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Sudan: Final Review Under the Medium-Term Staff-Monitored Program and the 2002 Progam—Staff Report; and Staff Supplement

In the context of the final review under the medium-term staff-monitored program and the 2002 progam, the following documents have been released and are included in this package:

- the staff report for the final review under the medium-term staff-monitored program and the 2002 progam, prepared by a staff team of the IMF, following discussions that ended on **April 24, 200,** the officials of Sudan on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 4, 2002**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **June 18, 2002** updating information on recent economic developments.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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SUDAN

Final Review Under the Medium-Term Staff-Monitored Program and the 2002 Program

Prepared by Middle Eastern and Policy Development and Review Departments

(In consultation with Fiscal Affairs, Legal, Monetary and Exchange Affairs, Statistics, and Treasurer's Departments)

Approved by Paul Chabrier and Anne McGuirk

June 4, 2002

- Discussions on Sudan's economic performance in the second half of 2001, and on the annual program for 2002 took place in Khartoum from March 31 to April 11, 2002 and at headquarters from April 19 to 24, 2002. The staff team included Mr. Shabsigh (head), Ms. Brixiova, Ms. Bal Gündüz, and Mr. Gemayel (all MED), Mr. Jacoby (PDR), Mr. Van Der Heeden (FAD), and Ms. Svensson (World Bank). Mr. Burton joined the team for the policy discussions.
- The mission met with His Excellency Abdel-Rahim Hamdi, Minister of Finance and National Economy, His Excellency Saber Mohammed Hassan, the Governor of the Bank of Sudan, and other senior Sudanese officials, as well as diplomatic representatives.
- The principal author of this report is Mr. Ghiath Shabsigh.

Appendices

Attachments

Executive Summary

Performance under the program

A three-year medium-term staff monitored program was completed at end-2001. The overall economic environment weakened in 2001 because of external factors and policy slippages. Growth slowed to 5.3 percent but the average annual CPI inflation rate remained low at 4.9 percent, below the program target of 6 percent. The balance of payments deteriorated sharply owing to external shocks, while the exchange rate depreciated only slightly in the course of the year. As a result, international reserves fell to the very low level of US$45 million (two weeks of imports). Following policy measures adopted in the second half of the year, the budget deficit was contained to 1 percent of GDP and broad money growth was brought back in line with the program target by year end. However, most quantitative benchmarks were missed. Some progress was made on structural reforms.

During the last quarter of 2001, Sudan did not fulfill its commitment to make monthly payments of US$5.5 million to the Fund, since its capacity to service its external debt was sharply reduced. The authorities also scaled down payments to all their foreign creditors.

Policy discussions

The discussions focused on the 2002 program and on Sudan's capacity to repay the Fund. The program aims to bolster macroeconomic stability, rebuild international reserves, and reinvigorate the reform agenda. The program targets real GDP growth of 5 percent, containing inflation to 6–7 percent, and increasing international reserves to US$123 million (4 weeks of imports). The structural elements of the program are particularly strong and include a more flexible exchange rate regime, a mechanism to manage oil revenue, and measures to strengthen non-oil revenue.

Based on Sudan's debt service capacity and the Fund's share in debt service obligations agreed with other creditors, Sudan is committed to monthly payments of US$2 million to the Fund in 2002, which would allow its outstanding arrears to the Fund to be reduced by an estimated US$6 million.

Staff appraisal

Sudan has made substantial progress over the past five years of staff-monitored programs in achieving macroeconomic stability and advancing structural reforms. The economic environment weakened in 2001 and there were policy slippages, but steps were taken in the second half of the year to tighten policies.

The program for 2002 represents a strong and credible effort to bring economic policies back on track, reinforce macroeconomic stability, and meet the challenges of weak external environment. The introduction of mechanisms for greater exchange rate flexibility and for saving oil revenues, are particularly welcome. On balance, while not without areas for improvement, the staff considers that the policy commitments and proposed payments, which provide for a small reduction in arrears to the Fund, are in line with what would be required for a rights accumulation program, if the necessary financing assurances had been available. The staff proposes to monitor the program and recommends that the Board consider the authorities' request that satisfactory performance under the program be taken into account in determining the timetable for arrears clearance and a resolution of Sudan's debt.

I. Background

1. A three-year medium-term staff-monitored program (MTSMP) was completed at end–2001; the MTSMP followed the successful completion of two annual staff-monitored programs (SMP) in 1997 and 1998. In recognition of Sudan's progress since 1997 in implementing appropriate macroeconomic and structural policies under SMPs, and in making payments to the Fund, on July 31, 2000, the Board lifted the suspension of Sudan's voting and related rights in the Fund, which had been in place since 1993. On March 5, 2001, the Board considered the paper, *An Illustrative Road Map to External Sustainability*, prepared by the staff, which outlined the key steps needed for initiating and successfully concluding a debt workout, including clearance of arrears to the Fund. A staff paper on "Fundamental Issues in Resolving Sudan's External Debt Problems" will be issued parallel to this report.

2. On November 14, 2001, the Executive Board concluded the 2001 Article IV consultation with Sudan and the First Review of the Third Annual Program under the MTSMP. Directors noted that strong policy implementation was required to keep economic performance on track. They stressed the need to strengthen non-oil revenue performance, create a mechanism to smooth oil revenue volatility, and allow greater exchange rate flexibility, especially given the low level of international reserves. Directors agreed that Sudan's capacity to repay the Fund in the period ahead should be reassessed by the staff, and asked for an early discussion of a staff paper on the fundamental issues to resolve Sudan's debt problem.

3. Peace efforts in the Sudanese civil war have intensified with U.S. mediation and Swiss participation, resulting in agreements on a partial ceasefire, ending attacks on civilians, and the resumption of humanitarian aid deliveries. U.S. special envoy to Sudan Mr. John Danforth submitted a report on prospects for peace in Sudan to the U.S. administration at end-April, 2002. The report concludes that the parties are capable of taking the steps necessary to reach a negotiated settlement, and called on the U.S. to act as a catalyst for peace through the ongoing regional peace initiative, currently being led by Kenya, and maintain high priority on humanitarian assistance to Sudan. The United Kingdom also appointed recently a peace envoy to Sudan, and the European Union has resumed discussions on development aid to Sudan under the Humanitarian-Plus initiative. Despite these developments, it is unclear if major creditors are ready to provide financing assurances to resolve Sudan's debt problem.

4. This report (i) reviews macroeconomic performance and the implementation of structural measures in 2001 and the first quarter of 2002; (ii) describes the economic program for 2002, as detailed in the attached Memorandum of Economic and Financial Policies (MEFP); and (iii) assesses Sudan's capacity to make payments to the Fund.

II. Recent Developments

5. **Macroeconomic overview.** The macroeconomic environment deteriorated in 2001, reflecting balance of payment difficulties and policy slippages (especially in the first half of the year) in the fiscal and monetary areas. As a result, real GDP growth slowed to 5.3 percent in 2001 from 6.9 percent in 2000 (Figure 1) and international reserves declined substantially, falling to a low level of US$45 million (2 weeks imports) by end-2001.

6. The average annual rate of consumer price inflation at 4.9 percent in 2001 was below the program target of 6 percent, though it has recently shown signs of picking up (Table 1). Despite external pressures, the Sudanese Dinar (SDD) was allowed to depreciate only slightly by year-end contributing to the loss of reserves.[1] Steps were taken in the second half of the year to tighten macroeconomic policies, including sharply reducing the growth of money and credit and containing the fiscal overrun.

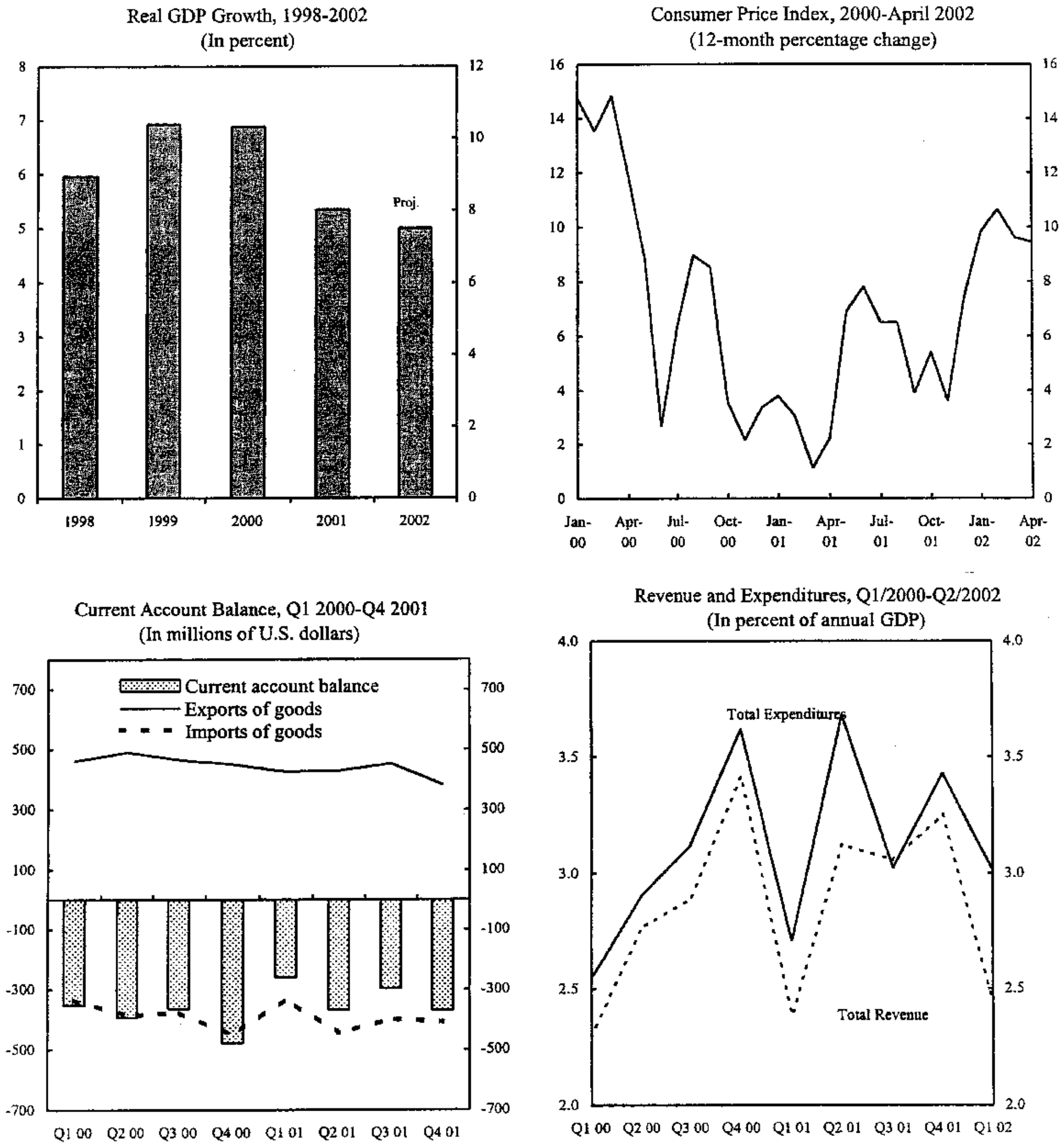
Sudan: GDP and Prices, 1999–2001
(Percent change)

	1999	2000	Rev. Prog. 2001	Actual 2001
Real GDP	6.9	6.9	5.0	5.3
CPI average	16.0	8.0	6.0	4.9

7. **The balance of payments came under strong pressure in 2001.** Revenue from oil exports fell below their level in 2000 as oil prices declined, particularly in the last quarter of 2001. Non-oil exports also fell, depressed by the sharp decline in international commodity prices (cotton in particular), the ban (lifted only at year-end) by the Gulf countries on imports of Sudanese livestock (a major export item for Sudan) for health reasons, and higher shipping and transportation costs after the September 11 events. In contrast, imports grew mainly because of higher petroleum product imports since the domestic refineries could not keep pace with the rapid growth in transportation. As a result, the current account deficit (on a cash basis) rose to 4.0 percent of GDP in 2001 compared with 3.6 percent in 2000 (Table 2).

[1] Following the sharp devaluation of the dinar prior to exchange rate unification in the second half of 1998, the real effective exchange rate (REER) appreciated in 1999 by about 20 percent (possibly reflecting, in part, an overshooting of the exchange rate adjustment). Since 1999, the REER appreciated by about 20 percent. So far, there has been little evidence that non-oil exports (mainly primary commodities) were negatively affected by the REER appreciation (Figure 2).

Figure 1. Sudan: GDP, Prices, External, and Fiscal Developments



Source: International Monetary Fund, Information Notice System.

Table 1. Sudan: Selected Social and Economic Indicators, 1999–2002

	1996	1997	1998	1999	Average for SSA 1997
Population (millions)	27.9	28.7	29.4	30.3	...
Age dependency 1/	87	87	87	86	90
Urban population (percent of total)	30.1	30.3	30.6	33.1	32.3
Total labor force (millions)	8.9	9.2	9.4	9.7	...
Life expectancy at birth	55.3	55.7	56.1	56.5	50.8
Adult literacy rate	53.5	...	57.2	...	58.3

	Actual		Program	Actual	Program
	Dec. 1999	Dec. 2000	2001	2001	2002
	(Annual changes in percent)				
National income, production, and prices					
Nominal GDP (in billions of Sudanese dinars)	2,541	2,832	3,194	3,130	3,483
Real GDP growth	6.9	6.9	5.0	5.3	5.0
Real non-oil GDP growth	5.9	3.0	4.7	4.5	4.8
Average CPI inflation	16.0	8.0	6.0	4.9	6.0
	(In percent of GDP)				
Investment and saving					
Gross domestic investment	16.7	18.1	18.4	18.1	18.5
Government sector	1.3	2.6	2.8	2.5	2.8
Nongovernment sector	15.1	15.5	15.6	15.6	15.7
Gross domestic saving	9.4	17.6	15.9	14.9	16.9
Government sector	0.4	1.8	2.0	1.6	1.8
Nongovernment sector	9.0	16.0	13.9	13.4	15.1
Net exports of goods and nonfactor services	-7.5	-0.5	-2.5	-3.2	-1.6
Central government operations					
Total revenue	8.1	11.5	12.4	11.8	12.5
Total expenditure	8.9	12.4	13.2	12.8	13.6
Overall balance (cash)	-0.9	-0.8	-0.8	-1.0	-1.0

Table 1. Sudan: Selected Social and Economic Indicators, 1999–2002 (concluded)

	Actual		Program	Actual	Program
	Dec. 1999	Dec. 2000	2001	2001	2002
	(Changes in percent of beginning broad money stock)				
Money and credit 2/					
Net foreign assets (excluding valuation changes)	5.6	10.7	-5.2	-8.6	6.0
Net domestic assets	18.1	23.9	30.0	33.3	12.0
Net domestic credit	16.0	18.6	14.9	25.9	11.8
Of which:					
Net claims on central government	12.0	2.9	4.5	9.0	4.2
Claims on nongovernment sectors 3/	4.0	15.7	10.4	16.9	7.7
Other items (net) 3/	2.1	5.4	15.0	7.4	0.2
Broad money	23.7	34.6	24.7	24.7	18.0
Reserve money (change in percent)	34.6	35.3	3.0	3.7	15.0
Velocity (GDP/e.o.p. broad money)	9.9	8.2	7.4	7.5	7.1
	(In millions of U.S. dollars; unless otherwise indicated)				
External sector					
Exports, f.o.b.	780	1,864	1,767	1,688	1,839
Imports, c.i.f.	-1,412	-1,553	-1,605	-1,585	-1,503
Current account balance (cash basis)	-373	-365	-407	-447	-476
In percent of GDP	-4.1	-3.6	-3.3	-4.0	-3.8
Terms of trade (change in percent)	12.6	15.1	-7.2	-4.1	-5.8
Real effective exchange rate (average, change in percent)	-8.2	11.9	...	7.5	...
Official exchange rate (end of period, SD/U.S. dollars)	256.9	257.4	258.0	261.4	...
Total external debt service (percent of current receipts)					
Commitment basis	84.4	53.8	36.6	38.4	38.7
Actual payments	4.2	4.6	5.4	3.5	...
External debt (billions of U.S. dollars)	23.7	20.4	21.5	21.5	22.7
BOS gross usable reserves (millions of U.S. dollars)	53.4	135.0	135.0	44.9	123.3
In months of imports	0.5	1.0	1.0	0.3	0.9
In months of next year's imports	0.4	1.0	1.2	0.3	0.8

Sources: Fund staff estimates and projections based on information provided by the Sudanese authorities. Social indicators were obtained from Central Bureau of Statistics, Ministry of Finance and National Economy; and World Bank's World Development Indicators.

1/ Population under the age of 15 and over the age of 65 as a share of the total working-age population.

2/ Definition of broad money in 2001 is based on the new presentation of monetary aggregates.

3/ In December 2001, some other items net of commercial banks (SDD 29 billion) were reclassified as credit to the nongovernmental sector.

Table 2. Sudan: Summary of Balance of Payments, 1999–2002

	1999	2000	Rev. Program 2001	Prel. Actual 2001	Program 2002
	(In millions of U.S. dollars)				
Trade balance	-632	311	162	102	336
Exports, f.o.b.	780	1,864	1,767	1,688	1,839
Oil	276	1,408	1,378	1,370	1,413
Crude oil	276	1,298	1,265	1,268	1,209
Oil products	0	110	113	102	204
Non-oil products	504	456	389	318	425
Cotton	45	53	54	44	41
Gum arabic	26	23	24	24	26
Livestock	114	66	25	2	100
Sesame	127	147	120	105	111
Other	191	166	165	143	149
Imports, c.i.f.	-1,412	-1,553	-1,605	-1,585	-1,503
Foodstuff	-276	-340	-381	-302	-295
Petroleum	-184	-137	-105	-98	-12
Other	-953	-1,076	-1,119	-1,185	-1,191
Services (net)	-88	-341	-463	-455	-527
Receipts	51	28	14	14	14
Payments	-139	-368	-476	-469	-541
Of which: Oil-related transport expenses	-85	-276	-343	-367	-435
Income (net)	-1,317	-1,887	-1,370	-1,359	-1,578
Receipts	19	5	26	18	16
Payments	-1,223	-1,269	-901	-893	-927
Of which: Public interest payments due 2/	-1,215	-1,253	-884	-880	-919
Oil-related expenses	-114	-623	-495	-484	-666
Current transfers (net)	437	344	445	434	438
Private transfers	446	315	422	398	418
Public transfers	41	29	23	36	20
Current account balance	-1,550	-1,573	-1,227	-1,278	-1,330
Excluding public transfers	-1,592	-1,602	-1,250	-1,314	-1,350
Capital account	0	21	5	2	0
Project aid	0	21	5	2	0

Table 2. Sudan: Summary of Balance of Payments, 1999–2002 (concluded)

	1999	2000	Rev. Program 2001	Prel. Actual 2001	Program 2002
Financial Account (net)	-60	-125	-35	-47	-15
Disbursements	44	41	23	-47	31
Amortization	-207	-265	-177	-177	-148
Short-term capital flows (net) 3/	108	117	120	120	122
Commercial banks net reserve (increase -)	-5	-18	-1	-37	-20
Errors and omissions and other private capital	308	454	414	338	475
Overall balance	-1,315	-1,223	-843	-986	-870
Change in official reserves (increase -)	-36	-108	-33	67	-84
IMF (net)	-10	-27	-33	-23	-6
Other	-26	-82	0	90	-78
Change in non-Fund arrears	1,351	1,331	876	919	955
Residual financing gap	0	0	0	0	0
Memorandum items:					
Current account deficit (percent of GDP)	-15.4	-14.3	-9.9	-10.6	-10.3
Excluding interest due and public transfers	-3.7	-3.2	-3.0	-3.6	-3.3
Current account (cash basis)	-373	-365	-407	-447	-476
In percent of GDP	-4.1	-3.6	-3.3	-4.0	-3.8
Gross usable reserves	53	135	135	45	123
In months of next year's imports	0.4	1.0	0.9	0.3	0.8
Terms of trade, non-oil (percent change)	1.3	0.3	-3.0	6.1	-0.7
Debt service paid to multilateral creditors	64	115	116	82	54
Of which: IMF	40	63	66	55	24

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

1/ Oil projections using government's assumptions on prices and volumes.

2/ Includes estimates of late interest accrued during the year and Fund special charges.

3/ Net short-term trade and other credit facilities of the Bank of Sudan and commercial banks.

In addition, the uncertainty caused by aftermath of the September 11 events led to a marked drop in private capital inflows. As a result of these developments, foreign exchange reserves fell to the low level of US$45 million by end-2001 (less than 2 weeks of imports).

Sudan: Balance of Payments, 2001
(In millions of U.S. dollars)

	First half	Full year	
	Actual	Rev. prog.	Actual
Trade balance	74.2	161.7	102.0
Exports	852.9	1,766.7	1,687.5
Oil	676.1	1,377.9	1,369.7
Non-oil	176.7	388.8	317.8
Imports	-778.7	-1,605.0	-1,585.5
Current account (cash basis)	-224.0	-407.0	-446.8
(In percent of GDP)	-1.9	-3.3	-4.0

8. **The fiscal position was more difficult than envisaged in the second half of 2001.** Sizable shortfalls in both oil and non-oil revenues, and unanticipated spending on food security and refugees put the budget under pressure, but mainly through expenditure cuts, the fiscal deficit was contained to 1.0 percent of GDP; only slightly higher than the program target (Table 3).

