

Sudan Integrated Framework Diagnostic Trade Integrated Study Aide Memoire on First Technical Mission

November 15, 2006

1. The World Bank led a mission to Sudan, November 1–15, 2006, to gather information for the Sudan Integrated Framework Diagnostic Trade Integration Study (DTIS). The objective of the DTIS is to evaluate constraints facing Sudan’s integration into the world economy and to identify priority technical assistance needs. The mission was conducted at the invitation of the Commission for WTO Affairs, which serves as the national focal point for the Sudan Integrated Framework (IF) program, and on behalf of the six IF core agencies.¹ This aide memoire reports on the activities and principal findings of the mission.

2. This was the first of two technical missions planned for the Sudan DTIS. This mission focused on supply-side constraints in selected agricultural, industrial, and services sub-sectors as well as exchange rate and macroeconomic policy. A second mission is planned for January 2007 and will cover cross-sector issues, including trade policy/WTO accession, customs administration, transportation and trade logistics, poverty, and foreign direct investment. The mission’s objectives were (1) to gather information on the potential for trade and growth in Sudan and the constraints on this potential, (2) to identify concrete actions that should be undertaken to overcome these constraints.

3. The DTIS team leader participated in a pre-DTIS workshop sponsored by UNCTAD. The workshop that was held in Khartoum October 30–31 to sensitize the national IF steering committee and update them on the Enhanced Integrated Framework.

4. Members of the November DTIS team and their responsibilities were as follows:

Hamid Faki and Jack van Holst Pellekaan	Agriculture
Gregory Sullivan	plant, animal, and food safety standards
Donald Mitchell	sugar industry
Mañuel de la Rocha	manufacturing; trade promotion institutions
Alaeddin Twebti	backbone services
Marial Awou Yol	real exchange rate appreciation at the sector level
Valeriano Garcia	real exchange rate and macroeconomic policy
Philip Schuler	team leader

5. The team met with government authorities, business leaders, and donors in Khartoum and Juba. Donald Mitchell took field trips to sugar factories located in White Nile, Sinnar, Gezira, and Kassala States. A list of organizations and individuals contacted is attached as an annex.

6. In its role as IF facilitator, the World Bank resident mission convened a meeting for the full team with external partners (donors and embassy officials) on November 5 and individual meetings with selected trade partners.

7. A wrap-up meeting was held in Khartoum with members of the task force of the national IF steering committee on November 13. The DTIS team presented preliminary findings and received many useful comments and suggestions from the task force.

¹ The IF core agencies are the IMF, ITC, UNCTAD, UNDP, World Bank, and WTO.

Preliminary Findings from the November Mission

Agriculture

8. Before the emergence of the oil sector, Sudan relied on the export of a number of agricultural commodities, notably cotton, gum arabic, livestock, oil seeds, and sugar. They now make up only around 15 percent of total exports. The value of these exports declined in real terms between the late 1990s and 2001, when livestock exports all but ceased due an import ban in the Gulf. The real dollar value of these products has regained ground between 2002 and 2005, although as will be noted, the dinar has also been appreciating. The team's preliminary conclusions are the following:

- Sudan has a comparative advantage in these traditional commodities, and there is potential to develop new agro-food exports, such as meat, fruits, and vegetables.
- Increased exports can contribute to incomes of the rural poor
- The principal barriers to expansion of exports include low or declining agricultural productivity, high domestic marketing costs, dinar appreciation, and health regulations in foreign markets.

9. The team gathered data on value chains from producers and traders, supplementing existing data compiled by staff in a number of government agencies. Value chains are being prepared for a number of products and sources, including the following:

- cattle: from Darfur, South Kordofan, Southern Sudan
- sheep: from Darfur, North Kordofan
- camels: from Darfur
- sorghum: from Gedaref
- sesame: from Gedaref and North and South Kordofan
- groundnuts: from North and South Kordofan and Gezira
- cotton: from Gezira
- gum arabic: from Blue Nile

10. Given southern Sudan's natural resources there is a considerable potential for trade between Southern Sudan and its neighbors and more broadly to COMESA countries. Following the Comprehensive Peace Agreement (CPA) there has been a substantial increase in the flow of food and other goods such as construction materials into southern Sudan from Uganda and Kenya. Trade will not go the other way until there is a substantial increase in the productivity of agriculture and major improvement in the road quality and number of roads.

