Sudan and the IMF

Country's Policy Intentions Documents

Sudan: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

March 18, 2005

The following item is a Letter of Intent and a Memorandum of Economic Policies of the government of Sudan. It is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that Sudan is implementing in the framework of a staff-monitored program. A members's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

March 18, 2005

Ms. Anne O. Krueger
Acting Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Krueger,

We have carried out with the Fund staff discussions on the successful implementation of the 2004 Staff Monitored Program (SMP) and the Article IV consultation. We have also reached agreement on strong SMP for 2005, which maintains macroeconomic stability, while incorporating the substantial resources needed to meet the peace agreement.

The government believes that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the objectives of the program. In light of the uncertainties surrounding the support from the International Community and oil prices, we may take further measures that may become appropriate for the purpose of implementing the program. Sudan will consult the Fund on adopting revision of the policies contained in the MEFP.

We look forward to the Executive Board's discussion of our performance under the 2004 SMP and endorsement of the strength of our policies under the 2005 SMP. We believe that the policy content of these programs is equal in strength to a Rights Accumulation Program (RAP). We will also redouble our efforts with international creditors to obtain financing assurances for debt relief under the Heavily Indebted Poor Countries (HIPC) framework and allow Sudan to move expeditiously to a RAP. However, in the event that such assurances are delayed, we would like the Fund to explore other options to resolve Sudan's arrears with the IMF in a timely manner to allow the normalization of Sudan's financial relation with its international creditors and the resumption of external assistance

In light of the substantial financing needs for post- peace reconstruction, we propose to maintain the payment to the Fund at the 2004 program level of US$30 million. We hope that both the Board and management will take into consideration the need to finance new commitments arising from the peace agreement.

Sincerely yours,

/s/
Al- Zubeir Ahmed AL-Hassan
Minister of Finance and
National Economy
Ministry of Finance and National Economy

/s/
Dr. Sabir Mohamed Hassan
Governor
Bank of Sudan

SUDAN
MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
MARCH 3, 2005

1. This memorandum reviews the outcome of the 2004 Staff Monitored Program (SMP), outlines the government's economic program for 2005, and sets forth our medium-term policy objectives.

I. PERFORMANCE UNDER THE 2004 SMP

2. Policy performance under the 2004 SMP was broadly in line with the program. All quantitative benchmarks were met except the one on the contracting of nonconcessional external debt (Table 1). On the background of lack of access to concessional external resources and urgent development needs, we have decided to contract US$310 million of nonconcessional debt to finance priority infrastructure projects in the electricity and water sectors. The structural measures scheduled for implementation by end-December 2004 were largely met (Table 2), though there were some delays because of the need to consider the implications of the peace agreement (see below). During 2004, Sudan paid the Fund $32.4 million, slightly above the program target.

II. RECENT MACROECONOMIC AND POLICY DEVELOPMENTS

3. We signed on January 9, 2005, a Comprehensive Peace Agreement (CPA) with the Sudan People's Liberation Movement/Army (SPLM/A), ending 20 years of conflict in south Sudan. The agreements, establishes an autonomous government for Southern Sudan, and provides for broader participation in government and the civil service, the restructuring of critical national institutions, and a new national constitution. The Wealth Sharing Agreement provides a national macroeconomic framework for resource allocation and sustainable decentralization.

4. The Sudanese economy achieved a real GDP growth of about 7.3 percent in 2004, compared to 6.7 percent under the program and 6.0 percent in 2003, because of stronger-than-expected oil production and continued robust growth in the non-oil sector—particularly in construction, agriculture, and livestock. Average inflation rose to 8.4 percent in 2004 compared with 6.5 percent under the program and 7.7 percent in 2003. Reflecting a stronger external position, the exchange rate of the Sudanese dinar against the U.S. dollar appreciated by 3 percent in the second half of 2004. For the year as a whole, the dinar appreciated by 8 percent in real effective terms, following a 4.7 percent depreciation in 2003.

