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ABBREVIATIONS AND ACRONYMS

BPT	Business Profit Tax	MTO	Medium Taxpayer Office
CIFA	Country Integrated Fiduciary Assessment	NPC	National Petroleum Commission
CNPC	Chinese National Petroleum Corporation	ORSA	Oil Revenue Stabilization Account
CoA	Chamber of Accounts	PER	(this) Public Expenditure Review
CPA	Comprehensive Peace Agreement	PFM	Public Financial Management
FFAMC	Fiscal and Financial Monitoring Allocation Commission	PIT	Personal Income Tax
GDP	Gross Domestic Product	PRS	Poverty Reduction Strategy
GFS	Government Finance Statistics	PRSP	Poverty Reduction Strategy Paper
GMP	Green Mobilization Program	SCCL	Sudan Cotton Company Ltd
GNU	Government of National Unity	SHHS	Sudan Household Health Survey
GOSS	Government of Southern Sudan	SPC	Sudan Petroleum Corporation
HIPC	Highly Indebted Poor Country	SPLA	Sudan People's Liberation Army
IDA	International Development Agency	SPLM	Southern Sudan People's Liberation Movement
IMF	International Monetary Fund	SSA	Sub-Saharan Africa
INC	Interim National Constitution	SSLA	Southern Sudan Legislative Assembly
JAM	Joint Assessment Mission	UNDP	United Nations Development Program
LTO	Large Taxpayer Office	USAID	United States Agency for International Development
MDG	Millennium Development Goals	VAT	Value Added Tax
MICS	Multiple Indicator Cluster Survey	WSA	Wealth Sharing Agreement
MOFNE	Ministry of Finance and National Economy		

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EXECUTIVE SUMMARY

A. Introduction

1. **The signing of the Comprehensive Peace Agreement (CPA) on January 9, 2005 marked the end of nearly four decades of civil war in Sudan and an optimistic beginning of reintegration into the international community.** This peace, together with macroeconomic stability and significant natural resources, has offered a tremendous opportunity to increase broad-based economic growth and poverty reduction in a united Sudan. However, more than two years after the signing of the CPA, the political and security context remains fragile and complex, even for a post-conflict situation, with lingering conflicts in several parts of the country, delays in implementing some important provisions related to wealth sharing in the peace agreement, and a pending referendum on national unity scheduled for 2011. The record on human development outcomes also remains weak (Sudan ranks 141 out of 177 countries in UNDP's 2006 Human Development Index), especially relative to the fact that income per capita has passed \$1,000 or roughly 25 percent higher than the SSA average.

2. **This Public Expenditure Review (PER) is the first for Sudan,** and reflects the initial phase of engagement with the newly formed Government of National Unity (GNU) and Government of Southern Sudan (GOSS) on fiscal management issues. The objective is to establish a baseline understanding of key fiscal management and policy challenges, highlight priority reform areas for policymakers, and set the agenda for the next phase of work. A fiscal dialogue has been rebuilt at the federal and sub-national levels, after more than a decade hiatus of World Bank engagement in Sudan. During this re-engagement, process has been as important as deliverables, with close and frequent discussions with the MOFNE Undersecretary and senior officials via a comprehensive PER Steering Committee, as well as a substantial resident presence in Juba. The scope of initial PER issues was agreed jointly with the GNU, and this report is essentially a snapshot of the on-going dialogue and draws largely on five background papers covering: revenue management, pro-poor spending, intergovernmental transfers, fiscal management and pro-poor spending at the state and locality levels, and fiscal management in Southern Sudan. The PER exercise has been an interactive process of focused and timely deliverables and dissemination through in-country workshops, and has served as an input into the 2007 and 2008 budget processes, the preparation of pro-poor monitoring for the 2006 and 2007 Sudan Consortia, and fiscal management at the state and locality level.

3. **The political and legal context reflected in the 2005 Interim National Constitution (INC) has key implications for expenditure management.** First and foremost is fulfillment of the wealth sharing obligations of the peace agreements, which limits the discretion of GNU spending as significant shares of oil revenues must be transferred to the GOSS (roughly 15 percent of total GNU expenditures in 2005-2006) and other oil producing states. Second, the vision of fiscal decentralization is a key aspect of a unified and peaceful Sudan, potentially addressing inequalities and the root causes of conflict

by increasing financing for marginalized and underdeveloped areas. This also has significant implications for discretionary spending of the federal government, as a greater share of revenues is transferred to the Northern states. And third, accountability at all levels of government is required to ensure resources are shared equitably and used in accordance with each level of government's constitutional responsibilities.

4. **The agenda for addressing challenges in public expenditure management is huge, and a programmatic approach has been adopted** for the PER program that is pragmatic and with reasonable expectations of what can be accomplished in this post-conflict environment. Accordingly, this first PER underscores the need to address basic elements of effective public expenditure management including comprehensive and transparent functional budget reporting, monitoring of actual spending and its outcomes to bolster accountability, costing sector and cross-cutting policies to make budget prioritization more transparent, improved budget credibility, linking development planning to the annual budget preparation process, and generally increasing the use of expenditure analysis in decision-making. Many of these issues are recognized as priorities by the authorities and reforms are either planned or underway. There are other key issues that this PER does not tackle in depth, including defense allocations and improving the transparency and accountability of oil sector governance. With the solid foundation of this first PER and on-going dialogue with the Sudanese authorities, these issues will hopefully be addressed as the PER program moves into its next phase.

B. Understanding Public Finance in Sudan

5. Fiscal management since the CPA has been dominated by the attempt to balance pressures for continued increases in federal expenditures and the need to finance new obligations to sub-national governments, on one side, with oil revenue volatility and shortfalls in expected revenue growth.

6. **While the discovery and exploitation of oil resources has facilitated an increase in national wealth, it has also brought a myriad of problems.** Sudan is one of the newest significant oil producing countries in the world. Significant oil production started in 1999, and the country is now the third largest oil producer in Sub-Saharan Africa, behind Nigeria and Angola. Real wealth has subsequently increased, with economic growth currently over 10 percent and among the highest on the continent. Oil revenues have expanded budget resources potentially available to support pro-poor development. The political economy of oil has also brought with it additional pressures for expenditure (some of which may be conditioned by capacity and other constraints), rent-seeking behavior, and reduced pressure to undertake key fiscal reforms that would help ensure medium- and long-term stability irrespective of the course of oil production and prices. Oil revenue in Sudan has also proven volatile. Oil production has fallen short of expectations in recent years. Moreover, Sudan has thus far not benefited fully from the recent rise in global oil prices, since much of its crude production is now of a lower quality and had been fetching unexpectedly low prices. Taken in tandem with a relatively low tax effort, these factors have caused severe difficulties for budget forecasting, formulation and implementation.

7. **Public expenditures have grown sharply**—from a low base of 7 percent of GDP in 1998 following the fiscal stabilization program to 22 percent in 2006—initially using the fiscal space from new oil revenues and more recently outpacing the growth in revenues with rapid increases in most categories of spending, including for some CPA-related obligations. A new feature is the fiscal deficits that have emerged (roughly 2 percent of GDP in 2005 and 4 percent of GDP in 2006), after nearly a decade of prudence. CPA-related spending pressures are partly responsible. The dominant effect of the CPA on the composition of GNU expenditures has been large increases in new obligations to sub-national governments—both CPA obligations to the GOSS and fiscal decentralization transfers to the Northern states—with the federal share dropping from 92 percent of total GNU spending in 2000 to 64 percent in 2006. Responsibility for basic service delivery has been devolved, and increases in sub-national resources implies higher levels of pro-poor spending (as discussed below) but has also underlined the importance of addressing deficiencies in effective expenditure management at lower levels of government. The effectiveness of decentralization and resource use at the sub-national levels is subject to improvements in public financial management.

8. **Fiscal expansion at the current pace appears to be unsustainable.** The 2007 budget called for a 13 percent increase in total expenditure over last year's budget to a total of \$11.8 billion. Large increases are planned for both the federal wage bill and transfers to Northern states (roughly 25 percent nominal increases for each). National development was also budgeted to increase significantly. The likelihood of meeting these expenditure plans is low given oil revenue shortfalls in the first half of 2007, at least not without high levels of domestic or external deficit financing which would be problematic, as noted by the IMF. The pressure for expenditure cuts and reallocation is high, raising the relevance of this PER and the need for subsequent government action to address the current trajectory of fiscal imbalances and avoid weakening the country's hard-won macroeconomic credibility.

9. **The fiscal pressures in the South have proven even more acute.** The overall balance in 2006 moved sharply into cash deficit due to limited spending discipline as well as oil revenue shortfalls in the second half of the year. Aggregate spending was driven by outlays on wages and operations that were roughly double planned amounts, while capital expenditures were cut sharply. In the first half of 2007, oil revenue shortfalls continued, GOSS significantly over-estimated non-oil revenue, and in the face of huge development needs, expenditure plans in the 2007 budget were significantly expanded relative to 2006. The cash reserves that could have provided cushions were largely run-down last year and are no longer available. One risk is that planned investments in roads, schools, clinics and so on will be squeezed by the burgeoning payroll.

10. **At the national level, budget credibility is hampered by limited costing and prioritization of sector and thematic policies during the budget preparation process, as well as execution volatility.** The macroeconomic framework, started early in the budget preparation cycle, focuses on deriving macro targets, but deriving sector envelopes through consideration of costed policies and a transparent prioritization process remains a challenge. Introduction of a functional budget classification promises to improve budget coordination of sectoral policies. Aggregate annual expenditure deviations from approved budget have improved since 2000, though 2006 experienced a low 87 percent execution rate due to oil

revenue shortfalls. Monthly variation of MOFNE releases is a significant issue. Without a predictable flow of resources to spending units, execution of spending plans is hampered, and of particular concern are the effects on financing of capital expenditure.

11. **Development funding is a key component for CPA implementation and poverty reduction, but has been volatile and heavily concentrated in a handful of large endeavors.** The largest five national projects absorbed more than 60 percent of total GNU investments in 2006, causing weak financing performance in the remaining national portfolio. Spending above budgeted allocations is common for the large projects. New projects make up more than a quarter of the recent annual portfolios. State-level development in poor states and rural areas is generally underfunded. There are serious deficiencies in development planning, at the program planning and project analysis levels, and at both the national and state levels. Linkages across levels of government, especially with respect to supporting service delivery on the ground, are weak. Evidence of project cost/benefit analysis is limited for the majority of investments in the annual portfolio. Deficit financing via government promissory notes is also particularly opaque.

12. **Notwithstanding on-going efforts by the authorities, public financial management systems in Sudan are generally weak.** Recent GNU measures, supported by the IMF, should be recognized. These include restructuring the budget to reflect sub-national transfers, computerizing the budget performance reporting system, training on functional budget classification, and establishment of a high level committee to help ensure allocation and monitoring of federal government resources in line with budget priorities. Nonetheless, significant deficiencies remain. The commitment control system is not effective, and expenditures are committed on the basis of appropriations rather than availability of cash resources. Cash management is weak, and for other than salary payments, there is a large amount of unpredictability regarding resource flows at the federal, state and locality level. Due to this, there is a regular build up of arrears although information regarding commitments or arrears is difficult to collect. Also difficult to define but widely acknowledged is extra-budgetary revenue collection and expenditure, including at the federal line ministry level. The Chamber of Accounts in MOFNE compiles monthly financial reports for the government as a whole, and monthly government finance data is produced on time, with a six week lag. However, the utility of this data is undermined due to shortcomings in the classification system and comprehensiveness.

13. **In the South, the GOSS is establishing a system of public financial management virtually from scratch.** The former SPLM Secretariat of Finance, which managed resources of around \$100,000, has transformed itself into a Ministry responsible for managing over one and a half billion dollars annually, including significant external financing. The government has committed itself to establishing sound and transparent financial management systems and to combat corruption. While some progress has been made, including the outsourcing of accounting and auditing functions and actions to address corruption, government finances are still characterized by weak management and lack of accountability.

C. Toward a Sustainable Pro-Poor Expenditure Framework

14. **With national income approaching lower-middle income status, there is a strong imperative to ensure adequate resources are channeled to address the weak record on human development outcomes and wide regional disparities, and relatedly, the underlying structural causes of conflict.** Promoting a shift to a more pro-poor budget has been a key focus of the PER exercise, and there is increased attention to defining pro-poor allocations in MOFNE planning/execution analysis. But there are serious limitations to measuring and monitoring pro-poor spending in Sudan, due to the quality of data on spending and outcomes and the complexities added by fiscal decentralization. Moreover, Sudan does not yet have a full PRSP, so it is not possible to point to a coherent set of policies that would anchor a definition of poverty-reducing allocations.

15. **Working within these limitations but also spurred by the rapid rise in public expenditures, the World Bank has been working with the GNU to define and monitor the share of public expenditures targeted to the poor.** According to the PER working definition (see Section 4), poverty-reducing expenditures have increased from a low base of \$16 per capita in the 2000-2004 pre-CPA period to \$68 per capita in 2006. But the amount realized—5.5 percent of GDP in 2006—was below budget plans (6.6 percent of GDP), JAM commitments (5.9 percent of GDP), and the average for HIPC countries (7.0 percent of GDP).

16. **The available information suggests a welcome increase in pro-poor allocations.** Much higher levels of MOFNE releases are designated for activities expected to benefit the poor than before the CPA. However, we don't have information directly from the spending units on the use of funds for the intended purposes and the quality and efficiency of spending. This is especially true at the state and locality levels. The growth in pro-poor spending has occurred in the context of rapidly expanding total expenditures, and did not involve reallocation in level terms from other spending categories given all areas experienced real growth. It will be important to protect and strengthen pro-poor spending as a policy reflected in the budget, given the current fiscal environment. The formulation of a national poverty reduction strategy should help in this regard.

17. **The increasing pro-poor efforts over the last two years were driven by higher transfers to Northern states,** which accounted for more than half of total pro-poor spending in 2006. The JAM called for a large majority of GNU pro-poor budget efforts in the form of transfers to the Northern states, to support decentralized delivery of basic services. The increase has been more federal than expected, with resources transferred to the states heavily skewed toward current expenditure over development, raising concerns given improving service delivery to the poor in the longer term requires development investment in schools, clinics, roads, etc. As more resources have come to the states, it is critical to improve the transfer system to do so with equity, transparency and predictability. Northern states rely heavily on transfers and problems with predictability are a key factor behind poor budget credibility.

18. **Progress in increasing financial support to the Three Areas has been slower than expected.** The Three Areas—South Kordofan state, Blue Nile state and Abyei—have been

accorded special status in the CPA, in recognition of their war affected status and challenges. As documented in the JAM, the bulk of the needs are in basic services delivery (education, health, water and sanitation), rural development, and new construction—in particular, of roads and a connection to the northern power grid. Financial support to the Three Areas in 2005-2006 was around 35-40 percent below what had been programmed in the JAM. In the 2007 budget, the GNU plans an increase to \$249 million, compared to \$183 million in 2006 (which is still 32 percent below the amount envisioned under the JAM).

19. **The PER exercise identifies three areas for increasing the level and quality of pro-poor spending: improving planning and the analytical underpinning of budget preparation, enhancing budget credibility, and reallocating from non-pro-poor spending.** Specific actions include addressing data constraints mentioned earlier (including a sorely-needed updated poverty analysis and household budget survey), requiring explicit poverty-motivation of budget plans at the sector level and within a medium term timeframe, eliminating the gaps in budget execution rates between pro-poor and non-pro-poor expenditures, much better data at the state and locality level on the use of funds to inform decisions and allocations, and dedicating resources to development expenditures at the state level where it will directly benefit the poor and marginalized areas.

D. Improving Accountability and Efficiency in Public Spending

20. **Accountability and effective public expenditure planning and management in the North are hampered by limited information and monitoring.** In this area, there are four significant deficiencies: (i) the current budget system does not provide a classification of expenditures according to their function and purpose; (ii) the country lacks a consolidated budget covering the various levels of government; (iii) GNU expenditure data currently only captures MOFNE releases to spending units, rather than actual use by spending units; and (iv) there is limited attention budget execution and less to the outcomes of expenditures. Overcoming these challenges and achieving the basic information requirements should be at the forefront of expenditure management reforms.

21. **Addressing budget planning deficiencies is a long term and multi-faceted effort, with many aspects dependent on immediate efforts to filling minimal information requirements.** The PER process has encouraged on-going reforms for adoption of the GFS budget classification and a consolidated GNU budget including coverage of the spending in the Northern states, but progress remains slow. A concerted effort by MOFNE and state ministries of finance is needed to accelerate progress, with buy-in at top levels of these government units and belief that the cost of adjusting systems and practices will deliver significant efficiency gains in expenditure management. The PER attempted to map the MOFNE releases by spending unit, combined with new information from the Northern states, to produce a consolidated functional dataset. While caveats regarding the source information remain, analysis in this PER of sector funding and trends demonstrates potential benefits of pursuing these reforms in expenditure management.

22. **From a more strategic standpoint, efforts to improve upstream budget planning activities, particularly the macroeconomic framework, may provide the best short term**

gains. The following areas are starting points for improvements: (i) better linking sector planning to current and capital expenditures; (ii) ensuring that allocations reflect policy anchors, such as the on-going Five Year National Strategic Plan; (iii) concrete estimates of the fiscal costs of policy actions are required; and (iv) predictability in execution is a necessary incentive for investment in the planning process.

23. **Other key areas that can deliver expenditure efficiency gains in the near term are improvements in development spending and core fiduciary dimensions.** Addressing development planning and implementation deficiencies will require a sector focus and significant capacity building at the federal and sub-national levels, with some efforts currently underway through World Bank Institute training workshops. Key aspects of financial management are being tackled by the on-going Country Integrated Fiduciary Assessment (CIFA). This assessment, in reference to international good practice (PEFA indicators) and appropriately accounting for the decentralized environment, will identify fiduciary strengths and risks and provide the basis for a policy agenda. Recent work by the IMF's Fiscal Affairs Department should also inform the agenda.

24. **Specific to the conditions in the South, budget and financial management concerns are acute, and the MOFEP has made a series of commitments in order to ensure sound public resource management and to guard against corruption and diversion.** Some of these have been fulfilled, but there is a significant way to go, and the following steps remain priorities:

- Adopt and implement the public finance bill that is currently under consideration by the Southern Sudan Legislative Assembly (SSLA);
- Put in place a transparent procurement system, by applying interim procurement regulations, enacting the new procurement law and proper use of the recently appointed Procurement Agent as well as urgently appointing an External Audit Agent;
- Work to effectively operationalize the Treasury Single Account where all revenues and expenditures are transparently consolidated and accounted for;
- Appropriately utilize ex ante controls, including the recently established Cash Management Committee;
- Build on the SSLA debate around the 2007 budget, and establish appropriate systems and structures for regular reviews of public expenditure and pro-poor spending by Cabinet, the Assembly and the public, with minimal lags in reporting; and
- Establish mechanisms for executive accountability, as per the Southern Sudan Interim Constitution, including the Southern Sudan Audit Chamber and the Anti-Corruption Commission.

E. A Seven Point Agenda for Action

25. Key recommendations for the near term, especially in the context of the 2008 budget formulation process, respond to the diagnostic work in this PER. Actions in these areas will address key deficiencies in basic building blocks of expenditure management, and many are mutually reinforcing. These recommendations are consistent with the CPA and the JAM, but remain relevant as progress has been slow (e.g., intergovernmental transfer reform, budget classification). Some have been elaborated upon and deepened through further analysis and field work of the PER. This is not a complete list of needed reforms, given important areas were not covered in this report, and additional reform areas may be tackled in the second phase of the PER as other priorities emerge.

1. Improve oil revenue volatility management, as a basis for budget credibility and better expenditure management. This issue is particularly relevant for the GOSS given its nearly complete dependence on oil revenues. Oil sector transparency and risk management are immediate priorities, including with respect to activities of state and quasi-state companies. The current oil savings fund has failed to provide a sustained buffer from the inevitable volatility faced by an oil economy such as Sudan. Reserve accumulation and credible management of the oil savings account through a transparent governance structure is needed, along with accelerated progress on non-oil revenue reforms.
2. Restore fiscal prudence at all levels of government by controlling expenditures, in line with abovementioned revenue measures, within a medium term outlook that focuses on the non-oil deficit as a key fiscal indicator. The 2008 budget preparation should promote leveraging existing levels of expenditure more effectively, though perhaps with changes to composition. A pro-poor expenditure framework is required to ensure adequate resources get to responsible spending units and levels of government, consistent with the vision of the CPA. Budget links to the Five Year National Strategic Plan and the upcoming PRSP should help in this regard, particularly in deepening the analysis of sectoral priorities.
3. Focus on fulfilling the vision of fiscal decentralization in the Interim National Constitution, namely monitoring the adequacy and efficiency of state and locality expenditures, and improving the equity, predictability and transparency of the intergovernmental transfer system. Successful fiscal decentralization will also require clarifying the legal framework of federal, state and local government responsibilities and powers, and institutional arrangements for grant allocation and monitoring. In addition, basic state economic data must be collected to bolster the quality of own-revenue estimation at the state and locality level.
4. Address the planning and implementation deficiencies of development project support, including at the sector program and project level, and at both the federal and sub-national levels. The dearth of development spending for poor and marginalized areas at the state and locality level must be addressed, given the expenditure responsibility for basic service delivery. However, assessing the appropriate balance

between recurrent and capital expenditures will require more detailed sector-specific analysis than is currently available. In addition, capacity should be built for evaluating investment projects, including modernizing policies and institutions for program evaluation.

5. Strengthen accountability for the use of public funds, financial management, and the overall results culture. On-going reforms in these areas include GFS application and consolidated budget reporting, but there is a strong need to bring expenditure analysis into decision-making in new areas such as the growth in the wage bill, sector allocations, rationalizing defense spending, and arrears management. These efforts will improve budget credibility and provide direct impact to the efficiency of spending. Demand-side accountability can also play a critical role and should be supported, for example through Parliament, the Auditor General, and NGOs. The financial management agenda will be informed by the on-going CIFA work. The agenda is particularly daunting in Southern Sudan.
6. Devote sustained and dedicated efforts to address the very difficult fiscal situation now facing the GOSS. A four point agenda has been identified in the background work—cash management, civil service, revenue management, and debt—and a high level fiscal mission in June 2007 should provide key entry points to these issues. The momentum of this on-going support to the GOSS must be continued.
7. Build capacity for more effective resource allocation and use, including in the states where responsibility for front line service delivery lies. While this is the last agenda point, it is the most fundamental and cross-cutting, as is necessary to address the abovementioned agenda items. The path to successful implementation of the CPA must include building capacities at the national and sub-national levels to fulfill roles and responsibilities of fiscal decentralization in Sudan.

1. BACKGROUND

1.1 Emerging from nearly four decades of civil conflict, the newly formed Government of National Unity agreed in late 2005 to engage with the World Bank and other external partners on analysis and dialogue on the public expenditure agenda. This agenda supports reforms envisioned in the Comprehensive Peace Agreement (CPA) and Interim National Constitution (INC) which are seen as vital to demonstrate equitable and transparent resource allocations, and thereby consolidate peace and reduce the risk of future conflict. Given the breadth of the agenda, the approach is programmatic. This Public Expenditure Review (PER), the first for Sudan, reflects the initial phase of engagement, with the objective of identifying and supporting improvements in budget planning, monitoring and institutional arrangements so as to contribute to improved resource use and outcomes. The emphasis is on establishing a baseline understanding of key fiscal management and policy challenges, highlighting reform measures for policymakers, and setting the agenda for the next phase of work.

1.2 **This synthesis provides a baseline assessment of two fundamental dimensions of public finance in post-CPA Sudan—fiscal management and the alignment of resources to broad-based growth and reduced poverty and inequality.**¹ As established in the INC, Sudan’s vision of fiscal decentralization has important implications for both of these dimensions, and the PER pays special attention to the issues of intergovernmental transfers and sub-national fiscal management, in the Northern states as well as the new Government of Southern Sudan (GOSS).

A. COMPLEX AND UNCERTAIN POLITICAL ECONOMY TEXT

1.3 **The current political economy context in Sudan is complex and uncertain, even for a post-conflict country.** In January 2005, the Government of Sudan and the Southern Sudan People's Liberation Movement (SPLM) signed the CPA and entered a six-year interim period after which a decision on national unity will be made by referendum. Thus the inherent fragility of a post-conflict situation has an extra-ordinary element of political uncertainty. The peace deal brokered between the North and South contains extensive provisions for sharing of power and wealth, including most notably a new autonomous regional government in the South, the creation of the Government of National Unity (GNU), and equal sharing of oil revenues generated in the South.

1.4 **The political and legal context now reflected in the INC has key implications for expenditure management** (Box 1.1). First and foremost is fulfillment of the wealth sharing obligations of the peace agreements, which limits the discretion of GNU spending as half of oil revenues generated in the South must be transferred to the GOSS (roughly 15 percent of

¹ A background volume available on the World Bank’s Sudan external website contains a compendium of supporting background work. Please visit www.worldbank.org/sd.

total GNU expenditures in 2005-2006). Second, the vision of fiscal decentralization is a key aspect of a unified and peaceful Sudan, potentially addressing inequalities, marginalized areas and the root causes of conflict. This also has significant implications for discretionary spending of the federal government, as a greater share of revenues is transferred to the Northern states. And third, accountability at all levels of government is required to ensure resources are shared equitably and used in accordance with each level of government's constitutional responsibilities.

Box 1.1: A Vision for Equitable Use of National Wealth in the 2005 Interim National Constitution

“Resources and common wealth of the Sudan shall be shared equitably to enable each level of government to discharge its legal and constitutional responsibilities and duties and to ensure that the quality of life, dignity and living conditions of all citizens are promoted without discrimination on grounds of gender, race, religion, political affiliation, ethnicity, language or region.” (*Excerpt from INC Article 185*).

The Interim National Constitution provides the vision for equitable and transparent use of national wealth to sustain peace, implement the CPA and achieve poverty reduction and human development. Key dimensions include equitable treatment of marginalized areas, commitment to fiscal decentralization to allow all levels of government work toward achieving targeted outcomes especially with regards provision of services, and the principles of transparency and accountability. The sharing and allocation of the resources and common wealth of the Sudan is premised that all parts of the country are entitled to development, and revenue sharing shall reflect a commitment to devolution of powers and decentralization of decision-making in regard to development, service delivery and governance.

There is significant detail in the Constitution regarding the distribution of responsibilities between levels of Government in Northern Sudan. Most notably, the responsibility for basic service provision is assigned to the sub-national level. The clarity of these expenditure assignments is crucial for expenditure management, and there remains significant room for improvement regarding state versus locality levels.

Annex A details the Interim National Constitution's assignment of responsibilities between levels of Government in Northern Sudan. The South, as an autonomous region, has a separate interim constitution.

Source: Interim National Constitution.

B. MACROECONOMIC STABILITY BUT BUILDING PRESSURES

1.5 Sudan has sustained macroeconomic stability following the turbulent 1990s, and has performed satisfactorily under a subsequent IMF Staff Monitored Program. Economic growth averaged 6 percent per annum between 2000 and 2004, and at over 10 percent in 2006 is currently among the highest on the continent. Agriculture remains the largest share of GDP (roughly one-third), but the oil sector and associated investment and services boom have driven the economy since the turn of the century (Table 1.1 and Figure 1.1).

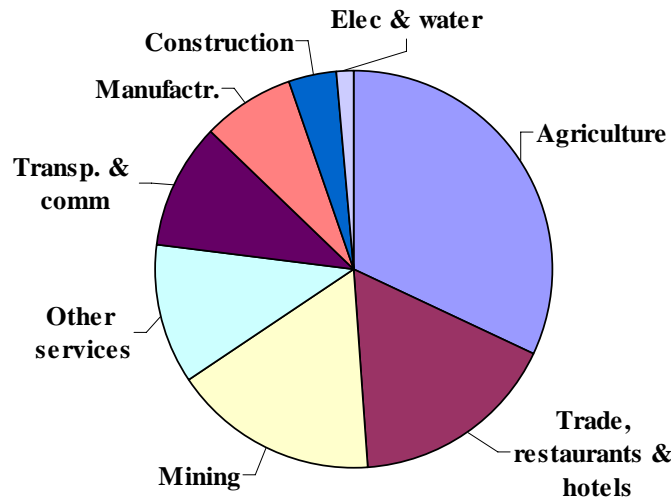
1.6 Inflation had been largely kept to single-digits, but internal pressures are a growing concern. Through the first half of 2006, price growth averaged 4 percent year on year, but high growth in monetary aggregates and the August 2006 domestic fuel price increase contributed to inflationary pressures with end-2006 year-on-year inflation growth at 16 percent. Inflation averaged 8-9 percent for the first half of 2007.

