

AFRICAN DEVELOPMENT BANK GROUP



PROPOSAL TO CLEAR SUDAN'S ARREARS TO THE AFRICAN DEVELOPMENT BANK AND THE AFRICAN DEVELOPMENT FUND

RDGE DEPARTMENTS

April 2021

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CURRENCY EQUIVALENTS, FISCAL YEAR, AND MEASURES

As of March 2021

| | |
|------|------------|
| UA 1 | SDR 1.00 |
| UA 1 | USD 1.44 |
| UA1 | EUR 1.19 |
| UA1 | SDG 544.74 |

FISCAL YEAR

1 January – 31 December

WEIGHTS AND MEASURES

| | | |
|-------------------|---|-------------------|
| 1 ton | = | 2204 Pounds (lbs) |
| 1 kilogram (kg) | = | 2.204 lbs |
| 1 meter (m) | = | 3.28 feet (ft.) |
| 1 millimeter (mm) | = | 0.03937 inch (") |
| 1 kilometer (km) | = | 0.62 mile |
| 1 hectare (ha) | = | 2.47 acres |

ACRONYMS

| | |
|--------------|---|
| ADB | African Development Bank Window |
| ADF | African Development Fund |
| ALSF | African Legal Support Facility |
| CB | Country Brief |
| ENABLE Youth | Empowering Novel Agri-Business-Led Employment for Youth |
| FCDO | UK's Foreign, Commonwealth and Development Office |
| GBP | British Pound Sterling |
| GDP | Gross Domestic Product |
| HIPC | Heavily Indebted Poor Countries Initiative |
| IFIs | International Financial Institutions |
| IMF | International Monetary Fund |
| MIC | Middle Income Countries |
| NPV | Net Present Value |
| PBO | Policy Based Operation |
| PRSP | Poverty Reduction Strategy Paper |
| PV | Present Value |
| SEDRACS | Sudan's External Debt and Arrears Clearance Strategy |
| SMP | Staff Monitored Program |
| SSTL | State Sponsor of Terrorism List |
| TSF | Transition Support Facility |
| UA | Unit of Account |
| USD | United States Dollar |

SUMMARY

This document presents the proposal for Sudan's arrears clearance, detailing: (i) update on the status of Sudan's arrears clearance to the Bank Group; (ii) evidence on Sudan's eligibility and readiness for arrears clearance under the Heavily-Indebted Poor Countries (HIPC) Initiative; and (iii) post-arrears clearance support to advance Sudan's development agenda.

As of end-2019¹, Sudan's external debt stood at USD 49.8 billion, with 86% in arrears. Sudan's debt is unsustainable, and arrears severely limit its access to resources needed to finance the country's development agenda. The Debt/GDP ratio in October 2020 was 172.9%, exceeding the 40% sustainability threshold for low income countries, and is expected to remain at 130.6% by 2040, if no urgent action is taken to address the crisis. To ensure that Sudan's debt-to-exports ratio is reduced to the HIPC threshold of 150% in Net Present Value (NPV) terms, a common reduction factor of 85.16% will be required to reach the decision point.

Efforts for supporting the reconstruction of Sudan and the implementation of a comprehensive economic reform program would be difficult without assistance from multilateral institutions, particularly the IMF. In this regard, IMF engagement prior to 2010 involved the execution of 13 Staff Monitored Programs (SMPs) which implementation was largely satisfactory. Since 2014, however, IMF engagement involved only surveillance and technical assistance. During an IMF mission to Sudan in 2020, the Authorities' capacity to carry out a reform program that could be supported by an SMP was assessed. Accordingly, the Government of Sudan formulated a comprehensive reform program in 2020 that has enabled the country to engage with the IMF on a new SMP, which was approved by the IMF's Executive Board in October 2020. The IMF observed that sustained commitment to economic reforms under the SMP will bring Sudan closer to realizing debt relief under the HIPC Initiative, thereby normalizing relations with International Financial Institutions (IFIs). The first assessment of the SMP implementation progress was conducted by the IMF in late February 2021 and found to be satisfactory and met the Upper Credit Tranche² conditionalities.

Sudan intends to normalize its relationship with the IFIs through an arrears clearance process under the HIPC initiative. Management proposes to clear Sudan's arrears through; (i) the transfer of UA151.4 million from TSF Pillar II to directly offset Sudan's African Development Bank (ADB) arrears and provide resources to cover charges due up to 31st July, 2022; and (ii) transfer of UA 144 million from TSF Pillar II to TSF Pillar I to finance a Policy-Based Operation (PBO) for Sudan that supports the Government's efforts at normalizing relations with the IFIs and the international community as well as reviving the country's economic sustainability. Management's proposal for a PBO is premised on the **UK's expressed confirmation to provide bridge financing to Sudan to clear its African Development Fund (ADF) arrears to the Bank Group**. The sanctions imposed on Sudan will be lifted upon clearance of its arrears to the Bank Group, thus paving the way for the Bank Group to resume full re-engagement with Sudan.

¹ Latest official statistics available

² Implies an annual access limit of 100 percent of a member's quota with IMF

The Bank Group's support to countries in transition remains one of the effective tools to stay engaged, support the transitions and foster peace and development. Sudan is one of two African countries still to benefit from HIPC debt relief.

1. INTRODUCTION

1.1 On 14 December 2020, the US Government delisted Sudan from the States Sponsors of Terrorism List (SSTL), which triggered the opportunity for debt relief under the HIPC Initiative. In anticipation, the International Financial Institutions (World Bank, IMF, and AfDB) started monthly tripartite meetings to discuss a timeline and coordinate action plans for clearing Sudan's arrears. Accordingly, Management submitted an Information Note in March 2021 to the Bank Group Boards of Directors, where it was indicated that Management would be presenting a proposal for clearing Sudan's arrears to the Bank Group, for the consideration of the Boards.

1.2 This document, therefore, presents the proposal for Sudan's arrears clearance.

1.3 Sudan has been featuring on the AfDB's and the World Bank's lists of fragile countries since the fiscal year 2013. In this context, the Bank Group has remained engaged with Sudan in order to support its transition from fragility to resilience. However, full Bank Group engagement and support to Sudan are constrained by accumulated arrears. Consequently, the Bank Group can only extend grant financing to Sudan. Under the Fifteenth Replenishment of the African Development Fund (ADF-15), Sudan received UA 53.59 million under the Transition Support Facility (TSF) Pillar I and a performance-based allocation (PBA) of UA 60.82 million, of which only 50% can be accessed due to its outstanding arrears with the Bank Group.

1.4 As of end-2019, Sudan's external debt stood at USD 49.8 billion, with 86% in arrears. Sudan's current debt situation is unsustainable, and arrears continue to severely limit its access to much needed resources for financing the country's development agenda. The debt/GDP ratio in October 2020 was 172.9%, exceeding the 40% sustainable threshold for low-income countries, and is expected to remain at 130.6% by 2040 if urgent action is not taken to address the crisis. As at 31st December 2020, Sudan owes about USD1.4 billion (about UA1 billion) to the IMF, about USD1.5 billion (about UA1.1 billion) to the World Bank, and about UA276 million to the African Development Bank.

1.5 Sudan intends to normalize its relationship with the IFIs through an arrears clearance process under the HIPC Initiative. Pursuant to a debt arrears clearance program, the Government of Sudan formulated a comprehensive reform program in 2020 that has enabled the country to engage with the IMF on a new SMP. The IMF's Executive Board approved the SMP in October 2020. The first assessment of the SMP implementation progress was conducted by the IMF in late February 2021 and was found to be satisfactory and met Upper Credit Tranche conditionalities. The IMF has indicated that Sudan is on course to meet all benchmarks and targets under the current SMP, which is an upper credit tranche type, and thus bring the country closer to realizing debt relief under the HIPC initiative. On-going efforts to secure donor commitments for interim debt relief are showing positive results and Sudan is likely to reach the decision point under the HIPC initiative by end of May or early June 2021.

1.6 Prior to the removal of Sudan from the US SSTL in December 2020, IFIs embarked on discussions to identify options for supporting the country to advance towards decision point under the HIPC Initiative. Within the Bank's participation in the HIPC debt relief process, Sudan and Zimbabwe are currently eligible for access to the TSF Pillar II resources for arrears clearance. A total of UA 390.51 million is available under TSF Pillar II to be drawn down on a first-come, first-

served basis.