5. The external current account deficit (on cash basis) declined to 4.1 percent of GDP compared to about 5 percent in 2003, owing to both high oil prices and a strong recovery in non-oil exports. Oil exports rose by 50 percent to reach $3.1 billion. Non-oil exports also grew strongly by about 37 percent, led by exports of sesame seeds, meat and livestock. Imports also grew by 41 percent with much of the increase coming from a continued rising

share of machinery and transport equipments in total imports. Net private transfers and foreign direct investment (FDI) flows also grew rapidly reaching $2.5 billion. Consequently, gross usable international reserves rose by about US$807 million to US$1.3 billion (2.9 months of the next year's imports).

6. Stronger oil and non-oil revenues and expenditure restraint led to a considerable improvement in the fiscal position in 2004. The budget recorded a surplus of 1.3 percent of GDP in 2004 compared to a deficit of 1.2 percent under the program. Oil revenues rose to 11.3 percent of GDP compared with 9.5 percent in 2003. Non-oil revenues rose from 8 percent of GDP in 2003 to 10.3 percent in 2004, largely because of recently introduced tax measures and better tax administration, including the establishment of the large taxpayer unit. On the expenditure side, current expenditures were slightly above the program level because of the need to fund internal security and humanitarian relief operations in Darfur and domestic debt repayments. Even though the domestic non-oil (primary) deficit rose in relation to non-oil GDP in 2004, it was only slightly higher than programmed, reflecting strong efforts on non-oil revenues and higher savings in the OSA. The latter accumulated the equivalent of 1.6 percent of GDP (compared to 1.1 percent under the program) despite the use of oil revenues to pay for emergency spending in Darfur.

7. Broad money growth (on an annual basis) decelerated to 30.8 percent by end-December after rising by 37.3 percent at end-June 2004. Reserve money growth also decelerated to 27.8 percent at end-December compared with 36 percent at end-June 2004, despite a substantial rise in Bank of Sudan's (BOS) net foreign assets and higher government spending. The fall in monetary growth reflected monetary tightening by the BOS in the second half of 2004, primarily through raising the reserve requirement from 12 to 14 percent (in mid-June 2004) and open market sales of government securities and foreign exchange.

8. We made progress in implementing structural reforms. In the fiscal area, a draft reviewing all regulations and agreements that grant tax exemptions has been completed. However, the action plan to streamline regulations in the context of the 2005 budget is still under preparation and will not be applicable until the 2006 budget. A large taxpayers' unit was established in early 2004 and is now operational. We also made progress in improving budget classification and the presentation of fiscal data. New budget classification systems have been approved for further piloting and implementation—economic and functional classifications in line with the Government Finance Statistics (GFS), and the fiscal data for 2001–2003 have been reclassified according to the new classification. Fiscal reports of the budget are now prepared on a monthly basis. We made efforts to improve public expenditure management by setting up a cash management unit at the Ministry of Finance, although we are still facing capacity and coordination problems in making the unit operational. Finally, to strengthen internal controls at the Ministry of Finance, its accounting and audit department has been reconstituted as a general directorate and has been empowered accordingly.

9. In the monetary area, the steady progress in making the monetary operations unit at the BOS operational has greatly facilitated the management and monitoring of domestic liquidity.

10. To strengthen external debt management, a high-level committee has drafted a new debt strategy and borrowing policy The policy has been approved by the Minister of Finance and due to be submitted to the Council of Ministers in 2005. The strategy emphasizes the use of alternative financing avenues and contracting external debt only rarely and on concessional terms. It identifies three preferred financing options: attracting foreign direct investments, considering build-operate-transfer (BOT) options, and borrowing from the domestic market.

11. In the oil sector, the 2003 accounts of the Sudan Petroleum Corporation (SPC) and many of its subsidiaries have been audited by the Auditor General of Sudan and a summary of the audit report was submitted to parliament.

