savings, the large nonmonetized sector, excessive liquidity in the banking system, the limited level of investment opportunities and the socioreligious conditions of the country.

10. Along with the restructuring of rates of return on savings and charges on borrowing, an attempt is being made to implement parastatal reforms, strengthen the role of the private sector, and move away from unnecessary regulations on private sector activity and private sector credit. The Government, with the assistance of the World Bank, is currently engaged in finalizing an action plan for parastatal reform, rationalizing the policy framework applicable to the private sector including, in particular, those relating to price and profit regulations, and preparing a comprehensive medium-term framework. With

this, as well as the reform of public enterprises, the mopping up of excess liquidity in the banking system, and a move away from detailed quantitative credit controls, the emergence and maintenance of a positive rate structure will, after some time, begin to have a favorable impact on both the mobilization of savings and resource allocation in the economy.

Agricultural pricing policies for 1987/88

11. The Government had indicated in general terms in the Program of Action its intention to maintain agricultural prices in 1987/88 at levels that would provide adequate incentives to producers. These prices are usually announced during the period between August and December. After detailed and careful review of the cost structure, yield, and world market prices, the Government has announced minimum prices for 1987/88 for groundnuts, white sesame, and mixed sesame of LSd 55, LSd 65, and LSd 61 per kantar, respectively. In addition, the procurement price for gum arabic has been set at LSd 400 per kantar and studies are underway both by the Government and by the Fund/Bank staff, to determine the procurement price for cotton, which we expect to announce by the end of November, to be followed up by announcements of prices for wheat and dura. The Government believes that these prices would ensure adequate incentives for maintenance and expansion of agricultural production.

Quarterly financial programming, cash flows, and monitoring of developments

12. In order to evaluate the impact of the policies adopted in the context of the Program of Action, the Government, with the assistance of the Fund staff, has specified quarterly financial targets for the Government's recourse to bank credit, public enterprise borrowing, and private sector credit expansion (see Table 1). These targets will facilitate timely monitoring of developments in key financial variables, thereby providing an early indication of the adequacy of the policies and the need for any adjustments. Similarly, detailed balance of payments projections, and related quarterly cash flows, have been prepared to identify the necessary external resources and their phasing to achieve the targets of the policy program (see Tables 2-4).

Concluding remarks

13. The Government firmly believes that the implementation of the Program of Action, and its reinforcement in the subsequent period, is essential for the desired reform of the economy and the Government intends to carry it through with vigor and determination. Nonetheless, it is clear that for the program to fully achieve its aims and not to be undermined at an early stage, financial support of the international community is extremely important. The Government is hopeful, therefore, that its bold effort to make fundamental adjustments in the economy for the achievement of sustained growth, relative price stability, and

balance of payments viability would be supported by timely inflows of external resources to cover the balance of payments gap for 1987/88 both to meet the requirements of the economy and to regularize Sudan's external financial relations.

Table 1. Sudan: Credit Program for the Government,
Public Entities, and the Private Sector, 1987/88

(In millions of Sudanese pounds)

	Changes during the period		Cumulative Benchmarks			
	1986/87	1987/88	Q1	Q2	Q3	Q4
			1987/88			
Government <u>1/</u>	1,315	800	229	493	750	800
Public entities <u>2/</u>	526	829	330	751	793	829
Private sector and specialized banks <u>3/</u>	1,185	695	64	162	739	695
Net domestic assets <u>1/</u> <u>4/</u>	2,961	2,324	623	1,406	2,282	2,324

1/ Excludes changes in accrued charges to the Fund.

2/ Covering entities borrowing under Section 57 A of the Bank of Sudan Act.

3/ Including dura and oilseeds financing.

4/ Excludes the effects of valuation changes on the local counterpart value of foreign currency deposits. The large programmed reduction in other items, reflecting the sterilization of a portion of external assistance, is netted out against the corresponding increase in net foreign assets.

