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Abbreviations and Acronyms

AfDB	African Development Bank
CCSS	Coordinating Council of Southern States
CEM	Country Economic Memorandum
CESI	Community Empowerment and Social Inclusion
CIDA	Canadian International Development Agency
CRN	Country Re-engagement Note
DFID	Department for International Development
DRC	Democratic Republic of Congo
ESW	Economic and Sector Work
EU	European Union
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries
HIV/AIDS	Human Immunodeficiency Virus
IDA	International Development Association
IGAD	Inter-Governmental Authority on Development
JPM	Joint Planning Mechanism
LICUS	Low-Income Countries Under Stress
MICS	Multiple Income Cluster Survey
NBI	Nile Basin Initiative
NC	National Congress Party
NDA	National Democratic Alliance
NGO	Non-Governmental Organization
NMPACT	Nuba Mountains Program for Advancing Conflict Transformation
NORAD	Norwegian Agency for Development
OLS	Operation Lifeline Sudan
PCF	Post-Conflict Fund
PRSP	Poverty Reduction Strategy Paper
SDF	Social Development Fund
SPLA	Sudanese People's Liberation Army
SPLM	Sudanese People's Liberation Movement
SSA	Sub-Saharan Africa
TA	Technical Assistance
TF	Trust Fund
TSS	Transitional Support Strategy
USAID	United States Agency for International Development
WBI	World Bank Institute
WFP	World Fund Program
UNDP	United Nations Development Program
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Fund

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**COUNTRY RE-ENGAGEMENT NOTE
FOR
REPUBLIC OF THE SUDAN**

TABLE OF CONTENTS

1.	Country Context.....	3
	A. The Conflict	2
	B. Recent Political Developments and Governance	3
	C. Social Context and Human Development	4
	D. Economic Context.....	5
	E. Sudan's External Debt.....	7
	F. The Peace Process.....	8
2.	Donor Involvement	9
3.	Bank's Proposed Program.....	10
	A. History of Engagement and Recent Work	10
	B. Timing and Scope of Re-engagement	11
	C. Windows of Change and Opportunities	14
	D. Proposed Work Program, FY04.....	15
	i. Knowledge sharing to foster national dialogue	15
	ii. Capacity building and action planning to support policy reform	16
	iii. Demonstration projects to help improve the delivery of basic social services.....	18
	iv. Arrears Clearance to the World Bank.....	18
	E. Partnerships	19
4.	Risks.....	20

Annex I IMF Relations

Country Re-engagement Note for Republic of the Sudan

1. COUNTRY CONTEXT

1. With an area of 2.5 million square kilometres, Sudan is the largest country in Africa and the ninth largest country in the world. Its vast area ranges from stretches of tropical forests, marshlands in the southern part of the country to mountains, savannah, deserts elsewhere. It shares its extensive borders with nine countries and contains 60 percent of Africa's irrigated lands. The diversity of Sudan's geography is also reflected in its people. Sudan's population of approximately 32 million¹ is multi-cultural, multi-ethnic, multi-religious and multi-lingual with 134 listed languages. But though well endowed with natural resources, Sudan's economic performance has been substantially below its potential.

2. Sudan's development prospects have been adversely affected by the civil war and related governance failures. In 2002, the Sudanese civil war entered its twentieth consecutive year. Conflict and internal displacement of civilians have resulted in food insecurity in parts of the country and continue to cause suffering and loss of life. Against this background, Sudan remains one of the poorest countries in the world, with widespread poverty and a weak and uneven economic base and infrastructure. Per capita income for 2000 is estimated at US\$330. Although rich in natural resources, Sudan has yet to find a successful formula for equitable sharing of resources and power across the country. The situation has been further complicated by factors of ethnicity and religion. All these have contributed to discontent; in addition, subsidiary conflicts have proliferated, many of them inter-tribal and land-related, and often exacerbated by land degradation, inequitable development and poverty.

3. Yet, Sudan's growth potential is promising. The advent of peace would allow the country to take advantage of its many assets – a rich agricultural/livestock resource base with considerable export potential and increasing oil revenues accruing to the country within 3-4 years. In addition, a peaceful Sudan can take full advantage of: a small but excellent core of human capital; a dynamic private sector; a rich and talented diaspora abroad; closer and peaceful relations with neighboring countries; and the goodwill of a number of donors to support the peace process. Sudan's macro-economic policy is basically sound, and there is a keen interest among a number of donors and international investors in supporting investment projects. Unleashing this potential will require complementary investments in infrastructure and reformist policies to fix the shortcomings of governance and decentralization, and a renewed focus on poverty reduction.

¹ Estimate for 2001 from United Nations Fund for Population Activities; last census conducted in 1993.

A. THE CONFLICT

4. Since the Torit Mutiny in 1955, a civil war has raged with the exception of an 11 years' peace period from 1972 to 1983. While complex alliances and coalitions lie behind the main factions of the war, the two leading protagonists are the ruling National Congress Party (NC) and the opposition National Democratic Alliance (NDA). The Sudanese People's Liberation Army (SPLA) is the main military member of the NDA, with its political arm the Sudanese People's Liberation Movement (SPLM).

5. The Addis Ababa Peace Accord, signed in 1972, brought peace for 11 years. President Numeiri, who came into power through a military takeover in 1969, was a principal architect of the agreement which gave substantial regional autonomy to Southern Sudan. As part of the autonomy agreement, a strategy for economic development was adopted for the first time and implemented in southern Sudan. However over time, relations and cooperation between President Numeiri and the regional government of Southern Sudan deteriorated steadily. In 1981, the Southern Regional Assembly, which was part of the local autonomy agreement, was dismantled and power was re-centralized in Khartoum. Other tensions arose out of plans to build the Jonglei Canal (in Jonglei state) designed mainly to increase the usable flow of the White Nile, and the start-up of oil drilling in the west of Upper Nile State. It was feared that the benefits of these projects would bypass the local population living in the southern part of Sudan. Cooperation broke down completely in 1983 when Shari'a Law was promulgated on the whole of Sudan. The civil war that resumed after 1983 was more intense than the conflict before 1972. The main war-affected areas include the southern region, the Nuba mountains, southern Blue Nile and Abyei. Since the mid-1990s, the SPLA has controlled portions of the rural areas in southern Sudan, while Government controls the major urban centers in southern Sudan. Since 2000 with the start of oil production, the stakes of the war have been raised with adverse consequences for those in close proximity to the oil producing areas.

6. **The main issues** which are under discussion may be categorized broadly along the following lines:

- **Political reforms** that safeguard basic rights, including legal recognition and protection for political opposition groups and constitutional guarantees for religious liberties.
- **Sharing of power**, including the structure of the state, parameters of federalism, representation in common central authorities, and self-determination for southern Sudan.
- **Sharing of national wealth and resources**, such as land, cattle and water resources (which feature in both the civil war as well as in community level "second tier" conflicts) but also oil.
- **Controversy around the three areas** of the Nuba mountains, Abyei and southern Blue Nile.
- **Land use**. The shift from subsistence farming to mechanized agricultural schemes has strengthened leaseholders for large-scale farming schemes at the expense of small-holders, nomads and pastoralists.