12. In line with our commitment to increasing the role of the private sector in the economy, we continued to pursue an active program of public sector restructuring and privatization. The restructuring of Sudan Airways has started to prepare it for privatization. In addition, the debts of a number of public sector companies were consolidated (e.g., Public Corporation for Sugar Trade, Rabak Cement Co., National Co. for Water Development, Public Corporation for Irrigation Works, and Atbara Cement Factory). The privatization of Khartoum Bank has advanced, albeit at a slower pace than expected. Because of the costs associated with restructuring and debt consolidation, net privatization receipts were negative, despite gross proceeds of about SDD 10 billion.

III. Outlook and Policies for 2005

13. We will continue to implement prudent economic policies in 2005 with the aim of maintaining macroeconomic stability and sustaining economic growth while meeting the demands of the implementation of the peace agreement and the expenditures associated with the situation in Darfur. The conduct of economic policy will be challenging, given the complexity of the post-conflict environment and the need to restructure institutions as mandated by the peace agreement. To support the attainment of the policy objective, relevant structural reforms will be implemented or initiated in 2005.

14. The program envisages 8.3 percent real GDP growth, an average inflation rate of 7.5 percent, and an increase in international reserves to about 3.2 months of imports. Oil GDP is projected to grow by about 27 percent, reflecting the coming on stream of new oil fields in the third quarter of 2005. Non-oil real GDP growth is expected to slow to 5.6 percent, largely because of below-average rainfall affecting agricultural output. Construction and transport services are expected to grow strongly, in part related to the initiation of peace-related projects.

15. On a cash basis, the external current account deficit net of official transfers is expected to worsen to 5.9 percent of GDP. Exports are expected to grow by about

31 percent reflecting the projected increase in oil exports and continued recovery of non-oil exports. However, import demand is also projected to grow rapidly in line with the post-conflict needs. We also expect cost-recovery and investment expenses in the oil sector to increase income payments to nonresidents significantly. The current account deficit will be financed, in part, by private capital inflows, some project financing and on-going international humanitarian aid (for south Sudan and Darfur). However, additional donor support of at least $400 to $500 million will be needed to finance the external current deficit in 2005. In the event that donor support falls short, we expect a slower build up of international reserves, as the room for tightening domestic policies is limited given the needs of peace.

Fiscal

16. Notwithstanding the high demands of the peace agreement, we remain committed to pursuing prudent fiscal policies, and we aim to contain the domestically financed budget deficit to about 1 percent of GDP. The 2005 budget incorporates the stipulations of the peace protocols, and envisages increased use of oil revenues, expenditure restraint, and domestic borrowing to finance the additional outlays. We note also that the 2005 budget does not include external assistance beyond what Sudan has been receiving in recent years. However, to address poverty issues adequately in the post-conflict environment, we foresee the need for external financial assistance to fund urgent social and development programs. These programs have been detailed in a needs-assessment report that has been prepared by the UN and the World Bank. In the event that additional external funding is secured, a supplementary budget will be submitted to parliament for funding the new program.

17. Fiscal revenues are projected to rise in 2005 by one percentage point of GDP because of higher oil revenues. Given the substantial efforts to raise tax revenues in 2004, imposing new taxes in a year when the peace agreement is about to be implemented will be difficult and thus no new measures are envisaged in the 2005 budget. Furthermore, non-oil revenues are expected to decline by just under 1 percent of GDP, because the excise tax on domestic petroleum products will be lowered in 2005 to offset the higher international oil prices. This will leave domestic oil prices at par with international prices. Nevertheless, we stand ready to phase back the petroleum excise tax or take other measures if fiscal pressures mount.

18. Oil revenues are projected to rise by about 2 percentage points of GDP, reflecting rising oil production. Despite an increase in the oil savings account (OSA) benchmark price to $30 per barrel, the OSA is expected to accumulate about 1.2 percent of GDP, assuming the price of oil averages US$35 per barrel. The saving in the OSA is expected to continue to provide adequate expenditure coverage in the event of an unforeseen drop in international oil prices.

