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February 19, 1986

To: Members of the Executive Board
From: The Acting Secretary
Subject: Sudan - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Sudan which is tentatively scheduled for discussion on Wednesday, March 12, 1986. A draft decision appears on page 32.

Mr. Drees (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.

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INTERNATIONAL MONETARY FUND

SUDAN

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985
Consultation with Sudan

Approved by A.S. Shaalan and J.T. Boorman

February 19, 1986

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I. Introduction

The 1984 Article IV consultation discussions were concluded on September 24, 1984 and the Staff Report (SM/84/253), together with the report on Recent Economic Developments (SM/84/265), was considered by the Executive Board on December 19, 1984. The 1985 Article IV consultation discussions were initiated during a staff mission to Khartoum in October 1985 and concluded on January 23, 1986 during a follow-up visit. In these discussions, the Sudanese representatives were led by the Minister of Finance and Economic Planning 1/ and included senior officials from the Ministries of Agriculture, Commerce, Finance and Economic Planning, and Industry, the Bank of Sudan, and various public sector corporations. 2/

Sudan's overdue obligations to the Fund amounted to SDR 226.1 million as of January 31, 1986. The Executive Board has held four reviews of Sudan's overdue financial obligations to the Fund following the issuance of the complaint on December 12, 1984. In the fourth review, held on January 3, 1986, the Board adopted a decision under which Sudan would be declared ineligible to use the general resources of the Fund on February 3, 1986 unless the country became current in its financial obligations to the Fund by that date. In the communication sent by the Managing Director to the Minister of Finance and Economic Planning on January 13, 1986, which was circulated to the Board, the Managing Director noted that he would be in a position to recommend to the Board a reconsideration of the decision only if Sudan had made major payments to the Fund and indicated in the clearest terms, including through the implementation of the policy package discussed with the staff, that prompt and full settlement of the arrears was in clear prospect. In the event, the Executive Director for Sudan requested a deferral of the decision of January 3, 1986, but the Board, in its meeting on February 3, 1986, did not approve the request. Accordingly, Sudan became ineligible to use Fund resources on February 3, 1986.

The Sudanese authorities and the staff have held frequent discussions on economic policies during the last year with the aim of reaching understandings on a package which, after full clearance of Sudan's arrears to the Fund, could serve as a basis for a stand-by arrangement. The discussions, which were initiated in December 1984, had to be temporarily halted with the change in Government on April 6, 1985. However, soon thereafter, the first Minister of Finance of the new Government visited

1/ The Sudanese representatives in the October and January discussions were led by H.E. Awad Abdel Magied and H.E. Sid Ahmed Tayfour, respectively.

2/ Staff that participated in either or both of these missions included Messrs. M. Yaqub (Head-MED), F. Drees (MED), J. Buyse (ETR), M. El-Erian (MED), D. McDonald (FAD), G. Oliveros (ETR), and C. Sassanpour (MED), Miss H. Sudo, and Mrs. J. Polk (Secretaries-MED). Mr. J. Dodsworth, the Fund's resident representative in Sudan, and Mr. J. de Leede (IBRD) also participated in the discussions.

Washington. This visit was followed, at his request, by staff missions to Khartoum in July and September 1985, as well as discussions during the Annual Meetings in Seoul. These discussions were concluded in October in Khartoum with understandings having been reached between the staff and the Minister of Finance on a policy package to address Sudan's economic problems. ^{1/} This package could have served as a basis for a possible stand-by arrangement after the clearance of Sudan's arrears to the Fund. Following management approval and an informal briefing by the Managing Director to the Executive Board in November 1985, the staff prepared the necessary documents for circulation to the Board in anticipation of implementation of the policy package by the authorities and clearance of the overdue obligations to the Fund. The Sudanese Council of Ministers, however, did not approve the entire policy package and, in the wake of subsequent developments, doubts emerged on the prospects for the continuance of the proposed scenario. Consequently, the staff postponed the issuance of the documents to the Board. At the end of December 1985, a Sudanese ministerial delegation, which included the Governor of the Bank of Sudan, visited Washington and, after making some progress in narrowing the differences that had emerged, invited a staff team to visit Khartoum for continuation of the discussions with the present Minister of Finance who was appointed in early January 1986. A staff team visited Khartoum during January 18-23, 1986 and, on its return, continued discussions with the Minister during his visit to Washington at the end of January. However, understandings on the outstanding economic policy issues could not be reached.

Sudan continues to avail itself of the transitional arrangements of Article XIV. Summary statements on Sudan's relations with the Fund and the World Bank Group are presented in Appendices I and II, respectively. Sudan compiles statistics essentially along the lines of the methodologies recommended by the Fund, but the country's data base remains weak despite improvements in certain areas (Appendix III).

II. Background

Economic and financial developments in Sudan in recent years have been reviewed in previous staff papers. ^{2/} As indicated in these papers, Sudan's economic situation worsened significantly beginning in the mid-1970s, leading to a sharp deterioration in the external payments position, a severe shortage of foreign exchange, and a buildup of external payments arrears.

^{1/} The Executive Board was informed periodically by the staff on the progress and outcome of discussions. See, in particular, Buff Statement 85/178 (9/26/85), EBS/85/253 (11/13/85), and Buff Statement 86/16 (2/3/86).

^{2/} For details refer to EBS/82/7 (1/14/82), EBS/83/9 (1/11/83) and Supplements 1-4, EBS/83/174 (8/16/83) and Supplement 1, EBS/84/83 (4/11/84) and Supplements 1-6, and EBS/85/30 (2/1/85).

In an attempt to deal with the country's increasing economic difficulties, the Sudanese authorities adopted several programs of economic and financial adjustment during the period 1978/79-1983/84; these programs were supported by use of Fund resources as well as external assistance provided by various donors and creditors in the form of cash and commodity aid as well as debt relief. Performance under various economic adjustment programs covering the period up to 1983/84 was evaluated in the Staff Report on the 1984 Article IV consultation. 1/ The same report also reviewed the one-year stand-by arrangement covering the period June 25, 1984-June 24, 1985 that became inoperative soon after its entry into effect due to the re-emergence of arrears to the Fund and to the failure of the authorities to carry out certain exchange system reform measures which they had proposed to implement in July 1984.

Sudan's performance in addressing its problems in the past several years has remained poor. This is mainly attributable to the inability of the Government to maintain continuity in domestic adjustment policies which not only stalled the momentum of economic recovery but also negated some of the gains that were achieved during this period. In addition, the performance was adversely affected by natural causes such as drought, and external factors such as disruptions in, and lower-than-anticipated levels of, foreign assistance, as well as by civil unrest which delayed work on important projects. It is in this general context that Directors emphasized, during the Board discussion of the 1984 consultation, the importance of implementing without delay a comprehensive set of policies framed within a medium-term strategy for economic recovery. 2/

III. Economic and Financial Developments in 1984/85 3/

Sudan's economic situation weakened substantially in 1984/85, as reflected in the lower levels of production and imports (Chart 1), a buildup of serious inflationary pressures, a further deterioration in the underlying balance of payments situation, and the accumulation of external

1/ See SM/84/253 (11/9/84), particularly Appendix III on "Performance under Economic Adjustment Programs, 1978/79-1982/83."

2/ See EBM/84/187.

3/ Until June 1984, Sudan's fiscal year covered the period July 1-June 30. Effective from September 26, 1984, the fiscal year was changed to coincide with the Islamic calendar which is shorter than the Gregorian calendar year by 11-12 days. The transition from the July 1-June 30 basis to the Islamic year was effected by adopting a transitional budget for the period July 1, 1984-September 25, 1984. The new authorities have decided to revert back to the July 1-June 30 fiscal year with effect from July 1, 1986, necessitating a 9 1/2-month budget covering the period September 16, 1985-June 30, 1986. Most of the staff estimates for 1984/85 and 1985/86 cover a September-September period or an October-September period in line with the availability of comprehensive monetary statistics. However, the output data cover the July 1-June 30 period.

payments arrears. This section is devoted to an analysis of the main economic trends in 1984/85, and the contributing policies, with a view to providing a perspective for the discussion of prospects and policies for 1985/86.

1. Overall economic activity

Sudan's overall economic activity declined for the third successive year in 1984/85, with real GDP estimated to have fallen by 7.0 percent. For the three-year period as a whole, the decline in the real GDP amounted to 13 percent. ^{1/} Of the factors responsible for the decline, drought was the most important, particularly in 1984/85, and was most visibly reflected in the decline in food production and the resulting famine conditions inflicted on both Sudanese nationals and the 1.2 million refugees (equivalent to about 6 percent of Sudan's population) from neighboring countries. A significant part of the famine-related requirements were met through substantial emergency food operations conducted by bilateral donors and relief organizations. Available information indicates that a total of 1.5 million metric tons of food-stuff were committed in 1985, virtually all of which had arrived by the end of the year.

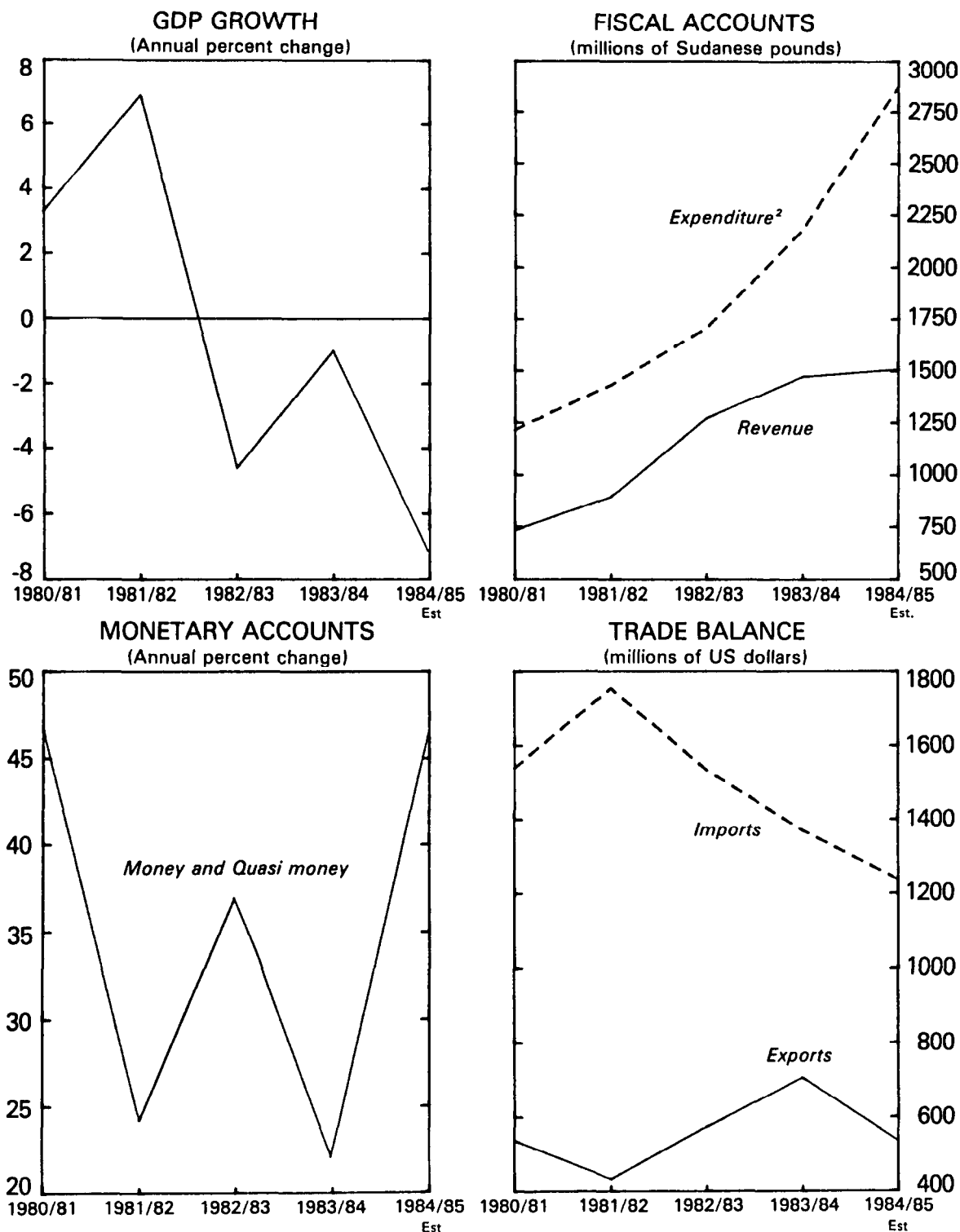
Agricultural production fell by some 20 percent in 1984/85. (Table 1), mainly as a result of the drought's effect on the rainfed agricultural areas. The 1984/85 output of dura (sorghum), the main staple food produced mostly in the rainfed areas, was only one third the level of three years earlier. Even production in the irrigated schemes was affected, as the low water level of the Nile and the scarcity of rain during the planting season led to declines in the cultivated area and in output, particularly of wheat, the second most important food crop.