1.7 Management has explored various options to support Sudan's arrears clearance, bearing in mind restrictions on using ADF resources to refinance ADF arrears; Sudan's limited capacity to repay the ADF arrears owed to the Bank Group, and need to ensure Bank Group policies are fully adhered to. Based on the Government request through the Letter of Development Policy addressed to the Bank's President which was received on 23rd February 2021, Management is proposing the following approach: (i) the use of resources from TSF Pillar II to offset ADB arrears, and (ii) securing bridge financing to cover the ADF arrears. Upon full clearance of the arrears, a Policy-Based Operation (PBO) will be provided to Sudan as part of the Bank's full re-engagement. The PBO will complement on-going Bank operations, especially the support provided by the Bank to undertake financial sector and governance reforms.

2. RECENT DEVELOPMENTS IN SUDAN

2.1 Political and Security Development

2.1.1 Limited progress towards inclusive development during the last three decades increased the Sudanese population's dissatisfaction with worsening economic conditions and poor accountability, which triggered peaceful demonstrations throughout the country and led to the overthrow of the previous regime in April 2019. In August 2019, the Transitional Government, led by the Prime Minister H.E. Dr. Abdallah Hamdouk was inaugurated. Since assuming duty in August 2019, the Transitional Government has been committed to addressing the macroeconomic imbalances and realizing people's aspirations of shared prosperity. A cabinet of 25 ministers was appointed and they work under the overall guidance of the Sovereign Council (SC)³. The Transitional Government has been tasked with addressing the socio-economic crisis, especially fuel and bread shortages, high inflation, and lack of employment opportunities. In October 2020, the Juba Peace Agreement was signed with former warring groups. This has put an end to two decades of civil war and a coalition government was formed on 10 February 2021.

2.1.2 Relations with neighbouring South Sudan have witnessed significant progress in addressing contentious issues that dominated the immediate post-secession years. The two countries continue to cooperate on several issues, including oil transit fees and border trade. The Transitional Government has reached out to South Sudan to strengthen the relations further. This new approach represents a departure from past relations that were characterized by mistrust and mutual allegations of hosting rebel groups. After being sworn-in in August 2019, the Transitional Government has been engaging the international community and US Government in particular, to ensure that economic and political sanctions are removed to enable the country to access debt relief and other development financing. Sustained dialogue with the US authorities culminated in Sudan's removal from the US SSTL on 14 December 2020.

2.2 Economic Development

2.2.1 Prior to the COVID-19 crisis, Sudan's macroeconomic outlook reflected negative but improving GDP growth forecasts due to enhanced investor confidence in the new Government and

³ Highest decision making government body of 11 comprising of both the military (6) and 5 civilians.

prospects for Sudan's reintegration into the global economy. However, the outbreak of the COVID-19 pandemic negatively affected Sudan's economic growth, as real GDP contracted by an estimated 8.4% in 2020, compared to 2.3% growth in 2019. This recession was due to the negative impact of the pandemic on commodity prices and trade, travel, and financial flows. Going forward, Sudan is still facing more complex challenges, as its economic outlook continues to be overshadowed by COVID-19 pandemic. In this regard, the economy is projected to remain in recession in 2021, with a return to modest growth expected in 2022. Also, the fiscal deficit widened to 12.4% in 2020, which is 1.1 percentage points higher than in 2019. The fiscal deficit, which represented 40% of Government revenues in 2019, has primarily been financed by monetization through Central Bank advances.

2.2.2 Inflation escalated to 124.9% in 2020 compared to 82.4% in 2019, mainly due to currency depreciation of 118% in 2020 and monetization of fiscal deficits. Multiple exchange rates also exacerbated economic distortions and undermined export competitiveness. The COVID-19 pandemic required an urgent increase in public spending on social and health sectors to cope with the health challenges and sharp decline in economic activity. In this regard, the Government is making efforts for fiscal consolidation over 2021–23, which will focus on (i) fuel subsidy reform to create space for the Sudanese Family Support Program (SFSP); ensure larger health expenditure to address the COVID-19 related spending and higher public wages to help mitigate social tensions and (ii) enhanced fiscal revenue mobilization through customs exchange rate reform and measures to expand the tax base. The Government, however, is facing more complex challenges including the recurring waves of the COVID-19 pandemic, huge number of refugees and internally displaced persons; droughts and frequent floods experienced recently.

2.3 Social Development

2.3.1 Poverty and inequality are widespread and exacerbated by inadequate delivery of basic social services. Low agricultural productivity, limited value addition and value chain development are among the main causes of unemployment, malnutrition, and poverty in Sudan. According to the World Bank assessment, the subdued economic activities have increased poverty from 48.3% in 2019 to an estimated 56% in 2020. Poverty is substantially lower in urban areas at 26.5% compared to 57.6% for the rural population. It is anticipated that poverty may be reduced by 0.5% by 2021 as the Government rolls out training programs to enhance opportunities for youth in the labor market and embarks on plans to create about 40,000 jobs in the medium-term. However, poverty in some of the poorest rural communities may be more difficult to reduce, due to unavailability of water in these areas.

2.3.2 Youth unemployment is higher in urban compared to rural areas and among females relative to males. The 2018 World Development Indicators reported that the unemployment rate among the youth (15-24 years old) was 26.7% (20.2% for male youth and 43.6% for female youth). Youth unemployment has increased over the past 10 years from 22% in 2009 to 26.7% in 2018 and is higher in urban areas (36.5%) than in rural areas (15.3%) due to skills mismatch and low employability of job seekers, which restrict their entry into urban labor markets. The Government is working closely with the Bank to reduce youth unemployment through the Enable Youth and Accelerating Women Entrepreneurship and Access to Finance projects, which seek to create business opportunities and employment for youth in priority agricultural value chains, agri-business, and agro-processing.

2.4 National Development Strategies and Donor Coordination

2.4.1 The Transitional Government articulated Sudan’s development priorities in its Economic Reform Program 2019-2020 and the 200-day Salvation Program from September 2019 to May 2020. Currently, the Government has prepared a framework for socio-economic development and a Poverty Reduction Strategy Paper (PRSP) covering the period 2021 to 2023, which is expected to be completed by April 2021. The PRSP proposes a five-pillar strategy that builds on an economic foundation for a diversified, inclusive, and sustainable growth path, at the heart of which is the aim to provide opportunities for broad-based growth and reducing poverty, supported by policies that ensure macroeconomic stability.

2.4.2 Sudan does not have established aid coordination and harmonization mechanism in place, which is attributed to the country’s limited access to external development financing, notably from the multilateral institutions. Donor aid to Sudan falls under the responsibility of two ministries, namely: Ministry of Finance and Economic Planning, which coordinates bilateral and multilateral financial institutions including the AfDB, the World Bank, and the IMF; and Ministry of Humanitarian Aid Commission, which is responsible for humanitarian assistance. Recently though, efforts are being made to organize the Sudan International Partners Forum, which is still in its formative stage. However, to support the Transitional Government, a Group of Donors established a forum called “Friends of Sudan”⁴, which has been handling almost all high-level donor coordination assistance to Sudan. Very recently, development partners, especially IFIs, have rallied themselves to support the Government to access debt relief under the HIPC initiative. The Bank has been playing a lead role to coordinate the IFIs’ support to the Government in its arrears clearance program through technical support for the preparation of the PRSP and update of the debt relief strategy.

2.5 Bank Group Strategies and Portfolio

2.5.1 The Bank’s Strategy for Addressing Fragility and Building Resilience in Africa (2014-2019)⁵ and the Sudan Country Brief (CB) 2017-2019 Extended to 2021, are both aligned to Sudan’s Economic Development Programs which guide the Bank Group’s interventions in the country. The Bank’s interventions are in accordance with ADF 15 priorities; aligned with Sudan’s National Development Plan expressed in its Twenty-Five year National Strategy (2007 – 2031); and the Bank Gender Strategy (2021 -2025).

2.5.2 The CB is articulated around two complementary pillars: (i) Capacity Building for Improving Social Service Delivery; and (ii) Agriculture for Job Creation and Livelihoods. Under Pillar 1, Bank support aims to build institutional capacity to improve social service delivery

⁴ The role is to rally support for Sudan during the transitional period to support implementation of economic reforms and cushion their effects on the most vulnerable.

⁵ The Strategy on Addressing Fragility and Building Resilience was extended to December 2021 and a new strategy is being prepared

particularly amongst the vulnerable population, and hence contribute to addressing fragility. Bank interventions have contributed to strengthening human and institutional capacities, improved governance and the macroeconomic environment, and supporting the country's progress towards accessing HIPC debt relief. Under Pillar 2, Bank support emphasizes sustainable livelihoods and job creation to build resilience and reduce fragility. Interventions have included support to develop agricultural value chains to create remunerative jobs and sustainable livelihood opportunities.