7. The costs of conflict have been heavy, especially on the civilian populations which have been denied social and economic development. The most devastating costs relate to the misuse

of human capacity, destruction of social and economic assets and lost opportunities. More specifically:

- **Human suffering**, including an estimated two million deaths since 1983, 4 million internally displaced persons, and half a million refugees in UNHCR camps in neighboring countries.
- **Chronic food shortages** caused by the war. Uncertain population movements, insecure access to land, and drought added to the chronic problems resulting in widespread famines in 1988, 1992 and 1998.
- **Relatively high military expenditures** consume an estimated at 25 percent of the federal budget. This excludes expenditures incurred by the SPLA and other factions.
- **Weak institutions.** Distrust and the absence of efficient institutions have resulted in the loss of opportunities for the timely settlement of differences and forging compromises necessary to resolve national disputes.
- **Loss of economic assets**, including damage from military action to road infrastructure, water sources, schools and hospitals, oil pipelines, livestock and other farm assets.
- **Loss of opportunities** caused by insecurity; erosion of good governance as war limits transparency; destruction of market institutions and reversion to subsistence; and,
- **Disruption of trade routes and communication** reflected in high transport costs which have inhibited trade and the efficient distribution of food (e.g. transport costs represent up to 75 percent of the total cost of food aid).

8. **None of the main actors is monolithic.** Each side has internal divisions based on religious loyalty, assets, geography, regional and sub-regional inequities, political affiliation and ethnicity. In some areas, cattle and economic assets have been at the center of largely inter- and intra-ethnic fighting. In the Nilotc heartland, there is deep rooted hostility between the Dinka and Nuer, the largest ethnic groups in southern Sudan, and among sections of the same ethnic group. In Bahr al-Ghazal/Southern Kordofan, relations between the Dinkas and Baggara have been marked by competition for scarce resources, occasionally leading to armed strife and abductions. These conflicts have been aggravated by the civil war, which have bred violence, increased the availability of weapons, reduced the livestock population, and limited access to grazing land and water.

B. RECENT POLITICAL DEVELOPMENTS AND GOVERNANCE

9. A series of political reforms initiated by the Government in the 1990s centered on liberalizing governance by providing legal recognition to the political parties and safeguarding basic human rights. A new constitution giving official recognition to opposition groups came into effect in 1998. However, while the constitutional reforms were in the direction of political pluralism, there were ambiguities in the provisions of the new constitution concerning the protection of political and religious rights.

10. On the governance front, decentralization structures have been developed in all parts of Sudan. The decentralization initiated by the Government in the mid-1990s is based on a three tier federal system, whereas in the non-government controlled areas, the present system has five tiers. Both systems have been weak in terms of devolving local tax and spending decisions closer

to the people. In the government-controlled areas, decentralization has been hampered by low fiscal transfers, lack of effective power devolution, and inadequate capacity. In the non-government controlled areas, the system is in embryonic form, and capacity to deliver social services is extremely scarce. In these areas, there is no administrative infrastructure for budget management, such as treasury mechanisms, for systematically collecting revenues and making payments.

C. SOCIAL CONTEXT AND HUMAN DEVELOPMENT

11. **Poverty is reportedly high** in Sudan, as reflected by several small-scale surveys. Most poor people in Sudan are rural residents, though urban poverty is also growing, fuelled by internal displacement, weak demand for labor, war and natural disasters. The civil war has seen the displacement of communities which has ravaged traditional safety net systems and caused famines. Even areas which are relatively stable, face isolation from markets and lack secure access to services for human development. Outside the war-affected areas, rural poverty is widespread in western Sudan (Darfur and Kordofan) as well as in the eastern and middle regions of the country. In the rural areas, pastoralists and small farmers are most vulnerable.

12. **Inequality is also high.** Various small-sample studies show that social and economic inequality is high and possibly widening. Data available from Labor Surveys show that the top 10 percent acquired 51.6 percent of all earning by labor in 1990; and 64.3 percent in 1996. At the same time, the middle income and low income groups have been severely squeezed. Inequality also relates to gender, rural-urban residence, and region. For example, in 2001, the adult literacy rate was over 60 percent for men and about 42 percent for women in the Government-controlled areas, but only 30 percent for men and 10 percent for women in war-affected areas.

13. **Human development:** UNICEF's Multi Indicator Cluster Survey (MICS), conducted in 2000, has provided a sampling of social indicators for accessible areas in Sudan, but there are major geographical gaps. The data paints a picture of unequal development with many regions falling behind. All standard indicators of literacy and primary education, including quality and efficiency in schooling, are below averages for SSA. Average enrolment rate in primary education has stagnated at about 50 percent, with wide geographic variations, including levels as low as 20 percent in some states, such as Bahr el Gazal. Repetition and dropout rates are high; average primary school completion rate is 53 percent. The gender gap in enrolments has narrowed nationally, but persists in rural areas. Quality of services is declining with only 64 percent of teachers having some training. In health, some indicators show improvement, but geographic disparities are wide. Average under-five mortality has declined from 123 per 1000 live births in the early 1990s to 105 by the late 1990s and is lower than the SSA average of 162, but this masks deep regional disparities: in South Kordofan, Kassala, Blue Nile and Red Sea, basic health indicators are among the worst in SSA. Incidence of HIV/AIDS is generally low, but there are concerns about the potential spread of the virus as displaced populations begin to move post-peace. Awareness of HIV/AIDS is reportedly low, but the authorities are working to increase it.

14. **In the southern part of Sudan**, there are marked differences in basic indicators between government-controlled and non-government controlled areas. For example, in 2001, average school enrolment in GoS-controlled urban towns was 58 percent, compared to only 30 percent in non-GoS areas (of which 26 percent for girls). Retention is extremely poor. There is prevalence of most tropical diseases eradicated or brought under control elsewhere in the world. The deadliest killer is malaria, which affects 24-36 percent of the population. Average under-five mortality is 145 per thousand. Malnutrition rates vary widely, depending on security conditions and access to humanitarian assistance. Legacies of the civil war are reflected in the condition of households. Children (child soldiers) and women are particularly vulnerable. Some 58 percent of children 5 to 17 years contribute to household subsistence. The average ratio of adult women to adult men is two-to-one and gender-based inequality is high.

15. **Weak service delivery.** At the federal level, an estimated 1.2 percent of GDP has been allocated for education and a meagre 0.7 percent of GDP for health during 1998-2000. Infrastructure for education, health care and rural agriculture facilities has deteriorated due to insufficient funding for these sectors in the 1990s. There are private education and health services, but most of the population (particularly in rural areas) cannot afford the costs. There is a shortage of textbooks and periodic arrears on teachers' pay. Coverage of primary health care is low: for example, inoculation coverage of children under one in 2001 was 66 percent for BCG and 65 percent for three-in-one inoculation, 61 percent for measles and 37 percent for second dose of tetanus. Eighty percent of urban residents, but only 47 percent of rural residents, have access to safe water.