Industrial output virtually stagnated and the value added of the construction sector declined significantly. These sectors were adversely affected by frequent electricity outages, and insufficient supplies of fuel, spare parts, and other inputs, as well as by labor disputes and political unrest. In addition, private sector activity, which was already at a very low ebb, suffered from the uncertainties created by the sudden institutional changes introduced since the fall of 1983. ^{2/}

^{1/} Sudan's national account statistics are subject to many limitations, including inadequate coverage as well as technical and organizational weaknesses in data compilation. Accordingly, the estimates should be interpreted with caution.

^{2/} These included the abolition of the limited liability form of business organization, cessation of enforcement of interest payment features of contracts, introduction of "Zakat" (wealth tax) to replace some of the traditional taxes, and the replacement of various penal and civil laws by those of Islamic Sharia. In addition, a state of emergency was declared in April 1984 which was lifted at the end of September 1984.

CHART 1 SUDAN ECONOMIC TRENDS¹



Source: Staff estimates based on information provided by the Sudanese authorities

¹The period covered is July-June for all periods except 1984/85 where the fiscal accounts cover the October-September period

²Excluding external interest payments

Table 1. Sudan: Output of Principal Commodities, 1983/84-1985/86

(In thousands of tons except cotton,
which is in thousands of bales)

	1983/84	1984/85	Proj. 1985/86
Agricultural commodities			
Irrigated areas:			
Cotton	1,148	1,065	864
Long-staple	(432)	(413)	(445)
Medium-staple	(716)	(652)	(419)
Groundnuts	180	257	111
Sorghum (dura)	359	422	664
Wheat	169	79	185
Rainfed areas:			
Cotton	19	9	17
Groundnuts	233	129	291
Sorghum (dura)	1,470	688	3,608
Sesame	206	133	228
Gum arabic	41	16	25
Manufacturing commodities			
Sugar	420	498	515
Cement	199	162	172
(Change in percent)			
Memorandum items:			
Agricultural production	-4.9	-19.8	33.2
Real GDP	-1.0	-7.0	8.4

Source: Staff estimates and projections based on information provided by the Sudanese authorities.

The execution of projects under the public investment program also slowed down with disbursements declining significantly in real terms. The implementation of the investment program was affected both by the suspension of aid disbursements for ongoing projects, due to the buildup of Sudan's arrears to certain creditors, and the continued disturbances in the southern part of the country.

The fall in resource availabilities and the famine conditions in a large part of the country, in combination with excessive money creation, led to a significant acceleration in inflation. Although the official consumer price index is not a reliable measure of the rate of inflation in the country, the increase of some 40 percent in the 12-month period ended September 1985 does indicate a significant buildup of inflationary pressures.

2. Fiscal developments

The past two years have witnessed some major institutional changes which have affected government finances. In early 1984, the Government decided to change the fiscal year from the traditional July-June period (which coincides with the crop production cycle) to one based on the Islamic (Hijri) year, taking effect with fiscal year 1984/85. Along with the change in the fiscal year, the authorities introduced a number of changes in the structure of the tax system. The Islamic Zakat was introduced, taking effect at the beginning of the 1984/85 fiscal year, replacing taxes on domestic income and production. As the year progressed and the critical nature of the revenue situation became apparent, many of the abolished taxes on domestic production were reinstated toward the end of November 1984 and a new social justice tax on personal incomes and business profits was introduced. ^{1/} In February 1985, further indirect tax measures were adopted, which included an increase in the customs valuation rate, higher import duties on tobacco and petroleum, and increases in taxes on domestic production of cigarettes.

While the above measures essentially restored indirect tax rates to the pre-September 1984 levels and reintroduced some of the traditional direct taxes, total revenue in 1984/85 was only about 2 percent higher than in 1983/84 (Table 2); this reflected the loss of revenue earlier in the year and the effects on customs receipts of lower imports and a change in their composition. Furthermore, nontax revenue fell significantly from its level in the previous year mainly reflecting lower contributions from public entities. Expenditure, on the other hand, continued to increase rapidly due in large part to the growth in current spending (excluding foreign interest payments), while development and equity expenditure, as well as actual payments of interest on foreign loans, were below their 1983/84 levels.

^{1/} Details of all the tax measures taken since September 1984 are given in the report on Recent Economic Developments, to be issued shortly.

Table 2. Sudan: Central Government Operations, 1983/84-1985/86 1/

(In millions of Sudanese pounds)

	1983/84	July-Sept. 1984	Prelim. Actuals 1984/85	9-1/2 mos. Actual Est. 1984/85	Budget 1985/86	Revised Budget 1985/86
Total revenue	1,474.4	357.4	1,510.2	1,195.6	1,576.0	1,644.0 2/
Tax revenue	1,246.8	309.2	1,307.2	1,034.9	1,348.0	1,416.0 2/
Nontax revenue	227.6	48.2	203.0	160.7	228.0	228.0
Expenditure 3/ 4/	2,529.4	671.9	3,542.0	2,804.1	3,245.5	3,379.5
Current expenditure 4/	1,986.1	573.1	3,034.4	2,402.3	2,557.5	2,691.5
Of which: foreign interest 4/	(348.0)	(1.0)	(706.0)	(558.9)	(612.5)	(612.5)
Development expenditure	463.3	98.8	456.0	361.0	638.0	638.0
Equity expenditure	80.0	—	51.6	40.8	50.0	50.0
Deficit (foreign interest on commitment basis) 3/	1,055.0	—	2,031.8	1,608.5	1,669.5	1,735.5
Change in arrears on foreign interest (increase -) 5/	-196.0	—	-587.0	-464.7	1,025.5	1,025.5
Deficit (on a cash basis) 3/	859.0	314.5	1,444.8	1,143.8	2,695.0	2,761.0
Financing 6/	859.0	314.5	1,444.8	1,143.8	-1,565.0	-1,228.0
External	633.0	88.3	1,018.5	806.3	-1,565.0	-1,228.0
Cash and commodity aid 7/	(450.0)	(57.0)	(798.0)	(631.7)	(916.0) 8/	(1,253.0) 8/
Project aid	(204.0)	(32.0)	(240.0)	(190.0)	(311.0)	(311.0)
Amortization	(-21.0)	(-0.7)	(-19.5)	(-15.4)	(-2,792.0)	(-2,792.0)
Falling due	[-704.6]	[...]	[-862.9]	[-683.1]	[-732.0]	[-732.0]
Debt relief on obligations falling due 9/	[503.0]	[...]	[148.6]	[117.6]	[--]	[--]
Change in arrears (reduction-) 10/	[180.6]	[...]	[694.8]	[550.1]	[-2,060.0]	[-2,060.0]
Domestic	226.0	226.2	426.3	337.5	...	...
Bank	(216.0)	(226.2)	(426.3)	(337.5)	(...)	(...)
Nonbank	(10.0)	(--)	(--)	(--)	(...)	(...)
Residual financing gap	==	==	==	==	4,260.0	3,989.0
Memorandum items:						
Deficit (including foreign interest on a commitment basis) (in percent of GDP)	(9.5)	(...)	(12.4)	(12.4)	(10.2)	(10.6)
Deficit (foreign interest on cash basis) (in percent of GDP)	(7.8)	(...)	(8.8)	(8.8)	(16.4)	(16.8)
Deficit (excluding foreign interest) (in percent of GDP)	(6.4)	(...)	(8.1)	(8.1)	(6.4)	(6.8)
Deficit (excluding foreign interest) (in millions of Sudanese pounds)	707.0	313.5	1,325.8	1,049.6	1,057.0	1,123.0

Source: Staff estimates based on information provided by the Sudanese authorities.

1/ For 1983/84, the fiscal year covered the period July to June. The 1984/85 fiscal year began September 26, 1984 and ended September 15, 1985. There was a transitional period of almost three months between the end of the 1983/84 fiscal year and the beginning of the 1984/85 fiscal year. The estimates included here for the transitional period and the 1984/85 fiscal year cover, respectively, the three months July 1 to September 30, 1984 and the period October 1, 1984 to September 30, 1985. The nine and a half month estimate for 1984/85 is prorated from the fiscal year estimate for purposes of comparison with the budget for 1985/86, which covers the period September 16, 1985 to June 30, 1986.

2/ Includes measures announced at the end of January 1986 which, by the authorities' estimates, will yield LSd 140 million in the last 5 months of 1985/86.

3/ Excludes externally financed defense expenditure.

4/ For the period July-September 1984, foreign interest is on a cash basis. For all other periods it is on the basis of commitments, i.e., foreign interest falling due during the year.

5/ Before debt relief.

6/ Includes both grants and loans.

7/ Estimated on the basis of receipt of domestic counterpart funds and, therefore, not on the same basis as aid in the balance of payments.

8/ Based on aid in the pipeline and domestic counterpart funds under collection.

9/ Includes relief on interest and principal falling due.

10/ Does not take into account debt relief on arrears outstanding at the beginning of the fiscal year.

Defense expenditure and unidentified operations 1/ were major factors in the growth of current spending, reflecting mainly the security situation in the South and the weakening of expenditure controls. Unidentified operations also reflected the impact of significant payments to cover the local cost of emergency food distribution and "compensation" payments to importers for domestic currency "losses" arising from the February 1985 devaluation. 2/

Reflecting these developments, the fiscal situation in Sudan weakened considerably with the fiscal deficit (excluding foreign-financed military outlays) increasing from 9.5 percent of GDP in 1983/84 to 12.4 percent in 1984/85. This deteriorating fiscal outturn led to a sharp increase in arrears on the domestic counterpart to foreign interest payments, as well as on principal payments, despite larger gross foreign financing of the budget. At the same time, government cash borrowing from the banking sector virtually doubled, amounting to LSd 426 million during the 12-month period 1984/85.

Toward the end of 1984/85, the new authorities took important steps to tighten financial discipline on government finances with the objective of eliminating the large-scale extrabudgetary operations. Instructions were issued to all government units to remain strictly within their budgetary appropriations and the Bank of Sudan was instructed not to finance the accounts of government spending units without prior approval from the Minister of Finance. At the same time, the authorities began to strengthen efforts to ensure that public enterprises make contributions to the budget. While it is difficult to quantify the effects of these measures it appears that they, indeed, reduced the level of extrabudgetary operations in the final months of 1984/85 which, in combination with the larger availability of foreign aid, led to a sharp reduction in government borrowing from the banking system in the last quarter of the fiscal year.

3. Monetary developments

Sudan's money supply increased by over 48 percent in 1984/85 (October-September) compared with 20 percent in the corresponding 1983/84 period (Table 3). 3/ The factors contributing to this rapid acceleration varied noticeably in each half of the fiscal year. The first six months of the year were marked in part by heavy government recourse to bank borrowing. By contrast, the domestic liquidity growth in the second half of the year reflected mainly borrowing by public entities, a substantial improvement in the bilateral account with Egypt, and an amelioration in the commercial banks' foreign asset position.

1/ Estimates of these operations are derived on the basis of differences between the financing data and the budgetary accounts and are subject to shortcomings.

2/ For details, refer to the report on Recent Economic Developments, to be issued shortly.

3/ Despite a number of revisions, Sudan's monetary data are still subject to limitations. An outline of these limitations is provided in Appendix III.