Sudan: Government Operations, June–December 2001
(In billions of Sudanese dinars)

	First half	Full Year	
	Actual	Rev. prog.	Actual
Revenue	173.0	397.3	370.0
Oil	69.8	162.3	149.7
Non-oil	103.3	235.0	220.3
Expenditures	199.7	422.1	401.1
Current	164.6	332.2	322.5
Capital	35.0	89.9	78.7
Balance	-26.7	-24.8	-31.2
Balance (in percent of GDP)	-0.9	-0.8	-1.0

Table 3. Sudan: Central Government Operations, 1999–2002

	1999	2000	Revised Program 2001	Actual 2001	Budget 2002	Program 2002
			(In billions of Sudanese dinar)			
Total revenues	205.5	326.3	397.3	370.0	470.3	435.7
Tax revenue	153.3	157.4	200.4	188.7	243.5	233.1
Direct taxes	36.1	37.4	45.0	41.5	52.0	42.9
Indirect taxes	117.2	120.0	155.4	147.2	191.5	190.2
Taxes on international transactions	84.4	69.6	77.8	77.1	99.5	101.6
Taxes on domestic transactions	32.8	34.3	35.8	32.5	39.9	38.9
VAT	0.0	16.1	41.7	37.7	52.1	49.7
Nontax revenue	52.2	169.0	196.8	181.3	226.8	202.7
Departmental fees	9.4	9.2	10.6	10.3	20.8	17.4
National revenues	42.8	159.7	186.3	171.0	206.0	185.3
Non-oil	27.1	18.9	24.0	21.3	32.0	26.8
Oil	15.7	140.9	162.3	149.7	174.0	158.5
Of which: export receipts	15.7	103.8	...	63.6	...	20.7
			(In billions of Sudanese dinar)			
Total expenditure	227.2	349.8	422.1	401.1	552.7	472.0
Current expenditure	195.0	275.3	332.2	322.5	415.6	372.9
Wages, salaries, and pension	80.4	105.9	136.9	131.6	170.9	170.9
Debt service paid	20.2	34.5	40.0	26.2	70.1	42.5
External debt service 1/	18.3	31.2	37.8	24.0	62.1	31.9
Internal debt	2.0	3.3	2.2	2.3	8.0	10.5
Goods and services	37.9	53.3	51.2	48.8	74.1	48.2
General reserve	24.9	36.8	46.1	59.5	22.5	29.8
Other obligations	11.4	9.3	9.0	15.1	19.1	19.1
Social subsidies	7.5	8.8	17.2	16.3	22.2	25.7
Transfers to states	12.8	26.8	31.7	25.0	36.8	36.8
Capital expenditure	32.2	74.5	89.9	78.7	137.1	99.1
Locally Financed	25.7	67.1	83.9	73.3	114.1	89.2
Of which: capital transfers to states	...	...	13.3	8.7	21.5	21.5
Foreign financed	6.5	7.4	6.0	5.4	23.0	9.9
			(In billions of Sudanese dinar)			
Overall deficit (cash basis) (deficit -) 2/	-21.7	-23.5	-24.8	-31.2	-82.4	-36.3
Financing	21.7	23.5	24.8	31.2	82.4	36.3
Foreign financing	8.5	11.7	6.0	5.4	23.0	9.9
Domestic financing	26.6	8.3	18.8	39.6	59.4	26.3

Table 3. Sudan: Central Government Operations, 1999–2002 (continued)

	1999	2000	Revised Program 2001	Actual 2001	Budget 2002	Program 2002
BOS	28.2	6.1	8.7	28.8	31.7	8.0
GMCs (net)	0.0	1.2	8.9	20.1	1.0	-1.0
Temporary advances	30.8	8.2	-0.2	10.0	30.7	9.0
Deposits	-2.7	-3.3	0.0	-1.3	0.0	0.0
DMBs	-3.0	1.2	7.0	2.4	15.0	10.0
Advances	-0.1	0.0	0.0	0.0	0.0	0.0
GMCs (net)	0.1	4.0	7.1	3.2	15.0	10.0
Deposits	-3.1	-2.8	-0.1	-0.7	0.0	0.0
Nonbanks (GMCs)	1.5	1.0	3.1	13.0	5.0	9.0
Domestic arrear repayments	...	...	-5.0	-7.0	-6.3	-6.3
Privatization	...	...	5.0	2.5	14.0	5.6
Unpresented checks and discrepancy 3/	-13.4	3.5	0.0	-13.9	0.0	0.0
Memorandum items:						
Non-oil revenue	189.8	185.5	235.0	220.3	296.3	277.2
Oil revenue	15.7	140.9	162.3	149.7	174.0	158.5
			(In percent of GDP)			
Total revenues	8.1	11.5	12.4	11.8	13.5	12.5
Tax revenue	6.0	5.6	6.3	6.0	7.0	6.7
Direct taxes	1.4	1.3	1.4	1.3	1.5	1.2
Indirect taxes	4.6	4.2	4.9	4.7	5.5	5.5
Taxes on international transactions	3.3	2.5	2.4	2.5	2.9	2.9
Taxes on domestic transactions	1.3	1.2	1.1	1.0	1.1	1.1
VAT	0.0	0.6	1.3	1.2	1.5	1.4
Nontax revenue	2.1	6.0	6.2	5.8	6.5	5.8
Departmental fees	0.4	0.3	0.3	0.3	0.6	0.5
National revenues	1.7	5.6	5.8	5.5	5.9	5.3
Non-oil	1.1	0.7	0.8	0.7	0.9	0.8
Oil	0.6	5.0	5.1	4.8	5.0	4.6

Table 3. Sudan: Central Government Operations, 1999–2002 (concluded)

	1999	2000	Revised Program 2001	Actual 2001	Budget 2002	Program 2002
Total expenditure	8.9	12.4	13.2	12.8	15.9	13.6
Current expenditure	7.7	9.7	10.4	10.3	11.9	10.7
Wages, salaries, and pension	3.2	3.7	4.3	4.2	4.9	4.9
Debt service paid	0.8	1.2	1.3	0.8	2.0	1.2
Goods and services	1.5	1.9	1.6	1.6	2.1	1.4
General reserve	1.0	1.3	1.4	1.9	0.6	0.9
Other obligations	0.4	0.3	0.3	0.5	0.5	0.5
Social subsidies	0.3	0.3	0.5	0.5	0.6	0.7
Transfers to states	0.5	0.9	1.0	0.8	1.1	1.1
Capital expenditure	1.3	2.6	2.8	2.5	3.9	2.8
Locally financed	1.0	2.4	2.6	2.3	3.3	2.6
Of which: capital transfers to states	0.0	0.0	0.4	0.3	0.6	0.6
Foreign financed	0.3	0.3	0.2	0.2	0.7	0.3
Overall deficit (cash basis) 2/	-0.9	-0.8	-0.8	-1.0	-2.4	-1.0
Financing	0.9	0.8	0.8	1.0	2.4	1.0
Foreign financing	0.3	0.4	0.2	0.2	0.7	0.3
Domestic financing	1.0	0.3	0.6	1.3	1.7	0.8
BOS	1.1	0.2	0.3	0.9	0.9	0.2
DMBs	-0.1	0.0	0.2	0.1	0.4	0.3
Nonbank (GMCs)	0.1	0.0	0.1	0.4	0.1	0.3
Domestic arrear repayments	...	...	-0.2	-0.2	-0.2	-0.2
Privatization	...	...	0.2	0.1	0.4	0.2
Unpresented checks and discrepancy 3/	-0.5	0.1	0.0	-0.4	0.0	0.0
Memorandum items:						
Non-oil revenue	7.5	6.5	7.4	7.0	8.5	8.0
Oil revenue	0.6	5.0	5.1	4.8	5.0	4.6
GDP (in billions of Sudanese dinar)	2541	2832	3194	3130	3483	3483

Sources: Sudanese authorities; and Fund staff estimates.

1/ External debt service includes interest amortization and arrears repayments.

2/ Staff's definition. The domestic arrears repayments, internal public debt in authorities' presentation, and the principal payments of GMCs are recorded below the line in financing while in authorities' definition, both recorded above the line.

3/ This line captures government checks not yet cashed although the payment is recorded in the fiscal accounts, as well as the discrepancy between the monetary and fiscal accounts regarding banking system financing of the budget. The discrepancy in 1999 is high due to a reclassification in the monetary accounts of some transactions from other items net to credit to government.

9. **Total revenue in 2001 fell short of the program target despite some additional measures implemented in the second half of the year.** Oil revenue was adversely affected by the decline in international oil prices, some delays in transfers from the Sudan Petroleum Corporation (SPC) to the government, and the closing down of the El-Obeid refinery for maintenance in December. Shortfalls in non-oil revenue also occurred, caused mainly by weak performance of excise taxes and profit transfers from public enterprises, due to production difficulties and lower tax collection from Sudanese working abroad. In order to mitigate this drop in revenue, the authorities, in the last quarter of 2001, increased petroleum product prices by more than those envisaged under the program,[2] and raised import tariffs by an average of 3.5 percent.

10. **Expenditures were curtailed sharply compared to the program.** Both current and capital outlays were reduced. Current expenditures were reduced through cuts in external debt service and in spending on goods and services, as well as by running arrears on current transfers to the states and the pension fund. Capital expenditures, including transfers to the states, were cut despite a further unplanned government lending to the agricultural sector in the second half of the year.

11. **Monetary policy was tightened in the second half of the year.** Annual broad money growth on a 12-month basis declined from 42 percent in July to 25 percent in December 2001, with the increase in broad money held to 5 percent during the second half of the year (Table 4). The BOS took steps during the third quarter to reduce credit growth, including raising reserve requirements and the margin on Murabaha foreign financing,[3] restricting bank financing of imports, and slowing Bank of Sudan (BOS) lending to public enterprises. As a result, the growth of credit to the nongovernment sector slowed sharply in the second half of 2001, although the BOS net domestic assets and net claims on government exceeded the program targets (Table 5; and Figure 2). The increase in reserve money remained modest at 3.7 percent due to the loss of foreign reserves and the measures taken by the BOS, as described above.

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[2] The gasoil price was increased by 27 percent and the gasoline price by 26 percent, bringing them to about 25 percent above international prices.

[3] See Appendix I for a summary of Islamic finance instruments.

Table 4. Sudan: Monetary Survey, 1999–2002 1/

	Actual		Program	Actual				Program			
	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2001	Jan. 2002	Feb. 2002	Mar. 2002	Jun. 2002	Sep. 2002	Dec. 2002	Dec. 2002
Net foreign assets	-728.2	-677.5	-670.4	-696.5	-687.6	-676.4	-667.1	-680.5	-674.6	-669.2	-669.2
Bank of Sudan	-793.3	-747.3	-740.6	-777.1	-773.1	-769.0	-763.7	-765.9	-760.2	-755.1	-755.1
Commercial banks	65.1	69.8	70.1	80.6	85.5	92.7	96.6	85.3	85.6	85.9	85.9
Counterpart to valuation changes 2/	800.2	777.0	751.6	766.1	763.5	764.5	765.5	765.0	765.0	765.0	765.0
Net foreign assets (excluding valuation adjustment)	72.0	99.5	81.2	69.7	75.9	88.2	98.4	84.5	90.3	95.8	95.8
Net domestic assets	185.5	247.1	351.3	362.5	371.7	385.0	371.5	397.4	404.5	414.3	414.3
Net domestic credit	154.6	202.5	254.5	292.2	297.4	308.8	300.3	326.5	333.6	343.3	343.3
Net claims on central government	98.8	106.1	121.8	137.3	139.3	148.0	141.7	150.1	153.1	155.3	155.3
Bank of Sudan	102.1	108.2	117.0	117.0	136.3	149.7	144.5	142.8	143.8	145.0	145.0
Commercial banks	-3.4	-2.1	4.8	0.3	3.1	-1.7	-2.8	7.4	9.4	10.4	10.4
Claims on nongovernment sectors 3/	55.9	96.4	132.6	154.9	158.1	160.8	158.7	176.4	180.5	188.0	188.0
Other items (net) 3/	30.9	44.7	96.8	70.3	74.3	76.2	71.2	71.0	71.0	71.0	71.0
Broad money	257.5	346.7	432.5	432.2	447.6	473.2	474.5	481.9	494.9	510.0	510.0
Currency outside banks	108.1	142.1	...	153.8	155.4	172.2	161.4	169.0	175.3	183.6	183.6
Deposits	149.4	204.6	...	278.4	292.2	301.0	313.2	313.0	319.6	326.4	326.4
Memorandum items:											
Reserve money (in billions of Sudanese dinars)	163.7	221.5	227.6	229.8	229.0	248.3	248.8	249.7	256.4	264.3	264.3
Reserve money (annual percentage change)	34.6	35.3	2.7	3.7	8.2	16.8	16.7	16.2	17.8	15.0	15.0
Broad money (annual percentage change)	23.7	34.6	24.7	24.7	27.9	32.7	29.7	17.0	16.6	18.0	18.0
Currency to broad money (in percent)	42.0	41.0	...	35.6	34.7	36.4	34.0	35.1	35.4	36.0	36.0
Excess reserves to deposits (in percent)	17.5	19.7	...	13.6	12.3	11.6	13.8	13.0	13.8	11.9	11.9
Broad money multiplier	1.57	1.56	1.9	1.9	1.95	1.91	1.91	1.93	1.93	1.93	1.93
Velocity (average)	10.7	9.2	8.0	7.8	...		...	...	...	7.4	7.4
Usable international reserves/broad money (in percent)	5.3	10.0	8.1	2.7	2.8	3.3	3.8	4.5	5.5	6.3	6.3
Usable international reserves (in millions of U.S. dollars)	53	135	135	45	48	59	70	82	103	123	123

Sources: Sudanese authorities; and Fund staff estimates.

1/ Revised presentation, consistent with the IMF guidelines, adopted in January 2000.

2/ In 2002 calculated using the program exchange rate of SD 262.4 per US$.

3/ In December 2001, some other items net (SD 29 billion) of commercial banks were reclassified as credit to the nongovernmental sector.

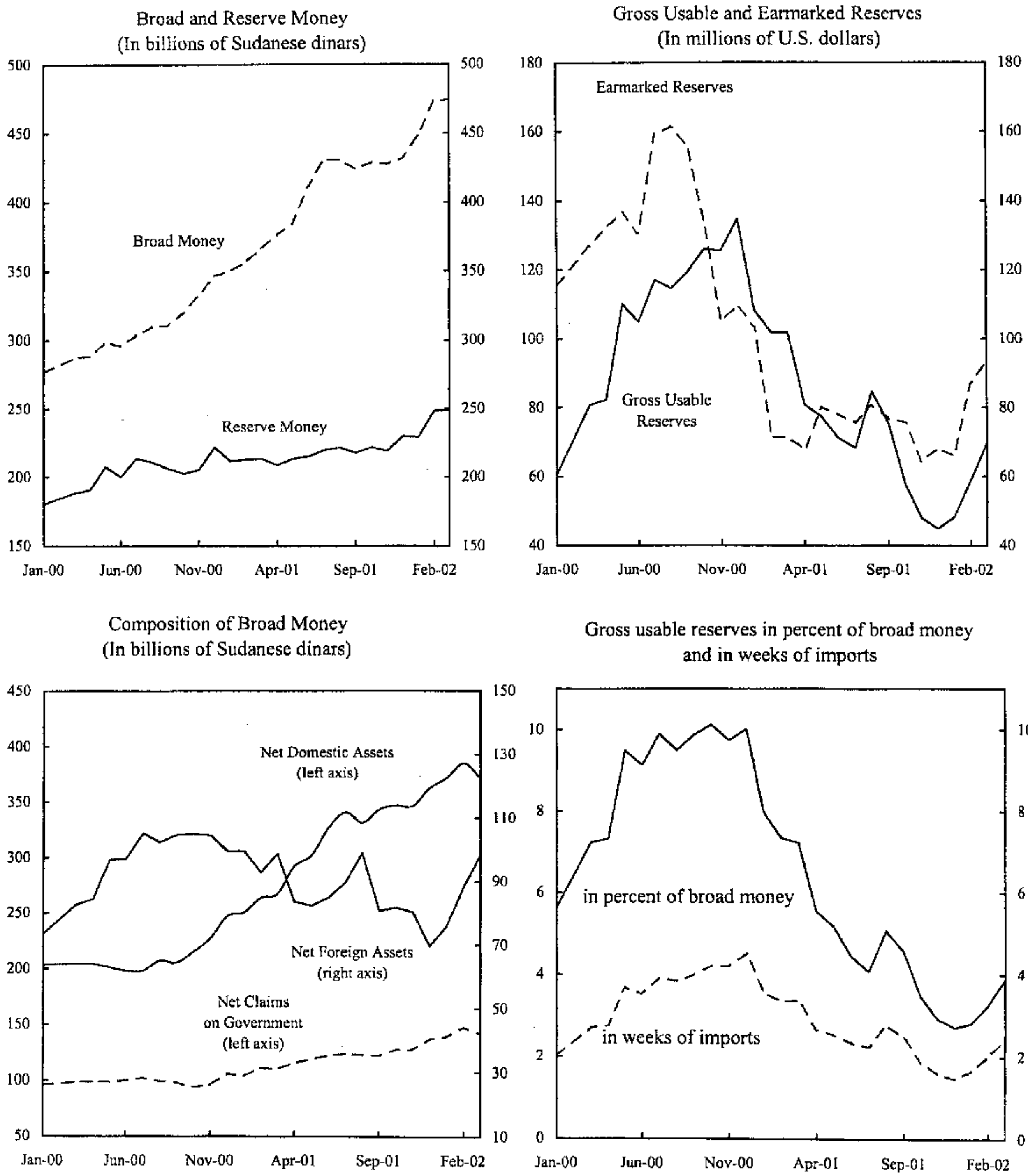
Table 5. Sudan: Monetary Authorities' Accounts, 1999–2002 1/

	Actual		Program	Actual				Program		
	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2001	Jan. 2002	Feb. 2002	Mar. 2002	Jun. 2002	Sep. 2002	Dec. 2002
	(In billions of Sudanese dinars)									
Net foreign assets	-793.3	-747.3	-740.6	-777.1	-773.1	-769.0	-763.7	-765.9	-760.2	-755.1
Foreign assets	45.0	73.1	73.3	41.2	41.8	49.5	53.3	51.1	56.7	61.9
Foreign liabilities	838.3	820.4	813.8	818.3	814.9	818.6	817.0	817.0	817.0	817.0
Counterpart to valuation changes 2/	799.8	776.2	754.2	766.0	762.9	763.9	764.8	764.8	764.8	764.8
Net domestic assets	157.2	192.6	214.5	240.8	239.2	253.5	247.7	250.7	251.8	254.5
Net domestic credit	113.9	133.1	149.5	163.8	164.9	177.6	172.9	175.8	176.9	179.6
Net claims on central government	102.1	108.2	117.0	137.0	136.3	149.7	144.5	142.8	143.8	145.0
Claims	107.3	116.7	...	146.7	151.5	161.4	160.6	152.5	153.5	154.7
Temporary advances	12.0	8.0	...	18.0	21.1	31.0	30.7	29.6	30.6	27.0
GMCs	0.0	1.2	...	21.3	23.0	23.0	22.4	15.4	15.4	20.2
Long-term claims	95.3	107.5	107.5	107.5	107.5	107.5	107.5	107.5	107.5	107.5
Deposits	5.1	8.4	...	9.7	15.2	11.7	16.1	9.7	9.7	9.7
BOS claims on public enterprises	7.2	17.1	20.5	14.8	14.9	14.6	13.6	14.6	15.0	15.0
BOS claims on banks	8.9	8.8	11.9	12.6	14.3	14.9	15.0	18.4	18.1	19.6
Money market instruments (CMCs)	-4.2	-1.1	0.1	-0.6	-0.6	-1.6	-0.2	0.0	0.0	0.0
Other items (net)	43.3	59.5	65.0	77.0	74.3	75.9	74.8	75.0	75.0	75.0
Reserve money	163.7	221.5	228.2	229.8	229.0	248.3	248.8	249.7	256.4	264.3
Currency outside banks	108.1	142.1	...	153.8	155.4	172.2	161.4	169.0	175.3	183.6
Reserves of commercial banks	48.2	65.7	...	64.7	63.3	64.3	72.3	69.0	69.1	68.1
Required reserves 1/	22.0	25.5	...	26.8	27.3	27.5	27.7	28.2	28.8	29.4
Excess reserves	26.2	40.3	...	37.9	36.0	34.9	43.2	40.8	40.3	38.8
Deposits at BOS included in broad money	7.4	13.7	...	11.3	10.2	11.8	15.1	11.8	12.1	12.5

Sources: Sudanese authorities; and Fund staff estimates.

1/ Revised presentation, consistent with the IMF guidelines, adopted in January 2000.
2/ In 2002 calculated using the program exchange rate of SD 262.4 per U.S. dollar.

Figure 2. Sudan: Monetary Developments, January 2000–March 2002



Source: Bank of Sudan.

Sudan: Monetary Developments, June 2001–December 2001
(In billions of Sudanese dinar)

	June	December	
	Actual	Rev. prog.	Actual
Broad money	411.9	432.5	432.2
NFA (excluding valuation)	84.9	81.5	69.7
NDA	327.0	351.0	362.5
Net claims on government	122.7	121.8	137.3
Credit to nongovernment 1/	115.6	132.6	154.9
Other items net 1/	88.7	96.8	70.3

1/ In December 2001, some other items net (SDD 29 billion) were reclassified as credit to the nongovernmental sector.

12. **Developments in the first quarter of 2002.** Inflation rate rose to 9.6 percent on a 12-month basis in March 2002, reflecting increases in food and petroleum product prices, as well as delayed effects of rapid money growth in the first half of 2001. The fiscal deficit amounted to SDD 19.7 billion compared to an annual target of SDD 36.3 billion, largely reflecting higher than expected lending to the agriculture sector, at least part of which should be repaid later in the year. The 12-month growth of broad money increased to almost 30 percent by end-March 2002, mainly due to accumulation of net foreign reserves by both the BOS and commercial banks. International reserves increased to US$70 million by end-March 2002.

13. **Some progress was made in structural reforms during the second half of 2001, but a number of benchmarks under the SMP were not met.** The budget for 2002 was prepared according to the GFS classification. A restructuring plan for the Agricultural bank was finalized, and the prudential framework for the banking sector was strengthened. However, a number of benchmarks were not met, particularly those related to netting operations among government agencies, and the formulation of a plan to improve state finances, (see Table 3 of the MEFP). In the agricultural sector, the action plan and the timetable for the reform of the Gezira agricultural scheme have not yet been approved, although some reforms have already been implemented in this area.

