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IMPACT OF MACROECONOMIC POLICIES ON MICROFINANCE IN SUDAN[1]

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February, 2006

[1] **Paper Prepared for UNICONS Consultancy Ltd. Khartoum, as part of the Project *"Formulation of a Vision for the Development and Expansion of the Microfinance Sector in Sudan"* Sponsored by the Central Bank of Sudan**

CONTENTS

ACRONYMS

AAOIFI	Accounting & Auditing Organization for Islamic Financial Institutions
ABS	Agricultural Bank of Sudan
ACCORD	Agency for Cooperation & Research in Development
ADS	Area Development Scheme (of UNDP)
BOSS	Bank of Southern Sudan
CBOS	Central Bank of Sudan
CBS	Central Bureau of Statistics
CMCs	Central Bank *Musharaka* Certificates
DUGAP	Dutch University Gadaref Assistance Programme
GDP	Gross Domestic Product
GICs	Government Investment Certificates
GMCs	Government *Musharaka* Certificates
FIB	Faisal Islamic Bank
IGAs	Income Generating Activities
ILO	International Labor Organization
IMF	The International Monetary Fund
ISBs	Islamic Banks
LLR	Lender of Last Resort
MFIs	Microfinance Institutions
MSEs	Micro and Small Enterprises
NGOs	Non-Governmental Organizations
NIDGB	Neilen Industrial development Group Bank
SDD	Sudanese Dinar
SMP	Staff-Monitored Programme (of the IMF)
SSDB	Social & Saving Development Bank
SWIFT	Society for Worldwide Interbank Financial Telecommunication
PLS	Profit & Loss Sharing
PRSP	Poverty Reduction Strategy Programme
ROA	Rate of Return on Assets
ROE	Rate of Returns on Equity
UNDP	United Nation Development Programme
UNIDO	United Nation Industrial Development Organization
VAT	Value Added Tax
WB	The World Bank

IMPACTS OF MACROECONOMIC POLICIES ON MICROFINANCE IN SUDAN

By

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Abstract

Macroeconomic stability is crucial to micro and small enterprises (MSEs). An unstable economic environment and lack of microfinance hit MSEs and the poor more severely than medium and large-scale enterprises, and the better off segments of the population. This paper discusses the impacts of the IMF-Monitored Macroeconomic Restructuring and Reform policies on microfinance in Sudan. It investigates the impacts of these policies on poverty and income distribution either directly through the growth in macroeconomic indicators, or indirectly through their effects on MSEs sector and its role in job creation, economic growth, income distribution, and poverty alleviation. The implications of reforming the banking system (both Islamic and conventional) on MSEs development are also contemplated.

Despite the theoretical soundness of these policies and the shaky progress stemming from them, whether in terms of economic growth or reduction in inflation or stability in exchange rate, poverty levels kept rising and income distribution worsening. This points to the conclusion that the implementation of these policies lead to no avail especially in regards to the empowerment of MSEs being singled out as an important sector for poverty reduction and employment generation. Due to the lack of information on the direct causal links between these policies and the development of MSEs sector in Sudan, proxy indicators are used to substantiate these findings.

1. INTRODUCTION

The argument two decades ago among some analysts that micro and small enterprises (MSEs) sector should be ignored or repressed because it lacked any growth potential has been definitively rebutted by events. For example, during the late 1980s, MSEs participating in a credit project in Indonesia directly generated roughly one-eighth of the country's economic growth. Moreover, in Bolivia in the early 1990s, successive household income surveys found that the single most dynamic segment of the national economy was MSEs, contributing significantly to the overall economic growth. Furthermore, in Bangladesh, where the Grameen Bank has now had a long history of microcredit lending to large numbers of people, the success achieved has almost certainly been of macroeconomic importance.

As for the Sudan, due to aggravating economic situation in the 1980s and 1990s, many families have moved towards micro and small enterprises. The number of those engaged in micro-enterprises as Productive Families constitutes a huge proportion of small enterprises in the country and this number is increasing all the time. This phenomenon has led the banking system to issue preferential financing treatment to such enterprises through policies directed by the central bank. Moreover, in recognition of the constantly growing number of Productive Families, a Council of Co-Ordination of Productive Families and Environmental Industries was established in the late 1980s by the Ministry of Social Planning with the intent to design policies, programmes and mechanisms of financing Productive Families.

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With emphases now given to MSEs currently considered as an essential sector for achieving economic and social development in developed and developing countries, microfinance has become very fashionable and is attracting increased attention worldwide.

In developing countries, microfinance programmes are effective tools for generating economic development and alleviating poverty. By targeting the poor and expanding opportunities through the provision of credit, they empower people and their micro and small enterprises through increased incomes, increased jobs that create broad access to a means of livelihood. This potentially can mitigate unrest by providing economic opportunity to those who might otherwise be disenfranchised.

It then remains for government institutions responsible for formulating economic, monetary, and social policies, as well as NGOs, aid agencies, and the micro and small entrepreneurs themselves to set in place the macroeconomic and monetary policies necessary to realize the potential now known to exist for growth and development through MSEs.

The aim of this study is two-fold, i.e. i) understand the structure of the Sudanese economy and the key drivers of growth in GDP ii) understand the key social and macroeconomic risks facing the Sudanese economy, in general, and microfinance, in particular. The analysis will focus on factors that have strong bearing on the growth of MSEs, their credit worthiness, and access to finance.

The following section briefly reviews the Sudan's macroeconomic setup. An exposition of the stabilization and economic reforms policies implemented during (1997-2005), and their likely theoretical outcomes are also given in this section. Section three reviews the regulatory framework, structure, policies and dynamics of the financial system in Sudan. Special emphases will be laid on the roles and potential of the dual financial system (Islamic versus conventional) in microfinance expansion. The role of MSEs and the impact of macroeconomic, restructuring and reform programmes and microfinance policies on MSEs are discussed in section four. Section five summarizes the main findings, constraints and opportunities and provides some recommendations of relevance, together with areas that deserve further research.

2. MACROECONOMIC OVERVIEW

2.1. Economy- Overview

Sudan has gone through a tough economic path since its independence in 1956. It began as a pastoral and agricultural economy (agriculture contributed 60% of GDP). However, through time it managed to develop its struggling economy with sound macroeconomic policies.

From 1997 to date, Sudan has been implementing IMF-Monitored Macroeconomic Reforms. In 1999, it began exporting crude oil and in the last quarter of the same year recorded the first trade surplus, which, along with monetary policy, has stabilized the exchange rate and reduced inflation rates. Increased oil production, revived industry, and expanded export processing zones helped sustain GDP growth at 6.4% in 2004 (*see annex, table 1)*.This is mostly attributable to growth in the oil sector.

Given the slow improvement in the share to the GDP of its manufacturing sector, agriculture continued as Sudan's most important economic sector employing well over 70% of the workforce, contributing 42.8% of the GDP (in 2005). Therefore, given that Sudan cultivates only about 10 per cent of its cultivable land and it has been bestowed with two river Niles, a sustained increase in cultivation of land through enhancement of irrigation, improved technology and a developed livestock breading and milk and meat industry in the states lacking irrigation or affected by drought will provide substantial and sustained incomes for the over 70 per cent of 33 million population who are dependent on agriculture and livestock and animal husbandry.

Sectoral Contribution to GDP (1956-2005)

Years / Sectors	1956 *	1997	1998	1999	2002	2004	2005
Agriculture (%)	60	47.4	48.7	49.8	46.2	44.5	42.8
Manufacturing & Mining (%)	5.00	7.40	8.1	9.10	16.5	19.0	27.5
of which: Oil **	0.00	0.00	0.00	0.60	5.40	10.0	13.0 (Proj.)
Services (%)	35.0	37.7	36.3	34.4	30.9	30.1	29.7
Others (%)	0.00	7.50	6.9	6.70	6.40	6.40	0
GDP (US$ Millions)	801**	9261	8403	9492	14720	19572	23891 (Proj.)
Growth Rate (%) *	na	6.6	(-9.3)	6.0	6.0	8.0	8.5 *
Per Capita GDP (US$)	78.0	332.7	284.8	313.3	419	567.3	625 (Est.)

*** World Bank, 2003. ** IMF Country Report No. 05/180, 2005.***
***** Multiplying per capita GDP by estimated total population in 1956 (10262536).***
Sources: CBS Annual Reports 1997-2004, & Report No. 187; COMESA, "Harmonization Programme Update"; and Ministry of Finance and National Economy (2005).

2.2 Stabilization & Restructuring Policies (1997-2005)

As mentioned earlier, in 1997, Sudan launched an important macroeconomic stabilization and economic reforms programme, with the aim of laying a solid foundation for sustained economic growth through an improvement in the macroeconomic situation supported by implementation of structural reforms to enhance resource allocation and encourage private sector activity. The programme agenda included monetary and fiscal prudential reforms and was supported by successive IMF staff-monitored programs (SMP). It included the following:

1. Prudent monetary policies and monetary structural reforms:

    - Strengthening monetary policy regime and improved liquidity management and monitoring of liquidity (See section 3.2 for CBOS Comprehensive Banking Policies and Restructuring and Reform Program).
    - Removal of institutional rigidities in broad money target and targeting broad money in consistence with inflation and economic growth objectives (reducing lending to government and open market sales of government securities and recalling CBOS loans to banks).
    - Establishment of a Monetary Operation Unit at the CBOS to facilitate the monitoring and management of liquidity
    - Amendment of the CBOS law to enhance independence and strengthening banking regulations, and legislating on anti-money laundering and combating the financing of terrorism.

2. Prudent fiscal policies, tax reforms and strengthening fiscal and oil sector regulatory system:

   - A ban of all discretionary tax exemptions – elimination of privileges tax on income of Professionals and on four oil distribution companies – and import exemptions from custom duties.

   - Imposition of (and phasing back) excise tax on petroleum. Introduction of the value added tax (VAT) in 2000. Raising excise tax on sugar. Abolishing corporate tax exemption for rehabilitation purposes. Elimination of privilege tax on the income of Professionals.

   - Rationalization of grants and introducing public expenditure management reforms

   - Improving tax efficiency and collection administration

     i. Establishment of Large Tax Payer Unit,
     ii. Introduction of a universal Tax Payers Identification Number,
     iii. Transfer of VAT collected by customs to Tax Directorate on a daily basis.

   - Improvement of public expenditure management by introducing a cash management unit and improving fiscal reporting (new budget classification systems were introduced and fiscal reporting is prepared monthly), and restructuring accounting and auditing department as a general directorate.

   - Oil sector governance and transparency

     i. Audit and consolidate accounts of all Subsidiaries of Sudan Petroleum Company.
     ii. Align their accounting system with international standard.
     iii. Establishment of a new National Petroleum Commission to oversee all petroleum activities and report to the Parliament.

3. Liberalization of the trade and investment regimes, (reduced tariff protection and elimination of most non-tariff barriers, and revision of Investment Encouragement Act).

4. Increase the role of private sector in the economy via privatization and public enterprise restructuring program (privatization of Free Duty Shops and Free Zone, Sudanese Estate Bank, Atbra Cement Factory, Bank of Khartoum, Sudan Airways. A reform program was set out to privatize another 42 enterprises and convert large enterprise to shareholding companies with a government share limited to maximum of 20%.

5. Deregulation of the foreign exchange market and lifting exchange rate controls (adoption of managed-floating exchange rate regime to prevent sharp exchange rate fluctuations that can undermine the non –oil export recovery and restrict direct foreign investment).

6. Improvement of external debt management and rationalization of new borrowings through a Debt Policy and Monitoring Committee.

2.3. Impact of Stabilization & Restructuring Policies

Orthodox stabilization policies are usually designed to address four main problem areas. These are fiscal deficits, balance of payments, inflation, and structural problems.

1. Fiscal Deficit Reduction

Fiscal deficits are the amount by which government expenditures exceed government revenues in a given year. Orthodox stabilization and structural policies generally include provisions to reduce such fiscal deficits for several reasons: The deficit may generate inflation or balance-of-payments problems by boosting domestic demand excessively; or it may "crowd out" private investment, thus depressing growth (Jeffrey (2000)). Whatever the motivation, some combination of spending cuts (ideally are concentrated on less productive government activities such as military spending or the size of the bureaucracy) and tax increases is commonly recommended to shrink the deficit. On the revenue side, stabilization programs commonly include measures aimed at simplifying the tax system by reducing the number of different taxes, unifying tax rates, and cutting tax shelters and loopholes. In the process, however, the overall tax burden generally rises. The exact break down between expenditure cuts and tax increases usually depends on the overall size of government spending in the economy (larger governments receive higher cuts), but it might also vary according to other factors (such as limits on a government's revenue-raising ability).

2. Tackling Balance-of-Payments Problems

For external imbalance, orthodox stabilization and structural programs rely on three sets of policies: cut in domestic demand, devaluations, and improve financing of the current account deficit. Cutting domestic demand reduces the demand for imports and improves the balance of payments. Tighter fiscal policy reduces public sector demand and may also reduce private demand, as the government transfers less money to the private sector via transfer payments or as the government extracts spending money from private hands in increased taxes. Tighter monetary policy also depresses demand by raising interest rates, which in turn lower investment and consumer spending financed by credit. Devaluation is another tool often used in stabilization policies to improve the current account. A devaluation raises the price of imports (in domestic currency terms) while making a country's exports more attractive abroad by lowering their cost to foreign buyers. Obviously, since imports become more expensive, devaluations have a demand-reduction component as well. The final component of a balance-of-payments policy is action to improve financing of the current account deficit. It is generally not optimal for a developing country to run a current account surplus (which means the country exports investment capital abroad). A deficit is desirable to provide needed imports with foreign capital financing investment projects. A balance-of-payments crisis arises only when the gap between exports and imports is larger than what can be financed abroad. In addition to reducing the overall size of the deficit, orthodox stabilization programs provide money to cover part of the remaining deficit (that is the explicit purpose of IMF loans). Other means include attracting foreign capital.

3. Reducing Inflation

Tight monetary policy is a common component of stabilization policies, because it can assist in a balance-of-payments crisis by both reducing domestic demand and encouraging inflows of foreign capital. In addition, tight monetary policy is an important element in the fight against inflation, both by reducing inflationary pressures from high domestic demand and by restricting the quantity of money available. Fiscal policy also plays a role in the fight against inflation, since it is often a fiscal imbalance that provokes the emission of inflationary quantities of money.