Table 3. Sudan: Factors Affecting Domestic Liquidity, 1/
1983/84-1985/86

	July 1983- June 1984	July 1984- June 1985	Oct. 1983- Sep. 1984	Oct. 1984- March 1985	April 1985- Sept. 1985	Oct. 1984- Sep. 1985	Oct. 1985- Sep. 1986 Projected 2/3/
Actuals							
Changes in Period (In millions of Sudanese pounds)							
Money and quasi-money	593.8	1,551.0	582.5	803.4	905.0	1,708.4	1,482
Domestic credit expansion	493.4	1,396.9	630.0	825.3	790.8	1,616.1	610
Claims on Government (net) 4/	216.0	709.3	355.1	491.1	-22.2	468.9	356
Claims on public entities 5/6/	97.2	145.3	96.6	20.6	346.9	367.5	413
Claims on private and specialized banks	258.9	291.8	296.0	239.9	13.3	253.2	464
Other items (net)	-78.7	250.6	-117.7	73.8	452.7	526.5	-623
Impact of external sector 6/	100.4	154.1	-47.5	-21.9	114.2	92.3	872
Changes in Period (In percent of broad money at beginning of period)							
Money and quasi-money	21.9	46.9	19.8	23.0	26.7 7/	48.4	26.0
Domestic credit expansion	18.2	42.2	21.4	23.6	17.7 7/	45.8	10.7
Claims on Government (net) 4/	8.0	21.4	12.1	13.7	-0.4 7/	13.3	6.2
Claims on public entities 5/6/	3.6	4.4	3.3	0.6	9.6 7/	10.4	7.2
Claims on private and specialized banks	9.5	8.8	10.1	6.7	1.1 7/	7.2	8.1
Other items (net)	-2.9	7.6	-4.0	2.6	6.6 7/	14.9	-10.9
Impact of external sector 6/	3.7	4.7	-1.6	-0.6	3.2 7/	2.6	15.3

Source: Staff estimates and projections based on information provided by the Sudanese authorities.

1/ Due to a number of revisions that have been made to the monetary statistics in an attempt to correct for data limitations, the estimates provided in the table are not strictly comparable to those presented in previous reports.

2/ Changes based on revised money supply stock of LSd 5,705 million as of September 30, 1985.

3/ Assumes no significant change in the exchange rate. Such a change, in addition to affecting the ex-ante credit requirement of various sectors in the economy, would alter the domestic currency valuation of residents' foreign currency accounts and the corresponding counter entry.

4/ Defined to include accrued arrears on charges on use of Fund resources for all periods except 1985/86.

5/ Incorporates credit extended to the public entities by the Bank of Sudan under Section 57-1-A of the Bank of Sudan Act. Extension of credit to other public entities is covered in the subsequent category.

6/ Does not take into account the effects of misrecording of matured letters of credit for which comprehensive information is not available. As a result of such misrecording, the data presented here may overstate foreign assets and understate claims on public entities.

7/ As percent of end-September 1984 broad money.

The Government's net borrowing from the banking system in the first half of 1984/85 amounted to the equivalent of 14 percent of broad money at the beginning of the period. This heavy recourse to bank credit reflected the decline in budgetary revenue, increased domestic expenditure, and lower budgetary support in the form of external assistance. By contrast, net government borrowing declined substantially in the second half as a result of the imposition of stricter budgetary controls by the new Government, and increased receipts of foreign aid. The reduction in the expansionary monetary impact of government operations was, however, offset by a significant increase in credit to public entities in the second half of the year. This was partly due to greater seasonal credit needs associated with higher costs of imported agricultural inputs, resulting from more depreciated exchange rates. The higher borrowing also reflected the difficulties faced by the Cotton Public Corporation (CPC) in marketing cotton and reducing its outstanding debt to the Bank of Sudan.

The expansion in domestic liquidity in 1984/85, due to borrowing by the Government and public entities, was reinforced by the expansionary impact of other items (net) and of the foreign sector. Other items (net) increased partly as a result of the revaluation in local currency of foreign currency accounts of residents following the February 1985 devaluation. The improvement in the net foreign assets of the banking system, despite Sudan's difficult foreign exchange situation, reflected partly the unusual and strong improvement in the balance on Sudan's bilateral account with Egypt due to large recorded exports of livestock to Egypt induced by the adverse weather conditions in Sudan. 1/ The expansionary impact of the external sector was also due to an improvement in the recorded net foreign asset position of commercial banks. 2/

4. Balance of payments and external debt 3/

Sudan continued to face serious balance of payments difficulties in 1984/85 when it recorded an overall deficit of US\$955 million, which was financed mainly by a further accumulation of arrears on external debt obligations. The deficit on the trade balance declined but this was achieved through a further compression of imports, as exports were lower than in the previous year (Table 4). Export receipts fell by 28 percent on account of lower revenues from both cotton and other agricultural products. Despite high cotton production in the irrigated

1/ A part of the improvement in the bilateral account is also believed to reflect some irregularities in the settlement of claims.

2/ As discussed in Appendix III, the improvement in the net foreign asset position of commercial banks may reflect classification problems, associated with the recording of liabilities on account of matured letters of credit. These problems may result in an overstatement of foreign assets and an understatement of claims on public entities.

3/ All balance of payments data cover the period September 16-September 15.

Table 4. Sudan: Balance of Payments, 1983/84-1985/86 ^{1/}

(In millions of U.S. dollars)

	Actual 1983/84	Prelim. 1984/85	Proj. 1985/86
Current account			
(excluding official transfers)	-903	-826	-787
Merchandise trade	-754	-678	-678
Exports	(651)	(469)	(557)
Cotton	[293]	[192]	[211]
Other	[358]	[277]	[346]
Imports ^{2/}	(-1,405)	(-1,147)	(-1,235)
Wheat and flour	[-117]	[-133]	[-110]
Petroleum	[-328]	[-325]	[-356]
Capital goods	[-328]	[-205]	[-272]
Other	[-632]	[-484]	[-497]
Services	-529	-598	-599
Interest obligations	(-459)	(-525)	(-524)
Other services (net)	(-70)	(-73)	(-75)
Receipts ^{3/}	[230]	[217]	[220]
Noninterest payments ^{3/}	[-300]	[-290]	[-295]
Private transfers (net)	380	450	490
Official transfers ^{2/}	281	404	382 ^{4/}
Cash and commodity	222	352	309
Project	59	52	73
Official capital flows	-367	-455	-361
Disbursements	127	76	249 ^{4/}
Cash and commodity	(48)	(3)	(165)
Project	(79)	(73)	(84)
Amortization	-494	-531	-610
Private capital and errors and omissions	125	-78	-77 ^{5/}
Overall balance	-864	-955	-843
Change in net foreign assets (- increase) ^{6/}	67	121	-292
Of which:			
IMF net	85	13	-292
Purchases	(101)	(--)	(--)
Repurchases	(-39)	(-5)	(-246) ^{8/}
Change in arrears on charges	(23)	(18)	(-46) ^{8/}
Debt relief	945	139	--
Net change in arrears ^{7/}	-148	695	-1,337 ^{8/}
1985/86 gap after "pipeline" aid and before debt relief	--	--	-2,472
1985/86 residual gap ^{9/}	--	--	-783

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

^{1/} Covering the September 16-September 15 period.

^{2/} Excludes imports and corresponding transfer payments on account of emergency food aid.

^{3/} Partly estimated.

^{4/} Disbursements from aid in the pipeline only.

^{5/} Reflects the discontinuation of the current practice of discounting export contracts.

^{6/} Excludes changes in liabilities on account of certain letters of credit for which information is not available.

^{7/} Excluding arrears on IMF repurchases and charges which are included in net foreign assets, but including arrears on interest and principal payments to the Trust Fund.

^{8/} Assumes full settlement of arrears outstanding as of September 15, 1985 detailed in Table 5.

^{9/} After debt relief on terms similar to those granted to Sudan in 1984.

schemes, reflecting in part the response to increased procurement prices, cotton exports declined by 34 percent as a result of the difficulties in marketing the crop and lower export unit values. The drought practically eliminated exports of groundnuts, reduced by over 50 percent receipts from sesame, and prompted a prohibition of exports of dura to mitigate domestic shortages of this basic staple. The collection and export of gum arabic were also adversely affected by the lack of drinking water in the harvesting areas. On the other hand, the drought led to an increase in livestock exports, reflecting distress sales. The decline in overall export receipts was offset to some extent by larger remittance inflows, induced in part by increased confidence in the new Government. This factor was also responsible for higher inflows of official cash and commodity assistance, which amounted to US\$295 million in the second half of 1984/85, compared with US\$60 million in the previous six-month period.

Sudan's overall external position in 1984/85 was again dominated by the burden of external debt payments. Total debt servicing (before rescheduling) during the year, including obligations to the Fund and arrears at the beginning of the period, exceeded US\$2 billion. In the absence of debt relief from bilateral creditors on obligations falling due in 1985 ^{1/} and reflecting the severe shortage of foreign exchange, Sudan accumulated further arrears. As a result, Sudan's total overdue external obligations to creditors amounted to an estimated US\$1.5 billion as of September 15, 1985 (Table 5). Arrears to the Fund at that time had grown to SDR 162 million, of which SDR 148 million represented arrears on repurchases and charges, and SDR 14 million overdue Trust Fund obligations. Actual debt service payments by Sudan during 1984/85 totaled some US\$210 million. Of this amount, an estimated US\$100 million constituted interest payments on short-term credits to ensure rollover of financing facilities. Multilateral institutions received the larger part of effected debt service payments on medium- and long-term obligations, including US\$45 million to the Fund. Most of the remaining payments were made to meet debt servicing on the rescheduled obligations to commercial banks.

5. Exchange and trade system

Substantial changes were made in Sudan's exchange and trade system during 1984/85. ^{2/} On February 12, 1985, the Sudanese authorities implemented a reorganization of the exchange system which resulted in the replacement of the three-tier exchange market system by a dual exchange rate system: an official rate, which was devalued from US\$1 = LSd 1.30 to US\$1 = LSd 2.50, and a commercial bank rate, which was expected to move in line with the underlying supply and demand conditions in the commercial bank market.

^{1/} For details of debt relief provided to Sudan in 1983 and 1984, refer to SM/83/54 (3/15/83) and SM/84/202 (8/16/84). Sudan has not concluded a number of the bilateral agreements under the 1984 Paris Club restructuring.

^{2/} For details on the exchange and trade system, refer to the report on Recent Economic Developments, to be issued shortly.

Table 5. Sudan: External Arrears and Debt Service Obligations, 1985/86

(In millions of U.S. dollars)

	Arrears as of September 15, 1985			Obligations Falling Due in 1985/86 1/			Total Obligations
	Prin.	Int.	Total	Prin.	Int.	Total	
International							
Institutions	<u>129</u>	<u>46</u>	<u>175</u>	<u>156</u>	<u>63</u>	<u>219</u>	<u>394</u>
IBRD/IDA	--	--	--	8	4	12	12
IMF	129	46	175	148	59	207	382
Regional							
institutions	<u>134</u>	<u>24</u>	<u>158</u>	<u>47</u>	<u>8</u>	<u>55</u>	<u>213</u>
African Development Bank/Fund	10	1	11	1	1	2	13
Arab Fund for Economic and Social Development	49 <u>2/</u>	10	59	12	3	15	74 <u>2/</u>
Arab Monetary Fund	36	8	44	25	2	27	71
EEC/EDF	1	--	1	1	--	1	2
Islamic Development Bank	28	1	29	--	--	--	29
OPEC Fund	7	1	8	6	--	6	14
Other	3	3	6	2	2	4	10
Arab National Funds	<u>60</u>	<u>27</u>	<u>87</u>	<u>28</u>	<u>9</u>	<u>37</u>	<u>124</u>
Abu Dhabi Fund	<u>27</u>	<u>14</u>	<u>41</u>	<u>10</u>	<u>4</u>	<u>14</u>	<u>55</u>
Kuwait Fund	16	8	24	8	3	11	35
Saudi Fund	17	5	22	10	2	12	34
Paris Club creditors	<u>88</u>	<u>131</u>	<u>219</u>	<u>112</u>	<u>131</u>	<u>243</u>	<u>462</u>
Other bilateral creditors 3/	<u>529</u>	<u>188</u>	<u>717</u>	<u>181</u>	<u>126</u>	<u>307</u>	<u>1,024</u>
Commercial banks	<u>110</u>	<u>30</u>	<u>140</u>	<u>219</u>	<u>87</u>	<u>306</u>	<u>446</u>
Short-term credits	--	--	--	--	100	100	100
Total 4/5/	<u>1,050</u>	<u>446</u>	<u>1,496</u>	<u>743</u>	<u>524</u>	<u>1,267</u>	<u>2,763</u>

Source: Staff estimates and projections based on information provided by the Sudanese authorities.