14. **The first audit of the SPC and the public oil sector by the auditor general was completed on time at end-2001.**[4] The auditors found no irregularities in the operations of the SPC, but were critical of its accounting of the government's oil revenue. They recommended a transparent accounting system that would allow fast and easy extraction of data. They also strongly urged the SPC to hire qualified accountants, and that the SPC, Ministry of Finance (MOF), Ministry of Energy, and BOS improve coordination, including in the reconciliation of oil revenue data.

15. **The collection and accounting of the government's oil revenue has been improved.** The frequent occurrence of arrears in the transfer of oil revenue from the SPC to the budget has been addressed. Also, the budget now fully incorporates the debt service payments for the construction of the Khartoum refinery into the budget.

16. **Progress has been achieved in strengthening prudential supervision and reforming the banking sector.** The loan-loss provisioning requirement for bad loans was raised in 2001 from an average of about 30 percent to 100 percent, with the corresponding limits for substandard and doubtful loans of 20 and 50 percent, respectively. Oversight of commercial banks with large shares of nonperforming loans was tightened; the lending policies of banks with the share of nonperforming loans exceeding 15 percent are currently under review by the BOS inspectors. The authorities initiated the restructuring of El-Nilein bank (the third largest bank) and the Agricultural Bank, focusing on reducing the number of branches, laying off excess labor, clearing wage arrears, and updating accounting and auditing systems. The restructuring of the Khartoum Bank (the second largest bank) and the Real Estate Bank was completed in 2001 and they will be put up for privatization in 2002. In spite of the progress made in addressing the difficulties facing banks, the sector remains in distress as evident by the high level of nonperforming loans (hovering around 15 percent of total loan portfolio) and low profitability.

17. **Payments to the Fund and to other international organizations were reduced in 2001.** As a result of the deteriorating external environment in the second half of 2001, Sudan did not make the agreed payments to the Fund (US$5.5 million per month) for the last quarter of that year. During the course of 2001, Sudan also substantially scaled back its payments to all other creditors, including the World Bank.[5]

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[4] The audit covered the period from the onset of oil production in mid-1999 to the end of 2000.

[5] Sudan paid to the Fund US$55 million, of which US$49.5 million were for obligations falling due in 2001, In addition, Sudan paid a total of US$37 million in debt service to creditors other than the Fund, compared with US$89 million planned under the program.

III. Report on Policy Discussions

18. **Subject of discussions.** The discussions focused mainly on the 2002 program and the need to substantially strengthen economic policy so as to reinforce macroeconomic stability and meet the challenges of the weaker external environment. In addition, the mission discussed the medium-term strategy of the authorities and assessed Sudan's capacity to repay the Fund.

A. Medium-Term Strategy

19. **The medium-term reform strategy aims at consolidating macroeconomic stability, removing remaining obstacles to sustained economic growth, and reducing poverty.** The authorities emphasized that macroeconomic stability had become a central policy objective, viewing it as essential for achieving sustained economic growth and poverty reduction. Their medium-term macroeconomic objectives include annual GDP growth rates exceeding 6 percent, maintaining consumer price inflation at about 5 percent, and strengthening the external position, notably reserves (Table 6). To achieve these objectives, the authorities intend to pursue prudent monetary and fiscal policies, containing the budget deficit to less than 1.0 percent of GDP.[6] They will pay particular attention to the macroeconomic and structural changes resulting from the development of the oil sector with a view to maintaining competitiveness and providing a sound basis for the further diversification of the economy.

20. **Structural reforms will build on the considerable progress achieved since 1997 (see paragraph 8 of the MEFP).** The reforms will concentrate on strengthening public finances, increasing the effectiveness of monetary policy, deepening and restructuring the financial sector, further advancing trade reform, improving the investment climate, completing the privatization program, strengthening the social safety net, and implementing programs for poverty alleviation and rural development. The implementation of these reforms should be supported by rising net receipts from oil exports and from strengthened non-oil revenue performance which would allow increased public investment in infrastructure and human development. In the coming months, the authorities intend to build on the reforms envisaged in the 2002 program and develop their medium-term reform agenda in time to be incorporated in the 2003 program, in close consultation with the Fund staff and other international organizations. The authorities view establishing peace in Sudan and normalizing relations with all creditors as essential to accelerate the inflow of foreign investments and the release of much needed external financial assistance.

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[6] The medium-term scenario presented in Table 6 is an update, based on staff projections, of the last Article IV consultation's scenario, which was considered by the Board on November 14, 2001. The medium-term scenario will be reevaluated when the medium-term strategy is developed with the authorities during the second half of 2002.

Table 6. Sudan: Medium-Term Macroeconomic Scenario, 1999–2006

	Actual			Projections				
	1999	2000	2001	2002	2003	2004	2005	2006
	(Change in percent)							
Production and prices								
Nominal GDP (in billions of Sudanese dinar)	2,541	2,832	3,130	3,483	3,887	4,339	4,847	5,419
Real GDP	6.9	6.9	5.3	5.0	6.3	6.3	6.4	6.5
Non-oil	5.9	3.0	4.5	4.8	6.2	6.3	6.4	6.5
Oil	118,672	337.0	16.7	8.1	13.0	7.7	5.0	5.0
Inflation (period average)	16.0	8.0	4.9	6.0	5.0	5.0	5.0	5.0
	(In percent of GDP)							
Investment and saving								
Gross domestic investment	16.7	18.1	18.3	18.2	18.0	19.8	20.8	22.9
Government sector	1.3	2.6	2.5	2.8	3.2	5.1	5.8	6.7
Nongovernment sector	15.4	15.5	15.6	15.7	15.8	15.8	16.0	16.2
Non-oil sector	12.3	12.7	13.2	13.4	13.6	13.8	14.0	14.2
Oil sector	3.1	2.8	2.4	2.3	2.2	2.0	2.0	2.0
Gross domestic saving	9.4	17.8	14.4	16.3	15.6	17.1	18.2	20.0
Government sector	0.4	1.8	1.5	1.8	2.7	4.6	5.3	6.2
Nongovernment sector	9.0	16.0	12.8	14.7	13.9	13.6	13.9	13.7
Net exports of goods and nonfactor services	-7.2	-0.3	-3.9	-1.9	-2.4	-2.7	-2.6	-2.9
Central government operations								
Total revenue	8.1	11.5	11.8	12.5	13.0	14.7	15.2	15.7
Oil revenue	0.6	5.0	4.8	4.6	4.9	5.9	5.7	5.6
Non-oil revenue	7.5	6.5	7.0	8.0	8.0	8.8	9.5	10.1
Total expenditure	8.9	12.4	12.8	13.6	13.5	15.2	15.7	16.2
Current expenditures	7.7	9.7	10.3	10.7	10.3	10.1	9.9	9.5
Capital expenditure	1.3	2.6	2.5	2.8	3.2	5.1	5.8	6.7
Overall deficit (cash basis)	-0.9	-0.8	-1.0	-1.0	-0.5	-0.5	-0.5	-0.5
Foreign financing	0.3	0.4	0.2	0.3	0.3	0.3	0.3	0.3
Domestic financing	0.5	0.4	0.8	0.8	0.2	0.2	0.2	0.2
External sector								
External trade balance	-6.3	2.8	0.8	2.6	2.1	1.6	1.4	1.1
Exports	7.7	16.9	13.9	14.2	14.2	13.8	13.5	13.1
Imports	-14.0	-14.1	-13.1	-11.6	12.1	-12.2	-12.1	-12.0
Capital/financial account balance (millions of U.S. dollars)	-60	-104	-45	-15	-39	-60	-90	-88
Gross official reserves (months of imports)	0.5	0.9	0.3	1.0	1.4	1.8	2.1	2.3
Total external debt service (as percent of current receipts) 1/								
Commitment basis	84.4	53.8	38.4	38.7	37.7	38.4	38.9	38.3
Actual payments	4.2	4.6	3.5	4.3	4.7	5.0	5.2	5.3
Export volume (change in percent) 2/	-12.5	-5.8	-24.1	34.6	9.7	7.3	6.9	6.7
Import volume (change in percent) 2/	2.4	32.6	7.2	-0.4	6.7	6.5	6.3	6.2
Terms of trade (change in percent) 2/	1.3	0.3	-6.1	-0.7	2.1	0.4	0.8	-0.1
Memorandum item:								
Current account on a cash basis (in percent of GDP)	-4.1	-3.6	-4.0	-3.8	-3.8	-3.2	-3.2	-2.9

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

1/ The medium-term scenario does not incorporate assumptions regarding a debt workout, but continuation of the status quo with a gradual increase in total debt service payments reflecting improvements in Sudan's payments capacity.

2/ Non-oil transactions.

B. Macroeconomic Program for 2002

21. **Macroeconomic objectives.** The program for 2002 aims at reinforcing macroeconomic stability and further advancing structural reforms in key areas (see Box 1) to meet the challenges of the weaker external environment and to sustain growth. The program targets real GDP growth of about 5 percent while containing inflation to 6–7 percent (Table 1). The current account position is expected to somewhat improve compared to 2001, as gains from the resumption of livestock export and increased petroleum shipments are likely to be offset by a further decline in oil export receipts owing to lower international prices (Table 2).[7] The program targets a buildup of gross usable reserves to US$123 million (4 weeks of imports), while resuming payments to the Fund and other creditors.

Exchange rate and external sector policies

22. **A new exchange rate system is in place.** In December 2001, the authorities introduced an auction based foreign exchange system and will implement a managed floating exchange rate regime (see Box 2 for details). Simultaneously, they abolished the fees on the BOS's sales of foreign exchange and the surcharge on banks' commissions and profits from the sales of foreign exchange. To further increase market flexibility and achieve the programmed international reserve target, the authorities agreed with the mission to widen the exchange rate band on the auction to 1 ½ percent, and to use monetary instruments to respond to exchange rate pressures rather than accommodating the demand for foreign currency. Under the new system, exchange rate movements would reflect market conditions while allowing the BOS to smooth out short-term fluctuations. The mission welcomed these modifications which should allow greater exchange rate flexibility than experienced so far (Figure 3). It noted, however, that there is still room for improvement, including widening and applying the band to the interbank market, and pre-announcing the volume of foreign exchange to be auctioned. The authorities agreed with the mission, but indicated that the new system should be firmly in place, with the market participants having had a chance to adapt to it, before any changes are introduced. The mission urged the authorities to request Fund technical assistance to review the new system.[8]

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[7] Based on WEO projections, the program assumes on average price of US$20 per barrel (Nile f.o.b.), compared with an average price of US$22.6 per barrel in 2001.

[8] Given that the new exchange system is still evolving, the staff is continuing discussions with the authorities and collecting information to ensure that the new system does not give rise to exchange restrictions, including multiple currency practices that are subject to Fund approval.

Box 1. 2002 Macroeconomic Program—Key Elements

Objectives

- Real GDP growth rate of about 5 percent.

- Average annual inflation rate of 6 percent to 7 percent.

- Current account deficit (cash basis, excluding transfers) of about 3.8 percent of GDP.

- Increase the net international reserves by US$78 million to US$123 million (4 weeks of imports).

Macroeconomic Policies

- Limiting the budget deficit to 1 percent of GDP.

- Introducing more flexible exchange rate system.

- Limiting the growth of broad money and reserve money by 18 percent and 15 percent, respectively, and the growth of net domestic assets of BOS by 5.7 percent.

- Rendering monetary policy more effective by instituting a coordinating mechanism with fiscal policy.

Structural Reforms

- *Fiscal policy*: Strengthening non-oil revenue, rationalizing tax exemptions, deepening the implementation of the VAT, reforming the direct tax system, improving the tax and customs administration, and developing and institute an expenditure smoothing mechanism in order to reduce the vulnerability of the budget to fluctuations in oil prices.

- *Monetary policy*: Moving closer to full indirect monetary control system, developing a second generation of financial instruments in line with Islamic finance principles, strengthening monitoring mechanisms and coordination with fiscal policy, and reforming agriculture finance.

- *Banking system*: Enhancing banks capital base and restructuring their loan portfolio, continuing bank restructuring and privatization, issuing anti-money laundering circular, and developing commodities future markets.

- *Privatization*: Accelerating privatization. Enacting a procurement law.

- *Social sector reform*: Finalizing the interim PRSP.

Box 2. The New Foreign Exchange System

The authorities maintained *de facto* fixed exchange rate regime from July 1999 until December 2001, with the Sudanese dinar stabilizing at about SDD 258 per US$1. The authorities introduced a more flexible exchange rate system in December 2001. The following are the main operational features:

- BOS sales and purchases of foreign exchange will be carried out through bi-weekly auctions.

- The BOS calculates an indicative rate based on the weighted average of transactions between the BOS, banks, nonbank dealers, and by individual foreign currency account holders, both within and across these groups during the previous day.

- The buying rate of the BOS is set at the level of the indicative rate and the selling rate is defined as the buying rate plus 1 percent. The midpoint between the two rates (central rate) is used for accounting purposes of government transactions.

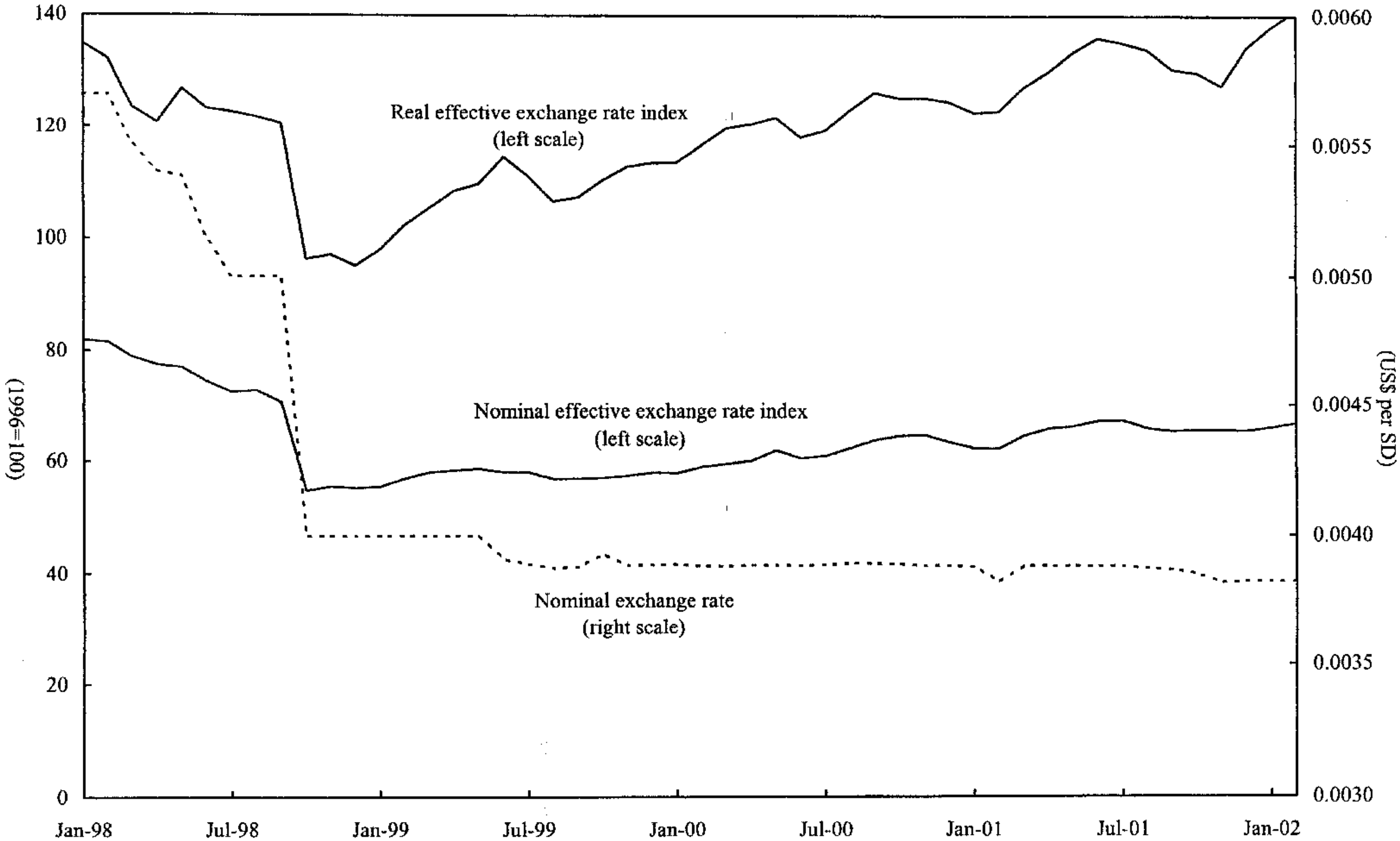
- Bids in BOS auctions are accepted within a band of $\pm$ 1.5 percent around the indicative rate, taking into consideration the market trend over the preceding three days.

- The auctions are based on the Dutch auction system, i.e., allotments are made in a descending order at the bid-rates until the supply is exhausted.

- The quantity of foreign exchange supplied by the BOS at the auction is decided in advance by a committee chaired by the governor, but it is not pre-announced at present. The amount varies from auction to auction taking into consideration external and monetary developments.

- There are no direct BOS interventions in the foreign exchange market outside of the auctions. However, short term fluctuations will be smoothed using open market operations in securities.

Figure 3. Sudan:Nominal Exchange Rate and Real and Nominal Effective Exchange Rates, 1998 - February 2002



23. **An interbank foreign exchange market is emerging.** The authorities are actively encouraging the development of an interbank foreign exchange market. To build confidence in banks to trade with each other and to establish trading processes, the BOS encouraged a number of leading banks to organize themselves as a "market-making" group, in order to pool resources and trade actively among themselves as well as with other market participants. Another group of banks is about to be formed, and two or three more groups are likely to emerge in the near future.

24. **The authorities intend to reverse the recent tariff increase by year end.** The authorities view these increases as temporary measures to counter the acute revenue shortfall triggered partly by external price developments, and intend to reverse them by end 2002. This would reduce the simple average tariff rate from 19.9 percent at present to about 16.5 percent. The authorities will also phase out the remaining restrictions on bank financing of imports (mainly the required advanced deposits on letters of credit) in conjunction with increasing capacity to absorb the released liquidity.[9]

25. **A new trade reform program is to be developed.** The authorities noted that the tariff protection, after reversing the recent tariff increase, is moderate, and nontariff barriers are largely nonexistent. Nevertheless, they intend to develop, in consultation with Fund staff, a new medium-term trade reform program, with the objective of further rationalizing the tariff structure to reduce the maximum and average level of import tariffs, and eliminating the defense tax that was introduced in 2001.[10]

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[9] The restrictions on import financing consist mainly of the requirement of advance deposits. For domestic financing, banks shall collect, as an advance, a 100 percent monetary margin on import transactions. Regarding foreign financing, the banks must collect from their clients an advance payment or first installment in the amount of 25 percent for dollar Murabaha operations. Similarly, the percentage of client's participation under Musharaka financing cannot be less than 25 percent of the volume of the financed operations. Although the advance import deposits are not remunerated, they do not seem to give rise to a multiple currency practice since there is no associated opportunity cost due to the lack of financial instruments, i.e., there are no remunerated term deposits (on fixed interest rate basis) under the Islamic banking system practiced in Sudan.

[10] A 5 percent "defense tax" was imposed in August 2001 on imports that are not subject to zero tariff rate or exempted from tariffs (see EBS/01/179).

Fiscal Policy

26. **Fiscal policy will be tightened compared to the authorities' 2002 budget.** The 2002 budget approved by the National Assembly envisaged a deficit of 2.4 percent of GDP. However, the deficit could have reached 3.4 percent of GDP without additional measures given the budget's optimistic oil price assumption.[11] The authorities agreed to limit the deficit to 1 percent of GDP, consistent with the program's macroeconomic objectives and adequate bank financing to nongovernment sectors.[12] To accomplish the adjustment, the authorities have adopted several revenue measures, in addition to those already envisaged under the original budget, and will cut expenditures to below budgeted levels. Moreover, the authorities identified contingency revenue measures and indicated their readiness to further cut spending, if necessary, while protecting social programs (see paragraph 14 of the MEFP). The fiscal situation will be reassessed during the mid-year review and, if needed, supplementary budget measures can be identified and subsequently implemented in an orderly and timely manner.

27. **Total revenues are projected to rise moderately.** Compared to 2001, the revenue increase in 2002 (0.7 percent of GDP) will be fully on account of non-oil revenue which is expected to increase by 1.0 percentage point of GDP (0.7 percent of GDP from tax revenue and 0.3 percent of GDP from nontax revenue). Revenue from oil exports is projected to decline, as the expected production increase in 2002 from 209,000 barrels per day to 230,000 bpd will be more than offset by lower oil prices and rising domestic consumption (Table 3).

28. **Non-oil revenue is expected to improve significantly** reflecting the full year effect of revenue measures introduced toward the end of 2001, (1 percent of GDP which is 0.7 percent of GDP higher than collected in 2001), and new measures, including temporarily broadening the "defense tax" base [13] (which will be reversed at the end of the year) and increasing the excise tax on sugar (0.1 percent of GDP). Moreover, collection of departmental fees and public enterprise profits is expected to strengthen (0.3 percent of GDP).[14] Finally, the authorities agreed, in the context of the 2002 program, to remove VAT exemptions on imports and sales of capital goods (0.1 percent of GDP).

29. **Total expenditures will rise as a share of GDP compared to 2001.** The increase in expenditure is largely driven by a 25 percent increase in the government wage and pension

[11] The authorities budget was based on an oil price assumption of US$24.8 per barrel for Brent (equivalent to about US$25.8 per barrel for the WEO compound price), which translates into an export price of US$22.8 per barrel fob for Nile oil.

