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Fact Sheet for the Chairman
Subcommittee on Africa, Committee
on Foreign Affairs
U.S. House of Representatives

June 1986

SUDAN

Conditions on U.S. Economic Aid

130021

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-211263

June 2, 1986

The Honorable Howard E. Wolpe
Chairman, Subcommittee on Africa
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

We reviewed conditions attached to the U.S. Economic Support Fund (ESF) program for Sudan in response to your request of February 3, 1986. We gave a preliminary briefing to your staff on the results of our work on May 2, 1986.

Through the Agency for International Development (AID), the United States has provided balance-of-payments assistance under the ESF program to Sudan since fiscal year 1980; funds provided through fiscal year 1985 totaled $506.3 million. ESF assistance has been in the form of cash transfers and/or commodity import financing, which included specific allocations for petroleum imports. Economic reforms stipulated in the ESF agreements in 1982 made this assistance conditional on Sudan's compliance with the International Monetary Fund (IMF) stand-by arrangement. Since 1983, as the AID mission to Sudan acquired the economic expertise to conduct its own analyses of the Sudanese economy and the need for economic policy reforms continued, the conditions negotiated by AID with the government have become more specifically defined.

AID has sought to achieve five objectives through its conditions: (1) strengthen the role of the private sector, (2) reduce the role of parastatal (or public sector) companies and the subsidies the government provides to them, (3) increase foreign exchange generation and improve the government's ability to manage it, (4) increase domestic revenue generation and resource mobilization, and (5) improve the management of the public utilities including the General Petroleum Corporation. According to AID officicals, improvements in the first four categories have been limited but significant reforms in the management of the General Petroleum Corporation have been obtained.

In accordance with your request, we focused our review for the period 1982 through 1985 on the conditions set by the United States; whether Sudan complied with conditions and whether compliance advanced the United States' long-term goals of political stability and economic development; the factors influencing Sudanese compliance; and how ESF expenditures related to U.S. goals. As agreed with your office, we did not make independent conclusions concerning these issues. The data presented in appendices I and II reports information shown in AID records and provided by responsible officials.

We met with officials at AID, the Departments of State and the Treasury, and the Office of Management and Budget in Washington, D.C., between February and April 1986. We obtained economic analyses and studies and other program documentation from AID and the State Department. In Sudan, during March 1986, we reviewed mission files and met with U.S. embassy and AID mission officials and with the resident representatives of the IMF and World Bank. We also met with the Sudanese Minister of Finance and Economic Planning and with a former minister of that department, the acting governor of the Bank of Sudan, the Minister of Energy and his under secretary, and the economic section chief of the Sudanese embassy to the United States; these officials represented the interim government in Sudan.

We did not obtain official agency comments but the information in this fact sheet was discussed with U.S. officials in Washington and Khartoum during the course of the work.

We are sending copies of this fact sheet to AID, the Departments of State and the Treasury, and the Office of Management and Budget. We will make the fact sheet available to other interested parties upon request. If we can be of further assistance in this matter, please call me at (202) 275-5790.

Sincerely yours,

Joseph E. Kelley

Joseph E. Kelley
Associate Director

C o n t e n t s

ABBREVIATIONS

AID	Agency for International Development
ESF	Economic Support Fund
GPC	General Petroleum Corporation
GDP	gross domestic product
IMF	International Monetary Fund
NEC	National Electricity Corporation

CONDITIONED ESF ASSISTANCE TO SUDAN

Throughout the 1960's, Sudan's current account balance was either stable or in surplus, with a low inflation rate and debt-service ratio. The economy was characterized by financial stability with a private-sector orientation, but there was little real economic growth. In the mid-1970's, the government of Sudan launched a major public-sector investment program, funded in part by the Arab oil-producing states, with the intention of making Sudan the "breadbasket" of the Arab world.

According to officials at the AID mission in Khartoum, the government of Sudan's programs were overly ambitious, inadequately planned and managed, and ineffectively implemented. Poorly conceived economic policies led to an imbalance between imports and exports. The government resorted to external borrowing to cover its balance-of-payments gaps.