4. Addressing the Underlying Structural Problems of the Economy

Increasingly, economic crises around the world are provoked by the macroeconomic effects of underlying structural problems. As a result, IMF stabilization programs more and more often include important structural reform components. These structural reforms generally address weaknesses that cause crises and improve overall economic efficiency.

Privatization of public enterprises is often high on the agenda of stabilization programs. Jeffrey (2000) asserted that in many crisis economies, fiscal imbalances have been exacerbated by losses registered by inefficient government-owned monopolies. Sale of these enterprises to private investors can thus help improve the fiscal balance. In addition, these firms commonly occupy crucial positions in the economy (basic utilities, energy, transport, banking, etc.), and their inefficiency has negative repercussions for the productivity of the entire economy. In the external sector, structural reform generally requires the reduction and homogenization of tariff rates and the elimination of quantitative restrictions on imports. These measures reduce protection for inefficient domestic industries and the distortion of investment priorities, which arises from differential protection. They can have the negative side effect of aggravating current account problems by making imports less expensive. It is for this reason that trade liberalization is often undertaken in stages or is linked explicitly to devaluation.

Weakness in the banking system can provoke a macroeconomic crisis, or at the very least aggravate an already existing crisis. Thus, financial sector reforms are taking center stage in the structural reform agenda. Measures enforced in this area include the closure, sale, or consolidation of insolvent banks and deregulation of interest rates, and increased regulatory supervision regarding the quality of banking system assets. The elimination of subsidized or direct lending programs and the privatization of state-owned banks also play an important role in many reform programs.

Now, how did these policies affect national economy in Sudan? It is observable from macroeconomic indicators summarized in Table (1) of the annex that:

- Economic growth has accelerated and so is the share of oil to GDP. Economic growth has averaged 6.5% during the period 2001-2005 (IMF, Report No. 5/180, p.10). The growth of the economic sectors includes utilities, services which can serve MSEs and help anti-poverty programmes. The prospect for growth over a medium term depends on a surge of oil production and on economic diversification drive and sectoral growth especially agriculture in the absence of new oil discoveries (IMF, Report No. 180, p. 17).
- Gradual fall in inflation rates and appreciation of exchange rate. The appreciation of the SSD is a result of strong balance of payments position, flexible exchange rate arrangements and monetary policy adopted by CBOS.
- Reversal of budget deficits. This outcome happened despite the high level of spending because of higher oil and non-oil revenue resulting from escalating oil price and production (oil price increase from 22.0 per/b. in 2001 to 34.0 per/b. in 2005, while production reach half a million bbd), as well as improved efficiency of tax collection and reduction of exemptions. However, the negative fiscal deficit sign can be seen from non-oil deficit to GDP ratio which is rising from around 5% during early years of

2000 to 7.3% in 2003 and the IMF estimates thereafter showed a further deterioration (IMF, Report No. 5/180, p. 31).

- Reversal of trade deficit. Higher oil revenues resulting from substantial oil export receipts due to both increase in production and prices, as well as strong recovery of non-oil exports turned trade deficit into surplus after 1999.
- Restoration of economic stability, the emergence of oil and the subsequent economic reforms helped to accelerate local and foreign investment. According to the Inter-Arab Organization for Investment Guarantee, Sudan was ranked third in attracting registered intra-Arab investment during the period 1995-2004.
- Reduction (but fluctuating) in current account balance deficits. Nevertheless, Current Account to GDP slightly declined from 5% in 2003 to 4.1 in 2004, reflecting a surge in oil exports receipts as well as strong non-oil exports and capital inflow. Despite these, Sudan's external position still remains vulnerable to oil price and private capital inflows.
- Unstable external debt which increases by almost one billion US$ a year. A new external debt management and borrowing policy was issued emphasizing alternatives of attracting FDI, build-operate-transfer (BOT) and domestic borrowing (IMF, 2005, Report No. 5/180, p. 53).

Overall, although Sudan economy is on the pathway to improvement especially in output growth rates and inflation reduction, it yet needs to correct its current account and budget balances. The IMF commended the macroeconomic achievement and progress and considerd them more favorable than other post-conflict cases especially that they are carried out without external assistance. Moreover, the World Bank (2003, p. i) concluded that Sudan has achieved high growth rates, but skewed distribution of income, and that stabilization and structural reforms are costly in social terms – social inequality and high poverty rates.

3. MICROFINANCE POLICIES

3.1. The Salient Features of the Sudanese Banking System

The Sudanese Banking system is fully Islamized. It is comprised of 21 national banks (all are Islamic and mostly private banks) with 281 branches. In 2001 there were 3 specialized banks and no foreign bank (CBOS, 2001). In recent years some foreign banks have been established or in the process to be established. Sudan has specialized banks for particular client groups like the Agricultural Bank of Sudan (ABS), the Animal Resources Bank, the Savings and Social Development Bank (SSDB), El Nilein Group for Industrial Development and the Farmers Bank. The salient characteristics of the Sudanese banks pertinent to microfinancing can be outlined as follows:

- ISBs are characterized not only by the declining number of branches in recent years but also by the regional inequality in the distribution of branches i.e. concentration of branches in commercial towns and urban areas. Khartoum State and the Central States (the most advanced States in terms of development projects, infrastructure, per capita income and the standards of living) share over 50% of the total banks in the country. If we include the Eastern and Northern States the ratio rises to nearly 80%. Moreover, the pattern of distribution has been more or less the same for the last five years or so. Another feature is the declining number of branches from over 700 in 1997 to only 533 branches in 2002 (CBOS, Annual Reports, different issues)[4].

- Although short-term (current account) deposits was higher than long-term (saving and investment) deposits for the period before 1998 (Ibrahim, Badr El Din, 2006), recent figures show an almost even distribution, despite the high growth rate of saving and investment deposits compared to current deposits. This is because historically the share of current account deposits is larger. The average of the period 1997-2001 is 46.4% and 52.6% for current and saving and investment deposits respectively. In SIBs normally prefer demand deposits which do not share profits with them, and few Islamic banks (ISBs) are hunting to attract investment deposits[5].

- According to our calculation from CBOS annual reports, on average, sales-based modes of finance (*Murabaha* and *Salam)* share more than 50% of total volume of finance for the period since 1996. While profit and loss-sharing formulae (*Musharaka* and *Mudaraba*) share around 34%[6] ISBs do not usually focus on *Musharaka* and *Mudaraba* in financing clients. The share of partnership modes of financing in Sudan, although not satisfactory, is, nevertheless, better than the general trends of ISBs in which these formulae constitute about one-fourth of the asset portfolio of the worldwide Islamic banks (Shapra 2001, p. 4). Tarik (1996) has cited different percentages for the period of 1980s and 1990s. He showed that the share of the profit and loss sharing techniques were in the range of 33-38% for Iranian banks (which, like Sudan, applies full Islamization of the banking system) and in the range of only 7-8% for banks in mixed financial sectors during the period 1981-1993[7]. While the mark-up techniques shared around 51-60% for Iranian banks and they are in the range of 83-90% for banks in the mixed financial systems in other countries over the same period (Tarik 1996). Sales-based modes of finance are neither suitable modes for financing for long-term projects nor for MSEs and social-oriented projects. From the other side, although profit and loss (PLS) modes conform to the real Islamic system of finance which stands contrary to interest-bearing traditional system they are, nevertheless, not free from application complications. Al-Harran (1993 p. 150) identified that risk, difficult nature of investment and long-gestation period in receiving returns and problems of

4 It is worth noting that the less developed Kordofan and Southern regions are currently sharing less of banking branches compared with during the late 1980s. In his comparative study of Fiasal Islamic bank and other commercial banks before banking Islamization, Ibrahim had cited percentages of the degree of banking concentration between 1979 and 1987 to be 38.9% for Khartoum, 17.5% for central region, 12.7% for Eastern region, 4.9% for Northern region, 11.9% for Kordofan region, 5.6% for Darfur region and 8.7% for the Southern Region (Ibrahim 1992, p. 225).

5 Studies depict some observations about shortages of long-term funds in Islamic banks. Ibrahim, (1992), for example, noted that during the period 1988-1992 Faisal Islamic Bank of Sudan (FIB) had shortages of medium and long-term funds. A shortage in deposits of ISBs has also been noted by Al-Harran. Al-Harran (1993, pp. 107-109), concluded that: "… if they (the Islamic banks) do not devise non-usurious tools of raising (investment) deposits, then these banks are likely to face problems in their growth particularly when they are working side by side with the modern banks" (emphasis between two brackets is added).

6 This result is not only confined to the Sudanese Islamic banking system. Islamic banks have shown strong preference for modes of finance, which are less risky, namely the 'mark-up' device. According to Yousif, Tarik, 1996. 'The evidence indicates that the majority of Islamic banks do not uphold the fundamental principles of profit-and-loss sharing; instead, the bulk of their financing takes on a debt-like character similar to that in conventional financing'.

7 Based on 22 banks in 13 countries with mixed banking system.

management are the major reasons why Islamic banks do not undertake equity financing modes. PLS modes require adequate experience in management, additional supervisory and monitoring roles compared with sales-based modes which are relatively less risky and easy to manage[8]. Moreover, PLS modes are subject to erosion of investment in the case of a loss that is why ISBs are hesitant to undertake them at the initial phases of their operations. Instead they use mostly debt-based Salam and *Murabaha* instruments which shift most of the risk to the client. The bank of Sudan Annual Report of 2001 admitted that the substantial use of *Murabaha* mode of finance in the Sudanese banking system is due to "the simplicity of this mode and the people's preference" (CBOS, 2001, p. 55).

- The average annual rate of growth of financing by the SIBs amounted to more than 50% during the period since 1994[9]. This increase in financing is not evenly distributed among sectors. Sectoral concentration of investment is biased towards the most organized sections with high profitability in the modern sector. Agriculture and industry share 42.1% of the total banking finance. Trade-related financing (exports, imports and local trade) shares over 31.3%. Moreover, the analysis of sectoral lending in 1993 shows that about 74 per cent of the combined total lending of commercial banks was directed towards modern agriculture, industry and exports. Small Producers shared only 6 per cent of the total lending (Al-Tigani et el (1995), p. 18)[10].
- SIBs usually do not present data relating to the distribution of finance as short, medium and long-term. But, nevertheless, because of inflation, most of the finance, even for agriculture and industry (via provision of raw materials, fixed assets, working capital, irrigation, inputs, storage, transport and marketing, land preparations etc) is Short Term for a period of maximum one year mainly through *Murabaha* and *Salam*. These two modes of finance are suitable for financing short-term projects. Tarik (1996), on the other hand, showed some evidence indicating that Islamic banks financing is rarely extended on a long-term basis and short-term lending dominates overall. ISBs distribution of finance during the period 1984-1992 was 75.4% short term, 5.4% medium term, 2.1% long term and real estate financing shared 15.4% (Tarik, 1996). If Islamic banks are not able to generate long-term sizable deposits, they will not be able to extend long-term loans that are deemed necessary to achieve developmental and poverty-alleviation goals.

3.2. Regulatory Framework and Recent Regulatory Reforms

The IMF Monitored Macroeconomic Stabilization and Structural Reforms, including CBOS prudential monetary and structural reforms policy regime, have impact on banking

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8 The same applies to the sales-based modes the agricultural-based *Salam* mode of finance may be riskier than *Murabaha* that is why it share in the banking system of Sudan is only around 5%.

9 Our calculation using figures from CBOS annual reports, different issues.

10 Likewise, Tarik has shown some sharp unequal sectoral distribution of Iranian and other banks in mixed financial sectors10. The sectoral distribution of finance during the period 1984-1992 favors trade and commerce (82.1%), while agricultural share is only 7.2% and the real estate's share is 10.5% (Tarik 1996). These led Tarik to conclude that: "The emerging corpus of facts about the operations of Islamic banks over the last two decades sheds serious doubt on their ability to perform this role (channeling financial resources into long-term investment projects in productive sectors of the economy on the basis of equity) which is vital for economic growth" (Tarik 1996), (emphasis between two brackets is added).

indicators. The soundness of the banking system is broadly improving in the last few years following the CBOS Comprehensive Banking Policy 1999-2002. The aim of this policy is to develop the banking system and ensure financial and banking prudential, banking automation and efficiency and to consolidate banking Islamization (CBOS, 2000, p. 17). Objectives set are short and medium term that require to be translated into annual workable programmes starting 1999.

The major policy issues covered are:

(1) The development of the banking and financial institutions that include raising capital and merger, revision of laws governing the banking system, enhancement of deposits, especially saving deposits, reduction of the current ratio of non-performing loans to the international standards, develop mechanisms and ensure precautionary supervision, revision of criteria of licensing new banks, branches and banks' companies, Human Resources Development, reduction of administrative costs, and consolidating banking researches and statistics.

(2) Activating and deepening Islamization of the banking system: which includes establishment of a model Islamic bank, activating internal banking auditing and application of the Accounting and Auditing Organization for Islamic Financial Institutions' standard, issue guidelines for application of Islamic formulae, and continue develop Islamic financial tools, especially liquidity management tools.

(3) Organization of foreign exchange market through liberalization and removal of distortions and establishment of foreign exchange reserve and develop practices of banks in foreign exchange dealings, organize the use of foreign exchange to balance the resources and the use of foreign exchange, and introduction of Euro in the foreign exchange market.

(4) Financing: reduction of administrative cost of financing to reduce the cost of production, ensure enough finance to priority sectors, contribution to social financing through Productive Families' and poor segments of the population, the gradual move towards *Musharaka* financing and reduce the share of *Murabaha*, and consolidate the CBOS role of liquidity-financing windows for liquidity management and ensure the financing required by banks.

(5) Banking operations: Introduction of a uniform procedures of opening and management of accounts to avoid returned cheques and fraud, revision of banking fees in line with falling inflation, encouragement of the public to deal with banks and enhance deposits, introduction of new means for financial dealings such as visa cards, assigning a new role of cheques as a guarantee.

(6) Banking technology: Inclusion of banking technology with supervision, introduction of magnetic cheques and computer and SWIFT System networking.

The main elements of the Comprehensive Banking Policy applied since 2000 are:

1. The Banking System Restructuring and Reform Program issued in 2000 is meant to create large-scale financing units, enhance Banks capital, restructuring of banks and loans portfolio, and addressing the difficulties facing them. Policies and achievements under this program are set below:

- The program set an optional bank merger under certain specified indicators as one alternative to create large financing units. This applies to public sector commercial banks. The specialized banks (Agricultural Bank, real Estate Bank and Saving and

Social development Bank), and foreign banks branches are subject to separate restructuring arrangements. Some incentives were given to make this alternative viable including exemptions from tax, priority for resolving non-performing loans, and some measures for resolving sacked labor force.

