ERF Policy Brief No. 100 | November 2022

ERF Policy Brief

Rebuilding the State and Fiscal Federalism in Sudan

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In a nutshell

- *Fiscal transfers to states varied substantially over time and relied heavily on oil exports. As a result, the secession of the South was catastrophic.*
- *Per-capital transfers failed to address the substantial geographic differences in standards of living.*
- *Fiscal federalism can support rebuilding the State in Sudan, if it moderates existing disparities across states and empowers citizens to determine the composition and financing of local public goods.*

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The diversity of the Sudanese in terms of culture, lifestyle, livelihood, and ancestry makes the country difficult to govern, even under the best circumstances. For the better part of the past six decades, Sudan has been locked in a cycle of conflict, military coups, and revolutions. Serial internal conflict empowered successive governments to weaken institutions and deliberate dismantling of the State and all pillars of civil society. In this context, it is fitting that the modern history of Sudan is tightly intertwined with the call for federalism, starting with the Southerners' push for regional autonomy since the independence. Although it was the South that led the argument for a federal system, it was arguably just as relevant for different regions in the country. In this brief, we examine the design and practice of one dimension of federalism – the ability of citizens to govern their fiscal affairs at the local level. Our goal is to examine how the central government designed and implemented fiscal relations with states, focusing largely on intergovernmental transfers over the past decade.

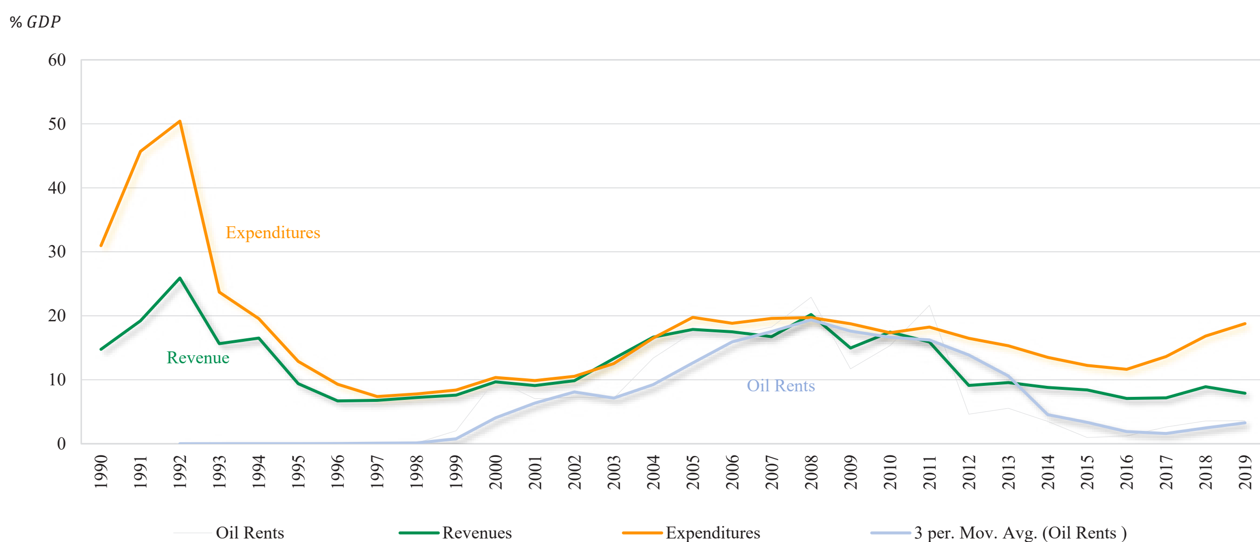
Documenting the evolution of the institutional framework and fiscal trends over several decades reveals several patterns. Severe central-government fiscal fragility meant that transfers to states varied substantially over time. The growth of oil exports facilitated higher transfers and the loss of the South sharply curtailed them. Regardless of the level of transfers, their distribution does little to offset long-standing inequities in standards of living across states, and may exacerbate them. If fiscal federalism is to support the rebuilding of the state in Sudan, it must address disparities and empower citizens to determine the composition and financing of local public goods.