2.5.3 The Bank Group's on-going portfolio consists of 18 operations (16 sovereign operations and 2 non-sovereign operations) for a total commitment of UA 344.5 million. In terms of sectoral distribution, the agriculture sector accounts for the largest share of total commitments (52%), followed by the social sector (21%), water and sanitation (16%), multi-sector (7%), and energy (4%). The disbursement rate as of March 2021 was 45.8% for combined SO and NSO (SO: 25.19% and NSO: 100%). The Bank Group also provided additional support through the African Legal Support Facility (ALSF) for legal and advisory services in the negotiations of complex transactions like stay of execution on the part of commercial debtors. The ALSF also conducted capacity building for government officials in the area of debt litigation.

2.6 Coordinated Arrears Clearance Efforts

2.6.1 Arrears clearance under HIPC framework requires coordinated efforts among the IFIs on two levels. First, for the country to establish a track-record on a set of complementary reforms as determined and assessed through IMF SMPs, and second, ensure that the concerned IFIs process their arrears clearance operations before HIPC decision point. The Government of Sudan is putting in efforts to ensure steady progress is made on economic and structural reforms to improve financial transparency, accountability, and the overall governance environment.

2.6.2 In October 2020, the IMF and the Sudanese Authorities agreed on an SMP that will support the government's home-grown reform program, which aims to stabilize the economy, improve competitiveness and strengthen economic governance. The SMP is expected to support the Authorities' ambitions of reducing macroeconomic imbalances and poverty. The SMP is designed to meet the Upper-Credit Tranche conditionalities to enable Sudan to access debt relief.

2.6.3 In anticipation of Sudan's removal from the SSTL that became effective on 14th December 2020, the IFIs started monthly tripartite meetings to establish a timeline and coordinate action plans for clearing Sudan's arrears. At the inaugural meeting held on 3rd November 2020, the IFIs agreed on late May/early June as the target date for arrears clearance. This timeline was considered adequate to complete the remaining requirements for HIPC decision point, notably, agreement and successful implementation of an IMF SMP and finalization of the PRSP. However, the World Bank has successfully cleared Sudan's arrears as approved by its Board on March 23, 2021, while the IMF Board decided on March 26, 2021 to proceed with mobilizing resources for Sudan's arrears clearance by end of May/early June 2021

2.6.4 The Bank Group has been providing technical assistance to support the preparation of the PRSP, including preparation of background materials and financing the household survey, which is one of the major milestones required for the country to reach the decision point. The PRSP is

expected to be finalized in April 2021. The Bank Group also supported the Authorities to update Sudan’s External Debt and Arrears Clearance Strategy (SEDRACS) to guide the resolution of the country’s debt with IFIs, the Paris and Non-Paris Club creditors.

2.7 Sudan’s Arrears Status and HIPC Initiative Perspective

2.7.1 As of end-2019, Sudan’s external debt stood at US\$ 49.8 billion (table 1), with 86% in arrears and 14% not yet due. Sudan’s debt is unsustainable, and arrears severely limit its access to resources needed to finance the country’s development agenda. The bulk of external debt in 2019 was owed to bilateral creditors (US\$ 38.2 billion or 77% of total external debt), roughly equally divided between Paris and non-Paris Club creditors at 38.5%, followed by commercial (12%) and multilateral (11%) creditors. The debt sustainability exercise undertaken by the World Bank and IMF in October 2020 showed that the Debt/GDP ratio was 172.9%, exceeding the 40% sustainability threshold for low income countries, and is expected to remain at 130.6% by 2040 if no urgent action is taken to address the crisis. Similarly, in 2019, the present value (PV) of debt-to-exports was about 1,028%, well above the 150% threshold. According to the IMF, the debt path will improve but will remain unsustainable without debt relief. However, debt service will increase in 2022 and 2023 due to the scheduled repayment of debt to Saudi Arabia and the United Arab Emirates. To ensure that Sudan’s debt-to-exports ratio is reduced to the HIPC threshold of 150% in NPV terms, a common reduction factor of 85.16% will be required to reach the decision point.

| Institution | Amount USD million |
|----------------|--------------------|
| Multilateral | 5,648 |
| Paris Club | 19,100 |
| Non-Paris Club | 19,100 |
| Commercial | 5,952 |
| Total | 49,800 |

2.7.2 **Sudan’s AfDB Current Debt, Arrears Status, and Projection:** Sudan’s total arrears to the Bank Group as of 31st December 2020 amounted to UA 275.8 million, with 52% being owed to the ADB and 48% being owned to the ADF. By the end of June 2021, when the arrears clearance is expected to have taken place, Sudan’s arrears to the Bank Group are estimated to be approximately UA 285.2 million, and will rise to UA295.3 million by June 2022 (see Annex 1 below). In previous arrears clearance programs for other countries, the Bank provided funding to cover Bank Group arrears as at the date of planned clearance plus payments due up to one year after the arrears clearance. This is to give the country time to adjust its fiscal position before it begins loan repayments to the Bank Group. Therefore, Sudan’s arrears clearance program would require about UA295.3 million (based on current exchange rates).

2.7.3 A total of UA 390.51 million of TSF Pillar II resources (dedicated to arrears clearance) is available to Sudan and Zimbabwe for debt arrears clearance on a first-come, first-serve basis. The resources in TSF Pillar II are enough to cover the projected arrears owed to the ADB window by Sudan (UA 151.35 million), leaving the ADF arrears, which are estimated at about UA 144 million. In this regard, the Bank Group team met with and sought the support of the Executive Directors representing the United Kingdom (UK) and Germany, requesting that their countries consider supporting Sudan to clear its ADF arrears to the Bank Group. The UK has confirmed its willingness to support in clearing Sudan’s arrears to the ADF window. This commitment was announced by the UK Secretary of State for Foreign, Commonwealth, and Development Affairs,

Dominic Raab, during a visit to Khartoum on 21st January 2021. Germany also continues to play a key role in hosting Friends of Sudan meetings, the latest of which was on 28th January 2021.

2.7.4 Consequently, Management proposes that Sudan's arrears clearance comprise: (i) the use of resources from TSF Pillar II to offset ADB arrears, and (ii) bridge financing from the United Kingdom to cover the ADF arrears. Management also proposes that following full clearance of the arrears through the bridge financing that will be provided by the UK, a policy based operation will be provided to Sudan to complement the country's efforts to advance its development agenda, notably to consolidate peace, accelerate poverty reduction, reduce income inequality and catalyze the much-needed financing for transformative and inclusive growth. The Bank Group will continue to provide advisory services, technical assistance and capacity building support to Sudan to strengthen institutional, policy-making, and human capacities to enable the implementation of rigorous economic and financial management reforms.

3. SUDAN'S ELIGIBILITY TO THE HIPC INITIATIVE

3.1 Eligibility to the HIPC Initiative and TSF Pillars I and II

3.1.1 Criteria for accessing the Bank Group's TSF Pillar II resources require that a country satisfies the two-stage eligibility criteria of the Supplementary Support Window (Pillar I) of the TSF. The Boards of Directors jointly approved Sudan's eligibility for TSF Pillar I resources in May 2020 as part of Sudan Country Brief 2017-2019 updated and extended to 2021. For a country to be eligible to TSF Pillar II resources it must meet two additional criteria, beyond those specified under Pillar I, and these are:

Stage 1: Demonstrate respect for the Bank Group's preferred status by servicing new maturities on all outstanding Bank Group loans or at least to the same relative level of debt service paid to other IFIs; and

Stage 2: Be eligible for debt relief support from the HIPC initiative, but not yet reached the decision point under the Initiative OR be approved for exceptional support by the Boards of Directors under an internationally coordinated arrears clearance and debt relief program.

3.1.2 The Stage 2 criterion has been met since Sudan is eligible for debt relief under the HIPC Initiative as it meets the income and indebtedness criteria and has not reached the decision point, thus qualifying to access TSF Pillar II. For stage 1, although Sudan has not been able to make regular token payments to the Bank since the secession of South Sudan and due to its attendant foreign exchange crisis, the Government had made considerable token payments amounting to about USD 20 million during the period 2003-2014. Beginning January 2021, the Government resumed the token payments, within the coordination framework with other IFIs, on a pari passu basis. Sudan has paid the agreed token payment for January, February, March and April to the Bank. Currently, Sudan has met the stages I and II criteria for debt relief.