11. It seems inevitable that most of the first surplus agricultural production resulting from higher productivity on Equatoria's small-scale farms will be marketed inside southern Sudan in major towns such as Juba and Malakal. One important development is the increased movement of cattle north from southern Sudan through markets such as El Obeid and Kosti although the mission has not yet ascertained the numbers. This integration of the livestock industries of the South and North is a sound development in economic terms but does bring the risk of diseases. Over the medium- to long-term, however, there appear to be good prospects for exporting teak, honey, coffee, tea, tobacco, fruits and vegetables. These future prospects will be investigated in the report.

12. Farm yields of many crops have been declining and now fall below those of regional competitors. Livestock production is being hindered by environmental degradation. In irrigated agriculture, actual yields are typically about 50 percent of the potential, as measured by the results of trials on farmers' fields. In rainfed agriculture, actual average yields are typi-

cally about 20 percent of yields in field trials. Shrinking budgets, decreasing training quality, and limited technology transfer prevent realization of this potential.

13. Looking to the future, Sudan should substantially increase and improve research on agriculture, livestock, fisheries and forestry. Agricultural development and growth in agricultural trade will not take place without continuous investment in improved technology. It is therefore imperative that public expenditures on agricultural research be immediately increased to overcome decades of under-funding. Achieving the potential yields can be achieved by adopting technologies that are available, including improved tillage techniques, better seeds and more strategic rotations.

14. Value chain data gathered to date show that costs of transport, taxes, processing fees and profits can be very high in relation to the price paid to farmers. Prices paid to cattle producers in Darfur, for example, can be as low as 50 percent of the final price for cattle walked to the Omdurman market. Of this marketing margin, taxes and charge can account for as much as 30 percent during the dry season and more during the wet season. Reports on livestock trade with Uganda during the late 1990s indicate that transport costs typically accounted for 50 percent of marketing costs and all taxes accounted for 30 to 40 percent of which one-third were regarded as unofficial taxes. The trade in livestock has almost disappeared in recent years because of increased insecurity. For sesame exports the share of the final price received by producers can also be as low as 50 percent for producers in Sennar and Upper Nile states. Taxes and other charges appear to be as high as 25 percent of the marketing margin. The report will evaluate the scope for reducing marketing margins.

15. Sheep exports appear to have been in systematic decline since 2004. This has coincided with the appreciation of the real exchange rate, which is resulting in lower prices received in local currency by producers for their exports. Information collected by the mission (such as planned sales by exporters) suggests that this decline could continue and spread to other agricultural exports. While the exchange rate appreciation has dampened the enthusiasm of sheep exporters, it should be noted that even during buoyant market conditions sheep exports make up only about 10 percent of total sheep sales for both domestic consumption and exports. Hence the impact of exchange rate appreciation will always be constrained by the opportunities for sales on the domestic market

16. There are many techniques that could be adopted to improve the efficiency with which the marketing of livestock and crops takes place, including better facilities on stock routes, more prevalent loading yards and ramps for livestock, and better roads and railways. The options for improving marketing efficiency and more strategic taxing arrangements will be pursued in the final report.

Food, Plant, and Animal Standards

17. World agro-food markets are increasingly affected by countries' domestic sanitary and phyto-sanitary (SPS) regulations. As noted above, animal health standards set in Saudi Arabia and the Gulf have at times posed a binding constraint on Sudanese exports of live animals. Sudan's ability to develop exports of high-value horticulture and meat products will depend on its capacity to meet trade partners' SPS standards.

18. Sudan's current SPS capacity is unevenly distributed within the country. In the Khartoum area, capacity is high in both the private and public sectors. The Sudan Standards and Metrology Organization is functioning with a complement of staff and facilities. Administrators understand their role in facilitating trade. Key government officials are knowledgeable about SPS for accession to the WTO. SPS capacity in southern Sudan is far more limited, in contrast.