- The second alternative is the strengthening of banking positions through raising additional capital. The program specified one billion Sudanese Dinar as a minimum capital requirement to be met gradually up to the end of 2000; rose to two billions to be met by end-2001, and three billions to be met by end-2002. The new policy is to raise it further to six billion to be met by 2008. Under this program the government-owned Bank of Khartoum and Nelien Industrial Bank are changed to public ownership Companies (CBOS, 2002).
- The restructuring programme also includes tightening the banks' large share of non-performing loans by enforcement of tide policy this respect (Improvement of loans classification system and enforced monthly reporting of non-performing loans to the CBOS and Boards of Directors, and imposing penalties of non-compliant banks).

2. Strengthening institutional prudential supervision standards:
    - A movement from instrumental independence to CBOS policy independence by passing a new CBOS law,
    - Setting new performance indicators such as identification and energizing of boards of directors, and,
    - Introduction of financial transparency and uniform accounting principles for all banks and financial institutions in accordance with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).
3. Liberalization of foreign exchange dealings, organize and develop a free unified wide exchange market and stabilization of the currency.
    a. A managed floating exchange rate system was introduced. A system of indicative exchange rate to be used as indicator (a weighted average of all rates transacted by all banks) was adopted and the CBOS interfere to smooth the market fluctuations by buying and selling foreign exchange when the indicative exchange rate exceeds a band of plus or minus 1.5%.
    b. Development of inter-bank market to cover foreign exchange requirements by allowing banks to work as a group in buying and selling of foreign exchange.
4. Introduction of new *Shariaa*' compatible instruments for policy and indirect liquidity management (indirect second-generation financial instruments), as well as modifying the existing ones to strengthen monetary mechanism.

    4-a: CBOS introduced Open Market Operations with equity base Government *Musharaka* certificate (GMCs) and Central Bank *Musharaka* certificate (CMCs) securities. In 2004 the Government Investment Certificates (GICs) were introduced. Those securities represent shares in special funds containing CBOS and government investment in commercial banks. GMCs and CMCs are sold through auctions and have face value and transaction price. GMCs, which are traded at Khartoum stock exchange under specific auction system, enjoy a one-year maturity period. Access to GMCs is not limited to individuals only but companies and banks can also participate.

4-b: Introduction of liquidity-financing windows as an overdraft facility in order to fulfill its function as a lender of last resort (LLR):

- Unrestricted *Musharaka* finance: limited to two times per month or four times per four months period were granted to commercial banks (extendable conditional upon the share of the CBOS in this specific loan's profits) for a maximum of 10% of current deposits of the commercial bank. Finance from the CBOS under restricted *Mudaraba* for priority sectors can also be granted to commercial banks.

- Investment finance window. Eligibility to this window requires banks not having liquidity problem and have a relatively stable position on their clearing accounts. Moreover, they should not possess a non-performing loans ratio higher than the average ratio of all banks for the last few years. Their distribution of profit ratio to investment accounts holders should also be greater than the average for the whole banks. In the case of *Mudaraba* auction the profit sharing ratio for their entrepreneurs must be specified by the bidding banks. Management and allocation of funds is based on profit sharing ratio between the bank and the CBOS. In the case of *Musharaka* allocation of funds depends on the Bank (s) contribution to the equity participation.

5. Introducing banking technology (introduction of a new magnetic ink recognition checking system in 2001, modernization of the computer systems as from 2000, an electronic banking service company was established as a public corporation to link bans through SWIFT services, establishment a Modernization and Automation of Banking Business Department at the CBOS to function for the CBOS and to supervise automation process at other banks).

3.3. CBOS Financing Policies

Perhaps the major problem facing ISBs in Sudan (and everywhere) is the conduct of monetary policy and banking supervision. The conduct of monetary policy in Sudan, which is under the purview of the Islamic Banking system, usually starts with setting annual objectives and targets. It aims at the general macroeconomic and social objectives of the economy. The main goal of the monetary policies in Sudan is to control money supply and credit to the private sector in order to check inflation. The other objectives are specific growth related and replenishing international reserves.

The CBOS annually sets the objectives of financing policies and rules governing extension of banking finance, as well as liquidity management through setting and monitoring quantitative monetary targets such as *Murabaha* margins, customers' share in *Musharaka* and administrative margins under *Murabaha* contract. Moreover, statutory reserve requirements and financing window requirements are also set.

The monetary policy of the CBOS (called the Financing Policy)[11] and its control instrument is unique, as it reflects the experience of full Islamization of the banking system. The major elements of such a policy are:

- Until late 1990s, besides credit ceilings and required reserve policies, the CBOS used quantitative and qualitative credit control through *Musharaka* rates and minimum *Murabaha* margins (minimum percentage of profits from *Murabaha* credit).
- In 1990, the CBOS started issuing detailed directives of discriminating profit and loss ratios as well as minimum contribution of clients under *Musharaka* contracts, and discriminating minimum mark-up rates under *Murabaha* contracts. R*atios of Musharaka* were eliminated. Client's management remuneration margin in *Musharaka* contracts, and client's *Mudaraba* share is left to be determined by banks. The CBOS-setting of minimum *Murabaha* mark-up varied between 36 and 48% per year until 1998. In 1999 they were substantially reduced to 20%. In 2000 it was again reduced to 18%. In 2001 it was further reduced to only 12% per annum to be used as an indicator, but should not exceed a maximum of 15%. The minimum *Murabaha* mark-up stayed at a maximum of 10% thereafter.
- The CBOS also annually announces combined credit ceilings for what is called “priority sectors”, (Craftsmen, Professionals and Small Producers including Productive Families, Agricultural Sector, Industrial Sector, Export Sector, Mining and Energy Production Sector, Co-Operatives, Investment in Shares, Cultural and Media Production, Private Sector Investment in Rural Services, Low Cost Housing Sector, Transport and Storage Sector)[12]. Finance to priority sector share amounted to 95% of the total banking finance in 1998, reduced to 90% in 2000 and 2001. Almost half of this volume of finance goes to the agricultural sector as stipulated by the financing policies of the CBOS. In recent financing policies banks are permitted to finance all sectors, and activities permitted to be financed through any of the Islamic mode of finance
- The required reserve policy has also been used by the CBOS as a tool of monetary control. The ratio has undergone many changes up and down since 1989. During the period 1989-2005 the ratio has been fluctuating within the range of 10-30% with a peak of 30% in 1993.
- The CBOS also introduced a separate reserve requirement on foreign currency deposit in 1997, but unified reserve ratios on current and foreign deposits in 2005. Other instruments are margins of Letters of Credit, foreign exchange transitions and directives of inter-bank lending.

The IMF-Monitored Macroeconomic Stabilization and Structural Reforms and CBOS financing policies have significant impacts on the financing system, and commercial and specialized banks compliance with prudential reforms is – up to now- satisfactory (14 out of 24 banks were classified as fair or better by the end of 2004 (IMF, 2005, p. 9). The outcome can be seen in Table (2) of the Annex. Most outstanding among them are:

11 In the non-interest-based Islamic system there are no credit loans as in the conventional system, as Islamic system extend finance mainly on profit and loss sharing or sales bases.

12 Non-Priority sectors include Local Trade and Services which are not related to priority sectors.

- The declining ratio of public spending to GDP and declining (but stagnant) ratio of broad money- currency-to-GDP (from 10% to 8%, compared with 30-40 for developing countries) and the steady reversal in the growth trends of velocity of circulation shows a reversal of financial disintermediation. Nevertheless, our calculation of the currency/deposits and currency/demand deposits ratios in 1997 and 2002 reveals that while the former is 65.8% in 1997, it increased to 93.4% in 2002. The latter increased from 153.4% in 1997 to 276.1% in 2002. The high growth rate of currency/demand deposits compared with currency/deposits suggests lower opportunity cost of holding currency compared to demand deposits, despite the fall in inflation. Moreover, the increase of the currency/deposit ratio indicates a clear preference for cash and low confidence on the banking system.

- Rate of Returns on Assets (ROA) and Rate of Returns on Equity (ROE) improved and capital adequacy showed slight improvement since 2001. Non-performing loans to total loans ratios are falling (the fall is between 7-12.7%)[13]. This is a higher level compared to the crisis periods in other developing countries in which it is between 8-10 (Kireyev. A. 2001). The relatively high ratio of non-performing loans to total loans reflects poor credit performance and defaults by big clients.

- The expansion of deposits increases domestic credit and money supply. The increase in deposits is caused mainly by a broad-based economic growth, oil revenue, increase in government expenditure, and foreign investment. FDI & private transfer increased to $2.5 billion in 2004 which is more than one third higher than 2003 (IMF, 2005, Report No. 5 /118, p.7).

- The reasonably high growth of demand deposits volume encouraged by the rise in real rate of returns as a result of the sizable fall in inflation rates in recent years. This resulted in an improvement of the ratio of total deposit -to- GDP. Nevertheless, despite the fall in the ratio of demand deposits (from 68% in 1997 to 42% in 2002; CBOS, 1997 and 2002), the short term structure of deposit is still high compared to most Islamic banks in other countries in which the ratio is 7-8% (Kireyev. A. 2001, p 15). Sales-based modes of finance (*Murabaha* and *Salam*) share nearly 50% of total volume of finance for the period since 1996. This largely unimproved term structure of deposits is a sign of weak deposits base of the Sudanese the banking system.

- Credit to GDP ratio shown is very low and stagnant. This reflects the difficulties faced by ISBs in providing funds. Moreover, a sizable part of demand deposit is used for extending finance.

- Loan-to-deposits ratio provides a measure of risk taking as demonstrated by the degree to which resources are extended. It indicates the ability of the banking system to mobilize deposits to meet credit demand. The increasing ratio of loans to deposits indicates no pressure on the whole banking system, and a high level of liquidity to respond to shocks.

- Total banking assets remain weak, as the financial reforms have not yet impacted significantly the total banking assets. The low and declining ratio of total assets-to-GDP and liquid assets to total assets reflect a weak financial base of the Sudanese banking system.

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[13] All loans overdue by one month are classified by the CBS as non-performing loans.

3.4. Commercial & Specialized Banks Financing Policies & National Finance Policies

In accordance with the Financing Policy of the CBOS outlined above, and the national financing policies, the Sudanese Banks determined their internal microfinancing policies. In addition to the financing regulations set by the Central Bank, the banks set internal regulations to ensure successful projects, consolidate the application of the central bank regulations and make sure the success of the marketing of the output and so on. Typical practices include conducting socio-economic surveys to verify applicants' reputation and skill, checks for debts and a review of the marketing experience of the loan applicant. Since 2001 CBOS regulations for financing Small Producers, Craftsmen, Productive Families, Professionals and Limited Income Groups require information regarding applicant's location, professional certificates and work license (for Professionals), opening of current account (to replace the absence of a proper identity).

Small Producers are subject to fees and duties when they are financed by banks, namely: (1) Finance tax (government tax): 0.005% based on the bank's participation in the case of finance through *Musharaka,* and on the volume of investment in the case of *Murabaha,* excluding the profit margin. (2) Management fees: (investment execution fees) based on the volume of investment in *Murabaha* and the participation of the bank in *Musharaka* (3) Stamp duties (SDD100) charges on the *Musharaka* or *Murabaha* application, based on the volume of the investment including both the share of the bank and the partner, in the case of Musharaka. In the case of financing via *Murabaha* it is based on the volume of *Murabaha* excluding *Murabaha* profit margin. This duty reached SDD 10000 in some banks. In addition to wounded solider stamp duty (Aljareeh), (SDD 500) and employer stamp duty (SDD1000). Tax and Zakat clearance certificates were abolished in 2001.

Banking financing policies are more or less the same. *Murabaha* is the most dominant mode of microfinance used within the Sudanese banking system. It has used up to 90 per cent in some banks. *Murabaha* margin for microcredits in general ranges between 3 to 4 per cent per month (36 to 48 per cent per annum), above the minimum margin of 15 per cent per annum stated in the financing policies. The current *Murabaha* margin is three to four times the minimum margin stated in the Financing Policy of the central bank. The repayment methods are also different from those stipulated. The CBOS financing policies, as we have previously mentioned, state that banks are free to obtain whatever "sufficient guarantees" they require when financing Small Producers. They do not include or exclude any of the guarantees currently used in the banking system of Sudan. Banks resort to traditional guarantees such as personal guarantees, post dated cheques, a certificate of employer to deduct from the applicants' monthly salary with the installments limit, and third party guarantees. Some banks (such as Saving and Social Development bank) make use of guarantees of Civil Societies (Unions, Sheiks, Omdas, etc.). This happens in-spite of the fact that Article (8/2/A) of the Financing Regulations refers to the possibility of evaluation of machinery and equipment as a way of ensuring a guarantee. The lack of specialized institutions to evaluate machinery and equipment in Sudan may hinder the application of this kind of guarantee.[14] Almost all banks require loans repaid in equal installments, but a grace period of one to three months is granted. There are variations in the total volume of microcredits, and similarities in the volume of finance per project. Although the target group is micro and Small Producers, banks separate it into different

14 NIDBG attempted to establish a 'Small Enterprise guarantee Fund' to be financed by banks and other financiers of small enterprises and donations (NIDBG, 1996 , Small Enterprises Guarantee Fund, NIDGB, Khartoum).

categories specified by the Financing Policy such as Productive Families, crafts, informal sector and so, without a clear definition of each category, and each bank specializes in one or two sub-sectors. No bank exclusively targets the poor. Moreover, there are no separate rules and procedures of financing female-owned enterprises, despite the growing phenomenon of women entrepreneurs. Most banks experiments, with few exceptions, were in urban or semi-urban areas. Among financing constraints are licenses, national and banking fees and duties, Opening of banks' accounts, requirements of cheques and collateral (Ibrahim, Badr El Din, 2004).

3.5. Microfinance in Sudan

Before embarking on what the banking system in Sudan can offer in terms of microfinance, a concise definition of what is meant by microfinance and how it works may be in order.

Definition of Microfinance:

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro and small enterprises.

Microfinance services are usually provided by three types of sources:

- formal institutions, such as banks (mainly rural banks) and cooperatives;
- semiformal institutions, such as Non-Governmental Organizations; and
- informal sources such as money lenders, shopkeepers and self-help groups.

Institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions, whose major business is the provision of microfinance services

Microfinance products such as savings accounts and microcredit loans empower the poor to lift themselves out of poverty. Through microfinance, they can secure better nutrition, education, healthcare and housing for their families. Microfinance has helped millions in developing countries raise their standards of living and protect themselves from economic setbacks.

The traditional banking system requires that a borrower have collateral in order to receive a loan. The world’s poorest people have no such collateral. Further, traditional banks are not generally interested in issuing small loans, as the interest benefits do not exceed the transaction costs. Given these constraints, how exactly does microfinance work?

Many microfinance institutions (MFIs) utilize social collateral in the form of peer groups to ensure loan repayment. Borrowers take out loans in groups. If a borrower defaults on his/her loan, the entire group typically is penalized and sometimes barred altogether from taking further loans. This peer pressure encourages borrowers to repay loans in full and on time, resulting in a higher percent repayment rates. Among the few who default, the most common reasons are illness, natural disaster or unanticipated crisis.

Microcredit loan cycles are usually shorter than traditional commercial loans – typically six months to a year with payments plus interest, due weekly. Shorter loan cycles and weekly payments help the borrowers stay current and not become overwhelmed by large payments. The transaction-intense nature of weekly payment collections is more expensive than running a bank branch that provides large loans to economically secure borrowers. As a result, MFIs tend to charge interest rates that may sound high in order to cover their costs. These interest rates are still significantly lower than the annual rates the borrowers usually pay to money lenders and are typical of the local credit card interest rates.

3.5.1 CBOS Microfinance Policies

In Sudan, the partial and gradual recognition of the MSEs sub-sector started in the early 1990s. The Financing Policy of the CBOS in 1990, for the first time, included crafts as one of the priority sectors for financing. In addition, the 1990 Financing Policy emphasized the importance of banks' financing to regional and backward areas and small enterprises. The full recognition of the MSEs' sub-sector started with the 1994/95 Financing Policy. "Craftsmen, Professionals and Small Producers including Productive Families" are considered one of the priority sectors for banking finance, together with the Agricultural, Industrial and Export Sector, Mining and Energy Production Sector, Low Cost Housing Sector, Transport and Storage Sector. The Financing Policies since mid-1990s included concessions and financing regulations to this sub-sector. These concessions and financing regulations can be summarized herein:

- The 1994/95 Financing Policy specified that finance to this sub-sector may be based on the restricted *Mudaraba*[15] or other financing systems, with the exception of the unrestricted *Mudaraba* system. Financing per transaction may not exceed 1 million Sudanese pounds, raised to 3 million in July/December 1995. Banks are free to obtain whatever "sufficient guarantees" they need when financing this sub-sector. The Financing Policies do not include or exclude any of the guarantees currently used in the banking system of Sudan. This exactly matches with the Law of Banking Regulation of 1991, Article 36/H and Article (8) of the Financing Regulations, which read: "Banks should make sure to impose reasonable and sufficient guarantees for financing clients, since it represents the last resort in case of a client's failure for repayment on the specified date".[16] Financing polices up to 2005 re-emphasized the importance of abiding with the Law of Banking Regulations with regard to guarantees, including held mortgage; crops, raw materials and goods; liquefiable financial assets; machinery and equipments, and real estate securities. Others types of guarantees added recently are shares, certificate and *Sukuk.*
- According to the 1994/95 Financing Policy and other Financing Policies afterwards, the first installment of *Murabaha* for small enterprises should not be less than 15 per cent of the value of the asset. The Financing Policy of 1994/95 permitted that the first installment of *Murabaha* can be delayed and be paid as part of the total installments. Starting from the 1995 Financing Policy, the first installment is abolished and the payments can be arranged between the bank and the client.
- In the financing policies of 1994/95 and July-December 1995, the percentage of participation in *Musharaka* of finance granted to Craftsmen or Professionals must not to be less than 15 per cent of the bank's total funding. In the case of Small Producers (including Productive Families) the percentage of participation is left for mutual

15 The *Mudaraba* is said to be restricted where the owner of the capital restricts the freedom of the *Mudarib* in the ways in which he or she invests the capital (e.g. carrying out business in a specific geographical area, or dealing with a specific commodity or commodities). The restricted *Mudaraba* is useful for closer monitoring and supervising by the capital owner (Abdalla, Ahmed Ali, 1997, p. 11).

16 Order No. 20/95, Bank of Sudan, Khartoum

agreement between the bank and the partner. In the 1996 Financing Policy, the percentage of participation for Professionals and Craftsmen was raised to 25 per cent, and that for Small Producers (including the Productive Families) was raised to 20 per cent. In 1997, both participation percentages were raised. The percentage of participation for Professionals and Craftsmen was raised to 35 per cent. As for Small Producers (including Productive Families) the partner's participation shall be a maximum of 30 per cent. In 1998 the two rates were unified at 36%. Since the Financing Policy of 1999 commercial banks are permitted to determine *Musharaka* Percentages, Management Remuneration Margins in *Musharaka* Contracts, and Share of Speculator in *Mudaraba* Contracts (See the table below).

MSEs *Musharaka* Shares (%)

Sector /Years	1994/95	July-Dec 95	1996	1997	1998	1999-2005
Professionals & Craftsmen	15	15	25	35	36	To be determined by banks
Small Producers	By mutual agreement		20	30	36	

Sources: CBOS Financing Policies (1994-2005)

- The minimum *Murabaha* margin for Small Producers (minimum percentage of profits from *Murabaha* credit) in 1994/95 and 1995 was 15 per cent per annum, and 30 per cent (for Professionals, Craftsmen). In 1996 margins were changed to 15% for Small Producers and 20% for Craftsmen and Professionals. In 1997, the two margins were 35 and 40 per cent respectively. The Financing Policy of 1998 unifies the minimum percentage of profit margin under the *Murabaha* system for all priority sectors (including Small Producers) at 36%, while leaving the minimum percentage margin under the *Murabaha* system for non-priority sectors undetermined. Since then the two rates were still unified but at declining margins. Moreover, since 2003, the CBOS decided that the minimum *Murabaha* margins that applied by each bank should be used for this sector. The same applies in the financing policies up to 2005. The following Table summarizes these changes.

MSEs Minimum *Murabaha* Margins (1994-2005)

Sector/Years	94/95	Jul.-Dec. 95	96	97	98	99	2000	2001	2002	2003-205
Professionals & Craftsmen	25	25	20	40	36	20	18	12-15	12-15	The use of the minimum share applied by each bank
Small Producers	15	15	15	35	36	20	18	12-15	12-15	

Sources: CBOS Financing Policies (1994-2005)

- The successive Financing policies determined the financing ceiling for priority and other non-priority sectors. For example, the 1996 Financing Policy determined that not less than 90 per cent of the bank's financing should be granted for the priority sectors. Agricultural sector was granted 40 per cent, but no specification for the other priority sectors, including Craftsmen, Professionals, and Small Producers including Productive Families was given. The 1999 Financing Policy specified that 95% of the total lending should be granted for priority sectors, out of which not less than 5% for Productive Families, Small Producers, crafts and Professionals. The 2000 Financing Policy separated cooperative and Professionals from Small Producers, Petty Traders and Productive Families. Moreover, Productive Families, Small Producers and

Craftsmen are granted a percentage rate not less than 5% of the total financing. Nevertheless all are coming under priority sectors. The Financing Policy of the Year 2000 specified that each bank should allocate a percentage not less than 7% of the total banking finance to this sub-sector. Moreover, the 2002 Financing Policy specified that each bank should allocate a percentage not less than 10% of the total banking finance to social development activities (Productive Families, Small Producers, Craftsmen, and Professionals). Term of finance for this sector may be two years maximum.

- Exemptions of Craftsmen, Professionals, Small Producers (including Productive Families) from Registration Certificates, audited statements and Profit and Loss accounts in the case of financing of less than five million Sudanese Pounds up to 2001 and less than twenty millions since 2001.

3.5.2. Potentiality of Islamic & Conventional Microfinance

In the Islamic principle of *Musharaka* modes of financing, loans are granted without an obligation on the part of the partner to pay back whether he or she gains or loses. Moreover, no strict security is demanded, as Islamic investment arrangements put great emphasis on the transaction itself, rather than the creditworthiness of the partner (Ibrahim, Badr El Din, 1997). If the operation ends in a loss the partner does not bear this loss alone. If he or she is unable to settle his or her bills, a grace period is given without any additional fees (Awad, Mohammed H. 1994). Islamic financing via *Musharaka* does not require the partner to present securities against possible losses. Any advancement demanded is made to cover the share of the partner in the venture and not as a security against losses. Since the Islamic principle is basically based on profit and loss sharing arrangement then “any security demanded by the Islamic bank is against possible fraud or repayment-evasion and not against the risk of losses “(Awad, Mohammed H. (1994) p. 5).

Partnership financing has many advantages to offer to MSEs. *Musharaka* is a flexible, fair, and easily understandable form of financing. It caters for both production and management, thus leading to increased incomes for income groups who do not own capital. It is a suitable mode of financing for both working and fixed capital. In countries with high inflation, *Musharaka* preserves the real value of capital invested — that is, at the time of selling the two partners may decide to wait in anticipation of higher prices. *Musharaka* does not require strict collateral guarantees and does not leave the partner with a heavy burden of debts, post-dated cheques or any other kind of obligations. Personal acquaintance with the client, and his behavior, in addition to continual supervision and follow-up by the bank’s management, are necessary requirements in the absence of conventional guarantees. SIBs usually use personal guarantees, storage of raw materials subject to partnership, and regular field visits, which limit the chances of dishonesty such as unrecorded sales of the product under partnership, or tampering with records. Another important advantage of *Musharaka* is that the client does not have to contribute in case his/her share might be in kind (inputs), labor, and machine depreciation. In *Musharaka* the bank may take an active role in marketing the product, thus reducing the marketing burden on small entrepreneurs. *Musharaka* also avoids repayments from small entrepreneurs who have already lost their livelihood in the case of a total failure.

Beside providing finance to the already established MSEs, partnership modes of finance are likely to create new economically and technically feasible small-sized investments, through the concentration of feasibility studies rather than the creditworthiness of MSEs. Wider branch networks and ranges of banking services are a prerequisite for banks in order to reach a large number of MSEs' entrepreneurs, through partnership formulae. The partnership arrangements can enhance the ability and incentives of banks to reach MSEs' entrepreneurs, thus overcoming the commercial banks’ reluctance to lend to Small Producers. Using partnership arrangements, however, does not mean providing finance to MSEs on concessional rates. In contrast, it will provide a high rate of return on capital investment to both the bank and the partner.

A *Murabaha* contract is beneficial to MSEs. Instead of a small entrepreneur having a loan (which he may use in a different purpose), the *Murabaha* contract will buy the asset or raw material for him for a certain period and at a profit. *Murabaha* profit margin and interest rates could be identical in value, but the process is different. *Murabaha* will make sure that money is used in the intended project for the benefit of small entrepreneurs.

It can be seen from the above that Islamic modes of finance have many advantages when funding MSEs. These advantages are as follows:

- In most cases financing is granted without an obligation on the part of the partner to pay back whether he or she gains or loses.
- No strict security is demanded, as the Islamic investment arrangements put great emphasis on the transaction itself, rather than the creditworthiness of the partner.
- If the operation ends in a loss the partner does not bear this loss alone. If he or she is unable to settle his or her bills, a grace period is given without any additional fees.

Musharaka, on the other hand, has the following advantages to MSEs:

- It is a flexible, fair, easily understandable form of financing.
- It caters for both production and management, thus leading to increased incomes for income groups who do not own capital.
- It is a suitable mode of financing for both working and fixed capital.
- It preserves the real value of capital invested.
- It does not require strict collateral guarantees and does not leave the partner with a heavy burden of debts, post-dated cheques or any other kind of obligations.
- In *Musharaka* the client does not have to contribute in case his/her share might be in kind (inputs), such as labor and machine depreciation.
- It avoids repayments from small entrepreneurs who have already lost their livelihood in the case of a total failure.
- It provides a high rate of return on capital investment to both the bank and the partner.

As regarding the conventional banking system, the excerpts below are quoted from the Peace Agreement.

- Consistent with the Machakos Protocol of 20th July 2002,there will be a dual banking system in Sudan during the Interim Period. An Islamic banking system shall operate in Northern Sudan and conventional banking system shall operate in Southern Sudan.
- Because of the urgent need of the facilities of the conventional banking in Southern Sudan a Bank of Southern Sudan (BOSS) will be established during the Pre-Interim period, as a branch of CBOS consistent with paragraph 1 above.

- During the Pre-Interim Period, the CBOS will be restructured so as to reflect the duality of the banking system in Sudan. The CBOS shall therefore use and develop two sets of banking instruments, one Islamic and the other Conventional, to regulate and supervise the implementation of a single monetary policy through: (i) an Islamic financing window in Northern Sudan under a deputy governor of CBOS using Islamic financing instruments to implement the national monetary policy in Northern Sudan; and (ii) the Bank of Southern Sudan (BOSS), headed by a deputy governor of CBOS, to manage the conventional window using ***conventional financing instruments*** in implementing the same national monetary policy in Southern Sudan.
- The CBOS shall be responsible for the conduct of monetary policy. All banking institutions shall be subject to the rules and regulations set by the CBOS.
- The primary responsibility and mandate of the CBOS shall be ensuring price stability, maintaining stable exchange rate, sound banking system and issuance of currency. The monetary policy shall be carried out accordingly relying primarily on market-based instruments instead of administrative allocation of credit.
- The CBOS shall be fully independent in its pursuit of monetary policy.
- The Governor of CBOS and his/her two deputies shall be appointed by the Presidency. The Governor of CBOS shall appoint in consultation with his/her two deputies other senior officers within the Central Bank.
- The BOSS shall be responsible for chartering and supervising financial institutions in Southern Sudan.
- All financial institutions shall be subject to internationally recognized regulatory and prudential standards for Islamic and conventional finance, as set by the CBOS.
- All financial institutions shall be bound to implement monetary policies set by the CBOS.
- Foreign borrowing by all sub-national governments shall be done in a manner that does not undermine national macroeconomic policies and shall be consistent with the objective of maintaining external financial viability. All sub-national governments' foreign borrowing transactions shall conform to the CBOS specifications.