Resources were directed toward public-sector programs and the establishment of parastatal enterprises. Private savings declined as consumption, subsidized by the government, was encouraged. The growing budget imbalance, triggering increased Bank of Sudan borrowing and coupled with external payments and debt problems, resulted in accelerating inflation and rapidly rising debt-service obligations. External debt payments became due before the public-sector investment programs began to produce exportable assets. As a result, Sudan's external debt-service obligations began to exceed its total export earnings.

Sudan is now experiencing economic stagnation and overwhelming debt and financial crises. Its overall economic activity declined for the third successive year in 1985, with an estimated decrease of 7 percent in gross domestic product (GDP) due to (1) the regional drought which cut food production and attracted an estimated influx of 1.2 million refugees from neighboring countries (equivalent to 6 percent of Sudan's population), (2) the civil war between the northern and southern parts of Sudan, (3) the structural inefficiencies of the parastatal enterprises, which account for 50 percent of the country's GDP and nearly 75 percent of its exports, and (4) the government's failure to undertake necessary economic reforms. Industrial production stagnated and the economic contribution of the construction sector declined due in part to frequent electricity outages and inadequate supplies of fuel, spare parts and other inputs.

Private-sector activity also suffered from the uncertainties created by the introduction of Islamic law (*Sharia*) under former President Nimeiri. The law resulted in abolition of the limited liability form of business organization, cessation of enforcement of interest-payment features of contracts, and the introduction of a *Zakat* "wealth" tax to replace some of the traditional taxes. Substitution of the Zakat, an obligatory Islamic tax, for traditional taxes resulted in less revenue generation for the government and is based upon fixed rather than productive assets. The April 1985 coup which deposed President Nimeiri also created apprehension and uncertainty in the private sector.

As the Sudanese economy continued to deteriorate and the government failed to undertake economic reforms, the United States set conditions, beginning in 1982, on ESF funds directed toward Sudan's economic stabilization and structural adjustment. The following table shows ESF assistance for fiscal years 1980-85.

Table I.1: ESF Assistance Programmed for Sudan

Fiscal year	Amount (millions)
1980	$ 40.0
1981	50.0
1982	100.0
1983	82.3
1984	120.0
1985	114.0
Total	$506.3

Source: AID

CONDITIONS SET BY THE UNITED STATES

The 1980 and 1981 ESF agreements between AID and the government of Sudan contained no specific conditions for economic policy reforms. However, AID required Sudan to take all steps necessary to make at least 50 percent of the commodity imports provided by ESF available to the private sector.

The 1982 and 1983 agreements contained general statements of support for reforms the government had negotiated with the IMF and had proposed in its 3-year development plan. A side letter to the 1982 U.S.-Sudan agreement included a government pledge to comply with the IMF arrangement and to (1) improve the efficiency of parastatals in the agricultural sector, (2) make progress in parastatal divestiture, (3) encourage private savings and investment, and (4) implement a new investment code. AID conditioned its assistance on government compliance with the IMF program because it did not at that time have the in-house expertise to perform the economic analyses required to determine the specific economic reforms needed in the country.

ESF conditions in the 1984 and 1985 agreements defined the microeconomic strategies (e.g., guarantee cotton quality) needed to address macroeconomic reforms (e.g., increase exports) sought in the earlier agreements. They were also greater in number, more specifically defined, and sectoral in scope. For example, the petroleum initiatives targeted reforms within the General Petroleum Corporation (GPC) and the National Electricity Corporation (NEC). AID also addressed the need for exchange rate adjustments and improved GPC procurement procedures and NEC management and revenue collection.

AID also included provisions calling for joint AID-government studies aimed at getting government officials to understand the pressing need for reforms.

SUDAN'S COMPLIANCE WITH U.S. CONDITIONS

AID sought to achieve five objectives: (1) strengthen the role of the private sector, (2) reduce the role of parastatal (or public sector) companies and the subsidies the government provides to them, (3) increase foreign exchange generation and improve the government's ability to manage it, (4) increase domestic revenue generation and resource mobilization, and (5) improve the management of the public utilities including the General Petroleum Corporation. According to AID officials, improvements in the first four categories were limited but significant reforms in the management of GPC were obtained.