19. Fiscal spending will rise rapidly in 2005, reflecting peace-related expenditures and our efforts to strengthen Sudan's federal system through greater decentralization. The 2005 budget envisages an increase in federal government transfers to the states (including to the

south) from 1.6 percent of GDP in 2004 to about 8.4 percent in 2005, of which, about 4.6 percent of GDP will be allocated to south Sudan for the south's share of oil revenues and the remainder to other states. We plan an across the board expenditure restraint to accommodate these higher transfers. Plans to implement the wage increase have been put on hold and public sector wages are projected to fall slightly in relation to GDP. In anticipation of an improved security environment, we have also reduced the allocations for emergency defense-related spending, as captured under the item "general reserve" in the budget.

20. We envisage a number of structural reforms on the fiscal front. To improve tax administration further, a medium taxpayers' unit will be established by end-June 2005. The cash management unit will be strengthened along the lines recommended by Fund technical assistance. In addition, we have prepared a two-year plan to move towards a single treasury account. As a first step, a single treasury account for all of Ministry of Finance operations will be set up by mid-2005. A two-year program to adopt economic and functional budget classification system (in line with the 2001 GFS classifications) has also been approved. In 2005, as a pilot project, we will begin implementation of GFS budget classification in two federal ministries and two states and we will formulate the 2006 budget in line with the GFS classification.

Monetary Policy and Financial System

21. The program will target a broad money growth rate of 28 percent in 2005, consistent with GDP growth and inflation objectives, and an increase in money demand reflecting the reintegration of the south. The monetary target and the projected build-up in foreign reserves should allow for an appropriate growth rate of credit to the non-governmental sector. The conduct of monetary policy will be challenging given a number of uncertainties, including the impact of the post-conflict activities (e.g., the introduction of new currency), the size of the private capital movements, oil export receipts, and aid flows. Accordingly, we expect to reassess the broad money growth target during program reviews to ensure that it remains in line with the program's inflation objectives.

22. The conduct of monetary policy will continue to rely on indirect monetary instruments and no restrictions will be imposed on market financing rates and banks' credit allocations. In addition, the lending to public enterprises (including for agriculture) will remain curtailed. However, the BOS will continue to assist in managing, but not extending, the financial support provided by the government to agriculture, given the underdevelopment of the agriculture finance infrastructure in Sudan at present. By mid-2005, we intend to rely completely on open market operations for supporting banks' liquidity needs. To support this objective, all government securities will be issued through competitive auction process. We have also closed the cost-free overdraft window for the government, and lending to the government will be carried out solely through government securities. Finally, direct lending to banks will be limited to support surges in seasonal credit demands.

23. We will continue to pursue our plan to restructure and strengthen the banking system. Commercial banks' minimum capital requirements will be raised from SDD 3 billion to SDD 6 billion with banks required to meet the new capital requirement by end-2008. Under performing banks will be encouraged to either merge, transform themselves into small-specialized banks, or will be close. Foreign banks are allowed to operate freely in Sudan, and a number of new foreign banks are expected to commence operations in 2005. We plan to prepare a new financial sector reform program by end-December in light of the recommendations of the recently concluded Financial Sector Assessment Program (FSAP) and the mandates of the peace agreement.

24. We are committed to maintaining an exchange system that is free of restrictions on the making of payments and transfers for current international transactions in accordance with our acceptance of the obligations of Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. We understand that further evaluation from the Fund's Monetary and Financial Systems and Legal Departments is required to ascertain compliance with Article VIII obligations and we are determined to implement any actions that may be required for that purpose. We are committed to implementing a managed float exchange rate regime that prevents sharp fluctuations in the exchange rate. In 2005, the dinar may continue to face appreciation pressures in light of the projected large foreign exchange (oil and aid-related) inflows, but we may resort to monetary sterilization to prevent an excessive appreciation that could undermine the recent recovery of non-oil exports and our efforts to diversify Sudan's economy away from oil dependency.