Table 1.1: Trends in Key Macro and Fiscal Indicators, 2002-2006

	2002	2003	2004	2005	2006 est
	(annual changes in percent)				
Real GDP	5.4	7.1	5.1	8.6	12.2
Oil	24.7	13.0	9.9	-0.2	26.5
Non-oil	3.8	6.6	4.7	9.5	10.8
Consumer prices (end of period)	8.3	8.8	7.3	5.6	15.7
	(in percent of GDP)				
GNU revenue	11.9	16.0	19.7	21.7	19.4
GNU expenditure	8.8	15.3	18.2	23.5	23.7
Overall balance (cash basis)	3.1	0.7	1.5	-1.8	-4.2
Non-oil balance	-2.4	-7.6	-8.3	-15.4	-15.9
	(in millions of US dollar, unless otherwise indicated)				
Exports f.o.b.	1,949	2,577	3,778	4,859	5,743
of which: oil	1,511	2,082	3,101	4,221	5,174
Imports, f.o.b.	2,153	2,536	3,586	5,946	72
Current account balance (cash basis, % of GDP)	-6.1	-4.7	-3.8	-8.3	-12.9
Real effective exchange rate (change in percent)	2.6	-1.4	2.9	17.3	21.0
External debt (in billions of US dollars, end of period)	23.6	25.7	26.0	27.7	28.2
External debt (in percent of GDP)	157.6	144.6	119.9	99.3	75.4
Net international reserves	84	290	1,144	1,889	1,384

Source: IMF

Figure 1.1: Agriculture, Mining and Services dominate the economy (2006 GDP by sector, at factor cost)



Source: IMF

1.7 The current account deteriorated in 2006 as import demand far outstripped exports, including lower-than-expected oil exports. The current account deficit is approaching 13 percent of GDP in 2006. Major imports include machinery and equipment which are part of an ongoing investment boom. Imported fuel costs are also significant,

though in-country refinery capacity is expected to meet domestic consumption demand in the next few years. Foreign direct investment inflows more than covered the current account deficit, helping foreign reserves grow to roughly 3 months of imports by end 2006.

1.8 Inflows of foreign exchange from oil exports and FDI, as well as the recent fiscal expansion, have contributed to a rapid appreciation of the real exchange rate since 2005 and raised significant competitiveness concerns for non-oil exports and sustainable long term growth. The dinar experienced double-digit appreciation in 2006, reaching the current level of around 200 dinar per dollar, compared to 250 in early 2005. While the authorities and IMF have supported the high appreciation as necessary for containing inflation, preliminary evidence from the on-going Diagnostic Trade Integration Study suggests profit margins for farmers have been squeezed by the appreciation, in addition to the adverse effects of supply-side bottlenecks.

1.9 Sudan's debt arrears prevent access to concessional finance. At end 2006, external debt was \$27 billion in nominal terms, with over 80 percent in arrears. This includes IDA arrears around \$420 million and IMF arrears of around \$1.6 billion. Donors have signaled that clearance of arrears will depend on progress on both the implementation of the CPA and the peaceful resolution of the Darfur conflict, and direct discussions on debt are stalled. Beyond this, Sudan is potentially eligible for debt relief under the HIPC initiative, but only once the government has prepared an interim or full Poverty Reduction Strategy Paper, and cleared its outstanding arrears. Debt relief under the Multilateral Debt Relief Initiative could also be available subsequent to reaching HIPC Completion. Improved external debt indicators reflect higher exports and GDP, but nominal debt keeps rising and it remains unsustainable.

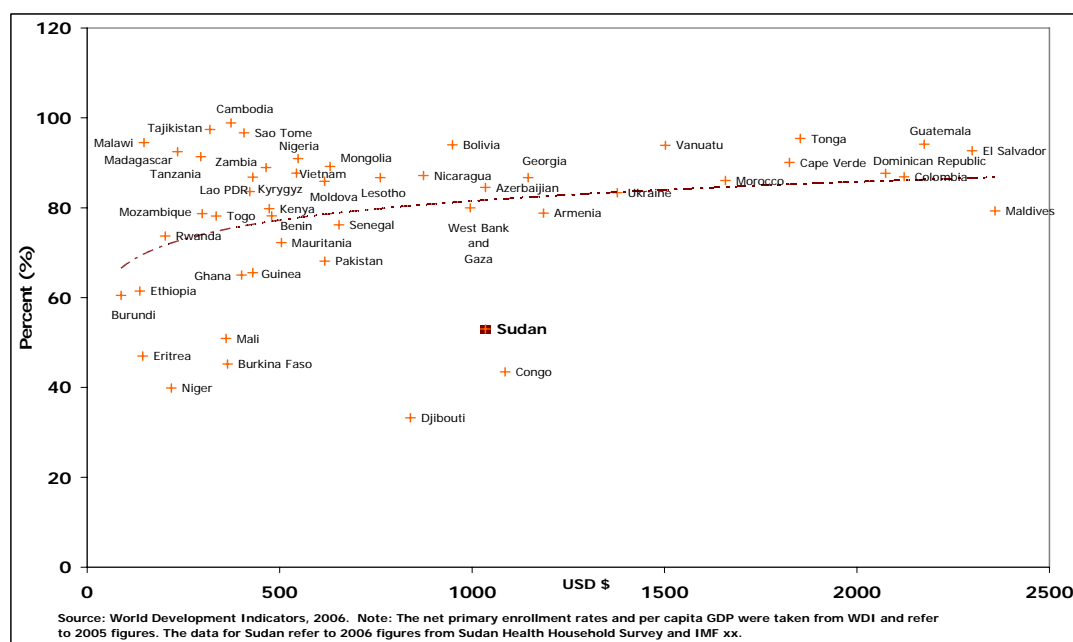
C. DAUNTING DEVELOPMENT CHALLENGES

1.10 The signing of the CPA opened tremendous opportunities to accelerate progress toward the Millennium Development Goals and address the wide regional disparities in human development outcomes. However, progress so far has been limited.

1.11 Sudan ranks 141 out of 177 countries in UNDP's 2006 Human Development Index, with 2006 per capita GDP over \$1,000 (more than one-third higher than the SSA average). There is no recent representative income or consumption data from which to calculate poverty headcounts, but preliminary findings on some non-income poverty outcomes are now available from the nationally-representative Sudan Household Health Survey (SHHS)² conducted in 2006. Outcomes for a number of individual MDG-related indicators show Sudan's low achievements relative to other countries at the same income level and even much lower income levels (Figure 1.2).

² The results of the Sudan Household Health Survey remain under discussion, and the authorities have not endorsed the preliminary findings. The analysis presented in this report should be considered tentative, but given the dearth of social data in Sudan it is presented as the best currently available. It is the first nationally representative survey in two decades and was commissioned to follow-up on the CPA/JAM. The sample size is 25,000 households, an average of 1,000 households per state, and an average of 25 households per cluster (40 clusters per state). Earlier data for the North cited here are drawn primarily from surveys including the SMS (1999) and MICS (2000).

Figure 1.2: Sudan Is a Country Outlier on Education (Net Primary Enrolment) Relative to Income



1.12 **The SHHS confirms that the major challenge facing Sudan’s progress towards the MDGs is the massive inequality in outcomes and access to services** (Table 1.2). Overall, there appears to be little evidence of aggregate improvements in social indicators such as educational enrolment or infant mortality. Moreover, the picture is mixed across regions and sectors—and particularly in conflict-affected areas, such as Darfur. Most averages also hide large gender disparities, with women suffering disproportionately from limited access to basic social services.

Table 1.2: Large Regional Disparities in Key MDG Indicators

	Indicator	Average of Highest 5 States	Average of Lowest 5 States	National Average
MDG 2	Net primary school attendance rate	84	7	53
MDG 3	Ratio of girls to boys attending primary education	0.99	0.61	0.93
MDG 4	Measles immunization coverage	82	31	65
MDG 5	Proportion of births attended by skilled health personnel	91	24	57
MDG 6	Comprehensive knowledge about HIV prevention	19	2	9
MDG 6	Contraceptive prevalence	16	1	8
MDG 6	Proportion of population using effective malaria prevention measures	50	10	28
MDG 7	Use of improved drinking water sources	80	35	59
MDG 7	Use of improved sanitation facilities	66	5	31

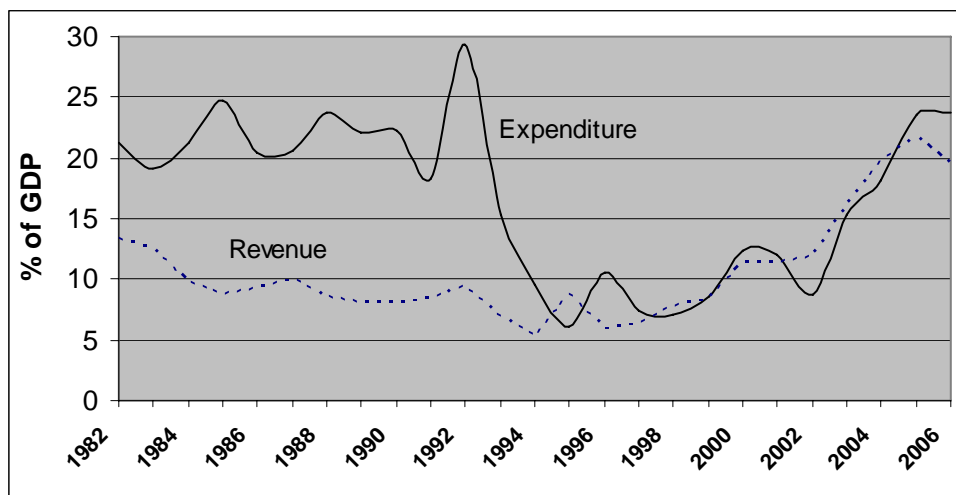
Source: Sudan Household Health Survey (2006).

1.13 **These preliminary findings from the 2006 survey suggest that getting onto a trajectory consistent with meeting the MDGs will involve a significant acceleration of progress.** At the same time, data constraints and the lack of a reliable baseline make it difficult to draw firm conclusions, and further analysis of the 2006 survey is needed. A closer look at geographical disparities (intra-state, as well as across states), as well as rural/urban and gender patterns, is needed to better understand trends. Looking forward, it will be important to strengthen capacity for monitoring and benchmarking relevant data to inform policy decisions and guide expenditure allocations. Very few of the JAM targets on improving monitoring systems have been met, which means that critical gaps remain in the regular information needed to underpin the formulation of a national poverty reduction strategy and the more comprehensive Five Year National Strategic Plan.

D. AN UNSUSTAINABLE FISCAL EXPANSION

1.14 **The macroeconomic stabilization of the late 1990s was underpinned by a fiscal stabilization program.** The center piece was expenditure control through a cash budget system (Figure 1.3). Fiscal imbalances were drastically cut, mainly through reductions in non-wage recurrent expenditures (e.g., transfers to the states, debt service payments, and O&M) and development expenditures. Priority of expenditures ranked wages and salaries at the top (Chapter 1), O&M second (Chapter 2), transfers to the states third (Chapter 3), and development last (Chapter 4). Annual fiscal deficits were quickly brought under control.

Figure 1.3: Recovery since sharp fiscal adjustment in the 1990s



Source: MOFNE and staff estimates.

1.15 **Revenue collections increased significantly with the advent of oil production in 1999. However, the fiscal picture deteriorated in 2006 driven by oil revenue shortfalls and expansion of spending, some of which relate to the CPA (e.g., transfers to the GOSS and to the Northern states).³** Remedial actions within the context of the IMF program were taken by the authorities in 2006 to cut expenditures. This included an increase in domestic

³ The DPA in May 2006 and ESPA later in the year both brought additional budget obligations of the GNU. Over half the planned increase in Northern transfers in the 2007 budget can be attributed to the DPA and ESPA obligations. However, under the current fiscal environment, it is uncertain if these plans will be met.

fuel prices to trim the subsidies of domestic fuel consumption by half and large withdrawals from the Oil Revenue Stabilization Account (ORSA). The latter have exhausted the fund and preclude its ability to provide relief from future revenue shortfalls without significant replenishment.

1.16 The fiscal balance has turned to growing deficits in 2005 and 2006, following three years of surplus. Including the rundown in the ORSA reserves, the projected 2006 budget deficit jumped to 4.2 percent of GDP, from 1.8 percent of GDP in 2005 and surplus in the preceding three fiscal years. The budget deficit in the 2007 budget exceeded 6 percent of GDP. The majority of deficit financing has been domestic, two-thirds in 2006, including government securities and Ministry of Finance and National Economy (MOFNE) net borrowing from the Central Bank. Foreign financing has increased significantly, reaching about \$450 million in 2006, compared to an annual average of \$45 million from 2000-2003.

1.17 Fiscal expansion at this pace appears to be unsustainable. The 2007 budget increased total expenditure by 13 percent in nominal terms over last year's budget to a total of \$11.8 billion. Large increases are planned for both federal wages/salaries and transfers to Northern states (roughly 25 percent nominal increases for each area). National development is budgeted to increase by roughly half. The likelihood of meeting these expenditure plans is low, at least without high levels of domestic or external financing. The pressure for expenditure cuts and reallocation is high, raising the relevance of this PER and the need for subsequent government action to address the fiscal imbalances and avoid weakening the country's macroeconomic credibility.

1.18 The fiscal pressures in the South have proven even more acute. The overall balance in 2006 moved sharply into cash deficit due to limited spending discipline as well as oil revenue shortfalls in the second half of the year. Aggregate spending was driven by outlays on wages and operations that were roughly double planned amounts, while capital expenditures were cut sharply. In the first half of 2007, oil revenue shortfalls continued, GOSS significantly over-estimated non-oil revenue, and in the face of huge development needs, expenditure plans in the 2007 budget were significantly expanded relative to 2006. The cash reserves that could have provided cushions were largely run-down last year and are no longer available. One risk is that planned investments in roads, schools, clinics and so on will be squeezed by the burgeoning payroll.

1.19 The rest of this synthesis report is structured as follows. Sections 2 and 3 cover GNU revenue and expenditure management, respectively. Section 4 summarizes key aspects of the PER dialogue on identifying and monitoring pro-poor spending in Sudan. Intergovernmental transfers and fiscal decentralization are the focus of Section 5, and section 6 summarizes the main findings from the PER state case studies. Section 7 is dedicated to fiscal issues in the South.

2. MANAGING AND MOBILIZING NATIONAL REVENUES

2.1 **Sudan's revenue structure mirrors that of a number of other low-income oil producing countries**, with a high dependence on oil revenue and relatively weak non-oil revenue collection (Table 2.1). While a number of improvements have been made in recent years, at about 6-7 percent of GDP, Sudan's tax effort is low compared with countries at a similar level of development. Direct taxes amount to only about 1.2 percent and indirect taxes for 4.3 percent of GDP. While the oil sector does not dominate the economy (contributing roughly 10 percent of GDP), oil is of critical importance to government revenue and the balance of payments, with its revenues accounting for 56 percent of revenue in 2006.

Table 2.1: Growth in Resources from Oil Revenues

	2001	2002	2003	2004	2005	2006
	(as share of GDP)					
Total revenues	10.7	11.9	16.0	19.7	21.7	19.4
Tax revenue	5.5	5.4	5.8	7.5	6.9	6.3
Direct taxes	1.2	1.0	1.1	1.3	1.4	1.2
Indirect taxes	4.3	4.4	4.7	6.2	5.6	5.1
Trade Taxes	2.2	2.5	2.4	2.8	3.0	2.6
Excise duties	0.9	0.8	1.1	2.0	1.3	1.3
VAT	1.1	1.1	1.2	1.3	1.3	1.2
Non-tax revenue	5.2	6.5	10.2	12.2	14.7	12.7
<i>of which: Oil</i>	4.3	4.6	8.4	10.3	13.3	10.8

Source: Ministry of Finance and National Economy, and staff estimates.

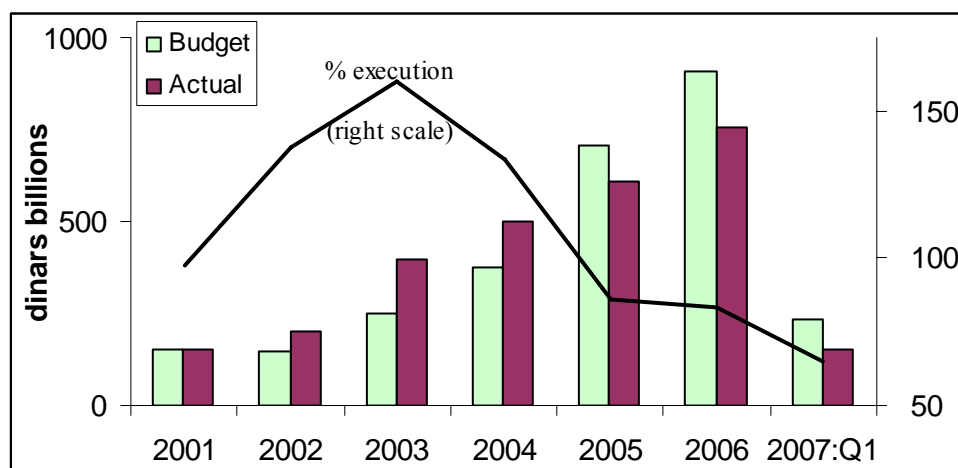
A. OIL REVENUE MANAGEMENT

2.2 **Sudan is one of the newest significant oil producing countries in the world.** Significant production started in 1999, and the country is now the third largest oil producer in Sub-Saharan Africa, behind Nigeria and Angola, with output at about 364,000 barrels per day (bpd) in 2006. Production forecasts are difficult for Sudan given the lack of detailed information regarding specific major projects, described below, but available data suggests peak production in the next two years near 730,000 bpd, holding for roughly five years and then declining.

2.3 **Oil revenue in Sudan—from export of crude and domestic sale of refined products—has proven volatile and oil production has fallen short of expectations in recent years.** Oil revenue amounted to some 55 percent of total government revenue in 2006. Crude oil exports accounted for roughly 84 percent of total exports in 2006, at some \$5.3 billion or 14 percent of GDP. Lower than expected production and price for Dar Blend

have driven significant oil revenue shortfalls relative to budget plans (Figure 2.1), creating fiscal pressures and undermining budget credibility given over 50 percent of total GNU revenue comes from oil. Fiscal pressures have been particularly strong for the South, where tax and customs revenue are minimal and oil revenue accounts for over 90 percent of the budget via transfers from the GNU as specified under the CPA.⁴

Figure 2.1: Oil Revenue Performance Deteriorates



Source: MOFNE and staff estimates.

2.4 The quality of Sudanese crude varies substantially between fields, with two main blends currently produced—Nile Blend and Dar Blend. Nile Blend is a relatively good quality, priced at a discount of \$2-3/bbl relative to the IMF’s benchmark WEO price. Dar Blend—which came on stream in October 2006 and was forecast to account for the majority of the production increase in 2007—is a lower quality, high acid crude. Initial sales of Dar Blend in 2006 were disappointing, and the price of Dar Blend in early 2007 stood at an exceptionally large discount of about \$30-34/bbl relative to the IMF’s benchmark WEO price. These low prices have been attributed to problems in finding buyers able to refine this type of crude. By June 2007, the discount of Dar blend had narrowed to about \$20/bbl, reflecting that this crude is gaining acceptance in the international market.

2.5 While the discovery and exploitation of oil resources has facilitated an increase in national wealth, it has also brought a myriad of problems. Oil revenues have expanded budget resources, potentially available to support pro-poor development. The political economy of oil has also brought additional pressures for expenditure (some of which may be conditioned by capacity and other constraints), rent-seeking behavior, and reduced pressure to undertake key fiscal reforms that will ensure medium- and long-term stability irrespective of the course of oil production and prices.

⁴ Much of Sudan’s oil production currently takes place in the South, and the CPA specifies that revenue generated in the South is divided equally between the GNU and GOSS after a 2 percent share to the oil producing state government. Revenue from production in the North goes directly to the GNU, after 2 percent to the specific state where the wells are located.

2.6 The Oil Revenue Stabilization Account (ORSA), which was established in 2002, is now depleted despite rising production and record world prices.⁵ The account accumulated a significant amount of funds over 2002-05, equivalent to 1 percent of GDP at end-2005. However, there were substantial draw-downs from the account in late 2006 to finance government expenditures, and by end-December 2006 the account was virtually depleted.⁶ Thus the ORSA, in its current state, is not able to provide any further risk management benefits. A concerted effort is needed to rebuild the account, along with stronger controls and management to ensure it can play a role in longer term oil revenue management.

2.7 Transparency in the sector is unusually weak, in comparison to many oil exporting developing countries. Specifically, as described below, the Ministry of Energy and Mining does not produce detailed statistics or reports about the sector or about project developments, the state oil company provides no public accounts, and there is very little information about business developments from the companies operating in Sudan. In most oil exporting countries one or more of these sources of information provides a basis for assessing sector trends and policy. Moreover, it should be noted that nine oil-rich countries in sub-Saharan Africa have joined the Extractive Industries Transparency Initiative (EITI), an international process committed to improving revenue transparency and public accountability in oil, gas and mining. This lack of transparency appears to be contributing to Sudan's current fiscal problems by making projections of oil production and revenues relatively inefficient. The Government of National Unity (GNU) plays a major role at every stage of production, refining, and marketing through the state-owned Sudan Petroleum Corporation (SPC). Sudapet is the subsidiary of SPC that holds the Government's equity share in specific oil exploration and production projects. Although the GNU Ministry of Energy and Mining is notionally responsible for the regulation and supervision of the sector, the GNU's regulatory functions are not independent of its commercial activities in the sector.

2.8 The SPC reportedly prepares an annual report that is sent to the National Petroleum Commission but is not made publically available. It provides accounts to Parliament, though on government terms rather than as a corporate entity. Further, accounts for SPC's subsidiaries are rarely available. For example, Sudapet, which is becoming a substantial oil producing company, does not publish annual reports or accounts. Improved accounting standards at the SPC and its subsidiaries would contribute to a more transparent oil sector.

2.9 On the positive side, the 2006 IMF program requirement that oil production, export and refining data be regularly published has been largely implemented. In addition, details of the monthly baseline production and pricing data for the calculation of the revenue share of the Southern Sudan have been shared and provide an insight into the development of the petroleum sector. However, these statistics are tailored for the respective requirements of the

⁵ The ORSA is a locked sub-account for the GNU at the Bank of Sudan, controlled by the MOFNE. At the start of the fiscal year, a benchmark production figure and oil price is agreed by the GNU and GOSS. Any revenues accruing from production or price above the benchmark are deposited in the ORSA. Withdrawals are distributed to both GNU and GOSS in proportion to their share of total oil revenue.

⁶ Under the terms of the agreement on the ORSA, when the GNU accesses funds from the account to finance expenditures, it must transfer an additional amount to the GOSS in accordance with its share of oil revenue—regardless of whether the GOSS needs the funds at that time.

IMF and the CPA, and do not provide a comprehensive base for assessing the petroleum sector. Moreover, the statistics are published in summary form and without comment by the Ministry of Finance, and few relevant statistics are published by the Ministry of Energy and Mining or the official statistical agencies.

2.10 Transparency is not facilitated by the fact that petroleum exploration and production in Sudan are carried out almost entirely by “new” international companies from China, India and Malaysia, of which the Chinese National Petroleum Corporation—CNPC—is the largest holder of reserves and production in Sudan. Some of these companies have less comprehensive accounting and reporting standards than the international norms for the sector.

2.11 **Going forward.** Oil represents tremendous potential for Sudan, but recent experience has been mixed. The large boost to revenues may have weakened incentives for expenditure management and fiscal reforms. Accountability is undermined by the lack of transparency that severely hampers the ability to properly manage the oil sector (in terms of natural resource management) and to adequately forecast and manage revenues, which in turn compromises overall fiscal policy. Volatility and over-estimation of oil revenues documented in Figure 2.1 has undermined budget credibility, forced expenditure rationing, caused complete elimination of the stabilization fund built up with past savings, and presently threatens the macroeconomic stability sustained over the past ten years.

2.12 **Several challenges are outstanding with respect to management of Sudan’s oil revenue, first and foremost being the need for transparency.** World class transparency is entirely consistent with commitments already made in the CPA and INC. While the sharing of oil revenue between North and South appears to be functioning broadly as outlined in the CPA, the lack of detailed information regarding other aspects of oil management and accounting is a cause for concern. Particularly with respect to state and quasi-state companies that deal in the sector, Sudan would benefit from a greater commitment to transparency and adherence to international accounting standards and best practices. Concrete recommendations could include: full accounting for activities of the state-owned oil companies and their subsidiaries (SPC, Sudapet, and affiliated operating companies); separating SPC, Sudapet, and the Ministry of Energy to clearly delineate regulatory versus market roles in line with international standards; reform of the rules governing the ORSA to replenish the account and make it a sustainable tool for risk management; and clarify further the role and responsibilities of the National Petroleum Commission (NPC) with respect to oil sector policy. It is also important to finalize division of oil production between North and South, which can only occur once the relevant border has been agreed.

2.13 **Improving the transparency and predictability of oil revenues is critical for fiscal management.** The shortfall in oil revenue in 2006 forced major deviations from planned GNU expenditures and fiscal pressure on all aspects of the budget. These pressures were partially offset by exhausting all available resources in the ORSA. However, the underlying production and price problems continued into 2007 and expenditure plans have been impacted more directly, without the benefit of oil savings. The pressures have been most acute for the GOSS, given its reliance on oil revenues to finance nearly all of its budget.

The abovementioned reforms to improve transparency should help enable a more robust and stable estimate of future oil revenues, and ultimately more prudent fiscal planning.

B. NON-OIL REVENUE MANAGEMENT

2.14 **Tax policy and administration in Sudan is relatively weak.** At about 6-7 percent of GDP, Sudan's tax effort is low for its level of development (Table 2.2). Direct taxes amount to only about 1.2 percent of GDP and comprise a Business Profit Tax (BPT), a Personal Income Tax (PIT), a tax on Sudanese residents abroad,⁷ and various stamp duties. Indirect taxes (customs duties, VAT, and excise taxes) account for roughly 80 percent of total tax revenue, with taxes on international transactions dominating. As a whole, the tax system is fragmented, unevenly applied, and suffers from widespread exemptions and tax holidays that limit the effectiveness of the existing regime—a weakness made possible by continued gains from the oil sector.

Table 2.2: Relatively weak tax efforts: Sudan and selected comparators 1/

	2001	2002	2003	2004	2005	2006	Average 2001-06
	(in percent of GDP)						
Sudan	5.5	5.4	5.8	7.5	6.9	6.3	6.2
Algeria	9.3	10.6	10.0	9.5	8.5	8.2	9.4
Egypt 2/	13.4	13.4	13.3	13.8	14.1	15.9	14.0
Kenya 2/	16.5	15.9	16.6	17.0	18.0	16.6	16.8
Nigeria	17.2	14.2	15.0	16.6	16.8	16.1	16.0
Yemen	7.3	7.3	7.1	7.3	7.3	6.6	7.2
Unweighted average	12.7	12.3	12.4	12.8	12.9	12.7	12.7

Sources: IMF country documents; *Government Finance Statistics* (IMF); and Fund staff estimates

1/ For all countries, except for Egypt and Nigeria, the fiscal coverage is the central government. For Egypt, the fiscal coverage includes central government, NIB, and social insurance funds. For Nigeria, the fiscal coverage includes the federal, state and local governments.

2/ For Egypt and Kenya, the fiscal year ends on June 30th.

2.15 The need for improved revenue collection and tax administration in Sudan is clear. A number of significant reforms have been introduced in recent years but Sudan's non-oil revenue base remains thin. Reform of both direct and indirect taxes will be critical to ensuring medium-term fiscal sustainability as well as non-inflationary domestic financing. There is a critical need for a comprehensive tax administration modernization strategy, which articulates a vision for tax administration over the long term.

2.16 While some major improvements have been made to the system of direct taxes (such as streamlining the customs tariff framework), some elements are distortionary, discretionary and inequitable. Corporate tax incentives exacerbate existing distortions and inequities, narrow the tax base, and undermine the overall tax effort. A key example of this are the unequal tax holidays and import duty exemptions to investors under the Investment Encouragement Act. In particular, reform of the direct tax structure could include the

⁷ This tax was reduced significantly in the 2007 budget, and may be eliminated in the future.

rationalization of BPT rates and coverage in conjunction with a larger effort to eliminate exemptions and tax holidays. In addition, all major allowances and exemptions allowed as part of remuneration could be brought under the PIT.

2.17 Indirect taxes account for the lion's share of total tax revenue in Sudan, with **customs** duties representing the single largest component—with the VAT a close second. The main challenges facing the indirect tax regime in Sudan are exemptions and the level of the VAT threshold. While customs duties play a critical role and account for about a third of tax revenue, the regime has an excessive number of exemptions. In particular, efforts should continue to reduce tariff dispersion, and the top tariff rate. Finally, there is a lack of cooperation between GNU and the GOSS regarding the application of customs duties and revenue collection—effectively creating two different trade regimes. As with customs duties and business taxes, reform of the VAT should focus on rationalizing rates across sectors and eliminating exemptions and holidays. Current exemptions from the VAT reduce the revenue take by roughly 1.2 percent of GDP.