The private sector

Overall, Sudan has not complied with AID's conditions to assist the private sector. AID has tried to assist the private sector by requiring the government to channel a portion of ESF program commodities to the private sector and revise government policies. The 1982 agreement specified that the government would make 60 percent of the proceeds from the commodity program available to the private sector. AID mission officials said that the government complied with this condition; subsequent agreements did not contain similar requirements. The 1983 agreement required the government to review its foreign exchange and import licensing systems to meet private-sector needs and to issue regulations implementing an investment code to encourage domestic and foreign private investment. The government did not comply with these conditions and according to AID, private-sector investment has declined over the past 3 years.

Similarly, the government did not comply with the 1984 condition to allow private-sector representation on a government committee that determined the mix of imports that would be funded by the U.S. assistance program. The intent of this condition was to ensure the private sector a voice in deciding what imports were necessary for the private sector. Between 1983 and 1984, $99 million out of $122.3 million provided under the commodity program by the United States was allocated to the parastatal enterprises. The 1985 agreement also contained provisions promoting private-sector development.

According to AID, the government's active policies have hampered AID efforts to strengthen the private sector. A March 1985 AID evaluation noted that, before a vibrant private sector could materialize in Sudan, hurdles to be overcome included (1) price and production controls which discourage plant and equipment investment, (2) fixed prices and profit margins, which restrict private-sector entry into many product lines, (3) an overvalued exchange rate, which discourages production for export, and (4) high labor costs resulting from labor legislation weighted in favor of employees.

Parastatals

AID conditions have called for a government review of the management of parastatals and accompanying progress in phasing out inefficient enterprises. According to U.S. and Sudanese officials, limited progress has been made. While parastatals account for 50 percent of GDP, according to the Minister of Finance, they operate at only 50 percent of productive capacity. A recent World Bank study of 16 major parastatals found that only one was financially sound, 4 were bankrupt, and 8 could not be analyzed due to the lack of adequate records. The U.S. embassy reported that the operating losses of parastatals were covered by the Bank of Sudan. By mid-1984 their losses led to indebtedness of over $250 million. Credit for the private sector was thus severely constrained.

AID officials reported that Sudanese officials are aware of the problems of parastatal losses and inefficiencies but view the parastatals as a means of control by which they can negate or modify the impact of current economic difficulties on selected groups. A January 1986 AID mission paper indicated that government officials' interests focus on keeping peace in the Khartoum populace.

Foreign exchange generation and management

AID became involved in the Sudanese exchange rate issue when it appeared that the 1983-84 IMF arrangement would collapse and important policy issues would go unaddressed. In prior years, the government had resisted when AID attempted to press exchange-rate reform, contending that this issue was solely within the purview of the IMF.

AID successfully negotiated an increase in the amount of foreign exchange allotted in October 1984 to commercial banks from 25 percent to 50 percent of total export earnings. Since commercial banks were the primary source of private-sector foreign exchange, AID saw this as a major step toward more resources for the private sector. However, the government subsequently changed the formula to permit the Bank of Sudan to retain all foreign exchange earned from exports. According to an AID official, this change was in response to the IMF, which wanted all available resources concentrated in the hands of the government in order to allow official obligations to be met.

AID conditions in 1983 and 1984 also required the government to make progress in aligning the exchange rates. Sudan had a fixed official rate and a parallel "floating" rate (which was also fixed to some extent). A free- or black-market rate was tolerated by the government. Although five devaluations occurred between June 1978 and February 1985, the official rate remained overvalued in relation to the parallel and free-market rates. Sudanese officials were opposed to any further devaluations and maintained that past devaluations had been unsuccessful and only led to increased inflation. The AID mission maintains that the overvalued exchange rate particularly effects the rural, agricultural sector and results in the loss of export markets. AID contends that this sector offers the greatest potential for increasing foreign exchange earnings and reserves.

Revenue generation

In response to AID conditions, the government completed a detailed study in 1984 on reform of the tax structure. Various policy options were presented to ensure that adequate revenues would be collected to meet the government's stabilization objectives. However, the results of the study were preempted by the introduction of a religious tax (Islamic Zakat) which replaced about 18 other taxes. Some of these taxes were subsequently reintroduced, but the government's budget deficit still doubled in 1984-85 as expenditures exceeded revenues. A contributing factor was increased expenditures on the civil war.