Economic and fiscal profile

Per-capita income in Sudan as of 2020 was $595, only half of the average in MENA countries, and one-quarter of that in Egypt. Consistent economic fragility meant anemic growth, leaving Sudan's 2020 per-capita income at barely 30% higher than at the start of Bashir's Ingaz regime. Fiscal data show government revenues and spending reached unsustainable levels early in Bashir's tenure. The government was running a deficit of more than 20% of GDP (see Figure 1). In the background, these deficits were monetized, resulting in inflation rates over 100%. Consequently, the Central government was forced to reduce spending sharply to balance its budget. It was at the tail end of this austerity that oil revenues began to flow and buttress the central government's public finances. A significant factor in the ensuing crisis was the increase in the central government's commitments and the resulting public sector borrowing.

State and local governments benefited substantially from the rise in oil revenues. Transfers to lower levels of government increased starting in 2005, from less than 10% to about 40% as required by the interim constitution (see Figure 2). The flow of resources supported important gains in socioeconomic outcomes, including life expectancy and schooling (Figure 3).

Figure 1. Central Government Revenues, Expenditures and Oil Rents, 1990-2020

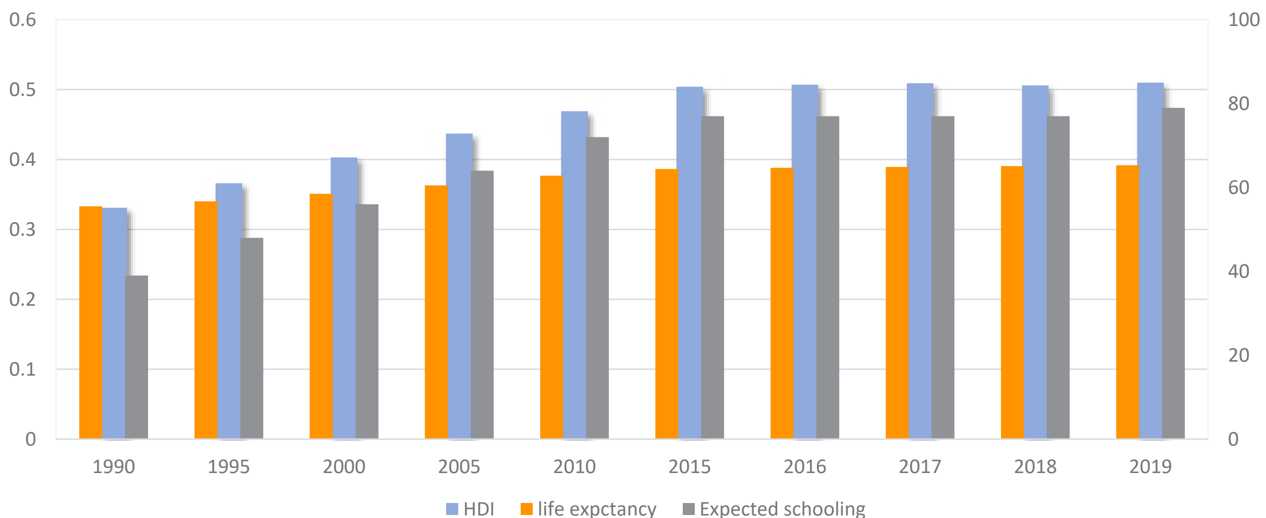


Source: IMF World Economic Outlook Database, October 2021 [Data from National Statistics Office. Sudan Central Bureau of Statistics]

Figure 2. State Transfers as a share of Central Government Revenue, 1970-2019

Notes: 2-year moving average.
IMF World Economic Outlook Database, October 2021 [Data from National Statistics Office. Sudan Central Bureau of Statistics]

Figure 3. Human Development Metrics



Source: U.N. Sudan Human Development Reports, 2020

De-Jure Fiscal Federalism in Sudan

History

The issue of federalism has been integral to the political fabric of Sudan since the country was under Anglo-Egyptian rule since 1922. The foundation for local government dates back to the 1922 Milner Commission and the adoption of Native Administration. in 1949 Marshall Commission formally addressed the provision and financing of public service. The latter's proposal for Town and Rural District Councils – adopted in the 1951 local Government Act – balanced the desire for meaningful local participation and the capacity to provide public services, raise local revenues, and administer central-government grants (Norris, 1983). This framework was at first successful: until 1959, local council budgets were in surplus and there none needed central government support (El-Battahani and Gadkarim – EG-2017). The early success, however, was shaky. Local government revenues stagnated and failed to cover spending requirements. In addition, growth in the number of District councils came with capacity constraints.