2.18 In order to strengthen the process of non-oil revenue collection, there is the need for a renewed effort toward reforming the tax administration and developing a comprehensive reform plan. Such a plan must include the development of an adequate information management system and the further development of human resources. Additional measures could include the further reform of the Tax Council (*TC*) including strengthening of the large taxpayer office (*LTO*) and the medium taxpayer's office (*MTO*), and reform of *taxpayer compliance* to avoid further evasion of taxes and the resulting need for a cumbersome administration.

2.19 The current headquarters structure of the *TC* includes both tax-type and function-based departments. Key steps could include a progressive restructuring of the network of operational offices, with separate offices for *LTO* and *MTO*, and regional/state offices for the remaining taxpayer segments. Key steps towards strengthening the *LTO* and *MTO* is a rationalization of processes used in administering tax types which could include: (i) the adoption of unambiguous, transparent and easily understood selection criteria for the selection of taxpayers; and (ii) moving to a fully integrated approach for all functions across tax types.

2.20 The heavy reliance on summary or arbitrary assessments hampers *taxpayer compliance* and perpetuates mistrust between the tax authorities and taxpayers. Full self assessment should be introduced progressively—focusing first on *LTO* followed by *MTO*. This should be accompanied by a comprehensive training program on self-assessment principles and risk management for all *LTO* and *MTO* staff.

C. CHALLENGES ARISING FROM DECENTRALIZATION

2.21 Fiscal decentralization, while key to the vision of the CPA/INC, poses a number of additional challenges to revenue management. Sub-national levels need adequate revenue to conduct expenditure assignments and address regional/local needs, and at present there are inadequate and unevenly distributed own-revenues at lower levels of government and

transfers have been unpredictable. A number of dimensions of fiscal decentralization require attention to ensure fulfillment of the vision of fair and transparent wealth sharing in Sudan.

2.22 For the oil sector, greater clarification is needed as to the role and responsibilities of the National Petroleum Corporation (NPC), as well as the division of oil production between the North and the South. The CPA provides for broad petroleum sector policy to be set by NPC, with equal representation of the North and South. The NPC also has within its original remit the authority for issuing new exploration and production licenses. The NPC has met infrequently to date, and with limited results. More rapid progress in this area could prove pivotal to resolving emerging problems with respect to new production and associated revenues. Current fiscal difficulties stemming from oil revenue volatility and uncertainty in the South underline particular vulnerability, given their near complete dependence on oil revenue and weak capacity to manage oil sector issues. Many of the most needy Northern states also are severely impacted, given state transfers are discretionary and have the lowest priority of GNU spending, especially development transfers. The CPA also provides for commissions to determine the boundary between the North and the South, and for the GNU and the GOSS to establish in which region oil wells are located. The work of the boundary commissions has not been completed, and hence the division of production appears not fully defined in accordance with the CPA.

2.23 On tax policy, greater clarity is needed in terms of the assignments of tax authority and revenue collection—both within the federal government and between the federal government, the GOSS and the Northern states. Early action phased-in over a reasonable timeframe will help prevent the need for more drastic adjustments later on (Box 2.1). Harmonization of the personal income tax base between the GNU and the states is vital. Preferably, the PIT should be a guide and or/vehicle for the states to choose and apply the state tax rate, although, currently, no states have yet approached the GNU to discuss this issue. On excises, while many federal state systems do allow sub-national governments to levy excises, it is preferable that the base be common across states and that excise rates not differ substantially between one state and the next.

Box 2.1: Medium-Term Gains from Tax Reform

Sudan has undertaken a number of tax reforms since 2000, including introduction of the VAT, imposition of the excise on benzene, and improvement of the tariff structure. As a result, tax revenue rose from 5.5 to 7.5 percent of GDP during 2001–04. However, tax revenue fell back to 6.3 percent of GDP during 2005–2006, and ranks among the lowest in the region.

Given the challenges ahead, including oil revenue volatility, trade liberalization, and investing in development and sustained peace, further efforts are needed to increase tax revenue, notably through improvements in tax policy and revenue administration. The following provides a basis for a medium-term tax reform—based on a set of measures recommended by the IMF—and an estimate of the potential gains over the medium term.

- **Replace the Investment Encouragement Act (IEA) with a single profit tax rate and accelerated depreciation allowance.** Unifying the business profit tax at 20 percent and eliminating exemptions under the IEA could generate about 2 percent of GDP in additional revenue.
- **Introduce a meaningful personal income tax.** The current PIT base is extremely narrow, with a large number of allowances. Almost all government employees and around 80 percent of private sector workers are exempt from it. This could raise PIT revenue from the current level of 0.1 percent of GDP to 1-2 percent of GDP.
- **Rationalize and/or eliminate VAT exemptions,** in particular on capital goods, water, electricity and other consumer goods. Given the erosion of the VAT base over time, VAT productivity is amongst the lowest in the world, merely 0.12. Eliminating the VAT exemptions could generate additional revenue of about 1.0-1.5 percent of GDP.
- **Rationalize and/or eliminate custom exemptions.** Eliminating exemptions not related to international treaties, while reducing the maximum tariff rate (40 percent), could generate additional revenue of 0.5-1.0 percent of GDP, including through reduced smuggling.

Improve tax administration by strengthening the Tax Chamber. Restructuring the Tax Chamber; strengthening the LTO and MTO; and improving compliance programs to support a proper self-assessment system could yield additional revenue of 0.5-1.0 percent of GDP.

Source: IMF.

2.24 Weak coordination between North and South. Emerging from several decades of conflict, South Sudan was a region without a formal tax administration. Since 2005, the GOSS has taken steps to reestablish a structure, but there are emerging issues regarding consistency with the GNU. The 2005 Interim National Constitutions (INC) assigns responsibilities for collection of specific revenue sources to the GNU, the GOSS, and state levels of governments. However, recent IMF mission have suggested that the current tax system in South Sudan differs significantly from the structure outlined in the INC, and that the legal framework outlined in the CPA and INC is not in force. The GOSS collects duties based on a preexisting customs and excise tariff adopted in 2000, which differs from the current national customs law. GOSS also collects export duties on agricultural products (1 percent), a list of other goods (with four different rates), and re-exports of finished goods (at 30 percent). It collects personal income tax from Sudanese working with NGOs (at rates of 5 and 10 percent), and road tolls based on an excise type tariff. State authorities within the South also collect a variety of taxes, fees, and duties.

2.25 Coordination between the North and the South on a range of tax issues, such as customs collection and non-oil revenue transfers, is important. Devolution of taxes need not entail a decentralization of tax administration, and there are pros and cons. A careful review

of the current tax system in Southern Sudan could help to ensure that the collection effort is guided by the provisions of the CPA and the INC, and that duty and tax collection are supported by valid legislation. Care should be taken to clearly lay out the respective roles of national, GOSS, and state revenue authorities in administering the tax system. Given the importance of transparency, it will also be critical to ensure that basic transparent tax assessment and collection procedures are defined and supported by consistent processes.

3. KEY ISSUES IN GNU EXPENDITURE MANAGEMENT

3.1 Fiscal management since the CPA has been dominated by the attempt to balance continued increases in federal expenditures and the need to finance new obligations to sub-national governments. Oil revenue has increased but in 2006 and the first half of 2007 have been significantly below budgeted plans. Public expenditures have grown sharply since the adjustment of the mid 1990s, initially using the fiscal space from new oil revenues and more recently outpacing revenue growth with more rapid increases in expenditure across most categories of spending. Significant fiscal deficits (over 2 percent of GDP) have emerged after nearly a decade of prudence, including budget surpluses from 2002-04. At over 20 percent of GDP, spending has returned to levels that characterized the 1980s when Sudan also ran up large external debts.

3.2 This chapter highlights the main features of GNU expenditure management. From the outset it is important to recognize that a detailed assessment of Sudan's public expenditure planning and management is hampered by four significant deficiencies:

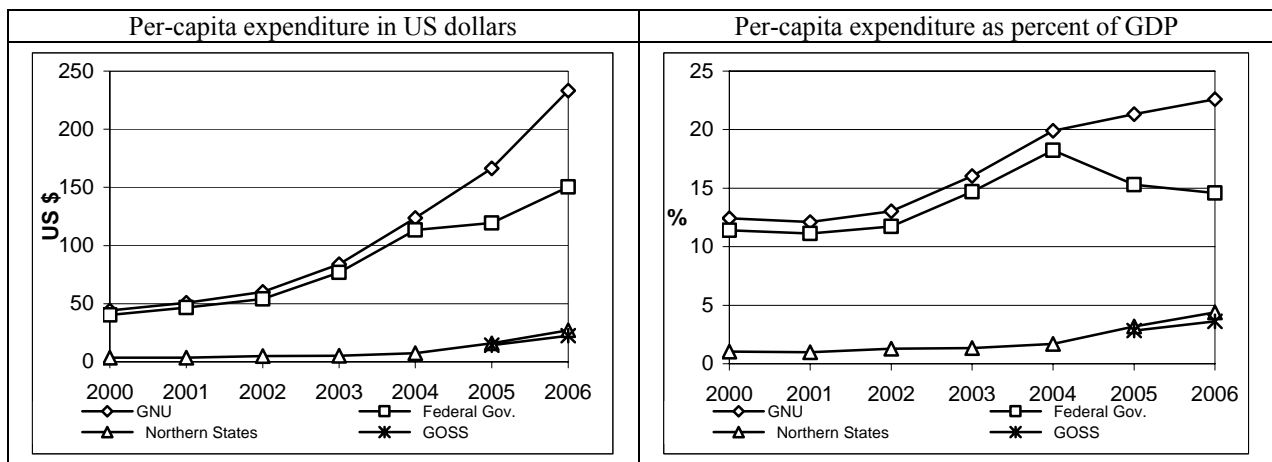
- First, current GNU budget reporting does not provide a classification of expenditures according to their function and purpose, which is required to enable adequate analysis and evaluation of aggregate fiscal discipline, allocative efficiency and operational efficiency.⁸ Sudan traditionally reports budget data along economic lines, and the data are insufficiently disaggregated to monitor spending geographically, across time (during the budget cycle), or across sectors and programs.
- Second, the country lacks a consolidated budget covering all four levels of government—GNU, GOSS, states, and localities. Budget data covered in this chapter is generally GNU reporting provided by MOFNE that covers federal recurrent and capital spending and transfers to lower levels of government (GOSS and Northern states). It is difficult to clearly identify the amount of resources dedicated to specific purposes at the local, state, and federal levels. This poses management issues, particularly in the case of development spending—for example, in the health sector, investments in health infrastructure require strong coordination between the federal and state ministries of health. This coordination can be undermined if expenditure responsibilities are unclear, or the distribution of resources is inconsistent with expenditure responsibilities—and it weakens accountability of each entity for ultimate outcomes.
- Third, GNU expenditure data currently only captures MOFNE releases to spending units, rather than actual use by spending units. This effectively precludes analysis of expenditure tracking and efficiency.

⁸ Under successive Staff Monitored Programs and dedicated technical support, the IMF is supporting MOFNE in working toward implementation of the GFS budget classification. Progress to date has been slow.

- Fourth, there is limited attention to budget execution, relative to presenting the prepared budget, and evidence is scarce about the outcomes of expenditures.

3.3 **Aggregate GNU expenditure has exhibited strong growth since 2000, increasing by 23 percent on average per annum in real terms, and nearly doubled to 22 percent of GDP by 2006** (Figure 3.1). Total per-capita expenditure in US dollars grew from \$44 in 2000 to \$233 in 2006. Fiscal discipline was maintained between 2000-04 with most years having an overall balance surplus (on a cash basis). Deficits of 2 and 4 percent of GDP, respectively, were observed in 2005 and 2006.

Figure 3.1: Rapid increase in GNU expenditure



Source: MOFNE and staff estimates.

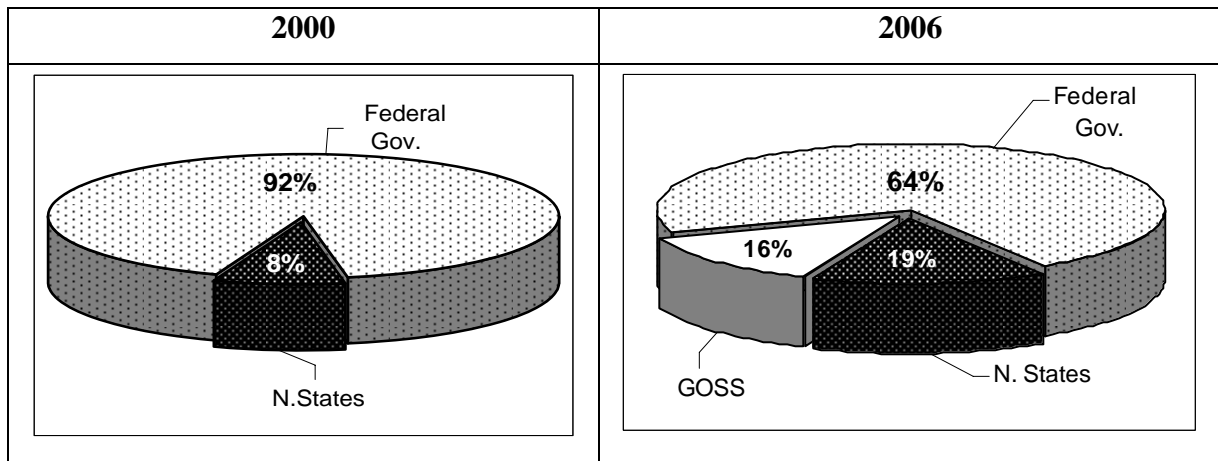
A. TRENDS IN GNU SPENDING COMPOSITION

3.4 Since 2006, Sudan’s national budget is presented to the National Assembly in three parts—Part I includes federal recurrent and capital expenditure, Part II covers transfers to the GOSS, and Part III covers transfers to Northern state governments. Oil revenue transfers to the GOSS, comprising over 95 percent of Part II, are dictated by the CPA. Before the CPA and establishment of the GOSS in 2005, the budget only included expenditures in the current Parts I and III.

3.5 **The dominant effect of the CPA on the composition of public finance has been large increases in new obligations to sub-national governments, consistent with the CPA emphasis on greater equity in wealth sharing.** The federal share of GNU expenditure has fallen from 92 percent in 2000 to 64 percent in 2006, in light of CPA obligations to the GOSS and the sharp growth in transfers to Northern states (Figure 3.2). However, federal expenditure over the period also rose significantly, from 11 percent of GDP in 2000 to 18 percent in 2004, before falling back to around 15 percent of GDP. GNU transfers to sub-national levels were modest over 2000 – 2004 (on average around 1 percent of GDP) and subsequently expanded after the CPA. This increase in transfers was largely driven by earmarked transfers, with the bulk for payment of civil servants salaries. Part of this reported

increase was due to a reclassification of previously federal expenditures to the Northern states, specifically the recurrent costs for judiciary, higher education and police which are now reported under Part III.

Figure 3.2: Growing obligations to sub-national governments, in percent of total GNU expenditures



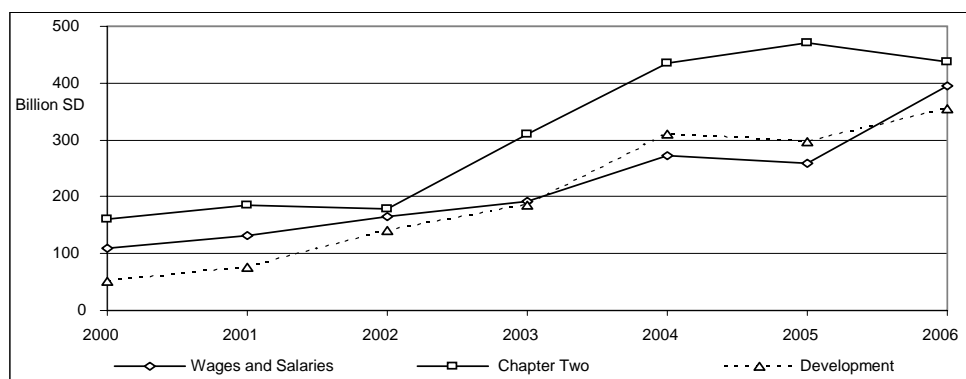
Source: MOFNE and staff estimates.

3.6 At the end of 2006, GNU transfers to the South were broadly in line with CPA commitments, notwithstanding the boundary uncertainties and sometimes significant monthly revenue shortfalls. Oil revenues dominate the GOSS budget. GNU per capita transfers to the GOSS totaled \$22 in 2005 (2.8 percent of GDP), which was a partial year given the formation of the GOSS late in the year, and \$37 in 2006 (3.6 percent of GDP).

3.7 **The economic budget classification reported by GNU only covers federal expenditures, or 64 percent of total GNU spending in 2006.** There are three economic “chapters”. Strict rules establish the priority for release of funds to these categories—federal wages and salaries have first priority, general operation and maintenance ranks second⁹, and the development budget has the lowest priority. Both current and development expenditures have increased, with relative growth in development spending (Figure 3.3). Chapter Two maintain the largest share of GNU federal spending.

⁹ Chapter Two contains: (i) centralized items (i.e., obligation towards internal and external debt, contribution to the international and regional organizations, general reserve, capacity building plan etc..) which accounted for 26 percent of Chapter Two in 2006; (ii) Goods and Services; and, (iii) social subsidies.

Figure 3.3: Federal expenditures by economic classification, 2000 – 2006



Source: MOFNE and staff estimates.

B. FEDERAL CURRENT EXPENDITURES

3.8 Current expenditures are largely for goods and services, which accounts for the largest share of GNU federal spending. Within this chapter, there is a significant “reserve” component that receives inflows during the year (i.e., beyond budget plans). Wages and salaries jumped in 2006, including a 20 percent wage increase for all public employees in April 2006. However, analysis of the wage bill to inform overall budget prioritization and possible reallocation is hampered by the lack of data on the number of civil servants, pay at different grade scales, and the prevalence of allowances in civil servants’ compensation packages.

3.9 With the lack of regularly reported functional data, the size of the military budget is not well understood. Indications are that defense spending declined sharply at the end of the North/South conflict in 2005, to 1.2 percent of GDP in 2005 from roughly 2.3 percent of GDP in 2001-2003 (Table 3.1). Subsequently, defense spending has reportedly increased sharply in 2006 to its highest level this decade, nearly 30 percent of all federal current expenditures or 2.9 percent of GDP. This increase is consistent with the authorities’ reporting of new spending on demobilization efforts and support of the Joint Forces since the CPA. Defense spending has also shown increases in other post-conflict situations, in support of DDR programs. The World Bank is working with MOFNE in order to collect more information to confirm this.

Table 3.1: Defense Spending Rises in 2006

Item	2000	2001	2002	2003	2004	2005	2006
	<i>in billion SD</i>						
Total Federal Government Expenditure	322.5	384.2	466.8	674.3	1010.7	1028.3	1186.5
Total Current Expenditure	270.3	317.5	344.1	501.0	709.2	730.5	814.7
Defense and National Security	76.4	79.5	92.8	109.2	106.9	80.0	235.5
Public order and safety	23.7	26.6	36.3	52.9	58.8	24.2	90.1
	in percent of total federal government expenditure						
Defense and National Security	23.7	20.7	19.9	16.2	10.6	7.8	19.8
Public order and safety	7.4	6.9	7.8	7.8	5.8	2.4	7.6
Other federal government expenditure	69.0	72.4	72.4	76.0	83.6	89.9	72.6
	in percent of total current expenditure						
Defense and National Security	28.3	25.0	27.0	21.8	15.1	10.9	28.9
Public order and safety	8.8	8.4	10.5	10.6	8.3	3.3	11.1

Source: MOFNE and staff estimates.

C. FEDERAL DEVELOPMENT EXPENDITURES

3.10 Public investment to facilitate growth and poverty reduction is paramount to Sudan's reconstruction and development challenge. The JAM highlighted the acute need for rebuilding the country's deteriorated infrastructure and service delivery framework, and the GNU has subsequently devoted an increasing share of its budget to public investment. The 2007 budget outlines over \$1.5 billion in national development projects.

3.11 **In practice, the increase in spending on national development projects has been volatile and heavily concentrated in several large projects, with spending outside of budget allocations common for these projects.** Aggregate spending on development projects rose from 1.3 percent of GDP in 2000 to 4.0 percent in 2004, then slowed-down to 2.9 percent on average over 2005-2006. This increase has not been smooth, with funding actually declining in nominal terms for two years during this period. The investment portfolio is heavily concentrated in a few large projects, with the largest five projects comprising 60 percent of total investments in 2006. The massive Merowe Dam project has dominated the portfolio with roughly one-third of project investment in 2006 (see the irrigation share in Table 3.2). Transport and energy make up almost another third of recent expenditures. The share of project disbursements in the social development sector increased sharply in 2006, with two new largely foreign-financed projects - rehiring military retirees (11.2 SDD billion) and the national program for good governance (7.0 SDD billion).

Table 3.2: Sector shares of national development projects (percent)

Sector	2000	2001	2002	2003	2004	2005	2006	2005-06 Average
Irrigation	18.3	14.7	7.3	30.3	35.5	44.9	34.7	39.8
Agriculture	16.5	5.0	2.2	4.6	4.5	5.4	8.4	6.9
Livestock	0.4	0.5	0.3	1.2	0.5	0.3	0.2	0.3
Industry	17.9	17.2	12.2	10.4	8.2	4.0	12.6	8.3
Transportation, Roads & Bridges	12.6	7.1	3.3	8.2	9.3	18.7	13.1	15.9
Energy	14.9	18.5	16.7	15.9	17.0	17.4	16.0	16.7
Social Development	7.6	12.9	1.2	5.2	5.8	7.5	13.5	10.5
Water	5.1	2.7	0.9	1.2	3.2	0.3	0.0	0.2
Others*	6.8	21.3	55.9	22.9	16.0	1.5	1.4	1.5

Source: MOFNE and staff estimates.

3.12 The concentration of the development portfolio in a few large projects is associated with large year-to-year changes and weak financing performance in the remaining portfolio. Table 3.3 shows the sharp contrast in execution rates of the portfolio, taking account of the five largest projects. Spending beyond budget allocations is common for the largest projects. For example, the Merowe Dam project spent more than \$125 million more than budgeted in 2006, due to higher than forecast resettlement costs, which crowded out part of the rest of the portfolio. Many projects slated for funding in the approved budget tend to receive little or no financing, especially in social development, water and livestock. Volatility of the portfolio is demonstrated in Table 3.4 with a high degree of “churning.” New projects make up between 25 and 43 percent of the portfolio, and there are frequent examples of projects that are not financed, dropped and re-enter the portfolio.

Table 3.3: Budgeted and Actual Expenditures on National Development Projects

Year	Budget Total (SDD bill.)	Actual Total (SDD bill.)	Actual Total (% of GDP)	Execution rate (%)		
				Total	Top 5 projects	Excluding top 5
2000	47.8	36.9	1.3	77.3	160.6	47.4
2001	99.2	56.7	1.6	57.2	80.1	45.7
2002	143.9	115.5	2.9	80.2	131.0	71.4
2003	138.8	107.4	2.3	77.4	166.8	56.4
2004	220.7	221.0	4.0	100.1	125.4	83.5
2005	173.9	185.9	2.6	106.9	135.7	80.0
2006	263.9	256.1	3.1	97.1	144.5	65.5

Source: MOFNE and staff estimates.

Table 3.4: Excessive Movements in the Portfolio of National Development Projects

	2000	2001	2002	2003	2004	2005	2006	Average	
Total number of projects (A)	49	59	74	82	115	101	88	81.1	
Total volume of projects	36.9	56.7	115.5	107.4	221	185.9	256.1	139.9	
Average size of projects	0.8	1.0	1.6	1.3	1.9	1.8	2.9	1.7	
New projects	Brand-new projects* (B)	-	16	32	24	36	33	22	27.2
	Vol. of Brand-new projects	-	6.1	14.1	8.1	14.8	32.6	54.0	21.6
	Recycled projects**	-	-	1	3	8	3	6	4.2
	Vol. of recycled projects	-	-	0.9	16.3	1.9	0.2	14.3	6.7
Ongoing projects (C)	-	43	41	55	71	65	60	55.8	
Volume of ongoing projects	-	50.6	100.5	83.0	204.3	153.1	187.8	129.9	
Exited projects*** (D)	6	18	19	11	50	39	-	23.8	
Volume of exited projects	3.0	7.0	8.4	9.0	31.2	27.6		14.4	
Share of brand-new projects (B/A)	-	27.1	43.2	29.3	31.3	32.7	25.0	31.4	
Share of ongoing projects (C/A)	-	72.9	55.4	67.1	61.7	64.4	68.2	64.9	
Share of exited projects (D/A)	12.2	30.5	25.7	13.4	43.5	38.6		27.3	

Source: MOFNE and staff estimates.

* Projects not in the portfolio of the previous fiscal year.

** Projects not in the portfolio of the previous fiscal year, but in an earlier portfolio.

*** Projects not in the portfolio of the current fiscal year, but in the previous portfolio.

3.13 There are serious development planning constraints in Sudan that require focused attention by the authorities. Constraints are faced at the program planning and project analysis levels, and both at the national and state levels. A comprehensive public investment program is lacking. There appears to be limited analytical consideration of the appropriate public investment envelope and trade-offs of interventions among and within sectors. Linkages across levels of government, especially with respect to supporting service delivery on the ground, are weak. Efforts to improve upstream budget planning activities, particularly the macroeconomic framework and revenue forecasting, may provide the best short term gains. The following areas are starting points for improvements: (i) sector planning needs to look at both current and capital expenditures; (ii) allocations need to link to policy anchors, such as the on-going Five Year National Strategic Plan; (iii) concrete estimates of policy actions are required; and (iv) predictability in execution is a necessary incentive for investment in the planning process.

3.14 At the project level, basic information on project objectives and components is hard to find. A recent World Bank mission was unable to obtain any evidence of minimal cost-benefit analysis and evidence of adequate project appraisal for a sample of large public investment projects. Project monitoring during implementation and evaluation of the achievement of intended benefits also appears very low, both in financial and economic terms. External assistance, from the World Bank and others, would help to build on this diagnostic and assist in the capacity building of development planning and project preparation.

3.15 In addition to funding for investment projects, development spending also includes several large line items for public capital contributions, agriculture subsidies, and on-lending to development financing institutions. Information on these activities is also limited and hampers an examination the effectiveness of GNU expenditures and short and long term

benefits. Some information on agriculture subsidies is emerging (Box 3.1), but a consolidated sector approach is needed that links both current and development expenditures to objectives.

Box 3.1: Agriculture Subsidies and Support under the Green Mobilization Program

In addition to the portfolio of national development projects, GNU development spending has several large line items for public capital contributions, agriculture subsidies, and on-lending to development institutions. Emerging information on the agriculture subsidies is available in the context of the Green Mobilization Program (GMP), started in 2006 and focusing on improved productivity and livelihoods for small-scale farmers. The GMP is considered mostly pro-poor.

The Green Mobilization Program (GMP) started in 2006 and focuses on improved productivity and livelihoods for small-scale farmers. Most of the activities are considered pro-poor. In 2006 – 2007, agriculture season support budgeted under the GMP was SD 33.2 billion—or 8.6 percent of the national development budget for agriculture in the years 2006 and 2007 combined—but execution was only 44 percent through May 2007. There can be little doubt that the agricultural sector is currently under severe stress for a number of reasons including export price pressures from recent appreciation of the real exchange rate and low productivity, and temporary assistance could be well justified in some circumstances.

Finance for Irrigated Cotton Production (4.1 billion SDD, 83 percent executed)

The ‘incentive’ payment for Acala medium staple irrigated cotton was intended to encourage farmers to produce this medium staple cotton which accounts for the bulk of the world market and has traditionally been Sudan’s major output. Subsidizing the price of Acala was meant to discourage substitution production of Barakat long staple cotton. A shortfall in Acala production would have resulted in a loss of market share for Sudan, and the international market for Barakat is extremely limited. This incentive program for the 2006/2007 crop represented a 28 percent increase in the price paid to farmers in the field compared with the typical price that the SCCL had paid in earlier years before the appreciation of the exchange rate and lower prices in the international cotton market. At the subsidized price the SCCL was able to just avoid a loss.

Other Programs in Irrigated Schemes

The GMP program allocated and fully executed SD 1.1 billion in subsidies to compensate for the increased costs of diesel fuel for turbines pumping water for irrigation schemes where water supplies are not gravity fed. Another program providing a SD 7 billion subsidy targeted for electricity tariffs associated with the use of turbines for irrigation has not yet been used. Ninety percent of allocated funds (SD 2 billion) have been used under a separate program for capital and running costs of cleaning boreholes and subsidiary canals in irrigation systems. Ninety percent of a subsidy of SD 5 billion for financing horticultural production, typically in irrigation areas, has been used.