3.1.3 **Burden sharing arrangement.** Under paragraph 3.32 of the TSF Guidelines, an additional requirement for burden sharing is provided, that: "a two-tier burden sharing arrangement will apply to the arrears clearance window of the TSF", that is, a beneficiary country must meet up to a

maximum of a third (1/3) of its arrears clearance obligations and the Bank Group provides a minimum two thirds (2/3). Donors are free to make voluntary contributions to assist beneficiary countries to fund their assessed burden sharing obligations or to assist in servicing new maturities until the country qualifies for debt relief under the HIPC initiative. The Bank's team is mobilizing additional grant resources from donors to reduce the burden on Sudan, while also ensuring that the burden-sharing principle is satisfied.

3.1.4 Drawing lessons from the Somalia arrears clearance experience, the Bank's team met with some EDs of bilateral donors to solicit contributions from any willing friends of Sudan towards a minimal 1% token contribution of Sudan's arrears to the Bank Group, in an amount of UA 3 million being part of the country's contribution of up to a maximum of 1/3 (or 33%) of its arrears clearance obligations to the Bank Group. This approach is similar to the case of Somalia, whose arrears to the Bank Group were cleared in March 2020, whereby a donor made a token contribution (of about 1% of Somalia's arrears) on the country's behalf thus enabling it to fulfil its burden-share. The government of Sweden has confirmed willingness to contribute UA 3 million in support of Sudan's burden-share for the arrears clearance.

3.1.5 As mentioned in section 2, an immediate post-arrears Policy-Based Operation is proposed following Sudan's arrears clearance to ensure the Bank Group fully re-engages with the country. Such an operation entails the exceptional transfer of TSF Pillar II resources to TSF Pillar I which mechanisms allow the provision of supplementary support for countries in fragile situations. As illustrated by Somalia's arrears clearance experience, this process is consistent with the TSF Operational Guidelines and enables the TSF to provide policy-based support to Sudan.

4. OPTIONS FOR SUDAN'S ARREARS CLEARANCE

4.1. Arrears Clearance Options

4.1.1 Acknowledging that arrears clearance operation under the TSF Pillar II framework was not entirely feasible due to Sudan's debt structure with the Bank Group, Management considered lessons learnt from last year's successful arrears clearance operation for Somalia.

4.1.2 **Utilizing Sudan's ADF15 unused performance-based allocation (PBA) and TSF Pillar I allocations** - Bank Group policy indicates that countries in arrears can access only 50% of their PBA. Even if the ADF15 resources were to be allocated for the purpose of arrears clearance, the funds would still not be sufficient. Moreover, Sudan's entire ADF15 PBA allocation (UA60.82 million, of which only 50% is accessible) has already been committed, hence this option will not be possible. Furthermore, if ADF15 resources were used for arrears, it would limit the level of Bank support to development interventions, post arrears clearance.

4.1.3 Consequently, the proposal is to clear Sudan's arrears through a bridge financing operation. The UK has confirmed its willingness to provide financing to Sudan for clearance of its arrears to the Bank Group. This is a welcome proposal that will provide an opportunity for the Bank Group to resume full re-engagement with Sudan.

5. PROPOSED BANK GROUP FULL RE-ENGAGEMENT PLAN IN SUDAN

5.1 Once Sudan has cleared its arrears, Management will lift the sanctions imposed on Sudan in accordance with the Bank Group's Policy on Loan Arrears Recovery (the "Sanctions Policy"), and Sudan will re-engage fully with the Bank on a clean slate. In anticipation of Sudan's clearance of the Bank Group arrears, the Bank is preparing to step up its full re-engagement with the country potentially through a Policy-Based Operation (PBO) that will be presented for Board consideration in April 2021. Considering that Sudan's ADF15 allocations have been almost fully committed, the PBO will be financed by an exceptional transfer of resources from TSF Pillar II to TSF Pillar I. TSF Pillar II provides funding for clearing Bank Group arrears and cannot support operations, unlike Pillar I which can be used to support all types of programs and projects. Therefore, a transfer of resources from Pillar II to Pillar I is necessary to finance the proposed PBO. The reallocation of resources between pillars is permissible upon the approval by the Boards of Executive Directors as per the TSF Guidelines.

5.2 Management proposes and will be seeking the approval of the Boards of Executive Directors, a PBO entitled **Economic and Financial Reforms Support Program (EFRSP)**. The proposed EFRSP will, in addition to on-going Bank operations in Sudan, provide timely support to the country's quest for accelerating inclusive growth, reducing poverty and income inequality. The EFRSP will be aligned with Sudan's CB, especially the first pillar on institutional capacity building and skills development. Approval of a total amount of UA 295.4 million, of which UA 151.4 million will be used to clear ADB arrears and transfer of UA 144 million from TSF Pillar II to TSF Pillar I to finance the EFRSP will also be sought by Management.

5.3 Considering that Sudan would have fully re-engaged with the Bank Group following arrears clearance, 100% of its PBA allocation will be available to the country. This will further support Sudan to implement its National Development Plan. To maximize the total amount of resources available to Sudan and to promote regional integration, opportunities for regional projects will be explored to benefit from additional allocations under the ADF15 regional envelope.

6. LEGAL ASPECTS

6.1 **Approval Authority.** The Operational Guidelines for the Implementation of the Strategy for Addressing Fragility and Building Resilience in Africa and for the Transition Support Facility (the "TSF Operational Guidelines"), provide flexibility with regard to the transfer or reallocation of resources between Pillars of the TSF as needs may require. The approval authority of such transfers or reallocations between Pillars lies with the Boards of Directors (Section 3.5, Table 3 of the TSF Operational Guidelines).

6.2 **Arrears Clearance :** For the clearance of its arrears, Sudan proposes to obtain financing from the United Kingdom of Great Britain and Northern Ireland, acting through the UK's Foreign, Commonwealth and Development Office (FCDO) which will be used to repay ADF arrears. For this purpose, Sudan will enter into a bridge finance agreement with FCDO. The ADB arrears will be cleared by the ADF resources in TSF Pillar II. In this regard, Sudan will enter into a grant agreement with the Bank and the Fund, as administrators of the TSF.

6.3 ***Lifting of Sanctions.*** Upon Sudan’s clearance of the ADB and ADF arrears, Management will lift the sanctions imposed on Sudan in accordance with the Bank Group Policy on Loan Arrears Recovery.

7. CONCLUSION AND RECOMMENDATIONS

7.1 Sudan’s arrears clearance exercise will be undertaken sequentially by the World Bank, the Bank Group, and the IMF. The preferred creditors are coordinating closely to enable Sudan reach HIPC Decision Point by May/June 2021. The World Bank has successfully cleared Sudan’s arrears as approved by its Board on March 23, 2021, while the IMF’s Board has decided on March 26, 2021 to proceed with mobilizing resources for Sudan’s arrears clearance by end of May/early June 2021. While the Bank Group will not directly participate in the debt relief efforts post HIPC decision point, its support, post-arrears clearance, will accompany Sudan to advance its national development priorities to build capacity and institutional strengthening to attain sustainable and inclusive growth through, inter-alia, access to basic social services and value chain development in productive sectors. The Bank Group will support Sudan to efficiently utilize the anticipated financing post-arrears clearance.

7.2 Management submits Sudan’s arrears clearance proposal to inform the Boards of Directors of the status of Sudan’s progress towards HIPC Decision Point and hereby presents the Bank Group arrears clearance plan for Sudan. Management further informs the Boards of Directors that the sanctions imposed on Sudan will be lifted as soon as it clears its arrears to the Bank Group.

7.3 Management recommends that the Boards of Directors consider and approve the amount of:

- (i) One Hundred and Fifty-One Million, Four Hundred Thousand Units of Accounts (UA 151.4 million) from TSF Pillar II to directly offset Sudan ADB arrears to the Bank; and
- (ii) One Hundred and Forty Four Million Units of Accounts (UA 144 million) from TSF Pillar II to TSF Pillar I to be utilized for the Policy-Based Operation for Bank Group’s full engagement with Sudan. The PBO will be submitted to the Board separately for consideration.