Around the time of independence, federalism was espoused by the South as means of addressing some of the glaring inequities that existed and gaining a modicum of power in a system dominated by the North. Subsequently, the government adopted a vision of "unity in diversity" espoused in the 1971 People's Local Government Act. Two key pillars directly acknowledge the challenges of inequity in a county with an ethnically diverse population. The Act abolished Native Administration and dramatically increased the number of local councils (to more than 5000) even as it usurped their autonomy. The reform, however, made the Provincial Executive Council became the primary policymaking and *sole* budgetary unit within the province. In addition, powers were devolved from the Central government to the provinces *en masse*.

Ultimately, insufficient central-government transfers, the scale of the change and the lack of local capacity doomed the Act and led to regional rule in 1980.[1] Nonetheless, the provinces continued to administer their own budgets leaving the central government (the Ministry of Finance) with the sole task of setting the allocation of subsidies to each province (Suliman, 2008). As a result, provinces built a bureaucracy that that increased overall spending and siphoned budgetary allocations (for wages and salaries) at the expense of developmental projects. With stagnant revenues, deficit finance filled the gap. This system remained in place with no meaningful changes until the Ingaz regime.

Citing the country's ethnic diversity and the aspirations of local populations to have a say in running their local affairs, the government adopted the 12th Constitutional decree to move towards a federal republic with federal, state, and local levels of government. (Mohamed, 2012; Yasin, 2008). The decree increased the number of states from 9 to 26 (16 in the North) with expenditure and revenues responsibilities assigned accordingly. Further, each state had three lower tiers of governance: provinces (*muhafaza*), local councils (*mahaliya*), and popular grassroots committees (*el ligan el shabia*). With this structure, the number of total jurisdictions increased dramatically with 98 provinces and 493 localities in addition to the 26 states (EG, 2017). Localities were considered the basic level of government in the state, expected to provide public goods and services, ensure the rights of citizens and oversee popular committees. To fund operations, localities could impose taxes on property, local transportation, local livestock production, and other local taxes or duties (Logan et al, 2021).

[1] Five new regional governments (Southern, Darfur, Kordofan, Central, Northern and Eastern) were created, which along with Khartoum meant a total of 6 operated from 1981 onwards.

To meet their responsibilities, state governments could collect revenue from several sources. These include central government transfers administered through the Northern States Subsidy Fund (NSSF), off-budget transfers – of 43% percent of VAT collections, – 10% of public enterprise profits, and own taxes, fees, and user charges. The quasi-independent sources of revenue did not translate to autonomy, however, as the central government exerted strong control over states.

Conflict continued to shape Sudan's political and economic standing until 2005, which marked the adoption of the Comprehensive Peace Agreement (CPA) and the Interim National Constitution (INC). These were meant to address regional disparities through more equitable wealth-sharing. Towards this end, the INC established a National Revenue Fund (NRF) to consolidate and fairly distribute transfers, with guidance from a newly established Fiscal and Financial Allocation and Monitoring Commission (FFAMC).[2] FFAMC was tasked with safeguarding fairness in the allocation of funds, with a "fair distribution," the formula might need a revision. Achieving equity in resource transfers to the local level through a formula that is transparent will facilitate the accountability and enhances mechanisms to allocate resources efficiently. state governments shall have exclusive authority to raise revenue through taxation as necessary to sustain their operation. In addition, states shall also have the power to receive and expend revenue to govern effectively and to meet their obligations. That should entail accountability.