Table 2. Sudan: Balance of Payments Financing Gap, 1987/88

(In millions of U.S. dollars)

	Action Program July 1987	Revised Estimate Oct. 1987
1. Exports, of which:	654	654
Cotton	(159)	(159)
Dura	(80)	(80)
Gum arabic	(77)	(77)
Groundnuts	(67)	(67)
2. Imports, of which:	-1,285	-1,285
Petroleum	(-230)	(-230)
Machinery	(-165)	(-165)
Insecticides	(-91)	(-91)
Fertilizers	(-45)	(-45)
3. Services (excluding interest)	-75	-75
4. Private transfers	260	260
5. Current account (excluding interest) (1+2+3+4)	-446	-446
6. Debt service (commitment basis), of which:	-4,777	-4,777
1987/88 obligations	(-1,179)	(-1,179) ^{1/}
Arrears as of June 1987	(-3,598)	(-3,598)
7. Changes in reserves (increase -)	-60	-60
8. Financing gap before foreign assistance and debt service (5+6+7)	-5,283	-5,283
9. Project aid utilization	181	181
a. Arab Fund refinancing	--	6
10. Cash and commodity aid utilization from pipeline aid as of July 22, 1987 ^{2/}	258	232 ^{3/}
11. Petroleum assistance not covered in cash and commodity aid, of which:	170	22
Saudi Arabia ^{4/}	(113)	(22)
Kuwait ^{5/}	(57)	(--)
12. Likely utilization from additional aid committed since July 22, 1987, of which:	--	108
World Bank	(--)	(55)
Netherlands	(--)	(9)
Germany, Federal Republic of	(--)	(5)
E.C.	(--)	(22)
Canada	(--)	(10)
Italy	(--)	(7)
13. Residual gap (8+9+9a+10+11+12)	-4,674	-4,734
14. Estimated debt relief on the basis of 1984 and 1985	3,111	3,111
15. Remaining debt service obligations (6+14), of which:	-1,666	-1,666
a. Trade credits and budgeted debt service	(-200)	(-200)
b. Obligations to the Fund	(-795)	(-795) ^{1/}
16. Gap after estimated debt relief (13+14)	-1,563	-1,623
Memorandum item:		
17. Gap assuming limited debt servicing of of US\$200 million (5+7+9+9a+10+11+12+15a) ^{6/}	-147	-207 ^{7/} ^{8/}

^{1/} On the basis of clearance of Fund arrears by December 1987. Postponement of such clearance would increase debt service obligations.

^{2/} Including U.S. commitment of US\$50 million, to be available in the context of clearance of the arrears to the Fund.

^{3/} After taking account of possible delay in disbursements (US\$26 million).

^{4/} The initial estimate was based on information by the Sudanese authorities as to the commitment of 6 months of petroleum supplies. The revised estimate is based on actual deliveries so far. There is currently some uncertainty concerning additional commitment, which is still under negotiation.

^{5/} The initial estimate was based on information by the Sudanese authorities as to the commitment of 3 months of petroleum supplies. Under the changed circumstances in the Gulf, the authorities believe that the originally contemplated assistance may not be forthcoming.

^{6/} Excludes U.S. commitment of US\$50 million to be available in the context of clearance of Fund arrears.

^{7/} The difference between this gap in the Action Program and the Revised Estimate is accounted for as follows (US\$ millions):

-147	Action Program
-148	Reduction in estimated petroleum assistance (11)
+108	Disbursements on newly committed aid (12)
+6	Arab Funds refinancing (9a)
-26	Reduction in estimated disbursements of aid from the pipeline (footnote 3)
-207	Revised Estimate

^{8/} Early clearance of the arrears to the Fund is highly desirable. Accordingly, this gap will be higher by the amount of payments to be made to the Fund.

Table 3. Sudan: Cash and Commodity Aid in the Pipeline

(In millions of U.S. dollars)