16. **In southern Sudan**, service delivery in the government-held towns varies widely but it is very low in SPLM-held areas. Humanitarian assistance from international agencies and non-governmental organizations are the major source of services in the war-affected areas. Infrastructure for service delivery is inadequate. Only 11 percent of schools have permanent buildings. Seven percent of teachers are trained; most can hardly guide pupils beyond second grade. Access to safe water in government-held towns in southern Sudan varies; the ratio for Juba is 91 percent, while in Malakal, it is 5.4 percent. In the SPLA-held areas, only 26 percent of the population has access to safe water during the dry season and 15 percent during the rainy season.

D. ECONOMIC CONTEXT

17. **Economic reforms contributed to high growth in some sectors of the economy.** Serious implementation of economic reforms began in the mid-1990s with encouraging results in such areas as: curbing macroeconomic imbalances and inflation; rolling back nationalization policies and making room for the private sector; liberalizing prices and eliminating market controls; and strengthening the financial system. The macroeconomic stabilization effort achieved the objective of reducing the level of the fiscal deficit and bringing inflation to single digits. The cash deficit fell from a peak of 9.2 percent of GDP during 1985/86-1989/90 to less than 1 percent of GDP during 1997/2000.² These achievements were made without external financing.

² The cash deficit was as high as 11 percent of GDP during 1991/92.

18. The reduction in the fiscal deficit, however, was obtained at the expense of government expenditures which were cut from about 20 percent of GDP in the early 1990s to less than 10 percent by 1998. Fiscal adjustment was achieved at the expense of public sector investment, social services and subsidies, federal transfers to the states, and support for the public enterprises. Arrears to creditors increased and worsened an already unsustainable debt situation (see next section). Revenue efforts remained low and declined until 2000 when the oil sector became an important source of income. With increasing oil revenues, federal fiscal transfers to the states improved somewhat. However, the states' budgets are still inadequate for delivering basic social services to the people of Sudan.

19. **Fiscal squeeze and oil revenues.** The Government's revenue effort has been weak, tax reforms aimed at raising revenues yielded only modest results. Consolidated federal and state revenues amounted to about 10 percent of GDP in 1998, and rose to 15.6 percent with the coming on stream of oil in 2000 – but tax revenues remain under 7 percent of GDP. On the expenditure side, defense is estimated to account for about 2.5 percent of GDP while development expenditures stand at about 1.5 percent of GDP only (and are biased towards capital intensive investments in energy and subsidies for large scale irrigation).

20. **Growth and poverty reduction.** The reforms were accompanied by a revival of economic growth and increases in average per capita income. Relatively good weather and petroleum production aided the growth recovery process. Annual average percentage change in per capita income accelerated from 1.2 percent during 1991-95 and to 4 percent during 1996-00. But high growth in the agricultural sector and the rapid development in the urban private sector did not translate into sizable poverty reduction because of deeply-rooted inequities in wealth distribution, as well as policies that do not favor the poor.

21. **The structure of spending is not pro-poor** as reflected in imbalances in the allocation of resources within sectors. In education, higher education is favored relative to basic education; in agriculture, capital intensive irrigation are promoted relative to traditional rain-fed farmers. There is also an urban bias with respect to infrastructure. The impact of formal safety net programs, such as the Social Solidarity Fund also have an urban bias in terms of the distribution of benefits, but a rural bias in terms of collections. Although recent reports suggest improvements, problems of transparency and accountability seem to remain, especially at the state level, regarding discretionary tax exemption, extra-budgetary spending, expenditure reporting, auditing and procurement.

22. **Agricultural strategy is not pro-poor either.** The national strategy is centered on publicly-owned, capital intensive irrigation schemes in an economy that has a vast land area suitable for rain-fed crops and livestock production and which is also labor abundant. The large national irrigation schemes have not been financially sustainable, requiring budget subsidies and government-guaranteed credit for annual operations. In addition, the schemes' infrastructure has deteriorated considerably because of inadequate maintenance. In 2001, semi-mechanized agriculture (together with irrigated agriculture) absorbed 90-99 percent of all formal credit to agricultural producers. With the lion's share of public resources allocated to irrigation and large-scale agriculture, funding for basic support services (such as research and extension) for small-scale agriculture, which provides an important source of food for the bulk of the rural poor, has

been neglected. Public investments in basic infrastructure for rural and agricultural development in traditional farming areas are also negligible. Low quality and sporadic support services, and the lack of infrastructure, have resulted in low yields and reduced production incentives for farmers in the traditional rain-fed areas.

23. Ineffective decentralization and public administration: The decentralized public administration introduced by the Government of Sudan under a federal structure in the mid-1990s is not delivering sufficient social services for sustainable social and economic development. This is to a large extent related to the low level of fiscal transfers which are inadequate to finance the far-reaching responsibilities for service delivery and social expenditures services that have been decentralized to states. This is compounded by weak tax bases at the state level. By 1998, the regions had a total budget of only 2.4 percent of GDP, which was supposed to finance all services and investments. By 2001, when new oil revenues equivalent to 5 percent of GDP were added to the Government's budget, regional expenditures had only risen to 4 percent of GDP. However, they are still inadequate to deliver their mandate. Human resources are also scarce; brain drain has deprived the system of skilled staff, especially in the regions.

24. Although in SPLM-held areas there are no national accounts, it is highly likely that because of the effects of war, average incomes have fallen since 1983. These areas are mostly food insecure and depend on humanitarian assistance, in spite of high agricultural potential, because of insecurity, lack of infrastructure and access to markets. Some federal funds have been disbursed through the Coordinating Council of Southern States (CCSS) to support rehabilitation programs in the GoS-held areas. In the SPLA-held areas, the budgeting process needs to be formalized, and civil institutions and capacity built. A provisional tax law exists, but there is no public information on the magnitude of tax collections or the uses of taxes collected. Anecdotal evidence indicates that total revenues generated are small, and most of the collections are used on the military.

E. SUDAN'S EXTERNAL DEBT

25. Structure of Sudan's debt. Sudan has a very large debt overhang: its external debt is projected at \$21.1 billion for end-2003. In net present value terms (\$20.4 billion), the debt is about 10 times the value of exports, 14 times the value of government revenue (including oil) and 135% of GDP.³ Of the \$21 billion, approximately 19 percent is due to multilateral creditors; 30 percent to Paris Club creditors; 36 percent to non-Paris Club official creditors; and 15 percent to commercial banks. About 86 percent of the country's total external debt will be in arrears by the end of the year, of which about \$1.5 billion to the IMF, \$262 million to IDA, and \$117 million to the African Development Bank/Fund.

26. Arrears clearance. Reactivating multilateral financial support to Sudan will require that arrears be cleared. Sudan will need to maintain the good track record of policy performance, including continued strong policy implementation. Bilateral donors would also need to be involved in either providing grants or facilitating the brokerage of bridge loans for arrears

³ IMF and Bank staff estimates.

clearance. More generally, principles for arrears clearance should be based on broad agreements reached among multilateral development banks in Rome in February 2003. These principles include the early involvement and timely sharing of information among as many creditors as possible; and ensuring positive net transfers. In the case of Sudan, clearing arrears to international financial institutions could generate enormous debt service obligations (depending on how arrears are cleared) that would be unsustainable for Sudan. Thus, it is crucial that the arrears clearance process also sets the stage for Sudan to be considered rapidly for HIPC debt relief. Moreover, given the pressing financing needs of reconstruction, it will also be important that the period between arrears clearance and HIPC decision point be as short as possible.