Trade and External Debt

25. We remain committed to an open trade regime. The current liberal non-tariff trade barrier regime will be maintained. We are also planning a new three-year import tariff reform program that will further reduce tariff protection, and will bring Sudan's tariff regime in line with the schedule mandated by the Common Market for Eastern and Southern Africa (COMESA) customs union agreement. However, because of the exceptional demands of peace on fiscal resources and uncertainties about donor support, we will postpone the launching of the new tariff reform program until 2006. In this context, we also received an exemption to delay any additional tariff reductions from the COMESA obligations for 2005. We will proceed to update the tariff reform proposal prepared in 2004 and incorporate it in the 2006 budget.

26. Sudan continues to pursue actively its application for accession to the World Trade Organization (WTO). It has presented all the required documentation to the WTO working party. Sudan has also applied for exemptions from agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) and customs duties on agricultural goods and some industrial products, and asked for a transitional period to implement all obligations.

27. Sudan's external debt is unsustainable by any standard, and most of it is in arrears. The estimated end-2003 stock of public and publicly guaranteed debt was about US$25 billion, of which about US$21 billion was in arrears. Solving the debt and arrears

problems is an important goal for the Government of Sudan and we are looking forward to the Fund's early update of the 2001 Board paper on resolving Sudan's external debt problems. Without an early resolution to this problem, Sudan will be denied access to concessional development assistance at a time when it is most needed to support the peace efforts in Sudan. In 2004, we had to contract or guarantee new external financing on nonconcessional terms in order to implement critical social and development projects, such as supply of water and electricity. In 2005, we will limit the contracting or guaranteeing of nonconcessional external loan to US$150 million only, for high priority projects, mainly in the social sector.

Other reforms

28. We are taking a number steps to encourage private sector participation in the economy. On the public enterprise front, we have adopted a reform program to privatize about 42 enterprises most of which operate on a commercial basis and do not receive budgetary support (e.g., the Sugar Trading Company, the Sudanese Company for construction, Shibak Transportation Company, Nile Cement Company), and convert other large enterprises to shareholding companies with the government's share limited to a maximum of 20 percent (e.g., Sudan Airways and the National Company for Roads and Bridges). All other economic activities are open to private sector participation; foreign investors are treated at par with local ones; an anti-trust law has been prepared and a legal review to modernize our commercial laws and legal institutions is underway.

29. With the expected rise in oil production, we are fully aware of the importance of continuously improving oil sector transparency, and we remain committed to this objective. One important milestone will be the establishment (as stipulated in the peace agreement) of a new National Petroleum Commission that will oversee all oil sector activities and report to parliament. The commission is expected to be constituted in mid-year and will begin reviewing immediately the existing oil operations and the process of managing oil revenues. The Commission is also mandated to prepare a national policy for future oil sector activities. In the meantime, the SPC will begin the process of changing its accounting standards with a view to aligning them with the applicable commercial accounting standards in Sudan.

30. As detailed below, our medium-term policies will focus on poverty alleviation and development. To this end, we are preparing an interim Poverty Eradication Strategy (PES), which is meant to provide a foundation for a full PES for the new national unity government. It stresses on relevant and flexible policies that ensure macroeconomic framework consistent with post-conflict challenges, decentralization, an enabling environment for private sector growth, and capacity and institutional building.

IV. MEDIUM-TERM OUTLOOK AND POLICIES

31. Our medium-term strategy is based on sustaining the high economic growth and macroeconomic stability achieved in recent years, while focusing on poverty alleviation (in

the context of pursuing the Millennium Development Goals (MDGs)) and post-conflict recovery. Structural reforms that enable private-sector led growth, coupled with public investments in health and education and key infrastructure will allow growth to be sustained over a longer horizon, while a reorientation of public expenditures will allow for increased spending on poverty reducing programs. International donor assistance will be critical for the attainment of the growth and poverty reduction objectives, by supporting the balance of payments needs and higher investment levels for reconstruction, infrastructure and human capital development.