Petroleum initiatives

Despite difficulties in getting the government to undertake its major conditioned reforms, AID's 1984 and 1985 petroleum initiatives succeeded in changing the General Petroleum Corporation's procurement process. An AID official said that the GPC did not have an accounting system to determine the quantity and costs of imported petroleum products prior to 1984. AID provided the GPC with computers and technical support, through development assistance funds, to establish an information base upon which reforms in the tendering and allocation of petroleum products would be based.

According to AID and confirmed by Sudan officials, government compliance with AID conditions resulted in accounting and control mechanisms which saved the government between $60 million and $100 million in its annual oil import bills (prior to the recent drop in world oil prices). We were informed that, before the government implemented competitive tendering practices for oil purchases, Sudanese officials were devising "back door" schemes to purchase oil from disreputable dealers. A government energy official, for example, said that former officials had received kickbacks of $75 million from such dealers in 1983 and as a result, Sudan paid prices which were considerably above world market prices for petroleum. The official credited AID's 1984 conditions for GPC reforms.

AID's efforts also increased the availability of petroleum products in regions outside Khartoum. When the government allowed regional governors to determine regional petroleum prices, the governors permitted distributors to recover transportation and other costs, which gave the distributors an incentive to ship products to the rural areas. The regional free markets in oil prices resulted in a 25 to 30 percent decline in benzene prices and a 45 to 50 percent decline in diesel fuel prices. The price declines produced a ripple effect throughout the agricultural sector and eventually even in food prices, according to AID.

AID was unable to secure reforms in GPC's petroleum allocation system, which gave preference to parastatal enterprises over the private sector.

FACTORS INFLUENCING COMPLIANCE

Several factors affected Sudanese compliance with U.S. conditions, including the (1) attitude of Sudanese officials, (2) introduction of Islamic law, (3) civil war, (4) lack of an IMF arrangement following termination of the 1984 program, (5) drought which affected the productive agricultural areas, and (6) April 1985 coup against President Nimeiri.

According to the AID mission, Sudanese government officials generally do not recognize the relationship between poor government policies and the country's economic problems nor do they support the need for reforms. There is a preference for the public sector and thus for continued dominance of the parastatals in the economy. Since many officials serve on parastatal boards and receive income from these positions, they are reluctant to begin divestiture.

Former President Nimeiri's introduction of Islamic law in late 1983 also caused major disruption in the banking and private sectors and further fueled the civil war in the non-Muslim southern part of the country. The private sector reduced its capital investment, inventories and production and capital flight and outmigration of skilled labor increased. The civil war has diverted resources of the central government and disrupted oil operations in the south.

Sudan's $250 million in arrearages to the IMF have prevented negotiation for a new stand-by arrangement and rescheduling of the country's $9-billion debt. The country's arrears on debt payments totaled $1.5 billion as of September 1985. Although the IMF is providing "technical assistance" to the Sudanese government, the arrearages to the IMF will prevent the government from using IMF trust fund moneys which could provide about $100 million over a 3 to 4 year period according to a State Department official.

The 1984 drought disrupted agricultural production, reduced exports and further strained government resources. Compliance with U.S. conditions were hampered as the government and AID directed their efforts to addressing the drought's impact on the Sudanese people and the refugees from neighboring countries.

The April 1985 coup disrupted the country further. The interim government added to the uncertain climate prevailing throughout the private sector. Also, responding to demands for measures to alleviate the economic burdens on the working class, the interim government reimposed price subsidies for food and consumer goods which had been reduced and/or eliminated by President Nimeiri, in response to U.S. conditions, immediately before the coup.

ESF EXPENDITURES AND U.S. GOALS

Most U.S. officials consistently emphasized the political importance of assistance to Sudan and the fact that the Nimeiri government was very pro-American. Some AID officials said that ESF balance-of-payments support has been viewed primarily as a means of political support for a friendly government rather than as a vehicle for initiating economic reforms. A State official noted that U.S. assistance had kept "the Soviets and Libyans out" of Sudan (during the Nimeiri regime). Following the overthrow of Nimeiri, U.S. goals under the interim government were to retain some influence and to balance that of the Libyans.