27. HIPC considerations. A comprehensive strategy for arrears clearance is needed in order to normalize relations with all creditors—multilateral, bilateral, and commercial creditors—and be followed by rapid debt reduction. Engineering debt sustainability is complicated not only by the sheer size of the financing needs for arrears clearance and debt relief, but by the parallel needs for short-term humanitarian support, quick impact interventions, reconstruction, and development. Therefore, extraordinary efforts will be required from all parties—multilaterals, official bilateral creditors as well as commercial creditors.

28. For its part, the **Government of Sudan** needs to simultaneously address a number of critical issues in relatively short order, including: (i) establish general faith in lasting peace; (ii) establish credible, transparent, and appropriate management of public resources (including oil); (iii) establish an appropriate expenditure program; and (iv) prepare an inclusive and pro-poor I-PRSP that genuinely reflects the needs and voices of the country.

29. Donor support. The United Kingdom has been asked by the Government and the SPLM to take the lead in organizing creditors and donors to support the resolution of the debt overhang. A first informal meeting, hosted by the U.K., was held in London on May 22, 2003 and attended by representatives from a wide group multilateral and bilateral organisations. The meeting discussed not only arrears clearance needed to help Sudan normalise its financial relations with the international community, but also stressed the need to provide necessary debt relief and to mobilise the needed reconstruction and development assistance. All of these will be essential to support lasting peace and sustainable development. Establishing such a formal support group, and of course any concrete steps towards arrears clearance, depends on the peace process being completed.

F. THE PEACE PROCESS

30. Numerous peace initiatives have taken place over the years, ranging from national, regional, international to grassroots initiatives and were important for contributing to a better understanding between the parties. To date, however, they have not managed to bring peace. But in recent years, a number of grassroot peace agreements have been concluded between and within ethnical groups and rebel factions. The resulting improved security led to increased access to grazing areas, water, farmland and fishing sites. Local markets and trade have mushroomed after these local peace agreements.

31. **Nuba Mountains ceasefire.** In September 2001, United States Senator John Danforth was appointed as a Peace Envoy to Sudan. His efforts helped to broker an initial six-month ceasefire agreement in the Nuba mountains (since renewed) that allowed humanitarian assistance for the area. The arrangement provides for free movement in the Nuba mountains. In the demilitarized zones, the Nuba people have access to fertile land, and the area is accessible for humanitarian agencies to deliver relief services by air. A Joint Military Commission, headed by a Norwegian general, is monitoring the on-going ceasefire.

32. **Recent peace negotiations under the auspices of the Inter-Governmental Authority on Development (IGAD)** and the Government of Kenya are promising. The present round of peace talks began between the Government of Sudan and the SPLA in June 2002; representatives of the United States, the United Kingdom, Norway and Italy—have also been present. Progress has been made in terms of a framework agreement, signed on July 20, 2002. This agreement, known as the Machakos Protocol, establishes principles of religious liberties and the rights for Southern Sudan to have a referendum on self-determination. According to the agreement, the parties will govern the country jointly for 6 years, at the end of which a referendum on self-determination will be held in southern Sudan. The on-going negotiations are now focussed on reaching details on the framework agreement, including protocols on power-sharing, wealth-sharing, and security arrangements. At the time this report was being prepared, both parties had signed a cessation of hostilities agreement. Current expectations are that a comprehensive agreement could be signed during the Summer of 2003.

2. DONOR INVOLVEMENT

33. **International development assistance plummeted** from about \$1.9 billion in 1985 to \$50 million by the late 1990s. Donors have tended to focus their attention on humanitarian relief. Since 1989, Operation Lifeline Sudan (OLS) has been the framework under which humanitarian assistance has been delivered to southern Sudan. It is a tripartite agreement between the Government of the Sudan, SPLM, and the UN to deliver humanitarian assistance based on the principles of neutrality, impartiality and transparency. OLS provides an operating umbrella for a consortium of 6 UN agencies and 45 NGOs. The OLS disburses about \$200 million a year from donor funds, mainly for food assistance. Of this, an estimated 60-70 percent is devoted to logistics, security and transport.

34. **The International Monetary Fund.** Although Sudan has been in arrears to the Fund since 1984, a record of cooperation has been established under successive staff-monitored programs (SMP) since 1997 (see Annex). These programs have noted generally satisfactory implementation of macroeconomic and structural adjustment policies. During this period, Sudan also benefited from technical assistance from the Fund in various areas (prices and national accounts, tax policy, tax administration, monetary instruments, etc.).

35. **Donor coordination.** Looking forward to the post-conflict period, donors will have a critical role in stabilizing peace and consolidating it over time, ensuring that the benefits of peace are widely distributed. Collaboration, cooperation, and transparency among donors will be a critical task in the first six months following a peace agreement. Needs will increase substantially as new areas are opened up to international assistance, including resettlement of

displaced populations, demobilizing combatants and de-mining. However, there is a risk of having large financial commitments early on, when absorption capacities are minimal, leading to chaos and tapering off quickly. It will be important, therefore, to focus on boosting the limited absorptive capacity, and especially in southern Sudan, to prepare for the expected surge in donor interest that a peace settlement would trigger.

36. To prepare for the post-war period, a series of donors meetings have been convened by the U.S., Norway and the Netherlands to explore, well in advance, the transition from humanitarian to reconstruction and development. In January 2003, a meeting in Oslo brought together key partners to begin preparations for post-peace. This was followed by a second and broader meeting in the Hague in April 2003 where the Government and the SPLM, as well as representatives from NGOs active in Sudan, also attended. That meeting began to clarify the coordination of donors' support for the first six-month period after the signing of peace, including areas of support for quick impact programs and critical capacity building needs. The Government and the SPLM agreed to meet at a technical level to discuss implementation modalities for capacity building and program priorities.

37. **Joint Planning Mechanism.** As a follow-up to the Hague meeting, a technical meeting was convened by USAID in Nairobi on May 9 and 10, 2003 to discuss the implementation modalities relating to capacity building and program priorities for the pre-interim period. The meeting led to an *Agreement* (dated May 10, 2003) that preparation for longer-term development programs (i.e. the shift away from humanitarian assistance) should begin immediately. Based on principles of Sudanese ownership consistent with the Machakos protocol, priority areas were identified for immediate focus.⁴ The *Agreement* also established the Joint Planning Mechanism (JPM) to be chaired jointly by the Government and the SPLM. The JPM will meet periodically to: assess needs; develop priorities; and draw up action plans for implementation; harmonize priorities, coordinate and present a common plan; and monitor, review and report on progress. Capacity building programs would also be proposed and developed/implemented either individually or jointly by the two parties. Through this mechanism, donors are expected to assist the Sudanese based on these agreed priority activities. The World Bank and the IMF, in particular, have been requested to support this *Agreement* through technical assistance.