[12] The authorities indicated that it will not be necessary for the National Assembly to ratify the adjustments to the budget agreed to under the program.

[13] A 2 percent defense tax was imposed on imported manufacturing inputs (which are exempted from tariff) in early January 2002.

[14] Mostly because of an increase in profit transfers and fees from SPC.

bill, part of which is earmarked for the ongoing restructuring of the civil service . The authorities argued that scaling down the increase in the wage bill was not politically feasible and, accordingly, the burden of adjustment will be on other current and capital outlays. Current expenditures will be reduced by 1.2 percent of GDP below the original budget, mostly through reduced spending on goods and services (53 percent of which from cuts in military expenditures), as well as lower external debt service payments (see paragraph 13 of the MEFP). Capital expenditures will also be reduced by 1.1 percent of GDP below the original budget; of which more than one-third is due to an expected shortfall in external financing mostly because of slower implementation of some externally financed projects. However, spending on priority social programs will remain at the budgeted level (Table 3).

30. **Military spending will be reduced.** Military expenditures were originally budgeted at SDD 102.4 billion (2.9 percent of GDP), which is about 13.5 percent above the 2001 level. As part of the expenditure containment that is necessary to achieve the deficit target, the authorities intend to cut military spending by about 13.4 percent below the budget to SDD 88.7 billion (2.5 percent of GDP). The authorities assured the mission that the envisaged cuts in military spending are feasible in light of the on-going peace efforts, including the recent partial cease fire agreement.

31. **Domestic oil prices will be reviewed more frequently.** The authorities assured the mission of their commitment to the policy of not subsidizing domestic sales of oil and petroleum products, which they have been implementing since 1998. To prevent subsidies from inadvertently emerging during periods of rising oil prices, the authorities will review petroleum product prices on a quarterly basis, adjusting them as needed (see paragraph 14 of the MEFP).

32. **The authorities identified contingency fiscal measures.** The authorities will implement additional measures to contain the deficit, if expenditure pressures arise (including from the need to provide further financing for agriculture) or revenue projections are not realized. Revenue measures could include the imposition of excise taxes on domestic sales of petroleum products and on mobile phone charges. If the revenue measures are not sufficient, the authorities indicated that they would make the necessary expenditure cuts (mainly from goods and services and capital spending), while protecting the budgeted social spending.

Monetary policy

33. **Fiscal consolidation will be complemented by a cautious monetary policy** geared at keeping inflation under firm control, while replenishing international reserves. Broad money growth is targeted to decline from 25 percent in 2001 to about 18 percent in 2002, a level that is consistent with inflation and growth objectives, while gross usable reserves are targeted to increase by US$78 million to US$123 million. Even with the sizable targeted buildup in international reserves, the average money growth should allow for an adequate increase in credit to the nongovernment sector, which is expected to grow by 21 percent in 2002 (Table 4).

34. **With the shift to a more flexible exchange rate system, the role of monetary policy in maintaining price stability will become crucial.** Since inflation targeting would not be feasible at this stage in Sudan given the institutional weaknesses, broad money growth will increasingly play a central role as the nominal anchor. The mission noted that the switch to the new anchor is appropriate but its implementation would face a number of challenges. There has been evidence of a structural rise in money demand over the past four years, the extent of which, however, is not yet clear. In addition, there is some uncertainty regarding the growth projections and the prospect for foreign exchange flows. These factors call for a cautious approach to monetary policy with frequent reviews, as well as close coordination with fiscal policy. The broad money growth target will be reassessed during the mid-year review to make sure that it remains in line with the program's macroeconomic objectives.

35. **Monetary policy will be supported by active use of indirect monetary instruments.** The authorities have succeeded in developing indirect monetary instruments of sufficient depth to manage liquidity without the need to resort to direct intervention. To increase the effectiveness of indirect monetary controls, the BOS will start conducting open market operations in government securities through regular auctions, allowing market determination of their prices. In addition, the authorities will eliminate the upper limit on banks' Murabaha margins, that was imposed in 2001, and indicated that they feel confident to consider eliminating the lower limit (the main direct control instrument) as well. The mission noted the importance of BOS developing further its capacity to manage liquidity, particularly in light of possible residual overhang from last year's monetary expansion. The authorities were encouraged to request Fund technical assistance in this area.

C. Structural Reforms in 2002

36. **The program envisages wide-ranging structural reforms** that are geared toward removing the obstacles to economic growth, strengthening the policy conduct, and reducing poverty. The reforms include measures to strengthen public finances, increase fiscal transparency, improve the efficiency of monetary policy, strengthen the financial system, address the difficulties facing the agriculture sector, accelerate the privatization program, and strengthen poverty alleviation efforts. While concrete actions will be taken in 2002 in many of the above mentioned areas, (see Table 4 of the MEFP) the program also envisages the initiation of preparatory work for structural reforms that can be implemented only over the medium term.

37. **Non-oil revenue will be strengthened.** The authorities agreed on a program to strengthen the performance of non-oil revenue with Fund technical assistance. As detailed in paragraphs 21 to 23 in the MEFP, the authorities efforts will concentrate on deepening the implementation of the VAT (see Appendix II), reforming the direct taxation system (see Box 3), and rationalizing the tax incentive regime. The mission pointed out that most of the envisaged reforms will bear fruit only over the medium term, since the reform process would involve comprehensive reviews and amending of laws. The mission urged the authorities to

identify areas where concrete steps can be taken in a short period of time, particularly with regard to tax exemptions. The authorities agreed to expedite the review of all tax exemptions (no later than end June 2002) and to begin rationalizing the exemptions based on the outcome of the review, including in the context of next year's budget.

38. **The management of oil revenue will be reformed.** To reduce the vulnerability of the budget to oil price fluctuations, the program foresees establishing, in the context of a rolling three-year medium-term budget, a process whereby prudent expenditure limits are determined premised on a conservative oil price assumption and on a steady adjustment path of the non-oil fiscal balance (see Box 4). The process is expected to be finalized in the third quarter of 2002, in time to be incorporated in the 2003 budget. In the meantime, the authorities agreed to a mechanism whereby expenditures in 2002 will be based on an oil-price assumption of US$20 per barrel, and any oil revenue arising from higher prices will be saved.[15]

39. **Expenditure management will be reinforced.** The authorities agreed to implement, starting June 2002, the GFS classification on a quarterly basis, and subsequently on a monthly basis in 2003. They also established a timetable for abolishing the netting of expenditures against revenues among government agencies (paragraph 27 of the MEFP).[16]

40. **Oil sector transparency is improving.** The authorities have begun implementing the recommendations of the SPC audit, including improving the accounting system, reconciling oil production and oil revenue data, and strengthening cooperation between the concerned agencies and ministries through monthly meetings. The audit of the SPC and the public oil sector for 2001 has commenced and is expected to be concluded by June 2002. In addition, the authorities will implement a system that will ensure cash payment, as budgeted, of oil collateralized debt service payments in order to avoid in-kind payments, thus increasing transparency in the accounting of oil revenue. Similarly, in-kind deliveries of petroleum products by the SPC to government agencies and the subsequent netting operations related to such deliveries it will be largely eliminated.

[15] The program incorporates an adjustor to targets on total domestic and BOS's net financing of the budget deficit, and BOS's net domestic assets. Since a savings fund for future generations is not intended to be established, given the massive development needs of Sudan, revenue from sustainable increases in production will be incorporated in the budget.

[16] The netting operations have not so far caused any significant accumulation of arrears. However, they complicate expenditure management, reduce fiscal transparency, and may give rise to concerns regarding governance.

Box 3. Sudan: Direct Tax Reform

Reforming the direct tax system is the next phase in Sudan's tax reform program after having completed the indirect tax reform program which introduced the VAT in mid-1999. Currently the direct tax system is composed of several taxes, which are all collected by the central government, and then earmarked for the federal and state governments. They include the profit and wage withholding taxes from legal persons (federal), the income tax from Sudanese individuals working abroad (federal), the profit tax from self-employed persons (state), some capital gains and rent taxes (state), and stamp duties (federal and state).

The direct tax system is based on very much outdated legislation and a weak and inefficient administration. The scope for improvement is wide, with significant potential for efficiency gains, and could play an important role in mobilizing new resources for the government.

A review of income tax policies and a redrafting of the legislation on the basis of that review, is urgently needed. The reform should mainly focus on the following issues:

- revising the tax sharing arrangements between federal and state budgets;
- modernizing the current systems and procedures of the tax administration, so as to render them more effective;
- enhancing the compliance control capacity by enforcing field audit programs and by providing audit training;
- implementing a functional organization in the tax offices by separating the audit and collection functions in order to avoid collusion; and
- integrating the three office networks; profit tax; withholding tax; and stamp duties; into one single office that handles all domestic taxes.

Box 4. Oil Revenue Management

Oil revenue share in total revenue is rising rapidly since the onset of oil production in mid-1999. This, however, is exposing the budget to the uncertainty and volatility associated with international oil prices, with a potentially adverse impact on fiscal stability.

The authorities intend to introduce a standardized and transparent mechanism to better manage oil revenue, in order to smooth expenditures and shield the budget and the domestic economy from the adverse impact of volatile and unpredictable world market prices of crude oil. However, given the massive development needs of Sudan, the new mechanism is not intended to function as a saving fund for future generations. The broad outline of this mechanism is as follows:

- The annual budgets will be prepared within the context of a rolling three-year medium-term budget.
- Medium-term expenditure limits will be set based on a conservative oil price assumption and on a steady adjustment path of the non-oil fiscal balance.
- Excess oil revenues resulting from higher oil prices would be deposited in the BOS.
- In case of lower oil prices, an accumulated financing margin would be used to prevent sharp expenditure cuts and smooth the fiscal adjustment.

41. **The range of instruments for indirect monetary management and for raising noninflationary financing to the budget is widening.** The authorities are keen on further enhancing the existing instruments and developing new ones. The authorities intend to develop a second generation of government securities to ultimately replace the Government Musharaka Certificate (GMC) and Central Bank Musharaka Certificate (CMC), with Fund technical assistance.[17] In the meantime, the government has added additional enterprises to the GMC fund which would increase the fund's capacity to issue new securities.

42. **Strengthening the banking system is a priority.** The banking system in Sudan has gone through substantial liberalization since 1997 which coincided with a major disinflation program. The mission pointed out that under these circumstances it is important to develop a medium-term reform plan based on a comprehensive assessment of the present condition of

[17] See Appendix I for a description of the GMC and CMC.

the banking system. The authorities have requested that Sudan be considered for a financial sector assessment program (FSAP) which could form the basis of the reform plan. In the meantime, the authorities will step up their efforts to address the problem of banks' nonperforming loans. The BOS has established several committees which have been working with banks to reduce nonperforming loans and will monitor their implementation, and penalties will be imposed on banks that do not comply with the provisioning requirements. The BOS will also continue with the effort to raise banks' capital base. Finally, the authorities are moving forward with privatizing and restructuring public banks (see paragraph 28 of the MEFP).

43. **The authorities intend to enact an anti-money laundering law**, and a draft is expected to be prepared soon. In the meantime, by end-September, the BOS will issue an anti-money laundering circular to banks by to prevent illicit financial activities.

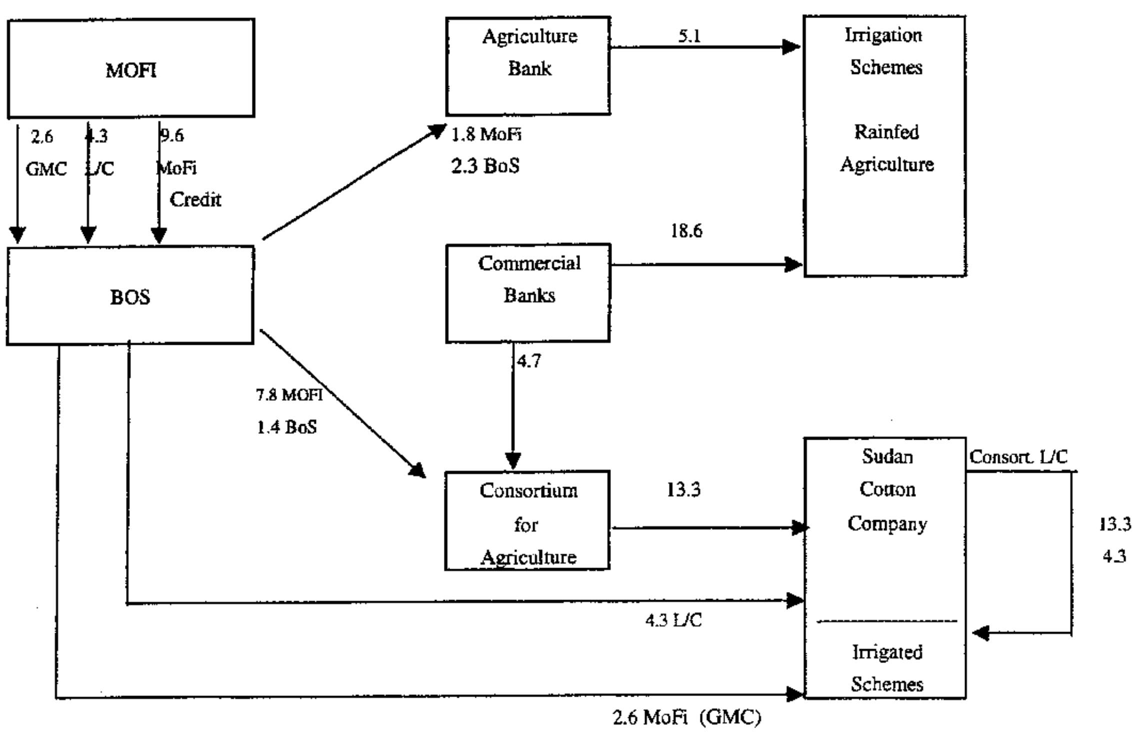
44. **Reforming agriculture finance.** Considerable efforts are needed to put in place a proper agriculture finance infrastructure that sustains the sector's financing needs while allowing the gradual replacement of the substantial public support with a greater market role (see Box 5; and Appendix III). In particular, markets where agriculture risks can be hedged need to be developed, proper insurance schemes need to be established, and the role of the government and other public agencies, particularly in addressing market failure, should be identified and streamlined. These are complex issues and the authorities' ability to address them will depend on technical assistance from international financial institutions. As a beginning, the authorities will review the role of the government in financing agriculture and take steps, with Fund technical assistance, to establish commodity future markets, consistent with Islamic finance principles.[18]

[18] The World Bank is expected to help in establishing credit schemes for small farmers and reforming the large irrigated agriculture entities.

Box 5. Financing of the Agricultural Sector

- During 2001, total lending to agriculture amounted to about SDD 44 billion, of which the Ministry of Finance and the Bank of Sudan provided about SDD 20 billion. In addition, the Ministry of Finance had considerable contingent liabilities through its guarantees of GMCs and loans extended by commercial banks via the bank consortium for agriculture.
- The main bulk of the credit was extended to the irrigated schemes (about 60 percent). The traditional small farmers received only 1 percent of the loans, whereas mechanized rainfed farmers (and some larger animal farms) received the remaining credits.
- In principle, credits were funded by private depositors (SDD 23.7 billion), the Ministry of Finance (SDD 16.5 billion) and the Bank of Sudan (SDD 3.7 billion).
- Credit was mainly channeled via commercial banks, who extended about SDD 18.6 billion directly through bank offices. Commercial banks also extended SDD 4.1 billion indirectly through the consortium for loans to agriculture. The government contributed SDD 9.2 billion through the consortium. The Agricultural Bank extended SDD 5.1 billion in loans to agriculture. The MOF also financed SDD 4.3 billion in letter of credit for imports of Sudanese Cotton Company and extended credit of SDD 2.6 billion (GMC issues) to the schemes through the BOS.

Financing Flows
(In billions of Sudanese dinar)



45. **The authorities have intensified their privatization efforts in 2002.** The Slaughterhouse Company and the Atbara Cement Factory have been privatized.[19] The Sudan Duty Free Zone Company and the Bridges and Roads Corporation are expected to be divested soon. Other likely candidates for this year are the Khartoum Bank Group, the Real Estate Bank, Sudan Airways, the Friendship Palace Hotel, as well as some other state-owned enterprises. Finally, a procurement law is expected to be promulgated this year, which will give a boost to the privatization process.

46. **Poverty alleviation.** The authorities have given a high priority to poverty reduction. They are preparing, with assistance from the World Bank and the United Nations Development Program (UNDP), a draft interim poverty reduction strategy paper (I-PRSP) which is expected to be completed by end-2002. In addition, two new units—a Directorate for poverty and social development, and a Directorate for rural, Southern and war-affected areas—have been recently established at the Ministry of Finance. The government also developed a US$50 million program to provide social services in health, education and drinking water to the population in the disadvantaged and war-affected areas.

D. Debt Service Capacity and Creditor Relations

47. **Under the proposed program, Sudan's overall external debt service capacity for 2002 is estimated at about US$120 million.** Non-oil exports are expected to recover by US$108 million (almost 35 percent in volume terms), primarily due to the resumption of livestock exports while most other categories are stagnating due to adverse price developments. Crude oil exports are expected to decline by about US$60 million as the increase in production will be more than offset by the decline in oil prices and increased domestic consumption.[20] In addition, a larger share of this income will be deducted in line with the transportation and profit sharing agreements with Sudan's foreign investors.[21] This will effectively cut the country's net foreign exchange proceeds from oil from US$410 million in 2001 to US$110 million in 2002. Given the absence of external financing and the very low level of international reserves, the financing gap (about US$200 million before any measures) could only be filled through the compression of imports and lower debt service payments. Total imports are programmed to decline by 5 percent in 2002, consistent with the program objectives but barely at the level that could be justified for an economy that is to

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[19] First payments on these sales amounted to SDD 5.6 billion which were incorporated in the 2002 program. Additional payments are expected in 2003.

[20] Production is expected to increase from 209,000 barrels per day in 2001 to 230,000 barrels per day in 2002, reaching the current capacity constraint of the pipeline. The authorities plan to expand the capacity of the existing refineries to close the supply gap in a number of petroleum products and keep up with rising domestic consumption.

[21] These contracts are designed to ensure the supply of crude oil to the domestic refineries; in turn, the government takes the price risk for the amortization and cost deductions.

grow by 5 percent. To close the remaining financing gap of about US$120 million, external debt service payments would need to be cut in half compared with the debt service payments of US$240 million agreed-upon earlier with some creditors in the context of regularization of creditor relations (Tables 7 and 8).

48. **Payments to the Fund could amount to US$24 million, based on Sudan's debt service capacity and the Fund's share in agreed-upon debt service obligations.** Once allowance is made for debt service payments for the Khartoum refinery (US$60 million), about US$60 million are left for payments to the Fund, the World Bank, and other creditors.[22] At a minimum, the program should allow for the resumption of payments to the Bank.[23] However, in light of Sudan's financial isolation, it is advisable to continue some debt service to those creditors that provide a net reflow. Among the multilaterals, these are the IsDB and IFAD, and, in 2002/03, AFESD and the AMF are also likely additions.[24] Furthermore, Sudan will have to continue payments to the Arab Funds in light of their contributions to financing a hydropower project that will dramatically improve the country's electricity supply.[25]

[22] The Khartoum refinery, a joint venture between Sudan and the CNPC (with mostly Chinese financing), supplies the bulk of petroleum products consumed in Sudan. If debt service for it is not met, the CNPC has the right to lift the equivalent of crude oil in kind: nonpayment thus is not a realistic option.

[23] Stabilization of arrears to the Bank would require payments of the US$35 million in 2002. In 1999, the authorities agreed to pay US$12 million yearly to the Bank, but payments were suspended in early 2001. Negotiations are currently underway on new payment schedule and are expected to be finalized soon.

[24] The IsDB is expected to provide a net resource transfer of US$19 million (US$23.4 million disbursements vs. US$4.2 million debt service). While disbursements expected from IFAD and the OPEC Fund in 2002 have not been quantified yet, both have been giving fresh money over the past years and IFAD has provided a constant net resource transfer to Sudan. As to the AMF, Sudan could become eligible for BoP financing from it in the second half of 2002, pending continued debt service payments and an increase in its quota. AFESD and some bilateral creditors (Saudi Fund, Kuwait Fund, Abu Dhabi Fund) will provide substantial resources to Sudan in the coming years.

[25] The Merowe Hydropower project is a multi-phased venture which is likely to span over 10 years with an estimated cost of about US$2 billion. The project involves the construction of a dam on the Nile (north of Khartoum), an electricity plant with a capacity of about 1,250 MW, and a national electricity grid. The project would more than triple the installed capacity (500 MW) in the country, thus eliminating the chronic power shortages and frequent blackouts (which began to adversely affect the growth prospects of the country), making Sudan self-sufficient in terms of power supply, and providing electricity to the poorer parts of the country. For the first phase (the dam construction), Sudan just contracted a total of US$550 million of financing with the AFESD, Saudi Fund, Kuwait Fund, and Abu Dhabi Fund. The financing is on concessional terms with an average weighted grant element of 47.5 percent. The maturities of the financing range from 25–28 years, and the grace periods range from 5–7 years, implying average annual debt service payments of about US$40 million after the grace period.