AID CONDITIONS IN ITS ESF PROGRAM

Condition	Intent	Status
1982		
No less than 60 percent of commodities to the private sector	Avoid support of parastatals	Covenant met
At least 15 percent of agroproducts imports from the United States	U.S. legislative requirement to increase U.S. exports	Covenant met
Execute IMF agreement, review parastatals new investment code; increase private savings and investment. (Total of 7 covenants specified in side letter)	Support IMF covenants and government 3-year economic development package	Government did not comply with the IMF agreement
1983		
Controlled prices maintained at prevailing exchange rates	Reduce budget subsidies; move prices toward import parity	Covenant met at commercial rate; not met at free market rate
Continue review of revenue policy and reform tax structure to insure adequate domestic revenue	Eliminate deficit financing	Review completed; results preempted by Islamic Zakat; covenant not met
Continue to review foreign exchange and import licensing systems to meet private sector needs	Maintain pressure on government to raise exchange rates and make timely devaluations	Convenant not met
Determine and institute reforms to encourage private savings and investment	Encourage government review of issue and complement ongoing IMF work	Convenant met; investment bureau created to encourage savings
Issue regulations implementing investment code to encourage foreign and domestic private investment particularly in agriculture	Not specified	Covenant not met; private investment has declined in last 3 years

AID CONDITIONS IN ITS ESF PROGRAM

Condition	Intent	Status
1984		
At least 15 percent of agroproducts from the United States	U.S. legislative requirement to increase U.S. exports	Covenant met; more than 15 percent spent
Invite three private sector representatives to attend commodity allocation meetings	Allow private sector voice in decisions	Covenant not met
Initiate steps that lead to official exchange rate adjustment	Encourage exports and set domestic prices at import parity	Covenant not met; devaluation occurred but did not encourage exports
Eliminate 15 percent discount on commodities' commercial bank rate used for local currency deposits	Eliminate subsidies to the public sector	Covenant met
Government/AID study on ways to increase development impact of program commodities	Reinforce public sector accountability	Covenant met; study done
At least $4 million of ESF commodities funded imports allocated to private sector rainfed agricultural areas	Target resources to rainfed (productive) areas	Covenant not met; drought intervened
Government will advertise availability of ESF foreign exchange	Provide information to farmers and private sector	Covenant met
NEC will reduce system losses to 25 percent by August 1985; independent audit of collections by October 1985	Reduce parastatal subsidies	Covenant not met; improved NEC efficiency but loss reduction not calculable
NEC submit to AID a plan to improve its management and performance	Not specified	Covenant not met
20 percent of policy analysis funds used for AID macroeconomic analyses	Allow AID to address sensitive issues without government approval	Covenant met

AID CONDITIONS IN ITS ESF PROGRAM

Condition	Intent	Status
1985		
Government will study a limited import licensing procedure	Grant licenses to private sector for agriculture imports	Covenant met; study undertaken
Government/AID study parastatal sector	Identify means for selling public-sector assets	Covenant not met
Government/AID study effect of budget and foreign exchange rate subsidies on goods and services	Measure effect of government subsidies on the budget and import demand	Covenant not met
Government analysis of monetary expansion in past 18 months	Identify means for expansion and beneficiaries	Covenant not met
Government develop a plan to allocate credit to development activities in the regions	Obtain more credit for the private sector	Covenant not met; contingent upon IMF arrangement
Government maintain system of import license issuance; implement plan to record categories of licenses used	Monitor essential foreign exchange allocation	Covenant not met
Government take aggressive steps to market cotton by contacting many brokers; guarantee cotton quality	Maximize cash payment for exportable cotton	Covenant not met; will not be addressed in future agreements
Government maintain special advisory panel with private sector representatives to advise Ministry of Finance	Private sector participation in monetary decisions	Covenant met
At least 15 percent of agroproducts from the United States	U.S. legislative requirement to increase U.S. exports	Disbursements not made at time of review
At least $5 million commodities allocated to rainfed agricultural areas in Kordofan and Darfur regions	Target productive sector	Disbursements not made at time of review
Government will advertise commodity funds availability in local press	Provide information to farmers and private sector	Disbursements not made at time of review

