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IMF Executive Board Concludes 2006 Article IV Consultation with Sudan

On May 3, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Sudan.¹

Background

Despite some delays, the implementation of the Comprehensive Peace Agreement with the South began in 2005. An interim national constitution was put into force, the Government of National Unity and the government of Southern Sudan were set up, and the central government began transferring oil revenues to the South as stipulated in the peace agreement. Further work is required, especially to make operational the commissions envisaged in the agreement.

Sudan's economy has been growing at a fast pace and macroeconomic conditions have been stable. Real GDP grew at an estimated rate of 8 percent in 2005, owing mainly to a recovery in agriculture and robust activity in construction and services. After rapid growth in 2003 and 2004, oil sector output remained virtually unchanged in 2005, while average inflation was 8.5 percent.

The external current account worsened in 2005 but the balance of payments was supported by strong capital inflows. Oil export revenues rose because of higher oil prices, but imports rose drastically and non-oil exports slowed (owing to transportation bottlenecks, high domestic demand, and to some extent, real exchange rate appreciation). A continuation in the strong trend in capital inflows—primarily foreign direct investment in non-oil sectors—allowed for a buildup of international reserves from 1.9 months of imports at end-2004 to 2.6 months at end-2005.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The central government fiscal balance turned to a deficit after three years of surpluses. Oil revenue continued to rise in 2005, but it could not keep pace with the increase in government spending, driven by higher transfers to subnational governments (including transfers to the South) and a large subsidy on domestic fuels. The subsidy is a significant drain on public resources without any direct benefit to the poor in Sudan.

In 2005, monetary growth remained high and the dinar appreciated. Money demand was bolstered by strong economic growth and further monetization, while the fiscal expansion, higher oil exports, and strong capital inflows contributed to an appreciation of the dinar.

The authorities took steps to improve the tariff structure and increase flexibility in the foreign exchange market. As part of a three-year import-tariff reform program, the top tariff rate was lowered from 45 percent to 40 percent, the average tariff rate fell to 20 percent, and is likely to decline further to 15 percent or less in the next two years. The authorities removed the remaining exchange restrictions under Article VIII of the Fund's Articles of Agreement and allowed for further flexibility (through auctions) in the pricing of foreign exchange. Sudan maintains a managed floating exchange rate regime.

There was progress on structural reforms in the fiscal and financial sectors, but more remains to be done. A medium taxpayer unit was set up to boost non-oil revenue. The adoption of Automated System of Customs Data system should improve efficiency at customs ports. Regarding financial reforms, the central bank introduced competitive auctions of government securities, privatized a large bank, and began to implement the financial reforms envisaged in the peace agreement with the South. Notwithstanding the progress made, more remains to be done to modernize the tax and the financial system, strengthen expenditure management at all levels of government, and improve fiscal and oil sector transparency.

Executive Board Assessment

Executive Directors commended the Sudanese authorities for pursuing prudent macroeconomic policies in recent years and carrying out structural reforms in a very difficult environment. These policies have resulted in a favorable economic performance marked by higher levels of foreign investment, robust economic growth, a strengthening of the external position, and single-digit inflation. Directors urged the authorities to continue implementing sound economic policies and to persevere with the structural reform agenda.

Directors noted the challenges that the authorities face in mobilizing and transferring resources to meet the requirements arising from the implementation of the Comprehensive Peace Agreement, reconstruction, and national unification, as well as in dealing with profound regional tensions and disparities. In this regard, Directors stressed the need to ensure the effective operations of the North-South commissions and resolve the crisis in Darfur in order for Sudan to realize its full economic potential. This will also set the stage for moving towards the Millennium Development Goals, which will also require the full support of the international community.

Directors considered that performance under the 2005 Staff-Monitored Program (SMP) was broadly satisfactory. In particular, they welcomed the policy actions to contain inflation and the implementation of most structural benchmarks under the program. Directors regretted, however, the higher-than-programmed level of nonconcessional borrowing and the delay in setting up the framework for fiscal reporting according to Government Finance Statistics methodology.

Directors broadly endorsed the policy package embedded in the 2006 SMP but urged the authorities to minimize nonconcessional borrowing. They commended the authorities for their commitment to carry out prudent monetary and fiscal policies and proceed with fiscal reform priorities. Directors particularly welcomed the measures to increase transparency in oil sector operations, including the monthly publication of detailed oil sector data, and encouraged the authorities to join the Extractive Industries Transparency Initiative. Directors also welcomed the authorities' decision to increase the level of payments to the Fund, despite severe financial constraints. However, some Directors called for a further increase in line with Sudan's increased repayment capacity.

Directors acknowledged the recent improvements in monetary management and the central bank's intention to focus on its reserve money targets and to broaden the range of monetary instruments for a dual (Islamic and conventional) banking system. They saw substantial merit in maintaining exchange rate flexibility within the current managed float regime, while remaining vigilant to achieve the program's inflation objectives and undertaking reforms to enhance the business environment. In addition, Directors noted that close policy coordination between the central bank and central and subnational governments would be required to maintain price stability.