Table 7. Sudan: Indicators of Debt Service Capacity, 1997–2002

(In millions of U.S. dollars, unless otherwise indicated)

	1997	1998	1999	2000	Est. 2001	Proj. 2002
Exports of goods and nonfactor services	624	612	831	1,891	1,692	1,835
Net current receipts, net of reserve change 1/	1,071	1,110	1,071	1,255	1,356	1,109
Gross official reserves	22	27	53	135	45	123
Total debt service paid	65	67	71	123	91	119
Payments to the Fund	58	60	40	63	55	24
Charges and interest falling due	38	36	29	33	32	18
Reduction in overdue obligations	23	25	18	46	23	6
Overdue obligations to the Fund	1,601	1,554	1,548	1,447	1,383	1,380
Total debt service paid, in percent of: 4/						
Exports of goods and nonfactor services	6.1	6.0	5.5	5.6	4.3	3.1
Net current receipts 1/	6.1	6.0	6.5	9.2	7.2	6.0
Net current receipts, net of reserve change 1/	6.1	6.0	6.6	9.8	6.7	6.4
Gross official reserves	297.3	248.1	132.7	91.3	203.1	57.6
GDP	0.6	0.7	0.7	1.1	0.8	0.5
Payments to the Fund, in percent of:						
Exports of goods and nonfactor services	9.2	9.8	4.8	3.3	3.3	1.3
Net current receipts, net of reserve change 1/	5.4	5.4	3.8	5.0	4.1	2.2
Gross official reserves	261.4	223.0	75.3	46.3	122.6	19.5
GDP	0.6	0.6	0.4	0.6	0.5	0.2
Quota 2/	24.6	26.2	17.3	27.9	25.3	11.0
External debt service 3/	87.9	89.9	56.7	50.7	60.4	33.9
Overdue obligations to the Fund, in percent of:						
Exports of goods and nonfactor services	257	254	186	76	82	75
Net current receipts, net of reserve change 1/	149	140	144	115	102	124
Gross official reserves	7,278	5,754	2,899	1,072	3,083	1,123
GDP	15.6	15.7	15.3	13.1	11.4	10.7
Quota 2/	685.7	674.9	667.1	646.4	635.8	632.8
External debt 3/	7.6	6.9	6.7	7.1	6.4	6.1

Source: Fund staff projections.

1/ Current receipts adjusted for oil related payments for services and transfers to foreign investors, net of change in reserves.

2/ As percent of Eight Review Quota.

3/ The stock of (late) interest payments in arrears and the projection of late interest payments were revised downward as a result of the reconciliation of the debt stock as per end-2000.

4/ Excluding debt service payments for the construction of the Khartoum refinery.

Table 8. Sudan: External Financing Requirements and Sources

(In billions of U.S. dollars)

	Actual		Prel.	Proj.
	1999	2000	2001	2002
1. Gross financing requirements	1834	1975	1424	1582
External current account deficit (excluding official transfers)	1592	1602	1314	1350
Debt amortization	207	265	177	148
Medium- and long term debt	207	265	177	148
Public sector	197	174	106	148
Multilateral 1/	54	54	51	53
Bilateral	143	120	52	95
Commercial Banks (London Club)	0	0	3	0
Private sector	10	91	71	0
Short-term debt 2/	0	0	0	0
Repayment of arrears	0	0	0	0
Gross reserves accumulation	26	82	-90	78
IMF repurchases and repayments	10	27	23	6
2. Expected financing	1835	1975	1424	1582
Official transfers and grants	41	50	38	20
Debt financing	31	41	47	36
Official creditors	31	41	47	36
Multilateral	24	23	29	27
Bilateral	8	17	18	9
Foreign direct investment, and errors and omissions	308	454	338	470
IMF purchases and disbursements	0	0	0	0
Accumulation of arrears (exceptional)	1351	1331	919	955
Other flows 3/	103	99	83	102
Financing gap	0	0	0	0

Sources: Sudanese authorities; and Fund staff estimates.

1/ Excluding the IMF.

2/ Original maturity of less than 1 year. Stock at the end of the previous period.

3/ Includes all other net financial flows.

49. **The overall debt service payments effort would remain broadly unchanged in 2002**, with a ratio of debt service payments to net current receipts of 6.4 percent broadly in line with the effort since 1997 (Table 7).[26] The respective share of debt service to the Fund would decline from 4.1 to 2.2 percent, continuing the trend of recent years, albeit at an accelerated pace. The main factor behind this trend is Sudan's progress in regularizing relations with other creditors, which the Fund has strongly encouraged. While payments to the Fund were almost 90 percent of total external debt service payments in 1997 and 1998, this ratio has since declined to almost 50 percent and, under this proposal, would continue to decline to 34 percent.[27] The main reasons for the latter are the incorporation of debt service payments for the construction of the Khartoum refinery into the budget, the resumption of debt service payments to the AMF in August 2001 (which will have a full year's effect in 2002) and the planned resumption of debt service payments to the World Bank.

50. **The World Bank has recently resumed its engagement in Sudan** and is currently preparing a Country Economic Memorandum (CEM) for Sudan. A World Bank mission in March explored possibilities of support short of lending (which would require clearance of arrears to the Bank), including technical assistance in the areas of poverty alleviation, health and education, and agricultural reform.

E. Other Issues

51. **Data issues.** The available data are sufficient for program monitoring, but further improvements are still needed. The statistical weaknesses include long lags in the compilation of national accounts and insufficient information on state budgets. Monetary statistics improved with the recent adoption by banks of a number of accounting procedures recommended by the Statistics Department mission, and the reclassification of Murabaha foreign financing from "other items, net" into credit to the nongovernmental sector. The reconciliation of external debt data has recently been completed. This will help the staff in conducting a proper loan-by-loan debt sustainability analysis, which is planned to be carried out jointly with the World Bank in the second half of 2002.

52. **Program duration and monitoring.** The program will cover one year ending in December 31, 2002. The staff proposes to maintain the present cycle of semi-annual Board reviews for end-June and end-December performance. This would also be consistent with Treasurer's current semi-annual review schedule of Sudan's overdue obligations to the Fund.

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[26] Debt service payments as a percentage of net current receipts (adjusting for changes in reserves) have averaged 6.3 percent since 1997, with the exception of the year 2000 when this ratio was almost 10 percent, as the authorities used the windfall revenue resulting from higher oil prices to increase debt service payments, in particular to the Fund.

[27] Since the resumption of debt service payments to the IMF in 1997, Sudan has regularized relations with most of its multilateral creditors, as well as Saudi Arabia, Kuwait, and Abu Dhabi.

However, the staff would continue to conduct quarterly review missions and any significant developments or deviations from the program would be reported to the Board during informal country matter sessions.

IV. Staff Appraisal

53. Sudan has made substantial progress over the past five years of SMPs in achieving macroeconomic stability and advancing structural reforms. Following years of stagnation and triple digit inflation rates, economic growth rose to an average of 6.5 percent while inflation declined to less than 5 percent during 1998–2001. Sustained efforts brought the fiscal position under control with the budget deficit (on a cash basis), averaging less than 1 percent of GDP over the past five years. Substantial progress was also achieved with structural reforms. Price controls were lifted, all economic activities were opened to the private sector, a liberal foreign investment regime was established, and an ambitious privatization program was adopted. On the fiscal front, expenditure management has been strengthened, all price subsidies were eliminated (except on electricity), tax and customs administrations have been improved, and the VAT was introduced. The financial system was substantially liberalized, indirect monetary instruments were introduced, and progress has been achieved in strengthening and restructuring the banking system. The exchange rate was unified and the exchange system was significantly liberalized. Finally, important trade reforms were introduced, including the elimination of nontariff trade barriers and a substantial reduction in tariff protection, and some payments on external debt service were resumed.

54. Sudan faced a difficult economic situation in 2001, as a result of the weakened external environment, aggravated by policy slippages, most notably expenditure overruns, and problems in controlling monetary growth in the first half of the year. Recognizing the potentially grave impact of these imbalances on macroeconomic stability, during the second half of 2001 the authorities implemented revenue and expenditure measures to contain the budget deficit and actively pursued a tight monetary policy. These measures, albeit ad hoc in nature, helped to preserve macroeconomic stability. However, the situation remained fragile at year end and most quantitative benchmarks were missed.

55. The strengthened program for 2002 is designed to bolster macroeconomic stability, rebuild international reserves, and reinvigorate the reform effort. The structural elements of the program, which include, inter alia, a more flexible exchange rate regime, a mechanism for saving higher-than-programmed oil revenue, and measures to strengthen non-oil revenue, represent important advances. The program has received strong political backing and the authorities are confident that they will be able to implement the envisaged policies.

56. Notwithstanding the authorities' strong commitment, the program faces several risks. The economy remains exposed to fluctuations in international oil and primary commodity prices. Adherence to the fiscal targets will be particularly challenging given the slippages at the beginning of the year and the possibility of unexpected expenditure pressures, including

for agriculture and in connection with the conflict in the South (on security, refugees, or in support of the on-going peace efforts). Strengthening non-oil revenue will also be challenging, particularly with regard to curbing exemptions. In the monetary policy area, the shift to a more flexible exchange rate regime and the move to target broad money growth as the nominal anchor will test the BOS's capacities and will require vigilance and substantially improved coordination with fiscal policy.

57. The staff also welcomes the authorities' intention to develop a detailed medium-term reform framework, in cooperation with the Fund staff and other international organizations. The framework would establish policy priorities for the period ahead, laying the foundation for a further strengthening of economic performance. The staff will assess progress during the mid-year review of the 2002 program. The staff notes that the medium-term reform efforts would likely require substantial technical assistance from the Fund and other international organizations.

58. The staff welcomes the authorities' commitment to limit the budget deficit to 1 percent of GDP, which will support the attainment of the program's macroeconomic objectives. The staff is encouraged by the authorities' intention to reduce military spending compared with the budget, while protecting social expenditures; the on-going peace efforts should help the authorities in their efforts. However, the risk remains that pressures could quickly arise and it will take substantial resolve from the authorities not to increase spending. The increase in the government wage bill in 2002 is excessive and the staff urges that further increases in real wages be explicitly linked to progress in implementing civil service reform. The staff is also concerned that the authorities have resorted to temporary increases in import tariffs and the broadening of the defense tax base to shore up revenues and welcomes their intention to reverse these measures by end–2002. Finally, lending to the agricultural sector remains a risk to the budget that might necessitate the activation of the contingency fiscal measures.

59. The recent introduction of a mechanism for stabilizing budgetary outlays in the face of fluctuations in oil revenue is an important reform. This should help avoid sharp cutbacks in expenditures when oil prices fall, which can be disruptive as last year's experience illustrates. It will be crucial to hold expenditures to the program path even if oil prices are higher than currently envisaged. The mechanism in place will need to be further developed, formalized, and fully and transparently integrated into next year's budget, which should be based on conservative oil price projections and itself embedded in a medium-term framework.

60. Efforts are urgently needed to strengthen the performance of non-oil revenue, in order to reduce the budget's exposure to volatile international oil prices and to mobilize additional resources for critical spending, particularly on infrastructure, social and poverty alleviation programs. The authorities have successfully reformed the indirect taxation system, including through the introduction of the VAT, with gains in efficiency and capacity to mobilize

revenue. It is now vital to begin a comprehensive reform of the direct tax system and to overhaul the tax incentive regime. The latter is particularly urgent to stem the proliferation of exemptions over the past two years (mostly under the Investment Encouragement Act), which in turn would allow for a faster mobilization of revenue while the direct tax system is being reformed. It is essential that the authorities begin the process of curbing exemptions this year.

61. The new managed floating regime is a welcome step away from the de facto peg that has been in place over the past three years. The staff believes that a managed floating regime is appropriate at this stage, given the thin foreign exchange market and potentially high cost of exchange rate volatility. The regime shift was urgently needed in light of the low level of reserves, declining terms of trade, and emerging financing gaps, and will help the economy respond more flexibly to external shocks. The new regime should also support Sudan's long- term development needs, including developing a competitive and diversified economy. As experience is gained under the new regime, the staff encourages the authorities to consider further improvements to the exchange system with Fund technical assistance.

62. The monetary program for 2002 appropriately envisages a further reduction in broad money growth, which should prevent a sizable pickup in inflation. Monetary policy in 2002, however, will face a number of challenges. With the shift to a more flexible exchange rate system, greater policy emphasis must be placed on controlling monetary aggregates than in the past, which will require further strengthening of indirect instruments and monitoring mechanisms. In addition, uncertainties about money demand and foreign exchange flows would call for a cautious approach to monetary policy, which will need to be kept under close review, including in the context of program reviews.

63. The staff welcomes the authorities continued efforts to strengthen the banking system. The efforts to restructure and privatize public banks, increase bank capital and strengthen supervision, are steps in the right direction, but important work remains ahead. In particular, the authorities should aim to bring banks in line with international minimum capital adequacy requirements, achieve a substantial reduction of banks' nonperforming loans, improve loan evaluation, and press ahead in strengthening bank supervision capacity and procedures. The staff endorses the authorities' request for an FSAP which could provide the basis for developing a medium-term reform and capacity building program.

64. The staff welcomes the authorities' commitment to enact an anti-money laundering law and regulations. The authorities are encouraged to approach the Fund and others for technical assistance in the drafting of the law and preparing a coherent program to develop their capacities in this area.

65. Regarding relations with the Fund, the staff regrets the deterioration of the payments record in the last quarter of 2001, while noting an increasingly difficult external position. The lower payments proposed by the authorities for 2002 of US$2 million per month appear reasonable given the still difficult balance of payments position. The staff, however, urges the authorities to increase payments to the Fund if the external situation improves, and

proposes to keep the adequacy of payments to the Fund under review. Furthermore, while monthly payments of US$2 million are adequate to meet currently projected obligations falling due, payments might need to increase should the SDR interest rate rise significantly. Finally, the staff calls on the authorities to further improve relations with major creditors and increase efforts to form a support group, since the creditors' willingness to provide large financial assistance remains the central requirement for a solution to Sudan's debt problem.

66. In sum, the staff welcomes the policy program which the authorities have established for 2002. Firm implementation should result in a substantial improvement in the macroeconomic position, following the policy slippages of last year. In particular, the introduction of mechanisms for greater exchange rate flexibility and for saving excess oil revenues represents a significant strengthening of the economic policy framework. The authorities' commitment to further elaborate its medium-term strategy, with assistance from the Fund and the World Bank, will ensure that the reforms initiated will be deepened over the medium term and help to strengthen Sudan's growth prospects. On balance, while not without areas for improvement, the staff regards the program as a strong effort to bolster macroeconomic stability and reinvigorate reform efforts. The policy commitments and proposed payments, which would provide a small reduction in arrears to the Fund, are in line with what would be required for a rights accumulation program, if the necessary financing assurances had been available. The staff, therefore, proposes to monitor the program and recommends that the Board consider the authorities' request that satisfactory performance under the program, building on the considerable progress achieved under previous SMPs, be taken into account in determining the timetable for arrears clearance and a comprehensive resolution of Sudan's debt. With regard to the longer-term strategy, the fundamental issues paper has detailed several options on how to proceed with resolving Sudan's debt problems. These hinge on Sudan normalizing relations with its major creditors. If the latter was achieved and performance under the 2002 program were satisfactory, Sudan should be well placed to move forward with resolving its debt problem.

SUDAN: ISLAMIC FINANCIAL INSTRUMENTS

Islamic financial instruments fall into three broad categories: profit-and-loss sharing, debt and quasi-debt instruments. While each category covers a wide variety of instruments, the following is a brief description of the main contracts that are used most frequently by banks.

I. PROFIT-AND-LOSS SHARING INSTRUMENTS

Musharaka. Is an equity participation contract with the bank and the client contributing jointly to finance a project. Ownership is distributed according to each party's share in the financing. The main features of this contract are: (i) profits are shared according to an agreed ratio but losses are born in proportion to contribution; (ii) the contract could be open ended or to term; and (iii) each party has the option of participating in the project's management.

Mudharaba. Is a trustee type finance contract where one party provides the capital and the other party provides the labor. The main features of this contract are: (i) profits are distributed according to an agreed ratio; (ii) in the case of a loss, the provider of labor will not be compensated for labor while the provider of capital bears the entire financial loss, provided that there is no violation of contract, mismanagement or criminal conduct on the part of the working partner; (iii) the Mudharaba could be restricted (e.g., to a specific transaction) or unrestricted, and (iv) the restricted Mudharaba can not be terminated until its conditions are fulfilled.

II. DEBT INSTRUMENTS

Murabaha. Is a purchase and resale contracts with the resale price determined based on cost plus profit mark up. The bank purchases the goods ordered by the client and resell them to him at a higher price, usually on deferred payment basis. The main features of this contract are: (i) the cost and the mark up must be known for the bank and the client; (ii) the bank must assume the ownership of the goods prior to reselling them to the client (bearing all the ownership risks in the interim); (iii) the client's promise to buy the goods purchased on his order by the bank may or may not be binding (in Sudan it is binding); (iv) no interest is levied for late payments but the bank could require a collateral; and (v) the bank can not sell the Murabaha contract to a third party except at par.

Salam. Is a purchase contract with deferred delivery of goods (opposite to Murabaha) and is mostly used in agriculture finance. The main features of this contract are: (i) the contract applies only to products whose availability on maturity date is normally assured and their quality and quantity can be specified; (ii) the bank pays the client the full negotiated price of the contracted goods (e.g., crops) when the contract is signed; (iii) the seller is only obliged to deliver the promised products or the price he received from the bank if the products could not be delivered; and (iv) the contract can be sold to a third party only at par.

Qard al-Hasan. (Good loan) is an interest-free loan contract (usually collateralized).

III. Quasi-debt instruments

Ijara. Is a leasing contract where a party leases an asset for a specified rent and term. The main features of this contract are: (i) the owner of the asset (the bank) bears all the risks associated with ownership; (ii) the asset can be sold at a negotiated market price, effectively resulting in the sale of the Ijara contract; (iii) the contract can be structured as a lease-purchase contract where each lease payment includes a portion of the agreed asset price; and (iv) the contract can be made for a term covering the asset's expected life.

Islamic banks offer their depositors mainly four classes of accounts, which are described below in broad terms.

Current accounts

Current accounts (CA) are similar to non-interest paying call or demand deposits. The bank provides the safe custody for the deposits, checking and other payment services. The bank guarantee that depositors can withdraw their deposits on demand. In return for the guarantee, depositors are not entitled to any share in the bank's profits. If the bank utilizes the deposits it will be at its own risk; all profits and losses will be borne by the bank. Because of the guarantee, banks are usually required by central banks to keep legal reserves on these accounts.

Savings accounts

Savings accounts (SA) are similar to current accounts in the right of customers to withdraw their deposits on demand. However, savings accounts can be classified into two categories, each with some special features that distinguish them from CA. Under the first type, the bank continues to provide the depositors with the guarantee to refund the deposits in full. The bank, however, may, at its sole discretion, reward depositors by sharing part of its profits with them from time to time. Under the second type of SA, depositors can benefit from the conveniences of CA but they share in the banks profits on the basis of a minimum balance that is maintained within a period of time (e.g., a month). Legal reserves are sometimes applied to SA.

Investment accounts

Investment accounts (IA) are based on an unrestricted Mudharaba/Musharaka contract between the depositors and the bank, where depositors provide the funds and the bank provides labor (and funds in lieu of its capital). The deposits are kept for a term and can not be withdrawn until maturity. Profits (and losses) from the bank's general operations are shared between the bank and depositors according to a negotiated ratio. Profits are distributed either when profits are realized or, alternatively, advances are paid to depositors in regular intervals with adjustments made, at maturity, for actual profits. Legal reserves are not kept against IA since the bank does not guarantee them.

Special purpose investment accounts

Special purpose investment accounts (SPIA) operate on the basis of restricted Mudharaba (i.e., restricted to a specific investment operation like financing a trade in a particular product). The bank manages the investment and depositors provide the funds. Profits and losses are distributed according to the principles of unrestricted Mudharaba.

Sudan developed two securities for managing liquidity and for raising non-inflationary financing for the budget. These are the Central Bank Musharaka Certificate (CMC), which was introduced in June 1998, and the Government Musharaka Certificate (GMC), which introduced in May 1999. The CMC is issued against a close-end fund consisting of government and Central Bank ownership in commercial banks. The GMC is issued against an open-end fund consisting of shares in government owned enterprises.

SUDAN: IMPROVING VAT PERFORMANCE

I. BACKGROUND

The value added tax (VAT) was introduced in Sudan on June 1st, 2000. It replaced a number of consumption and production taxes that were collected by either the federal, state, or local authorities. The VAT on domestic transactions is collected by the VAT department, which is part of the Taxation Chamber, an agency accountable to the Ministry of Finance.

At end-December 2001, VAT revenue amounted to 2.2 percent of GDP, resulting in an efficiency coefficient of 22.0 (GDP ratio divided by the tax rate). This coefficient compares well to many other countries in sub-Saharan Africa.

Over the past three years, the VAT stream of revenue has gradually shifted from imports to domestic transactions. Revenues have moved from 66 percent collected from imports in 2000 to 55 percent collected from domestic transactions, during the first two months of 2002. A higher share of VAT exempt imports[1] reducing VAT revenue from imports, as well as improved VAT control on domestic transaction have accounted for that shift.

The VAT revenue is shared between the federal government and the states. According to the revenue-sharing agreement reached between the two in April 1999, the states were allocated 35 percent of the VAT revenue in 2000. This ratio was subsequently raised to 40 percent for 2001, and to 43 percent for 2002.

II. VAT COLLECTION

The VAT department was established in 2000 right before the introduction of the VAT. This department is organized along functional lines with 600 staff spread between the headquarters and 13 other VAT offices around the country. This compares to 7,500 staff for the income tax department with 160 tax offices. Currently, there are about 8,000 registered VAT taxpayers nationwide. In recent years, management of the taxation chamber has focused on establishing a modern VAT department and has been fairly successful in doing so.

The VAT department collects about 85 percent of its revenue in the Khartoum area from about 5000 VAT payers. While the remaining 3,000 are managed by the 13 offices spread across the country. With a taxpayer to tax officer ratio of 13:1, the department is very well staffed (the ratio is 11:1 in Khartoum, while outside Khartoum it is 23:1). Given an entirely new tax, largely manual systems, and sometimes very complex systems to administer exemptions, ample staffing appears to be necessary for most of the administrative functions.

[1] A significant share of imports are exempt from VAT, including free zone imports, imports by oil companies, technical assistance projects, temporary admissions, and exemptions confirmed by the Minister of Finance on largely, recommendation of the taxation department when questions arise on the application of the VAT law.

III. Outstanding Issues

There are a number of outstanding issues that need to be resolved, and which are affecting the overall performance of the VAT:

- **The VAT exemptions on import and sale of capital goods should be eliminated.** Registered importers and purchasers need to be provided with a regular VAT credit. An up-front exemption for import and sale of capital goods will result in a significant loss of budgetary revenues.