Given the features of the conventional banking system, which is to be established in the South and its link with CBOS, it is anticipated that conventional microfinance policies will be implemented. As stated earlier, such policies usually do not cater for the special nature of the portion of the population who is desperately in need of microfinance services. In a post-war era, where the majority of the population in the war-affected area live in severe poverty and are assetless, such conventional microfinance will lead to no avail. A modified microfinance system, may be similar to the one prevailing under the Islamic system, specially designed to suit the residents of the areas hard-hit by war is certainly worth contemplating.

3.5.3. Commercial & Specialized Banks' Microfinance

In recent CBOS Financing Policies, all Commercial and Specialized banks are required to channel at least 10% of their total loan portfolio to finance the social sector, with the exact figure being discretionary. This lead to an increase in the average share of credit to Small Producers from 2.4% in 2000 to 11.9% in 2002, while the average total credit over the period 1999-2002 is only 8.8% (Rajivan, Anuradha, K. & Abukassawi, Mustafa, G. 2002, p. 14). Moreover, the discretionary element in the policy resulted in considerable variations in amounts of small loans extended to MSEs by these banks.

The share of microfinance to total deposits of commercial banks is shown in the following table. The overall average of microfinance loans out of total deposits of these banks during the period 1999 to 2002 was only 3.5%, compared with average total loans to total deposit ratio of 41.5%. Excluding the year 2002, the share reduced to about 1%.

Microfinance by Commercial Banks 1999-2002 (In SDD billions unless otherwise specified)

Description / Year	1999	2000	2001	2002	1999-02
Total microfinance loans **	1.6	1.9	13.2	16.5 *	33.2
Total deposits ***	145.5	179.2	274.2	363.1	962.0
Total credit	48.7	79.2	111.3	160.0	399.2
Microfinance to total deposits (%)	1.01	1.01	0.05	4.54	3.45
Total credit to total deposits (%)	33.5	44.2	40.6	44.1	41.5

*** Up to September 2002**
***** Source: Rajivan, Anuradha, K. & Abukassawi, Mustafa, G. 2002, p. 14***
****** CBOS Annual Reports 1999-2002 .***

Due to paucity of information, the exact total amounts of funds allocated to MSEs by specialized banks are not readily available. Nevertheless, some figures of the percentage share of microfinance by three of the specialized banks compiled from available sources are displayed in the following table.

Microfinance by Some Specialized Banks, 1997-2002 (% of Total Finance)

Bank / Year	1997	1998	1999	2000	2001	2002
Agricultural Bank * (Productive Families & Small Producers)	na	na	na	na	5.8	5.0
Ratio to total deposits	-	-	-	-	11.6	14.1
Real Estate Bank * (Productive Families & Small Producers)	na	na	na	na	6.1	0.9
Ratio to total deposits	-	-	-	-	4.2	1.1
Saving & Social Development Bank	15.3	34.4	30.8	15.6	16.5	20.7
of which:						
- Craftsmen, Professional, Productive Families & Small Producers	8.1	12.7	28.9	13.4	15.3	6.6
- Social Development	7.2	21.7	1.9	2.2	1.2	14.1
Ratio to total deposits	12.2	24.4	42.4	11.5	14.1	21.1

**** Prior to 2001 the CBOS has no compiled microfinance data for Agricultural bank and Real Estate Bank.***
Sources: CBOS Annual Reports (1999-2002).

With the exception of Saving and Social Development Bank, the average microfinance share of other specialized banks for the period 2001-2002 is (4.5) is nearly half of the average share of other commercial banks (8.8%). Moreover, although Saving and Social Development Bank allocated more share to microfinance compared to other specialized banks, nevertheless its microfinance as well as social development finance sharply fluctuated. Likewise, its microfinance ratio to total deposits also fluctuates.

In sum, total financing of MSEs by commercial banks is difficult to assess precisely, due to the lack of data, but according to available estimates it is around 9% of total lending and around 3.5% of total deposits, compared with 41.5% average share of total credit to total deposits. With the exception of SSD bank, Sudanese specialized banking finances to MSEs varied considerably, not only out of total volume of finances but also in percentage of total deposits. Microfinance share of some specialized banks (except SSD bank) is around half of that of commercial banks.

3.5.4. Social Schemes, NGOs & Social Funds

Apart from banks (commercial and specialized), microcredit in Sudan is extended through plethora of social schemes, NGOs, local and international and government social funds. *Khatta* (savers/investors self-administered revolving fund) is the most popular and widespread social effort of an informal savings and credit scheme. It is a self-managed system in which individuals contribute an agreed sum (*Sarfa*) at regular intervals. The pooled amount is distributed in predetermined order, and used mainly (but not wholly) for small businesses (rent, purchase of equipment/utensils, working capital etc). Apart from *Khatta*, village traders provide another way in which micro-enterprises are funded. They represent one of the most flexible and traditional financing institutions. They require only personal guarantees, but operate with high profit margins. Another form of small enterprise practice is the "traditional partnership" in the means of production. In this system, a relatively poor small entrepreneur gets access to the means of production. Returns are distributed equally between the factors of production. Provision of micro-credit in certain parts of the Sudan is made via kinship and tribal fibber. Members of the same clan/tribe or area, provide flexible financial help to start businesses without any additional costs. Another form is the collective help action (*Nafir*), where village inhabitants contribute to poor families in the form of collective work.

Over 100 local and foreign NGOs, with direct co-ordination with the official authorities, are active in providing micro-credit, emergency loans, medical care and educational services to the poor in Sudan. These forms of traditional microfinance are spreading all over the country, so it is not possible to quantify their volume of finance and their impact. Foreign NGOs provide loans for tiny projects such as tea making, sheep rearing, water services, petty trade, brick making, vegetable distribution, shoe making, women's handicrafts and house restaurants, in addition to providing training services, not only for migrants but also for the rural and urban poor. Conditions for providing financial support include the degree of poverty, minority group and unemployment. Other NGOs are based on saving/lending associations and a Grameen Bank-type of group guarantee, together with some use of the Islamic (*Murabaha*) finance system. PLAN SUDAN, Dutch University Gadaref Assistance Programme (DUGAP), and Agency for Cooperation and Research in Development (ACCORD) are a few of the groups involved in this kind of practice.

DUGAP has established four credit unions with a total membership of 146. In addition to small credit, DUGAP provides consumption loans, training on financial matters, and technical support. In providing small credits, the *Murabaha* mode of finance is used, with a profit margin of 4 per cent. Repayment is made monthly, and the maximum duration of the loan is six months (Janssen, Resi, 1995). PLAN SUDAN has four associations with a total membership of over 500. They offer the *Murabaha* mode of finance with a profit margin of 4 per cent, a grace period of one to two months, and repayment intervals of a month and a quarter. The objectives of ACCORD's programmes are to assist small enterprises through extended micro-credit for the poor and refugees in Port Sudan and Kassala, Eastern Sudan, and in so doing, raise the level of income and employment. ACCORD uses Islamic modes of finance such as *Murabaha*, *Musharaka, Mudaraba*, and *Quard Hassan* (benevolent). Between 1984 and 1992, more than 26,000 people benefited from the programme in businesses such as fisheries, retailing, welding and sheep rearing. The duration of the loans ranges between two and five months and the maximum profit margin of *Murabaha* is 4 per cent per month (Nourain, Asim, 1997, pp. 30-34).

The UNDP, Area Development Scheme (UNDP/ADS) has targeted around 500,000 poor people in rural areas as part of its funding programme. This is a community self-reliance, participatory rural development programme, to alleviate rural poverty and raise the standard of living of selected areas. The project targeted poor individuals including women in 1,000 villages. The project provides capital through a self-administered rural revolving credit financing system (*Sanduq*), which is applied through the Islamic *Murabaha* mode of finance to extend credit. Payment and collateral are secured through third party guarantees, social pressure and, sometimes, valuable assets. The actual amount of the loan, loan repayment schedules and the length of the grace period, all depend on the type of the project (grain milling, poultry, goat raising, soap making, crafts, and traditional small grain stores).

Some of the local social funds and local NGOs (the National Pensions Fund, the National Fund for Social Insurance, National Fund for Student Support, the National Corporation for Health Insurance, *Takaful* Fund, *Zakat* Fund, Social Solidarity Fund, *Elkifaya* Bank etc.), are established to serve specific social and economic goals. Some are financed from the budget, while others are financed through charity, or by beneficiaries. Among other activities including expenditure on essential services and health insurance, they are also engaged in providing small-credit for living-provision kind of projects (such as leatherwork, cloth-making, tailoring, macaroon production and poultry production) especially for poor, university students, widowed, divorced and deserted women.

4. ROLE OF MICRO AND SMALL ENTERPRISES IN DEVELOPMENT

4.1. Definition and Scope

In all parts of the world, there is no universal definition of "micro" and "small" sized enterprises. In fact, different agencies and institutions adopt various broad definitions either from a quantitative perspective such as: number of persons employed, volume of output or sales, level of investment in the fixed assets, use of factory space or energy, etc; or from a qualitative perspective such as whether the owner of the enterprise works alongside his/her workers, the enterprise is classified in the "unformal" sector. Typically, the significance of the criteria varies according to type of activity, or the national/institutional priorities and needs or whether for promotion or protection of MSEs or for the application of labour/investment/tax legislation.

Efforts in Sudan to formalize a national definition have been elusive for some time now. Institutions derive definitions suitable for their purposes by combining some of the abovementioned criteria. To mention a few of these, the Institute of Industrial Consultancy and Research, and the Arab Organization for Industrial Development use the number of those employed between which should not exceed 25. In addition to the employment of less than 25, UNIDO uses the value of fixed assets. The concept of the “informal sector” in which the enterprises covered by this concept are generally thought to show similar characteristics, such as ease of entry; labour-intensive; small-scale; reliance on indigenous resources; adaptive technology and skills acquired outside the formal school system' is used by different researchers and organisations which look at tiny, unorganised small businesses. The ILO first used the concept in Sudan in 1976. In their efforts to support poor families in Sudan. Non-Governmental Organizations (NGOs), used the concept of “Income Generating Activities”, (IGAs). IGAs are part of small production sub-sectors used to describe kinds of projects aimed at self-dependence in capabilities and skills of the target group of poor people, by increasing incomes through small projects in production and services sectors.

The concept of a “Productive Family” represents one of the main forms of small enterprises in Sudan. There is no unified definition of this concept, but it generally refers to small sized (not necessarily home-based) family business. A productive family is defined in the by-laws of the Co-ordination Council of Productive Families and Environmental Industries, Ministry of Social Planning as “a family which has the ability and readiness to provide some of its day-to-day needs by applying means of production to raise its standard of subsistence”.

Banks in Sudan tend to categorize MSEs in a manner suitable for the prevailing Financing Policy. Major categories are: Small Producers, Productive Families, Craftsmen, Professionals and informal sector.

For the purpose of this paper, emphases are centred on the characteristics of the production or service unit such as smallness, lack of proper bookkeeping systems. Moreover, here we have to accept a basic distinction between micro-enterprise (household and survival sector; one-person activity), and small enterprise (relatively formalised small-sized activity). Accordingly, microenterprises are business enterprises found in all sectors of the economy, excluding high-tech consultancy firms and other high-tech establishments. They are firms that employ 9 or fewer workers, with the majority of such firms at the lower end of the size spectrum, i.e. 1-2 workers. Small Enterprises: are business enterprises, excluding high-tech consultancy firms and other high-tech establishments. They are firms that employ 10-25 workers.

4.2. Contribution of MSEs to Economic Growth, Job Creation, and Poverty Alleviation

In developing countries, MSEs sector is characterized by a range of highly diversified activities, work with relatively smaller capital, are labor intensive and create more jobs per unit of investment as compared to larger firms. While we cannot deny the importance of larger enterprises for the growth of the economy of a developing country, there is ample evidence to suggest that the labor absorptive capacity of the MSEs sector is high, the average capital cost per job created is usually lower than in medium and large enterprises, and its role in technical and other innovative activities is vital for many of the challenges facing such a country (Jaslin, 2004).

MSEs sector is also described as the natural home of entrepreneurship. It has the potential to provide the ideal environment for enabling entrepreneurs to optimally exercise their talents and to attain their personal and professional goals.

In addition to the abovementioned characteristics, MSEs sector in Sudan is further characterized by having a wide range of operators: petty traders to small restaurant owners; a shoeshine boy to a small shoe factory owner; a peddler in the streets to a grocery business operator, etc. By virtue of these characteristics, MSEs are a major source of job creation, economic growth and equity in most of developing countries. They play a critical role in absorbing labor, penetrating new markets and expanding economies in creative and innovative ways.

One of the prime causes of high incidence of poverty in Sudan is low rate of job creation. Thus, in the absence of high volume of foreign direct investment needed to revitalize big industry in Sudan, promotion of micro and small enterprises is viewed as an effective tool for decreasing the level of unemployment in the country and raising incomes, thereby reducing poverty levels. The overall goal is attacking unemployment from different fronts and stimulating MSEs development in Sudan thus contributing to economic growth and poverty alleviation through self-employment.

The following is a brief summary of the contribution of different MSEs sector to employment generation (according to available statistics).

1- MSEs are generally considered as major sources of employment generation. They dominate agricultural and non-agricultural sector not only in number of enterprises but also in numbers employed.MSEs provide important services to medium and large enterprises by providing repair and maintenance services, supplying parts and components, processing semi-finished products and selling manufactured products to consumers, thus contributing to overall employment.

2- The scope and scale of MSEs and their relative intensity varies considerably among regions of Sudan. In some regions, MSEs have played a dynamic role in economic growth and employment generation, and in other regions they have acted more as a source of employment for those unable to secure employment in public sector or large enterprises. During the past decade, growth in employment generated by MSEs has also varied across regions.

3- The deterioration in the living conditions taking place since the 1980s forced quite a number of families to resort to MSEs sector as Productive Families. Their ever growing number led the banking system to issue preferential financing treatment to such enterprises through policies directed by the central bank. Moreover, the Ministry of Social Planning has also recognized this by establishing the Council of Co-Ordination of Productive Families and Environmental Industries, which is composed of academics, NGOs, government officials and banks, to formulate policies, programmes and mechanisms of financing these families. The share of this group to national economy and job creation and poverty reduction is unknown.