3. BANK'S PROPOSED PROGRAM

A. HISTORY OF ENGAGEMENT AND RECENT WORK

38. The World Bank has been mostly absent from Sudan since 1992. World Bank disbursements to Sudan have been suspended since April 1993, and the country has been in non-accrual status since January 1994. In the 1970s and 80s, the Bank was a major player in the development of Sudan, following the 1972 Addis Ababa peace agreement. IDA assistance to Sudan covered all sectors, with a particular focus on infrastructure and rural development (including the Gezira irrigation scheme). From 1973 to until 1993, when disbursements were

⁴ Broad areas identified in the Agreement included: capacity building, with special attention to war affected areas; return and reintegration of IDPs; economic development; infrastructure development; rehabilitation of basic services; data collection; governance; peace culture and information; and mine action programs.

suspended, IDA disbursements to Sudan averaged \$56 million per year, peaking in 1988 at \$123 million. Sudan also received a smaller level of IBRD support. By the end of 2003, Sudan's outstanding IDA debt will total \$1.2 billion, of which \$262 million will be in arrears. In recent years, the Bank has occasionally supported small initiatives through grants, such as the UNICEF MICS effort. As the prospects for peace have risen, the Bank has engaged the Government in a policy dialogue on reforming agriculture, and a Country Economic Memorandum has been produced to start rebuilding its knowledge base. The Bank has also re-established working relations with key partners in the bilateral and UN system (see Partnerships section below).

39. Reforms in the Gezira Irrigation Scheme. The Gezira Scheme between the Blue and White Niles, just south of Khartoum, was a mainstay of Sudan's colonial economy because of its substantial cotton and grain production. Characterized by decades of mismanagement, in one of the richest areas in the country, the Scheme has been heavily subsidized by the central government. Yet there are opportunities for substantial reforms in the management of the Scheme which would benefit tenant farmers and the one million or so people who depend on the Scheme for employment. The Bank contributed to the design of a reform program in a report: *Options for the Sustainable Development of the Gezira Scheme*⁵. Some of the proposed irrigation management reforms were tested in a pilot program in one block with FAO financing. The pilot was successful in showing that the proposed reforms can be implemented by farmers following adequate training. As a result, management in the pilot block (e.g. independent operation and management of irrigation water in the minor canals by farmer-controlled water users associations and freedom of crop choice) have been approved by the Scheme management for sustained implementation. The strong commitment by the Gezira Farmers' Union and the Government to the reform program in the Gezira suggest that most of the recommended reforms will eventually be implemented in the whole of the Scheme, but it will need adequate technical support.

40. Country Economic Memorandum (CEM). A CEM, recently discussed with the Government, provides a solid stock-taking of the current socio-economic situation (the previous CEM was produced in 1990)⁶. The CEM is an important step in re-establishing the Bank's contacts and knowledge base on Sudan and in helping to collate some preliminary analytical and statistical information for a country where isolation has produced a longstanding dearth of reliable data (see Box 1). Additional work has been commissioned from local think tanks to initiate a further round of policy analysis and a program of participatory learning.

B. TIMING AND SCOPE OF RE-ENGAGEMENT

41. Powerful and urgent reasons argue in favor of a stronger Bank re-engagement in Sudan. In the short term, the development of a more favorable receptive environment for Bank activities means that policy dialogue and capacity building operations can be effective. But in addition, with peace looming on the horizon, there is an increasing consensus, both within the Bank and outside, that the Bank's engagement in Sudan, if timely, would contribute to the consolidation of

⁵ Report No. 20398-SU, October 27, 2000.

⁶ Report No. 24620-SU, (Green Cover draft, May 2003).

peace and the reconstruction of a unified Sudan. To pave the way for the resumption of a full-fledged lending program, the Bank needs to accelerate its efforts at re-building its knowledge base and developing relations with the main actors and stakeholders. Therefore this re-engagement strategy is squarely founded on LICUS principles.⁷

42. But large obstacles remain in the way of a full-fledged resumption of Bank lending activities, not least the size of Sudan's arrears to the IMF, the AfDB, and the Bank. Because the presence of arrears will inhibit the World Bank becoming fully engaged financially, this document covers the Bank's re-engagement in Sudan until the clearance of arrears. The strategy covers two sequenced levels of engagement:

- **Scenario I: Before peace agreement.** Activities undertaken by the Bank with partners would include preparing for a post-conflict Sudan and through the auspices of the Joint Planning Mechanism. During this period, the Bank would focus on leveraging donor trust funds for knowledge and capacity building activities and drawing on Post Conflict Fund grants to support small pilot projects. In anticipation of peace, intensified work would also begin on arrears clearance in close collaboration with the IMF, the AfDB and other multilateral creditors as well as bilateral creditors.
- **Scenario II: Peace agreement reached.** This ramped-up approach would continue knowledge and capacity building activities and accelerate the search for a solution to the arrears issue. In addition, the Bank could explore the possibility of a pre-arrears clearance grant and/or Bank administration of a multi-donor trust fund. The Bank would work closely with the United Nations and bilateral partners and focus on stabilization and immediate post-conflict needs, with the idea of producing a demonstrable peace dividend. In addition, the Bank would start actively preparing a portfolio of projects for when arrears would be cleared.

43. Following clearance of arrears a **Transitional Support Strategy (TSS)** would be prepared with a focus on recovery and reconstruction. An exceptional IDA allocation for Sudan as a post-conflict country would be sought. Although the timing of arrears clearance is difficult to predict, a TSS might be expected within 6-18 months after the signing of a peace agreement. The size of the initial IDA allocation for Sudan would be based on the prospects for peace, country needs, capacity and resources, and government commitment to sustainable development.

⁷ Principles include: identification of reforms which are politically feasible and have quick results; focus on knowledge; capacity building for targeted policy reforms; strengthening basic service delivery; and leveraging partnerships. See "Report on World Bank Group Task Force on Low-Income Countries Under Stress", SecM2002-0367, July 8, 2002.

Box 1: Sudan CEM: Stabilization and Reconstruction

The CEM focuses on Sudan's economic and social development during the 1990s. Substantial reforms were undertaken during this period, but the civil war continued to have a serious negative impact on Sudan's people and its economic prospects. While the results of the reforms have been very promising, particularly in the area of macroeconomic stabilization and liberalization, the distribution of economic wealth needs to improve.

Although there has not been any national household survey since 1978, social indicators point to low levels of welfare throughout Sudan with some indicators well below those in Sub-Saharan Africa (SSA). Among the key issues facing Sudan are:

- **High growth but skewed distribution.** The Government's strong economic reform package contributed to high economic growth during the 1990s. The start-up of oil production and favorable weather conditions for agricultural production also helped to sustain growth. Higher growth, together with economic reforms, have increased the Government's budget revenues. However, widespread poverty, highly skewed income distribution, and inadequate delivery of social services remain serious problems.
- **Stabilization costly in social terms.** The government can justifiably take credit for its stabilization program that brought inflation down to single digit levels after 1997 and improved prospects for sustainable growth. With inflation running at three digit levels during the period 1992-96, with no access to external finance, and with the continuing drain of resources to finance the civil war, the government balanced the budget through drastic cuts in public expenditures. They were cut virtually in half relative to GDP causing considerable reductions in social services and infrastructure development.
- **Decentralization ineffective.** Under the Government's decentralization strategy (1992), the delivery of key services in education, health and agriculture was delegated to the states and local communities who had neither the revenues nor the administrative capacity for the tasks. Wages of civil servants had to be kept at levels that undermined incentives for performance. Under these circumstances the government's strategy to decentralize and improve governance faltered.
- **High poverty rates persist.** The Government's stringent economic policy and ineffective decentralization contributed to the poor outcomes in the areas of poverty reduction and human development. Despite the improved macroeconomic situation, widespread poverty persists.
- **Social inequalities may undermine macroeconomic stability.** The favorable macroeconomic situation may not be sustainable in the absence of structural reforms that can unleash pro-poor growth.
- **Peace dividend depends on external support and development.** But while peace is necessary, it is not sufficient for developing the country and reducing poverty. For peace to be sustained, it must be accompanied by economic and governance reforms and a formula for equitable sharing of resources and power must be found for resolving the major root causes of decades of civil war. The peace dividend is potentially high, but reconstruction and development needs are enormous, and will require external financing.
- **Resolving debt problems is only the beginning.** Given the size of the debt, creditors will be asked to make extraordinary efforts. A comprehensive and phased approach, including multi-donor support, will be essential. Even after arrears clearance, Sudan will still have difficulties financing all the development and reconstruction needs. Additional resources, including HIPC relief will therefore be needed, and Sudan will urgently be expected to put measures in place to improve public resource management.

C. WINDOWS OF CHANGE AND OPPORTUNITIES

44. **Preparing for peace.** At the request of the IGAD Secretariat, the Bank and the IMF provided technical experts (e.g. on fiscal federalism, banking and currency, flows of financial assistance, and land ownership issues) to inform the discussions around the wealth sharing talks. In addition, the Bank is playing a constructive role in shaping the future post-peace reconstruction program and the evolving architecture of donors relations, including transitional financial and institutional arrangements. There are also demands to start building basic absorption capacity in the war-affected areas, and to support the emergence of a national PRSP for the purposes of an eventual shift to development financing by donors and the HIPC process.

45. **Building up the reform agenda.** The Government is keen to re-enter the community of nations through opening up of trade, foreign financing and investment. Within the Government and civil society, debate is beginning on specific aspects of economic policy. The key cross-cutting issues that run through these debates relate to reforming governance and fiscal federalism and unleashing pro-poor growth. At a national level, the question of federal relations and revenue-sharing lies at the heart of hopes for a peaceful unified Sudan, but in the medium-to-long term it will also provide the critical context for policy reform across the sectors. Pro-poor growth will require the reversal of elite policies in agriculture, a refocus on food security, especially in the war-affected areas and other poor regions, a rebalancing of spending towards primary level health and education, and fixing social services delivery mechanisms. A reduction in military spending and improved management of oil revenues will be central. Under the umbrella of the PRSP, the Bank has the possibility of engaging the Government and other stakeholders in order to define an inclusive poverty reduction strategy for a unified Sudan, with all the capacity for sector reform planning, consultations, and civil society involvement that this implies.

46. **The need for creating absorption capacity in the war-affected areas.** For the war-affected areas, the capacity needs are larger in scale and, in many cases, more rudimentary. Reconstruction of these areas is bound to attract wide donor interest; the resulting management and coordination demands will present new and different challenges compared with those associated with humanitarian relief programming. The basic governance structures and functions at different levels, starting with the operations of the budget, need to be assessed. Within that framework capacities to set priorities, plan strategically and manage for results will need to be rapidly upgraded and expanded. The transition period will also require the introduction of new skills and understanding of civilian governance and leadership. Important issues will need to be resolved in the short term, such as improving food security and redirecting donors' support towards development. More broadly, stakeholders will need to be involved in figuring out strategies for quick impact programs as well as long term development strategies.

D. PROPOSED WORK PROGRAM, FY04

47. To move forward on re-engagement, a four-pronged approach will tap the Bank's comparative advantages and focus on:

- Knowledge generation and sharing to foster national dialogue
- Capacity building to support policy reform
- Demonstration projects to help improve the delivery of basic social services
- Resolution of the debt overhang.

48. The Bank, like other donors, is committed to working within the framework of a unified Sudan and in support of the principles and priorities of the Joint Planning Mechanism. The possibilities of working with a broad range of stakeholders, including civil society, will be important to prepare for post-peace re-engagement.

i. Knowledge sharing to foster national dialogue

49. The Bank needs to undertake **analytical work** on a range of issues to inform the national and international dialogues on the quick impact program, capacity building measures, reforms, and to be in a position to start building a portfolio of interventions after debt clearance. This analytical work is critical within the LICUS context to identify a feasible sequencing of selective reforms. These studies will help create a favorable environment for improved governance, social service delivery and increased pro-poor growth in the near term, and to prepare the ground for a more ambitious reform agenda in the post-conflict period. Sudan's immense problems receive little public debate. The preparation and dissemination of such work would generate new ideas and provide for informed and transparent discussion on a set of policy debates on the major challenges that face Sudan.

50. Following the CEM, the areas of focus of new economic and sector work (ESW) will be rural development, private sector development, human development, and governance (civil service reform, inter-governmental relations, and service delivery). These reports will bring in contributions from technical experts and civil society organizations from a wide range of all parts of the country and from the diaspora. The approach for this analytical work will be to encourage a process of discussion and consensus building—among Government, stakeholders and development partners--on the issues and the ways forward.

51. A keystone report will be "**Development in a Peaceful Sudan**". This report will focus on Sudan's longer-term development and be based on a series of in-country workshops on selected themes (e.g. agricultural systems, infrastructure, human development, fiscal decentralization). The workshops, held with leading stakeholders both inside and outside government, would discuss Sudan's growth potential and the policies needed to make good on this potential if Sudan is to substantially reduce poverty. As the emerging policy issues become clear, the workshops and report would develop a framework for thinking about a unified Sudan's longer term future and thus complement the PRSP. In addition, the workshops would build capacity along the way and lay the foundation for effective policy design and implementation and establish the ground for future Bank and other donor interventions.

52. **Public sector.** Efforts have been initiated to diagnose the state of existing inter-governmental arrangements and institutions. This work will be followed by a focus on reform options, and a deeper analysis of Sudan's civil service, budget, and public expenditures systems, especially at the state level. Work analysing public expenditures at the various levels of Government will be conducted jointly with DFID.

53. **Rural Development.** In order to support reforms in Sudan's evolving development strategy that would benefit the rural poor, analytical work would be undertaken on the current state of agricultural policies and possible options to improve productivity in the poorer rain fed areas. This works would build on the Bank's earlier Gezira report on irrigated agriculture (para. 39).

54. **Infrastructure.** After decades of under-investment in infrastructure, coupled with the destruction of the civil war, infrastructure needs in Sudan are acute. Analytical work would be done to help Sudan develop a clear strategy for infrastructure development that would support pro-poor development throughout Sudan. It would focus on transport, water and sanitation (including building on efforts of the Nile Basin Initiative), telecom, and energy in the whole of the country.