19. A similarity between the North and the South is the high domestic transaction costs in the marketing of agricultural products. These costs reduce Sudan's competitiveness through lower quality products and time in transport, as discussed in the previous section of this aide memoire. These costs also deter investment in Sudan's SPS capacity, since revenues are reduced that could support SPS interventions by the private sector.

20. *Livestock and veterinary standards.* The SPS report for the DTIS will give primary emphasis to standards that affect the livestock/meat supply chain. Sudan has implemented a bilateral agreement with Saudi Arabia to monitor the health of livestock exports, mainly for sheep and some goats. The SPS program requires 100 percent testing of animals for brucellosis and a series of vaccinations. Live animals are rejected by Saudi Arabia for health reasons. Live shipments of cattle and small ruminants are banned from Egypt because of the presence of foot and mouth disease.

21. Though no exact data are available on flows of livestock across the southern borders, it is recognized that there is cross-border movement of livestock, cattle, sheep and goats with Uganda, Kenya, and Ethiopia. Livestock from the South also move northward and into the export market channel. The potential to develop export markets is constrained by the fact that tsetse fly, East Coast Fever and Foot and Mouth Disease are endemic in southern Sudan. It will be important to understand more about the capabilities of the three regional labs to do surveillance and reporting.

22. The mission identified the following SPS constraints on other agro-food trade:

- *Horticulture.* An export market has developed for green beans, but Sudanese exports get sold in the lower price points on quality grounds. A horticulture export center is under construction outside Khartoum. This will facilitate better implementation of SPS requirements from importing countries. Further work will address the soft technologies to effectively establish SPS.
- *Groundnuts.* Some shipments of groundnuts to the European Union have been rejected because of the presence of aflatoxins. Follow-up investigations will be conducted on this situation based on Trade Alerts.
- Southern Sudan is experiencing a large volume of imports, mainly from Uganda and less from Kenya and the North. Any SPS activities could be directed at testing the quality of these imports.

Sugar

23. Sudan has the potential to become a significant sugar exporter. It is a low-cost sugar producer, relative to other major international producers. It enjoys preferential access to major international markets, including the COMESA free trade area and, after 2009, to the European Union under the Everything But Arms Initiative. With the expansion of the industry to include the White Nile sugar factory in 2008 and the prospects of developing the Blue Nile and other sugar factories in the future.

24. A collection of government policies elevate the domestic sugar price above world market prices. Since 1993, government has set ex-factory prices on a cost-plus basis to guarantee profits for the sugar producing companies. Imports are constrained through both protective tariffs and administrative measures. In recent years, the domestic price has usually been double the world market price.

25. In addition to high protection for producers, there are also high taxes on domestic sales of sugar and sugar-using products such as soft drinks. Central government taxes on sugar are 34.8 percent of the factory gate price, and other local and VAT taxes on sugar

wholesalers and retailers are also levied. Soft drinks are one of the fastest growing areas of processed foods, and they are very heavily taxed because both sugar and soft drinks pay 17 percent excise duty taxes as two of only six products which are charged excise duty taxes.

26. High domestic sugar prices reduce competitiveness of industrial users of sugar, who must increasingly compete against imports of processed food and other products from Egypt and other neighboring countries where food processors are able to buy sugar at world market prices. High domestic prices also limit export opportunities of industrial users of sugar. Tight controls of sugar imports by the Ministry of Industry creates occasional shortages for industrial sugar users with consequent high prices, and the quality of imported sugar does not always meet the needs of industrial users.

27. Government revenue from sugar and profits enjoyed by sugar producers come at the expense of consumers and the competitiveness of industrial users. Such high protection is no longer needed for the sugar industry to compete in the global market and such high taxes on a basic food item are difficult to justify.

28. Sudan's sugar policies need to be reconsidered as the country prepares to join the WTO and to avoid potential disputes with fellow COMESA members. The cost-plus pricing policy could be construed as one that cross-subsidize exports from higher priced domestic sales, potentially leading trade partners to closer their markets to Sudanese sugar.

29. A draft report on the sugar sector was delivered to the IF focal point before the wrap-up meeting and circulated with officials from sugar companies and the Ministry of Industry.

Manufacturing

30. Manufacturing represents about 15 percent of total Sudanese economy, but its share is declining, especially since discovery of oil. Manufacturing exports are very small, concentrated in very few products (mostly from firms based in Khartoum), and have declined substantially in recent years: excluding sugar, manufactured exports declined to \$250,000 in 2005 from \$42 million in 1995.