4- One major sub-sector of MSEs in Sudan is the “informal sector”, which first appeared in the 1970s, following a huge migration influx from rural to urban areas as the result of unequal development, civil wars and drought. The ILO (1976) showed that self-employment in this sub-sector amounted to between 25 and 30 per cent of employment in urban areas. Moreover, the ILO (1986) report re-emphasized the importance of the informal sector and estimated its contribution to be 60 per cent of the total urban employment in Sudan. In a study conducted by the Ministry of Planning, it was shown that over 100,000 people who are employed in the informal sector of Khartoum, in almost all production and services sectors, migrated annually. Moreover, the number of informal sector establishments has multiplied within the past few years, and there is a move towards commerce and services at the expense of industry. The role of women in the informal sector was estimated to be 12 per cent in 1990, up from 2.9 per cent in 1983 (Faiza, Idris & Al-Almin Al-Faki, 1993).

5- According to an outdated Industrial Survey of UNIDO, small enterprises have a major contribution to Sudan’s industrial sector, sharing 95 per cent of the total industrial establishment. Small-scale industries accounted for less than 10 per cent of investment in the industrial sector, but more than 35 per cent of gross manufacturing output and constituted nearly 50 per cent of the industrial revenue. Small-scale industries in Sudan need less capital measured by the average investment per enterprise, yield an annual output of three times the level of investment, and need about half the investment of large-scale industries to create one job. Small industries also appear to produce larger ratios of value added to gross output and value added to employment (UNIDO, 1986). Moreover, according to the 2005 Comprehensive Industrial Survey, small-scale industries contributed 93% of total industrial establishments and almost 18% of gross manufacturing output. Although the contribution of small industries in Sudan is overwhelming, when we investigate the contribution in each branch (or sub-sector), the results are mixed.

6- There is no data on Craftsmen covering their distribution, ages, number or types of activities. Also there are no statistics on their contribution to the country's GDP. Unsystematic data is available from different scattered sources, official reports and personal research, in addition to general observations. The number of registered Craftsmen co-operative associations has increased tremendously in recent years. The major objectives of these co-operative associations are finding workshop facilities for members, training of school leavers, maintaining relationships with local authorities and creating good relations with similar international associations. This is an indication of the increased number of organized Craftsmen.

7- Since the late 1970s, Sudan has played host to refugees from neighboring countries, in addition to rural-urban migration as a result of famine, drought and civil wars. The number of refugees has now reached more than one million. As a result, NGOs started programmes for refugees and migrants, specifically income-generating schemes for women with the aim of creating employment opportunities through tiny investment projects. This has been achieved by revolving funds, and by charging very low interest and administrative fees, without noticeable guarantees. More than 100 local and foreign NGOs are presently active in providing income generating credit, counselling and training programmes. Owing to lack of data, it is difficult to estimate the contribution of such income generating activities. However, as is clear from the number of the target group, and the volumes of finance from both local and foreign NGOs, the contribution is undoubtedly huge.

To conclude, despite the lack of precise and up-to-date statistical data, the consensus among development experts is that MSEs sector offers the greatest potential for economic development if proper macroeconomic policies are developed and appropriately implemented to it. The sector could then become a major force in the creation of new employment opportunities, particularly for the poor.

4.3. Impact of Macroeconomic and Financing Policies on MSEs

Experience in many developing countries which embarked on stabilization and structural adjustment programs shows that many MSEs were able to take advantage of the changed environment, while others were constrained by increased competition, financial difficulties, inputs, and the business environment.

Generally, the likely positive effects of more market-oriented policies on MSEs include access to inputs. The removal or reduction of import licensing usually gives MSEs greater access to imported inputs than any other licensing systems likely to be biased toward large, influential companies. Employment in MSEs sector generally increases during the reform period, but such an increase is expected to be inversely related to firm size. In Sub-Saharan Africa it was observed that production and employment growth were especially high in new firms that entered after the implementation of the reform programmes, indicating that dynamic MSEs were actively taking advantage of new opportunities. The change in relative prices through devaluations squeezed producers who relied mainly on imported inputs (a high proportion of large firms) relative to those who made greater use of domestic materials and labor (a comparatively high proportion of MSEs). Easier access to imports led a higher proportion of MSEs to increase their use of imported inputs under structural and economic reform programmes. Moreover, reduction of state monopolies and price controls gave MSEs freer rein in obtaining resources and marketing products.

Privatization and the restructuring of public enterprises can have a salutary effect on micro and small enterprise by improving the basic public services on which they rely for their business operations (electricity, water, telephones, transport). In some cases, privatization can even directly involve micro and small enterprises.

On the negative side, MSEs generally face intensified competition in the post reform environment. Trade liberalization makes competing imports more readily available, and rapid growth in self-employment (as a result of layoffs and slow growth in formal sector employment) increases domestic competition, especially for microenterprises. Some firms are likely to experience continued difficulties obtaining inputs. A combination of relative price changes and increased import competition may prompt a large number of MSEs to change their product lines. On the whole, competition can stimulate successful adaptation. Growing MSEs also are more likely to purchase new equipment-presumably to introduce new products and upgrade technology.

It is generally recognized that small enterprises tend to be more market-oriented than microenterprises. They are more likely to purchase new equipments during the post-reform period, make product-line changes, and realize rising profits. Microentrepreneurs, on the other hand, tend to be motivated by "push" factors such as losing a job or family tradition.

Banking reforms and restructuring can also have positive impact of MSEs. The rising share of broad money to GDP and deposits to GDP reflect a rise in real rate of returns and thus manifested in stable financial sector and stable financial liquidity and financial depth of the banking system. This can enhance credits to MSEs. Moreover, improving banking indicators such as reducing non-performing loans-to total loans reflects good credit performance and absence of defaults incidences. The improvement of the credit to GDP reflects no difficulties faced by banks to provide funds for all sectors including MSEs. The increase of loan-to-deposits ratio enhances the ability of the banking system to mobilize deposits to meet credit demand, and also augments liquidity to respond to shocks. The increasing ratio of total assets-to-GDP and liquid assets to total assets reflect a strong financial base of the banking system that serves MSEs. Monetary policy tools in the fight against inflation, reduces the inflation rate, the net effect might well be favorable for micro and small enterprise. Financial sector reforms also reduce the costs of credit as banks improve their efficiency in the wake of deregulation and privatization. Nevertheless, all these healthy indicators cannot have positive impact unless MSEs get access to formal lending at suitable conditions. If financial sector reforms make access to credit fairer and more open, micro and small entrepreneurs might actually see an improvement in their access to loans.

Following this broad theoretical background, it is essential to see the outcome of stabilization and Comprehensive Prudential and Restructuring Reforms on MSEs in the Sudan. However, due to the lack of relevant data, no empirical evidence is provided here. The proper way to assess the impact of these reforms on MSEs is to conduct a series of repeated surveys that trace the same MSEs for different periods and observe the effects.

As discussed in detail above, stabilization and structural reforms are generally oriented toward eliminating distortions in the economy that favor some groups over others. Because MSEs are rarely among the favored few, they stand to lose. Nevertheless, in the long run, MSEs stand to gain much more from a stable, growing, and unfettered economy. Even in the short-term some gains from such reforms can be anticipated. Some of f these likely effects in Sudan can be summarized as follows:

First: MSEs were hit by the slow growth of social spending programs for the poor, and cuts in subsidies to public enterprises.

Second: the increases in taxes in Sudan following the fiscal reform are likely to hit MSES less severely than other sectors of the economy because they tend to have relatively low incomes and to be difficult to tax due to their small size.

Third: The reduction of the costs of financing following banking efficiency improvement benefits MSEs by reducing *Murabaha* margins. As we mentioned earlier, in Sudan the financial sector reforms that make access to credit fairer and more open, did not improve MSEs access to loans.

Forth: The reduction in the inflation rates in Sudan during the last few years might well be favorable for MSEs in Sudan, because MSEs are now borrowing at longer maturities and lower margins. If banks shorten loan maturities quickly (and ruthlessly) to maintain their profit margins MSEs will loose.

Fifth: The appreciation of the Sudanese Dinar makes imported goods less expensive. Nevertheless, the benefits of this fall more heavily on those who import more. MSEs tend to have a much lower import coefficient than large, formal enterprises, so they will gain less, especially productive families.

Sixth: Privatization and the restructuring of public enterprises are likely to improve basic public services on which MSEs rely for their business operations.

4.4. Impacts of Macroeconomic and Financing Policies on Poverty in Sudan

Poverty can result when individuals are unable to generate sufficient income from their labor to maintain a minimum standard of living. The extent of poverty, therefore, can be viewed as an outcome of the functioning of labor markets. Because labor is often the most significant, if not the only, asset of individuals in poverty, the most effective way to improve the level of welfare is to increase employment opportunities and labor productivity.

The main objective of macroeconomic reforms and adjustment policies implemented in Sudan were to establish conditions for sustainable economic growth in order to eradicate poverty. Attaining a sustainable balance-of-payments deficit, low inflation, and a competitive exchange rate are important goals if, and only if, such reforms contribute to economic growth and lead to an improvement in the living standards of the majority of Sudanese citizens who are poor. An indirect effect of such reforms on poverty is also seen to be through creating an environment conducive to the growth of MSEs sector and improving its capability of generating more jobs.

Moreover, as has been stated earlier, providing efficient microfinance services for the poor and low-income households and, their microenterprises is important for a number of reasons.

i. Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smoothen their consumption, manage their risks better, build their assets gradually, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life. Microfinance services can also contribute to the improvement of resource allocation, promotion of markets, and adoption of better technology; thus, microfinance helps to promote economic growth and development.

ii. Without permanent access to institutional microfinance, most poor households continue to rely on meager self-finance or informal sources of microfinance, which limits their ability to actively participate in and benefit from the development opportunities.

iii. Microfinance can provide an effective way to assist and empower poor women, who make up a significant proportion of the poor and suffer disproportionately from poverty.

iv. Microfinance can contribute to the development of the overall financial system through integration of financial markets.

Now, within the context of MSEs and microfinance in Sudan, how did the macroeconomic and financing policies reviewed earlier affected, directly or indirectly, poverty in Sudan?

Any attempt to examine poverty and inequality of income distribution in Sudan is hindered by a lack of systematic, reliable and up-to-date data sets. Moreover, an estimate of the number of people in poverty depends on the choice of the poverty threshold. For, what constitutes such a threshold of minimum basic needs is subjective, varying with culture and national priorities. Definitional variations create difficulties when it comes to making comparisons over time.Thus, despite having a number of studies conducted by different researchers from time to time, it is rather difficult to piece them together and make a coherent picture.

Some estimates of poverty levels pertaining to different thresholds quoted from various sources are presented in Table (3) of the annex. The Gini index is also given, as it is a convenient summary measure of the degree of inequality based on either income or expenditure.

A cursory look into the statistics summarized in table (3) reveals that incidence of poverty increased from 50% in 1968 to over %٩٢ in 199٧, with the situation in rural areas generally being more appalling than in the urban domains. According to EL-Tahir Nur (1996), the increase in poverty line resulting from an escalating cost of living index prior to 2000 led to an increase in the proportion of poor at an annual rate of 2.5%.

Moreover, income is unequally distributed, with the Gini index being relatively larger for urban than for rural areas. This conforms to estimates of regional Gini coefficients computed by Ali (2005b). The Gini coefficient for the South is 0.4711, North is 0.5149, and for the whole country is 0.5101. Moreover, the widening inequality of formal salaries suggest that the top 10% acquired about 52% labor earnings in 1990 and 64% in 1996 (World Bank, 2003, p. vii).

Faris's (1997) estimates of Gini coefficient for rural and urban Gadaref showed discrepancy between provinces as well as between rural and urban domains within the same province. Our calculation of the Gadaref Gini coefficient using Faris's provincial Gini indices showed that rural Gini coefficient is 0.444 whereas the urban one is 0.569, while the state's index is valued at 0.475.

It is observable from information summarized in table below (quoted mainly from the work by Ali (1994), Ibrahim (1996), and Faris (1997) that the structural adjustment programs introduced by IMF and WB during 1978-1985 or solely implemented by the government during 1989-1992 followed by the economic liberalization introduced in 1992 coincided with a substantial increase in both poverty threshold and incidence.

Years / Indicator	1968	1978	1986	1992	1996	1997*
Poverty Threshold (Sudanese Pounds)	136	777	6384	270000	325545	357626
% Poor	50	53	75	91	91	92

**** Source: Faris (1997).These figures are for Gadaref State***

Despite the steady growth of the economy, there is a broad consensus among observers, policy-makers and academicians that structural adjustment programs and economic liberalization policy were the main causes of increase in incidence of poverty and inequality of income distribution in almost all parts of the country. Ali (1994) reported that those policies lead to an increase in income inequality from 46% in 1978 to 64% in 1986, whereas Faris (1997) reported a Gini index of 48% for Gadaref State in 1997. This conclusion was supported by the headcount index values reported in Ali (1994), Ibrahim (1996), and Faris (1997). As for recent years, the non-poverty specific surveys conducted (e.g. MICS) and other non-income measures, as those reported in the MDGs report, conclude that the rise in incidence of poverty is maintained in spite of recent economic growth.

5. CONCLUSONS & RECOMMENDATIONS

National interest in microfinance has burgeoned during the last decade: banks, lending and donor agencies, government and non-government organizations (NGOs) all support the development of microfinance. Microfinance empowers the poor to secure better nutrition, education, healthcare and housing for their families thereby lifting themselves out of poverty. The efficacy of microfinance is, however, largely dependent on macroeconomic and financial policies prevailing in the country.

This paper investigated the effects macroeconomic and financial reform programmes embarked on by the government for more than a decade on microfinance and thereby on MSEs development. It brought some lessons for viable Micro and Small entrepreneurship in Sudan.

5.1 Main Findings

It is nowadays widely accepted that a stability oriented macroeconomic policy is a necessary condition for development and for achieving and sustaining high levels of development. However, it seems that the stabilization policies proposed by IMF have often not met with success and sometimes even worsened the economic conditions of developing countries.

In Sudan, despite the growth of GDP, reduction in inflation, and mixed progress in other macroeconomic indicators seemingly attributed to macroeconomic reforms and liberalization policies adopted by the government during the last two decades, incidence of poverty is on the rise. This may be attributed to the non-targeting of the poor within these programmes that resulted in an unfair distribution of income revealed by the high values of the Gini index.

Measures undertaken by the state and NGOs to alleviate poverty, as well as social adaptation mechanisms have not substantially reduced the number of poor. Moreover, it is our observation that the rich-poor gap is fast growing as reflected by the increasing Gini coefficient, reflecting polarization and social class disintegration. The World Bank Country Economic Memorandum rightly concluded that high growth rate and more pro-poor growth distribution are needed to bring down poverty in Sudan. Thus, macroeconomic reforms need to be supplemented by decentralization, income distribution and broad-based rural development (World Bank, 2003, p. 34). Macroeconomic reforms are required not only to remove obstacles for growth, but also to be favorable to the poor. Scattered poverty reduction efforts have proven inefficient. Perhaps the adoption of a widely accepted poverty reduction strategy by the government is highly needed at this stage of development.