55. **Health and Education Status Reports.** Status notes for both the health and education sectors have been initiated with the goal of understanding the issues facing human development. The goal of these reports is to begin laying the ground for policy reforms in the context of the PRSP. The reports will be built on existing knowledge and will look carefully at the fiscal underpinnings of the sectors, discuss unit costs in relation to management concerns, and explore the political economy of service delivery. There will be a focus on availability, coverage and quality, sustainability, financing, bottlenecks, regional disparities, and political dynamics.

56. **Private Sector Development.** To better understand the private sector in Sudan, analytical work is proposed with a particular focus on identifying the growth potential for small and medium enterprises (SMEs). Attention will be paid to identifying constraints to the further development of the private sector, including major policy issues and institutional factors influencing enterprises' performance and the provision of infrastructure and financial and non-financial services.

ii. Capacity building and action planning to support policy reform

57. **Capacity building programs.** A range of activities – both standard and specially designed - will be available to address demand for capacity in the areas of policy analysis, design, and reform. These activities would be carried out under the auspices of the Joint Planning Mechanism established between the Government and the SPLM. At the request of the Government, a Post-Conflict Fund grant for \$1.5 million (managed by the UNDP and UNICEF) has been approved and will finance many of these activities. Supporting these activities will be a range of WBI learning activities which would also complement the analytical work agenda described above. Wherever possible, learning activities will be used as a point of contact

between the different parties, in which dialogue and action-planning may take place in a relatively neutral setting. The main focus will initially be on fiscal and expenditure management issues and issues of inter-Governmental fiscal relations. In addition, programs will also be developed in the areas of rural development, and health and education. A special effort will be made to involve local institutions. In the war-affected areas, a series of training seminars will be convened to introduce basic concepts of civilian governance. This will be matched by a program which will introduce critical functions including strategic planning, sectoral coordination, and monitoring of results.

58. Support for PRSP process. Responding to a request from the Government, the Bank provided assistance in May 2003 to the Government and other stakeholders for improving understanding and building capacity to prepare a national Poverty Reduction Support Strategy. A daylong I-PRSP workshop was held in Khartoum with over 100 participants, including government officials, members of the National Assembly, representatives of trade unions and other civil society organizations, and donors. It is expected that the full PRSP would be a summary and a rolling roadmap of a national vision which would reflect post-peace settlement dynamics, and take into account needs in the war-affected areas. The I-PRSP would take stock of existing data and policies, launch broader processes of rethinking current strategies, and produce time-bound roadmaps for the preparation of a full PRSP. Preparing the I-PRSP will trigger Government reflection on policy reforms for pro-poor growth and for making progress towards the meeting of the Millennium Development Goals. It will also mark the beginning of a process that would eventually lead to debt reduction under the enhanced HIPC initiative. Additional technical assistance has been requested by the Government and will be provided by the Bank as the PRSP process moves forward.

59. The capacity of local NGOs and civil society organizations is likely to prove a critical bottleneck to post-conflict service delivery, especially if public sector reforms call for service provision on a decentralized basis. A diagnostic of NGO capabilities, carried out in collaboration with other donor partners, will pinpoint capacity gaps related to the effective articulation of NGO efforts with the plans of local government. It will also provide the basis for a wider, WBI-assisted program of support to community-driven development. With the support a Post Conflict Fund grant, a Development Marketplace for Sudanese and Ethiopian NGOs was held in Addis Ababa in February 2003. The goal was to share experiences between NGO groups and identify a small portfolio of innovative approaches for social service delivery and livelihood and civil society initiatives.

60. Data needs. No systematic poverty data has been collected since 1978. The Bank has convened a meeting of interested donors (DFID, Norad, UNDP) to help support government efforts for a national household survey that would serve as a baseline for the PRSP and reform efforts. In terms of technical assistance, support will be provided to the Central Bureau of Statistics in Khartoum in coordination with regional centers to help strengthen capacities for the collection and analysis of reliable and gender-disaggregated poverty data that enables the government to formulate effective pro-poor policies and to facilitate the PRSP process. The implementation of the survey will cost an estimated \$1.5 million, and the activity is likely to attract external donors. Beyond poverty data, there is also a need to support the strengthening of

macro-economic data, including national accounts. The Bank will explore with other interested donors and programs options to evaluate and support statistical capacity building.

61. **Connectivity.** Knowledge sharing will be assisted by the establishment of basic video-conferencing facilities in collaboration with UN partners in Sudan. Such facilities will help to re-introduce Sudanese partners to global communities of practice after long isolation, and will eventually help to connect Sudanese to each other to address the common challenges of the post-conflict era.

iii. Demonstration projects to help improve the delivery of basic social services

62. **Support for social service delivery in Nuba Mountains:** The January 2001 Nuba Mountains cease-fire agreement is considered a test case for the broader peace process. The opening up of the long-blockaded SPLA-controlled areas of Nuba has created new opportunities, as well as new challenges. A framework comprising a phased, multi-agency, multi-sectoral effort was in the Nuba Mountains Program for Advancing Conflict Transformation (NMPACT). Under NMPACT, which aims to promote local, Nuba-led solutions to the needs of the Nuba people, the Bank will propose a Post-Conflict Grant to explore options for innovative service delivery at community levels. The benefit of the framework is to enable the Bank to work with the Government, the SPLM, other donors and, in a highly participatory manner, with local Government, local NGOs and civil society.

63. **Social Development Fund (SDF).** Building up on the experiences from local NGOs and the Nuba Fund, the Bank would begin to develop a Social Development Fund project to be one of the first activities financed by IDA. The Fund would align itself with the Government's reform strategy and could become an effective channel for the delivery of social services. Viewed as a source of funds for local development, the SDF would also generate support for decentralization efforts in Sudan. The SDF would work in partnership with local governments and will support municipal strengthening, citizen participation and decentralization initiatives in Sudan.

iv. Arrears Clearance to the World Bank

64. Although the Sudanese authorities have taken steps towards normalizing relations with the Bank and making notional debt service payments since mid-1999⁸, this has not been sufficient to prevent a continued accumulation of arrears to the Bank. As discussed earlier, clearance of these arrears, which stood at \$195 million by end-2001 and will rise to about \$262 million by end-2003, is an essential prerequisite for the Bank to resume financial support to Sudan. In collaboration with other donors and creditors, the Bank has started considering options for moving Sudan towards debt sustainability. These options are considered very much within the context of a comprehensive solution to Sudan's debt problem, including the need to assist Sudan to begin the process leading toward HIPC relief. There are two main modalities for clearing arrears to the World Bank. Grant financing by bilateral donors could clear the arrears.

⁸The Sudanese authorities started to make payments of \$1 million per month in July 1999. However, payments were interrupted but then resumed in October 2002 with monthly payments of \$0.5 million.

Alternatively, bridge financing from official or commercial lenders could be sought to pay the arrears, followed by the extension of fast disbursing funds by the Bank to enable Sudan's immediate payment of the bridge loan. The size and composition of IDA's support program would then be developed in more detail in the context of a Transitional Support Strategy (see para. 43).

E. PARTNERSHIPS

65. **Consultation.** The basic elements of this re-engagement strategy have been developed in consultation with key bilateral and multilateral partners, including the UNDP in the context of a broader LICUS partnership. Donor coordination efforts facilitated by the IGAD Partners' Forum have been invaluable for ensuring the Bank's activities are complementary with those of other actors. Without a full office in Sudan, the Bank will need to rely on other partners, especially UNDP and UNICEF, to provide operational capability (in particular as the implementing agencies for the two mentioned PCF grants), and to provide the benefit of their longstanding presence and knowledge of Sudan. In the meantime, the Bank has established a liaison office in Khartoum, hosted by UNDP.