- **Federal government agencies should be held responsible for the nonpayment of VAT on their purchases.** The VAT exemption on purchases by oil companies, if at all needed, should be given in the form of a refund. The current procedure of presumption of VAT paid is administratively cumbersome and prone to abuse.

- **Improve compliance control systems and audit capacity.** The main elements of a good compliance control system are effective registration of new taxpayers, immediate detection of and follow-up on the non-filing of returns and payment of tax, a comprehensive field audit program to prevent under reporting of the tax due, and appropriate penalties whenever a taxpayer fails to comply. Consequently, field audit capacity of the VAT department should be increased to 30 percent—compared to 15 percent currently—of the professional staff over the next three years, with a first allocation in 2002 of 20 qualified auditors.

- **Prioritize net credit balance taxpayers.** Although the net credit balance in VAT returns is decreasing as a percentage of VAT collected, the problem imposed by that balance increases over time as more taxpayers may consider demands for an effective refund of the outstanding balance. Therefore, an audit priority should be given to VAT payers with a relatively long outstanding net credit balance, mainly the one involved in export trade.

- **Registration of relatively small businesses.** The VAT law should be amended to limit registration of small importers and traders. In fact, controlling and collecting small businesses may exceed the VAT payable by them, and will diminish the available control capacity for the larger enterprises. On balance, the addition of many small businesses to the VAT population may decrease rather than increase the overall VAT revenues.

- **Implementing an appropriate management information system.** In order to monitor overall performance of the tax administration, management needs to receive information on a set of performance criteria. On the basis of that information, management can measure overall performance and would be able to set standards to be achieved in following reporting periods. Currently, a very limited set of data is provided to management on a regular basis.

SUDAN: AGRICULTURAL FINANCING

I. BACKGROUND

The Sudanese economy depends heavily on agriculture for production, employment and consumption. Agriculture accounts for about 40 percent of the GDP, employs more than 50 percent of the population, generates 90 percent of non-oil exports, and drives annual fluctuations in income levels and food security of the country. About half of the agricultural sector consists of livestock production and the other half is crop production. Crop production, which accounts for about 20 percent of GDP falls into three distinctive modes of production: large irrigated schemes (65 percent of crop production), mechanized rainfed farming (5 percent of crop production), traditional smallholders in rainfed areas (30 percent of crop production). Agriculture has huge potential in terms of resources—arable land is estimated to be 200 million feddans, but only less than 40 million feddans are actually cultivated. Majority (18 feddans) of the arable land is occupied by traditional rainfed agriculture, 14 feddans by mechanized rainfed agriculture and 5 feddans by irrigated agriculture. Whether the potential of agriculture is realized depends to a large extent on availability of credit for new production inputs and technology, as well as on implementation of structural reforms, especially of the irrigated schemes (EBS/01/5 January 2001, Box 5).

II. CREDIT TO AGRICULTURAL SUBSECTORS

The irrigated schemes are government owned and operated in collaboration with tenants. Until early 1990s, commercial banks' lending to agriculture accounted for less than one percent of their total lending and funds to the schemes were provided almost exclusively by the Bank of Sudan. Under the influence of the National Economic Salvation Program launched in 1990, the Consortium of Commercial Banks was formed in 1992/93 with the objective of raising agricultural credit. Since in the early years of the consortium the schemes remained profitable, the ratio of agricultural lending in total lending of commercial banks increased to 36 percent by end 1993. The banks continued to lend to the schemes even when these became unprofitable, as the BOS has mandated them to extend 40 percent of their credit to agriculture. In 1997, the BOS abolished the requirement that lending to agriculture accounts for 40 percent of total credit. Since 1998, after the irrigated schemes failed to repay the loans, banks were reluctant to extend credit to them and the government returned to the practice of direct lending to the schemes, which will remain necessary until the profitability of the schemes improves. In 2001, restructuring of the Agricultural Bank and the Bank of Khartoum further exacerbated the problem of inadequate financing of the schemes. More specifically, in 2001 the credit extended from the Consortium to the SCC amounted to SDD 13.3 billion, of which SDD 7.8 billion was financed by the Ministry of Finance (MOF), SDD 1.4 billion by the BOS and the remaining SDD 4 billion by the commercial banks (but the MOF guaranteed these loans). The MOF also financed SDD 4.3 billion in L/Cs for imports of Sudanese Cotton Company and extended credit of SDD 2.6 billion to the schemes directly through the BOS. The MOF also financed the schemes through its lending to the Agricultural Bank (Table 1).

The rainfed agriculture is dominated by the private producers. After the mandated credit to agriculture was abolished, the share of credit to private agriculture in total private credit declined from 30 percent at the end of 1997 to 12 percent at the end of 2001. Similarly, annual rate of growth of agricultural credit extended by the commercial banks to the private sector declined from average 99 percent in 1997 to 20 percent on average in 1998 and minus 2 and minus 19 percent in 1999 and 2000, respectively. In 2001, credit to the private agriculture grew by 29 percent, as some restrictions on bank lending in general were abolished, with most of the credit channeled to the mechanized rainfed subsector.

Rural credit to small scale farmers. Small scale farmers in rainfed areas (traditional rainfed agriculture) are poor with very limited access to credit. In 2001, they received only one percent of total formal credit to agriculture; all formal credit being extended by the Agricultural Bank. The Agricultural Bank is now being restructured, including through cutting expenditures and increasing capital base, to be better suited to provide credit to small and medium-scale farmers, including through microcredit. Sudan, however, has so far limited experience with microcredit mainly due to the lack of donor funds. The exceptions are the UNDP, (which started to extend micro-credit in 1990 through "area Development Schemes" and "Area Rehabilitation Schemes") and IFAD.

As Table 1 shows, in 2001 the main bulk of credit was extended to the irrigated schemes (58 percent). The traditional small farmers received only one percent of the loans, whereas mechanized rainfed farmers (and some larger animal farms) received about 41 percent of credits.

Table1. Credit to Agriculture, 2001
(In billions of Sudanese Dinar)

Financier	Billion SDR	Lender	Billion SDR	Borrower	Billion SDR
Ministry of Finance	16.5	Commercial banks	18.6	Irrigated schemes	25.5
Bank of Sudan	3.7	Consortium	13.3	Mechanized farmers	17.9
Commercial banks	23.7	Agricultural Bank	5.1	Smallholders	0.5
		GMCs	2.6		
		L/C	4.3		
Total	43.9	Total	43.9	Total	43.9

Sources: Bank of Sudan, Bank of Khartoum, Agricultural bank, own estimations of borrowers shares.

III. The Role of Specialized Institutions

The Agricultural Bank was established in 1957 as a specialized Government owned bank for agricultural finance and as a tool for the Government's efforts for food security. It is still fully owned by the Government, and has 95 branch offices. The total staff was about 2,000 during 2001, out of which more than half had some expertise knowledge in agriculture, but professional financing experts were more rare. During the years, the Agricultural Bank has successively engaged in activities outside its original goals. Currently, the bank is undergoing restructuring. In 2001, the Agricultural Bank received direct credits from the Ministry of Finance and the Bank of Sudan amounting to 4.1 billion SDR. It extended 5.1 billion SDR in rural credits, out of which 3 billion was for mechanized rainfed farmers, 1.6 billion to irrigated schemes, and 0.5 billion to small traditional farmers in rainfed areas. Since loans to the rainfed areas are so risky, the Bank's policy is that it only extends credit to those areas where rainfall averages more than 500 mm per year.

Sudan Cotton Company originated in 1970, when cotton trade was nationalized and all private cotton companies were merged into four public companies under a Cotton Public Corporation (CPC). At the beginning of the 1970s, the CPC was responsible for marketing a yearly cotton production of about 1.3 million bales. In 1993, the CPC was reorganized, renamed to Sudan Cotton Company, and its ownership was transferred to the three largest cotton producing schemes (Gezira, Rahad and New Halfa), Farmers Bank and the National Pension Fund. In 2001, the Sudan Cotton Company was responsible for selling and marketing cotton both to domestic buyers and for export. It worked as a broker between the large cotton producing schemes, the Government and traders. It channeled SDD 13.3 billion in credits from the Consortium, and it assisted in importing inputs. On the request of the Ministry of Finance, Bank of Sudan financed 4.3 billion SDR worth of imports, mainly through opening Letters of Credits; the Sudan Cotton Company is to repay the Bank of Sudan through sales of cotton.

IV. FUTURE REFORMS

To improve the financing of the agricultural sector, the government intends to undertake (in parallel to reforming the irrigated schemes and the Agricultural Bank) the following measures over the next few years:

- **creating credit risk guarantee schemes,** that is risk sharing agreements between the government (or a guarantee institution) and the lending institutions. The main difference from the current mechanism, where the government provides 100 percent guarantee, is that while a large share of the risks would still be borne by the guarantee institution, the residual would be borne by the lending institutions themselves.

- **introducing commodities future markets** provides a possibility of hedging risks, while protecting farmers against price volatility. Future markets for commodities are a natural complement to the Islamic financial instruments, especially Salam credit (where farmers obtain cash advance on the promise of selling or delivering a certain amount of their future crop to banks at the time of harvest).

- **developing microfinance institutions,** with an emphasis on achieving their financial sustainability, while still maintaining the social aspect of providing credit to the poor segment of the population.

SUDAN: FUND RELATIONS

As of March 31, 2002

I. Membership Status: Joined 9/05/57; Article XIV

II. General Resources Account:	SDR Million	% Quota
Quota	169.70	100.0
Fund holdings of currency	549.08	323.56
Reserve position in Fund	0.01	0.01

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	52.19	100.0
Holdings	0.00	0.0

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Stand-By Arrangements	210.95	124.31
Extended arrangements	138.33	81.51
Contingency and Compensatory	30.08	17.73
Trust Fund	59.23	34.90

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	06/25/1984	06/24/1985	90.00	20.00
Stand-by	02/23/1983	03/09/1984	170.00	170.00
Stand-by	02/22/1982	02/21/1983	198.00	70.00

VI. Projected Obligations to the Fund:[1] (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	3/31/2002	2002	2003	2004	2005	2006
Principal	438.60	--	--	--	--	--
Charges/Interest	655.70	9.30	12.30	12.30	12.30	12.30
Total	1,094.3	9.30	12.30	12.30	12.30	12.30

[1]The projection of charges and interest assumes that overdue principal at the report date (if any) will remain outstanding, but forthcoming obligations will be settled on time.

VII. Exchange and Trade Arrangements

The legal tender is the Sudanese dinar, which replaced the Sudanese pound in proportion SDD 1=LSd 10 in 1999. Since October 1998, the exchange rate system has been unified—market participants determine the exchange rate and trade freely within a unified regulatory framework. The Bank of Sudan (BOS) administers exchange controls and actively transacts in the foreign exchange market at negotiated rates. For the purposes of accounting for official transactions, the BOS calculates the official exchange rate as the median rate quoted by commercial banks the previous day. This rate is regularly published by the BOS and is used mainly for customs and budgetary transactions.

The trade regime in Sudan has been gradually liberalized. With a few minor exceptions for religious and security reasons, all exports are free from nontariff restrictions. With the same exceptions, all imports are free from nontariff restriction. As of January 1, 2001, Sudan uses three import tariff bands, plus a zero rate. The only surrender requirement still in effect is the surrender of proceeds from payments related to services in the petroleum sector. Sudan maintains one inoperative bilateral payments agreement with Egypt and an inoperative payment clearing account with the Soviet Union.

VIII. Article IV Consultation

The last Article IV consultation discussions were held during June 25–September 9, 2001. The Staff Report (EBS/01/179, 31/10/01) and the Recent Economic Developments (SM/01/324, 31/10/01) were discussed by the Executive Board on November 14, 2001.

IX. Technical Assistance

In January 1995, the Executive Board decided to resume Fund selective technical assistance (TA) to Sudan. Since then, there have been the following TA missions: (i) reform of indirect taxation (August 1995, March 1997, May 1997, October 1997, May, October, November 1998, October 1999, and November 2000); (ii) multisector technical assistance in statistics (September/October 1995); (iii) exchange system reform (April 1997, November 1997, May and September 1998); (iv) monetary management and banking supervision (June 1997, November 1997, May, September, December 1998, May, October 1999 and November 2000); (v) government finance statistics (June 1997 and May 1998); (vi) monetary statistics (July 1997, May 2000, and February 2001); (vii) balance of payments and monetary statistics (April 1999); (viii) expenditure control and management (September 1997, May 1998, and May 2000); (ix) oil sector taxation (October 1999); (x) introduction of the VAT since October 1999; and (xi) training course on financial programming and policies (April 2000); Monetary Statistics (February 2000 and April 2001); GDP and CPI statistics (March 2002).

X. Resident Representative

The Fund's resident representative in Khartoum was withdrawn in June 1990.

SUDAN: RELATIONS WITH THE WORLD BANK[1]
(As of March 2002)

The World Bank has no active lending portfolio in Sudan because of Sudan's default on its financial obligations to the Bank, which led to the suspension of disbursements in April 1993. As a result of discussions between the Bank and the Sudanese authorities on the need for Sudan to take steps towards normalizing its relations and establishing a track record with the Bank, the authorities started making "good faith" payments of US$1 million per month to the Bank starting in July 1999. Monthly payments due since March 2001 have yet to be received. The amount of payments has not been sufficient to prevent a continued accumulation of arrears, which stood at about US$185 million at the end of May 2001 (from US$145 million at the end of 1999). Sudan's outstanding Bank debt, including arrears, is approximately US$1.21 billion.

At the request of the Sudanese authorities, and in recognition of the start that Sudan had made in payments in 1999, the Bank initiated nonlending assistance in the areas of irrigation, Nile Basin management, and social services. A joint team of Bank staff and Sudanese government officials completed a report on the reform of the Gezira Irrigation Scheme, and an action plan for implementation, based on the report, has been circulated in the Government. Irrigation accounts for about 25 percent of total value added in the Sudanese economy, and the Gezira Irrigation Scheme is a major agricultural production asset, representing about two-thirds of the total area of the large national irrigation schemes. Bank staff have been working with the Sudanese authorities on the issue of water resource sharing and management involving countries along the Nile river basin. In the social area, the Bank has approved a grant from the Post-Conflict Fund to support a series of analysis of social sector issues. In that connection, a survey supported by the Bank and UNICEF aimed at providing information on selected human resource indicators, such as nutrition, immunization, infant mortality, and maternity health, has just been completed. In addition, the Bank, working with the Carter Center, has been involved in processing and supervising bilateral funds for guinea worm eradication in Sudan, with special emphasis on Southern Sudan. The effort aims to eradicate a disease whose debilitating effect undercuts production, limits access to basic social services, and contributes to perpetuating poverty.

[1]Prepared by World Bank staff.

SUDAN: DATA QUALITY

Type of data	Scope and timeliness of reporting	Adequacy for monitoring	Areas of concern	Steps to improve integrity
Real sector: National accounts	Historical data reported on time by CSO	Broadly acceptable: real and nominal GDP by sector available with a 2/3-year lag.	1968 SNA still in use; oil sector value-added calculation not completed; no real GDP by expenditure; 4-year delay in nominal GDP by expenditure; private consumption derived as a residual; estimations rather than surveys are used for most GDP components.	Rebuild the CBS institutional capacity; introduce of 1993 SNA; conduct census of agriculture production. Implement in full the multisectoral 1995 TA mission recommendations.
	Last and current year estimates reported to missions by MOF	Acceptable	Estimates are based on incomplete data, in particular for oil value-added, livestock, and fruit and vegetable production.	Improve coordination between MOF, CBS, and Ministry of Agriculture.
Prices	Monthly CPI reported on time, with a minimal lag	Acceptable: only CPI for Khartoum area available promptly; weekly CPI upon request.	CPI for Sudan as a whole available with a 4-month lag and its coverage still incomplete; the CPI is based on an outdated consumer basket; income-group indices are not regularly aggregated into CPI.	Conduct new household income and expenditure survey; reduce timing discrepancies and other reporting inefficiencies by individual states.
	Monthly WPI reported on time, with a minimal lag	Acceptable	Weighting scheme is not available; WPI based on prices for 32 mainly agricultural commodities.	Introduce WPI methodology consistent with SNA.
Government Finance	Monthly reporting of main budgetary items, generally on time; 1.5-month lag	Good: main revenue and expenditure items reported, financing consistent with monetary accounts	Only partial data on state budgets available; incomplete functional classification; MoF allocations to ministries are reported, but not their actual expenditure; slow progress on the introduction of the GFS classification.	Introduce the GFS classification; improve accounting and reporting procedures at MOF. Implement in full GFS (1997) TA mission recommendations.
Monetary accounts	Monthly reporting of balance sheets. Generally on time; 1.5-month lag	Acceptable following recent STA missions to improve transparency and reliability of the monetary statistics.	Large and variable other items (net); frequent misclassification errors by commercial banks, in particular for consortium financing which prevents meaningful analysis of the composition of NDA.	Establish a working group to review the BOS' foreign assets; review and revise the guidelines related to consortium financing, and ensure compliance. Implement the 2001 TA mission on monetary statistics recommendations, including improvement of commercial banks' other items net.

Type of data	Scope and timeliness of reporting	Adequacy for monitoring	Areas of concern	Steps to improve integrity
	Weekly flash reports of key monetary aggregates; 1-week lag	Good: new format introduced in 2000	Some divergence between reserve money in balance sheets and end-of month flash reports.	Include data on returns on investment deposits.
External sector: Foreign exchange reserves	Monthly reporting of BOS active balances. Generally on time; 0.5-month lag	Acceptable but needs improvement: frequency of monitoring should increase to weekly; quality of data needs to be strengthened.	Gross usable reserves are part of BOS active balances, which also include unusable reserves earmarked for particular purposes (such as oil, medicine and spare parts imports). The composition of the earmarked reserves and their potential usability in a case of a BOP need are not clear.	Clarify the items that qualify as international reserves in general, and those included in earmarked reserves in particular.
Exchange rate	Upon request; minimal lag	Good: daily exchange rate available		
Balance of payments	Quarterly full BOP data provided on time and during missions; 3 month lag	Acceptable but needs improvement	Incompleteness of data on some services (oil transportation costs), investment income (oil related expenses and interest payments due on external public debt), transfers (workers' remittances), financial account (amortization due on external public debt) and FDI; large positive errors and omissions.	Introduce the revised reports form for commercial banks; improve data collection procedures; enforce the use of residency criterion; enhance institutional capacity of the BOS BOP compilation unit. Implement in full the recommendations of the 1999 TA in BOP statistics.
	Monthly trade data Upon request provided with a 2–3 month lag	Acceptable but needs improvement	Discrepancies between BOS data and customs data.	
External debt	Monthly payments to creditors. On time;1.5-month lag	Good: BOS cash flow table is not available.	BOS cash flow table does not reflect exactly actual payments made by the MOF.	Eliminate timing and recording discrepancies between the BOS and the MOF.
	Other debt data; 10-month lag	Good: coverage is comprehensive, although weaknesses in some areas persist.	BOS records are not reconciled with those of some creditors; data on ODA not available; interest on interest in arrears not calculated; for some creditors interest on arrears not separated from delayed interest.	Reconcile the data with creditors; further disaggregate the data according to standard definitions.

Sudan: Core Statistical Indicators as of February 15, 2001 1/

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates (Rates of Charge)	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service 2/
Date of Latest Observation	04/30/02	03/30/02	3/31/02	3/31/02	3/31/02	03/31/02	04/2002	Q4/2002	Q4/2002	Q4/2002	1998	Q4 2002
Date Received	05/06/02	04/10/02	04/10/02	04/10/02	05/06/02	04/10/02	05/13/02	4/2002	4/2002	4/2002	12/2001	5/2002
Frequency of Data	D	M	M	M	M	W	M/W	M	Q	M	A	A
Frequency of Reporting	W	M	M	W	M	M	M	M	Q	M	A	A
Source of Update	A (BOS)	A (BOS)	A (BOS)	A (BOS)	A (BOS)	A (BOS)	A (MOF)	A (BOS)	A (BOS)	A (MOF)	A (MOF)	A (BOS)
Mode of Reporting	C (Fax)	C (Fax)	C (Fax)	C (Fax)	C (Fax)	C (Fax)	C (Fax)	C (Fax)	C/V (Fax)	C (Fax)	C/V (Fax)	C/V (Fax)
Confidentiality	B	B	B	B	B	B	B	B	B	B	B	B
Frequency of Publication	M	M	M	M	M	M/W	M	M	Q	M	A	A

Abbreviations: Frequency: D-daily, W-weekly, M-monthly, Q-quarterly, A-annual. Mode of reporting: A-direct reporting by authorities; C-reporting by fax; V-staff visits. Confidentiality: B-for use by the staff and the Executive Board. BOS- Bank of Sudan, MOF-Ministry of Finance.

1/ (M) published monthly and (Q) quarterly in IFS, (W) weekly in BOS fact sheets. All data published annually in BOS Annual Report.
2/ The latest external debt stock data (for end 2000) were provided by the authorities in June 2001.

Khartoum, June 9, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. We are writing to inform you that, following the expiration of our medium-term staff monitored program at the end of last year, we have completed discussions with Fund staff on a strong program for 2002. This program is described in the attached Memorandum, which also discusses our medium-term strategy and reviews economic performance in 2001.

2. We very much appreciate the interest shown by a number of Directors and Fund management during the Board discussion on Sudan in November 2001 in finding innovative ways to address Sudan's arrears and debt problems. We look forward to the staff paper that we understand is being prepared on this issue. At the same time, we appreciate that we need the support of major creditors to be able to move forward with the HIPC process. We would like to assure you that we are putting our best efforts into normalizing our relations with our creditors, and that we believe good progress is being made in this respect. In the meantime, we would hope that the Executive Board will give due recognition to the strength of our policy program for 2002, which we believe is comparable in quality to the standards of upper credit tranche conditionality, and that performance would be taken into account in future consideration of the timetable for resolving our debt problem.