Finance for Improved Seeds (3.9 billion SDD, 195 percent executed)

This program has achieved notable success in achieving its pro-poor goals of raising productivity of small-scale farmers in the traditional rain-fed sector. This is a continuation of an existing government program (initiated in 2003) which was adopted by the GMP to scale up earlier success.

Finance for Traditional Rainfed Farming Areas

Other potential ‘pro-poor’ subsidies within the GMP program include SD 3 billion allocated for rain-fed agriculture. It is unclear what form this subsidy might take but in any case none of the SD 3 billion allocated was used in 2006/2007. In addition, SD 5 billion allocated for the financing of animal resources has not been used although its purposes are not clear.

3.16 The lack of functional information and analysis of expenditures is a major shortcoming. Analysis of expenditures by purpose or sector is valuable for planning, monitoring and linking expenditures to outputs and development outcomes—in other words, to determine whether spending by relevant agencies is generating the expected results. For

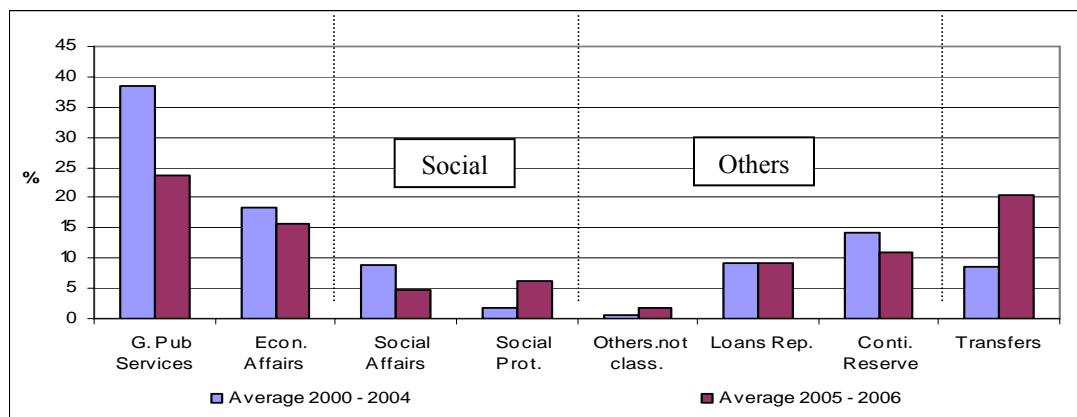
example, a public expenditure review would typically attempt to correlate changes in the level and distribution of spending at the sector level, and increases or decreases in relevant outputs and outcomes. It would answer questions such as:

- *Inputs:* How much was spent on primary education? What was the intra-sectoral breakdown (how much was spent on wages versus textbooks versus infrastructure, and so on)?
- *Outputs:* What were the tangible outputs? (How many teachers were paid, textbooks were distributed, schools were built, etc.?)
- *Outcomes:* What was achieved? (How many children completed primary education? What share are girls? Over time, what is happening to the literacy rate?)

3.17 More sophisticated and in-depth studies could look more closely at value for money within the sector, since international evidence shows that higher levels of spending do not necessarily lead to better results. However, sector expenditure analysis in Sudan has been limited by both the types of classification used and a lack of a consolidated budget. An attempt was made to overcome the first problem by mapping MOFNE releases by spending unit to a functional template. While not strictly conforming to GFS methodology, the data should be reasonably robust in looking at broad trends in the functional use of federal expenditures.

3.18 The preliminary functional data on GNU expenditures shows the increase in transfers to sub-national levels of government has been largely financed by a reduced share of general services (Figure 3.4). The shares of economic affairs, social affairs and reserves have also decreased, though the latter remains large by international standards. Besides the increase in transfers, social protection also increased. This can be traced to huge jumps in the wage and salary expenditure of the Ministry of Social Care and Development, from less than 0.1 percent of total federal wages and salaries between 2000 and 2004 to 30 percent in 2005 and 40 percent in 2006. The PER did not examine the destination of this spending. The current-development mix shows that two-thirds of current expenditure for general public services and social affairs, while nearly three-quarters of economic affairs expenditure is development.

Figure 3.4: Functional Composition of GNU Spending (percent shares)



Source: MOFNE and staff estimates.

3.19 Working together with MOFNE staff, an attempt was made to supplement the functional data on federal transfers with new data on state expenditure covering GNU transfers as well as expenditures financed by own-revenues. The result is a more comprehensive measure of expenditures that allows more complete sectoral analysis, given the divided responsibilities across government levels. But it is important to emphasize the data limitations. The states' annual total expenditure was estimated by using the individual final accounts annual report for all the northern states for the period 2000-2005. These reports were reviewed by the Chamber of Accounts federal representatives in the state, but given the overall weak state of PFM systems in Sudan, especially at lower levels of government, the findings can only be taken as indicative.

3.20 By way of examples, Table 3.5 summarizes a comprehensive picture of federal and Northern states' spending on health, which has grown sharply but was still only 1.4 percent of GDP in 2005.¹⁰ The bulk occurs at the state level, consistent with the fact that the primary responsibility for basic service delivery lies with state governments. Thus the growth is driven by rising federal transfers to Northern states, though the growth in health spending has been lower (39 percent annual growth in 2005 relative to 155 percent for total state transfers). A major concern is the extremely low level of investment spending in the health sector, with over 95 percent going for current expenditure. In 2005, development spending rose to 9.3 percent of health expenditure, but from negligible levels in both absolute and relative terms. However, assessing the appropriate balance between recurrent and capital expenditures will require more detailed sector-specific analysis than is currently available. The recent North Kordofan Basic Services Study demonstrates some early work in this direction (see Box 3.2), and is available in the PER background volume (see footnote 1) to promote further studies of the outcomes of public expenditure and sub-national service delivery.

¹⁰ Among countries with 2004 per capita GDP less than \$2,500 the expected level of per capita public spending on health by a country of GDP per capita of \$1,000 would be around 3 percent of GDP, although with wide variation.

Table 3.5: Federal and Northern States Health Spending,¹¹ 2000-2005

	2000	2001	2002	2003	2004	2005
SDD billions						
Total Health Expenditure	23.2	32.5	37.9	49.1	75.2	98.4
I- Current spending	21.7	30.5	37.2	47.7	71.7	88.4
II- Development spending	1.5	2.0	0.7	1.4	3.5	10.1
I- Federal Expenditure	7.1	9.0	8.8	11.7	20.8	19.4
Current spending	6.0	7.3	8.7	11.3	18.8	16.7
Development spending	1.1	1.7	0.1	0.4	2.0	2.7
II- State Expenditure	16.1	23.5	29.1	37.4	54.3	79.0
Current spending	15.7	23.2	28.5	36.4	52.9	71.7
Development spending	0.4	0.3	0.6	1.0	1.5	7.3
Breakdown of TOTAL health expenditure (%)						
Current spending	93.5	93.7	98.1	97.2	95.4	89.8
Development spending	6.5	6.3	1.9	2.8	4.6	10.2
Breakdown of FEDERAL health expenditure (%)						
Current spending	84.1	80.7	98.9	96.5	90.4	86.0
Development spending	15.9	19.3	1.1	3.5	9.6	14.0
Breakdown of NORTHERN STATES health expenditure (%)						
Current spending	97.7	98.7	97.9	97.4	97.3	90.7
Development spending	2.3	1.3	2.1	2.6	2.7	9.3

Source: State Final Accounts Annual Reports, MOFNE. Note: total health expenditures exclude the GOSS.

Box 3.2: Insights on Sub-national Health Spending

The Federal and State Ministries of Health and the World Bank undertook a study in 2006 of the financing of basic health services at the local level in North Kordofan. Financial data were collected from the State and Locality administrations, a facility survey measured service quality and utilization indicators, and focus groups revealed patient perceptions. The main messages are as follows.

Most state/locality public spending on health is for salaries, with negligible investment spending. Health services in the state, including primary health care and hospital services, are largely the responsibility of the State and Localities. Total estimated government spending on these services in 2005 was around SDD 2,400 million, or \$10 million. This represented about SDD 1,500 per capita, or \$6.20. Of this, about \$4.00 was spent by the State government and USD 2.20 by Localities, mostly on salaries financed by transfers from the State. It is estimated that 60 percent of public spending on health is for salaries. Investment spending is negligible. This health spending, although steady as a proportion of total government spending, is considerably increased from previous years in line with the overall growth in public spending, linked to increased Federal transfers to the state. In 2003, for example, State government health spending was SDD 700 million, about half the 2005 figure.

Higher spending is correlated with higher levels of service utilization. Estimated public spending on non-hospital services varies considerably by locality and is well-correlated with utilization rates. Without accounting for possible confounding factors such as differing levels of socio-economic status between localities, utilization increases by 0.05 patients per capita annually with each increase in spending on non-hospital services of SDD 10. Utilization is similarly well-correlated with numbers of health workers, and this

¹¹ Due to data limitations, the calculations do not include foreign finance, direct federal expenditure on medical equipment, expenditures from revenue collected directly by health facilities, and other expenditures not captured in the MOFNE budget figures.

is the case both with higher and lower-skilled workers. This can be seen, for example, in Um Rwaba locality, where overall utilization is relatively high and facilities are largely staffed by community health workers. Similarly, utilization of public sector non-hospital facilities in rural areas, mostly staffed by lower-level cadres, is higher than in urban areas.

Spending is concentrated on urban health services in hospitals. About two-thirds of government health spending in the state is allocated to the 14 hospitals, concentrated in urban areas, in particular the State capital. Seventy percent of spending on hospital services is for salaries. Non-hospital basic services receive only about a third of public spending on health in the state, and of this about 40 percent is for staff remuneration.

Facilities rely on cost recovery for significant financing. Official user fees are a significant revenue source for the financing of basic health services, representing about a fifth of total expenditures. In addition, many fees retained by health facilities are not included in revenue reports, but certainly represent a significant source of financing, likely covering most non-salary recurrent costs. By policy, most drug costs are borne by patients. As would be expected, higher fees are charged in higher-level facilities staffed by more skilled personnel. The reported cost to patients of treatment for an episode of malaria ranged from SDD 500 (\$2.20) in primary health care (PHC) units to SDD 870 (\$3.80) in hospitals.

... thus the rural poor have less access to services. Fees for services represent a significant barrier to access to care, particularly in rural areas. Health facilities reported that 25 percent of patients fail to pay for services in rural areas, compared to only 5 percent in urban areas. Of those who failed to pay in rural areas, only 1 percent was subsequently supported by a social support mechanism, compared to 62 percent in urban areas. Focus groups generally indicated the fees for services were higher than ability to pay and that this was an important barrier to access. It could be expected that higher public spending would be accompanied by lower user fees, which in turn would lead to higher utilization, but such a pattern is not evident.

Overall, this study sketches a picture of an under-financed but moderately-performing public sector health system that privileges hospital services in urban areas. Most public financing goes to salaries and higher financing (and greater numbers of health workers) are reflected by higher service utilization. A large proportion of total resources are concentrated in Sheikan Locality, which contains the main referral hospital in the State capital, but there is also evidence that lower-level services in rural areas and some Localities function well enough to attract moderate levels of utilization.

The main policy implications of this study are that further increases in government health spending (largely tied to increases in Federal transfers) should: (i) be better allocated to non-hospital basic services in rural areas and under-served Localities; (ii) improve spending on non-salary recurrent costs and investment; and (iii) be tied to reductions in the financial burden on households, which implies both reducing user fees and starting to subsidize drug costs.

Source: North Kordofan Basic Services Study (2007), included in PER background volume, Chapter 6.

3.21 Table 3.6 shows the federal and Northern state allocations on education. The trend and composition is broadly similar to health, albeit with more modest growth and slightly higher state and recurrent shares. Total education spending was 1.3 percent of GDP in 2005.¹² Over the period 2000-2005, education averaged 4 percent of federal and 23 percent of state expenditure. As in the health sector, increases in state-level spending have been almost entirely absorbed by salaries, however, as mentioned with health spending, more detailed sector work is required to assess the right recurrent/development balance. Capital

¹² Among countries with per capita GDP less than \$2,500 (in 2004) the expected level of per capita government spending on education by a country of GDP per capita of \$1,000 would be around 4 percent of GDP, although with wide variation.

investment (i.e., school construction) is possibly necessary but certainly not sufficient to improve education services. Improved teacher remuneration, as well as public financing of other recurrent costs (particularly textbooks) will be crucial to reduce the financial burden on households among the poor and in under-served rural areas. In states and cities where enrolment is relatively high, investment in quality improvement would appear necessary.

Table 3.6: Federal and Northern States Education Spending, 2000-2005

	2000	2001	2002	2003	2004	2005
SDD billions						
Total Education Expenditure	32.7	37.3	53.8	58.9	91.4	88.5
I- <i>Current spending</i>	32.0	36.3	44.8	57.3	85.2	80.7
II- <i>Development spending</i>	0.7	1.0	9.1	1.7	6.3	7.9
Federal Expenditure	14.3	17.0	21.7	29.1	40.7	21.6
<i>Current spending</i>	13.8	16.2	21.6	27.8	36.3	17.0
<i>Development spending</i>	0.5	0.8	0.1	1.3	4.4	4.6
State Expenditure	18.4	20.3	32.1	29.8	50.8	66.9
<i>Current spending</i>	18.2	20.1	23.1	29.4	48.9	63.6
<i>Development spending</i>	0.2	0.2	9.0	0.4	1.9	3.3
Breakdown of TOTAL education expenditure (%)						
<i>Current spending</i>	97.9	97.2	83.2	97.1	93.1	91.1
<i>Development spending</i>	2.1	2.8	16.8	2.9	6.9	8.9
Breakdown of FEDERAL education expenditure (%)						
<i>Current spending</i>	96.6	95.0	99.8	95.4	89.2	78.9
<i>Development spending</i>	3.4	5.0	0.2	4.6	10.8	21.1
Breakdown of NORTHERN STATES education expenditure (%)						
<i>Current spending</i>	99.0	99.1	72.0	98.8	96.3	95.0
<i>Development spending</i>	1.0	0.9	28.0	1.2	3.7	5.0

Source: State Final Accounts Annual Reports, MOFNE. Note: total health expenditures exclude the GOSS.

D. BUDGET PROCESS AND CREDIBILITY

3.22 The GNU has an established budget planning process in the second half of the fiscal year (July—December). The specific steps are outlined in Table 3.7. The steps generally occur on time and in a transparent manner, with broad representation in the various committees and participation of the Northern states.¹³ The time period for budget formulation is compact, especially for coordination with sub-national levels. The current practice of contemporaneous preparation of central and state budgets in the North does not give the states a reliable estimate of central transfers in time for state budget formulation.

Table 3.7: Main Steps and Timetable for Budget Preparation

Formulation of macroeconomic committees	2 nd to 4 th week of July
Preparation of macroeconomic framework	3 rd and 4 th weeks of July
Budget circular initiated	1 st week of August
Budget circular distributed	2 nd to 4 th weeks of August
MOFNE Undersecretary meets with line ministries and DG of public corporations on budget circular	4 th week of August
MOFNE Minister meets with sub-national representatives (Northern states and GOSS)	1 st week of September
Budget proposals received from line ministries and government units	1 st to 3 rd weeks of September
Budget discussion committee reviews proposals	3 rd to 4 th weeks of September
First draft budget completed	3 rd to 4 th weeks of September
Meeting with different Social actors (trade unions, civil society)	4 th week of Sep. to 1 st week of Oct.
Discussions of first draft budget and second draft completed	1 st to 3 rd weeks of October
Draft budget approved by Higher Committee and signed by MOFNE Minister	4 th week of October
Inform sub-national representatives (Northern states and GOSS)	4 th week of October
Discussions of budget proposal with civil society	1 st week of November
Submission of the budget to Council of Ministers	3 rd week of November
Submission of the budget to the National Assembly	End November to early December
Approval of budget by the National Assembly	Mid December

3.23 While the budget preparation process is orderly, the budget has credibility concerns stemming from systemic deficiencies in the upstream and downstream budget processes. Efforts to improve upstream budget planning activities, particularly the macroeconomic framework, may provide the best short term gains. As mentioned earlier, the following areas are key: (i) sector planning needs to look at both current and capital expenditures; (ii) allocations need to link to policy anchors, such as the on-going Five Year Plan; (iii) concrete estimates of policy actions are required; and (iv) predictability in execution is a necessary incentive for investment in the planning process. A longer term issue is the need to ensure all revenues are collected in the NRF. It is unclear whether the full extent of fee collection by line ministries is reflected in GNU revenues.

3.24 A second source of budget credibility concerns is execution performance (Table 3.8). Expenditure deviations in annual aggregates from approved budget have tended to improve

¹³ Southern Sudan has an autonomous budget process, which is discussed in the Section 7.

over time, though 2006 experienced a low 87.5 percent performance due to oil revenue shortfalls. However, monthly variation of MOFNE releases is a significant issue. Without a predictable flow of resources to spending units, execution of spending plans is hampered and of particular concern are the effects on financing of capital expenditure. Roughly one-third of foreign disbursements for national development projects for 2006 were reported as released in the month of December. Nearly 20 percent of 2006 state development transfers also occurred in December. Thus while the GNU has increased its budget commitments to pro-poor spending via fiscal decentralization, execution in aggregate terms was low for 2006 and the timing of releases erratic. This has a devastating effect for state budgets which rely on central transfers for a significant share of revenues. Overly optimistic revenue projections and expenditures across budget categories having little or no relationship to the amounts budgeted. It is therefore not uncommon for there to be revenue shortfalls of around 30-40 percent on an annual basis along with similar variability on the expenditure side.

Table 3.8: GNU Budget Execution (actual expenditures as percent of budget)

Items	2000	2001	2002	2003	2004	2005	2006
Total Public Expenditure	96.5	90.7	86.6	105.4	102.3	98.8	87.5
Wages and Salaries	104.1	96.2	96.5	96.0	95.5	86.1	94.6
Goods and Services	95.3	103.1	77.5	121.4	108.2	124.5	83.4
Capital Expenditure	79.1	65.2	88.7	99.6	106.7	109.3	96.9
o/w National Development	77.3	57.2	80.2	77.4	100.1	106.9	97.1
Intergovernmental Transfers	118.2	89.5	89.6	85.9	85.0	81.2	82.2
o/w GOSS transfers	118.2	89.5	89.6	85.9	85.0	95.5	75.2
o/w N. State transfers						69.4	92.6

Source: MOFNE and staff estimates.

E. FINANCIAL MANAGEMENT

3.25 The authorities have made a number of efforts to improve financial management and public expenditure. Efforts by the authorities to improve financial management systems and public expenditure include restructuring the budget to reflect sub-national transfers, a computerizing budget performance reporting system, training on functional budget classification, and establishment of a high level committee to help ensure allocation and monitoring of federal government resources in line with budget priorities. Nonetheless, a significant number of key deficiencies remain.

3.26 Key aspects of financial management are being tackled by the on-going Country Integrated Fiduciary Assessment (CIFA). In the North, there is wide variability between the performance of the system at the federal level and in the states.¹⁴ Notwithstanding the aforementioned budget and accounting classification issues, there is regular and effective monitoring of expenditures at the federal level. However control systems are weak. The Auditor General's report for 2004 states that internal controls systems are particularly weak at the federal government resulting in practices such as complete or partial offshoring of revenues or depositing them in creditors accounts and then spending them and imposing of

¹⁴ An assessment of PFM issues in Southern Sudan is covered in Section 7.

unapproved fees and regularly issuing of unofficial receipts. At the State and locality levels financial management capacity is far weaker, which is a particular concern given the increase in transfers to Northern states. Much greater attention is required on the ability to effectively use these resources. (See section on state case studies.)

3.27 There is a consistent and large build up of arrears in the system as the commitment control system is not effective. Expenditures are committed on the basis of appropriations, rather than availability of cash resources. Cash management is weak, and for other than salary payments, there is a large amount of unpredictability regarding resource flows at the federal, state and locality level. Due to this, there is a regular build up of arrears. Information regarding commitments or arrears is neither collected nor analyzed.

3.28 **Regarding fiscal reporting,** accounting is the responsibility of the Chamber of Accounts (CoA). The CoA has around 8000 staff posted in various spending units. Reconciliation of banking and fiscal records is undertaken satisfactorily on a monthly basis. In accordance with the 1995 regulations, each spending unit reconciles its accounts with the bank statement and submits the same to the CoA by the 15th of the following month. The CoA in turn uses this information to compile the monthly account for the Government as a whole. Monthly government finance data is produced on time, with a six week lag. The utility of this data is undermined due to shortcomings in the classification system.

3.29 Annual public accounts are produced on time both at the Federal Government level as well as in the States. This is a relatively recent development. There has been a marked improvement in closing of accounts since 2002 when all 16 states in the North closed their accounts on time. However, the Auditor General's report for 2004 records that even though States did manage to close their accounts on time, this was through not fully recording either revenues or expenditures in the final accounts. Accounts are audited in a timely manner and submitted to the legislature. However there are widespread capacity constraints at both the Federal level and in the states. The quality of auditing needs to be improved to bring it in line with international standards.

3.30 In summary, the main agenda for the 2008 budget includes:

- Accelerating reforms to address the basic information deficiencies that undermine effective public expenditure management. Two key dimensions are consolidated budget planning and monitoring using the GFS functional budget classification, and building capacity for fiscal management and reporting. The latter is on-going, including through World Bank support, and will be further guided by the on-going CIFA.
- Rationalize the current expansionary fiscal policy, in light of revenue mobilization difficulties. This should include focusing on using existing expenditure levels more efficiently, especially national development expenditures and state-level expenditures. A much greater focus on accountability and the outcomes of public spending is required. Development planning and execution should be a priority in this regard.
- Improve budget credibility through: stronger and more transparent linkages during budget preparation (e.g., via the macroeconomic framework) to sector and thematic

policies, including poverty reduction; more transparent expenditure prioritization and predictable budget execution, including checks on the significant spending beyond budgeted allocations (e.g., operation and maintenance, and large development projects); and monitoring and reporting of arrears.

4. TOWARD A PRO-POOR PUBLIC BUDGET

4.1 In a post-conflict, decentralized Sudan, equitable and transparent budget allocations (how much is spent and on what) are key. Progress on this front will support successful implementation of the CPA, broad-based growth, and poverty reduction and sustained human development towards the Millennium Development Goals (MDGs). Improved fiscal decentralization with state and local governments fulfilling their service delivery responsibilities is thus critical. These are clear motivations for measuring and monitoring pro-poor spending, as the Sudanese people expect public expenditures to address the underlying structural causes of conflict and underdevelopment. Additional fiscal effort is not the only constraint to better outcomes, but recent studies point to significant underfunding as a critical obstacle to progress.¹⁵ And the gap is large, given the weak national record on human development outcomes, especially relative to income per capita. While per capita GDP nears \$1,000 or roughly 25 percent higher than the SSA average, recent estimates place Sudan's health outcomes on par with countries near \$400 per capita GDP.¹⁶ Rapid economic growth is relatively recent, and programs and policies will affect outcomes with a lag. At the same time, a concerted effort is needed to ensure this opportunity is used to put the country on a path for significantly improved pro-poor outcomes.

A. A PROXY FOR POVERTY REDUCING EXPENDITURES

4.2 **There are several challenges in Sudan that make international good practices in monitoring pro-poor spending difficult to apply.** A conceptual understanding of pro-poor spending in the relevant development literature¹⁷ is that pro-poor spending refers to “*spending that benefits the poor more than the non-poor; spending that actually reaches the poor; and spending expected to have an impact on the welfare of the poor over time*”. Identifying pro-poor spending in Sudan is constrained by:

- the quality and classification of budget data;
- the decentralized responsibility for basic service delivery;
- the lack of data on outcomes and a missing culture of accountability; and
- the lack of a coherent set of policies that can anchor a definition of poverty-reducing allocations (e.g., via a national poverty reduction strategy).

4.3 **Recognizing these constraints and building on the JAM, the PER exercise derived a feasible definition of GNU pro-poor spending in Sudan.** Over the past two years better information on public expenditures has become available, including via PER

¹⁵ See section 6 of this volume, as well as *Darfur: Dimensions of Challenges for Development – A Background Volume* (World Bank, 2007).

¹⁶ North Kordofan Basic Services Study, 2007, included in the PER background volume (see footnote 1).

¹⁷ See for example, PRSP Sourcebook, (2004, Klugman editor) or Tim Williamson and Sudharshan Canagarajah (2003) “Is There a Place for Virtual Poverty Funds in Pro-Poor Public Spending Reform? Lessons from Uganda’s PAF.”

state case studies, allowing for an improvement in identification of pro-poor categories relative to the 2005 JAM. The PER working definition of pro-poor expenditure for the GNU includes:

- selected federal recurrent expenditures—recurrent spending on basic health care; primary education; water supply and sanitation; parts of agriculture, irrigation and livestock; rural infrastructure (roads and bridges); energy and electricity; and the social subsidy;
- selected federal development expenditure—local financing of pro-poor projects identified based on broad international experience (in lieu of beneficiary information); this includes national development projects in basic education, primary health, and drinking water and sanitation, and most basic infrastructure; and
- selected transfers to Northern states—three-quarters of current and block transfers (based on observed expenditures at the state level via the state case studies (see Section 6), plus all local financed development transfers, plus all transfers to the three Areas.

4.4 While recognizing this definition is only an approximation based on newly available data, further improvements are expected during the process of PRS preparation and the National Strategic Plan. However we also recognize that very little is known on the actual use of the funds classified as pro-poor, which is a gap to be filled in the future.

4.5 **During the PER dialogue, MOFNE took ownership of defining and measuring pro-poor spending.** Identification of pro-poor spending is of course highly context-dependent, and is most useful when country-driven, developed through a wide participatory discussion, and used as a means to help guide and track government efforts. The PER exercise motivated the government to start developing its own definition of pro-poor spending. While differing from the PER working definition described above, a MOFNE working definition is an important step to formalizing monitoring in budget reporting and will hopefully be incorporated in the 2008 budget preparation process. The MOFNE definition is a work in progress and currently includes:

- from federal recurrent expenditures—all recurrent spending except wages/salaries/pensions for ministers and politicians, and all expenditure on goods and services, excluding defense;
- from federal development expenditures—all development spending, both locally and foreign financed; and
- from transfers to Northern states—80 percent of current and block transfers to northern states, plus all regional development projects both locally and foreign financed.

B. APPLYING THE DEFINITION

4.6 **GNU pro-poor spending has increased significantly.** The pre-CPA period (2000-2004) exhibits a low level and flat trend of pro-poor spending averaging roughly \$16 per capita (19.3 percent of total GNU expenditures and 2.8 percent of GDP). Since the CPA, GNU poverty-reducing spending increased significantly to \$68 per capita in 2006 (24.8

percent of total GNU expenditures and 5.5 percent of GDP). This represents a commendable increase, but is below budget plans (6.6 percent of GDP), JAM commitments (5.9 percent of GDP), the average for HIPC countries (7 percent of GDP), and, for example, neighboring Ethiopia (19 percent of GDP) and Uganda (11 percent of GDP).

4.7 As noted above, we don't have information directly from the spending units on the use of funds for the intended purposes and the quality/efficiency of spending. This is especially true at the state level. Moreover, the growth in pro-poor spending has occurred in the context of rapidly expanding total expenditures, and did not involve reallocation in level terms from other spending categories (i.e., all categories experienced real growth). It will be important to protect and strengthen pro-poor spending as a policy reflected in the budget, especially given fiscal pressures. The formulation of a national poverty reduction strategy should help in this regard.

4.8 **Composition of Pro-Poor Spending.** To determine the underlying factors behind the aggregate trends, three aspects are analyzed:

- **By level of government.** The increasing pro-poor efforts over the last two years are largely explained by higher transfers to Northern states, which account for more than half of total pro-poor spending in 2006. The JAM called for a large majority of GNU pro-poor budget efforts in the form of transfers to the Northern states, to support decentralized delivery of basic services. The increase in pro-poor transfers was, however, less than the government committed to in the JAM. This feeds into an overall trend in pro-poor spending which is skewed toward the federal level, suggesting under-funding of poverty-reducing expenditure at the state, and local levels, where basic services are financed and delivered.
- **By economic budget classification.** Most of the federal share of pro-poor spending is development spending, while state pro-poor spending has increasingly been allocated to recurrent expenditure (two-thirds in 2006). The dominance of recurrent pro-poor spending over development spending at the state level raises concerns, since improving service delivery to the poor in the longer term requires investment in schools, clinics, roads and so on. The relative emphasis on recurrent spending leaves little room for items that have a direct impact on the quality of services (e.g. investments in facilities, equipment and capacity development).
- **By functional budget classification.** Sectoral expenditure analysis in Sudan has been constrained by both the economic classification of the budget and the lack of a consolidated budget. An attempt was made at overcoming these challenges by using the available functional dataset as well as new data on state expenditure covering GNU transfers as well as expenditures financed by own-revenues.