Intergovernmental transfer formula

The capacity of Sudanese states to impose and collect taxes varies considerably. Poorer states –with a smaller per capita tax base – raise less revenue at any given tax rate than richer states (Bongo, 2019). In addition, the cost of public services varies due to a host of factors such geography and population density. Therefore, a standard level of services requires different transfer amounts. Regardless of their individual circumstances, most states in Sudan rely heavily on central government transfers that reflect revenue sharing (vertical transfers) and redistribution (horizontal transfers) to fulfil their mandates.

The NSSF (later renamed the National Revenue Fund) administered the transfer, under the mandate that transfers would be based on a specified formula and distributed equitably.

[2] Sudan's Constitution of 2005

De-Facto Fiscal Federalism in Sudan: Trends over Time and Across States

No fiscal federalism system matches its statutory design and Sudan is no different from other countries in that sense. What is striking in Sudan is the dominant presence of the central government, even with decentralization. Also, the variability of transfers (and limited capacity) means that subnational governments struggle (to different degrees) with service provision. In this section, we examine the fiscal federalism system implemented in Sudan, focusing on its impact across states and its evolution over time.

The discovery, export and loss of oil dominates the fiscal position in Sudan, for all levels of governments. Figure 4 presents central government revenue and expenditures from 1994[3] to 2019. Oil rents raised total central government revenue by 10 percentage points of GDP at their peak, but they were highly volatile because of market and political factors. For its part, the government did little to plan for the foreseeable secession of the South and the loss of more than half of its revenue. Overall, real central government expenditures increased by about 16 percent annually for 20 years starting in 1999 such that their share in GDP increased from 8 to 19 percent at their peak. Equally striking is the extent to which the volatility in revenues filtered to expenditures: except for the tail end of the regime, expenditures fell and rose along with revenues.

As it increased resources to states, the central government gave them more leeway to make decisions about the set of public goods and services they would provide. This delegation came by way of a shift from conditional to unconditional transfers. The share of transfers sent without conditions rose from 27 percent in 2000 to 63 percent in 2017. Data on expenditures are available only from 2012 to 2018, but at least over this period, they show states shifted spending from wages (-9 percentage points) to entirely capital goods.

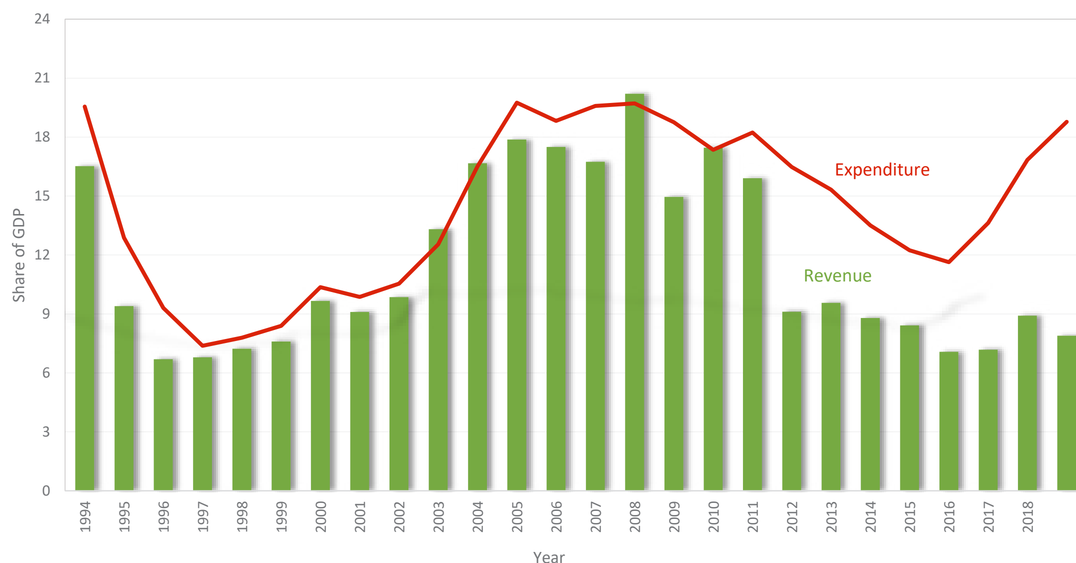
Transfers from the central government vary widely across states and shows little resemblance to what might be expected from the transfer formula. Figure 5 shows the distribution of real total transfers between 2012 and 2018.[4] Khartoum (13.1) and Al Jazeirah (11.9) received the largest share of money in that period. At the other extreme, Darfur (East, Central, West), Blue Nile and Red Sea receive the smallest share.