ANNEX 1: SUDAN DEBT ARREARS AND PROJECTIONS IN UA

| | | | | In UA | | |
|--|--|--|--|--------------------|----------------------|--------------------|
| Annex 1: Sudan Arrears and Debt Service Projects | | | | Arrears on Charges | Arrears on Principal | Total Arrears |
| ADB | | | | | | |
| Arrears | | | | 89,564,850 | 55,177,322 | 144,742,172 |
| Bills Due 01 Janaury - 01 July 2021 | | | | 2,965,728 | - | 2,965,728 |
| Bills Due 01 August 2021 to 01 July 2022 | | | | 3,638,499 | - | 3,638,499 |
| Total ADB | | | | 96,169,077 | 55,177,322 | 151,346,399 |
| ADF | | | | | | |
| Arrears | | | | 33,118,640 | 97,944,540 | 131,063,180 |
| Bills Due 01 Janaury - 01 July 2021 | | | | 1,375,195 | 5,079,395 | 6,454,590 |
| Bills Due 01 August 2021 to 01 July 2022 | | | | 1,375,195 | 5,079,395 | 6,454,590 |
| Total ADF | | | | 35,869,030 | 108,103,330 | 143,972,360 |
| Total Bank Group | | | | 132,038,107 | 163,280,652 | 295,318,759 |

ANNEX 2: SUDAN DEBT ARREARS AND PROJECTIONS IN UA AND GBP

| | | | | In UA | | | |
|--|--|--|--|--------------------|----------------------|--------------------|--------------------|
| Sudan Arrears and Debt Service Projects | | | | Arrears on Charges | Arrears on Principal | Total Arrears | Equiv in GBP |
| ADB | | | | | | | |
| Arrears | | | | 89,564,850 | 55,177,322 | 144,742,172 | 169,032,803 |
| Bills Due 01 January - 01 July 2021 | | | | 2,965,728 | - | 2,965,728 | 3,463,436 |
| Bills Due 01 August 2021 to 01 July 2022 | | | | 3,638,499 | - | 3,638,499 | 4,249,112 |
| Total ADB | | | | 96,169,077 | 55,177,322 | 151,346,399 | 176,745,351 |
| ADF | | | | | | | |
| Arrears | | | | 33,118,640 | 97,944,540 | 131,063,180 | 153,058,203 |
| Bills Due 01 January - 01 July 2021 | | | | 1,375,195 | 5,079,395 | 6,454,590 | 7,537,800 |
| Bills Due 01 August 2021 to 01 July 2022 | | | | 1,375,195 | 5,079,395 | 6,454,590 | 7,537,800 |
| Total ADF | | | | 35,869,030 | 108,103,330 | 143,972,360 | 168,133,803 |
| Total Bank Group | | | | 132,038,107 | 163,280,652 | 295,318,759 | 344,879,154 |

ANNEX 3: COUNTRY RESOURCE OUTLOOK – BALANCE OF PAYMENTS ANALYSIS

Sudan's economy has never fully adjusted to the secession of South Sudan in 2011, which resulted in a sharp decline in its oil exports and fiscal revenues. Sudan lost about 75% of oil production, 66% of exports, and half of fiscal revenues after the secession. Despite the U.S. revocation of economic sanctions in October 2017, Sudan, for a long time remained, on the U.S. list of state sponsors of terrorism (SSTL), which was revoked in December 2020. This has hindered external investment and presented challenges for progress towards the clearance of large arrears, including to the Bank, IMF and World Bank. Due to these complications, the economy is shrinking, fiscal and external imbalances are large, inflation is high, the currency is overvalued, and competitiveness is weak. The new civilian-led government has undertaken efforts to reform and stabilize the shrinking economy and re-engage Sudan with the international community, but the economic situation remains fragile.

In line with the overall economic imbalances, both domestic and external resources are in short supply. This has affected the position of the Sudan's Balance of Payments (BoP), which remained in deficit and hasn't recovered since the secession of South Sudan. The trade deficit accounts for most of the deficit, which has reached 14% and 15% in 2019 and 2020, respectively. While the economy is yet to fully adjust to the sharp decline in exports, imports of most goods were broadly stagnant. This has resulted in sustained trade deficit due to higher imports of food items and petroleum products. Apart from a slight increase in gold exports, exports were also stagnant. The large trade deficit continues to reflect overvalued exchange rates, slow recovery in oil production, and large dependence on imported food. Therefore, the external current account deficit (cash basis) stood at 11% of GDP in 2019 and reached 13.2% in 2020, mainly due to a widening trade deficit and despite higher external grants. At the same time, gross usable international reserves reached a very low level of \$190 million at end-2019 and has not improved in 2020 due to COVID-19. The banking sector remains fragile with several banks undercapitalized.

However, policy adjustment and reforms, external financing and prospective debt relief, will help reduce macroeconomic imbalances and support robust and inclusive growth in the medium term. Sudan authorities target to reduce the fiscal deficit by 7.3% of GDP by 2021, with a further significant reduction in 2022 following the planned exit from the Sudanese Family Support Program (SFSP). Exchange rate and structural reforms would strengthen competitiveness, significantly narrow the external current account deficit and increase GDP growth to 4.5% over the medium term. While fuel subsidy and exchange rate reforms would generate sharp increases in prices over 2020–21, inflation would fall considerably thereafter as internal and external imbalances are reduced.

The Government is committed to macroeconomic and structural policies under the currently implemented SMP which is of Upper Credit Tranche (UCT) quality and look forward that this qualifies the country to gain eligibility to debt relief. Consequently, balance of payment is expected to improve, reflecting an improvement in competitiveness after the exchange rate liberalization. Also, the trade balance is expected to slowly improve in the long term as the economy stabilizes (see table below).

To reduce external imbalances and enhance resilience, the Sudanese authorities need to tighten fiscal and monetary policies, eliminate deficit monetization, remove multiple exchange rate

practices and allow for greater exchange rate flexibility, and undertake urgent structural reforms to improve export competitiveness. The Government has taken step one and unified the exchange, but further coherent reforms are also required to accompany this step (i.e. unification of customs rate).

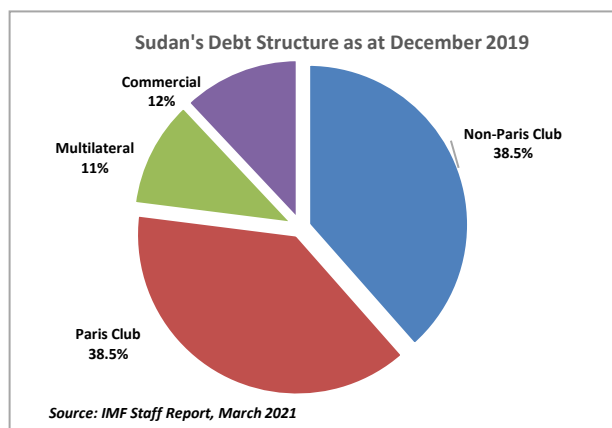
| Sudan: Balance of Payments, 2018–26 | | | | | | | | | |
|---|-------|-------|-------|-------|-------|-------|-------|------|------|
| (In percent of GDP) | | | | | | | | | |
| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| | | | | Proj. | | | | | |
| Current account balance | -13.0 | -15.6 | -17.5 | -11.2 | -13.5 | -11.4 | -10.1 | -9.4 | -8.5 |
| Current account balance (cash basis) | -8.7 | -11.4 | -13.2 | -7.1 | -9.8 | -7.5 | -6.2 | -5.7 | -4.9 |
| Trade balance | -9.0 | -14.0 | -14.7 | -13.2 | -11.6 | -9.9 | -9.1 | -8.4 | -8.1 |
| Oil | -1.1 | -3.2 | -3.1 | -2.5 | -3.0 | -3.0 | -2.9 | -2.8 | -2.7 |
| Non-oil | -8.0 | -10.8 | -11.6 | -10.6 | -8.6 | -6.9 | -6.2 | -5.6 | -5.4 |
| Exports, f.o.b. | 9.7 | 11.1 | 11.1 | 12.0 | 14.0 | 15.5 | 16.1 | 16.6 | 16.8 |
| Oil | 1.4 | 1.6 | 0.2 | 0.4 | 0.5 | 0.5 | 0.6 | 0.7 | 0.8 |
| Non-oil | 8.3 | 9.6 | 10.9 | 11.6 | 13.6 | 14.9 | 15.5 | 15.9 | 16.0 |
| <i>Of which: Gold</i> | 2.3 | 2.9 | 4.3 | 5.4 | 5.6 | 5.6 | 5.6 | 5.5 | 5.4 |
| Imports, f.o.b. | 19.7 | 25.0 | 25.9 | 25.3 | 26.3 | 26.5 | 26.5 | 26.5 | 26.4 |
| Oil | 2.5 | 4.8 | 3.3 | 3.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| Non-oil | 17.2 | 20.2 | 22.6 | 22.4 | 22.8 | 23.0 | 23.0 | 23.0 | 22.9 |
| Services (net) | 0.9 | -0.2 | 0.1 | 0.2 | 0.7 | 1.1 | 1.3 | 1.4 | 1.5 |
| Primary income (net) | -5.0 | -4.8 | -4.3 | -4.9 | -6.1 | -5.2 | -4.5 | -4.3 | -3.6 |
| Receipts | 0.4 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Payments | 5.4 | 5.1 | 4.5 | 5.0 | 6.3 | 5.4 | 4.7 | 4.5 | 3.8 |
| Secondary income (net) | 1.0 | 3.2 | 1.6 | 6.8 | 4.2 | 3.7 | 3.5 | 3.3 | 3.2 |
| Private | 0.1 | 0.5 | 0.7 | 1.4 | 2.2 | 2.5 | 2.6 | 2.6 | 2.5 |
| Official | 1.0 | 2.7 | 0.8 | 5.4 | 2.0 | 1.2 | 0.9 | 0.7 | 0.7 |
| <i>of which: transfer for payment to victims of terrorism</i> | 0.0 | 0.0 | 1.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Capital account | 0.5 | 0.5 | 0.4 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 |
| Financial account (net) | -8.3 | -10.6 | -7.4 | -10.6 | -13.0 | -10.9 | -9.8 | -9.1 | -8.1 |
| Direct Investment (net) | -3.2 | -2.8 | -2.1 | -4.9 | -4.0 | -4.0 | -3.6 | -3.3 | -3.3 |
| Portfolio Investment (net) | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other investment (net) | -5.1 | -7.9 | -5.5 | -6.0 | -9.6 | -7.5 | -6.8 | -6.8 | -6.3 |
| Reserve assets | -0.1 | 0.0 | 0.1 | 0.2 | 0.5 | 0.6 | 0.6 | 0.9 | 1.4 |
| Errors and omission | 4.3 | 4.5 | 9.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance | -4.3 | -4.5 | -9.6 | 0.0 | 0.1 | 0.1 | 0.2 | 0.2 | 0.1 |