Directors considered the recent implementation of financial system provisions contained in the peace agreement with the South to be commendable. They encouraged the central bank to proceed with the reform agenda, especially the implementation of FSAP recommendations including the increase in minimum capital requirements. Directors also urged the authorities to embark on a well-planned and transparent process to introduce the new currency, a key step to foster development in the South and to integrate Sudan's economy.

Directors underscored the importance of pressing ahead with fiscal reform priorities. Investment incentives and other tax exemptions need to be rationalized in line with best international practice. These policies will ensure a level playing field, improve governance, and protect non-oil tax revenues. Another priority is to reduce fuel subsidies in order to alleviate economic distortions and preserve fiscal sustainability. In this regard, Directors were encouraged by the authorities' intention to carry out a public information campaign about the subsidies and develop an automatic mechanism for future price adjustments in line with changes in world oil prices. Directors encouraged the authorities to further reduce and ultimately eliminate the fuel subsidies, while, in this context, a few Directors also noted that the authorities will have to take into account the realities of such a process as they move forward.

Directors commended the authorities for the pro-poor focus of the 2006 budget framework,

including the higher transfers to the South and Northern states and higher capital expenditures. To address capacity constraints and improve transparency, especially in subnational governments, they stressed the need to move expeditiously to improve expenditure management systems, including through appropriate regulations, effective monitoring, and transparent reporting. Furthermore, Directors urged the authorities to begin compiling budget execution reports according to Government Finance Statistics methodology for both the Government of National Unity and the Government of Southern Sudan.

Directors urged the authorities to minimize the level of nonconcessional borrowing in 2006 in view of Sudan's already unsustainable external debt burden and in order to avoid complications in a potential debt relief operation. While acknowledging the country's reconstruction and unification needs, the larger transfers to the South and other states, and the need for higher social spending in order to make progress toward the Millennium Development Goals. Directors urged the authorities to use any windfall oil revenues to finance intended infrastructure projects or to seek concessional terms for any loan facility, and they supported their efforts in this regard. Many Directors underscored that all creditors have a responsibility in helping to ensure that Sudan's unsustainable debt is not aggravated further. They also pointed out that all creditors should participate fully and on equal terms in any debt restructuring and the HIPC Initiative for Sudan, and that the authorities should treat all creditors equally. Directors underscored the importance of tracking nonconcessional borrowing—both actual and planned—and called for close cooperation and exchange of information among all creditors.

A number of Directors called for a zero ceiling on nonconcessional borrowing in 2006, and could not support the inclusion of a ceiling of \$700 million in such borrowing in the SMP. In light of this level of nonconcessional borrowing, these Directors did not consider the 2006 SMP equivalent in strength to a Right Accumulations Program (RAP) that could contribute to Sudan's efforts to build a track record. Many other Directors, however, felt that a zero ceiling on nonconcessional borrowing would not be realistic given Sudan's exceptional circumstances. Some of these Directors viewed the 2006 SMP as equivalent to a RAP in all respects except for the level of nonconcessional borrowing, while others considered that all the policy commitments under the 2006 SMP continue to be in line with what would be required for a RAP. A number of Directors felt that Sudan's performance under the successive SMPs should be reflected in the timetable for arrears clearance, and emphasized the importance of presenting a timely and clear road map in this respect. Stressing the need for a continued constructive engagement with Sudan, most Directors felt that a final evaluation of performance under the SMP should take into account actual developments, including in the evolution of nonconcessional borrowing. They urged the authorities to continue to work, in close cooperation with staff, towards ambitious measures that would substantially reduce the level of nonconcessional borrowing.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [Staff Report](#) for the 2006 Article IV Consultation with Sudan is also available.

Sudan: Selected Economic Indicators, 2001-2005

	2001	2002	2003	2004	2005
Real Sector					
Real GDP growth (percent change)	6.1	6.4	5.6	5.2	8.0
GDP (in billions of dinars)	3,454	3,978	4,614	5,573	6,748
GDP (in millions of U.S. dollars)	13,369	15,109	17,680	21,610	27,699
GNP per capita	374	425	486	579	790
Inflation (in percent)					
Period average	4.9	8.3	7.7	8.4	8.5
End-of-period	7.4	8.3	8.3	7.3	5.6
Central government operations (in percent of GDP)					
Revenue and grants	10.7	11.8	16.1	19.8	21.8
Expenditure	11.6	8.7	15.4	18.3	23.6
Overall balance (commitment basis)	-0.9	3.1	0.7	1.5	-1.8
Monetary Indicators					
Reserve money (end-of-period growth rate, in percent)	3.7	22.0	26.6	27.8	34.9
Broad money (end-of-period growth rate, in percent)	24.7	30.3	30.3	32.1	44.7
Broad money velocity	8.1	7.1	6.6	5.7	4.8
External Sector					
Current account balance (including transfers)	-1,257	-918	-827	-816	-2,341
In percent of GDP	-9.4	-6.1	-4.7	-3.8	-8.5
External debt					
In billions of U.S. dollars	20.9	23.6	25.7	26.0	27.7
In percent of GDP	157	156	145	120	100
Net international reserves (in millions of U.S. dollars)	-109	84	290	1,144	1,889
In months of next year's imports of goods and services	-0.5	0.3	0.8	1.9	2.6

Sources: Sudanese authorities; and IMF staff estimates.