Despite the substantial improvements in the banking performance due to the CBOS prudential monetary and structural reforms policy, the improvement of some banking overall performance had no positive impact on microfinance. The financing policies extend many concessions to MSEs sector since 1994, including minimal *Murabaha* profit margin and partners contribution to *Musharaka,* freedom of choice of 'reasonable guarantee', exemptions from certificates of registration and audit reports and the recent specification of upper lending limits for projects of MSEs. Despite these concessions and some preferential treatments of CBOS extended, credits to MSEs are not increasing accordingly, not only out of total credit but also in percentage of total deposits.

The unusual characteristics of the SIBs inhibit MSEs to realize full potentials from macro and banking reforms. SIBs are characterized not only by the declining number of branches, but also by the regional inequality in the distribution of branches and their location in big towns. Therefore, they are not designed to extend finance to the poor segment of the society, who are still outside the formal financial umbrella. Moreover, the dominance of short-term (current account deposits) and sales-based modes of finance and the meager use of MSEs-friendly equity financing modes constitute barriers to effectively extend financing to MSEs. The outcomes are: a short-term nature of financing, an uneven distribution of the increased banking finance among sectors, a low share of finance to MSEs.

The lack of specialized institutions to evaluate machinery and equipment in Sudan necessitates the use of traditional guarantees. Moreover, strict internal banking policies and regulations to ensure successful projects or consolidate the application of the CBOS regulations and national financing policies, fees, and taxes restrict the volume of finance.

It is our belief that the most effective way to rebuild an economy is by rebuilding its financial system. The CBOS has moved a head in institution-building and monetary policy reforms. No doubt the CBOS prudential monetary and structural reforms policy regime have observable substantial improvements in the banking performance. Trends in the growth of velocity has been reversed, and monetary aggregates and rates of returns started to pick up, independence of the CBOS gave more policy freedom and allowed the shift of priorities toward price stability. Moreover, open market operations and foreign exchange market became effective monetary tools. Financial reforms are, nevertheless, far from being complete. However, despite the achievements financial intermediation (domestic credit and deposits) still remain low, infrastructure and communications are poor, and the banking system is still largely undercapitalized and weak.

Unexpectedly, the improvement of some banking overall performance hasn't affected positively outcome of microfinance (See section 3.5.3). This is because of the many constraints facing the effectiveness of providing microcredit by Sudanese banks. Consequently, credits to MSEs did not increase. The shortage of capital allocated to this sub-sector is a symptom of difference in the guarantees required, lack of proper marketing strategies, scattered target groups, low educational standard of the target groups and inadequate comprehension of dealing with money, the burden of tax and other government fees and duties, are some outstanding examples.

Moreover, poverty and inequality both at the regional and the national levels are increasing, and measures undertaken by the state and NGOs to alleviate poverty, as well as social adaptation mechanisms have not substantially reduced the number of poor.

5.2 Challenges and Constraints Facing the MSEs Sector

Micro and small enterprises are hampered by a number of constraints. The most frequently mentioned constraints may be categorized into internal and external ones.

1. Internal Constraints (i.e. inherent in MSEs)

In Sudan, as in most developing countries, MSEs face a wide range of constraints and they are often unable to address the problems they face on their own - even in effectively functioning macroeconomic policies. The constraints relate, amongst others, to: access to markets; finance; business information; business premises (at affordable rent); access to appropriate technology; access to quality business infrastructure. These constraints certainly hamper the growth of MSEs and lead to poor performance of the sector.

The majority of people involved in the micro and small enterprises sector are likely to be poor, asset-less, and, for those operating in urban areas, land-less. They are also characterized by lower educational standard and inadequate comprehension of dealing with money. It is for this reason that they have difficulty accessing credit.

Apart from constraints facing banking effectiveness to extend financing to MSEs, this poor outcome is also a symptom of lack of proper marketing strategies, scattered target group, low educational standards of the target group and inadequate comprehension of dealing with money, and the burden of other government fees and duties.

2. External Constraints (i.e. caused by factors external to MSEs sector)

A major point that emerged from this review undertaken is that, in Sudan, there is inadequate recognition of the dynamic potential of MSEs. While they are viewed as necessary for job creation in the short run, the fact that their development can play an important role in the growth process and poverty alleviation is insufficiently appreciated. As a result, a coherent policy framework is lacking, although some programmes for micro-level assistance to MSEs exist. We observed that the regulatory framework for the operation of MSEs is either non-existent or inappropriate and is thus rarely supportive and often discriminatory, skill development programmes scarcely address their specific problems and very little effort has been made to promote their linkages with large enterprises. Unless these problems are addressed, MSEs will remain precarious providers of low-quality jobs rather than become dynamic agents of economic growth. For, in the absence of a coherent macroeconomic framework, support programmes can at best prevent the extinction of MSEs.

From this perspective, it can be said that future policies will need to address three major problems.

- Defining an appropriate regulatory framework for MSEs**.** Very often micro and small enterprises operate in a twilight zone. While some of them belong to the formal sector so that the regulatory framework designed for large enterprises becomes inappropriately applicable, others operate in the informal sector where there is virtually no well-defined regulatory framework. Thus, while some MSEs face over-regulation, others have to depend on the whims of local authorities (for example, in matters of taxes or access to business premises), and face serious problems of access to markets, technology and credit. A lot of attention needs to be paid to defining an appropriate regulatory framework which assists rather than obstructs the growth of MSEs.
- Conditions of work in MSEs. The work environment, wages and job security are often unacceptably poor in these enterprises. Sustainable improvements in conditions of work fundamentally require development of skills both entrepreneurial and management skills of the employers and professional skills of the workers. The problem of developing the skills of workers in MSEs is essentially linked to the problem of establishing mechanisms for skill development in the informal sector. Development of employers' management skills also requires attention.
- Developing linkages between MSEs and large enterprises. Such linkages can be developed in both production and marketing, and can be beneficial for both types of enterprise. Indeed, the dynamism of micro and small enterprises usually derives from such linkages, as medium and large enterprises can provide an important stimulus for technological innovations and skill development in MSEs. Policy innovations are needed to develop such linkages.

Globalization and liberalization of economies around the world have brought about competitive pressures on enterprises of all sizes. No doubt the current globalization creates more international wealth, but it also creates unbalanced outcome, both between and within countries. Too many countries and people are not sharing the benefits reaped by the new wealth created by globalization. That is to say this reflects the social dimension of globalization. We agree with the recent ILO Report that responses to globalization have to come from within. The Report stated that: *"…*How (people) managed their internal affairs influences the extent to which people will benefit from globalization and to be protected from its negative effects. In this important sense the response to globalization can be said to begin at home" (ILO, 2004, p. xi), (emphasis between two brackets is added). Therefore, the survival and success of MSEs have come to depend on improving innovativeness and productivity in the face of intense competition. The requirements of information and resources for such improvements have become greater and far more complicated. In addition, some war affected regions were facing problems of obsolete technology and skills, and inadequate credit, besides lack of access to market and raw materials even in the pre-war period. It is anticipated that more and more enterprises too small to compete with larger domestic and multinational corporations will be marginalized, and in many cases may have to become informal sector enterprises.

It is also recognized that one of the key factors that limits access, is the transaction costs and risks associated with the sector. Access is related to proximity, and that financial institutions in Sudan haven't networks near to borrowers (e.g. social banking) that can provide greater access at a reduced transaction costs.

5.3. Recommendations

If micro and small enterprises are to be an engine for employment creation and poverty alleviation, certain conditions and requirements must be met; chief among them are regulatory, financial and non-financial services.

There is a broad, though not universal, consensus among development economists that a poverty-eradicating strategy must be based on increasing the productivity of smallholder agricultural producers and the promotion of small- to medium-sized manufacturing enterprises that are labor-intensive (Helleiner, 1992, 1994). Economic growth and structural transformation of the economy depend on increasing labor productivity which, in turn, can be achieved by adopting a broad-based human resource development strategy.

Thus governments should engage in a full scale screening of the most adequate macroeconomic policies for promoting the goal of employment and decent work, and look into questions like the room for maneuvers in national macroeconomic policy in developing countries, the avoidance of the "stabilization trap", the contribution that an appropriate macroeconomic policy can make to poverty reduction and employment creation, and more generally, the possibilities and limits of expansionary macroeconomic policies. It should also contribute to the analytical and policy discussion regarding poverty-employment relationships, and will analyze, in particular, the interactions between macroeconomic policy and labor market policies.

Further work will also contribute to related debates on development, especially in showing the relationship between growth, employment and poverty.

Regulatory:

- A healthy macroeconomic environment that generates demand for the goods and services of MSEs is likely to enhance their prospects more than any targeted measures can. Macroeconomic reforms are required not only to remove obstacles for growth, but also to be favorable to the poor by raising productivity which is one major source of poverty. Macroeconomic reforms need to be supplemented by MSEs policy decentralization, rural social and infrastructural spending, income redistribution and broad-based rural development strategy, including MSEs rural development strategy. We strongly support the contention that the impact of Zakat and Social Solidarity Fund need to be fully assessed in this context.
- To curb unemployment and facilitate a suitable environment for new job seekers and for self-employment, direct intervention and support by the government is crucial. MSEs government supportive strategy should be based on broad policies that lower the costs of entry and stimulate demand, and ensure a supportive attitude of government officials toward informal activities and deregulation. Moreover, policy reversal is required to stop government micro and small enterprises harassment.

Financial:

- Better household savings instruments can raise the ability of people to go into business for themselves. Financial development strategy, beside formal banking, are required to promote informal savings collectors, savings and credit associations, credit unions, cooperatives, and informal financial institutions that can meet microentrepreneurs' demand for financial services on a sustainable basis.
- Measures to improve the accounting practices of firms and their ability to provide audited statements can improve credit worthiness by reducing the cost to banks of obtaining reliable information.

- Banks' concern with risk can be addressed through a joint guarantee scheme to be formulated by the banks themselves under the supervision of CBOS, and establishment of a better legal system to document register and collect property offered as collateral. The NIDGB formulated joint guarantee plan in 1996 need to be adopted (see e.g. NIDBG, 1996).
- Governments across the regions have adopted specific policy measures to promote MSEs in order to create jobs. Such interventions have been at the macro, intermediate and micro levels. Macro-level measures are concerned with formulating a supportive and enabling policy environment, while facilitating access to and participation in delivery systems. At the intermediate and micro levels interventions are more concerned with providing training, credit, and so on, to entrepreneurs. Sudan, as the case of many developing economies in the region, although managed to carry out sound macroeconomic policies, failed to adequately address MSE macro-level policies although they have been carrying out some micro- and intermediate-level interventions. For instance, coherent MSE policies have been lacking in many of regions, although various programmes have existed to promote MSEs. Government efforts in some regions have focused in the past on promoting livelihood (survival) activities by facilitating training and micro-credit, which has caused microenterprises to increase in number without prospects for improving incomes and productivity through establishing linkages with larger enterprises.
- MSEs in the informal sector are considered to be the last resort for job creation in many urban areas in Sudan. Authorities in these areas are required to promote MSEs to achieve competitiveness and productivity by regularly planning for creating an environment conducive to reforming MSE management. Their plans should include promoting deregulation, supporting the start-up of new businesses, reviewing corporate laws and the relevant rules, and strengthening the financial/capital market to facilitate new businesses.
- As it appears in Sudan now, loan size and terms do not particularly suit the needs of MSE operators. The fact that more and more microfinance institutions are established as of recent is quite encouraging. Nevertheless, the low prevalence of banking branches in rural areas requires some considerations. However, as long as the legal framework and the financial resources do not allow access to relatively bigger credit sizes and longer terms to maturity, operators will have the incentive to choose hand-to mouth business opportunities rather than better and sensible ventures. Very small loan size and short loan maturity might have proved important in surmounting house-hold food insecurity; but this does not sound so good when viewed from the perspective of private sector development. It thus seems that the current microfinance practice needs some improvements that take the long-term objective of MSEs sector development into account.
- The challenge facing Sudan is how to provide enough funds to micro-businesses at affordable cost, while at the same time beneficial to the lender. We suggest that this can be achieved through spreading banking facilities in rural areas (to reduce costs of lending), appropriate and well-designed guarantee schemes and less severe regulations, taxes and fees (to enhance lending opportunities), and a partnership between private financial institutions and Government (to encourage financial institutions to extend credit to MSEs). The government could provide some type of guarantee and incentive, while private entities could provide funds by earmarking a fraction of available funds for the micro sector with the clear understanding that as a contribution to social development, profits on these funds will be lower.

- Generally speaking, if SIBs are not able to generate enough long-term sizable deposits, they will not be able to extend long-term loans that are deemed necessary to achieve developmental and poverty-alleviation goals. Moreover, as we mentioned before, partnership financing modes, opposed to sales-based modes, are better suited for meeting the needs of MSEs. In most cases financing is granted without an obligation on the part of the partner to pay back whether he or she gains or loses. Moreover, no strict security is demanded. If the operation ends in a loss the partner does not bear this loss alone. If he or she is unable to settle his or her bills, a grace period is given without any additional fees. One of the major deficiencies of the financial system in Sudan is the small size venture capital in general, but particularly for micro-businesses. It is a well-known fact that the overwhelming majority of new micro-enterprises are likely to fail, which means that the risks are great and this serves to inhibit those who are already in poverty. Venture capital can overcome this constraint. The lack of the venture capital could be partially addressed if large businesses and government would collaborate in establishing a venture capital fund specifically for the micro and small-business sector.
- Measures are required to reach the scattered and lower educational standard and inadequate comprehension of dealing with money of the target group, especially in rural areas, by having networks near to borrowers to provide greater access at a reduced transaction costs. Moreover, lowering the burden of banking fees and taxes and other government fees and duties, and easing strict internal banking policies and regulations via increasing the share of less policy- demanding partnership modes are also required.