66. **Leveraging partnerships.** In addition to the Bank's own administrative budget, the activities in the work program are also being supported by other donors. Norway is currently funding a series of WBI activities for preparing the leadership and emerging administration in southern Sudan. DFID has offered to work very closely with the Bank particularly in support of PRSP preparation and public expenditures analysis. Canada has supported the Development Marketplace and work with local NGOs. Canada, along with Switzerland, are also considering supporting the work on fiscal federalism.

67. **Multi-Donor Trust Fund.** In the context of the peace talks, there has been discussion about the need for a multi-donor trust fund to finance intensive capacity building efforts, including at the local level, as well as to finance post-peace reconstruction needs, to pool resources and reduce transactions costs. As these talks proceed and as the structures for donor coordination become clearer, the possibility and modalities of a multi-donor trust fund will be clarified. Should the World Bank be asked to administer such a fund, lessons including good practice from other post-conflict countries, would be adopted.

68. **Local stakeholders.** The program will work hard to involve local institutions and individuals centrally in the delivery of the program. Work on reforming the Gezira Scheme has brought the Bank in close connection with representatives of think-tanks and farmers associations. Work on the CEM has involved local universities, think-tanks, and intellectuals in Sudan and in the diaspora.

4. RISKS

69. Despite the current optimism surrounding the peace process, there remain serious risks that could either derail prospects of a sustainable peace as a whole, or complicate the implementation of an eventual agreement. These risks must be taken into account, and include the following:

70. **Collapse of the peace talks.** There have been several crises in the peace talks already, usually linked to military activity by one side or the other in the war-affected areas. A cessation of hostilities, signed in mid-October, has already come under acute strain, most recently in the west (Darfur) of the country.

71. **Peace settlement but no real peace.** A peace settlement may be signed, but it may not lead to real peace on the ground because of enduring mistrust between the parties and weak security arrangements. There is also a risk of political upheaval in the Government of Sudan fueled by opponents of peace, and of intensified violence between the various parties in the war-affected areas.

72. **Conflict in the transition areas remains tense** (Nuba Mountains in South Kordofan, Abyei in western Kordofan and the Funj areas in Southern Blue Nile). In the Nuba Mountains, the January 2002 cease-fire continues to hold, but now needs to demonstrate tangible benefits of a peace divided. In Abyei, grassroots peace talks between local Baggara and Dinka have not resolved the issue of who will control the town and its environs. And the long frontline in Southern Blue Nile remains very tense. Although discussions have begun on these three areas, tensions remain.

73. **Arrears clearance.** Given the large amount of financing required for arrears clearance (and for enhanced HIPC relief), clearing arrears could be protracted. Beyond the obvious implication that the Bank could not lend to Sudan, there is the risk that lack of large-scale funding for reconstruction and development could undermine a sustainable peace. To address this risk, the Bank is working intensively with Government and other creditors (especially the IMF and other multilaterals) to find a solution to the debt problem. In the meantime, the Bank would continue to provide policy advice and capacity building activities. A pre-arrears IDA grant could also be explored, provided Sudan meets the criteria approved by IDA for use of such grants. Such a grant could also leverage donor resources for a multi-donor trust fund.

74. **Donor support.** As has been documented in a recent World Bank publication,⁹ a large risk is that international engagement and support will be untimely and unsustained which could, in turn, undermine the consolidation of the benefits of peace in the long term. Donors, including the World Bank, need to respond in a coordinated and timely way to demonstrate the benefits of

⁹ Collier, Paul et. al. *Breaking the Conflict Trap : Civil War and Development Policy*, Oxford University Press, 2003.

peace in the short term and be prepared to support Sudan to consolidate peace in the medium and long term. To address this risk, the Bank is working intensively with a group of interested donors in the period leading up to peace to ensure that the phasing of assistance, including the transition from humanitarian to reconstruction to development, is appropriate.

75. **The Bank is aware of these risks.** The re-engagement strategy addresses these risks in several ways. First, by building capacity for peace and supporting forces for positive change – not least by the mere fact of its re-engagement and the promise of a more robust presence further down the line – the Bank contributes to help sustain the momentum for peace. Second, Bank support to the Nuba Mountains through the Post-Conflict Fund would explore options for one of the transition areas. Third, the strategy can survive temporary returns to violence. The efforts to build capacity, encourage reform and enhance service delivery can and should all continue, even if localized conflict endures in the short term. Finally, the strategy is built in ways that prepare the Bank to scale up rapidly when peace is signed.

76. **Exit Strategy.** The Bank, like others, is hopeful that the current peace talks will bear fruition and produce a lasting peace. However, should peace not be realized, the Bank would continue to be engaged in Sudan along LICUS principles of knowledge generation and limited capacity building; project preparation and work on options for arrears clearance would be put on hold.

SUDAN: RELATIONS WITH THE IMF¹⁰

(As of May 2003)

Sudan has been in continuous arrears to the Fund since 1984 and over the years the Fund has taken a number of remedial measures, pursuant to the arrears strategy, culminating in 1994 in the Managing Director's issuance of a complaint regarding Sudan's compulsory withdrawal from the Fund. However, since 1997, Sudan has established a record of cooperation with the Fund, reflected in the generally satisfactory implementation of macroeconomic adjustment and structural policies under successive staff-monitored programs (SMP) and regular payments in excess of obligations falling due. As a result, the Executive Board lifted the declaration of non-cooperation against Sudan on August 27, 1999 and restored the country's voting and related rights on July 31, 2000.

Under the successive SMPs that started in 1997, Sudan has undertaken a successful stabilization program, whereby economic policies and performance have improved considerably. This performance has been underpinned by macroeconomic policies and structural reform, which included (i) fiscal consolidation, by lowering subsidies, streamlining tax administration, and improving budget management; (ii) reform of the monetary policy framework, by introducing indirect monetary instrument and moving to broad money targeting; (iii) unification and liberalization of the exchange rate system; (iv) lifting of all price controls; and (v) significant privatization. These policies and reform facilitated real GDP growth rates averaging 6.5 percent and reducing inflation from 116 percent in 1996 to about 8 percent in 2002. During this period, Sudan also benefited from technical assistance from the Fund in various areas (prices and national accounts, tax policy, tax administration, monetary instruments, etc.).

The economic policies and the agreed payment to the Fund under the 2002 SMP were considered by most Directors to be broadly in line with what would be required for a rights accumulation program (RAP), if financing assurances could have been obtained. Most directors also indicated that they would be prepared to take satisfactory performance under the 2002 SMP into account in setting the timetable for arrears clearance at a later stage. In March 2003, the staff met with the Sudanese authorities in The Hague, whereby the mission completed the last review under the 2002 SMP and reached an agreement, ad referendum, on the 2003 SMP. The staff will report to the Board that performance under the 2002 SMP was satisfactory.

¹⁰ Prepared by IMF staff.