31. High cost of production hampers competitiveness and is the main constraint to increased. Three key cross-cutting factors affecting cost of production:

- *High, numerous, cumbersome, and un-transparent taxes.* These include customs fees and charges, local taxes, etc. They represent an especially high burden for small and medium enterprises. In many cases they can be as high as 20 percent of cost of production.
- *High cost of finance.* Firms report lending margins of 15–20 percent, and banks require high collateral and short terms of repayment. These factors prevent firms from increasing investment and expanding exports. This is clearly constraining the modernization of plants and machinery, which is badly needed in many sectors (e.g., leather, edible oils, textiles).
- *High cost and unreliability of power.* The average cost electricity is 12 cents per kwh, substantially higher than in competitor countries (e.g., Egypt). Blackouts and interruptions in supply force plants to rely on generators for between 20–30 percent of their power consumption at much higher costs.

32. The mission identified several industries that seem to offer potential for exporting: leather industry, pharmaceuticals, edible oils, and textiles. These will be assessed in more detail in the draft report.

Backbone Services

33. During the concept note review process, it was agreed that the DTIS would focus exclusively on the contribution of backbone services sectors to Sudan's international competitiveness. The November mission investigated financial services, telecommunications, and electricity. The January mission will continue with transportation and trade logistics services.

Financial Services

34. As noted above, Sudanese private sector representatives identified the high cost of finance as one of the main barriers to improving industrial and agricultural productivity, and thereby developing the export sector. High public sector borrowing is a key contributor to the private sector's lack of access to finance, but there are others. Despite the large number of banking sector operators in the market (around thirty), the lack of reliable credit-rating mechanisms means that small and medium borrowers are less able to move between lending institutions. The result is limited competition among lenders, helping to maintain the high cost of borrowing. The current system of syndicated loans serving the agricultural sector raises efficiency questions. Microfinance methods have proven more effective and efficient in delivering financial services to small agricultural producers in other countries, and should be explored more extensively in Sudan.

35. The insurance sector suffers from under-regulation and an excessive number of operators. Many operators are failing due to an inability to pay claims. The result is an unreliable and unstable direct insurance market, which affects the ability of entrepreneurs and small businesses to mitigate operating risk, and therefore limits private sector growth.

36. There is limited openness to competition in the reinsurance market. Government regulations mean that only 35 percent of any insurers' reinsurance needs may be met from competitive international reinsurance markets. Even if the direct insurance sector is consolidated and properly regulated, the lack of competition in reinsurance will maintain higher than necessary premium levels in the direct insurance market.

37. *Data needs:* The team requested the following data from the Bank of Sudan

- lending margins for the various modes of Islamic lending for 2004–2006
- data on the structure/concentration of the market

Electricity

38. Along with finance, the high cost and unreliable nature of electricity services has also been mentioned as a primary barrier to productivity. Most businesses rely on diesel generators to maintain a consistent supply of energy. Some firms estimate that these are used to meet 20–30 percent of weekly demand in the manufacturing sector. Demand will continue to increase rapidly but supply is unlikely to increase quickly enough to avoid steady price increases.

39. There appears to be some scope for power exchange between the north of Sudan and Ethiopia and Egypt. However, the rapid growth of domestic demand combined with the high potential for energy output in other countries in the region (e.g., Ethiopia and DRC) argue against the possibility of large-scale energy exports from the north. South Sudan may have some scope for power exchange with Kenya and Uganda based on proximity (therefore lower transmission costs) and low demand forecasts, but such exports are at least seven years away, and are likely to take even longer due to a lack of finance and an uncertain investment climate.

Telecommunications

40. Telecommunications services have improved with the liberalization of the sector and the licensing of new operators. The right of new licensed operators to set up their own international gateways is particularly welcome. However, there are questions regarding the effectiveness of roll-out policies to under-served areas outside the main cities in the North, and across all areas of southern Sudan. These will be investigated in the report.