4.9 The preliminary functional data show the bulk of pro-poor spending at the federal level is devoted to economic affairs:

- Agriculture and livestock has been the largest line item on average, although year-to-year allocations have fluctuated significantly.

- Total infrastructure spending (roads and bridges, energy and electricity, and water) has represented about a fourth of federal pro-poor spending, on average, as have social subsidies.
- Health, education and water shares remain stable at 8 percent, 4 percent and 0.3 percent of total federal pro-poor spending. This reflects the fact that the primary responsibility for health education and water lies with the state governments, and does not therefore constitute a significant share of federal poverty reducing spending. Nonetheless the state case studies found that state spending on pro-poor facilities remains very low, especially given the eroded state of infrastructure in the country, and remains way below what is needed to meet the MDGs, a situation which needs to be addressed through improvements in resource reallocations.

4.10 State-level allocations to expected pro-poor activities were mostly for general public services, reflecting support for wages and salaries:

- There is a significant “General Public” category, which absorbs about 30 percent of the budget (although it decreased to about one-fourth in 2005).
- Expenditure to support the agriculture sector has been relatively low (only about 5 percent).
- State infrastructure spending (roads, bridges, electricity, and water) has been slightly lower than at the federal level as a share of total expenditure, at about 20 percent of the total budget.

4.11 **Pro-poor spending on health and education.** Unlike the federal level, where allocations to the health and education sectors constituted less than 15 percent of pro-poor spending over the period 2000-2006, state-level expenditure on health and education amount to about half the state budgets (one-fourth each). This is consistent with the fact that the primary responsibility for basic service delivery lies with state governments. A key concern is the extremely low level of investment spending in the health and education sectors, with over 95 percent going for current expenditure. Improved service delivery to the poor in the longer term will require larger investment in health infrastructure. In 2005, development spending rose to 9.3 percent of health expenditure and to 4.9 percent of education expenditure, but from negligible levels and in both absolute and relative terms remains very low.

4.12 **The Three Areas**—South Kordofan, Blue Nile and Abyei—have been accorded special status in the CPA, in recognition of war-affected status and challenges. However, in contrast to the increase in overall transfers to Northern states, financing for development directed to the Three Areas remains very low, especially given the eroded infrastructure and weak public financial management in these areas.

C. INCREASING THE LEVEL AND QUALITY OF PRO-POOR SPENDING

4.13 The PER exercise has identified three entry points for increasing the level and quality of pro-poor spending:

- **Improving planning and analytical underpinning.** Strategic pro-poor planning appears to be weak at the national level. Lack of integration of public investment planning with the annual budget allocations process is a key problem in this context. Low capacity in planning and prioritizing pro-poor spending can in turn be traced to weak coordination within federal level (MOFNE and line ministries), and between federal and state level in preparing and executing the poverty reducing budget, in particular information sharing (e.g. budget and execution data). The PRS, and the ongoing Five Year National Strategic Plan, can be used to match expenditures to specific poverty-reducing efforts and establish/bolster the monitoring and evaluation system for public expenditures and promote a results culture.
- **Enhancing budget credibility.** Budget credibility, as defined by the degree to which actual expenditures deviate from budgeted levels, is important for effective implementation of government's poverty reduction programs and development efforts more generally:
 - Pro-poor budget credibility is relatively low, compared to execution of non-pro-poor expenditures. This is likely to remain a challenge in the current fiscal environment. In 2006, the execution rate for pro-poor spending deteriorated by 17 percent points. In this context, we can observe lower likelihood to protect poverty related sectors during resource envelope shortfalls, with development expenditures the hardest hit area.
 - Weak budget credibility is even more acute at the state level. State transfers deviated on average deviation by 18.4 percent. The annual execution for development poverty related transfers to states was only 71 percent. This pattern has serious repercussions for the effectiveness of the budget as an instrument to address regional disparities and the success of fiscal decentralization in the country.
 - There is a disappointing track record on budget credibility on federal allocations on basic social services, especially education and health. Weak predictability strongly limits the ability of line ministries to plan and implement policies and programs. This underlines the urgency of improving the budget processes at both the federal and sub-national levels through clarifying the roles of the different levels of government in resource management and strengthening the involvement of line ministries, Parliaments and broader stakeholders in the budget process.
- **Reallocating from non-pro-poor spending.** The current fiscal pressures in Sudan underscore the importance of increasing expenditure efficiency and effective use of scarce resources. The growth in pro-poor spending has occurred in the context of rapidly expanding total expenditures, which have allowed increases without reallocation. Government revenue leapt from \$1.3 billion in 2000 to \$6.9 billion in 2006, and an estimated at \$9.1 billion in the 2007 budget. However, there has been

only a weak effort to shift expenditure priorities of government during this period. Non-poverty reducing expenditure dominate, at 85 percent of total federal expenditures. Federal spending on pro-poor sectors increased over the same period, but in absolute terms by much less—from \$0.137 billion to \$0.364 billion. Within an overall prioritization of GNU expenditures, the authorities need to look for opportunities to increase pro-poor spending through reallocations.

4.14 Further review of the composition of federal non-pro-poor spending in 2000-2006 shows:

- Expenditures on goods and services, especially on “centralized items,”¹⁸ account on average for 46 percent of the federal total non-pro-poor budget;
- Non-pro-poor spending on wages and salaries, including the defence and security wage bill as well as chapter one reserves, account on average for 35 percent of the federal total non-pro-poor budget; defence spending had declined significantly in 2005, but jumped to 72 percent of non-pro-poor wages and salaries in 2006; and
- Non-pro-poor development spending averaged around 19 percent of total federal non-pro-poor spending.

4.15 **Next Steps.** Increasing the level and quality of pro-poor efforts will require a concerted effort in the near term, and in summary, the reform agenda includes:

- **Development of MOFNE’s definition, and monitoring, of pro-poor expenditures.** Ownership of this process is necessary for meaningful pro-poor expenditure management. In this regard, the precision of the definition is less important than its use in budget planning and monitoring, and further engagement with the authorities will aim for a reasonable MOFNE definition that is presented in the 2008 budget and subsequently monitored. Two specific areas for possible adjustment to the definition presented in the PER may involve including foreign financing of national development projects deemed to be pro-poor as well as significant components of the Merowe Dam project assuming a detailed breakdown of activities supports their focus on the poor as primary beneficiaries.
- **Data constraints.** Improved underlying analytical base—it is hard to identify pro-poor spending without knowing where the poor are and what the most basic needs are. The key analytical gaps include poverty analysis, house budget survey, development planning, sector approach, national prioritization, etc. There is also need for improved budget data, including a comprehensiveness coverage of budget data (consolidated budget); disaggregated budget classifications (GFS); skills in the statistics and PFM areas; timeliness,

¹⁸ Centralized items include domestic and external debt repayments and debt services; delegations and conferences; subscription in regional and international organizations; custom duties; and government travel and hospitality.

availability and readability of budget information; feedback loops from poverty analysis to budgeting; and monitoring of program budgets and other results-oriented policy-making tools to encourage evidence-based budgeting.

- **Budget processes.** Improve the budget processes at the Federal and sub-national levels, starting with the 2008 budget process, including stronger poverty-motivation in the budget, strategic thinking at the national and especially sector planning, and a culture of accountability to use of resources. This might be through clarifying the roles of the different levels of government in resource management; and fostering the involvement of line ministries, Parliaments and private sector in budget process. The PRSP process should contribute significantly, if adequately linked to the budget (e.g., monitoring of pro-poor expenditures in the budget and spending). Targeted efforts are needed to improve the budget credibility through concerting efforts to lower budget deviations; and improve revenue estimation. State budgets need reliable estimates from the center on transfers, which are the single most important factor behind severe credibility problems at the sub-national level.
- **Decentralization.** Since responsibility for basic services devolved to the state and locality levels, this is the frontline for addressing poverty. As more resources are getting to the sub-national level, it is imperative to gather information at the state/locality level on the use of funds, in a manner, for example, similar to the North Kordofan Basic Services Study (PER background volume, Chapter 6; see footnote 1). At the same time, financial management capacity building efforts must be strengthened.
- **Concentration on development spending.** There is an urgent need to direct resources to development at the state level, where it will directly benefit the poor and marginalized areas. Making development planning more effective through better coordination between the federal and state levels; information sharing (e.g., budget and execution data); and developing guidelines for more streamlined procedures at the state level.

5. INTERGOVERNMENTAL TRANSFERS AND FISCAL DECENTRALIZATION

5.1 With the recent peace agreements and the emphasis on equitable sharing of national wealth and resources, the issue of intergovernmental fiscal relations is central to the policy agenda in Sudan. The roles and responsibilities of sub-national governments, and associated public resources, have grown significantly in the past few years. In this context, the GNU has presented a vision for a more equitable and transparent system of intergovernmental resource allocation across its northern States, and well as between the north and south of Sudan. This vision is anchored in the 2005 Comprehensive Peace Agreement (CPA) and Interim National Constitution (INC).

5.2 This section summarizes the motivation for fiscal decentralization, reviews the current state of intergovernmental fiscal arrangements and presents a forward-looking set of challenges and policy options to inform the reform dialogue. The focus is on the Northern states, with the nascent structures of decentralization in the South and its unique challenges addressed in Section 7. This section also provides the backdrop for Section 6, which looks *inter alia* at the linkages between deficiencies of the intergovernmental transfer system and state-level budgets and fiscal management.

A. MOTIVATION

5.3 **The CPA and INC define the vision of fiscal decentralization in Sudan, and underscore its vital importance for successful implementation of wealth and power sharing agreements during the Interim period.** The vision has been initiated with a range of objectives, including post-conflict stabilization and the improved access and delivery of public services for a broader range of beneficiaries across all of Sudan's regions. Marginalization and neglect of the periphery and the dominance of the center have been central to the various conflicts in Sudan. Wide cross-regional variations in development outcomes, emphasized in Section 1 (and in more detail in the PER background volume, Chapter 2 on pro-poor spending; see footnote 1), reflect the large differences in the allocation of resources across states and regions. Fiscal decentralization is expected to redistribute resources to match public service delivery responsibilities, and thus improve inter-regional equity, responsiveness in public services to local level demand, sub-national autonomy and accountability and regional economic development more generally. It also promises to help ameliorate continued and potential conflicts such as in Darfur and Eastern Sudan by supporting the near term peace dividend through poverty reduction and economic growth.

5.4 **The primary component of successful fiscal decentralization is a more equitable and transparent system of intergovernmental resource allocation** between the North and South of Sudan, as well as across and within its Northern states. The specific objective of a good transfer system is to address vertical imbalances between the center and sub-national levels of government with respect to revenues and responsibilities (as expenditure

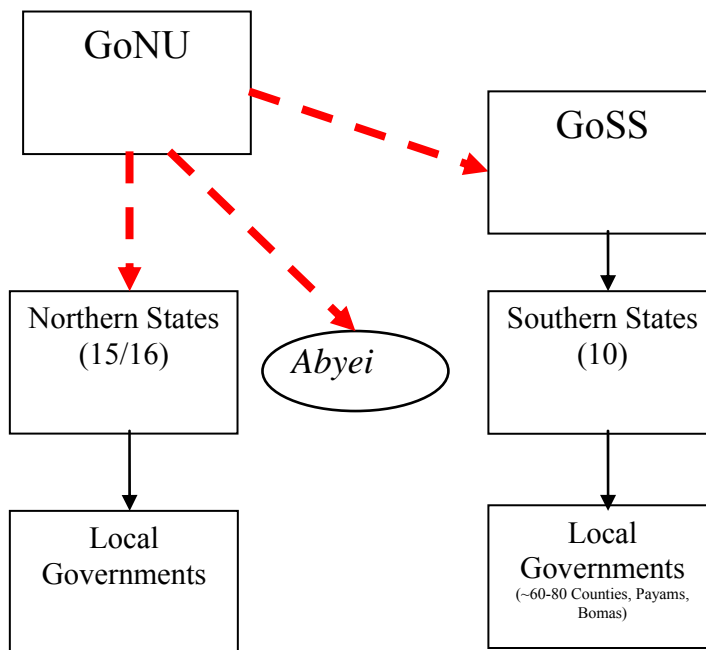
responsibility for basic services shifted to state and local levels), as well as horizontal (inter-state) imbalances due to differing own-revenue potential and differing needs.

5.5 International experience suggests that it is important to evaluate the impact of an intergovernmental transfer system in terms of its incentive effects on sub-national governments. These include the overall efficacy of sub-national public service delivery and accountability, sustainable fiscal policies, and own source revenue mobilization. In post-conflict settings, the promotion of state legitimacy and national unity tends to represent an especially important ingredient for intergovernmental fiscal design. The analysis discussed below is a baseline assessment of ongoing issues in Sudan's various levels of fiscal decentralization that will hopefully inform strategies and prioritization by Sudan's policy makers, at various levels of government, and the engagement by international development partners. This understanding will enable the identification of the capacity and technical support that is likely to be needed.

B. CURRENT STATE OF THE INTERGOVERNMENTAL TRANSFERS IN THE NORTH

5.6 The intergovernmental structure itself reflects the legacy of conflict and regional grievances in the Sudan. Inclusiveness, in its various aspects, and equitable sharing of wealth and power thus became central pillars of the CPA. Figure 5.1 depicts the principal intergovernmental relations and fiscal transfers emerging from the CPA and ensuing legislation. The June 2005 Interim National Constitution (INC) mandates three tiers of government (federal, state and local) in the north, with an additional level—the Government of Southern Sudan (GOSS)—in the south.

Figure 5.1: Intergovernmental Relations in Sudan



5.7 **GNU resources transferred to sub-national governments have increased sharply, and Northern states have become increasingly dependent on central transfers.** In 2006, 36 percent of GNU expenditures were fiscal transfers to either GOSS or Northern states, with budgeted levels rising to over 38 percent in 2007 (see Section 3). This represents a very large increase, both in level and share terms. The share of GNU budget transferred to sub-national levels, also known as the “vertical share,” was only 8 percent in 2000 (for Northern states). Data on states’ own source revenue collections is not readily available for all states, but case study evidence from six states suggests that own source revenue shares in 2005 ranged from 66 percent in Red Sea to 12 percent in North Darfur (Section 6). Major sources of state own source revenues include non-tax items, such as departmental fees and charges collected by the ministries and localities in addition to state public enterprise profits, as well as taxes such as the business profit tax, property tax, capital gains tax, animal tax, and state stamp duties.

5.8 **There is a complex array of revenue and transfer types.**¹⁹ Table 5.1 summarizes the main types of revenues of Northern States, ranked broadly by the level of autonomy sub-national governments enjoy over these revenues. Own source revenues imply that local governments have a high degree of autonomy (e.g., rate setting authority) over revenue sources (see Ebel & Yilmaz 2004). In practice, they can also be understood as those that accrue directly to state accounts/treasuries, rather than passing through the national budget/treasury. Shared revenues are transfers returned on a derivation basis. Finally, other types of transfers could be determined on the basis of a number of criteria, ranging from formula based to purely discretionary.

Table 5.1: State Revenue Sources in Northern Sudan

Revenue Type	Revenue Items	Determination of Collection/Allocation
<i>Own Source Revenues (OSR)</i>	State land and property tax and royalties; service charges for state services; licenses; state personal income tax; levies on tourism; state government projects and national parks; stamp duties; agricultural taxes; grants-in-aid and foreign aid; excise duties; border trade charges or levies in accordance with national legislation; other state taxes, which do not encroach on National or Southern Sudan Government taxes, many other tax as may be determined by law.	Combination of fiscal base and effort by individual states Potential bases provided by Article 193 of the INC
<i>Shared revenue (SR)</i>	VAT Sharing 2 percent of petroleum revenues by derivation	State share of revenue based on derivation basis (and other criteria), established by CPA
<i>Grants and Transfers (TR)</i>	Historical offset for eliminated states agricultural taxes Current transfers (largely for wages) Development transfers Other transfers Social transfers Emergency transfers Ad hoc transfers Special transfers to the Northern Areas Additional fee on benzene	May be determined by formula, existing establishment costs (e.g., wages), or are in a sense ad hoc.
<i>Borrowing</i>	Loans/borrowing in accordance with the Constitution	

¹⁹ The PER background volume contains a fuller descriptions of the various types of transfers (see footnote 1).

5.9 Table 5.2 presents fiscal transfers to the Northern states by specific line items, along with execution rates for 2006 (actual over budgeted) and pro-rated developments based on 2007 Q1 data. VAT transfers account for almost a quarter of budgeted transfers in 2006. While in principle these are allocated on a derivation basis, in practice different horizontal criteria are used (see below), suggesting that these revenues can best be understood as transfers rather than derivation-based shared revenues. The remainder of transfers are allocated for current transfers, compensations for historically abolished state revenues (agricultural compensation), and development transfers. There are significant differences in execution rates across the different transfer items. While the execution rate for aggregate fiscal transfers in 2006 was 75 percent, rates for capital expenditures (61 percent) were significantly lower than for current transfers.

Table 5.2: Fiscal Transfers to Northern States (2006/2007)

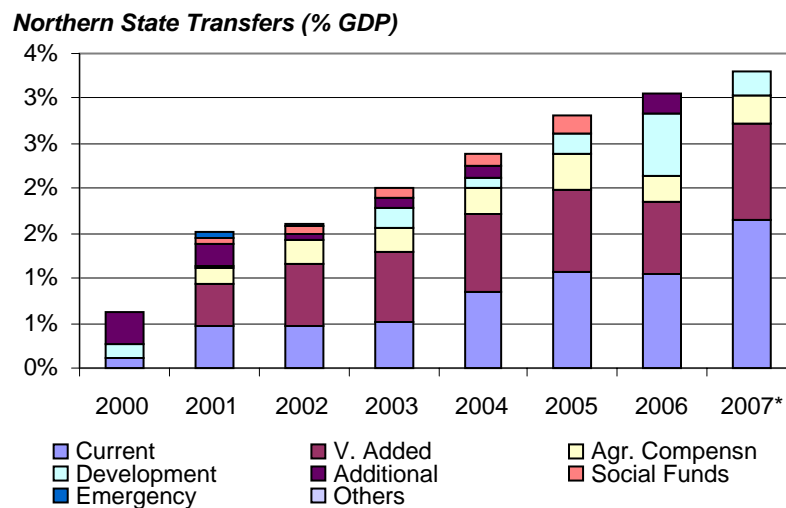
	2005 Budget	2005 Execution	2006 Budget	2006 Execution	2007 Budget	2007 Q1 Execution *
	<i>(SD Billions)</i>	<i>(% Budgeted)</i>	<i>(SD Billions)</i>	<i>(% Budgeted)</i>	<i>(SD Billions)</i>	<i>(% Budgeted)</i>
GNU budget, part III - Northern States Transfers	224.8	95.6%	477.8	75.2%	602.3	53.9%
a. Current Earmarked Transfers	55.5	90.5%	62.6	84.3%	75.1	76.2%
Wages (Chapter I), (Judiciary, Police, Higher Edu.)	47.9	100.0%	48.8	94.5%	60	90.0%
Operation (Chapter II), (Judiciary, Police, Higher Edu.)	7.6	30.3%	7.8	32.1%	4.2	28.6%
Social Subsidy (Chapter II)	-	-	6	68.3%	10.9	18.3%
b. Block Transfers	130.3	86.8%	273.6	80.4%	288.6	80.5%
Additional Excise on Benzene	10	-	-	-	-	-
Transfers to Oil Producing Northern States	1.3	53.8%	5.3	94.3%	4.9	130.6%
Current Transfers to Northern States	90	97.2%	124.8	86.2%	134.8	82.8%
Develop. Trans. to Nuba Mountains & Blue Nile Area	5	0.0%	10	68.0%	12	0.0%
Development and Construction Transfers to Abie Area	3	0.0%	6	8.3%	6	446.7%
National Reconstruction Fund for War Affected Area	3	13.3%	-	-	-	-
Agricultural Tax Compensation	18	91.7%	22.5	99.1%	24	46.7%
Value Added Tax	-	-	105	74.2%	106.9	71.5%
c. Development Subsidy	39	132.1%	141.6	61.2%	169.7	31.3%
States Development Projects (Local Component)	27.2	183.1%	92.1	75.2%	124.7	38.2%
States Development Projects (Foreign Component)	11.8	15.3%	49.5	34.9%	45	11.6%
d. Reconstruction Funds	-	-	-	-	69	0.6%

Source: MOFNE and staff estimates. * 2007 Execution Rates are based on Q1 data only

5.10 **Horizontal (i.e., inter-state) allocation criteria vary across the different types of GNU transfers.** While the NSSF documentation suggests that VAT transfers are made on a derivation basis, the reality appears to be more complex. While a formula based allocation

appears to be underlying current transfers, it is not immediately possible to reproduce these allocations. The aggregate vertical share for overall NSSF reported transfers therefore seems to represent the summation of these various individual transfer pools, rather than some aggregate vertical share that is consequently allocated on a transparent formula basis across states. The newly established FFAMC has in this context proposed a number of reforms to the prevailing transfer distributions. Prior to turning to options for implementing these or other comparable reforms, it is useful to describe the workings of the present system using the latest available data from 2007. (See Figure 5.2.)

Figure 5.2: Transfer to the Northern States (% GDP, 2000-2006, and budgeted 2007)



Source: NSSF Annual Reports

5.11 Historically the National State Support Fund (NSSF) has acted both as an intermediary and monitoring institution for state transfers. The NSSF has been mandated to determine the distribution criteria of VAT, as well as some capital and current expenditures. It annual monitoring reports providing a more detailed review of allocations made under the various flows. While some of these flows are first transferred by MOFNE to the NSSF for onward execution, others are transferred directly to the states. Increasingly, however, the reports by the NSSF only encompass part of the transfers to the states as other direct flows from MNFE for current and capital expenditure allocations have gained prominence.

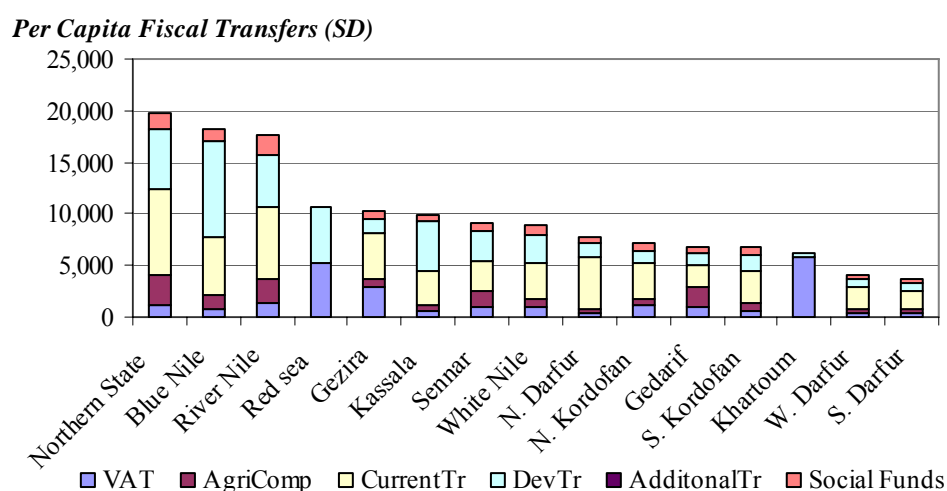
5.12 The newly established FFAMC has advocated making transfers to the Northern states more rules-based. The CPA and the INC mandate the creation of a new institution—the Fiscal and Financial Monitoring and Allocation Commission (FFAMC)²⁰—as the entity with key responsibility for implementing the vision of fiscal decentralization. Recent reports by the commission propose transfer levels quite close to those reflected in the NSSF data (SD 227.5 and 265.7 billion in 2006 and 2007, respectively). However, the reports do not provide a clear statement of how these vertical pools are arrived at, but presumably they are in line with the absolute aggregate amounts determined below. The FFAMC proposes a more

²⁰ See article 198 of the INC (reproduced in the PER background volume, Annex B; see footnote 1).

explicit horizontal allocation across states, based on (i) 40 percent minimum required for government responsibility; (ii) 40 percent population; (iii) 15 percent development indicators; and (iv) 5 percent fiscal effort by the state.²¹

5.13 **Actual allocations to states are characterized by significant differences.** Figure 5.3 reveals large variation across states in the volume of the transfers per capita for 2006 (using NSSF data). In 2006 there was more than a five times difference between Northern State which received SD 19,573 (US\$ 98) per capita and South Darfur that received SD 3,636 (US\$ 18) per capita. In 2000 Northern State (the top recipient) received over eight times what was received by Gedarif (the lowest ranking recipient). River Nile and Blue Nile (along with Northern State) are the highest recipients of transfers on a per capita basis. Prior to turning to a more detailed examination of the proposed horizontal distribution, we detail the practice of actual reported transfer to the states to-date.

Figure 5.3: State Transfer Levels (Per Capita, 2006)



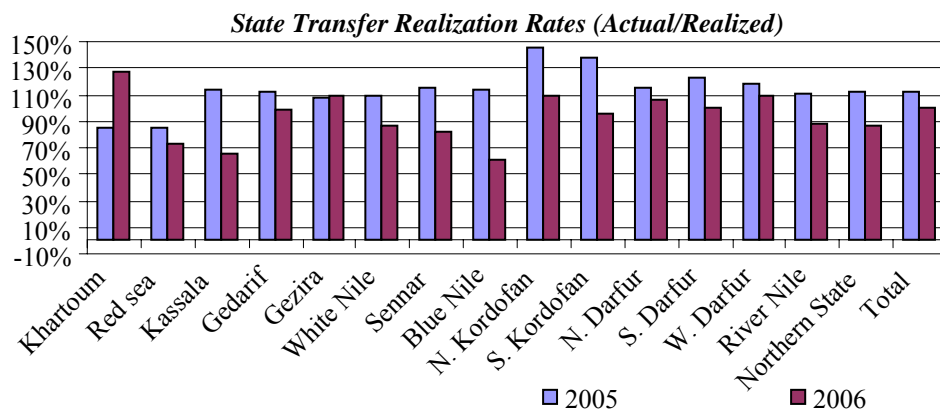
5.14 **Disparities in per capita allocations do not necessarily imply poor equalization.** More careful analysis is needed to assess the extent of fiscal capacity and expenditure needs of the individual states (Hofman, Kaiser, and Suharnoko, 2006). Fiscal capacity for example would be reflected by an ability to generate own revenues. However, Figure 5.3 does not even reflect actual revenues currently being collected from the states. Expenditure needs could encompass population, but also other factors such as area, cost of service delivery, etc. However, *prima facie* it appears that some states are getting less (others more) than would be justified by any equalization criteria.

5.15 **Fiscal transfer realizations have varied significantly by state.** Using NSSF data for planned and actual fiscal transfers, the annual realization ratios for the total volume of transfers have varied quite extensively. Figure 5.4 shows the realizations by state for 2005 and 2006. Evidence to suggest any systematic differences in realizations across states is,

²¹ See also “Interview with FFAMC Chairman: The Commission Ensures Transparent and Prompt Transfers of Funds from the Federal Government to the States,” *Sudan Vision*, Sunday, June 24, 2007.

however, quite weak. Furthermore, rank correlation between realizations in 2003 and 2004 is 0.35 and between 2003 and 2005 is 0.34. However, there is virtually no correlation between the ranking in 2004 and 2005. Khartoum has remained at the top of the rankings across the three years whereas West Darfur has been consistently at the bottom. Based on available information, it is not possible to reach any robust conclusions as to whether differences are a result of states' performance/capacity or a result of actions on the part of the NSSF and/or the MOFNE. More generally, however, the poor predictability of fiscal transfers, given state dependence on this source of revenue, will in turn significantly undermine overall budget credibility and financial management at the sub-national level (see Section 6).

Figure 5.4: State Transfer Realization Ratios (2005/2006)



Source: NSSF Annual Reports

C. GOING FORWARD—CHALLENGES AND POLICY OPTIONS

5.16 **The design and implementation of intergovernmental finance stands to promote both good public finance as well as peace.** In Sudan, political-economic considerations articulated in the CPA and the DPA make this even more critical than would ordinarily be the case. The system must be seen to be equitable and fair, in particular in sharing oil wealth, and should address the severely uneven development that has resulted from a combination of inequitable sharing of resources and prolonged civil strife in certain areas. In Sudan, sustaining the peace (an extremely valuable public good with huge positive externalities) should be viewed as an important objective of the federal grants/transfers. This justifies the case for special transfers/arrangements for this purpose.