Compared to each state's share of population, residents of the five Darfur states are more consistently and severely shortchanged than any other. Collectively Darfur states account represent nearly 28 percent of the population but receive less than 18 percent of transfers. This stands in

[3] Between 1989 and 1994, the government implemented severe austerity program to stabilize inflation and reduce the deficit. We exclude that period to focus the discussion on intergovernmental fiscal relations.

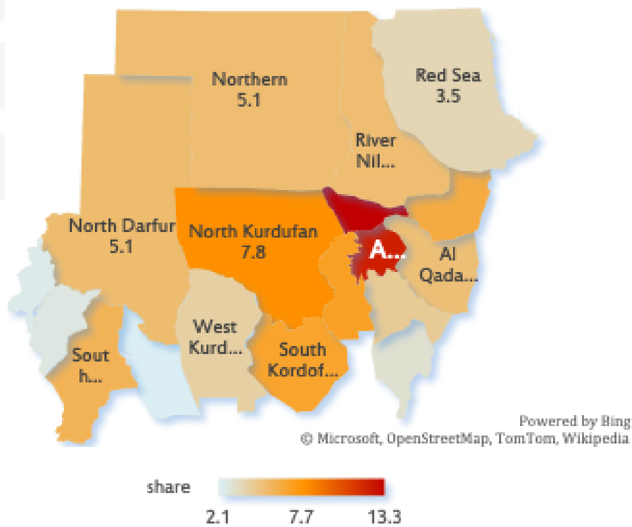
[4] Although the empirical analysis is based on per-capita transfers, we present total transfers to show the flow of resources from the central government.

Figure 4. Central Government Fiscal Balance, Share of GDP



Source: IMF, World Economic Outlook Database, October 2020

Figure 5. Distribution of Total Transfers, 2012-2018



sharp contrast to Northern, whose transfer share is more than double its population share. The pattern is more confounding when considering the relative development of states, since those receiving higher transfer shares are relatively well-off. One could argue a case of reverse causation, that states developed faster *because* they received more resources. But the pattern remains even at the beginning of the period. In 2012, Northern ranked second only to Khartoum on measures of standard of living (HDI, IWI) while the Darfur states were at the bottom. Even putting aside Darfur (because of the war), there is no state of the world in which one would argue for sending relatively more money to residents of Northern, Khartoum or Al Jazeira than of poorer states.

A clearer picture of how transfers were distributed emerges from per-capita transfers and transfers as a share of total state revenues (Figure 6).

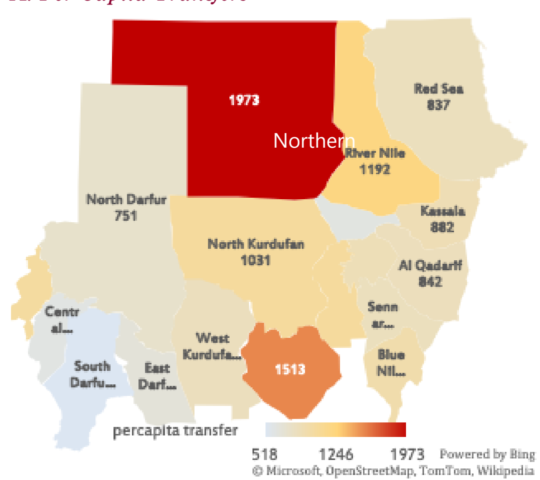
The pattern of per-capita transfers (Panel A) confirms the findings suggested by total transfers: transfers are distributed in a regressive manner. At the extremes, residents of the poorest states, Darfur, receive the least and residents of the richest state, Northern, receive the most. One exception is the degree to which Khartoum receives preferential treatment. Although Khartoum received the largest share of total transfers, it was in the middle of the pack in per-capita terms. This is in sharp contrast to its position in 2005 when it had the third highest per-capita transfer (out of 16 states). Khartoum is also the state who relies least on transfers from the central government, which represent about 20 percent of total revenues. To get a sense of how different Khartoum is from the rest of the country, its share of transfers is half that of the next state (Red Sea). At the other extreme are Darfur and Kordofan, which rely on the central government for at least two-thirds of total revenues. Therefore, states that receive the lowest per-capita transfers tend to rely more heavily on transfers.