1/ September 16, 1985 to September 15, 1986.

2/ Includes US\$26 million of unpaid capital subscription.

3/ Includes OPEC countries, Eastern European countries, and other non-Paris Club official creditors.

4/ Excludes obligations in arrears to nonguaranteed suppliers which include an amount of US\$191 million which is under investigation regarding its legitimacy.

5/ Discrepancies between constituent figures and totals are due to rounding.

The official exchange rate, which applies to all exports and government receipts and payments, 1/ was pegged to a basket of currencies on August 12, 1985 on the basis of the prevailing rate of US\$1 = LSd 2.50, after which the rate fluctuated in the range of LSd 2.47-2.55 per U.S. dollar until end-September 1985. With the depreciation of the U.S. dollar in the international market however, the authorities reverted to a system of discretionary adjustments and the rate has been set at US\$1 = LSd 2.50 since late September 1985.

As regards the commercial bank exchange market, which covers private imports and transfers, there was only limited movement in the rate. The majority of banks maintained the Bankers' Association rate of US\$1 = LSd 3.30 (buying) adopted in April 1985. In practice, however, a large portion of the import transactions passing through this market effectively took place at the more depreciated black market rate. 2/ Specifically, "linked transactions" were taking place whereby importers acquired foreign exchange in the black market and sold it to the commercial banks at the more appreciated "bookkeeping" rate with the understanding that the bank would, in turn, resell the foreign exchange to the importers at the more appreciated rate (plus a spread), and open letters of credit for imports upon presentation of import licenses, thereby satisfying the legal requirements for import financing.

Sudan's nominal effective exchange rate, as measured by a trade-weighted index which takes account of the multiple exchange rates, depreciated by an estimated 42 percent in the 12-month period ended September 1985 (Chart 2). The depreciation reflected principally the February 1985 devaluation. In the absence of satisfactory cost and price data for Sudan, no reliable series for the real effective exchange rate could be derived. However, a limited indication of the general movement may be obtained from a series based on the consumer price index. Using this proxy, Sudan's real effective exchange rate depreciated by 21 percent in the 12-month period ended September 1985.

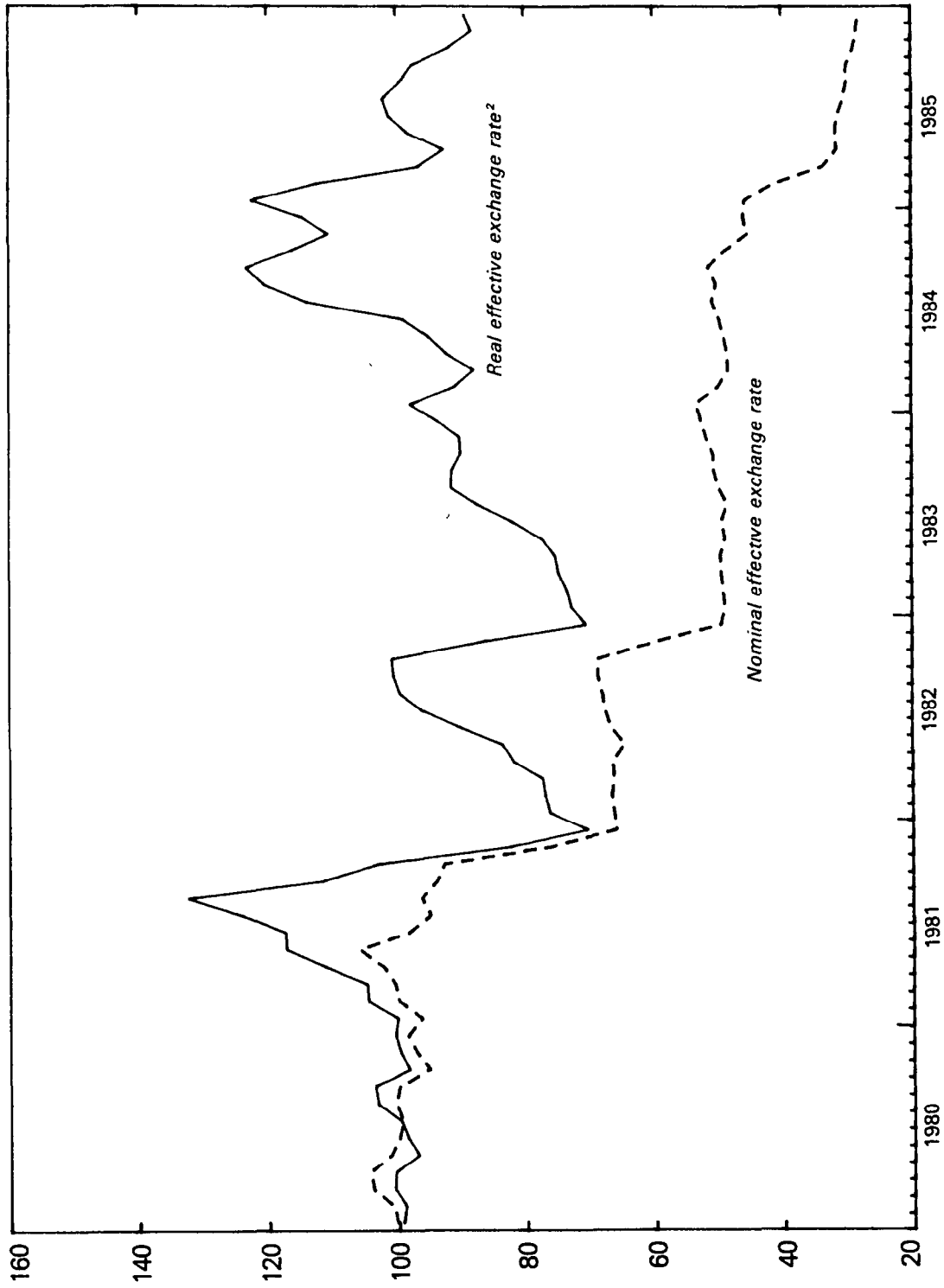
As regards Sudan's current payments system, the authorities imposed more stringent limitations on the opening of foreign exchange accounts by residents in view of the severe foreign exchange difficulties. In addition, the number of prohibited import items was increased from 40 to 108 and licensing procedures were tightened. 3/

1/ The accounting rate that is applied for the purpose of valuing the counterpart of commodity aid depends on the aid protocols with the individual countries and is more depreciated in the case of many commodities.

2/ The black market rate, which stood at US\$1 = LSd 4.10 in late September, depreciated sharply and was reported at around US\$1 = LSd 5.00 at end-January 1986.

3/ See the report on Recent Economic Developments, to be issued shortly.

CHART 2
SUDAN
EFFECTIVE EXCHANGE RATES¹
(1980 = 100)



Sources: Data provided by the authorities, /FS, and staff estimates

¹An increase in the index reflects an appreciation

²Based on consumer price index.

IV. Economic Prospects and Policies in 1985/86

In the context of a precarious economic situation characterized by severe internal and external imbalances, the staff discussed with the authorities the prospects for 1985/86 and the policies that need to be pursued to address the country's serious economic problems. The authorities and the staff agreed that these policies must lay emphasis both on supply promotion and on demand management, and that the short-term policies need to be formulated in the context of a medium-term framework. It was also fully recognized that in view of the substantial accumulation of external debt, the domestic adjustment efforts would need to receive the support of the international community through financial assistance in the form of debt relief and foreign aid on exceptional terms, if domestic policies were to be effective in promoting medium-term economic and financial viability.

1. Supply-related policies

The favorable weather conditions experienced this year are expected to lead to a significant recovery in agricultural production in the rainfed subsector. To reinforce this, the Government is implementing policies to ensure adequate producer prices, a satisfactory supply of inputs and financing, and in general, is assisting the farmers in the expansion and marketing of production. As regards agricultural producer prices, the procurement price for gum arabic has been increased by 77 percent, while the floor prices for groundnuts and sesame have been raised by 15 percent and 41 percent, respectively. Moreover, the authorities are taking steps, through market purchases by the Agricultural Bank, to support dura prices, which have declined sharply as a result of this year's bumper crop. As regards cotton, the authorities have announced procurement prices which maintain producers' incentives at an appropriate level. Prices for the 1985/86 season have been set at 57 percent and 40 percent above the previous season's prices for long- and medium-staple cotton, respectively. The staff noted that at the current official exchange rate, these prices would involve a "loss" of over LSd 100 million which, if not covered through a budgetary allocation, would result in a further increase in the cotton marketing company's indebtedness to the Bank of Sudan. In the area of agricultural costs, the staff emphasized the need to move toward full cost recovery in the major agricultural schemes--a policy strongly recommended by the World Bank staff. In this context, the 30 percent increase in the land and water charges announced for the current season is insufficient since it implies a reduction in the real charges for the services. The authorities stressed their commitment to the principle of full cost recovery but noted the socio-political difficulties involved in increasing charges by 60 percent, as recommended by the Fund and Bank staff.

While fully recognizing the importance of appropriate pricing policy for the expansion of output and exports, the Sudanese authorities believe that the exploitation of the agricultural potential also crucially depends on timely and adequate availability of inputs and

spare parts, rehabilitation of various agricultural projects, and improvements in infrastructure. In view of the foreign exchange difficulties, the authorities believe that this can only be ensured through the provision of debt relief and foreign aid by the international community of a magnitude and composition sufficient to cover the balance of payments gap.

As a result of favorable weather conditions and improved pricing policies, and assuming the availability of the necessary inputs in a timely manner, agricultural output is expected to recover by 33 percent in 1985/86, thereby contributing to a large growth in real GDP.

As regards the manufacturing sector, the growth of industrial output has been inhibited by several factors, including (a) poor performance of the public entities; (b) low rates of domestic saving and investment; (c) an unstable environment; (d) inadequate infrastructure; (e) a scarcity of foreign exchange for importation of spare parts and raw materials, and (f) extensive price and profit controls. The Government intends to revitalize the manufacturing sector by improving the efficiency of units in the public sector, and creating an attractive environment for investment and industrial activity. In the case of the parastatal sector, the Government, assisted by the World Bank, is currently reviewing the performance of the public entities with a view to improving their financial and economic position. To this end, the authorities intend to strengthen the entities' financial management through the granting of greater operational autonomy and the adoption of adequate monitoring procedures. In addition, rehabilitation and restructuring programs will be developed for a number of the larger, potentially viable, industrial enterprises.

The staff has discussed with the authorities the need to relax, within the overall supply-side policies, the price and profit controls currently prevailing in Sudan. ^{1/} These controls have tended to affect adversely the productive capacity of the economy by reducing the revenue potential of enterprises, and limiting their capacity for investment and maintenance of the necessary working capital. As a result, unit costs of production have increased, both in absolute terms and relative to unit revenues, thereby further discouraging domestic production activities already constrained by inadequate infrastructure, inappropriate exchange rates, and shortages of essential inputs. In some cases, these controls, while designed to protect consumers, have, in effect, resulted in higher prices as the limited supply of goods at the controlled rates has often been supplemented by purchases from the black market; this, in turn, has benefited the intermediaries at the expense of both producers and consumers. In this context, the staff recommended to the authorities the abolition of controls except those on a limited number of commodities deemed to be of "strategic importance"

^{1/} Details of the operation of these controls are contained in Appendix I of the report on Recent Economic Developments, to be issued shortly.

and to streamline the procedures applicable to these commodities so as to ensure that the system does not discourage production. The authorities recognize the adverse impact of the prevailing controls and stated their intention to proceed toward their liberalization. However, in January 1986, steps were taken to strengthen the operations of marketing boards, including the restoration of monopsony power to the oil seed crushing corporation. In response to the staff's reservations, the authorities noted that these steps are transitional and are intended to address the problem of scarcity currently facing the country.