32. The medium-term macroeconomic framework envisages economic growth of about 8–9 percent and prudent macroeconomic policies that ensure single digit inflation and a steady build up in international reserves. We anticipate economic growth to be broad-based across all economic sectors to ensure economic diversity. A surge in oil production and post-conflict activities will spur growth in the next two years, while over the longer term the economy will diversify away from oil as sectoral policy reforms begin to yield results. Achieving the growth objectives would require higher domestic investment rates and greater reliance on foreign savings. Gross domestic investment is expected to rise by about 3 percentage points of GDP reflecting a substantial increase in public spending (at all levels of government), particularly on reconstruction in the south.

33. The external position is likely to worsen over the medium term. On a cash basis, the external current account deficit will rise from 4 percent of GDP in 2004 to about 6 percent in 2006 and stabilize at that level thereafter, as both oil export growth tapers off and post-conflict import needs mount. We expect private inflows (transfers and FDIs) to remain strong and responsive to our policies, especially given the assumption of peace, and to continue playing an important role in funding the balance of payment. Nevertheless, a significant external gap is likely to emerge without international donor support. We are hopeful that this support will be forthcoming in the near future. However, in the unfortunate event that such support falls short of what is needed, we will tighten our policies to the extent possible and, if necessary, aim for less ambitious build up of international reserves. As a result economic growth and poverty reduction efforts will be adversely affected and the vulnerability of our external position will rise.

34. Fiscal policy will aim at maintaining low domestically financed deficit to support macroeconomic stability, mobilize new domestic resources, reorient expenditures towards infrastructure development, human capital improvement, poverty reducing programs, and support the decentralization process. The continued savings of oil revenues will ensure fiscal stability in the face of unexpected oil price shocks, and facilitate macroeconomic stability. Strengthening non-oil revenues will remain a priority and we aim to raise these revenues, at a minimum, from about 10 percent of GDP in 2004 to about 12 percent by 2010, notwithstanding the expected customs revenue loss from the planned tariff reform (about 1 percent of GDP). Measures will include a further reduction in exemptions, broadening of the tax base, phasing back the excise tax on petroleum products, and strengthening tax and customs administration. On the expenditure side, the focus will be on supporting demobilization and fiscal decentralization, reducing military spending subject to

the Demobilization, disarmament and reintegration program (DDR), and channeling substantially higher resources to social programs (in line with the poverty alleviation goals) and development spending (particularly on much needed basic infrastructure).

35. Monetary policy will continue to target a broad money growth rate consistent with the inflation and economic growth objectives. The existing monetary regime, in close coordination with fiscal policy, should be adequate to support the achievement of macroeconomic objectives while responding to the challenges of monetary policy in coming years. These challenges include potentially large private capital movements, oil export receipts, aid flows, and unforeseen fiscal shocks (at the federal and state levels).

36. We believe that a managed-float exchange rate regime remains appropriate for Sudan over the medium-term, although we foresee a steady move towards an independent floating regime as conditions improve in the foreign exchange market. The maintenance of the current system is justified because of the lumpy nature of key foreign exchange flows (aid flows, and FDIs), and the underdevelopment of foreign exchange markets and instruments. Still, we will ensure that the exchange rate remains responsive to underlying fundamentals to avoid exchange rate misalignments.

37. We would like to express our appreciation for the technical assistance extended by the Fund to Sudan in different fields, and we hope for a continuation of this valuable and indispensable assistance, particularly in support of the post conflict needs. In the central banking area, technical assistance is needed for the introduction of new currency, central banking restructuring and bank regulations to accommodate the dual banking system, monetary operations, and payment systems. As for the fiscal area, we are in need for technical assistance in development of a public expenditure management strategy, budget accounting and classification, fiscal decentralization, government securities, tax policy, tax and customs administration, and modernization of treasury. In addition, the statistical macroeconomic database needs to be improved and technical assistance in the areas of fiscal statistics, balance of payments; management of monetary data for banking supervision, and national accounts is needed to improve further the macroeconomic database.