5.17 Three topics addressed below pose the highest challenge to implementation of a transparent, predictable, and equitable intergovernmental transfer system, with policy options discussed to inform future dialogue: rationalizing the types of individual transfers; the formula for horizontal distribution of transfers; and institutional arrangements. Additional areas to support the effective service use of these transfers by states are added to conclude this section.

Rationalizing the types of individual transfers

5.18 **By international standards, the current modalities of allocation are quite complex and hence may lack more broad based buy-in by stakeholders, notably at the state level.**²² Greater transparency and simplicity will help in mitigating the risk of further conflicts and promote legitimacy. The points below are meant to set out a possible prioritization and subsequent sequencing of reforms, with the larger goal of an improved system over the medium term (3-5 years).

5.19 VAT Sharing: It is not clear whether the horizontal allocations for VAT are made on an annual derivation basis, or based on some historic collection estimates. Sharing revenues on a derivation basis potentially provides a more direct link between revenues transferred, respective fiscal capacity, and associated economic developments in the state. This may provide some incentives for the state to provide pro-growth policies, although the actual impact of such incentive effects in practice would need to be more closely examined. However, allocating revenues on some measure of fiscal capacity also results in greater fiscal disparities across states. To better address incentive effects and resulting fiscal disparities, greater clarity concerning the exact allocation criteria for VAT would be recommended. If VAT is allocated on a sharing basis, this could call for a more explicit and graduated approach on how this fiscal capacity is considered for other transfers (e.g., current transfers for states such as Khartoum). In turn, if VAT transfers are allocated across states on the basis of some other criteria such as needs, this would alter how these revenues would be considered for other revenue sources (see Section 4). Generally, each revenue transfer should be best understood as part of an intergovernmental fiscal transfer system intended to achieve a range of objectives. These principles may be weakened if different transfers appear to evolve over time in a more ad hoc fashion.

5.20 Agriculture Compensation: Similar to the VAT, the agriculture compensation transfer was introduced to compensate the states for an abolished tax. However, there is little clarity as to the current determination of the vertical pool or whether horizontal distribution of these allocations is linked to current agriculture production levels. Over time, it may no longer make sense to distribute these resources based on some measure of agriculture production. Hence, it makes sense to either introduce new model of tax sharing or fold these resources into the overall block grant. It is also not clear whether the rationale for these transfers reflects a higher expenditure need of these states given their agricultural sector, or it is being used as a proxy for fiscal capacity. In that case, it may make more sense to expect states to tax agriculture directly (without reproducing the poor features of the abolished taxes).

5.21 Current and Development Transfers: Current transfers appear to be based largely on existing public sector establishment costs and are provided as a compensation. Simply paying states for existing establishments suggests states have limited autonomy over the actual management of their establishment sizes and the wage and salary structure, and that these grants may be setting poor incentives. The basis for the development transfers is not

²² For example, formula based allocations in India and Nigeria typically use far fewer factors in allocations and are thus more easily understood.

easily understood. It is not clear whether these provide federal support to ongoing state schemes based on an annual determination or whether these reflect federal schemes that are being implemented in states but are accounted in this way. Allocating recurrent and capital budgets in parallel processes may also be leading to poor incentives. Policy analysis is needed to help determine the extent to which these transfers can be made more transparent for a formula basis.

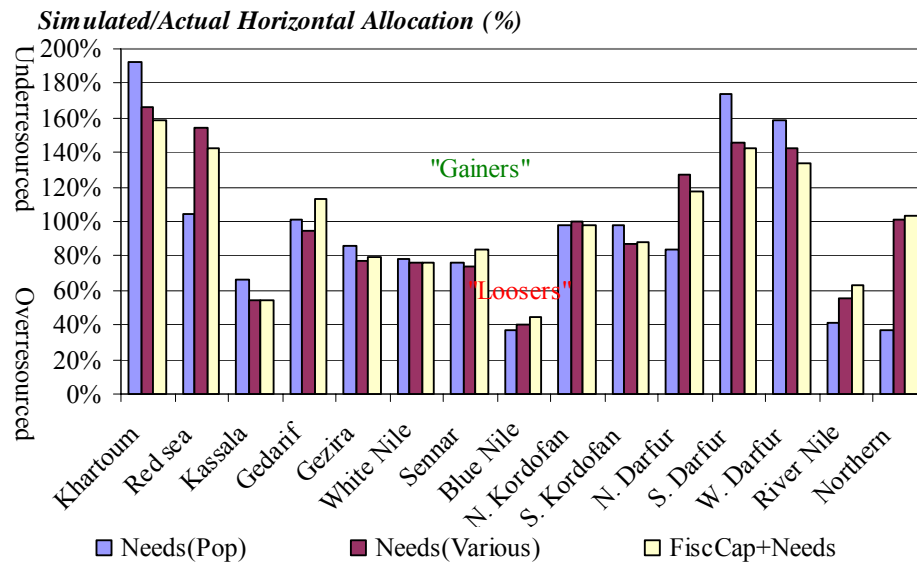
5.22 Specific Conditional Grants: These transfers appear to have declined through 2005, then increased significantly in the 2006 budget (from SD 5.5 to 36.4 billion). One part includes “earmarked” transfers for items that were previously on the national budget. One question is whether these will be regularized as part of the standard transfers. Specific grants can play an important role in intergovernmental fiscal systems, for example to address externalities or promote specific national programs. However, a series of non-transparent special grants can be problematic, and individual specific grants should have a clear policy goal. Policy work is needed to identify the demand and appropriate design for a limited number of this type of transfer.

An improved formula for horizontal distribution of transfers

5.23 Ongoing policy discussions in Sudan and in the FFAMC suggest that the Government may be considering moving to a fully formula based transfer for northern states. Such an approach would, in effect, abolish the current transfer windows (e.g., VAT, current, development, other), and consolidate these in a single pool for further rule-based allocation. For the purpose of discussion, three purely illustrative simulations and benchmarks are presented, which allocate the overall vertical pool (i.e., SD 248 billion realized in 2006): (i) based on population as a broad proxy for need; (ii) based on a mix of needs proxies, Population (50 percent), Area (20 percent), Primary Child Enrolment (20 percent), Ruralness (10 percent); and finally (iii) allocating part on fiscal capacity/derivation basis (VAT+Ag transfers), with the remainder using the needs formula used for (iii). The different formulas simply represent different scenarios on possible horizontal distributions.²³ International experience suggests that a range of transfer designs are used in practice (cf Boadway and Shah 2006). Some examples such as Indonesia’s general equalization block grant incorporate both measures of expenditure needs, and proxies for fiscal capacity (for own source revenue mobilization and shared revenues).

²³ These simulations do not address the related question of the adequacy of the overall vertical pool, given prevailing expenditure assignments for states.

Figure 5.5: Simulations of Alternative Transfer Formulas to States (2007)



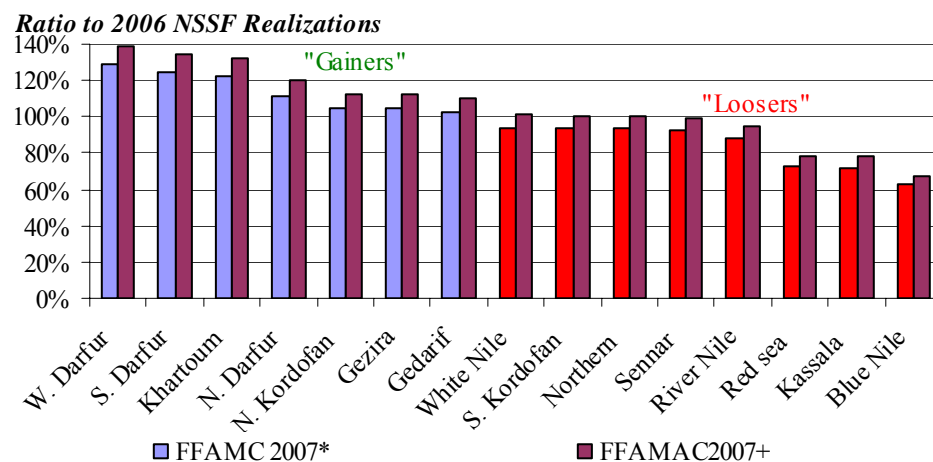
5.24 Figure 5.5 presents the ratio of transfers simulated in accordance with the three scenarios described above to the current transfers. Under each of these scenarios, Khartoum, Red Sea, South Darfur and West Darfur are currently under-resourced and would be significant gainers from changes in this direction. Clear losers would include River Nile, Blue Nile, and Kassala. These results should, however, be treated with caution, as we have only partial information as to the own source fiscal capacity of the various states, and what would happen if a full-fledged fiscal gap formula is introduced. Some of these results may well be reversed to some extent as result that is more starkly achieved by the current approach of not assigning any current transfers to Khartoum and Red Sea. This raises the question of whether some of the proxies for expenditure needs fail to capture special needs for these states. In contrast, the fact that states like Khartoum are under-resourced by these measures might be accounted for by the fact that these simulations do not take account of other fiscal capacity (e.g., property and personal income taxes assigned to the states).

5.25 **The simulations highlight the sensitivity of selecting a different formula for states.** For example, Northern state would lose less on a needs based formula relative to a purely population based one. The work highlights the need to have a more concerted discussion of actual state fiscal capacity and expenditure needs (based on functional allocations) to arrive at a preferred set of formulas for horizontal allocations. These simulations touch on horizontal allocations, but a clearly related question is whether states on aggregate receive enough (i.e., their vertical share) to carry out their expenditure responsibilities.

5.26 The FFAMC proposed a simplified formula for new state allocations, but the precise criteria need to be clarified. The FFAMC proposed a more explicit horizontal allocation across states, based on (i) 40 percent minimum required for government responsibility; (ii) 40 percent population; (iii) 15 percent development indicators; and (iv) 5 percent fiscal effort by

the state.²⁴ While the numbers for the vertical pool allocation used by FFAMC differ slightly from those of the NSSF figures (although are also far smaller than those used by the MOFNE), the magnitudes are almost the same. This suggests that the FFAMC has used these numbers to determine its vertical pool. Figure 5.6 simulates the FFAMC allocations against the realized 2006 allocations using the same vertical pool (i.e., SD 248 billion). This suggests that the main winners of the FFAMC formula would be the Darfurs and Khartoum. In contrast, Red Sea, Kassala and Blue Nile would be the “losers” from these revised transfers. The second simulation simply increases the overall vertical pool to the NSSF budget number for 2007 (SD 268 million). While the ratios used are the same, the greater absolute amounts mean that even with the formula changes some states would under this scenario would not loose out in absolute terms (e.g., Gedarif).

Figure 5.6: FFAMC Proposed Federal Transfers



5.27 The foregoing simulations highlight the sensitivity of state transfers to various formula designs. The initial simulations tried to make explicit the expenditure and fiscal capacity measures used. These generated quite different allocations to the currently prevailing ones, suggestion that any move to a formula would need to be subject to a phased in introduction. Finally, the simulations highlight the fact that current allocations appear to deviate significantly from a formula basis. The FFAMC formula has the merit of being simpler than that presumably applied by NSSF to-date. However, the documentation does not separately state the underlying data used for each of the factors. Greater transparency in this regard would be useful to specify the most appropriate formula and a phasing in path that would be acceptable to all states.

Institutional arrangements

5.28 **Another important element of intergovernmental fiscal design is the institutional arrangement by which intergovernmental transfers are determined and made.** A number of agencies and commissions have been engaged in the determination, execution, and

²⁴ See also “Interview with FFAMC Chairman: The Commission Ensures Transparent and Prompt Transfers of Funds from the Federal Government to the States,” *Sudan Vision*, Sunday, June 24, 2007

monitoring of intergovernmental transfers in Sudan. The foregoing review suggests that overall quantum of transfers (the “vertical” share) and the allocation (“horizontal”) and disbursement to states is decided and implemented by some combination of the MOFNE, the NSSF and a “Supreme Council” that includes all the state Governors, with a growing role of the FFAMC. The current system of determining and implementing intergovernmental transfers can be perceived to lack transparency and to perform sub-optimally in terms of equity and efficiency.

5.29 The roles of the various institutional players such as the MOFNE, NSSF and the FFAMC need to be clarified and understood by all stakeholders. The Presidential Decree of 2006 does not fully address this, and in July 2007 a new Presidential decree dissolved the previous FFAMC and established a new commission under the same name and general responsibilities, replacing the previous chairman with an ex-head of the NSSF. This latest development raises questions on the standing of previous recommendations of the FFAMC, and particularly whether the formula discussed in paragraph 5.26 remains valid for continued monitoring and the 2008 budget. In the end, most important for the transfer system is that the institutions ensure that ultimate allocations conform to good intergovernmental fiscal design principles and that their determination and delivery is transparent to all stakeholders. Agreement in the context of intergovernmental forums in principle provide a means to achieve this, but independent grants commissions can also play an important role in infusing ultimate agreements with good design principles. In this context the legislative framework for the FFAMC is of critical importance.

5.30 Existing good practices should be retained and enhanced. The NSSF has a record of regularly publishing annuals report, which provide information on existing allocations. However, greater transparency is needed. For example, South Africa’s periodic intergovernmental fiscal reviews provide an example of good practice, and have increasingly been extended to incorporate not only allocations but performance in such areas as service delivery. Mandates of any new institutions that are established and the revised mandates of existing ones should be clearly spelt out. For example, to be effective, the FFAMC should have legal legitimacy with the legislation clarifying its roles and responsibility, powers and autonomy.

Other areas for effective use of transfers

5.31 Reforms in the design and application of intergovernmental fiscal systems are only one ingredient to potentially promoting conflict resolution, improved state legitimacy, and broad-based improvements in service delivery. A number of other reforms will need to enhance mechanisms of accountability at all levels of governments.

5.32 Strengthening state level data for monitoring and evaluation, as well as fiscal transfer design. Currently, no comprehensive data is available concerning state own source revenue mobilization. General efforts to strengthen comparable GFS-consistent reporting on the revenue side would be a first step towards addressing this information gap. On the expenditure side, reporting by functional (e.g., across health, education, roads) and economic lines (e.g., wages) would also allow for a more systematic analysis the fiscal position of states. In turn, improved data on sectoral outcomes would highlight potential disparities

across states. At the same time, a few basic and credible indicators for the design of intergovernmental transfers will need to be updated on a periodic basis.²⁵

5.33 Strengthening sub-national public financial management and accountability.

Most of the discussion has focused on fiscal transfers. However, a critical need will be to strengthen the commensurate horizontal accountability (e.g., to state legislatures) and external accountability (to audit agencies) for sub-national expenditures.²⁶ Capacity building in this regard are needed in the Northern states, and also in particular the South. The ongoing CIFA work is the starting point to engage in more systematic assessments of even benchmarking sub-national PFM for all states, and ultimately also local governments.

5.34 Making decentralization work for service delivery. The reform on intergovernmental fiscal relations in Sudan has the potential to promote peace and national cohesion. Ultimately, however, these outcomes will need to ensure that national and sub-national expenditures deliver a peace dividend in terms of service delivery outcomes throughout Sudan. This will require a host of reforms, only starting with greater clarity and transparency in allocation and use of fiscal resources. At the sectoral level (e.g., education, health, basic infrastructure), this will require special attention to sub-national capacity and implementation strategy, as well as role of line agencies/deconcentrated structures.

²⁵ Generally, it is inadvisable to use administrative data reported by the states for this purpose, as linking finance to indicators may create incentives for misreporting.

²⁶ Accounting and audit is set out in Articles 204 and 205. Calls for a National Audit Chamber and a Southern Audit Chamber, both to be further specified by Law.

6. BUDGETS AND FISCAL MANAGEMENT IN NORTHERN STATES

6.1 Improving fiscal decentralization and increasing pro-poor spending at the state and local levels is a key focus of the current phase of the PER, which has been informed by Northern state case studies.²⁷ The main motivation of the sub-national PER work is fourfold: (i) to have a better understanding of the budgets in the Northern states; (ii) to have a better understanding of pro-poor spending at the national and lower levels of government, including the linkage of sub-national transfers; (iii) to identify key constraints to better spending; and (iv) to identify ways to address these constraints.

6.2 Case studies were undertaken in six states—namely Gezira, Red Sea, North Kordofan and North, West and South Darfur—covering 2000-2005. In each case, the budget preparation, execution and monitoring in the state as well as the overall fiscal performance at the state and the locality level were analyzed. Special attention has been placed upon the scrutiny of the two major components of the states' budgets: the intergovernmental transfers on the revenue side and the pro-poor component of the expenditure side. The main messages which emerged are as follows.

A. LIMITED PROGRESS ON FISCAL DECENTRALIZATION

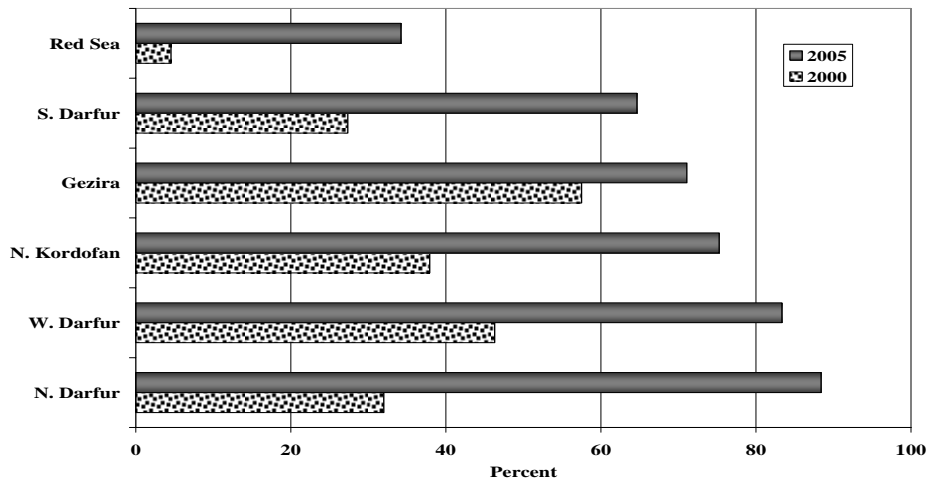
6.3 Successful fiscal decentralization depends on sufficiently autonomous and accountable sub-national governments with credible budgets and sound fiscal management practices. The state case studies show that by these criteria, fiscal decentralization remains a work in progress and requires additional reform and capacity building efforts. These reforms have become more imperative as increased central funding has been delivered to Northern states, which shoulder the bulk of expenditure responsibility for service delivery to the poor.

6.4 **The fiscal and decision-making autonomy of states and localities is limited.** This stems from the high degree of reliance on the resource transfers of higher levels of government and the central control over a significant share of these transfers. While central transfers are a general feature of fiscal decentralization and necessary to effect redistribution to poorer states, an increasing share of state revenues comes from central transfers, with unpredictable and non-transparent distribution. Figure 6.1 shows the large majority of state revenues come from the federal government, with the exception of Red Sea state. Federal transfers account on average for roughly 70 percent of the case study states' revenue in 2005, and existing transfer practices of little information on expected transfers and erratic delivery

²⁷ Between April and July 2006, draft case study reports were completed for the Red Sea, Gezira, and North Kordofan states covering fiscal trends and budget management. Case studies of the three Darfur states were also conducted in support of the Darfur Joint Assessment Mission during June-July 2006, following the same methodology as the PER case studies. Results were discussed in a November 2006 workshop in Khartoum, with representatives from all 15 Northern states. Thus assessments for six of the fifteen Northern states have been completed, yielding a representative sample across the range of state-level incomes.

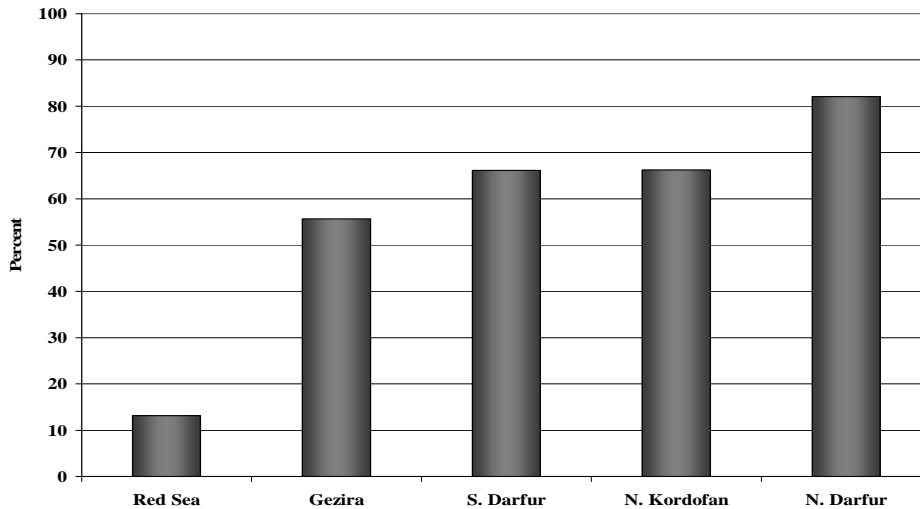
prevent longer term planning by the states. The level of reliance on transfers is greatest for the locality level. In Gezira and North Kordofan states, over 80 percent of locality revenues on average come from the state level. Adding to the lack of autonomy is the high share of transfers that are earmarked (Figure 6.2). Development transfers, for example, require submission of proposals from the states and approval from the central government. States also mention the influence of central policies of wage determination and employment of management personnel on the state labor bill, which is the single highest component of state budgets. Comparison of other states to Khartoum state suggests these influences may be inversely related to the ability to raise own revenues.

Figure 6.1: Share of Federal Transfers in State Revenues



Source: World Bank staff estimates in the individual state case study reports.

Figure 6.2: Share of Federal Transfers That Are Earmarked

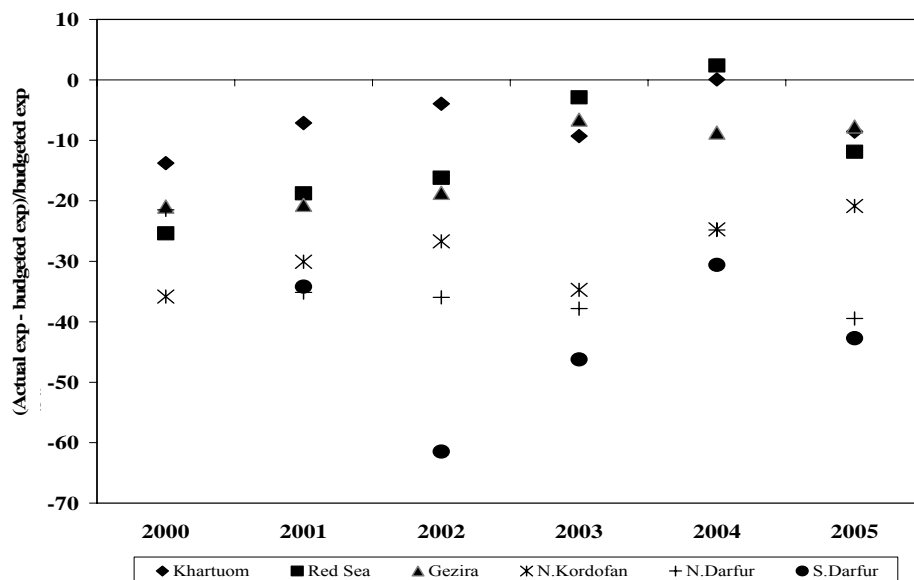


Source: World Bank staff estimates in the individual state case study reports.

6.5 **Budget credibility is a major problem.** Budget performance, as defined by the degree to which actual revenues and expenditures deviate from budgeted levels, has been poor by international standards for most years in most states. Figure 6.3 shows the extent of deviations for annual state expenditures.

6.6 The key causes of poor budget performance appear to be threefold: data limitations, weak capacity to estimate a budget constraint, and political pressure to exaggerate budgets. Key data limitations include the lack of timely and accurate information from higher levels of government on expected transfers, a lack of coordination between states and central authorities, a lack of information on state-level economic activity and thus sources of own-revenue, and poor quality data bases on which to base state and locality tax imposts. Capacity issues include both limitations in carrying out skill-intensive processes (e.g., economic monitoring, project cost/benefit analysis, consolidated monthly cash planning, etc.) as well as technical constraints from lack of computers and equipment. On the political side, a consistent pattern emerges across the case studies whereby budgets are often used for political signaling rather than fiscal management. Expenditures tend to be estimated on a needs basis, and revenues are inflated to depict a balanced budget, thus serving in effect as a residual. For example, in North Kordofan state, locality own revenues were nearly doubled between the initial 2006 locality budget proposal and the final state budget approved by the State Assembly, from 2,807 to 5,000 million dinar.

Figure 6.3: State Budget Credibility - Planned Vs. Actual Expenditures



Source: World Bank staff estimates based on data from state Ministries of Finance.

6.7 The effect of weak budget formulation shows up quickly during budget execution. Consistent revenue shortfalls force a misalignment between expenditure assignments and resource allocations, and spending is normally rationed early in the fiscal year, with development expenditures the hardest hit area. Federally mandated increases in wages and salaries were the major source of the noted rapid rise in expenditure and received priority in

budget execution, crowding-out other budget allocations, especially for investments in development.

6.8 **Financial management at state and locality levels is weak.** The type and availability of budget information showed a poor financial management environment in Northern states. Little information on the effectiveness of public expenditure is either produced by the state Ministry of Finance or expected by the public, which compounds budget credibility problems and may also partly explain limited and falling local tax collection since constituents can't see what comes from taxes they pay. State budget classification is in economic terms, following the national budget practice, which seriously impedes the transparency of fiscal operations and the ability to plan, execute, and monitor poverty reduction efforts. State officials seem frustrated at not having functional information available.

6.9 The lack of clear guidelines for financial management and intergovernmental coordination also limits financial management. Three areas stand out in this regard. First, there are significant problems with budget planning and execution with respect to transfers. Between states and localities, precise revenue sharing arrangements require more clarity, for example on what taxes are shared and at what rate. Second, budget authorization processes and payment systems could not be substantiated in the case studies, and cash management procedures were unclear. Third, communication and coordination between levels of government are limited. Guidelines developed across government levels would enhance development planning and implementation by clarifying roles and responsibilities. State and locality officials queried during field visits were often unaware of items included in the list of federally supported on-going projects in the states provided to the mission by MOFNE.

B. SUB-NATIONAL PRO-POOR EXPENDITURES RISING

6.10 An attempt was made in each case study to apply the methodology used to define GNU pro-poor spending to the state level, to understand the composition of spending. Estimates were made in three states, but not for the Darfur states due to data and time limitations. According to case study calculations, per capita pro-poor spending estimates in Red Sea, Gezira, and North Kordofan reveal strong growth over recent years, rising to \$38 - \$46 in 2005 (Table 6.1). This mirrors the rise in overall expenditures, and confirms that a significant share of state-level expenditures is directly poverty-orientated.

6.11 Analyzing the composition of pro-poor spending shows roughly 75 percent of state-level pro-poor spending is current in nature, which by assumption includes all locality current expenditures since functional breakdowns were not available at this level. Pro-poor development spending varied significantly by ministry across years but was largely driven by increased expenditures on roads, water, and electricity in the Red Sea and education and health in Gezira.

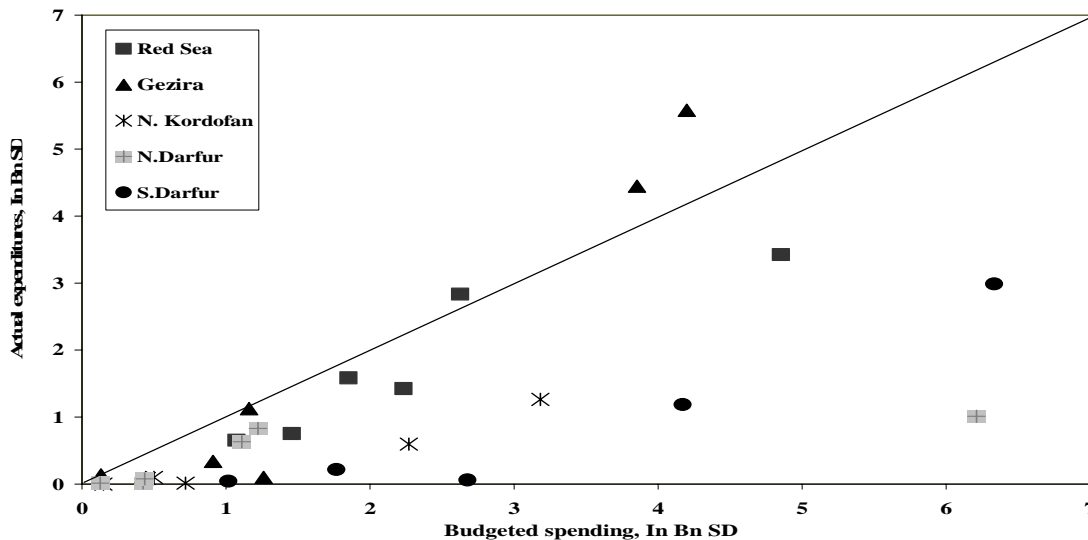
Table 6.1: Per Capita Pro-Poor Spending

		SDD Mn			US \$		
		2003	2004	2005	2003	2004	2005
Red Sea	Total	5,763	8,366	11,128	22	33	46
	Current	4,329	6,503	8,139	17	26	33
	Development	1,434	1,863	2,988	6	7	12
N.Kordofan	Total	3,399	6,586	9,096	13	26	33
	Current	2,448	4,080	6,498	9	16	27
	Development	951	2,505	2,598	4	10	11
Gezira	Total	4,377	7,222	9,222	17	29	38
	Current	3,665	5,786	7,167	14	23	29
	Development	712	1,436	2,054	3	6	8

Source: World Bank staff estimates in the individual state case study reports.