2. Budgetary policy

The new Government, which took office in April 1985, set about strengthening financial controls with a view to eliminating extrabudgetary spending and restraining the growth in other current expenditure. Having achieved some success in this regard in the last quarter of the previous fiscal year, the authorities set initial spending targets for 1985/86 at levels that allowed for only a 17 percent nominal increase in total expenditure (excluding foreign interest payments). This was to be achieved basically by restraining defense outlays and eliminating extrabudgetary operations. Thus, while current expenditure other than on defense, extrabudgetary operations, and contingencies, was budgeted to grow by 31 percent, defense spending was to be reduced by 11 percent from its 1984/85 level, and extrabudgetary operations, which constituted 33 percent of other current expenditure in 1984/85, were expected to be totally eliminated. The containment of defense spending, which in the past has also accounted for a significant share of extrabudgetary operations, to the budgeted level in 1985/86 was predicated on (a) progress in the settlement of the civil disturbances in the South; (b) larger availability of external defense assistance, and (c) the imposition of a greater degree of budgetary discipline on military spending. In light of the uncertainties and the prominent role in expenditure containment assigned to the elimination of extrabudgetary operations, the authorities also provided for a "contingency" amounting to about 17 percent of current expenditure.

The expenditure targets had indicated that even with the envisaged spending restraint, a major fiscal imbalance was in prospect for 1985/86 without additional revenue efforts. In the absence of new revenue measures, the deficit (excluding foreign-financed military outlays) would have amounted to LSd 1.9 billion (11.6 percent of GDP), compared with LSd 2.0 billion (12.4 percent of GDP) in 1984/85. With the authorities' intended reduction in arrears on interest payments, a total net financing requirement of LSd 2.9 billion (17.8 percent of GDP) was envisaged. Taking into account external amortization obligations (including settlement of outstanding amortization arrears) and

foreign assistance already in the pipeline, the budget contained a residual financing requirement of LSd 4.3 billion; however, exceptional external assistance in line with that needed to close the balance of payments gap was expected to fill all but LSd 520 million of this requirement.

Following discussions with the staff, the authorities decided to raise revenues from new measures amounting to LSd 320 million, leaving the balance of LSd 200 million, which was to be financed by borrowing from the banking system. Based on the recommendations of a fiscal technical assistance mission from the Fund, the authorities adopted a number of revenue measures yielding LSd 230 million. These measures included increases in tax rates on soft drinks, cement, airline tickets, and hotel services; the introduction of a new tax on telephone and telecommunication services; restoration of taxes on income and business profits, which had been abolished in September 1984, and the institution of a current payments system for the tax on business profits. In addition, the authorities decided to impose a surtax on banks and insurance companies.

During the months following the introduction of the budget and these measures, the fiscal outlook deteriorated markedly. Preliminary data indicate that government cash borrowing from the banking system amounted to LSd 275 million in the period October-December 1985. The large recourse to bank financing by the Government reflected, in addition to the slow progress in the implementation of revenue measures, substantial expenditure overruns, partly on account of the intensification of the conflict in the South. In January 1986, the authorities re-evaluated the budgetary situation for 1985/86, in consultation with the staff, and concluded that if government borrowing from the banking system was to be limited to the amount already incurred (LSd 275 million) in the first quarter of the year, revenue measures yielding LSd 220 million in the remainder of the fiscal year needed to be implemented. The authorities, however, could only implement measures which, according to their own estimates, would yield some LSd 140 million in the remainder of the fiscal year. These measures, implemented on January 31, 1986, included the introduction of two-tier markets for sugar, benzine, and gas oil, with part of the supplies being sold at prices above the then prevailing prices. In addition, the authorities indicated that the contribution of Zakat revenue to the central budget would be higher than expected earlier and that additional budgetary resources would be obtained from both collections from the existing windfall profits tax on cotton and gum arabic exports, and higher cotton seed prices. The staff expressed some reservations as to the practicality, desirability, and yield of a number of these measures. The staff also noted that in the absence of further actions, and based on the authorities' own estimates of the recent measures, government borrowing in the fiscal year would be considerably higher than the original target of LSd 200 million established in October. Moreover,

the staff noted that the substantial external aid programmed in the budget was unlikely to materialize in the absence, inter alia, of further budgetary efforts and a Fund-supported package of policies, which in turn would lead to more bank borrowing by the Government and/or an accumulation of external arrears.

The authorities and the staff also discussed the medium-term budgetary prospects and attempted to identify the policy measures that could be adopted to strengthen the fiscal situation. It was agreed that the financial controls recently introduced should be continued and, indeed, strengthened. There was also a need for a broadening of the revenue base and improving the elasticity of taxes so as to move toward medium-term viability in the budget. The most important medium-term goal for the tax system was to widen its currently narrow base and, in particular, to introduce appropriate levels of taxation at the provincial and regional levels. This should involve a higher share of the tax burden being borne by the agricultural sector. Similarly, the net contribution to the budget of parastatal enterprises needed to be substantially increased. As regards the existing taxes, the staff mentioned the desirability of adjusting certain elements (such as specific tax rates and the customs valuation rate) in an adequate and timely manner; similarly, there was a need to make nontax revenue collection more elastic through, inter alia, appropriate adjustments in fees and charges.

3. Monetary policy

In view of the rapid monetary expansion recorded in the past several years, the staff stressed to the authorities the need to curtail monetary growth. Preliminary data indicate that for the quarter ended December 1985, Sudan's money supply grew by 10 percent, compared with a target of 20 percent established in October for the 12-month period ending September 1986. This continued rapid growth of liquidity reflected mainly the deteriorating budgetary position and the inability of the Sudan Cotton Company (previously CPC) to retire seasonal credit due to difficulties in the marketing of the cotton crop. The Sudanese authorities indicated that they recognized the importance of monetary restraint as an essential element for moderating internal financial imbalances. For this purpose, in addition to the fiscal measures aimed at reducing government recourse to bank borrowing discussed in the previous section, the authorities intend to follow a tight credit policy for the public entities and the private sector. This tightening would be undertaken without compromising credit requirements for genuine production and trading activities. In this context, the authorities, with the assistance of the staff, have projected credit requirements of various public sector entities and of the private sector on the basis of a detailed analysis that took into account, inter alia, the anticipated recovery in domestic economic activity and the higher level of exports, as well as the working capital and seasonal credit requirements of the productive sectors. However, in order to implement effectively the

credit program, the authorities will need to impose strict discipline on the retirement of the public entities' seasonal credit and ensure that the sectoral priorities for private sector credit are observed by the banks within their overall ceilings. Effective implementation of the credit program for the public entities and the private sector, in combination with the observance of the proposed limit on government borrowing, would lead to a deceleration in monetary expansion from about 50 percent in 1984/85 to about one half that rate in 1985/86-- this compares with the initial target of 20 percent established in October. As noted earlier, however, in light of the uncertainty relating to aid availability, the staff believes that the rate of monetary expansion could well be in excess of the revised target.

Real rates of returns on financial savings and charges on borrowings in Sudan have been significantly negative for a number of years, thereby adversely affecting the process of financial intermediation. Moreover, the process was further weakened by the institutional changes introduced in 1984/85. It is in this context that the staff stressed the importance of establishing a stable system of financial intermediation without any prejudice as to its character. Similarly, the staff emphasized the importance of positive real rates of return on savings and charges on borrowings for the promotion of savings and efficient allocation of loanable funds. The authorities agreed that institutional stability and certainty are important for financial intermediation and gave indications that they will adopt appropriate measures to achieve this objective. As regards policies to achieve positive real rates, the authorities mentioned a number of institutional, cultural, and economic factors that limit the allocative functions of these rates in a country like Sudan. These include underdeveloped banking habits, the existence of a substantial nonmonetized sector, a low elasticity of savings and investment with respect to rate changes, and limited investment opportunities in general.

4. External sector prospects and policies

a. Balance of payments prospects in 1985/86

Staff projections, prepared in collaboration with the Sudanese authorities, point to a 19 percent improvement in export receipts occasioned by the recovery in agricultural exports associated with more favorable weather conditions, and higher cotton export volumes which would more than offset the projected decline in export unit values (Table 4). As regards imports, the authorities and the staff estimated requirements which, inter alia, would relieve some of the production constraints by ensuring a more adequate supply of current inputs and capital goods. The resulting import level, estimated to be some 8 percent above the suppressed level of the previous year, in association with projected export receipts, would result in a deficit on Sudan's trade balance of the same level as that recorded in 1984/85 (Table 6).

Table 6: Sudan: Balance of Payments Gap, 1985/86

(In millions of U.S. dollars)

	Sept. 16, 1985- Sept. 15, 1986
Exports, f.o.b.	557
Imports, c.i.f.	-1,235
Net services (excluding interest)	-75
Net private transfers	490
Debt service	-2,840
Obligations overdue at beginning of period	(-1,496)
Interest	[-446]
Amortization	[-1,050]
Obligations falling due during the period	(-1,267)
Interest	[-524]
Amortization	[-743]
Other <u>1/</u>	(-77)
Financing gap	-3,102
1. Aid flows in the pipeline <u>2/</u>	630
Cash and commodity aid	(473)
Project	(157)
2. Debt relief <u>3/</u>	1,689
3. Residual gap	783

Source: Staff estimates and projections based on information provided by the Sudanese authorities.

1/ Reflects the discontinuation of the current practice of discounting export contracts.

2/ Disbursements from commitments outstanding as of January 15, 1986 only. No estimate has been made of the "normal" aid flows in 1985/86 due to the prevailing uncertainty in the country's external relations and the difficulty in distinguishing between "normal" and "additional" aid.

3/ The calculations are provided for illustrative purposes and are based on the assumption that all bilateral creditors, including Kuwait and Saudi Arabia, reschedule in 1985/86 on 1984 Paris Club terms. In 1984 Kuwait and Saudi Arabia granted complete relief on all debt service obligations which implies more generous terms than those assumed for the 1985/86 rescheduling. As regards commercial banks, the 1985/86 rescheduling is based on the terms specified in the document agreed in October 1985.

Receipts of workers' remittances are expected to increase by 9 percent, in line with the trend observed since the government changeover in April 1985. Accordingly, the current account deficit, excluding foreign interest and official transfers, could decline from US\$301 million in 1984/85 to US\$263 million in 1985/86.

The overall balance of payments outlook is again dominated by Sudan's debt servicing obligations. As noted earlier, Sudan's external arrears amounted to an estimated US\$1.5 billion at the beginning of 1985/86. Moreover, debt servicing on account of obligations falling due during the year (before rescheduling) is projected at some US\$1.3 billion. As a result, Sudan's overall balance of payments gap before external aid amounts to US\$3.1 billion. Disbursements from cash, commodity, and project aid in the "pipeline" (as of January 15, 1986) are estimated at US\$630 million. Scheduled disbursements from the Socialist People's Libyan Arab Jamahiriya and the United States account for the majority of the pipeline commodity aid. In addition to normal project financing, the Arab Funds are to provide resources estimated at some US\$145 million for the local cost component of some projects, thereby supplying the Bank of Sudan with the foreign exchange necessary to repay a bridge loan extended to settle Sudan's debt obligations to these Funds. Debt rescheduling by official bilateral creditors and commercial banks ^{1/} on terms broadly comparable to those obtained by Sudan in 1984 would provide total debt relief of some US\$1.7 billion in 1985/86. This, in association with full disbursement of pipeline aid, could reduce Sudan's overall payments gap to US\$783 million. A substantial part of this residual gap would need to be covered by aid in the form of cash and extraordinary debt relief, due to both the nature of the country's external payments requirements and the constraints on what Sudan can absorb in commodity aid. Should Sudan be unable to secure appropriate debt relief and the required external assistance, significant shortfalls are likely to appear with respect to debt servicing. In effect, in light of Sudan's severe shortage of foreign exchange, the authorities have in the past tended to utilize available finance to secure essential imports, and to confine their debt servicing essentially to short-term trade related obligations.