V. Relations with the Fund and other creditors

38. We remain committed to regularizing relations with all our creditors and, in particular, strengthening Sudan’s relations with the Fund. In addition to strong cooperation with the Fund on economic policy matters, including through satisfactory performance on SMPs since 1997, Sudan made regular payments to the Fund as committed under the 2004 SMP ($30 million), and paid a total of $366 million since the first SMP in 1997, reducing our arrears by about 120 million SDRs. We hope that our record of cooperation will be fully recognized, particularly when moving forward with arrears clearance.

39. In 2005, Sudan’s debt service capacity will be constrained by the considerable burden of post-conflict needs and emergency imports for Darfur. Any shortfall (or even a delay) in donor assistance or a negative shock in oil prices would further limit our capacity

to service its debt obligations. As continued proof of our commitment to normalize our relations with the Fund and notwithstanding the demands of peace and imports for Darfur emergency, we would like to maintain the level of payments to the Fund at US$30 million in 2005.

40. We are making good progress in regularizing relations with external creditors but clearance of large arrears remains a daunting challenge. Partial debt service payments are being made to almost all of the multilateral creditors. Sudan is also servicing its obligations to a number of bilateral Arab funds, which in most cases are providing net financing inflows for various social sector projects. Finally, we will work closely with the creditor support group led by the United Kingdom to secure the support of donors for resolving our external debt problem under the Heavily Indebted Poor Countries (HIPC) initiative.

VI. Program Monitoring

The proposed semi-annual quantitative targets for the periods up to end-June and end-December 2005 are set forth in Table 1, and the structural benchmarks are detailed in Table 2. The quantitative targets focus on ceilings on the change in net domestic assets of the BOS and the domestic financing of the fiscal deficit; floors for the buildup of international reserves; and ceilings on new nonconcessional external debt. There is an oil revenue adjustor to be applied to the targets on international reserves, net domestic assets of the BOS, and the domestic financing of the government based on any difference between the projected change in the balance of the oil savings account and the actual change. We will closely monitor financial and economic developments in coming months and will implement any measures that may be needed to safeguard macroeconomic stability in consultation with the Fund staff.

Table 1. Sudan: Quantitative Indicative Targets for 2005 Staff-Monitored Program

(In billions of Sudanese dinars; unless otherwise indicated)

	Dec. 2004	Cumulative Change During 2005 1/			
		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
	Actual 2/	Indicative Target	Mid-year Program	Indicative Target	End-year Program
Bank of Sudan net domestic assets 3/	129.5	20.5	11.8	19.7	14.3
Domestic financing of the fiscal deficit 4/	-100.4	-4.0	-6.3	-6.4	-17.5
Privatization	0.0	4.3	6	9	10.0
Contracting or guaranteeing of external nonconcessional debt by government and BOS (in millions of U.S. dollars) 5/	310.2	...	...	...	150.0
Gross official usable reserves (in millions of U.S. dollars) 6/	1,334	80.0	180.0	280.0	420.0
Payments to the Fund (in millions of U.S. dollars)	32.4	...	15.0	...	30.0
Memorandum items:					
Broad money 3/	960.4	78.9	128.0	193.3	268.9
Oil saving account	129.0	18.4	32.7	49.8	72.6

1/ Cumulative change from end of the previous year.
2/ Outstanding stock at end-of year.
3/ Net BOS financing is defined as borrowing by the central bank from the BOS (including GMCs) minus central government deposits at the BOS (excluding deposits accumulation in the OSA).
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 but excluding the OSA), net sales of GMCs outside the BOS, revenues from privatization, and repayments of internal domestic debts.
5/ This indicative target 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 indicative target excludes the financing of the Merowe hydropower project.
6/ 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 2. Sudan: Structural Benchmarks for 2005

Prior Actions 1. Begin pilot implementation of GFS budget classification in two states and two federal ministries.
By end-June 2005 2. Introduce an auction system with competitive selling price for the General Musharaka Certificates (GMC) and General Investment Certificates (GIC) securities in the primary market. 3. Set up and operationalize a single treasury account for all Ministry of Finance's operations. 4. Establish a Medium Taxpayer Unit. 5. Develop a program (including timetable) for aligning the SPC and its subsidiaries' accounting systems with commercial standards by end 2006.
By end-December 2005 6. Formulate the 2006 budget based on GFS classification. 7. Prepare a three-year import tariff reform program and incorporate it in the 2006 budget. 8. Establish a new financing window that allows liquidity constrained banks to sell securities to the central bank at a penalty rate. 9. Prepare a financial sector reform program in light of FSAP recommendations.