Sincerely yours,

Al-Zubeir Ahmed Al-Hassan
Minister of Finance and
National Economy

Saber Mohamed Hassan
Governor
Bank of Sudan

Sudan

Memorandum of Economic and Financial Policies

I. Review of Economic Performance in 2001

1. This Memorandum reviews, first, the economic performance in 2001, the final year under our medium term staff-monitored program (MTSMP). Second, it briefly sets out our medium term policy objectives, and in that context describes in detail our economic program for 2002.

2. Sudan encountered a difficult economic environment in 2001 as a result of declining prices of oil and non-oil commodities (especially cotton), a ban on imports of meat and livestock by our major trading partners for these commodities, higher insurance costs, and shipping difficulties owing to security concerns in the region after the September 11 events. As a result, economic growth declined to 5.3 percent, compared with 6.9 percent in 2000, the balance of payments deteriorated sharply, with exports declining by about 9.5 percent compared with 2000, and the fiscal position came under pressure owing to a revenue shortfall. These difficulties were compounded by problems in controlling monetary growth and by expenditure overrun especially in the first half of the year, which in part, covered the cost of food reserves and the settlement of displaced people. In response to the deteriorating situation, significant actions were taken to strengthen the macroeconomic policies in the second half of 2001 and we believe we have contained the situation.

3. In particular, monetary policy was tightened after midyear. The annual growth of broad money was brought down sharply from a peak of 42 percent in July 2001 to 25 percent in December—in line with the program target. The reduction in broad money growth was led by a substantial reduction in the growth of bank credit to the nongovernmental sector, as banks responded to measures adopted by the Bank of Sudan (BOS), including an increase in reserve requirements and restrictions on import financing. Reserve money grew by only 4 percent during 2001, as a sizable loss in net foreign assets offset an increase in credit to government as the fiscal situation weakened.

4. Despite additional revenue measures implemented in the last quarter of the year, the fiscal position continued to be under pressure, owing to a significant shortfall (SDD 27 billion) in revenues, reflecting both declining international oil prices and also lower-than-expected fees and profit transfers from public enterprises. In response to weakening revenue performance, expenditures were cut by SDD 21 billion, mostly on external debt service, transfers to the states and capital outlays. As a result, the budget deficit was contained to 1.1 percent of GDP, only moderately above the program target of 0.8 percent of GDP.

5. Because of the sharp decline in exports, the current account deficit rose to 3.8 percent of GDP, compared with the program target of 3.3 percent. Our external position was further weakened by a marked drop in private capital inflows following the September 11 events,

and a reduction in our share of oil production when oil prices declined, as per profit-sharing agreements with our foreign oil investors. During this period, the exchange rate depreciated by less than 2 percent (from SDD 257.4 per U.S. dollar in June to SDD 261.4 per U.S. dollar in December), while gross international reserves fell from US$71.1 million in June to US$45 million at end-2001.

6. Progress was made in implementing structural reforms during 2001. We completed the audit of the public oil sector for 1999 and 2000. Also, we prepared a detailed functional and economic budget classification system according to GFS classification, including for the 2002 budget. However, the shift to quarterly preparation is being delayed by the long approval process of credit and debit advices by the Ministry of Finance. A civil service reform plan was approved by the Economic Council and was submitted to the Council of Ministers. We have also strengthened the banking system, including: initiating the restructuring of the Agriculture Bank and El-Nilein Bank, and beginning the privatization process of the Bank of Khartoum and the Real Estate Bank, raising banks' capital adequacy ratio to 7 percent, and increasing the mandatory provisioning requirement for banks' bad loans to 100 percent. While our privatization program generated only limited investor interest in 2001 (the privatization of the Sudan Duty Free Zones Company and the Bridges and Roads Corporation is proceeding, but of the Privatization of Sudan Airways and the further reduction of the state share in Sudatel (currently at 41 percent) is pending emergence of a strategic buyer), it has more recently picked up momentum as described below.

II. LONGER-TERM PERSPECTIVE AND WAY FORWARD

7. The completion of our (MTSMP) is an appropriate moment to take stock of the progress that has been made in strengthening Sudan's economic performance over a longer period, and in that context, to establish policy priorities for the period ahead.

8. While in many ways 2001 was quite a difficult year for Sudan's economy, we have made major strides over the past five years of staff-monitored programs in achieving macroeconomic stability and advancing structural reforms. Following years of stagnation, economic growth averaged 6.5 percent during 1997 to 2001, and inflation declined from 133 percent in 1996 to 5 percent last year. At the same time, the fiscal position was brought under control with the budget deficit averaging less than 1 percent of GDP over the past five years. Expenditure management has been substantially strengthened, all price subsidies were eliminated (except on electricity), and the value added tax (VAT) was introduced. The financial system was substantially liberalized, indirect monetary instruments introduced and their application widened, and good progress has been achieved in strengthening and restructuring the banking system. Important trade reforms were introduced including eliminating nontariff trade barriers and a substantial reduction in tariff protection. Moreover, the exchange system was unified and significantly liberalized. Finally, all price controls were lifted, all economic activities were opened to the private sector, and an ambitious privatization program was adopted.

9. The next phase of economic reform will concentrate on consolidating macroeconomic stability, removing remaining obstacles to sustained economic growth, and reducing poverty. We recognize that entrenching macroeconomic stability is essential for achieving sustained

economic growth and poverty reduction. At the same time, given that structural reforms would constitute a significant part of the next reform phase, we intend to develop more fully a medium term framework over the next few months in consultation with Fund staff and other international organizations. The reforms would concentrate on strengthening public finances, increasing the effectiveness of monetary policy, deepening and restructuring the financial sector, advancing trade reform, improving the investment environment, strengthening the social safety net, and implementing programs for poverty alleviation and rural development. In the coming years, rising budgetary receipts from the oil sector will continue to be used predominantly for public investment in infrastructure, and for outlays to strengthen human development. Significant efforts will also be directed at achieving peace and development in areas of conflict. Finally, we would hope that we would be able in the immediate period ahead to resolve, with your help and support, our arrears and debt problems and normalize our relationships with all our creditors.

III. Outlook and Policies for 2002

The macroeconomic framework

10. In 2002 we have conservatively projected real GDP growth at about 5 percent, well below the country's potential because of the continuing adverse impact on our economy of the weakened external environment described above, and somewhat faster growth may be possible. We are targeting an average annual inflation rate of 6 percent to 7 percent, slightly higher than the 4.9 percent in 2001, reflecting an expected increase in food prices (owing to the resumption of livestock exports), and adjustments in energy prices. The current account deficit in 2002 will remain broadly unchanged compared to 2001, as the resumption of livestock exports will likely be offset by lower net oil sector receipts. Finally, we aim to increase our international reserves by US$78 million to US$123 million (4 weeks of imports).

Fiscal policy

11. We are committed to pursuing prudent fiscal policies in 2002, and we aim to limit the budget deficit for the year as a whole to about SDD 36 billion (1 percent of GDP). Given expected foreign financing, domestic financing will be limited to SDD 26 billion 0.8 percent of GDP, consistent with a restrained monetary program. In addition, we will address underlying fiscal weaknesses by strengthening non-oil revenue, reducing the vulnerability of the budget to fluctuations in oil revenue, and firmly controlling expenditures. However, we will protect outlays on social and development needs, especially in the areas of health, education, and agricultural infrastructure.

12. We will not hesitate to introduce revenue measures that are aimed at strengthening non-oil revenue, which is projected to rise by one percent of GDP. Witness to this, measures already taken (including some late last year) included: (i) an increase of 27 percent in domestic petroleum prices; (ii) a further increase in the sugar excise tax; and (iii) as temporary measures, we have raised import tariffs by an average of 3 ½ percentage points and broadened the basis of the defense tax. In addition, we intend to (iv) apply the regular VAT mechanism on all imports and sales of capital goods; and (v) rationalize tax

exemptions, following the completion of a comprehensive review (see below). The projected increase in non-oil revenues more than offsets a small decline in oil revenues in relation to GDP, and total revenues are projected to rise to 12.5 percent of GDP in 2002.

13. Consistent with our overall deficit target, we intend to limit total expenditures to 13.5 percent of GDP, up modestly from their level in 2001. Both current and capital expenditures will increase as a ratio to GDP. Within current expenditures, wages will increase significantly, but part of the increase is earmarked for the restructuring of the civil services, including through a retrenchment program. The electricity tariff has been increased on average by 11 percent, as part of a gradual process of phasing out the electricity subsidy, which is the last remaining general subsidy (as a special safety net, electricity consumption below a certain threshold has been exempted to protect the poorest households.) Also, military outlays will be reduced as a ratio to GDP. As regards capital outlays, priority is being given to agriculture, power, and infrastructure.

14. The fiscal deficit in the first quarter of 2002 was higher than targeted, largely reflecting lending to the agriculture sector by the government. However, we expect that about half of this lending will be repaid later in the year. As discussed below, we are taking steps to strengthen substantially expenditure controls to keep outlays in line with our program targets. To the extent, however, that pressures on the deficit persist because of slippages on either the revenue or expenditure sides, we would strive, as indicated earlier, to take any contingent measure to rectify the situation. This may include the imposition of excise taxes on domestic sales of petroleum products and on mobile phone charges. In addition, to prevent subsidies from inadvertently emerging during periods of rising oil prices, we plan to review petroleum product prices on a quarterly basis, adjusting them if needed.

Exchange rate and trade policy

15. The stability of the exchange rate over the past three years has helped to break entrenched inflationary expectations and tame inflation to a single digit. While we believe that this policy has served us well, we recognize the need to introduce exchange rate flexibility to counter the impact of the continued real exchange rate appreciation on our economy's diversity and external competitiveness. We also recognize that exchange rate flexibility is particularly important at present to mitigate the impact of the weakened external environment and to help rebuild the country's international reserves. However, it would be difficult for us to implement a fully floating exchange rate regime at present, as our foreign exchange and financial markets are underdeveloped and lack the depth and instruments that are necessary to hedge exchange rate risks. Furthermore, given the thinness of the market, a floating rate could be highly volatile.

16. Accordingly, we have recently introduced a managed floating exchange rate regime under which exchange rate movements would reflect market forces, while allowing the BOS to smooth short-term fluctuations. The BOS has established a band of $\pm$ 1½ percent around a central rate, which itself is the average rate on all transactions conducted the previous day. This allows the central rate to move by a maximum of 1 ½ percent per day. The BOS intervention takes place through bi-weekly auctions of predetermined amounts of foreign exchange, with foreign exchange sold to the highest bids within the band limits. With the

exception of daily auctions of small amounts to nonbank dealers, the BOS undertakes no other intervention in the market. Reflecting the change in the regime, an interbank market in foreign exchange is beginning to emerge. To facilitate the development of the market, we provide daily, weekly and bi-monthly reports on market conditions to participants. As this new arrangement becomes established, consideration will be given to widening the band and preannouncing the amount of foreign exchange to be auctioned.

17. As a temporary measure, we raised tariff rates and re-imposed the defense tax on imports, as noted above. We intend to reverse the tariff increase and eliminate the defense tax by end 2002. Fiscal position permitting, we will consider reducing, in the context of the 2003 budget, the maximum tariff to 30 percent and the average tariff rate to below 15 percent. Moreover, we will phase out the remaining restrictions on bank financing of imports (mainly the required advanced deposits on letters of credit) in conjunction with increasing our capacity to absorb the released liquidity. Finally, in the coming months, we will develop a strategy for further trade reform over the medium term.

Monetary policies

18. Fiscal consolidation will be complemented by a cautious monetary policy geared to keeping inflation under firm control, while replenishing our international reserves. With the adoption of a more flexible exchange rate regime, monetary policy will need to place greater focus on controlling monetary aggregates than in the past. In this connection, broad money growth is targeted to decline from 25 percent in 2001 to 18 percent in 2002. This should be consistent with our inflation and growth objectives, assuming a continued decline in velocity in line with the trend over the past three years. Even with the targeted sizable buildup in international reserves, the envisaged broad money growth would allow for an ample increase in bank credit to the nongovernmental sector. In line with the broad money growth target, reserve money growth is targeted to increase by 15 percent in 2002. Consistent with this and our targeted increase in net international reserves, we intend to limit the increase in the net domestic assets of the BOS to SDD 13.7 billion during the course of 2002. Continuing uncertainty about money demand will require that our monetary policy be kept under close review during the course of the year, including in light of developments in inflation and exchange market pressures, and, that monetary targets be adjusted as necessary, including to accommodate potentially higher real GDP growth.

19. To increase the effectiveness of the BOS's conduct of monetary policy we intend to take several measures. The upper and lower limits on banks' Murabaha margins will be replaced by an indicative rate. The BOS intends to start conducting its open market operations in GMCs through regular auctions, allowing market determination of their prices. We also intend to strengthen the mechanisms at the BOS for policy coordination, including especially with fiscal policy. Finally, to improve the ability of the BOS to monitor financial developments on a timely basis, we will strengthen the weekly flash reporting system to provide timely estimates and analysis of BOS and monetary survey broad aggregates.

Structural reforms

20. We intend to significantly strengthen our structural reform program with emphasis on removing obstacles to economic growth and reducing poverty. We will develop, in cooperation with other agencies, including the World Bank, a fully articulated medium term structural reform framework at the time of the mid-year review of the 2002 program. In 2002 we intend to focus on strengthening public finance, increasing fiscal transparency, strengthening the financial system, addressing the difficulties facing the agriculture sector, strengthening our poverty alleviation efforts, and accelerating the privatization program.

21. In the public finance area, priority is being given to strengthening non-oil revenue to maintain diversified revenue base and mobilize much needed resources to increase funding, on a sustainable basis, for priority expenditures. Our efforts will focus on rationalizing the exemptions, deepening the implementation of the VAT, reforming the direct tax system, and improving the tax and customs administration. We will review the current list of taxpayer exemptions and calculate its fiscal cost by end–June 2002, with the objective of rationalizing them. All tax exemptions and their costs will be reported in the annual budget, as well as in the quarterly budget reports to the Cabinet of Ministers and the Parliament. In addition, we will begin in 2002 to overhaul the tax incentive regime, including the investment encouragement act, with a view to centralizing the authority to grant exemptions, establishing a narrowly defined eligibility criteria, and limiting the renewal of exemptions.

22. We have conducted, with Fund technical assistance, an initial review of the VAT since its introduction in mid–2000. Based on the review, we intend to take the following measures to strengthen the implementation of the VAT: (i) apply the regular VAT mechanism on all imports and sale of capital goods, which would result in the elimination of VAT exemptions for these goods while providing a regular VAT credit to VAT-registered importers and purchasers; (ii) increase the field audit capacity of the VAT department to 30 percent of the professional staff over a three-year period (compared to 15 percent at present), with a first allocation in 2002 of 20 qualified auditors; and (iii) amend the VAT Law to limit registration of small importers and traders.

23. Reforming the direct tax system will be the next major tax reform following the introduction of the VAT. We intend to undertake a comprehensive review of all aspects of direct taxation, including policy, legislation, administration, and incentive regime, with a view to making a thorough overhaul of the system. We would greatly appreciate Fund technical assistance in this area.

24. The coming on stream of oil revenue has exposed our budget to oil price fluctuations, which, as the experience of 2001 has shown, can cause unexpected and costly cutbacks in expenditure, including on development projects. Therefore, we plan to develop and institute a new process to reduce the vulnerability of the budget to fluctuations in oil prices. This process would involve: (a) preparing the annual budgets in the context of a rolling three-year medium-term budget; (b) using a conservative oil revenue assumption to help ensure that expenditures can be maintained on a steady path consistent with medium-term fiscal targets; (c) depositing any surplus that may be generated by excess oil revenue with the BOS, correspondingly reducing net credit to the government; and (d) in case of lower oil prices,

using any accumulated financing margin to smooth the fiscal adjustment. We envisage that this process would be fully transparent and integrated in the budget. We are targeting end-September 2002 for finalizing, with Fund technical assistance, the details of all aspects of this process, and envisage that it would be fully incorporated in the 2003 budget. The 2002 program budget is based on oil price assumption of US$20 per barrel for our oil exports. In the event oil prices rise above US$20 per barrel, we intend to limit expenditure to the programmed level, and deposit the surplus revenue in BOS, correspondingly reducing net credit from the BOS and our overall fiscal deficit.

25. We have achieved substantial transparency in the oil sector and improved the collection and accounting of the government's oil revenue. The frequent occurrence of arrears in the transfer of oil revenue from the SPC to the budget (primarily due to valuation adjustments) has been addressed by introducing fixed prices for the delivery of crude oil to the refineries. We have fully incorporated into the budget the debt service payments for the construction of the Khartoum refinery. In addition, we will implement a system that will ensure cash payment, as budgeted, of oil collateralized debt service payments in order to avoid in-kind lifting, thus further increasing transparency in the accounting of oil revenue and avoiding distortion of oil delivery obligations. We also have reduced in kind deliveries of petroleum products by the SPC to government agencies and the subsequent netting operations related to it.

26. We have completed the first audit of the SPC and the public oil sector, covering the period from the onset of oil production in mid-1999 to the end of 2000. While the auditors found no irregularities in the operations of the SPC, they suggested the implementation of a transparent accounting system based on double entries that would allow fast and easy extraction of data as needed by other government agencies. They also recommended that the SPC hire qualified accountants, and that the SPC, MOF, Ministry of Energy (MOE) and BOS improve coordination, which we are now doing on a monthly basis, including the reconciliation of oil and oil revenue data. We intend to implement these recommendations in the coming months, working with the advisory group for the oil sector and the staff of the Auditor General. Meanwhile, the audit of the SPC and the public oil sector for 2001 has commenced and we expect it to be concluded by June 2002.

27. We have taken several steps to improve the transparency of the budget. The GFS classifications have been applied to the 2002 budget, and we plan to implement the GFS classification on a quarterly basis by end-June 2002, and subsequently on a monthly basis in 2003. In addition, we intend to abolish netting of expenditures against revenues among government agencies by end-June 2002, except for transactions in oil for the National Electricity Corporation and the Ministry of Defense, for which netting will be abolished in 2003.

28. We intend to press ahead with our efforts to improve the soundness of the banking sector. We have achieved some progress in enhancing the capital base of the banks: one bank has already increased its capital to SDD 3 billion, three banks have increased their capital base to SDD 2 billion, and the capital base of six others exceeds SDD 1 billion. However, the share of nonperforming loans in total credit has risen to 16 percent at the end-December 2001, and provisioning remains below international standards. The bulk of the

nonperforming loans were held by a few banks, and we will strongly encourage these banks to restructure their loan portfolios. We intend to take additional measures including further building up the banks' capital and reducing the lending limits to insider borrowers. We have also started the restructuring of the Agricultural Bank, which will be geared to finance both small and medium size farms, including through microcredit schemes to the rural rainfed areas. The restructuring of El-Nilein Bank is underway, and the Bank of Khartoum, the largest commercial bank, and the Real Estate Bank are ready for privatization. In addition, in order to improve compliance of banks with BOS circulars and information requirements (in terms of both accuracy and timeliness), instructions were issued to banks to appoint compliance officers. Also, the BOS has issued guidelines on corporate governance, disclosure, transparency, and risk management.

29. The creation of the CMCs and GMCs has been instrumental in developing the indirect monetary control capacity of the BOS and in rising noninflationary financing to the budget. Given the need to raise medium- to long-term finance we intend to develop a second-generation instrument, in line with Islamic finance principles. We have already started the process and we would greatly appreciate Fund technical assistance.

30. To guard against using the banking system for illicit financial activities, we intend to enact an anti-money laundering law. A committee consisting of BOS and the Ministry of Justice has been established to draft the law. We plan to prepare the draft law within the next three months. Pending the final approval of the Law, the BOS will soon issue a circular covering aspects of money laundering issues.

31. Agriculture is the backbone of the Sudanese economy. However, the agriculture sector is currently facing serious shortcomings in production and profitability affecting both the irrigated and rainfed sectors. As regards to the irrigated sector, we plan to undertake comprehensive institutional and management reforms. We also intend to conduct a review of the rainfed sector, with World Bank assistance.

32. Inadequate financing for agriculture is an important factor behind the difficulties facing the sector. Our experience shows that banks cannot carry alone the risk of financing agriculture, which is intrinsically high. In particular, markets where risks can be hedged need to be developed, the appropriate role of the public institutions in reducing the agriculture finance risks and addressing market failures would need to be determined, and the access of small farmers to finance, possibly through micro finance schemes, would need to be assessed. These are complex issues and our ability to address them properly would depend on technical assistance from international financial institutions. Establishing a commodity future market for agricultural products could be one way of hedging risks while protecting farmers against price volatility and improving the quality of agricultural outputs. However, this would also need to be further analyzed in the context of Islamic finance. We would like to reiterate our earlier request for Fund technical assistance to establish a futures commodity market.

33. We remain committed to our privatization program. During 2001, we achieved some success in areas such as transportation, cement, and telecommunication, while progress in other areas has been hampered because of a lack in investor interest. In 2002, the

slaughterhouse company and Afbra Cement Factory have already been privatized during the first quarter and the Sudan Duty Free Zone Company and Bridges and Roads Corporation are expected soon to be privatized. In addition, we are preparing a promotion to attract domestic and international investors to participate in the privatization of Khartoum Bank Group, Real Estate Bank, Sudan Airways, the Friendship Palace Hotel, as well as some other state-owned enterprises. Overall, we expect the privatization to yield about SDD 14 billion during the current year.

34. We have increased our focus on poverty reduction. A new Directorate for Poverty and Social Development was established in 2001 in the Ministry of Finance, headed by a State Minister of Finance, to serve as a focal point for poverty-reducing programs and to coordinate social expenditure. The National Poverty program was introduced in 2001 and is a US$50 million "cash program" to provide social services in health, education and drinking water. The civil society support program has been introduced in 2002 to support NGOs. Also, the government-owned Saving and Social Development Bank has been reoriented to provide macro finance in the context of our poverty reduction efforts.