^{1/} A debt restructuring agreement was reached between Sudan and the commercial banks in October 1985 resulting in estimated debt relief of US\$406 million for 1985/86. The agreement affects Sudan's outstanding medium- and long-term debt to these banks, which was consolidated into two loans. The first loan covers all obligations with the exception of interest accrued as a result of the 1982, 1983 and 1984 consolidations, which was capitalized; this interest is covered by the second loan. Both loans carry the same grace period and repayment schedule (17 quarterly installments, starting April 1988). The first loan bears a 1-3/4 point spread over LIBOR, while the spread on the second loan is 1-1/4. The agreement allows for the currency denomination of rescheduled debt to be switched from U.S. dollars to Swiss francs, and for the capitalization of a portion of the interest obligations falling due in 1985/86.

b. Exchange rate policy

Exchange rate policy has been a subject of thorough discussions between the Sudanese authorities and the staff, and was discussed again in the context of the 1985 Article IV consultation. The staff believes that Sudan should move at a rapid speed toward a unitary rate at a realistic level so as to promote efficient resource allocation, expand production and exports, and contain imports and domestic absorption. To this end, the staff has advocated freedom of movement in the commercial bank exchange rate in line with the forces of supply and demand, which will encourage remittances and increase availability of foreign exchange resources for private sector imports. At the same time, the staff has urged that the official rate be moved so as to initially reduce, and subsequently eliminate, the differential between the commercial bank rate and the official rate in a relatively short time.

While agreeing, in principle, on the objective of unification of the rates, the authorities believe that it should be achieved more gradually, given the circumstances of Sudan. In their view, financial stability and effective demand management should precede exchange rate adjustment. The authorities are also not convinced of the merit of a sharp depreciation of the Sudanese pound in a short period of time. Their main arguments are that (a) past devaluations were not successful; (b) the country cannot absorb the shock of frequent or large-scale changes in the exchange rate; (c) the production structure, marketing conditions for exports, and the import regime will limit effects on exports and imports arising from price changes; and (d) the reduction in domestic absorption could be better achieved through other demand-management policies. The authorities also believe that remittances are not elastic to exchange rate changes and that, in fact, depreciation could reduce them via income effects.

Notwithstanding the difference in perception between the staff and the authorities on the role of the exchange rate in the Sudanese economy in general, the authorities are aware of its importance for determining the competitiveness of particular exports; accordingly they recognize that the country must follow a flexible exchange rate policy, particularly to ensure competitiveness of exports. Even from this limited perspective of export competitiveness however, recent staff evaluations indicate that the official rate needs to be adjusted in order to maintain adequate price incentives for exports without resorting to budgetary subsidies and/or increased bank financing.

As regards the commercial bank rate, the authorities introduced a number of changes on January 30, 1986 relating to the operation of the market. A committee, composed of representatives of seven commercial banks, was established to determine the exchange rate which was henceforth binding on all banks, and set the initial rate at LSd 3.30/3.35 per U.S. dollar, equal to the rate prevailing previously. The committee

was also empowered to pool all foreign exchange purchased by the banks and allocate it according to established priorities. The previous system of "linked transactions" for import financing was effectively prohibited. In addition, the January measures prohibited "physical possession" of foreign currency by individuals in excess of US\$2,000.

The authorities believe that the changes in the commercial bank market will allow the banks to compete more effectively with the illegal currency dealers and thus capture a substantial share of resources currently flowing through the dealers. The staff has serious reservations as to the appropriateness of the scheme and its effectiveness in attracting the necessary resources to the banking system; a reduced availability of remittances to finance private imports could adversely affect production. The staff is in the process of collecting more information on the operation of the new system.

V. Medium-Term Balance of Payments Projections

Sudan's medium-term external prospects, in addition to being dependent on exogenous factors such as weather conditions and the availability of foreign aid, will be crucially determined by domestic policies affecting production, investment, consumption, and prices. On the assumption of favorable weather conditions, adequate support from the international community, and the pursuit of appropriate economic and financial policies by the Sudanese authorities, Sudan's real GDP could grow at an annual average rate of 4 percent over the period 1986/87-1988/89; growth could accelerate thereafter provided that petroleum production comes on stream. 1/ Such growth would require, inter alia, sustained policies aimed at the rehabilitation of productive capital, the promotion of new productive investment, and the limitation of public and private consumption. More specifically, the staff has assumed (a) the adoption of appropriate switching policies which would contribute to a shift in production toward exportables and result in a 7 percent annual increase in noncotton export volumes (excluding petroleum); (b) a moderate annual increase in cotton production combined with a recovery in cotton prices; 2/ (c) crude oil exports of 70,000 b/d commencing in 1989/90; (d) an increase in

1/ Work on the oil pipeline has been delayed by the civil unrest in the southern part of the country. For the purpose of the medium-term scenario, it is assumed that work will resume by end-1986, and that initial production will amount to 70,000 barrels per day (b/d). The authorities believe that production could commence at 100,000-150,000 b/d. Under the terms of the petroleum production agreement, and on the basis of World Economic Outlook assumptions regarding petroleum prices, exports would be US\$170 million higher in 1990/91 than projected here if the production level amounts to 100,000 b/d compared to the 70,000 b/d assumed.

2/ Stagnation of cotton export unit values would increase the deficit on the overall external accounts by about US\$70 million in 1990/91.

imports in line with GDP growth and the estimated income elasticity of demand for imports; (e) a shift in the composition of imports toward intermediate goods, induced by prudent demand-management policies; (f) a 2 percent real growth in private transfers in line with recent trends and the adoption of appropriate policies in the areas of exchange rate, financial intermediation, and in the investment climate, ^{1/} and (g) availability of concessional financial assistance, in the form of debt relief and cash and commodity aid, to close the balance of payments gap without, at the same time, contributing significantly to the already heavy burden of external debt (Table 7).

On the basis of the above assumptions relating to Sudan, and World Economic Outlook assumptions with regard to the world economy, the staff has, in consultation with the Sudanese authorities, attempted a quantification of the balance of payments prospects for the period up to 1990/91 (Table 8). This scenario indicates a gradual improvement in the balance on the current account (excluding official transfers and foreign interest) for the period 1986/87-1988/89. With the start of petroleum exports, the current account deficit (excluding official transfers and foreign interest) would fall substantially with effect from 1989/90. Accordingly, the overall external gap before foreign aid would be reduced to US\$1,196 million in 1990/91. It needs to be reiterated that this medium-term scenario is based on the assumption of (a) favorable weather conditions and cessation of civil disturbances in the South; (b) sustained adjustment efforts on the part of the Sudanese authorities; and (c) net resource transfers to Sudan from abroad.

VI. Staff Appraisal

The economy of Sudan, which in the previous several years had been operating on a very fragile basis, suffered further setbacks in 1984/85. While the drought led to a decline in national output for the third consecutive year, and imports had to be curtailed further in view of the precarious balance of payments position, the financial situation worsened with a sharp expansion in money supply caused mainly by a deterioration in the central government finances and increased credit extension to the public entities. The growing imbalance in supply and demand conditions led to an acceleration in inflation and intensification of pressures on the balance of payments. This general economic deterioration reflected failure to implement effectively appropriate economic policies, political uncertainty, and social tensions, as well as natural factors such as the drought, and external factors such as disruptions in the availability of foreign aid, particularly in the first half of the year.

^{1/} For every 1 percent change in the assumed growth of transfers, the overall external payments gap would change by about US\$30 million in 1990/91.

Table 7. Sudan: External Public Debt Service, 1985/86-1990/91

(In millions of U.S. dollars)

	1985/86 Sept. 16- Sept. 15	1986/87 Oct.-Jun.	1987/88	1988/89 July-June	1989/90	1990/91
Principal <u>1/</u>	1,464	420	558	722	692	654
International and regional institutions	466	156	159	129	101	80
Paris Club creditors	200	104	144	153	161	158
Other official creditors	798	160	200	194	184	170
Others	-- <u>2/</u>	--	55	246	246	246
Interest <u>2/</u>	892	390	524	498	471	439
International and regional institutions	140	39	46	32	23	20
Paris Club creditors	262	112	90	82	74	64
Other official creditors	350	95	126	105	85	70
On new disbursements	--	40	79	105	133	158
Others	140 <u>2/</u>	104	183	174	156	127
Total debt service obligations	2,356 <u>2/</u>	810	1,082	1,220	1,163	1,093
Memorandum items:						
Debt service ratio (in percent) <u>1/3/</u>	(303) <u>2/</u>	(139)	(124)	(128)	(98)	(83)
IMF repurchases (SDR million) <u>1/</u>	227	106	116	73	56	26
IMF charges (SDR million) <u>1/4/</u>	92	23	28	18	12	7
Trust Fund obligations (SDR million) <u>1/5/</u>	28	8	14	11	6	1

Source: Staff estimates and projections based on information provided by the Sudanese authorities.

1/ Including obligations in arrears which are assumed to be settled in 1985/86.

2/ After rescheduling with commercial banks resulting in estimated debt relief of some US\$406 million in 1985/86.

3/ As a percent of exports of goods and nonfactor services.

4/ Including projected SDR charges.

5/ Covers both interest and repayments.

Table 8. Sudan: Medium-Term Outlook for the
Balance of Payments, 1985/86-1990/91

(In millions of U.S. dollars)

	1985/86 Sept. 16- Sept. 15	1986/87 Oct.-Jun.	1987/88	1988/89	1989/90	1990/91
				July-June		
Exports	557	449	671	736	906	1,006
Cotton	211	157	236	252	278	307
Petroleum	--	--	--	--	91	103
Other	346	292	435	484	537	596
Imports	-1,235	-971	-1,339	-1,413	-1,531	-1,659
Services, excluding interest	-75	-59	-81	-84	-87	-90
Private transfers	490	384	542	573	606	640
Current account, excluding interest	-263	-197	-207	-188	-106	-103
Debt service <u>1/</u>	-2,433	-810	-1,082	-1,220	-1,163	-1,093
On existing obligations	-1,000 <u>2/</u>	-770	-1,003	-1,115	-1,030	-935
Principal	(-524) <u>2/</u>	(-420)	(-558)	(-722)	(-692)	(-654)
Interest	(-476) <u>2/</u>	(-350)	(-445)	(-393)	(-338)	(-281)
On new disbursements	--	-40	-79	-105	-133	-158
Arrears reduction	-1,433 <u>2/3/</u>	--	--	--	--	--
Gap before external finance	-2,696 <u>4/</u>	-1,007	-1,289	-1,408	-1,269	-1,196
<u>Memorandum item:</u>						
Real GDP growth (in percent)	8.4	4.5	3.5	3.5	4.5	4.5

Source: Staff estimates and projections based on information provided by the Sudanese authorities.

1/ Incorporates debt servicing on account of the 1985 debt restructuring agreement with commercial banks.

2/ After rescheduling with commercial banks.

3/ Includes a reduction in trade credit lines (US\$77 million) reflecting the discontinuation of the practice of discounting export contracts.

4/ The difference between this gap and that reported in Table 6 reflects the treatment of the commercial bank rescheduling which results in an estimated debt relief of some US\$406 million in 1985/86.

The immediate, and in certain ways the most daunting, economic challenge facing the country in 1984/85 was a large-scale famine. The combined efforts of the Sudanese Government and the international community, aided by the return of adequate rainfall, have succeeded in containing human suffering and loss of life. With the easing of the immediate problem, the emphasis needs to shift to addressing structural weaknesses in the agricultural sector and improving infrastructure so as to reduce the country's vulnerability to the vagaries of nature.

The staff has, during the past several years, pointed out that Sudan's economic and financial problems are of a structural nature and that their resolution requires early implementation of a medium-term strategy designed to expand output, contain demand, and change relative prices so as to encourage exports and import substitution. The most fundamental financial imbalances that need to be tackled are in the budget and the balance of payments. Budgetary prospects for 1985/86 are indicative of the magnitude of these imbalances. Thus, even after the substantial revenue and expenditure measures taken recently, the country's budgetary revenue is projected to cover around one half of total expenditure (including interest on a commitment basis). In the case of the balance of payments, exports are projected at less than one half of the already compressed import level, while the scheduled debt service obligations, without taking account of the settlement of the outstanding arrears, exceed expected receipts from exports and aid in the pipeline. The outstanding external arrears are almost three times the estimated export receipts of the country for 1985/86 and constitute about 20 percent of the GDP.