AID CONDITIONS IN ITS ESF PROGRAM

Condition	Intent	Status
1985 (continued)		
NEC study on improvements in its management efficiencies	Improve NEC organizational structure and internal functioning	Convenant not met; address in 1986
Government repay loans guaranteed with grant funds in accordance with loan agreement	Bridge financing for IMF arrears; $50 million set aside	No IMF arrangement
1984 Petroleum Initiative		
Government deposit $240 million for petroleum needs within 1 year of agreement	Assure financing of petroleum needs	Covenant not met
Government obtain non-U.S. financing for $65 million; additional amounts for diesel fuel needs	Assure financing of petroleum needs; prohibit import of luxury items	Covenant partially met; additional diesel fuel not procured
Government deposit $15 million monthly to petroleum account	Maintain orderly tendering and procurement of petroleum	Covenant met
Government permit five private sector distributors to import diesel fuel and some benzene directly	Target private sector fuel needs	Covenant met
All petroleum products imported through Petroleum Facility using open and competitive tendering; terms of donor petroleum assistance given to all donors	Ensure timely petroleum procurement and competitive prices; control petroleum donations	Covenant met
Government adhere to monthly financial plan	Regularize monthly purchase of fuel	Covenant met
Government make timely deposits into Petroleum Facility	Assure proper tendering, awarding, and payment	Covenant met
Ministry of Energy complete new internal allocation and distribution plan addressing needs of industry and rainfed agriculture	Ensure allocations to private sector	Covenant not met; address in 1986

AID CONDITIONS IN ITS ESF PROGRAM

Condition	Intent	Status
1984 Petroleum Initiative (continued)		
Government retain international auditing firm to review Special Account and petroleum purchased	Internal controls to prevent past illegalities	Covenant not met; no money to finance
Government/World Bank study of petroleum prices effects on production and exports; implement study results	Encourage price revisions that will encourage rainfed agricultural exports	Covenant met; study completed and diesel fuel prices increased
Government allow internal distributors to recover transport and other costs of internal marketing	Increase distributions to regions	Covenant met
GPC consider all economic factors in determining mix of imports and make analysis available to the donors	Force GPC planning in petroleum needs assessment; donor information	Covenant met
Government review diesel fuel allocation plans of four private distributors	Private sector input to allocation system	Covenant not met; respecified in 1985
All surplus fuel oil exports by competitive tendering	Ensure full value for all exported fuel oil	Covenant met
Internal petroleum distribution by rail or private truck	Encourage more efficient transport system (truck)	Covenant met by default trains used for food relief
Government quarterly review of prices and changes based on dollar cost, exchange rates and domestic handling	Assure import parity	Covenant not met
1985 Petroleum Initiative		
Government provide evidence of competitive bidding system	Assure competitive market prices for petroleum products	Covenant met
Petroleum tenders or commercial agreements for no more than 3 months; full information on prices and terms to any donor	Make tenders shorter and more responsive to market prices	Covenant met

AID CONDITIONS IN ITS ESF PROGRAM

Condition	Intent	Status
1985 Petroleum Initiative (continued)		
Private sector procure petroleum products with non-Bank of Sudan foreign exchange	Enhance private sector procurements of petroleum needs	Covenant met
All petroleum products imported through Petroleum Facility use open and competitive tendering; terms of donor petroleum assistance given to all donors	Ensure timely petroleum procurement and competitive prices, control petroleum donations	Covenant met; same as 1984
Government retain international auditing firm to review Special Account and petroleum purchases	Internal control to prevent past illegalities	Covenant not met; same as 1984
Government/AID review of import parity pricing of petroleum products by January 1986	Encourage government movement toward parity pricing	Covenant met
Government institute pricing system allowing internal petroleum distributors to recover transport and other costs	Raise prices to cover petroleum deliveries to regions	Covenant met; same as 1984
Government consider all economic factors in determining mix of imports and make analyses available to donors	Force GPC planning in petroleum needs assessment; donor information	Covenant met; same as 1984
Government review diesel fuel allocation plans of private distributors	Private sector input to allocation system	Covenant partially met; plans submitted but no allocations made
All surplus fuel oil exports by commercial tendering	Ensure full value for all exported fuel oil	Covenant met; same as 1984
Government deposit $40 million of local currency into Special Account for mutual agreed upon activities of commercial bank rate	Encourage use of commercial bank rate	Covenant was met

(472101)

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