6.12 **There is a disappointing track record on development spending in all the case study states.** Figure 6.4 shows budgeted development allocations versus outturns for the six states for five years. The 45 degree line represents full budget execution, with planned development allocations equal to actual development spending. Clearly, the execution in the majority of state budgets has resulted in development spending far less than planned. This is especially acute in the Darfur states, where the situation is exacerbated by the ongoing conflict.

Figure 6.4: Planned and Actual Development Spending



Source: World Bank staff estimates in the individual state case study reports.

6.13 A consistent message from the case studies was that communication between the state and federal ministries (including functional line ministries) regarding development projects is weak and that guidelines are needed to clarify the specific roles of each level of government, in terms of planning, execution, and monitoring development projects. In some cases, state

finance officials did not have knowledge of national development projects under implementation in their own states. This situation highlights the need for a more strategic overall public investment program.

C. WEAK FISCAL MANAGEMENT CAPACITY

6.14 The limited capacity for fiscal management at the subnational level was the most frequently cited constraint to more effective resource allocation and use. For example, only 11 percent of the labor force in the public sector in North Kordofan state has above higher secondary school qualifications (technical diploma, bachelors, masters or PhD). Some proponents of continued central control in key fiscal areas and limited autonomy for the states have argued their case based on existing administrative weaknesses. However the only way to achieve successful implementation of the CPA in the long run is to build capacities at the subnational level to fulfill roles and responsibilities laid out in the legal framework of fiscal decentralization in Sudan.

6.15 The foregoing shortcomings suggest an agenda for capacity building in Northern states, though a more detailed assessment would be useful (e.g., in the context of the upcoming Country Integrated Fiduciary Assessment. Immediate needs include capacity building in overall budget processes, revenue estimation and collection procedures, and development planning and execution. However, it is important to underline that these efforts would be largely wasted in the event of failure to move decisively on the reform agenda.

6.16 The poor track record on development spending has gone hand in hand with very limited capacity at the state level to plan and maintain development projects. Most of the planning is centralized at the federal line ministry level, with weak communication to state line ministries. To ensure the satisfactory returns and sustainability of current increases in public investment, there is a critical need to involve and strengthen the state and local development institutions. The case study work suggests capacity building should include strengthening state-level project appraisal and management capacities, encouraging and utilizing the existing locality capacities to identify development priorities, and beginning to strengthen fiscal management at the locality level. An improved approach could involve a combination of the state and local levels driving the identification of priorities, and in turn driving the funding and strategic management, alongside an active capacity building push that will help sustainability over the medium term.

6.17 Financial management capacity is also weak on the revenue side, which in turn contributes to the states' poor own revenue collection efforts. Also, states appear unable to accurately forecast either own or transferred revenues, which help drive budget credibility problems. There is limited ability to estimate and monitor basic economic activity in the state, which is necessary for estimating own tax and non-tax revenues. Gezira is an exception, where state officials were upgrading their ability to collect and monitor economic indicators. Some of the localities visited did have or were starting to make databases for revenues sources and expenditures. However, the process is just beginning and the need for a more reliable system of recording of all sources of tax- and non-tax revenues and inputting them into a computer for documentation and easy retrieval and presentation purposes is widespread.

6.18 Development partners can play a significant role in meeting Sudan's capacity building challenge in the Northern states. The recommendations of the PER subnational work are planned to feed into the Bank-supported Capacity Building and Decentralization Project. Also, the World Bank Institute has designed a program to support training activities on budget management in the Darfur states, as part of the DJAM. The six proposed themes to be covered are the project cycle, project management, procurement, local government financial management, intergovernmental fiscal relations, and broader orientation to development concepts to raise awareness of pro-poor policy options (including participation and gender issues), and principles of good governance.

D. KEY NEXT STEPS

6.19 There are important reforms needed to improve pro-poor spending and budget management overall at the state and locality level. Below are specific areas presented at a November 2006 workshop attended by policymakers at the federal, state, and locality levels.²⁸ It is recognized that these measures are focused on supply-side accountability, and there is a large gap on the demand-side context, including the specific needs of the expected beneficiaries and resulting value-added. This was beyond the scope of an initial round of case studies, but is generally quite relevant for the next phase of PER work.

➤ **To build capacity for effective resource allocation and use:**

Federal level: Expand and deepen federal training programs currently in place for state and locality government officials.

State level: Identify priority areas for training and capacity enhancement, including a review of needs for training activities on budget management.

➤ **To improve budget processes:**

Federal level: 1. Accelerate GFS adoption in the states to enable a consolidated budget. 2. Make the transfer of funds from the Federal to sub-national levels formula-based, predictable and transparent to recipients. 3. Provide data directly to the States on monthly expected transfers for the remainder of 2006. 4. Establish procedures for the 2008 annual budget, and beyond, to give States firm estimates of intergovernmental transfers and expected monthly cash flows to establish more credible State and Locality budgets. Estimates should distinguish between block and earmarked transfers. These procedures may consider suggested changes in budget calendars.

State level: 1. Prepare guidelines to clarify revenue and expenditure assignments between the state and locality levels and lower budget deviations. These guidelines should incorporate budgeted levels of transfers consistent with the abovementioned federal estimates. 2. Improve revenue estimation, including development of analytical basis and database of supporting information. The latter may consider longer term instruments such as use of the national census as an instrument for data

²⁸ The recommendations benefited from a workshop on the Darfur case studies held in Khartoum on September 3-4, 2006.

collection. 3. Outline steps for states and localities to follow the federal reporting format. 4. Summarize current actions taken to make budget plans publicly available. Develop plans for similar treatment of budget outturns. 5. Prepare an empirical review of civil service size and composition, to clarify the trends over time.

➤ **For more effective development planning/management:**

Federal level: Provide data for each state on development transfers (budgeted and outturns), including source of financing.

State level: States to provide a functional/sectoral breakdown of 2000-2005 expenditures and the 2006 budget, to enable an estimate of pro-poor spending.

Joint: Prepare guidelines for a more streamlined and effective procedure for development planning, including roles of various parties in development planning and execution (MOFNE, federal line ministries, state MoF and line ministries, and localities).

7. EXPENDITURE AND REVENUE POLICY IN SOUTHERN SUDAN: PROGRESS AND CHALLENGES

7.1 The Government of Southern Sudan (GOSS) was established only two years ago, facing the daunting task of rapidly improving the well-being of the people, and getting the region onto an accelerated development path consistent with its rich endowments. One key advantage of Southern Sudan is the large domestic resources flowing from oil production in the region, such that there is much less aid dependence than many post conflict economies—e.g. Afghanistan, Mozambique and Cambodia—provided that public resources are managed appropriately.

7.2 This section provides an overview of the progress and status of budget management in Southern Sudan. It begins by reviewing the institutional set-up, then the GOSS budget for 2006 with particular attention to plans against execution, and analyzing the plans for 2007. The final section presents a series of key challenges—namely salaries and the payroll, revenue forecasts and predictability and debt. We do not separately address the issue of management of the defense budget, nor the role of budget information and accountability, though the latter is a cross-cutting theme.

A. BUILDING BUDGET INSTITUTIONS FOR GOOD GOVERNANCE

7.3 **The GOSS has been establishing a system of public financial management virtually from scratch.** The former SPLM Secretariat of Finance, which managed resources of around \$100,000, has transformed itself into a Ministry responsible for managing over one and a half billion dollars annually, including significant MDTF financing. In 2005 and 2006, the Ministry of Finance and Economic Planning (MOFEP) was characterized by very weak capacity and undeveloped structures, with Directors being formally appointed only in July 2006. As in most ministries, there were no appointments below the Assistant Director level, where staff are being paid, but have not been formally appointed.

7.4 **It is important to recognize the evolution over the past 18 months or so,** where at the time of this writing some major progress could be seen in operationalising key aspects of the system:

- In October 2006, a Single Treasury System was initiated to enhance accountability of GOSS ministries and units and to exercise control over their spending. GOSS ministries cover one fourth of the annual operational budget which can be recouped on the basis of subsequent adjustments and submission of vouchers.
- Interim Procurement Regulations were submitted to the SSLA as a part of the budgetary proposals for 2006. These regulations were subsequently approved by the Council of Ministries in June 2006. A Procurement Act is being drafted.

- In February 2007, a procurement agent (Crown Agents) became operational.
- A Public Financial Management Act has been drafted and submitted to the SSLA.
- The appointment of an External Audit Agent is scheduled in October 2007.

7.5 In order to ensure sound public resource management and to guard against corruption and diversion, the MOFEP has made a series of commitments. As noted above, some of these have been fulfilled, but there is a significant way to go, and the following steps remain priorities:

- Adopt and implement the public finance bill that is currently under consideration by the Southern Sudan Legislative Assembly (SSLA);
- Put in place a transparent procurement system, by applying interim procurement regulations, enacting the new procurement law and properly employing the recently appointed Procurement Agent as well as urgently appointing an External Audit Agent;
- Work to effectively and fully operationalise the Treasury Single Account as a medium term objective for a transparent consolidation and accounting of all revenues and expenditures and for ensuring oversight over operational expense;
- appropriately utilizing ex ante controls, including the recently established Cash Management Committee;
- Build on the healthy parliamentary debate around the 2007 budget, and establish appropriate systems and structures for regular reviews of public expenditure and pro-poor spending by Cabinet, Parliament and the public, with minimal lags in reporting; and;
- Fully operationalize mechanisms for executive accountability, as per the Southern Sudan Interim Constitution, including the Southern Sudan Audit Chamber and the Anti-Corruption Commission.

B. PERFORMANCE OF THE 2006 BUDGET

7.6 The planned allocation of funds in 2006, as laid out in the budget documents passed by Parliament, was broadly consistent with the development targets laid out in the JAM, even if the allocation of funds to the SPLA (around 40 percent of the budget) was larger than initially expected. Sector programs were launched in 2006 for infrastructure, health, education and water and sanitation. This process has been bolstered by budget sector working groups (BSWGs) which have been functioning since 2006 to assist the Government in sector planning and budget formulation, currently with a three year perspective.²⁹ With joint participation of external partners, BSWGs help GOSS define objectives and activities

²⁹ There are ten such groups each clustering around related functions; accountability, economic function, education, health, infrastructure, justice, law and order, natural resource and rural development, public administration, security and social and humanitarian affairs.

for individual ministries and are also a forum for training participants in the budget cycle. In 2007 the functioning of the BSWGs has been strengthened and enlarged to include participation by the state governments thereby enhancing the comprehensiveness of the planning exercise and extending capacity building in budget formulation to the states.

7.7 However, there was limited fiscal discipline over much of the year and actual execution bore little relation to the plan. Table 7.1 depicts the overall fiscal position and execution performance in 2006. The overall balance in 2006 moved sharply into cash deficit due to inadequate spending discipline. Aggregate spending was driven by outlays on wages and operations that were roughly double planned amounts, while capital expenditures were cut sharply. Cash deficit *before grants* summed up to \$430 million, which was augmented by suspense and direct expenditures that await clearance and was financed through significant draw-downs on accumulated reserves.

Table 7.1: GOSS Overall Balance During 2005-2006, million USD

	2005 Actual	2006 Budget	2006 Actual	Execution Rate
Revenue and grants	822	1494	1330	89%
Revenues ¹	822	1304	1267	97%
Oil revenues		1300	1266	97%
Transfers		1300	899	69%
ORSA drawdowns			327	
Unreconciled receipts, plus adjustment			40	
Nonoil revenues		4	2	50%
Donor grants		184	63	34%
Grant from GoNU		6		0%
Expenditures	295	1383	1697	123%
Wages	14	253	546	216%
Operations	277	296	542	183%
Development ²	4	835	451	54%
Other expenditures		0	158	
<i>Suspense expenditures</i>			132	
<i>Imprest</i>			-1	
<i>Approved direct expenditures</i> ³			24	
<i>Net foreign exchange loss</i>			3	
Cash Surplus/Deficit	527	111	-367	
Excluding grants	527	-79	-430	
Financing of deficit	494	-36	-367	
Reserves ⁴	459		367	
Errors and Omissions	34			
End Period Cash Balance	494		64	
<i>Memo items: Breakdown of 2006 Budget</i>				
<i>Expenditure financed by GoSS revenues</i> ⁵		1377	1539	
<i>Expenditures funded from other sources</i>		6		
<i>Development expenditure financed by MDTF, excluded above</i>		147	63	

Notes: 1. Transfers include the US\$53 million received by oil producing states. Budget for donor grants exclude non-MDTF sources, which amounts to US\$242 million. Accounting for this budget results to revenue and grants execution of only 77 percent instead of 89 percent. The 2007 GOSS Budget document excluded this amount, thus dropped from the above presentation. 2. Development budget are net of MDTF, total amounts to US \$982 million. Unreconciled receipts reported by KPMG, pertaining to the US\$34 million difference between the amounts that GNU transferred and received by the GOSS. 3. Direct expenditures that have not yet been approved amounts to \$13 million. 4. The amount of reserve rundown to finance the deficit is derived from the change in the end period cash balance in 2005 and 2006, net of donor grants. The end period cash balance figures were taken from the KPMG 2006 report. 5. Taken from the 2007 Budget document. *Source:* KPMG, MOFEP, GoSS Budget document 2006 and 2007, MOFNE Petroleum Unit Report December 2007.

7.8 Existing revenue cushions were exhausted in 2006. Withdrawals from the national Oil Revenue Stabilization Account (ORSA) accounted for about a quarter of the GOSS revenues in 2006, together with virtual depletion of GOSS's own reserves, compensated for the shortcomings on oil revenue transfers and donor finance. In aggregate, revenues were 89 percent of plans. Delays in bringing significant Dar blend production on-line as well as poor

initial export sales prices lowered oil revenue to the South, only \$953 million in 2006 against a budgeted amount of \$1.3 billion. Actual transfers from the GNU were even lower, at \$846 million, due to arrears in GNU payments (\$64 million) as well direct expenditures by GNU. A shortfall in donor grants was another contributing factor to revenue problems, with only a third of expected support realized. The grants came solely from the MDTF. There was no financial support received from non-MDTF sources which was expected to finance about US\$ 242 million³⁰ worth of development program in South Sudan.

7.9 Aggregate spending was nearly one-quarter above targets, with uneven adjustments in budget priorities. Table 7.2 shows the largest proportionate reductions can be observed for infrastructure (share falling from 20 to 11 percent), education (10 to 4 percent) and health (8 to 4 percent). On the other hand, the share under the broad label of “accountability” substantially increased—mainly because of significant over-spending by MOFEP, which is included in this category. The agencies accounting for the largest spending were, in rank order, the SPLA, MOFEP and interior affairs, collectively comprising 60 percent of the outlays. Resources to health and education together accounted for only 7 percent of total expenditures. Available information about the execution of capital spending suggests that little was initiated by way of development projects, and that the bulk of this spending so far has gone on vehicles for GOSS ministries and agencies. There were also significant operational expenditures.

Table 7.2: Expenditures Relative to Plans, 2006 USD million and percent

	Budget	Actual	Execution Rate (%)
Accountability	14	285	1982
Finance and Economic Planning	5	278	5139
Economic Functions	18	21	119
Education	137	104	76
Health	109	63	57
Infrastructure	279	166	60
Natural Resources & Rural Development	59	55	93
Public Administration	26	85	328
Rule of Law	74	162	218
Security	533	555	104
Of which SPLA	526	552	105
Social & Humanitarian Affairs	13	39	308
Unconditional Transfers	115	3	3
Reserves			
Total Ministerial Expenditures	1377	1539	112
Plus: Other items (budget financed by other sources and other expenditures including suspense items and direct expenses)	6	158	
Total GoSS Expenditures	1383	1697	123

Source: KPMG and MOFEP.

³⁰ This figure is taken from the 2006 GOSS budget document.

7.10 Spending increases in 2006 were driven by outlays on salaries and operations of ministries and public administrators that were larger than planned. The increase in the wage bill reflected the characteristics of a transition of South Sudan to a post conflict environment, including establishing a government and the popular expectations associated with the provision of support for members of the SPLA and the states. It appears that the escalation in the size of the organized forces³¹ (prison wardens, wildlife, police and war veterans) to about 80 percent of the civil service is associated with some de facto demobilization of the SPLA. The number of personnel supported by GOSS in the states is unknown; conditional transfers by the ministries of agriculture, health, education and legislative assembly to cover personnel compensation accounted for 16 percent of total wage bill in 2006. The purchases of general office supplies and the cost of travel and staff training were incurred to carry the operations of the ministries. The operations in the states and other levels of cabinet affairs cost \$166 million. The food supply for SPLA also contributed substantially to operational expenditures.

7.11 Weak administrative controls were associated with an expansion in the size of the bureaucracy. The progress in building an effective civil service has been slow and constrained by the lack of a functioning payroll, shortages of qualified staff and the absence of proper procedures for recruitment and incentives. Administrative controls are weak and perpetuate a system whereby appointments, due process of recruitment and verification of qualifications are not prerequisite for pay. The lack of administrative controls in face of further expansion in the bureaucracy and in existing operations raise the need for urgent control measures in order to become fiscally sustainable.

7.12 Major wage bill measures exerted an upward pressure on salary expenditures. The adoption of a higher salary scale during the second half of 2006 substantially raised wage expenditures. The decision to use an exchange rate of 250 Sudanese dinar to the US dollar for staff compensation in early 2007 is also expected to raise wage costs by about 25% relative to the budgeted amount.

7.13 The slow process of the DDR program and the lack of social security schemes to support war affected persons put pressure upon employment as a safety net for children, orphans, widows, disabled soldiers and demobilized soldiers. However, this could undermine the quality of the civil service with prevalence of low-skilled persons. Donor assistance for social security and livelihood schemes could be encouraged to target support to this group to mitigate the fiscal burden of public employment.

7.14 Bolder initiatives are required to reform the civil service. A comprehensive payroll and payment system for both the civil service and army is an important element in the assertion of fiscal discipline. At this point, it appears that the payroll reform requires several key elements, including control over the appointment process, matching of approved posts to appointed persons, release of monthly payments of the correct amount after appropriate

³¹ This excludes SPLA.

application of deductions, and a stoppage of salary payments on death, retirement or attrition. We are unaware of any explicit GOSS initiatives in any of these areas.

7.15 The overspending on wages and operations appeared to squeeze aggregate capital expenditures in 2006 (Table 7.3). The execution for capital spending has been skewed in favor of the MOFEP and the ministries of environment, telecommunication and internal affairs and at the expense of agriculture, forestry, water resource and irrigation, and road and transport infrastructure. The poor implementation and disbursement of funds for capital in above-stated sectors might be partly explained by the long duration of time required to prepare the projects and follow procurement regulations.

Table 7.3: Execution of Wages, Operations and Capital, percent of plan, 2006

	Salaries	Operating	Capital
Accountability	93	4,503	766
Finance and Economic Planning	78	6,978	9,320
Economic Functions	81	141	130
Education	82	66	71
Health	107	61	50
Infrastructure	27	110	58
Natural Resources & Rural Development	209	109	39
Public Administration	274	535	183
Rule of Law	221	224	212
Security	360	229	14
SPLA	363	235	14
Social & Humanitarian Affairs	131	189	442
Unconditional Transfers		0	
Reserves			
Total	216	183	54

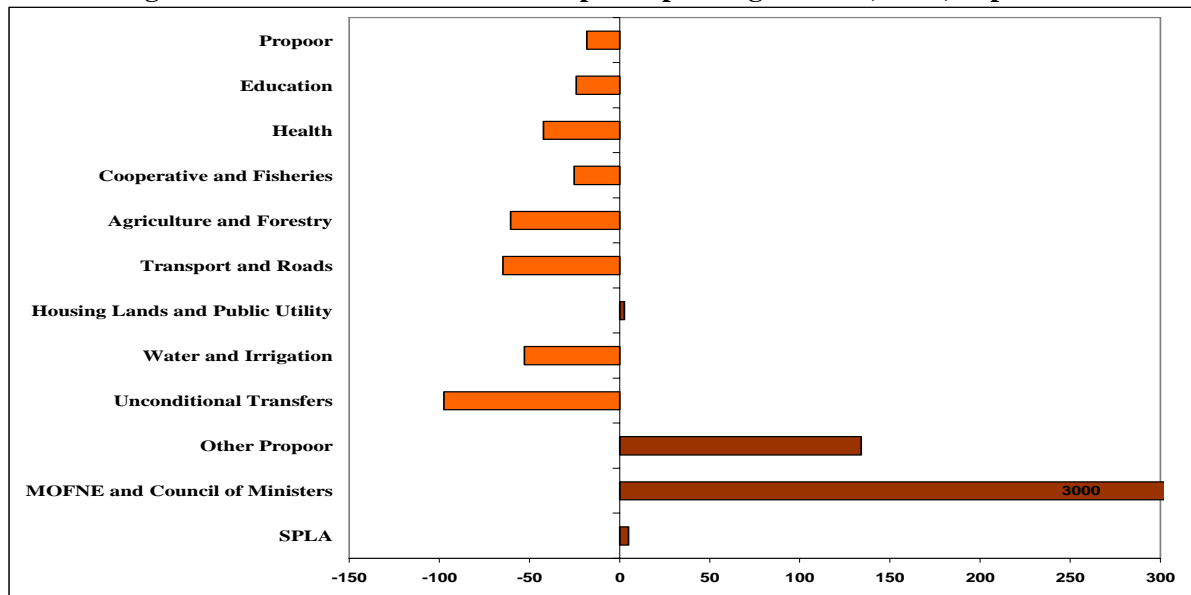
Source: KPMG and MOFEP.

7.16. The composition of budget expenditures diverged from the stated emphasis on development and pro-poor expenditures. Execution of pro-poor expenditures, here defined as the expenditures by the ministries except by SPLA, MOFNE and Council of Ministers, ran below plans. The disproportionate spending incurred for the functioning of rule of law, public administration, social affairs and economic activity happened alongside serious cuts in the planned support for infrastructure, health, education and rural development. Figure 7.1 illustrates the magnitude of deviations in actual pro-poor spending from the budget. The spending by the MOFNE and the Council of Ministries on the other hand was above plans.

7.17. The observed overspending is a byproduct of myriad factors, with lack of capacity for public financial management being key. The situation was characterized by underdeveloped accounting practices, absence of a well-defined system of controls, low human resource and governance capacity and underdeveloped financial institutions.

7.18. **The non-oil revenue base in South Sudan is very thin.** At the same time, there are non-oil revenue items that are not reported in the GOSS accounts, such as the non-tax income generated by the ministries for the services they render. For 2007, these ministries are estimated to have a budgeted income of US\$17 million. There are other sources of income that appear *off-the budget* such as the police registration fee and travel taxes. There are also reportedly taxes collected by the GNU in the South, 50 percent of which are due to the GOSS, but the amounts are unknown.

Figure 7.1: Deviations of Actual Pro-poor Spending to Plans, 2006, in percent



Note: Only the unconditional transfers are depicted in the illustration. Other pro-poor expenditures refer to public administration, rule of law, economic function and social and humanitarian affairs. Above expenditures exclude suspense and direct expenditures that have no functional classification.

Source: World Bank estimates.

7.19. **The significant appreciation of the Sudanese dinar effectively raised GOSS spending.** For 2006 and 2007, GOSS made budget expenditure plans in dollars based on oil revenue transfers from GNU in dollars, while expenditures such as the wage bill are made in local currency. With the dinar strengthening over time, there were significant difference between the assumed exchange rate used in valuing budgeted expenditure and the actual exchange rate at time of payments. Estimates put this exchange rate effect to have raised the wage bill burden on the GOSS by 25 percent. In future, the GNU plans to transfer GOSS shares of oil revenue in local currency, thus eliminating the exchange rate risk for GOSS.

7.20. **In sum, performance of the 2006 budget underlined the need to exercise greater control over budgetary outlays and to significantly limit spending that was not provided for in the approved budget, and to improve revenue estimation, jointly with the GNU.** Revenue predictability and associated issues around oil sector transparency (noted above) pose a major challenge to the GOSS. We have noted that the burgeoning cost of staff salaries is a major concern. The identification of root causes (ghost workers, slow processing of appointments) is an important step, alongside reforms to preclude its perpetuation, e.g. payroll reform) in order to make serious progress on the public financial management agenda.

7.21. **Improving information and accountability remains a priority**, at several levels: (i) better transparency in oil revenue sharing with the GNU, and more timely information to allow predictability in resources and expenditure planning; and (ii) better, and much more timely, accounting for expenditure, by spending unit, and the MOFEP. The present lags not only inhibit parliamentary and public scrutiny, but also make sound budget management much more difficult.

C. AN ANALYSIS OF 2007 GOSS BUDGET

7.22. **The GOSS 2007 budget was passed by Parliament in January 2007. On the revenue side, the planned envelope was similar to 2006**, at \$1.622 billion. In addition to oil revenue, the budget was premised on operationalization of the new revenue authority and non-oil revenue of \$234 million, or about 5.5 percent of total GOSS income. This is an ambitious target. The SSLA increased the target for non-oil revenues by some \$150 million, without specifically identifying sources. Moreover, since half of customs and excise duty (about one fourth of the estimated non-oil revenue for 2007) is shared with the GNU, this would require a huge incremental effort. Given the nascent state of the revenue authority and the lack of proper taxation rules and legislation, and the fact that non-oil revenue in 2006 was only \$2 million, this will be a difficult task to complete.

7.23. **Turning to the expenditure side**, the stated priorities for 2007 were outlined by the Minister in his budget speech as follows: (i) address priority development needs, notably agriculture, rural water, education, health and infrastructure development; (ii) control the wage bill and ensure that the payroll and salary scales are adhered to; and (iii) enforce budget discipline and control extra-budgetary expenditures, and eliminate suspense accounts. There will be a significant rise in total spending, which is projected to be over 10 percentage points higher than in 2006. The breakdown by economic category suggests a large increase in salary costs, which at \$865 million, amount to half of the total budget. This represents more than a tripling from the 2006 budget plan, and a 58 percent increase from the actual outturns in 2006. Development spending is planned to drop significantly, from almost \$1 billion in the 2006 budget to about \$541 million for the coming year, and include a significant foreign financing component. Thus for 2007, the MDTF would account for about 40 percent of total development spending (\$218 million), compared to 15 percent in the 2006 plan and 10 percent in outturns.

7.24. **The 2007 budget involved several major changes in the spending pattern relative to 2006**. Most notably, spending on public administration and economic functions increase by almost 150 percent, which appears to respond to the over-spending in 2006. Justice and law enforcement, accountability functions, and spending on services for the disadvantaged were also given large spending increases. On the other side of the spectrum, spending on education and health was significantly reduced, of the order of \$25 million in each case. Transfers to southern states are planned to increase by 10 percent, to \$125 million.

7.25. **The GOSS budget that was adopted by the SSLA is balanced only because of the projected increase in non-oil revenue**. The original budget presented to the SSLA by MOFEP was more realistic, but deliberations resulted in additional funds being allocated across different ministries, and the SSLA directed MOFEP to look at options for increased

taxes. This issue raises potential disincentives to private sector investors. The draft Public Financial Management Act aims to prevent Parliament from changing the resources envelope.

7.26. Data on mid-year execution of the 2007 budget shows continued oil revenue shortfalls, with expenditure rationing given reserves and oil savings are exhausted. Dar blend production shortfalls continued to cause oil revenue shortfalls into 2007. Production has since picked up considerably, with the completion of the dedicated export terminal in Port Sudan. Dar blend has also been getting more favourable prices on the export market toward the middle of the year. In fact, oil revenue surged from a six month average of \$86 million to \$167 million in July 2007 which was well above the budgeted prorata level of \$108 million. Future inflows will depend on market forces, and continued volatility is expected. The fiscal crunch appears to have been borne so far by capital and operating expenditures. For the first six months the execution rate is 33 percent for operational expense (excluding block grants to states) and 15 percent for capital expenditures.

D. KEY CHALLENGES

7.27. The foregoing has revealed a series of major challenges for Southern Sudan that are related to the budget. Looking forward, the following are priority areas for further dialogue with the GOSS authorities.