Notwithstanding the inherently difficult nature of the structural imbalances, the staff believes that the country could have the potential to resolve them in the medium term. However, for this potential to be realized, a number of conditions must be fulfilled. These include (a) persistent and determined pursuit of both short-term adjustment policies and medium-term structural reforms by the Sudanese authorities; (b) restoration of conditions suitable for completion of development projects in the South and major rehabilitation projects throughout the country, and (c) commensurate support of the international community in the form of extraordinary debt relief and aid. The policy package to be pursued by the Sudanese authorities should concentrate on the following major areas (a) the expansion of agricultural output on a sustained basis; (b) the rehabilitation of industries; (c) the promotion of savings and investment in the private sector; (d) the mobilization of resources in the public sector; (e) the containment of demand through a considerable slowdown in the rate of monetary expansion, and (f) the expansion of exports and encouragement of remittances.

The staff believes that the authorities have adopted some appropriate measures in 1985/86 to assist agricultural recovery, which should also benefit from the favorable weather conditions. Specifically, the Government has ensured adequate price incentives for cotton production, priority is being given to securing and providing the

necessary agricultural inputs, the cotton marketing difficulties are being addressed and, from a long-run perspective, awareness is being shown of the importance of the rehabilitation of projects and infrastructure in the rural areas. The problems of the manufacturing sector are more difficult, but attempts are being made to reform public enterprises in order to improve their performance and remove bottlenecks affecting industries in the private sector. As for the promotion of private sector savings and investment, the authorities intend to formulate and implement policies to restore institutional stability for financial intermediation. It is equally important that the authorities take steps to move toward positive real rates of return on savings and charges on borrowing. Similarly, implementation of policies to free the private sector from unnecessary and, in many cases, ineffective controls on prices and profitability would contribute to a more conducive production environment. In short, the staff believes that effective and sustained implementation of measures to encourage private savings and investment are essential to achieve a sound and sustainable basis for expansion in industrial production.

Resource mobilization in the public sector is required both from the point of view of short-term stabilization and long-term structural reform. Although the authorities have taken expenditure control and new revenue measures in the context of the 1985/86 budget, the staff believes that these measures are insufficient to address the problems of fiscal imbalance and thus to reduce significantly government borrowing from the banking system. It is important that the authorities strengthen their effort to contain the budget deficit, as well as limit bank credit to the public entities, in order to reduce the rate of monetary expansion in 1985/86 from the high level of the previous year.

In the case of public finances, past experience indicates that new budgetary measures tend only to arrest further erosion in the revenue base caused by the inelastic tax structure. The medium-term requirement, however, is for the revenue/GDP ratio to rise sharply from the existing low level. This would require early adoption of fundamental fiscal reforms to expand the revenue base and improve tax elasticity. The staff believes that there is considerable scope for taxation at the regional and provincial levels; these opportunities must be exploited to reduce the need for transfer of resources from the center to these layers of government. Similarly, the financial performance of the parastatals should be improved, initially to reduce their nonseasonal credit needs, and ultimately to develop them into a major source of contribution to the budget. It is equally important that prices of public goods and services reflect their economic cost and that these prices, as well as rates for other nontax revenues, be adjusted appropriately. The valuation basis of the traditional taxes and the administrative efficiency to collect them should also be improved to make the system more revenue productive.

As regards the external sector, the staff agrees with the authorities that an environment of expanding output and relative financial stability is important for export expansion and, similarly, institutional and political stability is necessary to encourage remittances for purposes other than the maintenance of families. In the view of the staff, physical and socio-political factors must, however, be strengthened through the adoption of a realistic and flexible exchange rate policy. In addition, the Government should also follow a clearly defined time path for the early unification of exchange rates, which will promote more efficient resource allocation. The staff would also emphasize the importance of international support of Sudan's domestic adjustment efforts to help the country achieve medium-term balance of payments viability. In the absence of such assistance, the prospects for an improvement in Sudan's performance will remain highly uncertain. In particular, Sudan would be unable to meet its external payments obligations and secure the importation of essential agricultural and industrial inputs.

The staff is aware of Sudan's social and political circumstances and the difficulties that the authorities may face in implementing further policy measures in the coming few months. At the same time, it must be recognized that the country is faced with a grave economic situation and further delays in the implementation of a comprehensive policy package would aggravate the problem. Meaningful progress toward medium-term viability can only be made with the early and sustained implementation of substantive adjustment policies to be strengthened over a number of years and supported by exceptional foreign assistance. This process must start with the adoption of a comprehensive package of economic policies and the staff stands ready to assist the authorities in the formulation of such a package.

During the extensive discussions with the authorities in the past year, the staff has repeatedly stressed the urgency and importance of prompt and full settlement of Sudan's overdue financial obligations to the Fund. The authorities have repeatedly stated their firm intention to settle fully these arrears and, on January 30 and 31, 1986, payments were made totalling US\$10 million. However, reflecting Sudan's continuing nonobservance of its financial obligations to the Fund and the lack of understanding on a comprehensive package of adjustment policies offering the prospect for a settlement of these obligations in the near future, the country was declared ineligible to use the Fund's general resources with effect from February 3, 1986. The staff hopes that steps will soon be taken by the authorities which could lead to the normalization of relations between the Fund and Sudan.

The quality of Sudan's statistics improved somewhat in the last year, mainly due to technical assistance provided by multilateral organizations, including the Fund, and by regional and bilateral sources. However, it is important that Sudan continue the effort in this area, with active support of the international community.

As regards the exchange and trade system, Sudan maintains a multiple exchange rate regime and restrictions on current payments, including arrears on external obligations. The staff does not recommend approval of these restrictions and urges the adoption of policies that would facilitate the liberalization of the exchange and trade system and the elimination of multiple currency practices.

It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

VII. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board.

1. The Fund takes this decision relating to Sudan's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1985 Article XIV consultation with Sudan, in the light of the 1985 Article IV consultation with Sudan conducted under Decision No. 5392-(77/63) adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Sudan's exchange system includes multiple currency practices and restrictions on payments and transfers for current international transactions as described in SM/86/33. These restrictions are subject to approval by the Fund under Article VIII, Sections 2 and 3. The Fund urges the authorities to eliminate the restrictions on payments and transfers for current international transactions and to take appropriate steps toward an early unification of the exchange system.

Sudan - Fund Relations
(As of January 31, 1986)

(Amounts in millions of SDRs, unless otherwise indicated)

I. Membership Status

- (a) Date of membership: September 5, 1957
(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

(As percent of quota)

(a) Quota:	169.7	100.0
(b) Total Fund holdings of Sudanese pounds:	775.0	456.7
(c) Fund credit:	605.3	356.7
Of which:		
Credit tranches	93.6	55.2
Extended Financing Facility	120.9	71.2
Supplementary Financing Facility	154.5	91.0
Enlarged Access Resources	144.8	85.3
Compensatory Financing Facility	91.6	54.0
(d) Reserve tranche position:	--	--
(e) Current Operational Budget (maximum use of currency):	--	--
(f) Lending to the Fund:	--	--

III. Stand-By Arrangements

- (a) Current: None

(b) Recent arrangements:	<u>Date of Effectiveness</u>	<u>Amount</u>	<u>Utilization</u>
Stand-by (one year)	6/25/84	90	20
Stand-by (one year)	2/23/83	170	170
Stand-by (one year)	2/22/82	198	70
Extended (three year)	5/4/79	427	251

- (c) Special facilities since 1981: Sudan purchased SDR 45.7 million on April 13 and 14, 1981 and SDR 39.1 million on March 16, 1983 under the Compensatory Financing Facility.

IV. SDR Department

(a) Net cumulative allocation:	52.2
(b) Holdings:	--
(c) Current Designation Plan:	Nil

V. Administered Accounts

(a) Trust Fund Loans	
(i) Disbursed	70.4
(ii) Outstanding	67.4
(b) SFF Subsidy Account	
(i) Donations) to the Fund	Nil
(ii) Loans)	Nil
(iii) Payments by Fund	17.7

VI. Overdue Obligations to the Fund (as of January 31, 1986)

Total	226.1
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B. Nonfinancial Relations

VII. Exchange rate arrangement:

Sudan maintains a multiple exchange rate regime. Foreign exchange is transacted in:

(1) The official market where the exchange rate has been pegged in principle to a basket of currencies since August 12, 1985. However, the rate has remained unchanged at LSd 2.50 = US\$1 since September 23, 1985. The official exchange rate is applicable to all exports, certain imports and invisible transactions, debt service payments on public sector debt, and specified capital transactions.

(2) The commercial bank market (also known as the "free" market) where, since January 30, 1986, the rate is set by the Bankers' Association, which also pools and allocates the foreign exchange acquired in the market. The rate stood at LSd 3.30/3.35 = US\$1 at the beginning of February 1986.

Sudan's restrictions on payments and transfers for current transactions, and the multiple currency practices, are unapproved.

VIII. The last Article IV consultation was held in August and September 1984. The Staff Report (SM/84/253 and Supplement 1) was discussed by the Executive Board on December 19, 1984. The decision adopted December 19, 1984 was as follows:

1. The Fund takes this decision relating to Sudan's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Sudan, in the light of the 1984 Article IV consultation with Sudan conducted under Decision No. 5392-(77/63) adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Sudan's exchange system includes a multiple currency practice and restrictions on payments and transfers for current international transactions as described in SM/84/253, 11/9/84. These restrictions are subject to approval by the Fund under Article VIII, Section 2. The Fund urges Sudan to take prompt steps to unify the exchange system and to eliminate the restrictions on payments and transfers for current international transactions.

IX. Technical assistance

One expert has been assigned to advise the External Debt Management Unit at the Ministry of Finance and Economic Planning. A second expert has been assigned to provide technical assistance at the Bank of Sudan on bank supervision. The expert assigned to serve with the Joint Monitoring Committee, which is responsible for monitoring progress of adjustment programs and for coordination with external donors, left Khartoum in October 1985; this expert had also served as adviser to the Bank of Sudan. A statistical adviser is scheduled to arrive in the coming weeks to work at the Bank of Sudan.

X. Resident representative

Mr. J. Dodsworth was appointed resident representative in August 1983.

Sudan--Relations with the World Bank 1/

1. The Bank Group's approach in Sudan is to encourage and support government efforts to implement a broad program of economic reforms to address the structural imbalances in the economy and thus lay the foundations for self-sustaining economic growth. The Bank operates through its lending program, policy dialogue, and technical assistance work.

2. Sudan is eligible only for IDA lending. The size of the lending program is related to the Government's progress in addressing its economic problems. Efforts made last summer by the new Government already have been reflected in a substantial increase in lending in fiscal year 1986 compared with the low level last year. Should performance improve, Sudan could become eligible for the Special African Facility. IDA has concentrated its lending on the primary production sector, mainly in irrigated agriculture, but also in rainfed agriculture and livestock development. The Bank Group is closely involved in Sudan's infrastructure and, in more recent years, has directed its projects toward the rehabilitation of existing capital assets and the removal of bottlenecks to the productive sectors. The Bank is also involved in the petroleum sector through technical assistance and the promotion of the Red Sea gas finds with private sector investors. IFC has assisted in bringing together an international consortium that would finance an oil pipeline project of about US\$1 billion, but this project is stalled because of the civil unrest in the South preventing the development of the discovered oil reserves.

3. The Bank's lending program reflects the position that the key to higher overall growth and export performance is in the agricultural sector. Production should be stimulated by incentive prices, improved organization and research. The international competitiveness of the agricultural sector should be maintained and producer prices kept at incentive levels. The priority for investment is in projects that protect or improve the existing production potential. Regarding industry, the Bank recommends to improve sector policies by assuring access to credit and imported inputs, while allowing enterprises more freedom to set profitable prices. The Bank gives high priority to reform of the parastatal sector through technical assistance, aiming at a combination of measures, including privatization, but excluding financial assistance to enterprises that cannot demonstrate long-term economic viability and do not have workable rehabilitation plans. It is aiming at the establishment of clear objectives and management autonomy to reach these objectives combined with improved monitoring and incentive schemes to select and reward good management.