Real Exchange Rate Appreciation and Dutch Disease

41. The boom in oil exports has caused the Sudanese dinar to appreciate in real terms by 31 percent between the beginning of 2000 and the end of 2005, appreciating 17 percent in real terms during 2005 alone. An appreciated dinar increases the price of Sudanese exports in world markets, and many business people have pointed to dinar appreciation as one constraint on export competitiveness.

42. During the mission the team gathered data to assess the extent to which dinar appreciation is reducing exports in practice, relative to other explanatory variables (e.g., declining productivity, high trade transaction costs, foreign market access barriers, etc.). The mission's initial findings include the following:

- The current account of the balance of payment is in deficit despite the increase in oil exports.
- Monetary policy has been excessively expansive (average rate of growth of money supply has been more than 30 percent per year). This threatens price stability and can undermine export competitiveness.
- Fiscal policy has been extremely lax: there is already a primary fiscal deficit for 2006 of about 3 percent of GDP and the non-oil fiscal deficit is estimated about 16 percent of GDP.

43. If current macroeconomic policies remain unchanged, it is likely that the dinar will continue to appreciate. Government authorities and the private sector can take measures to dampen the effects of such appreciation:

- reduce trade taxes and transactions costs
- increase productivity in the traditional export sector by strengthening property rights and improving incentives for research, development, and technology transfer

44. A partial draft report on macroeconomic dimensions of exchange rate appreciation was submitted to the IF focal point during the mission and discussed with the IMF.

45. The team will estimate the impact of real exchange rate appreciation using sector-level information on costs, productivity, sales, etc. gathered for value chain analyses. Contrary to initial expectations, cotton and sugar producers reported no decline in the dinar price of imported inputs, which one would expect to mitigate lost export revenue. Prices of certain agro-chemicals are correlated to oil prices.

46. The mission found that the dinar appreciation affects southern Sudan in a somewhat different manner than in the north. On the one hand, the economy in the South is less monetized and less dependent on non-oil export revenue. In some areas money transactions are carried out in currencies other than dinar. On the other hand, the GOSS depends much more heavily on oil revenue than the federal government, and the current budget was developed using the assumption that the dinar/dollar exchange rate would remain at 250.

47. *Data needs:* The team has requested quarterly exchange rate and monetary policy data through mid-2006 from the IMF.

Trade Promotion Institutions

48. Trade promotion institutions are small and under-funded. The most important one is Trade Point, which is very much centered on exports from the Khartoum area. Plans exist for Trade Point to open an office in the South, which would help market some agriculture commodities out of the country, although it seems unlikely that manufacturing exports will develop in the near term in the South.

49. Dialogue between government and exporters is fragmented and not well organized. The sector export councils used to meet regularly, but recommendations were not often implemented, so some are meeting less frequently. The National Export Development Council has not been an effective mechanism for organizing public-private engagement on trade issues.

50. Two Free Industrial Zones have been set up Red Sea Free Zone (2000) and Al Gaili (2003) offering special incentives to firms. However, very few firms have set up there and activity is small. One likely explanation is that firms prefer to make use of the many duty and tax exemptions allowed by the investment law, hence the incentive for the Free Zone is not so interesting. The GOSS Ministry of Commerce, Trade and Supplies is developing a proposal for an industrial zone in the South.

51. Exporters report that the system for refunding VAT on imported inputs works relatively well, relative to other LDCs. Refunds are received about one month after filing the request.² They report that there is no system of drawbacks on customs duties paid for imported inputs used in the production of exports. Under current investment policies, industries are eligible for substantially reduced customs duties (three percent on all imports), which reduces the burden of Sudan's protective tariff schedule.

Implications for January Mission

52. Several issues arose during this mission that will be followed up by the January mission.

53. *External constraints.* During the wrap-up meeting, members of the steering committee task force raised concerns that the focus on value chains and supply-side constraints was diverting attention from external constraints, such as cotton subsidies and sugar protections imposed by industrial countries, as well as the U.S. economic embargo.

54. *Import policies.* Manufacturers reported that current trade policies sometimes prevent them from obtaining inputs at world-market prices. In addition to paying high customs duties, industrialists face administrative restrictions imposed on an ad hoc basis by various ministries.