SUDAN
TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum specifies the understanding reached with the Fund staff regarding the quantitative benchmarks and indicative targets for the 2005 Staff-Monitored Program (SMP).

2. The 2005 SMP relies on five quantitative indicative targets for the first and the third quarters of the year and an equal number of quantitative semi-annual benchmarks. The indicative targets and the quantitative benchmarks are subject to an oil revenue adjustor. The quantitative targets are (i) ceilings on the change in net domestic assets of the Bank of Sudan (BOS); (ii) ceilings on the domestic financing of the fiscal deficit; (iii) floors for the buildup of gross usable reserves of the central bank; (iv) ceilings on new nonconcessional external loans contracted or guaranteed by the government or the central bank; and (v) floors for payments to the Fund. Broad money and oil revenues will be monitored as memorandum items. All the targets and benchmarks are presented in Attachment I, Table 1.

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

4. **Net domestic assets (NDA) of the BOS** are defined as the sum of the Net Domestic Credit of the BOS, the net issue of money market instruments and other items net (OIN) of the BOS. The Net Domestic Credit of the BOS is defined as total credit to the central government (including government musharaka certificates (GMCs) and government investment certificates (GICs)) 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 No. 11, Group No. 12, and some accounts of the Group No. 19 in the BOS general ledger), the *Zakat* funds (recorded under Group No. 13), and margin deposits placed with BOS by the central government against letters of credit issued by the BOS. The definition includes all oil-related accounts controlled by the government. The identification of all accounting balances recorded under OIN has been established with the help of the IMF's Statistics Department mission in May 2000 and is detailed in the corresponding report.

5. **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 and GICs), net sales of GMCs and GICs outside the banking system; revenues from privatization; and repayments by the central government of internal domestic debts to public agencies, banks, and private companies. The definition of central government for the purpose of this criterion is the same as the one applied for the NDA of the BOS.

6. **Gross usable official reserves** are foreign reserve assets (as defined in the balance of payments manual), that are controlled by the BOS and are immediately and unconditionally available for meeting balance-of-payment needs. They consist of balances on accounts

maintained with overseas correspondent banks and foreign exchange banknotes in the vaults of the BOS.

7. **Contracting or guaranteeing of new non-concessional external debt** by the government or the BOS 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 applied to the contractual schedule of charges and principal payments, indicates a grant element of at least 35 percent.[1]

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

9. **The oil revenue adjustor** will be applied as follows: oil revenue arising from an export price of over $30 per barrel for crude 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 match the amounts targeted under the program. The program targets for domestic financing of the budget deficit and for changes in the NDA of the central bank will be reduced, and the international reserve target will be raised by the difference between programmed and actual revenues accumulated in the oil savings account. In the event of oil revenue shortfalls below the program targets, the accumulated balance at the BOS can be drawn down to make up the shortfall in revenue; correspondingly, the program targets for domestic financing of the budget deficit and NDA will be raised, and the international reserve target reduced.

[1] For program purposes, a loan is considered concessional if the grant element is at least 35 percent calculated using a discount factor based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the loan maturity. The margins are 0.75 percent for repayment periods of less than 15 years, 1 percent for 15–19 years, 1.15 percent for 20–29 years, and 1.25 percent for 30 years or more. The average of the CIRRs over the last ten years will be used for loans with a maturity of at least 15 years and the average of the CIRRs for the preceding six months will be used for shorter maturities.