	Disbursed Aid July 1987- Sep. 1987	Committed Aid as of October 1	Expected Disbursements October 1987- June 1988	Identified Additional Possible Commitments
Total	<u>113.1</u>	<u>298.7</u>	<u>248.7</u>	<u>55.0</u>
Cash	<u>17.0</u>	<u>50.0</u>	<u>50.0</u>	--
United States	--	50.0 <u>1/</u>	50.0 <u>1/</u>	--
E.E.C.	17.0	--	--	--
Commodity	<u>96.1</u>	<u>248.7</u>	<u>198.7</u>	<u>55.0</u>
United States	44.0	20.0	20.0	30.0
PL 480 wheat	(38.0)	(--)	(--)	(30.0)
Agricultural inputs	(--)	(8.5)	(8.5)	(--)
Industrial inputs	(6.0)	(11.5)	(11.5)	(--)
Italy	3.1	46.0	46.0	--
Insecticides	(3.1)	(9.9)	(9.9)	(--)
Industrial inputs	(--)	(15.0)	(15.0)	(--)
Medical products	(--)	(0)	(4.0)	(--)
Lubricants	(--)	(9.0)	(9.0)	(--)
Other	(--)	(8.1)	(8.1)	(--)
Netherlands	14.0	--	--	10.0
Lubricants/base oil	(2.5)	(--)	(--)	(10.0)
Insecticides/herbicides	(11.5)	(--)	(--)	(--)
Canada	--	10.0	10.0	--
Wheat	(--)	(10.0)	(10.0)	(--)
Germany, Fed. Rep. of	--	23.7	23.7	--
Industrial inputs	(--)	(16.6)	(16.6)	(--)
Lab equipment	(--)	(1.0)	(1.0)	(--)
Medicines	(--)	(6.1)	(6.1)	(--)
E.E.C.	5.0	20.0	20.0	--
Sugar	(5.0)	(--)	(--)	(--)
Fertilizers	(--)	(20.0)	(20.0)	(--)
Japan	3.5	4.0	4.0	15.0
Fertilizers and other chemicals	(3.5)	(4.0)	(4.0)	(--)
Other	(--)	(--)	(--)	(15.0)
Saudi Arabia	21.5	--	--	--
Petroleum	(21.5)	(--)	(--)	(--)
Kuwait	5.0	--	--	--
Transport equipment	(5.0)	(--)	(--)	(--)
Turkey	--	40.0	20.0	--
World Bank	--	85.0 <u>2/</u>	55.0 <u>2/</u>	--

1/ U.S. cash aid to be available in the context of clearance of Sudan's arrears to the Fund.

2/ Comprises commitment for Agricultural Rehabilitation Program (III) which is still subject to approval by the World Bank Executive Board.

Table 4. Sudan: External Sector Quarterly Cash Flow, 1987/88

(In millions of U.S. dollars)

	July-Sept.	Oct.-Dec.	Jan.-March	Apr.-June	1987/88
Exports	128	148	166	212	654
Cotton	(39)	(44)	(32)	(44)	(159)
Gum Arabic	(10)	(2)	(30)	(35)	(77)
Dura	(18)	(32)	(--)	(30)	(80)
Groundnuts	(2)	(10)	(30)	(25)	(67)
Sesame	(1)	(2)	(9)	(10)	(22)
Other	(58)	(58)	(65)	(68)	(249)
Imports	-307	-337	-287	-354	-1,285
Petroleum	(-50)	(-61)	(-62)	(-57)	(-230)
Fertilizers	(-13)	(-8)	(-4)	(-20)	(-45)
Insecticides, herbicides	(-31)	(-10)	(--)	(-50)	(-91)
Machinery	(-23)	(-55)	(-43)	(-44)	(-165)
Sugar	(-14)	(-10)	(--)	(-6)	(-30)
Other	(-176)	(-193)	(-178)	(-177)	(-724)
Services	-19	-19	-19	-19	-75
Private transfers	60	80	60	60	260
Debt service, budgeted and trade credits	-64	-36	-50	-50	-200
Reserves accumulation	7	-5	-25	-37	-60
Subtotal	-195	-169	-155	-188	-707
Cash and commodity aid <u>1/</u>	91	58	40	47	236
Saudi petroleum aid	22	--	--	--	22
World Bank ARP III	--	--	--	55	55
Project aid	46	45	45	45	181
Arab Fund refinancing	6	--	--	--	6
Egypt bilateral	22	-7	-7	-8	--
Other, including commercial banks	8	-2	-3	-3	--
Gap	--	-75	-80	-52	-207
Other debt service obligations <u>2/</u>	--	...	...	...	-4,577
U.S. cash aid <u>3/</u>	--	...	...	...	50
Debt relief <u>4/</u>	--	...	...	...	3,111
Total financing gap	--	...	...	...	-1,623

1/ Disbursements in first quarter and likely disbursements in subsequent three quarters from pipeline aid as of July 22, 1987 (US\$232 million) plus from additional aid committed since July 22, 1987 (US\$108 million), but excluding World Bank (US\$55 million) and United States cash aid to be available in the context of clearance of Fund arrears (US\$50 million) which are shown separately in this table.

2/ Assumes that the debt service is normalized by April-June 1988.

3/ To be available in the context of clearance of Sudan's arrears to the Fund.

4/ Assumes terms similar to those granted to Sudan by creditors in 1984 and 1985.