Sources: Central Bank of Sudan; and IMF staff estimates and projections.

ANNEX 4: COUNTRY DEBT SUSTAINABILITY ANALYSIS – ANALYSIS OF THE COUNTRY’S DEBT STRUCTURE INCLUDING ARREARS

Sudan is in debt distress; the public and external debt ratios are high, and the bulk of external debt is in arrears. According to the October 2020 World Bank/ IMF Debt Sustainability exercise, the domestic and external debt to GDP ratios stood at 200.3% and 198% respectively in 2019 and 2020. The debt ratios remain at relatively high levels in the long term. Despite very limited access to new external financing, the total estimated debt burden continues to grow at a very high rate due to the continued depreciation of the SDG and to rising outstanding interest and fee payments and charges maturing on the existing debt in arrears.

The bulk of public and publicly guaranteed (PPG) external debt (\$49,8 billion) mainly owed to bilateral creditors, is roughly equally divided between Paris Club and non-Paris Club credit.



The principal of PPG external debt that is in arrears is estimated at USD 10.9 billion and the remainder represents interest arrears. The fact that a large portion of the increase in these estimated total arrear amounts is due to assumed accumulation of interest arrears has major consequences on Sudan’s external debt structure, where about 86% of it is in arrears. Limited portion of the debt (about \$5.9 billion) is to private suppliers. Sudan’s external debt stock continues to build-up arrears and will

remain unsustainable if no debt relief is reached.

Debt Sustainability and Risks’

The 2020 World Bank/ IMF debt sustainability analysis indicated that all PPG external debt indicators exceeded their indicative thresholds and debt solvency indicators stay above the threshold throughout the 20-year projection period. The present value (PV) of PPG external debt is at about 164.6% of GDP at end-2019—more than fivefold the 30% threshold for weak policy performers—and is projected to stay above the threshold through the projection period. Similarly, the PV of debt-to-exports is about 1,028%, well above the respective threshold. Debt service to exports and debt service to revenue will gradually decline over the long-term under the SMP scenario. The debt path improves but remains unsustainable without debt relief. However, debt service will increase in 2022 and 2023 due to the scheduled repayment of deposits of Saudi Arabia and U.A.E.

Sudan’s external debt outlook is vulnerable to a range of shocks. The PV of debt-to-GDP and debt-to-revenue are most vulnerable if key variables remain at their historical average, whereas the PV

| Sudan PPG External Debt Sustainability Indicators - Sudan | | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|-------------------|
| | 2019 | 2020 | 2025 | 2030 | 2040 | Thresholds |
| PV Debt/Exports | 1028.1 | 941.1 | 687 | 642 | 555.5 | 140 |
| PV Debt/ GDP | 164.6 | 172.9 | 170.2 | 156.5 | 130.6 | 35 |
| Debt service % of exports | 8.2 | 7.1 | 3.9 | 2.0 | 0.2 | 10 |
| Debt service % of revenue | 17.7 | 24.5 | 6.7 | 3.5 | 0.4 | 14 |

Source: IMF Article IV Report, March 2021

of external debt-to-exports is most vulnerable to an export shock. Although the PV of public debt (172.9% of GDP at end of 2020) will remain above the threshold through the projection period, it is projected to decline to 556% of GDP by 2040 due to the removal of fuel subsidies and elevated high real GDP growth. The rapidly rising historical scenario is in large part due to the structural break provoked in the debt path by the separation of South Sudan which led to negative historical averages. See the table below on major DSA indicators.

Debt Management Strategy

Sudan’s reduced fiscal space compressed the debt repayment capacity which increased arrears and worsened the debt carrying capacity. Additionally, the large depreciation of parallel market exchange rate and high inflation have caused further turbulences to macroeconomic environment and haven’t helped the Government to service its debt and adopt consistent debt management policy. Due to accumulation of arrears, the Government has not been able to make debt repayment since mid-1990s, awaiting debt relief from the international community using Heavily Indebted Poor Countries (HIPC) terms. Sudan’s access to debt forgiveness under the HIPC is triggered by the US action to delist Sudan from the SSTL, which was formally declared in December 2020. In this regard, International Financial Institutions (IFIs) have started discussions to coordinate their stands to support Sudan reach HIPCs “Decision Point” and normalize relations with the international community.

The Bank Group continues to provide technical assistance to support Sudan to fulfil the preconditions for HIPC debt relief. This includes technical assistance to prepare Sudan’s new PRSP 2021-23, which is expected to be completed by April 2021. The Bank also support Sudan to prepare Sudan External Debt and Arrears Clearance Strategy (SEDRACS), and support to prepare a long-term development vision document to guide the country’s socio-economic recovery.

Conclusion

The IMF analysis concludes that Sudan’s external debt remains in distress and unsustainable. Owing to the ongoing reform efforts the authorities have initiated, DSA indicators have improved compared to previous DSA figures. However, it is still impossible for Sudan to service its high debt without debt relief. In the long term, all public and public-guaranteed external debt burden

ratios remain well above their respective indicative thresholds. Thus far, Sudan is gathering momentum to tap the support of the international community to resolve debt.

ANNEX 5: SUDAN FRAGILITY NOTE

1. Introduction

1.1 Independent since January 1, 1956, the Sudanese state faces significant challenges inherited from the colonial period. The vastness of the territory and the scarcity of infrastructure make national integration difficult, even if the Islamic faith and the use of Arabic augur a relative cultural homogeneity in the most developed part of the country, in the north. However, the colonial administration - different in the north and south of Sudan - makes it even more problematic for populations divided by language, religion (the south is essentially animist with a Christian minority), diverse political histories and cultural cleavages marked by the slave trade to coexist within the same state. A bloody civil war from 1956 to 1972 undermined the country's development. Peace was only a brief interlude, as hostilities resumed in 1983 and did not end until 2005 with the signing of agreements that made possible the secession of the South following a referendum on self-determination held in January 2011. This divorce, however, does not mean the end of tensions.

1.2 Indeed, South Sudan's independence, which was acted in July 2011, was a watershed event in Sudan's history, not only because it jeopardized the common future envisioned by the country's colonizers for regions with very different historical trajectories but intimately intertwined for several centuries, but also because it destabilized the immediate future of the Khartoum regime. As a result of this event, the central government lost control of nearly two-thirds of the country's exploited oil fields and thus of the associated oil revenues.