4. In the field of macroeconomic policies, the Bank believes that higher levels of domestic resource mobilization are critical to economic growth. In the private sector, resource mobilization should be improved

1/ Prepared by the World Bank staff.

by policies that would promote higher returns on financial and physical investments. In the public sector, this should be achieved by a reduction in government reliance on monetary financing, and an increase in budget revenues as a share of GDP. While supporting policies of constraint and discipline on the expenditure side, the Bank recommends that the Government improve incentives for key civil servants.

5. While stringent policies remain required to achieve a satisfactory situation in the medium term, the immediate debt problems will have to be resolved in a multi-year framework of economic planning and very concessional annual aid packages, including debt relief. Solutions for the debt problem must preserve the possibilities for modest long-term economic development.

6. The Bank has cooperated with the IMF in the design and implementation of the economic recovery program. It helped to introduce a cycle of annual policy papers, each year containing an updated three-year rolling investment program. It chaired the Consultative Group meeting. In its economic work program, the Bank will emphasize aspects of supply response and long-term growth such as supply problems in the rainfed agricultural sector, investment priorities in irrigation and hydropower, population policy issues, and reform of the parastatal sector. The Bank participated in most of the recent IMF missions and intends to continue this cooperation.

A. Statement of Bank Loans and IDA Credits - Sudan
(As of September 30, 1985)

				Amount (US\$ million) (<u>Net of cancellations</u>)		
<u>Loan/ Credit No.</u>	<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Bank</u>	<u>IDA</u>	<u>Undisbursed</u>
Seven loans and nineteen credits fully disbursed				139.0	320.2	
Credit 782	1978	Sudan	Livestock marketing		25.0	9.48
Credit 804	1978	Sudan	Mechanized Farming III		16.0	5.06
Credit 834	1978	Sudan	Agricultural Research		15.0	5.14
Credit 1006	1980	Sudan	Third Power		65.0	20.15
Credit 1022	1980	Sudan	New Halfa Rehabilitation		40.0	23.66
Credit 1118 1/	1981	Sudan	Blue Nile Pump Rehab.		32.0	29.55
Credit 1119 1/	1981	Sudan	White Nile Pump Rehab.		35.0	31.40
Credit 1153 1/	1981	Sudan	Second Tech. Assistance		6.0	3.07
Credit 1181 1/	1981	Sudan	Western Savannah		13.0	0.67
Credit 1201 1/	1982	Sudan	Agricultural Services		18.0	14.17
Credit 1233 1/	1982	Sudan	Second Port		25.0	2.86
Credit 1388 1/	1983	Sudan	Gezire Rehabilitation		80.0	78.95
Credit 1389 1/	1983	Sudan	Agric. Rehab. Program II		50.0	0.73
Credit F011 1/	1984	Sudan*	Third Education Project		10.0	9.50
Credit 1451 1/	1984	Sudan	Third Education Project		5.4	3.73
Credit 1450 1/	1984	Sudan	Third Highway Project		16.0	16.00
Credit 1506 1/	1984	Sudan	Sugar Rehab. Project		60.0	60.00
Credit 1513 1/	1984	Sudan	Petroleum T.A. Project		12.0	8.78
Credit 1525 1/	1984	Sudan	Stock Route Project		5.5	5.50
Credit 1614 1/	1985	Sudan	Drought Recovery		20.0	20.00
Credit 1624 1/	1985	Sudan**	Power Rehabilitation Prog.		30.0	30.00
Total				139.0	899.1	378.40
of which repaid				103.2	15.3	
Total now outstanding				35.8	883.8	
Amount sold				5.8	8.4	
of which repaid				5.8	8.4	
of which outstanding				--	--	--
Total held by Bank and IDA				35.8	883.8	
Total undisbursed				Nil	378.4	378.40

1/ Credits denominated in SDRs (credit 1118-SU and above) are shown in US\$ equivalents, based on the exchange rate in effect at the time of negotiations.

(Note: SDR amounts of these credits are: SDR 25.1 million, SDR 27.5 million, SDR 4.9 million, SDR 11.2 million, SDR 15.7 million, SDR 21.5 million, SDR 74.2 million, SDR 46.4 million, SDR 9.6 million, SDR 5.2 million, SDR 15.2 million, SDR 56.4 million, SDR 11.6 million, SDR 5.5 million, SDR 20.2 million and SDR 30.3 million, respectively.)

* Special Fund credit.

** Not yet effective.

B. Statement of IFC Investments
(as of September 30, 1985)

<u>Fiscal</u> <u>Year</u>	<u>Obligor</u>	(Amount in US\$ million)		
		<u>Loan</u>	<u>Equity</u>	<u>Total</u>
1964 and	Khartoum Spinning and Weaving Co.			
1972	Textiles	1.9	0.3	2.2
1976	Cotton Textile Mills	8.7	1.3	10.0
1978	Seleit Food Production Ltd.	11.1	1.1	12.2
1978	Gezira/Managil Textile Co. Ltd.	6.7	1.4	8.1
1980	Sudan Cement Company	--	0.2	0.2
1982	White Nile Petroleum Co. Ltd.	--	0.3	0.3
	Total gross commitments	<u>28.4</u>	<u>4.6</u>	<u>33.0</u>
	Less cancellations, terminations, repayments and sales	<u>6.9</u>	<u>0.6</u>	<u>7.5</u>
	Total commitments now held by IFC	<u>21.5</u>	<u>4.0</u>	<u>25.5</u>
	Total undisbursed by IFC	<u>1.9</u>	<u>0.2</u>	<u>2.1</u>

Sudan--Statistical Issues

1. Outstanding Statistical Issues

a. National accounts

Production data have been collected in an ad hoc and partial manner in recent years. Moreover, the methodology used for deriving the GDP deflator, which is based on the CPI index after taking partial account of export and import unit values, is less than adequate. These limitations were discussed during the 1985 Article IV consultation and the authorities have indicated that they are in the process of reviewing the compilation of national account statistics. In the meantime, the staff has prepared independent estimates for the GDP deflator, as presented in the report on Recent Economic Developments.

b. Prices

The consumer price index published in IFS covers the lower-salaried Sudanese population in the Greater Khartoum area. The authorities also construct a consumer price index covering the higher income group, which is presented in the report on Recent Economic Developments. Apart from their geographical limitation, these indices are deficient in terms of the coverage of products and the weighting structure (the weights relate to 1970). However, it is understood that the indices are presently being revised on the basis of a Household Expenditure Survey (1979/80).

At present the reporting of data is infrequent so that the indices published in IFS are not current. The authorities have been urged to cable data each month, in order to improve the currentness of the published information.

c. Monetary accounts

The authorities are currently reviewing the report of a Bureau of Statistics' technical assistance mission which visited Khartoum in June-July 1985. The report emphasized the need for substantial revisions of the monetary accounts, concerning both the collection and compilation procedures being followed by the Bank of Sudan. The report noted that there are problems with the banking system's data for foreign assets and liabilities, credit to Government and public enterprises, and money. In preparing the monetary account data for use in the consultation reports, the staff has undertaken a number of modifications to reduce these problems. Notwithstanding this, data limitations still prevail. In particular, the off-balance sheet recording of matured and overdue letters of credit has led to a substantial understatement of gross foreign liabilities and credit to public entities. Furthermore, the commercial banks' gross foreign assets appear to be overstated because of accounting and classification problems. The authorities have requested further assistance in these areas.

As a step toward improving the monetary data, the authorities have started implementing the new reporting system for the commercial banks established earlier by a Fund statistical adviser.

d. Government finance

The last year of data covered by the 1985 GFS Yearbook is 1982 and includes detailed figures for revenue, expenditure by function and by economic type, and financing by type of debt instrument and of debt holder. No data are presently available for debt and for local and general governments, and no detailed breakdown exists for lending minus repayments, and capital expenditure. The reply to the 1985 GFS questionnaire, which includes 1983 data, was received too late for publication in the 1985 Yearbook.

e. Balance of payments

A report on a balance of payments technical assistance mission was sent to the authorities in August 1984, and their comments on its recommendations were requested. Partial responses were communicated and it is understood that the authorities are devoting more resources to improving the data.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Sudan in the February 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Sudan, which during the past year have been provided on a timely basis, although the coverage and currentness of the data on prices, government finance, and external trade could be improved.

Status of IFS Data

		<u>Latest Data in November 1985 IFS</u>
Real Sector	- National Accounts	1979 (1982 GDP only)
	- Prices: Consumer	Q3 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1982
	- Financing	1982
	- Debt	n.a.

Monetary Accounts	- Monetary Authorities	Q4 1984
	- Deposit Money Banks	Q4 1984
	- Other Financial Institutions	Q4 1984
External Sector	- Merchandise Trade: Value	Q1 1984
	Unit values of cotton exports	Q1 1984 <u>1/</u>
	- Balance of Payments	Q2 1985 <u>2/</u>
	- International Reserves	December 1985
	- Exchange Rates	December 1985

1/ Data on cotton exports (wholesale price) are available through December 1985.

2/ Information for the third quarter of 1985 was received recently and will be published shortly.

Sudan: Selected Economic and Financial Indicators, 1981/82-1985/86 1/

	1981/82	1982/83	1983/84	Estimated 1984/85	Projections 1985/86
(Annual percent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	6.9	-4.6	-1.0	-7.0	8.4
Consumer prices	22.6	29.7	24.1	74.1	35.0
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	-19.6	32.6	23.4	-23.1	18.8 2/
Imports, c.i.f.	13.9	-12.5	-10.8	-9.6	7.7 2/
Non-oil imports, c.i.f.	13.2	-15.1	-15.2	-10.3	6.9 2/
Real effective exchange rate (depreciation -) 3/	-23.2	-9.2	21.0	2.2	...
Government budget					
Revenue	21.9	42.1	15.9	2.4 4/	37.5 6/
Total expenditure 5/	17.9	19.4	27.6	30.0 4/	23.2 6/
Money and credit					
Net domestic assets 7/	25.4	38.6	18.2	42.2	10.7 2/
Government (net) 7/	-1.3	0.8	8.0	21.4	6.2 2/
Public entities 7/	14.1	16.0	3.6	4.4	7.2 2/
Private sector 7/	16.5	19.2	9.5	8.8	8.1 2/
Money and quasi-money	24.2	37.1	21.9	46.9	26.0 2/
Interest rate (annual rate, one-year deposit)	12.0	15.0	15.0	...	...
(In percent of GDP unless otherwise specified)					
Central government budget deficit (cash basis)	9.0	6.5	7.8	8.8 4/	16.8 6/8/
Domestic bank financing	0.5	0.5	1.9	2.6 4/	... 6/
Foreign financing	8.5	5.6	5.7	6.2 4/	... 6/
Central government budget deficit (excluding foreign interest)	8.1	5.0	6.4	8.1 4/	6.8 6/
Central government budget deficit (including foreign interest on a commitment basis)	...	...	9.5	12.4 4/	10.6
Current account, including official transfers					
Excluding interest	-10.9	-2.0	-0.4	-0.2	1.6 2/
Including interest	...	...	-6.6	-6.6	-5.3 2/
Current account, excluding official transfers					
Excluding interest	-13.3	-8.8	-4.7	-4.5	-3.4 2/
Including interest	...	...	-10.9	-11.0	-10.2 2/
Public external debt, inclusive of use of Fund credit 9/ (in billions of U.S. dollars)	6.9	6.8	7.0	7.4	...
Debt service ratio 10/					
As percent of exports of goods and nonfactor services	46.6	33.5	31.0	30.6	355.6 2/8/
As percent of exports of goods, nonfactor services, and private transfers	30.8	22.3	21.8	18.4	218.1 2/8/
Overall balance of payments (In millions of U.S. dollars)	...	...	-904	-830	-843 2/

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

1/ Covers the period July-June except where indicated.

2/ September 1985 to September 1986.

3/ End of period.

4/ September 1984 to September 1985.

5/ Excluding foreign interest payments.

6/ Revised budget covering the 9 1/2 month fiscal period ending June 30, 1986.

7/ Increase as a percentage of money and quasi-money at the beginning of the period.

8/ Including repayment of arrears and before debt rescheduling.

9/ Calendar years 1981, 1982, 1983, 1984 and 1985.

10/ Includes IMF.