55. *Customs and revenue:* Inadequate customs control along southern borders allows goods to enter free of taxes collected from domestic producers, weakening incentives to enter the formal economy and increasing GOSS dependence on oil revenue and ODA.

56. *Transportation infrastructure:* Information gathered in the south highlighted the need for rural feeder roads. There is a large demand for food products in Juba that is being not be-

² The Zambia DTIS reported that a three month minimum waiting time to receive refunds of import VAT and that delays of 6–9 months were the norm.

ing met by local producers; at the same time, farmers living outside of Juba reported that would be willing to move out of subsistence if they could economically transport goods to Juba.

57. *Sensitization workshop in Juba.* The awareness of the Integrated Framework program among government, private sector, and donor community in Juba lags behind what the team experienced in Khartoum. The Minister of Commerce, Trade, and Supply requested that the January mission hold a workshop in Juba to sensitize trade stakeholders.

Next Steps

58. Members of the November mission will submit draft reports by mid-December 2006. These will be discussed with stakeholders during the January 2007 mission.

January Mission Schedule

59. The team leader discussed plans for January 2007 mission with the IF focal point and World Bank staff. Tentative dates for the next mission are January 10–24, 2007. The team leader and IF focal point propose to include the following in the January mission:

- a half-day meeting of the national steering committee to launch the mission and discuss the reports submitted by members of the November mission
- a field trip to Port Sudan for the customs and trade logistics specialists
- a meeting with donors and external partners at the World Bank to discuss papers from November mission and preliminary findings from January mission
- a field trip to Juba that would include a workshop in Juba to sensitize the GOSS, private sector, and Juba-based donors on the Integrated Framework, as well as discuss findings from the January mission
- a wrap-up meeting with the task force of the national IF steering committee

60. The team thanks Dr. Dingle, the staff of the Commission on WTO Affairs, and staff of the World Bank resident mission for their hard work in organizing meetings and providing logistical support.

Annex: Individuals and Organizations visited during the Mission

Federal Government

Central Bank of Sudan
Central Bureau of Statistics
Central Laboratory
Central Veterinary Laboratory
Commission for WTO Affairs
Dams Implementation Unit
Insurance Supervisory Authority
Ministry of Agriculture and Forestry
Ministry of Animal Resources and Fisheries
Ministry of Finance and National Economy
Ministry of Foreign Trade
Ministry of Health
Ministry of Industry
Ministry of International Cooperation
Ministry of Investment
National Electricity Corporation
National Telecommunications Corporation
Sudan Customs
Sudan Standards and Metrology Organization
Sudan Trade Point

Government of Southern Sudan

Commissioner for the Central Juba Food and Agriculture Organization
Minister of Presidential Affairs
Ministry of Agriculture and Forestry
Ministry of Animal Resources and Fisheries
Ministry of Commerce, Trade, and Supply: minister and director-general

Khartoum State Government

Horticulture Export Center

Enterprises and Private Sector

Amin Hassan, business consultant
Ahmed Idris, livestock trader
Agricultural Research Corporation
Animal Resources Services Company
Banks: Blue Nile Commercial Bank, Nile Commercial Bank, Bank of Khartoum, Emirates and Sudan Bank, Sudanese French Bank
Coca Cola Co.
Comexindo Trade and Investment
DAL Food Industries Co., Ltd.
Gum Arabic Company
Hagger Holding Company]
Kenana Sugar Company
Manufacturing firms: Tag Cosmetics, pharmaceuticals, tannery, edible oils, textiles
Market in Kadu West and producers in Sero
Mweli Livestock Market

Nyala Slaughterhouse
Saaed Industrial and Commercial Group
Sideeg Mahmoud Modawi Yadoub, livestock trader
South Sudan Chamber of Commerce, Industry, and Agriculture
Sudan Chambers of Industries Association
Sudan Cotton Company
Sudanese Businessmen and Employers Federation
Sudanese Sugar Company and factories in Gunnied, Sennar, Assalaya,
Taxation Chamber

External Partners

American Refugee Committee
DFID
Embassy of India
Embassy of the United States
Embassy of Turkey
European Commission Delegation
Food and Agriculture Administration
Joint Donor Team
Sean White, Winrock International
UNDP
UNIDO
UNMIS
UNOPS
USAID