2. Country Context

2.1 The republic of Sudan is located in the northeast Africa and was, until its partition into two independent states on July 9, 2011, the largest state on the continent. It is now the third largest African country with 1,861,480 square kilometers. A desert with a tropical continental climate, the country with a population estimated at more than 42.8 million has forged many ties with its seven neighbors, especially through labor migration and wars that have caused significant movement of populations across borders. As a result, the country often serves as a land of asylum, a vocation for which it is destined by the important African route of the Muslim pilgrimage to Mecca and by trans-Saharan trade. These migrants also play an essential role in the agricultural development of the country and in the construction of trade networks between Africa and the Arabian Peninsula.

2.2 Sudan is in a transitional phase towards peace and development. The country is experiencing a period of stability unprecedented in at least 15 years and the partial lifting of economic sanctions, including Sudan's removal from the U.S. list of state sponsors of terrorism, has created new opportunities for social and economic development. However, Sudan is still characterized by macroeconomic instability, gender inequality, high rates of malnutrition and food insecurity. As a result of these internal challenges, the country ranked 140th out of 159 countries on the Gender Inequality Index, 165th out of 189 countries on the Human Development Index (2019) with a score 0.51, which places it in the low human development category, and has serious shortcomings on most socio-economic indicators. Two thirds of the population live in rural areas and the Sudanese economy is heavily dependent on agriculture. Agriculture, especially for smallholder farmers, is predominantly rain-fed so that increasing climate variability poses a major problem for the economy, livelihoods and food security. Low agricultural productivity is due to

poor farming practices, high post-harvest losses, persistent gender gaps, and conflicts. Moreover, the country is still struggling with weak state institutions and capacities, and public financial management systems.

3. Overview Of The Country Resilience And Fragility Assessment

3.1 An assessment of Sudan's Country Resilience and Fragility Assessment (CRFA) indicates that the country displays general fragility in all 7 dimensions, while at the same time lacking the capacity sufficient to deal with it. The country faced accrued fragility in the areas of corruption and bribery, insecurity, poverty, regional spillover, youth and gender marginalization, food insecurity and nutrition, as well as vulnerability to natural disasters. A deep dive into the seven dimension shows the following:

3.2 In terms of the **Inclusive Politics**, while Sudan's low scores for political instability are based on 2018 data and do not reflect the vast public demonstrations that began in December 2018 and culminated in a historic regime change in April 2019, the country still faces enormous challenges despite some improvement noted since the revolution. A transitional government now manages a power-sharing coalition that expects to establish a civilian-led government after 30 years of autocratic rule. Obstacles to inclusion still loom but civilians are cautiously hopeful. Highest-ever voter turnout, active public dialogue, and women's presence in parliament and the protest movement are promising entry points for democratic governance.

3.3 On the **Security** front, Sudan's military expenditure – among Africa's highest – helps explain the role of military leaders in the April 2019 regime change. Yet the capacity of Sudan's security institutions is low, as illustrated by the decade-long UN/AU peacekeeping mission tasked to maintain peace and stability in Darfur. Ongoing concerns include organized crime, violence, and general insecurity in Darfur and in the Blue Nile and South Kordofan states. The transitional government represents new opportunities for peacebuilding, contingent on the success of its efforts to provide human security and good governance.

3.4 Regarding the **Justice** sector, Sudan's pluralistic legal system operates with moderate efficacy and multiple options for dispute resolution based on Islamic law, civil codes, and customary law. The transitional government has repealed a series of laws used by the former regime to regulate women's behaviour. Access to justice is moderate and the number of cases pending in the courts is low. Judicial independence is restricted, however, and despite the efforts of international humanitarian law to end impunity, senior officials rarely face legal consequences for malpractice. A noteworthy women's rights movement has spearheaded calls for legal reform, hoping to make access to justice more gender sensitive.

3.5 The **Economic and Social Inclusiveness** dimension shows that weak economic performance in 2018 pushed the inflation rate to about 70.3% and devalued the Sudanese pound. Although income inequality in some states is very low, poverty is a significant pressure linked to slow policy reforms and a poor business environment that restricts economic opportunities, especially for youth. Recent promises of reform with support expected from the African Development Bank, the IMF, and the World Bank could improve economic performance. The recent lifting of US trade sanctions is also expected to boost exports and increase the resilience of the economy.

3.6 Concerning the **Social Cohesion** dimension, years of government crackdown and censorship restricted the activities of civil society, including the media. Rapid transformations are

now underway as citizen action grew in 2019 with prominent contributions from women's rights activists, students, and religious leaders. Transport infrastructure provides some domestic mobility and digital connectivity has grown increasingly influential in generating social change. Group-based polarisation is low but challenges to the inclusion of minorities persist.

3.7 On the **Externalities and Regional Spillover Effects** front, economic diversification is needed to safeguard Sudan from external shocks. The country has cooperative economic relations with neighbouring African countries and growing ties to the Middle East, China, and India. Significant spillover effects arise from conflicts in neighbouring countries, and unresolved border disputes have occasionally escalated tensions with South Sudan and Egypt, but diplomatic talks have been initiated. Resolving diplomatic relations and securing borders against human trafficking could help to ease growing pressures on the transboundary management of the Nile.

3.8 The dimension related to **Climate and Environmental Impacts** indicates that Sudan is vulnerable to the environmental impacts of deforestation, over-cultivation, overgrazing, desertification, and periodic drought. With 80% of the population dependent on agriculture for their livelihood, these adverse events greatly aggravate food insecurity. Water scarcity is a major area of concern because of the ongoing decrease of the annual discharges of the River Nile. Sudan has an uneven record in environmental conservation; it could increase its adaptive capacity by developing sustainably, going forward.

4. Other Key Development Challenges In The Country's Recovery Path

4.1 Sudan is an arid country with typical Sahelian characteristics that affect food availability and access. This situation particularly affects small-scale farmers, who suffer from low rainfall, water scarcity, and a single agricultural season. The country is also regularly subject to recurrent droughts that last two to three years and annual flooding in some areas. In recent years, the severity and frequency of climatic shocks have intensified, particularly affecting the poor and food insecure population, to varying degrees across segments of society, including rural and urban households as well as women and men. The government's ability to address these issues is limited. In addition, there is a need at both the national and state levels to better formulate and implement coherent policies and legislation that address the causes of food insecurity and malnutrition, including systemic inequalities.

4.2 Economically, Sudan has been experiencing significant economic instability since late 2017. The monetization of budget deficits, loosening of monetary policy, devaluation of the Sudanese pound, reduction of fuel subsidies, and removal of wheat subsidies have been factors in accelerating inflation. In addition, government institutions have limited capacity to address the emerging challenges of economic instability, climate variability, and conflict. Furthermore, the country is constrained by severe arrears on its debts to international financial institutions (IFIs) and other creditors, for which debt relief is needed in order to unlock access to concessionary funding. Such funding will enable Sudan to finance public investments and activities that would boost economic growth and reduce poverty. Moreover, just like the rest of the world, Sudan has been confronted with the social and economic impact of the COVID-19 pandemic. The economic impact of COVID-19 includes food inflation, rising unemployment, and falling exports. Limitations on movement exacerbate the economic situation as price of many commodities goes up in many regions of the country. On account of COVID-19, the economy is projected to grow only marginally in 2021.

4.3 Some external factors affect the country's ability to eradicate poverty and strengthen people's resilience, including a relatively unstable regional, political and economic context in which at least five countries bordering Sudan are themselves in conflict or have large numbers of internally displaced people to accommodate. Furthermore, for many years, U.S. sanctions have been one of the main reasons for the country's deteriorating economic performance. Among other things, sanctions have made it almost impossible to use banking networks to send workers' remittances or transfer money related to foreign trade in imports and exports. In addition, sanctions have limited access to spare parts for railroads and aircraft, reduced opportunities for educational exchange, disrupted knowledge transfer, and prevented Sudanese from benefiting from modern technologies.

5. Sources of Resilience and Prospects for Building Peace and Inclusive Development

5.1 Given its abundant natural resources, Sudan has the means to stimulate investments, revive its economy and consolidate a level of development that promotes inclusiveness by reducing key factors of fragility and fostering community resilience. The country could take advantage of under-exploited opportunities that can boost economic growth. In that regard, about 63 percent of Sudan's land is agricultural, and only about 20 percent of it is cultivated, offering considerable opportunities for private investment. Large-scale irrigated agriculture could create jobs and increase national income and foreign exchange earnings. Non-food agribusiness can accelerate growth by developing value chains that diversify the economy, thereby offsetting the loss of oil revenues. The government should undertake structural reforms to facilitate the movement of labor from subsistence agriculture to industry and services to accelerate growth that absorbs labor and reduces unemployment. The latest developments in Sudan are pillars on which the country can achieve this and implement other community-based operations to strengthen resilience.