35. In addition, we prepared a draft interim PRSP that we plan to finalize by end-2002 and submit to Parliament in 2003. The process for preparing the PRSP is designed to be consultative, with a number of working groups, committees and councils have been established, each consisting of a majority of members outside of the Government. We expect the PRSP process to be supported by technical assistance from the UNDP and the World Bank.

IV. Relations with the Fund and Other Creditors

36. We remain determined to regularize relations with all our multilateral and bilateral creditors and, in particular, to strengthen Sudan's relations with the Fund. We regret that it was not possible to make the previously agreed payments for the last three months of 2001. Our capacity to service our external debt was sharply reduced in the second half of 2001 because of the deterioration in our balance of payments. As a result, we had to scale back payments to all creditors. Our balance of payments position in 2002 is expected to remain weak. In addition, our usable international reserves have declined to the precariously low level of less than two weeks of imports, and it is vital that we rebuild our reserves. Accordingly, we believe that we will only be able to make payments of US$2 million per month to the Fund. While lower than the payments of last year, this amount will still be US$6 million above that needed to stabilize arrears to the Fund in 2002.

37. To safeguard the improvement achieved in our relations with some of the other creditors, we are explaining to them our difficult financial position and hope to reach agreements with them on a reduction of the 2002 payments.

V. Program Monitoring

38. Proposed quarterly quantitative benchmarks for the period January 1–December 31, 2002 are set out in the attached Table 2 and quarterly structural benchmarks in Table 4. The definition of the quantitative benchmarks is provided in the attached technical memorandum of understanding. We will monitor financial and economic developments closely and will, in consultation with Fund staff, implement any measures that may be needed to safeguard macroeconomic stability.

Table 1. Sudan: 2001 Quantitative Quarterly Benchmarks

(In billions of Sudanese dinars; unless otherwise indicated)

	2000	2001 2/							
		Cumulative Change							
	Dec.	1st quarter		2nd quarter		3rd quarter		4th quarter	
	Actual 1/	Program	Actual	Program	Actual	Revised Program	Actual	Revised Program	Actual
Benchmarks:									
BOS net domestic assets 3/	192.6	3.7	5.9	2.6	21.9	30.1	27.4	21.8	48.2
Central government non-oil revenue	...	54.2	46.0	113.7	102.3	161.2	156.0	235.0	220.3
Domestic financing of the fiscal deficit 4/ 5/	...	2.5	12.2	2.5	16.0	25.6	13.0	18.8	29.7
Net BOS financing 3/	...	2.5	6.1	2.5	11.9	13.7	14.7	8.7	28.8
Contracting or guaranteeing of external nonconcessional debt by government and BOS 6/	0.0	0.0	0.0	0.0	0.0	0.0	...	0.0	...
BOS gross usable reserves (in millions of U.S. dollars) 7/	134.9	3.0	-32.1	21.6	-63.9	-44.9	-59.6	0.1	-90.2
Payments to the Fund (in millions of U.S. dollars)	...	16.5	16.5	33.0	33.0	49.5	49.5	66.0	49.5
Central government social and development expenditures									
Social expenditures 8/	...	20.3	12.3	43.2	30.5	67.0	42.6	94.3	57.5
Local development expenditures 9/	...	12.4	5.1	26.4	11.2	40.9	17.6	57.6	41.3
Memorandum items:									
NDA of the banking system	247.1	10.9	20.0	16.0					
Reserve money 3/	221.5	6.6	-8.3	12.3	-6.7	0.9	-3.8	6.7	12.1
Payments to non-Fund creditors (in millions of U.S. dollars)	...	18.0	12.6	36.0	23.6	43.1	34.8	80.9	...
Central government oil revenues	...	38.8	28.5	77.3	69.8	117.0	111.4	162.3	149.7

Sources: Sudan authorities; and Fund estimates.

1/ Outstanding stock at end-December 2000.

2/ Cumulative change from December 31, 2000.

3/ Based on new presentation of the monetary data, consistent with IMF guidelines, adopted in January 2000.

4/ Defined as total net borrowing by the government, including net borrowing from the Bank of Sudan (including GMCs and changes in deposits of the central government with the BOS), net sales of GMCs outside of the BOS, revenues from privatization, and repayments of internal domestic debts (notably to the Pension Fund, the Sudan Construction Company, and other public agencies, banks, and private companies).

5/ For the first two quarters, the financing numbers are derived from monetary survey and they differ by SDD -4.1 billion (Q1), SDD 8.5 billion (Q2), and SDD 7.8 billion (Q3) on a cummulative basis from the budget financing reported by the Ministry of Finance.

6/ This benchmark applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274 (00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Debt will be deemed concessional when the currency-specific discount rate (determined by the market-related "commercial interest reference rates (CIRR)" as published by the OECD) applied to the contractual schedule of charges and principal payments, indicates a grant element of at least 35 percent.

7/ In the new presentation of the Monetary Authorities' Accounts, gross usable reserves include foreign banknotes in the vaults of the BOS.

8/ Central government expenditures on research, enhancing institutional capacity, and social subsidies.

9/ Central government expenditures on removing agricultural bottlenecks, roads, transportation, and electricity.

Table 2. Sudan: 2002 Quantitative Quarterly Benchmarks

(In billions of Sudanese dinars, unless otherwise indicated)

	Dec 2001 Actual 2/	Cumulative change in 2002 1/						
		1st quarter	2nd quarter		3rd quarter		4th quarter	
		Estimate	Program	Actual	Program	Actual	Program	Actual
Benchmarks:								
BOS net domestic assets 3/	240.8	6.8	9.9	...	11.0	...	13.7	...
Domestic financing of the fiscal deficit 4/	...	10.0	24.2	...	28.3	...	26.3	...
Net BOS financing 3/	...	7.5	5.8	...	6.8	...	8.0	...
Contracting or guaranteeing of external nonconcessional loans by government and BOS 5/	...	...	...	...	...	...	...	...
BOS gross usable reserves (in millions of U.S. dollars) 6/	44.9	19.5	37.0	...	58.4	...	78.0	...
Payments to the Fund (in millions of U.S. dollars)	...	0.0	12.0	...	18.0	...	24.0	...
Indicative benchmarks:								
Broad money 3/	432.2	40.7	39.5	...	49.4	...	77.5	...
Central government social expenditure 7/	...	10.8	20.5		31.4		43.3	
Memorandum item:								
Central government oil revenue	...	32.1	72.4	...	115.2	...	158.5	...

Sources: Sudanese authorities; and Fund estimates.

1/ Cumulative change from December 31, 2001.

2/ Outstanding stock at end-December 2001.

3/ Based on new presentation of the monetary data, consistent with IMF guidelines, adopted in January 2000. Net BOS financing is defined as borrowing by the central government from the BOS (including GMCs) minus central government deposits at the BOS.

4/ Defined as total net borrowing by the government, including net borrowing from the Bank of Sudan (including GMCs and changes in deposits of the central government with the BOS), net sales of GMCs outside the BOS, revenues from privatization, and repayments of internal domestic debts (notably to the Pension Fund, the Sudan Construction Company and other public agencies, banks and private companies).

5/ This benchmark applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No 12274 - (00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Debt will be deemed to be concessional when the currency-specific discount rate (determined by the market-related "commercial interest reference rates (CIRR)" as published by the OECD) applied to the contractual schedule of charges and principal payments, indicates a grant element of at least 35 percent. The benchmark excludes the financing of the Merowe hydropower project.

6/ In the new presentation of the Monetary Authorities' Accounts, gross usable reserves include foreign banknotes in the vaults of the BOS.

7/ Central government expenditure on medical care; health services; poor students' support; supplement to poor consumers of electricity; social and health insurance; water, health, and education development.

Table 3. Sudan: Structural Benchmarks of 2001

Policy Area	Status of Implementation
End-March 2001 *Fiscal* 1. Issue instructions to abolish netting by government agencies of expenditures against revenues by end-June 2001 and by public enterprises and private sector entities of payments against claims by end-December 2001.	Issued a circular in June 2001 to abolish netting by government agencies. All but two ministries (Interior and Justice) have complied. Instruction to abolish netting by public enterprises and private sector entities has not been issued yet.
Monetary 1. Amend GMC/CMC market procedures to: (a) include the adoption of a multiple price competitive auction in which successful bidders pay actual price submitted; (b) include the limitation of sales at auctions to the amount originally offered; and (c) have the BOS to act through the SFC as the sole agent for the Ministry of Finance sales of GMCs.	Done
Other 1. Approve and make public and well-specified action plan and timetable for the reform of the Gezira scheme.	Not done. Tentative action plan was formulated and is now being reviewed by Ministry of Agriculture and affected interest groups and agencies. The government, however, has already started implementing several aspects of the reform plan including: (i) several projects for the rehabilitation of the irrigation infrastructure with support from OPEC; (ii) introduction of new crops and farmers' choice of crops through a pilot project with cooperation from FAO; and (iii) evaluation of assets in ginning, in preparation for privatization.
End-June 2001 *Monetary* 1. Instructions issued which: (a) Reduce the price at which BOS repurchases GMCs and CMCs when transactions are initiated by commercial banks; and (b) establish clearing procedures for interbank transactions involving GMCs and CMCs to effect the same day transfer of funds.	Done.

Policy Area	Status of Implementation
2. Consolidate monthly budget, including revenue and expenditures, and reconcile with BOS financing data (including deposits), prepared by the Ministry of Finance Accounting Office for December, January, and February, and onward throughout the program.	Done.
End-September 2001	
Fiscal	
1. 2001 budget classified on an FAD-agreed GFS basis, with technical assistance from IMF.	Done.
2. Government audit general certification on an annual basis that the 2001 budget accounts are prepared on a gross basis (without netting).	Not done.
Monetary	
Preparation of a restructuring plan for the Agricultural Bank.	Done.
External	
Interbank clearing system enhanced to allow same-day settlement of transactions.	Not done.
End-December 2001	
Fiscal	
1. Conclude the audit of the public oil sector, including the SPC and the relevant parts or accounts of the ministries of Energy and of Finance and of the Bank of Sudan, including proposals to simplify the administrative and accounting procedures and enhance the transparency of oil revenue on an accrual and cash basis.	Done.
2. Issue instructions to abolish netting by public enterprises and private sector entities of payments against claims.	Not done. Instructions are being drafted.

Policy Area	Status of Implementation
External Reduction of the maximum import tariff from 40 percent to 30 percent and reduction of the average tariff to below 15 percent.	Not done.
Others 1. Formulate a plan for civil reform.	Done.
2. Formulate an action plan to improve the financial position of the states and strengthen the states' capacity to provide primary health and education services.	Not done. Action plan being formulated.

TABLE 4. SUDAN: STRUCTURAL BENCHMARKS FOR 2002

By End-June 2002

1. Prepare a first draft of a mechanism to smooth expenditures against fluctuations in oil prices, including through the preparation of the annual budgets in the context of a rolling three-year medium-term budget.

2. Implement GFS classification on a quarterly basis.

3. Abolish netting by public enterprises and private sector entities of payments against claims.

4. Conduct a comprehensive review of all tax exemptions and calculate their fiscal cost.

5. Implement a system that will ensure cash payment, as budgeted, of oil collateralized debt service payments in order to avoid in-kind lifting.

6. Complete the 2001 audit of the SPC and the public oil sector.

7. Discontinue in-kind deliveries of petroleum products by the SPC to government agencies and the subsequent netting operations related to it, except for transactions in oil for the National Electricity Corporation and the Ministry of Defense, for which netting will be abolished by in 2003.

8. Eliminate the ceilings on Murabaha rates in both domestic and foreign currency and the limit on the share of Murabaha financing in banks' credit.

9. Establish coordinating mechanism between monetary and fiscal policies.

10. Strengthen flash reporting system, by including weekly estimates of key aggregate monetary variables.

By End-September 2002

11. Finalize the design of a mechanism for the smoothing of expenditures against fluctuations in oil prices.

12. Compile data on budgetary arrears by collecting reports on arrears from all budgetary agencies on a monthly basis.

13. Prepare a plan for rationalizing exemptions.

14. Establish a mechanism for frequent review and adjustment of domestic petroleum prices.

15. Complete a proposal for introducing new instruments to replace GMCs and CMCs with the Fund technical assistance.

16. Introduce and enforce a schedule of fees/fines on commercial banks that do not comply with NPLs provisioning and capital adequacy ratios.

17. Issue BOS circular on money laundering.

By End-December 2002

18. Increase the field audit capacity of the VAT department to 30 percent of the professional staff over a three-year period, with a first allocation of 20 qualified auditors in 2002.

19. Amend the VAT law to limit registration of small importers and traders, within the context of the 2003 budget.

20. Undertake, with the Fund technical assistance, a comprehensive review of direct taxation, including policy, legislation, administration and incentive regime.

21. Complete the restructuring of El-Nilein Bank.

22. Conduct a study, with the Fund technical assistance, examining introduction of a market based mechanism for hedging agricultural finance risks, including possibly through the establishment of commodity future markets for agricultural products.

23. Draft revised I-PRSP, incorporating the action plans formulated with World Bank technical assistance.

Table 5. Social Expenditures, 2002

	Q1 Actual	Q2 Program	Q3 Program	Q4 Program	Total Program
Total	10.8	9.7	10.9	11.9	43.4
Free medical care	0.6	0.6	0.6	0.8	2.6
emergency	0.5	0.5	0.5	0.6	2.1
life-savings drugs	0.1	0.1	0.1	0.2	0.5
Health service	0.6	0.7	0.7	0.7	2.7
Poor students support	0.2	0.3	0.4	0.6	1.5
Supplement to poor consumers of electricity	5.7	5.7	5.7	5.7	22.8
Social and health insurance	0.4	0.4	0.5	0.6	1.9
Water, health and education	3.3	2.0	3.0	3.5	11.9

Source: Sudanese authorities.

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum specifies the understanding reached with the Fund staff regarding the quantitative benchmarks and indicative targets for the 2002 program.

The 2002 program relies on six quantitative quarterly benchmarks, two indicative quarterly benchmarks and an oil revenue adjustor. The quantitative benchmarks are: ceilings on net domestic assets of the Bank of Sudan (BOS), ceilings on the domestic financing of the fiscal deficit with a subceiling on the net borrowing by the government from the Bank of Sudan, floors for the build up of gross usable reserves of the BOS, ceilings on new nonconcessional external debt contracted or guaranteed by the government, and floors for payments to the Fund. Indicative benchmarks are set for broad money and a floor for the central government social expenditures. Central government oil revenues will be monitored as a memorandum item. All benchmarks are presented in Table 2.

The relevant definitions for the quantitative and indicative benchmarks, and the oil revenue adjustor are set out hereafter.

Net domestic assets (NDA) of the Bank of Sudan are defined as the sum of the Net Domestic Credit of the Bank of Sudan, the net issue of Money Market Instruments (CMCs) and Other Items Net (OIN) of the Bank of Sudan.

The net domestic credit of the Bank of Sudan is defined as total credit to the central government (including GMCs) minus total central government deposits with the BOS plus BOS claims on public enterprises plus BOS claims on banks. The definition of the central government comprises all accounts of the line ministries and agencies controlled by them (corresponding to Group #11, Group #12, and some accounts of the Group #19 in the BOS general ledger), the *Zakhat* funds (recorded under Group #13) and margin deposits placed with BOS by central government against letters of credit issued by the BOS. The definition includes two oil related accounts controlled by the government: Account 429 (crude oil products) and Account 451 (petroleum export proceeds).

Net issues of CMCs by the BOS are classified as part of the NDA, in accordance with Fund standards, to facilitate the effects of money market operations on the monetary base.

The identification of all accounting balances recorded under Other Items Net has been established with the help of the IMF's Statistics Department mission that visited Khartoum in May 2000 and is detailed in the corresponding mission report.

Domestic financing of the fiscal deficit is defined as total net domestic borrowing by the central government including net borrowing from the banking system (including GMCs), net sales of GMCs outside the banking system, revenues from privatization, and repayments by the central government of internal domestic debts to public agencies, banks and private companies. A separate subceiling is set on the net BOS financing of the central government.

The definition of central government for the purpose of this criterion is the same as the one applied for the NDA of the Bank of Sudan.

Bank of Sudan gross usable reserves are foreign reserve assets, as defined in the BOP manual, that are controlled by the BOS, are immediately and unconditionally available to the BOS for meeting balance of payments needs and are not earmarked by the BOS for meeting specific payments. They consist of balances on accounts maintained with overseas correspondent banks and foreign exchange banknotes in the vaults of the BOS.

Contracting or guaranteeing of new nonconcessional external debt by the government applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No 12274 - (00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Debt will be deemed to be concessional when the currency-specific discount rate (determined by the market-related "commercial interest reference rates (CIRR)" as published by the OECD) applied to the contractual schedule of charges and principal payments, indicates a grant element of at least 35 percent.

Broad money is defined as sum of local currency circulating outside of the banks and banks' demand, time and savings deposits. It also includes transferable deposits and margin deposits against letters of credit placed by local government, nonfinancial public enterprises and the nonbank private sector with the BOS.

Central government oil revenues from export proceeds consist of the government's exports of crude oil, net of the oil consortium's partners' deductions for operating costs and profit sharing, the government's services payments for transportation of its oil through the consortium pipeline, and the government's repayments to the Chinese National Petroleum Corporation (CNPC) for the construction of the Khartoum refinery.

The oil revenue adjustor applies as follows: oil revenue arising from an export price of over US$20 per barrel for Nile oil exports f.o.b., Port Sudan will be deposited in a government account at the BOS. However, amounts will be transferred if necessary to the government, at least on a quarterly basis, to ensure that government oil export receipts are not less than the amounts targeted under the program. The program targets for domestic financing of the budget deficit, net BOS financing of the central government, and BOS NDA will be reduced, and the international reserve target will be raised by amounts corresponding to the accumulated deposits during the program period. In the case of shortfalls in oil revenue below the quarterly program targets, the accumulated balance at the BOS can be drawn down to make up the shortfall in revenue, and, correspondingly, the program targets for domestic financing of the budget deficit, net BOS financing of the central government, and BOS NDA will be raised, and the international reserve target will be reduced. The adjustor will be reviewed at the regular program reviews. In the event that no balances accumulated and oil prices declined, the contingency fiscal measures will be activated to maintain the program target for domestic financing.

Central government social expenditure corresponds to central government expenses on medical care; health services; poor students' support; supplement to poor consumers of electricity; social and health insurance; water, health, and education development.

INTERNATIONAL MONETARY FUND

SUDAN

Final Review Under the Medium-Term Staff-Monitored Program And the 2002 Program

Supplementary Information

Prepared by Middle Eastern and Policy Development and Review Departments

Approved by P. Chabrier and A. McGuirk

June 18, 2002

1. This supplement provides information on the latest economic developments and relations between Sudan and the Fund that has become available to the staff since the circulation of the final review under the medium-term staff-monitored program and the 2002 program (EBS/02/97), June 5, 2002.

2. Sudan paid the Fund US$2 million on May 23 and another US$8 million on June 6, in line with its proposal to make monthly payments to the Fund of US$2 million in 2002. On June 14, Sudan's overdue financial obligations to the Fund were SDR 1,089.4 million, down from SDR 1,096.6 million on May 24, 2002.

I. Economic developments

3. The end-May 12-month CPI inflation rate declined to 5.8 percent.

4. Usable foreign exchange reserves rose to US$78 million in May (about US$4 million below program target for end-June).

5. The 12-month broad money growth declined from about 30 percent in March to 27 percent in April and (based on preliminary estimates) to 25 percent in May.

6. The budget deficit was SDD 0.5 billion at end-April 2002 compared to a program target deficit of SDD 7.3 billion for the second quarter.

II. Progress in structural reforms

7. A number of structural benchmarks have been met as detailed in the attached table. In addition, the following two measures have been adopted:

a. the exchange rate band was widened in early June from 1.5 percent to 2 percent; and

b. the restrictions on import financing have effectively been abolished. The cash margin on imports was lowered from 100 percent to 75 percent and is no longer mandatory.

Sudan: Structural Benchmarks for 2002

Policy Area	Status of Implementation
By End-June 2002	
1. Prepare a first draft of a mechanism to smooth expenditures against fluctuations in oil prices, including through the preparation of the annual budgets in the context of a rolling three-year medium-term budget.	Draft being prepared.
2. Implement GFS classification on a quarterly basis.	
3. Abolish netting by public enterprises and private sector entities of payments against claims.	Done.
4. Conduct a comprehensive review of all tax exemptions and calculate their fiscal cost.	Done.
5. Implement a system that will ensure cash payment, as budgeted, of oil collateralized debt service payments in order to avoid in-kind lifting.	Done.
6. Complete the 2001 audit of the SPC and the public oil sector.	Underway.
7. Discontinue in-kind deliveries of petroleum products by the SPC to government agencies and the subsequent netting operations related to it, except for transactions in oil for the National Electricity Corporation and the Ministry of Defense, for which netting will be abolished by in 2003.	Done.
8. Eliminate the ceilings on Murabaha rates in both domestic and foreign currency and the limit on the share of Murabaha financing in banks' credit.	Done.
9. Establish coordinating mechanism between monetary and fiscal policies.	Done.
10. Strengthen flash reporting system, by including weekly estimates of key aggregate monetary variables.	Done.
By End-September 2002	
11. Finalize the design of a mechanism for the smoothing of expenditures against fluctuations in oil prices.	Underway.
12. Compile data on budgetary arrears by collecting reports on arrears from all budgetary agencies on a monthly basis.	Data compilation started.
13. Prepare a plan for rationalizing exemptions.	Underway.
14. Establish a mechanism for frequent review and adjustment of domestic petroleum prices.	Underway.

Sudan: Structural Benchmarks for 2002

Policy Area	Status of Implementation
15. Complete a proposal for introducing new instruments to replace GMCs and CMCs with the Fund technical assistance.	Underway.
16. Introduce and enforce a schedule of fees/fines on commercial banks that do not comply with NPLs provisioning and capital adequacy ratios.	Circular issued.