Non-financial:

- Judging by the current availability of service to the MSEs in Sudan, it can be concluded that the provision of non-financial services to this sector is not a high priority. The availability of service is very poor in the urban areas but it is essentially non-existent in the rural areas. As a consequence, the full potential of the sector to create employment and reduce poverty is not being realized. The absence of such services jeopardizes the sustainability of the MSEs sector and retards the development of communities and the nation. Marketing, management, and training (including technical education and training that enhances people's business-related skills and business culture and supplies disciplined and quality workforce), are by far the three most crucial areas of non-financial service that must be addressed if MSEs sector is to achieve its full potential. People often lack the capital to invest in micro-business; but even when they have or obtain the capital; they may lack markets, management skills, training or any combination of these. The success of micro and small enterprises in creating employment and reducing poverty depends on our ability to identify and fill the gaps that may exist in any of these areas.
- Non-financial constraints vary widely by region. Region-specific and sub-sector studies can help to identify specific bottlenecks. Entrepreneurs' associations, self-help groups, cooperatives, and local NGOs are potentially useful in dealing with individual problems and communicating with policy-makers to address systemic ones. There is little consensus, however, on replicable, cost-effective methods for providing non-financial services. Hence, technical assistance should emphasize adaptability to local conditions and demand-driven approaches. Program design should include periodic assessment of impact and demand in order to evaluate and improve practices.
- The supply of good infrastructure, like power, telephone, working premises, etc. is absolutely essential for the private business sector to operate efficiently. The supply of

such services is essentially the responsibility of public institutions. For public institutions to avail the required infrastructure for the business sector resources have to be mobilized from tax revenue, domestic and foreign loans as well as grants. Mobilizing these resources is quite demanding for the government. Government efforts remaining constant, the business sector has also a part to play in the development of the infrastructure that it makes use of. This can be realized when business operators abide by existing tax rules & regulations.

5.4. Areas for Further Work

Apart from the scanty data compiled from different sources to substantiate the arguments made on various issues addressed in this paper, which we consider insufficient, there are serious information gaps, and further empirical work is needed. Areas of priority include:

- Households' incomes and expenditures at both regional and national levels. A carefully planned and well designed household income and expenditure survey conducted regularly is capable of providing wide scope information that could be used in evidence-based studies of most of the issues tackled in this paper especially poverty and employment.

- MSEs survey is needed to assess the size, scope and diversity of MSEs and the sector's contribution in economic growth, and poverty alleviation. Information will also be needed to measure the sensitivity of employment and poverty with respect to changes in various forms of finance provided to MSEs; i.e. to compute elasticities of employment and poverty.

- Attempts should be made to draw a widely acceptable definition of MSEs for financing and strategic purposes.
- UNICONs' efforts need to be complemented by a more comprehensive study of all banks to determine the exact volume and impact of actual banking finance to MSEs, and constraints facing ISBs to extend finance to MSEs. Among the most important area of investigation is how to carry forward appropriate and well-designed guarantee schemes (including those mentioned here).
- The impact of Zakat and Social Solidarity Fund on MSEs needs to be fully explored and appropriate regulations developed in a manner that realizes the full potentials of the sector[17].
- The collaboration of the government and large businesses in providing venture capital fund specifically for the micro and small-business sector should be further explored.

[17] A new role of *Zakat* as a microfinance source in Sudan is now being studied by the authors. The outcome will be publish in a book soon.

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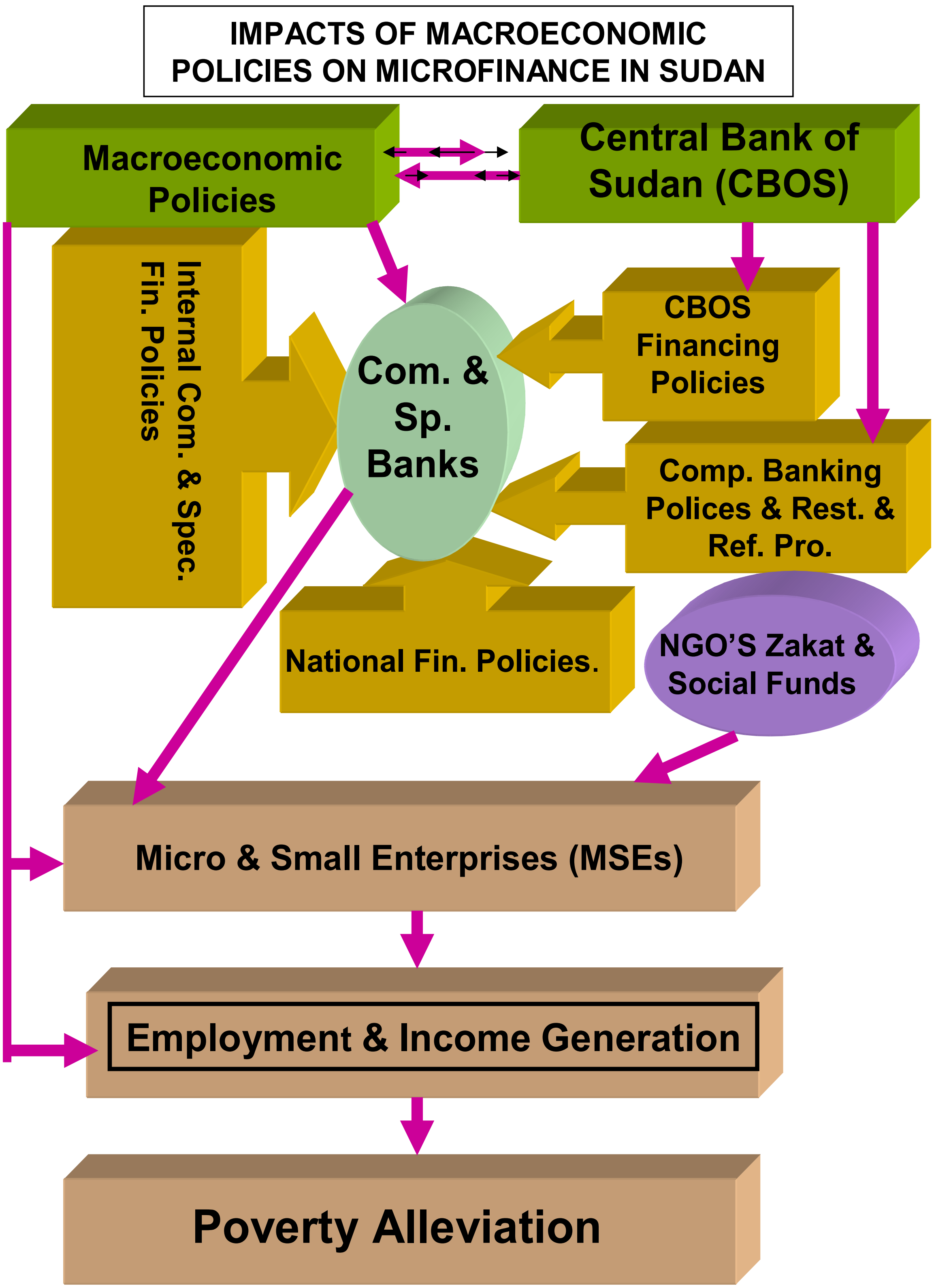

IMPACTS OF MACROECONOMIC POLICIES ON MICROFINANCE IN SUDAN
Macroeconomic Policies
Central Bank of Sudan (CBOS)
Internal Com. & Spec. Fin. Policies
Com. & Sp. Banks
CBOS Financing Policies
Comp. Banking Polices & Rest. & Ref. Pro.
National Fin. Policies.
NGO'S Zakat & Social Funds
Micro & Small Enterprises (MSEs)
Employment & Income Generation
Poverty Alleviation

Annex: Key Macroeconomic Indicators

Table (1): Sudan Macroeconomic indicators (1997-2005), (In millions of SDD, unless otherwise specified)

Description/ Years	1997	1998	1999	2000	2001	2002	2003	2004	2005
Nominal GDP (SDD Billions)	1601.2	1991.6	2541.0	2969.5	3380.5	3483.0	4426.0	5138 *	5973 *
Oils Sector (%)	-	-	-	-	4.4	4.5	8.0	10.3	9.5
Growth Rate	-	24.4%	16.9	16.9	13.8	3.0	27.1	16.1	16.3
GDP Real Growth Rate	-	5.4	6.0	8.3	6.4	6.0	6.0	7.3	8.3*
Inflation Rate (Average CPI)	46.5	17.7	16.6	8.1	4.9	8.1	7.7	8.4 *	7.4*
Crude oil price US$/b)	-	-			22.0	23.0	27.0	36.0*	34.0*
Exchange Rate (Aver. SDD/US$)	157.65	199.47	251.60	257.14	258.70	263.34	260.82	258.26	243.58
Investment/GDP (%)	1.8	0.9	18.7	18.7	19.5	19.1	19.1	22.6	24.4
Exports (Millions US$)	594.2	595.7	1780.0	1806.7	1698.7	1839.0	2577.0	3778*	4975*
Oil Exports (Million US$)	zero	zero	275.9	1350.8	1376.6	1413.0	1968.0	2811.0*	2957.0*
Imports (Millions US$)	1579.7	1924.6	1414.9	1552.7	1585.5	1503.0	2536.0	3586.2*	4711.5*
Trade Balance (millions US$)	(985.5)	(1328.9)	(634.8)	254.0	113.2	336.0	40.0	-	-
Current Account Balance (US$)	(927.3)	(957.4)	(431.1)	(517.6)	(518.8)	n.a.	(827.0)	(816.1)*	(1408.5)*
Total revenues (SDD Billions)	108.6	159.2	205.2	331.4	365.2	470.7	742.0	1105 *	1348*
Oil Revenue (Ex.OSA) (% of GDP)	-	-	-	na	4.4	4.7	8.8	12.2	na
Total Expenditures (SDD billions)	128.2	175.5	227.0	352.2	418.8	503.4	699.0	1040*	1387*
Surplus (Deficit) Budget	(19.6)	(16.2)	(21.8)	(20.8)	(53.6)	(32.7)	43.0	65	(39)
Primary Balance (% of Non-Oil GDP)	-	-	-	-	(4.7)	(4.3)	(4.6)*	(6.3)*	(6.6)*
External Debt (Billions US$)	20.2 *	20.5	20.5	20.0	21.5	23.0	24.1	25.3	26.5*

*** Projected or estimated.**

Source: Central Bank of Sudan, Annual Reports, different issues; World Bank, 2003, p. 4; IMF, Country Report No. 03/390, 2003; IMF Country Report No 05/187, 2005, IMF Country Report No. 05/180, 2005.

Table (2): Sudan : Banking Performance (1997-2005), (In SDD millions, unless otherwise specified)

Description/Years	1997	1998	1999	2000	2001	2002	2003	2004	2005
Public Expenditure (Cur.& Dev./GDP) (%)	**8.0**	**12.6**	**8.9**	**11.8**	**12.4**	**14.9**	**15.8**	**20.2**	**-**
Demand Deposits (Total in SDD mill.)	**38673**	**54881**	**62752**	**93505**	**117551**	**158682**	**-**	**-**	**-**
Growth Rate of Demand Deposits (%)	**-**	**41.9**	**14.3**	**49**	**25.7**	**35.0**	**-**	**-**	**-**
Total Deposits/GDP (%)	**6.0**	**6.0**	**5.9**	**6.6**	**8.2**	**10.6**	**-**	**-**	**-**
M2-Currency/GDP (%)	**10.0**	**10.4**	**10.5**	**6.9**	**8.2**	**16.2**	**16.6**	**18.7***	**20.6***
Credit/GDP (%)	**2.6**	**3.4**	**4.3**	**2.4**	**3.0**	**4.6**	**-**	**-**	**-**
Non-Performing Loans/Total Loans (%)	**25.6**	**15.6**	**24**	**16.0**	**16.0**	**12.7**	**11.4**	**10.2**	**-**
Capital Adequacy Ratio	**7.2**	**9.0**	**6.0**	**7.0**	**11.0**	**9.0**	**9.9**	**10.8**	**-**
ROA	**-**	**-**	**-**	**-**	**0.5**	**1.1**	**1.5**	**3.5**	**-**
ROE	**-**	**-**	**-**	**-**	**26.4**	**29.9**	**32.9**	**38.9**	**-**
Ratio of Loan Provision to Bad Loans	**-**	**-**	**-**	**-**	**23.0**	**24.0**	**22.0**	**23.0**	**-**
Velocity (GDP/M2), (Average %)	**10.0**	**9.6**	**9.5**	**8.7**	**7.8**	**6.2**	**6.9**	**5.3**	**-**
Total Banking Assets/GDP (%)	**10.1**	**16.0**	**17.4**	**12.0**	**13.5**	**11.3**	**-**	**-**	**24.1***
Banking Liquid Assets / Total Deposits (%)	**29**	**26**	**1.0**	**28.9**	**20.9**	**18.6**	**-**	**-**	**-**
Loans / Total Assets (%)	**18**	**14**	**11**	**22**	**24.5**	**26.2**	**-**	**-**	**-**
Total Deposits / Total Liabilities (%)	**41**	**37**	**35**	**55**	**60.2**	**59.4**	**-**	**-**	**-**
Loans -To- Total Deposits Ratio (%)	**43**	**37**	**33.5**	**44.2**	**40.6**	**44.1**	**-**	**-**	**-**

* Projected or estimated.

\- Indicates not available.

Source: Calculated from figures obtained from the Central Bank of Sudan, Annual Reports, different issues; IMF, Country Report, No. 03/390, 2003; IMF Country Report No 05/187, 2005

Table (3): Estimates of Measures of Poverty (Head Count Index) & Inequality of Income Distributions (Gini Index) for Sudan

Author / Particulars		El-Tahir Nur M. & CBS	Ali, A Ali	Ibrahim, A Ibrahim	Kimo, A. Adiebo	Faris, Arbab I B
Data Set Used		1992	1992 Household Income & Expenditure Survey	Migration & Labour Force Survey (1996)	Formal Salaries of Employees of Khartoum State	Gadaref State Household Income & Expenditure Survey (1997)
Poverty Threshold (in Sudanese Pounds)	Rural			284757		344181
	Urban			420716		384515
	Combined		270000	325545		357626
Poor (%)	Rural			94		94
	Urban			85		86
	Combined	71 Expenditure) 86 (Income)	50% (1968) 53% (1975) 75% (1986) 91% (1992)	91	80-100% (Income) 57% (Expenditure)	92
Gini Index (%)	Rural		47 (South)			44.4
	Urban		51 (North)			56.9
	Combined		51.1			47.5

Sources: El-Tahir Nur & Central Bureau of Statistics, 1995; Ali Abdel Gadir Ali, 1994; Kimo A. Adiebo, 1997; Ibrahim A. Ibrahim, 1997; and Faris, Arbab B (1997).