5.2 On the political front, prospect of long-lasting peace has been materialized by the event of 31st August 2020 where Sudan's transitional government signed a historic peace agreement with the Sudan Revolutionary Front (SRF), a coalition of rebel groups from the regions of Darfur, Southern Kordofan, and the Blue Nile. Moreover, Sudan's removal from the US list of states sponsors of terrorism in 2020 has paved the way to access financing from IFI. In that regard, Sudan has resumed diplomatic relations with the state of Israel, ending a 1958 law that prohibited the establishment of formal relations and the conduct of business by the Sudanese with Israel citizens and companies. Alongside this act, a financial aid package worth \$ 1 billion of annual support by the World Bank was signed.

5.3 On the social front, protests comprising people of different ethnic and religious backgrounds represented a shift towards a sense of national unity for a country marked by religious and ethnic-based frictions during Omar Bashir's era. More actions marking a shift towards state and nation building sentiment, which lacked for decades in the country, included the revocation in 2019 of the restrictive public order law that defined how women should dress and behave in public, as it marked the harmonization in treatment by the morality police of women in poor and rural areas and those in affluent and urban ones.

5.4 On the economic front, the country can count on the over \$1.8 billion pledged by donors at the High-Level Sudan Partnership Conference to support the country's economic reforms. The conference was organized in 2020 and co-hosted by the UN, European Union, Germany, and Sudan. Furthermore, the lifting of US sanctions paved the way for debt relied dialogue which are currently at an advanced stage, and economic cooperation.

6. Supporting the Arrears Clearance Process of Sudan

6.1 Sudan is over-indebted, which reduces its ability to mobilize domestic resources or to borrow on international markets. Sudan's huge debt is mainly due to accrual of interest and steep penalties when the Sudanese government fell behind on its payments. The issue of debt relief for Sudan has been in discussion and gained strength in momentum since the interim government took office. Sudan is currently on a positive outlook and is expected to normalize its relationship with the international financial institutions through an arrears clearance process under the Highly-Indebted Poor Countries' (HIPC) initiative. The international community, for once, is mobilizing to support the country's efforts to revive its development as demonstrated by the monthly meetings between the key IFIs, namely the Bank, the IMF and the World Bank, with the aim of having a common approach both with regard to the country's compliance with the prerequisites for the clearance of arrears, as well as agreed and coordinated deadlines for finalizing this operation by each institution. Securing its arrears clearance is a crucial step in this process in that, arrears clearance once finalized, will unlock resources from the Bank and other IFIs, and also allow a Heavily Indebted Poor Countries (HIPC) Initiative decision point to help Sudan get its large debt challenge under control. While Sudan's external debt is large, a large share of this debt is in interest arrears caused by an accumulation of decades of compound interest⁶.

6.2 The Operational Guidelines for the Implementation of the Strategy for Addressing Fragility and Building Resilience states that eligibility to the Arrears Clearance Window (Pillar II) requires a country to meet the two-stage eligibility criteria of the Transition Support Facility's Supplemental Support Window (Pillar I). Furthermore, the country must:

- i) Demonstrate respect for the Bank Group's preferred creditor status by servicing new maturities on all outstanding Bank Group loans or at least to the same relative level of debt service paid to other International Finance Institutions (IFIs); and
- ii) Be eligible for debt relief support from the Heavily Indebted Poor Countries (HIPC) initiative, but not yet reached the decision point under the Initiative; Or be approved for exceptional support by the Boards of Directors under an internationally coordinated arrears clearance and debt relief program.

6.3 The Board of Directors approved Sudan's eligibility to TSF Pillar I resources in June 2020. The country has made progress towards debt relief and has resumed token payments on its debt obligations to all the preferred creditors, including the Bank, the IMF, the World Bank. Sudan is currently implementing the IMF Staff Monitoring Program (SMP), which is among the key milestone for achieving the HIPC Decision Point, which Sudan is expected to reach by June 2021.

7. Conclusion and Recommendation

7.1 Despite progress on various fronts since the revolution that brought down the former regime of Omar Al-Bashir, significant challenges remain in Sudan. The road is still full of hazards as the demise of the former regime did not translate into the prosperity that was expected by the already tired and frustrated population; life for ordinary Sudanese has grown only tougher over the past year, with citizens facing rampant inflation, long queues for basic commodities and major

⁶ As an example, a single loan amounting \$130 million from Kuwait from the late 1970's has now exploded to a \$2.8 billion debt. Sudan owes \$60 billion to other countries and financial institutions including the Bank, the IMF, the World Bank, etc. (IMF)

power outages. The unstable economic situation, the increased variability of the climate, the degradation of the environment, the mismanagement of natural resources as well as the risk of renewed violence are all major difficulties that the country will have to address in order to regain the path of prosperity following the final clearance of its arrears.

7.2 A more stability could allow the country to regain its role as the region's breadbasket. The government's greatest asset, however, is to seize the opportunity of the international momentum around its development and continue to invest in the strengthening of the institutions, and build national capacity to maintain recent security gains. It needs to continue its efforts in effective policy, planning, and governance, including social justice and gender equality, which are essential to enable economic stability and development and reduce poverty.

7.3 There is also a need to strengthen partnerships to build national capacity to design and deliver needed services at the intersection of humanitarian action, development assistance, and peacebuilding aimed at promoting peace and consensus building to mitigate conflict and violence while establishing mechanisms that promote equitable access to resources.

ANNEX 6: COUNTRY FUTURE BANK GROUP DEBT SERVICE – ANALYSIS OF THE PROJECTED NEW MATURITIES DUE TO THE BANK GROUP

| Financing Window | ADB | | | ADF | | | Grand Total |
|--------------------|------------------|-----------|------------------|-------------------|-------------------|-------------------|-------------------|
| | Charge | Principal | Total | Charge | Principal | Total | |
| 2021 | 2,203,884 | - | 2,203,884 | 1,303,535 | 5,055,368 | 6,358,903 | 8,562,788 |
| 2022 | | | | 1,221,944 | 5,055,368 | 6,277,312 | 6,277,312 |
| 2023 | | | | 1,184,028 | 5,055,368 | 6,239,397 | 6,239,397 |
| 2024 | | | | 1,153,795 | 5,055,368 | 6,209,163 | 6,209,163 |
| 2025 | | | | 1,081,124 | 4,916,158 | 5,997,282 | 5,997,282 |
| 2026 | | | | 1,044,304 | 4,916,158 | 5,960,462 | 5,960,462 |
| 2027 | | | | 1,007,079 | 4,914,535 | 5,921,614 | 5,921,614 |
| 2028 | | | | 972,852 | 4,914,535 | 5,887,388 | 5,887,388 |
| 2029 | | | | 922,407 | 4,822,678 | 5,745,085 | 5,745,085 |
| 2030 | | | | 851,731 | 4,618,267 | 5,469,998 | 5,469,998 |
| 2031 | | | | 784,587 | 4,396,520 | 5,181,107 | 5,181,107 |
| 2032 | | | | 700,454 | 4,127,604 | 4,828,058 | 4,828,058 |
| 2033 | | | | 667,605 | 4,127,604 | 4,795,208 | 4,795,208 |
| 2034 | | | | 636,647 | 4,127,604 | 4,764,251 | 4,764,251 |
| 2035 | | | | 583,732 | 3,895,177 | 4,478,910 | 4,478,910 |
| 2036 | | | | 538,506 | 3,662,749 | 4,201,255 | 4,201,255 |
| 2037 | | | | 326,284 | 2,473,906 | 2,800,190 | 2,800,190 |
| 2038 | | | | 327,504 | 2,330,438 | 2,657,943 | 2,657,943 |
| 2039 | | | | 71,104 | 608,293 | 679,397 | 679,397 |
| 2040 | | | | 52,798 | 412,949 | 465,746 | 465,746 |
| 2041 | | | | 15,018 | 108,803 | 123,821 | 123,821 |
| Grand Total | 2,203,884 | | 2,203,884 | 15,447,039 | 79,595,451 | 95,042,490 | 97,246,374 |