1. Building an effective cash management system requires the setting up of commitment and expenditure controls, a well functioning payment system and sound government banking and institutional arrangements. Strengthening the Treasury Single Account, streamlining and revising the accounting and payment processes and the utilization of freebalance could enhance the accounting and payment system. Government banking arrangements for oil revenue deposits and transfers to states must be studied in greater detail.
2. Reforming the payroll system for SPLA and organized forces, GOSS civil servants and state personnel is key to addressing the excessive outlays on wages. Eliminating ghosts and ineligible employees, enforcing workforce ceilings, adopting affordable and uniform pay and allowance structures and collection of personal income tax constitute the immediate actions for payroll reform on civil servants. Accelerating the DDR process is integral in managing the size of the payroll. Donor assistance is needed in providing support packages for retrenched employees.
3. Broadening the fiscal base by increased mobilization of non-oil revenues reduces the vulnerability to oil volatility. Conservative revenue planning on both oil and non-oil revenues is prudent. Revenue diversification requires the establishment of an enhanced Tax/Revenue Department in MOFEP to raise collections from customs, corporate tax and VAT, the modification to the Revenue Act to address overlaps in tax responsibilities across the various levels of government, its adoption and implementation, the training and computerization and the imposition of additional taxes or user fees.

4. Improved transparency and understanding of the oil market, industry dynamics and relevant operations of the oil industry is required in improving oil revenue management. This includes bridging the knowledge gap on the PSA, revenue sharing agreements, and on production and investment plans in oil fields. The development of an effective National Petroleum Corporation is crucial in the coordination of GOSS and GNU and thus in improved governance of oil revenue.

5. Intergovernmental relations between the North and the South and between the GOSS and the states are integral to effective fiscal management and to development achievement. The creation of a directorate of intergovernmental relations within MOFEP with a sole task of monitoring and managing fiscal relations between the GOSS and GONU can facilitate their coordination on revenue planning and execution. Increasing the knowledge on the fiscal situation in the states, particularly on the pattern of their expenditure, provision of pro-poor services and revenue generation is a short-run concern. The level of autonomy of states and county governments must be ascertained and must be the basis behind their shares to tied and untied funding. The distribution of grants must also consider the fiscal capacity of the states and their relative need for services.

ANNEXES

ANNEX A: FISCAL DECENTRALIZATION RESPONSIBILITIES ACCORDING TO THE INTERIM NATIONAL CONSTITUTION

Annex Table A.1: Distribution of Responsibilities between levels of Government in Northern Sudan

Reference in Constitution	Function	National Government	State Government	*Local Government	*Native Admin.	Concurrent Powers
A 1	Defense, national security and border protection	√				
A 2, 3, 25 & 38	Foreign Affairs, Nationality and Naturalization, signing international treaties, issuance of national ID cards	√				
A 4 & 5	Passports and Visas, Immigration and Aliens	√				
A 37	National elections and the Electoral Commission	√				
C 29	State referenda		√			
Economic management and planning provisions						
A 6, 16 17 & 26	Central bank, currency, coinage, exchange control, issuing of paper money, bills of exchange and promissory notes, national debt and borrowing	√				
D 8	Banking and Insurance					√
C 11	State borrowing		√			
A 35, C 39, D 28	Taxation and Revenue raising	√	√	√	√	√
A 22	Customs, excise and export control	√				
A 36, C 35, C 37, D 20	Budget and finances	√	√	√		√
A 32	National economic policy and planning	√				
D 6, D 28	Trade, commerce, industry and economic planning and development					√
Law and the Administration of Justice						
A 7	Constitutional and other National Courts	√				
C 1	State Constitution		√			
C 7, 19 & 20	State Courts and the administration of justice		√			
	Local Justice (incl. some criminal cases)				√	
D 9	Bankruptcy and insolvency					√
C 34	Traditional and Customary law		√			
Service provision						
A 8, C 2	Police	√	√			
A 20, C 2	Prisons	√	√			
C 14	Reformatory Institutions		√			
A 10	Postal services	√				

Reference in Constitution	Function	National Government	State Government	*Local Government	*Native Admin.	Concurrent Powers
C 24	Airports and airstrips		√			
A 12, 13 & 14	Maritime shipment, beacons and navigation	√				
A 15	National Parks	√				
A 19	Meteorology	√				
A 28, D 13	States of Emergency	√				√
A 31, C 33	Museums and heritage sites	√	√			
C 9, C 33	Cultural matters within a State, libraries,		√			
C 38	State archives, antiquities and monuments		√			
A 33	Nile Water Commission and interstate water management	√				
D 12	River Transport					√
D 15	Water and waste management					√
C 36	State Irrigation and Embankments		√			
D 27	Water resources other than interstate waters			√	√	√
A 34, C 4, D 16	Information, publications, telecommunications and regulations	√	√			√
C 5	Social welfare, including State pensions		√		√	
C 15, C 42, D 4, D 13, D 31	Health care – regulation - hospitals - other health institutions - ambulance services - health policy - epidemics control - drug quality		√ √ √ √	√		√ √ √
C 22, D 3	Education - Primary schools - Secondary schools - Administration of schools - Tertiary - Education policy		√ √ √	√		√ √
D 3	Scientific Research					√
C 23	Agriculture		√			
D 23, D 31	Animal and livestock control, diseases, pastures and veterinary services, animal drug quality			√	√	√
C 27	Pollution control		√			
D 17	Environmental management, conservation and					√

Reference in Constitution	Function	National Government	State Government	*Local Government	*Native Admin.	Concurrent Powers
	protection					
C 32	Town and Rural Planning		√			
D 5	Urban development, planning and housing					√
C 41	Vehicle licensing		√			
C 42	Fire fighting		√			
C 43	Recreation and sport		√			
C 44	Firearms licenses		√			
D 7	Delivery of public services			√	√	√
D 15	Electricity generation					√
	Traditional and Customary Law				√	
	Land ownership and use adjudication				√	
Regulatory Activities						
A 11	Civil aviation regulation	√				
A 29	International and interstate transport	√				
C 25	Intrastate transport		√			
A 30	Public Utilities	√				
C 3	Local Government		√			
C 10	Regulation of religious matters		√			
C 16	Regulation of business, trade licenses etc		√			
D 10	Manufacturing licenses					√
D 2	Legal and other professions					√
A 15, C 8, C 21, C 31	Natural Resources (incl. Forestry and quarrying)	√	√			
A 18	Weights, measures and standards, dates and time	√				
C 34	Traditional and Customary law		√			
D 24	Consumer safety and protection					√
A 23	Intellectual property rights, including patents and copyright	√				
Other Functions						
C 8, C 13	State land		√			
A 21	Institutions established under a Peace Agreement or the INC	√				
A 9, C 6, C 12	Civil service salaries and allowances	√	√			
A 24	National Flag, emblem and anthem	√				
C 45	State flag and emblem		√			

Reference in Constitution	Function	National Government	State Government	*Local Government	*Native Admin.	Concurrent Powers
A 27	National Census, surveys and statistics	√				
C 28	State statistics and surveys		√			
C 17	Local works and undertakings		√			
C 18	Marriage, divorce, births, deaths etc		√			
C 26	Population policy and family planning		√			
C 30	Charities and endowment		√			
D 14	Traffic regulations					√
D 21, 22	Women's empowerment and gender policy					√
D 26	Mother, Child protection and care					√

- The allocation of functions to local government and Native Administrations is based on interviews with officials and needs expansion and clarification.
- This table is quoted from Bob Searle (September 2006) "Distribution of Responsibilities between levels of Government in Northern Sudan" Discussion Paper No. 3 Prepared for the D-JAM Governance Cluster, Track 2

ANNEX B: GNU BUDGET TABLES

**Annex Table B.1: GNU Revenue and Expenditure: Economic Classification, with older chapter structure for compatibility across time
(in billion SD, 2000 – 2006)**

ITEM	2000		2001		2002		2003		2004		2005		2006	
	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.
<u>TOTAL REVENUE</u>	297.9	334.0	402.9	365.2	81.7	472.2	603.6	715.0	821.0	1,023.9	1,275.0	1,218.4	1,709.4	1,499.8
Oil revenue	63.6	143.8	153.2	149.7	145.5	200.6	249.0	399.0	373.6	499.0	706.0	608.6	908.4	758.1
Non-oil revenue	234.3	190.2	249.7	215.5	236.2	271.6	354.6	316.0	447.4	525.0	569.0	609.8	801.0	741.7
<u>TOTAL GENERAL EXPENDITURE</u>	364.9	352.2	461.6	418.5	598.0	518.2	698.2	736.1	1,079.0	1,103.7	1,451.0	1,433.3	2,085.0	1,823.9
Federal Government Expenditure	339.8	322.5	433.7	393.6	561.3	485.2	640.2	686.3	980.0	1,019.5	952.0	1,028.3	1,287.8	1,168.8
Total Current Expenditure	273.9	270.3	317.2	317.5	402.2	344.1	454.2	501.0	689.3	709.2	679.6	730.5	922.5	814.7
<u>Chapter One:</u>	105.6	110.0	136.9	131.6	170.9	164.9	199.0	191.1	286.2	273.2	301.0	259.2	418.3	395.7
Wages and Salaries	86.2	85.5	105.3	103.6	136.3	135.0	166.6	164.0	194.4	184.7	238.4	180.7	336.9	347.0
Insurance Privileges	10.3	15.5	20.1	21.4	21.5	20.6	18.0	18.1	72.2	74.3	28.5	48.9	45.6	25.0
Chapter one Reserve	9.1	9.0	11.5	6.6	13.0	9.4	14.4	9.0	19.6	14.2	34.1	29.6	35.8	23.8
<u>Chapter Two:</u>	168.2	160.4	180.3	185.9	231.3	179.2	255.2	309.9	403.1	436.0	378.6	471.3	504.2	419.0
Goods and Services	60.8	56.2	69.8	47.5	74.1	51.5	77.3	63.0	83.2	70.7	101.5	62.1	127.5	76.9
Centralized Items	98.0	95.4	96.9	122.2	135.0	107.0	154.2	225.6	294.1	338.2	247.1	374.6	337.4	304.9
General Social Subsidy	9.4	8.8	13.6	16.3	22.2	20.7	23.7	21.3	25.8	27.1	30.0	34.6	39.3	37.2
<u>Chapter Three: Transfers</u>	25.1	29.6	27.9	25.0	36.8	32.9	58.0	49.8	99.0	84.2	499.0	405.0	797.2	655.1
<u>Northern States Transfers</u>	25.1	29.6	27.9	25.0	36.8	32.9	58.0	49.8	99.0	84.2	224.8	214.8	477.8	359.4
<u>Current Earmark Transfers</u>	-	-	-	-	-	-	-	-	-	-	55.5	50.2	62.6	52.8
Wages (Chapter I), (Judiciary, Police, Higher Edu.)	-	-	-	-	-	-	-	-	-	-	47.9	47.9	48.8	46.1
Operation (Chapter II), (Judiciary, Police, Higher Edu.)	-	-	-	-	-	-	-	-	-	-	7.6	2.3	7.8	2.5
Social Subsidy (Chapter II)	-	-	-	-	-	-	-	-	-	-	-	-	6.0	4.1
<u>Block Transfers</u>	25.1	22.4	27.9	25.0	36.8	32.9	58.0	49.8	99.0	84.2	130.3	113.1	273.6	220.0
Additional Excise on Benzene	-	-	-	-	-	-	-	-	-	-	10.0	8.0	-	-
Transfers to Oil Producing Northern States	-	-	-	-	-	-	-	-	-	-	1.3	0.7	5.3	5.0
Current Transfers to Northern States	25.1	22.4	27.9	25.0	36.8	32.9	45.0	37.1	83.0	70.9	90.0	87.5	124.8	107.6
Develop. Trans. to Nuba Mountains & Blue Nile Area	-	-	-	-	-	-	-	-	-	-	5.0	-	10.0	6.8
Development and Construction Transfers to Abie Area	-	-	-	-	-	-	-	-	-	-	3.0	0.0	6.0	0.5
National Reconstruction Fund for	-	-	-	-	-	-	-	-	-	-	3.0	0.4	-	-

ITEM	2000		2001		2002		2003		2004		2005		2006	
	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.
War Affected Area														
Agricultural Tax Compensation	-	-	-	-	-	-	13.0	12.7	16.0	13.3	18.0	16.5	22.5	22.3
Value Added Tax	-	-	-	-	-	-	-	-	-	-	-	-	105.0	77.9
<u>Development Subsidy</u>	-	7.2	-	-	-	-	-	-	-	-	39.0	51.5	141.6	86.6
States Development Projects (Local Component)	-	7.2	-	-	-	-	-	-	-	-	27.2	49.8	92.1	69.3
States Development Projects (Foreign Component)	-	-	-	-	-	-	-	-	-	-	11.8	1.8	49.5	17.3
States Development Reserve	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reconstruction Funds	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<u>Government of Southern Sudan GOSS</u>	-	-	-	-	-	-	-	-	-	-	274.2	190.3	319.4	295.7
Government of Southern Sudan Oil Revenue Share	-	-	-	-	-	-	-	-	-	-	-	-	306.9	277.0
Southern Sudan Oil Producing States Share	-	-	-	-	-	-	-	-	-	-	-	-	12.5	18.8
National Revenues Collected by The GOSS	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Chapter Four: Development Expenditure	65.9	52.2	116.6	76.0	159.1	141.1	186.0	185.3	290.7	310.3	272.4	297.8	365.4	354.0
Total National Development	47.8	36.9	99.2	56.7	143.9	115.5	138.8	107.4	220.7	221.0	173.9	185.9	263.9	256.1
Onlending and capital contribution	18.2	15.2	17.4	19.3	15.2	25.6	47.2	77.8	70.0	89.3	98.5	111.9	101.5	97.9

Source: MOFNE and Bank staff estimates.

Annex Table B.2: GNU Revenue and Expenditure: First Quarter 2007 Performance, in Economic Classification (SDD billions)

ITEM	BUD. 2007	Total JAN	Total Feb.	Total Mar	Total Q1
<u>TOTAL REVENUE+GRANTS</u>	1,880.6	84.9	108.7	114.5	308.1
<u>Total REVENUE</u>	1,824.6	84.9	108.2	114.5	307.6
<u>A- Tax Revenues</u>	739.5	38.7	54.6	48.8	142.1
1 - Direct Tax	119.5	7.1	9.2	7.2	23.5
2 -Customs & Excise	380.0	19.7	25.7	28.4	73.7
3- VAT.	240.0	12.0	19.8	13.2	44.9
<u>B-Non-Tax Revenue</u>	1,085.1	46.2	53.6	65.7	165.5
1 - Departmental Fees	26.0	1.4	1.4	1.3	4.1
2 - National Revenues	1,059.1	44.8	52.2	64.4	161.4
Oil Revenues	929.1	44.2	46.7	59.4	150.2
Non Oil Revenues	130.0	0.6	5.5	5.0	11.2
<u>C-Grants</u>	56.0	-	0.5	-	0.5
<u>TOTAL EXPENDITURE</u>	2,358.9	102.6	146.0	125.1	373.7
<u>PART 1: National Government</u>	1,460.4	61.6	104.3	83.7	249.6
<u>Chapter One</u>	520.8	28.1	36.8	31.6	96.4
A - Wages& Salaries	479.5	27.6	33.0	29.9	90.5
B - Insurance Benefits (Pen.&Soc. Insu.)	41.3	0.5	3.8	1.7	5.9
<u>Chapter Two</u>	522.2	16.6	39.8	32.1	88.6
A- Debt services	82.0	0.2	3.2	7.0	10.4
- External	44.0	0.2	1.8	1.4	3.4
- Internal	38.0	-	1.4	5.6	7.0
B-GMCs/ GICs Repayment	52.5	-	14.1	-	14.1
C - Goods & Services	121.0	1.9	9.4	8.0	19.4
D-General Reserve	94.5	6.4	7.7	5.5	19.6
E-Other Obligations	93.4	4.9	3.5	2.8	11.1
F -Social Subsidies	78.8	3.2	1.9	8.8	14.0
<u>Chapter Three : Capital Services</u>	23.3	1.1	1.4	1.2	3.7
<u>Chapter four : National Development</u>	394.1	15.8	26.3	18.8	60.9
A- National Development projects	340.8	15.8	26.0	18.5	60.2
- Local	207.0	9.6	13.6	13.0	36.1
- Foreign	133.8	6.2	12.4	5.5	24.1
B -Strengthening of Development Financing Institutions	5.0	-	-	-	-
C- Government Capital Contribution	31.3	0.1	0.1	0.1	0.2
D- Agricultural Season Support	17.0	-	0.2	0.3	0.5
<u>PART 11: GOSS</u>	296.2	16.3	13.4	13.2	42.9
GOSS Oil Share	284.6	15.8	12.1	12.7	40.6
Southern Oil Producing States Share	11.6	0.5	1.3	0.5	2.3
<u>PART 111: Transfers To Northern States</u>	602.3	24.7	28.3	28.2	81.2
A - Agricultural Taxes Compensations	24.0	1.4	1.6	2.0	5.0
B - Transfers to Other Oil Producing States	4.9	0.2	0.9	0.5	1.6
C - Current Transfers to Northern States	134.8	9.4	9.8	8.8	27.9
D - Development Transfers to Nuba Mountains and Blue Nile Areas	12.0	-	-	0.0	0.0
E - Development Transfers to Abeyi Area	6.0	-	-	-	-
F - Development Projects	169.7	4.8	4.4	4.2	13.3
- Local	124.7	4.1	3.9	3.9	11.9
- Foreign	45.0	0.6	0.4	0.3	1.3
- Reconstruction Fund	69.0	0.1	-	0.0	0.1
G - Wages Transferred To :	60.0	3.6	3.6	6.3	13.5
- Judiciary	-	-	-	-	-
- Interior	19.0	1.6	1.7	3.4	6.7
- Higher Education	24.0	2.0	-	2.0	4.0

ITEM	BUD. 2007	Total JAN	Total Feb.	Total Mar	Total Q1
- Graduates	17.0	-	1.9	0.9	2.8
H- Goods & Services Transferred To :	4.2	-	0.1	0.1	0.3
- Judiciary	-	-	-	-	-
- Interior	2.4	-	0.1	0.1	0.3
- Higher Education	1.8	-	-	-	-
I - Social Subsidies	10.9	-	0.1	0.4	0.5
J - VAT Transfers	106.9	5.3	7.8	5.9	19.1

Source: MOFNE and Bank staff estimates.

Annex Table B.3: GNU Expenditure: Preliminary Functional Classification (SDD billions, 2000 – 2006)

ITEM	2000		2001		2002		2003		2004		2005		2006	
	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.
<u>TOTAL GENERAL EXPENDITURE</u>	364.9	352.2	461.6	418.5	598.0	518.2	698.2	736.1	1079.0	1103.7	1451.0	1433.3	2085.0	1823.9
<u>a) Federal Government Expenditure</u>	339.8	322.5	415.5	384.2	536.8	466.8	616.9	674.3	953.5	1010.7	952.0	1028.3	1287.8	1168.8
<u>General Public Services</u>	150.9	143.9	174.8	157.8	211.3	193.8	279.7	315.1	350.2	378.5	436.5	305.4	567.2	520.8
Executive and Legislative Organs	47.3	43.8	53.8	51.7	65.6	64.8	110.7	153.0	162.9	212.8	200.3	201.2	231.6	195.1
Defense and National Security	78.8	76.4	90.7	79.5	104.4	92.8	120.5	109.2	128.0	106.9	189.2	80.0	244.3	235.5
Public order and safety	24.7	23.7	30.3	26.6	41.3	36.3	48.5	52.9	59.4	58.8	47.0	24.2	91.4	90.1
<u>Economic Affairs</u>	55.8	54.4	87.7	66.1	123.8	120.4	113.9	108.6	232.5	245.4	178.2	201.7	264.3	257.0
<u>Agriculture & Livestock</u>	17.5	17.6	26.7	16.3	54.8	59.2	61.8	52.4	98.9	98.2	89.0	99.7	120.7	122.2
<i>Agriculture</i>	14.9	16.6	22.1	15.2	49.8	57.8	56.6	49.8	89.6	95.4	80.3	98.1	113.8	119.6
<i>Livestock</i>	2.7	1.0	4.5	1.1	5.0	1.4	5.2	2.6	9.3	2.8	8.7	1.6	6.9	2.6
Transport, Roads and Bridges	5.3	4.7	12.1	4.1	13.5	3.9	11.3	8.9	23.2	20.7	31.4	34.9	43.7	33.8
Energy and Mining Industry and Construction	11.3	5.5	14.5	10.5	17.7	19.4	16.5	17.2	38.0	37.9	22.3	32.9	38.1	41.7
Communication	4.3	6.7	11.7	9.9	10.9	14.3	4.7	11.4	7.3	18.5	8.0	7.6	8.3	32.9
Other Economic Services	3.6	3.1	5.3	3.5	5.0	3.9	6.4	4.7	6.5	7.9	7.2	5.5	9.3	7.3
<i>Labour</i>	13.8	16.7	17.5	21.8	21.8	19.7	13.1	13.9	58.6	62.1	20.4	21.2	44.3	19.1
<i>Trade</i>	12.8	16.3	17.4	21.8	21.8	19.7	13.0	13.9	58.5	62.0	20.3	21.1	44.1	19.0
<i>Trade</i>	1.0	0.3	0.04	0.03	0.04	0.03	0.04	0.04	0.1	0.1	0.1	0.1	0.2	0.2
<u>Social Affairs</u>	43.4	38.3	61.2	49.5	81.5	59.1	94.4	69.3	121.3	105.1	142.8	185.9	174.6	124.1
Health	7.9	7.1	10.5	9.0	14.1	8.8	17.7	11.7	24.2	20.8	35.8	19.4	42.2	27.3
Education	16.4	14.3	22.1	17.0	28.7	21.7	34.3	29.1	46.2	40.7	37.7	21.6	37.5	29.7
Environmental Protection	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1
Housing and Community Amenities	9.9	8.1	13.8	14.6	21.3	18.2	23.1	17.1	24.0	24.5	17.2	23.1	20.1	24.4
Recreation, Culture and Religion	0.3	0.2	0.3	0.2	1.8	0.7	2.3	1.1	3.2	1.9	5.1	2.3	4.2	3.7
Social Protection	8.9	8.6	14.5	8.6	15.5	9.6	16.9	10.2	23.7	17.1	46.9	119.4	70.4	38.9

ITEM	2000		2001		2002		2003		2004		2005		2006	
	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.	Bud.	Act.
Others	89.7	86.0	91.8	110.8	120.2	93.5	128.9	181.2	249.5	281.7	194.5	335.2	281.7	266.9
External Loans														
Repayment	34.9	31.2	35.6	23.1	68.4	29.2	48.0	53.8	50.0	60.1	55.0	65.7	47.0	40.5
Local Dept Repayment														
& Other Repayment	4.5	5.3	18.9	21.1	0.0	0.0	25.7	26.4	47.0	38.8	35.0	71.1	111.7	93.4
Reserves /														
Contingencies	49.5	49.0	31.5	64.0	50.1	63.0	48.7	96.0	139.7	171.2	90.0	166.8	109.4	118.4
Development														
reserves/contingencies	0.5	0.3	0.8	0.6	0.8	0.3	0.5	0.5	0.5	0.7	1.0	2.8	2.8	0.1
Others not classified by														
Item	0.4	0.2	5.0	1.9	0.9	0.9	6.0	4.5	12.3	11.0	13.5	28.9	10.7	14.5
b) Intergovernmental														
Transfers	25.1	29.6	46.1	34.3	61.3	51.4	81.3	61.8	125.5	93.0	499.0	405.0	797.2	655.1
Northern States														
Transfers	25.1	29.6	46.1	34.3	61.3	51.4	81.3	61.8	125.5	93.0	224.8	214.8	477.8	359.4
Government of Southern														
Sudan Transfers	-	-	-	-	-	-	-	-	-	-	274.2	190.3	319.4	295.7

Source: MOFNE and Bank staff estimates.

Annex Table B.4: GNU Expenditures: 2007 Budget in Functional Classification (SDD billions)

ITEM	2007 Bud.
<u>TOTAL GENERAL EXPENDITURE</u>	2358.9
<u>a) Federal Government Expenditure</u>	1460.4
<u>General Public Services</u>	617.0
Executive and Legislative Organs	188.6
Defense and National Security	311.9
Public order and safety	116.5
<u>Economic Affairs</u>	407.5
Agriculture & Livestock	188.4
<i>Agriculture</i>	175.8
<i>Livestock</i>	12.7
Transport, Roads and Bridges	54.8
Energy and Mining	95.0
Industry and Construction	13.9
Communication	9.9
Other Economic Services	45.4
<i>Labour</i>	45.2
<i>Trade</i>	0.2
<u>Social Affairs</u>	173.6
Health	51.0
Education	42.2
Environmental Protection	0.2
Housing and Community Amenities	26.1
Recreation, Culture and Religion	8.1
Social Protection	46.1
<u>Others</u>	262.3
External Loans Repayment	44.0
Local Dept Repayment & Other Repayment	90.5
Reserves / Contingencies	119.1
Development reserves/contingencies	2.0
Others not classified by Item	6.7
<u>b) Intergovernmental Transfers</u>	898.5
Northern States Transfers	602.3
Government of Southern Sudan Transfers	296.2

Source: MOFNE and Bank staff estimates.

ANNEX C: NORTHERN STATES EXPENDITURES

Annex Table C.1: Northern States Expenditures: Economic/Functional Classification (SDD billion, 2000 – 2005)

Item	2000	2001	2002	2003	2004	2005
<u>TOTAL GENERAL EXPENDITURE</u>	73.6	92.7	119.5	148.8	247.5	313.7
<u>Wages and Salaries, Improvement and Privileges</u>	33.9	44.3	52.5	65.7	110.7	144.7
I- Wages and Salaries	33.8	44.0	52.4	65.2	110.5	143.8
Agriculture Sector	2.3	2.9	3.2	3.8	7.3	9.8
Transport, Roads and Bridges Sector	2.5	2.8	3.0	3.5	5.8	7.2
The Sovereignty Sector	1.0	1.1	1.0	1.8	1.6	1.7
Financial and Economic Sector	1.7	2.6	3.4	3.2	7.7	7.3
Health Sector	10.8	17.0	20.8	25.3	38.9	54.8
Education Sector	14.9	16.6	19.5	25.1	43.8	57.7
Administrative and Social Sector	0.6	1.0	1.5	2.5	5.4	5.3
II-Improvement and Privileges	0.0	0.3	0.0	0.4	0.2	0.9
<u>Goods and Services and Centralized Items</u>	33.1	38.4	45.1	45.8	76.2	89.8
I-Goods and Services	28.4	31.0	35.8	40.9	58.4	65.7
Agriculture Sector	2.7	1.9	2.2	2.3	3.5	3.6
Transport, Roads and Bridges Sector	2.7	3.2	3.3	3.3	6.2	7.3
The Sovereignty Sector	2.5	3.6	4.2	2.9	5.2	7.0
Financial and Economic Sector	9.9	10.4	11.1	13.4	18.6	18.5
Health Sector	5.0	6.2	7.7	11.1	13.9	16.9
Education Sector	3.3	3.5	3.6	4.3	5.1	5.9
Administrative and Social Sector	2.4	2.3	3.8	3.6	6.0	6.6
II-Centralized Items	2.2	3.0	4.0	2.4	8.8	12.3
III-Capital Services	2.5	4.4	5.3	2.4	9.0	11.8
<u>Total of Development Expenditure</u>	6.6	10.0	21.9	37.4	60.6	79.3
Agriculture Sector	0.5	0.2	0.5	0.7	1.7	2.9
Transportation, Roads & Bridges Sector	3.9	5.8	2.1	21.0	33.2	47.9
Energy Sector (Electricity)	0.0	0.1	0.2	0.1	0.4	0.4
Social Development Sector	1.9	3.6	18.5	12.9	8.2	23.5
Capacity building and human resources development projects	0.5	3.0	1.0	11.1	2.2	9.4
Health	0.4	0.3	0.6	1.0	1.5	7.3
Education	0.2	0.2	9.0	0.4	1.9	3.3
Social Care and administrative Sector	0.8	0.1	7.8	0.5	2.7	3.5
General Public Services Sector	0.2	0.1	0.3	1.7	0.6	0.2
Water's Projects financed through loans and grants	0.0	0.1	0.2	0.2	0.5	1.1
Development reserves/contingencies	0.0	0.0	0.0	0.0	0.1	0.1
Centralized Items	0.0	0.0	0.0	0.1	13.8	2.8
Others	0.0	0.1	0.2	0.7	1.9	0.2

Source: Ministry of Finance and National Economy, Northern States Final Account Reports, and Bank staff estimates.