It should be no surprise that the distribution of transfers translates to inequities in expenditures. Figure 7 (Panel A) presents state per-capita expenditures and shows how Northern' s position as the recipients of the largest per-capita transfer leads to the state having the highest per-capita expenditures. On the other hand, states in the Southwest and Southeast of the country have the lowest per-capita spending. Not only do these states have less fiscal capacity, but they also receive less per-capita from the central government.

Another dimension of state expenditures that is relevant is the share spent on goods and services. Panel B shows the share of expenditure varies between 10 and 28.7 percent. While worse off states tend to allocate a higher share to goods and services, they remain far behind because of the vast difference in available resources.

Figure 6. State Transfers 2012-2018

A: Per-Capita Transfers



B: Transfer Share in State Revenue

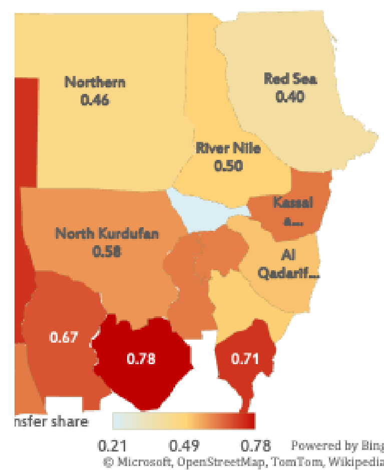
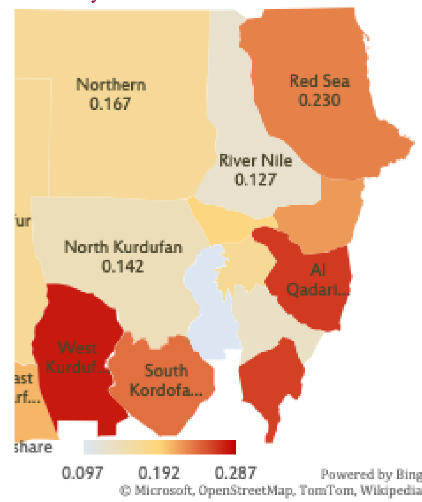


Figure 7. State Expenditures, 2012-2018

A: Per Capita Spending

B: Share of Goods & Services



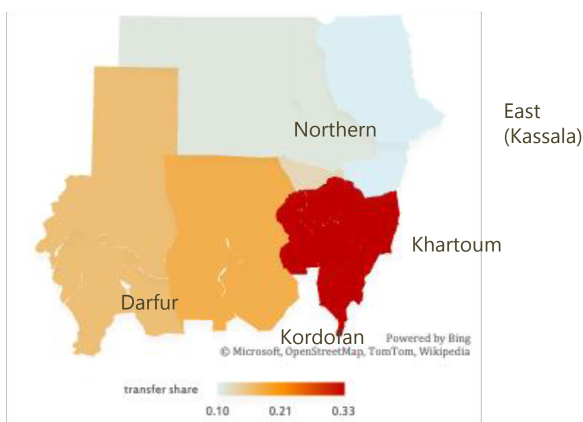
The cycle of autocracy and short-lived democracy in Sudan and the resulting haphazard changes in the design of the fiscal federalism warrant reconsideration of the original six regions of Sudan – Khartoum, Northern, East (Kassala), Central (Blue Nile), Darfur, and Kordofan.[5]

The byproducts of breaking up these regional governments were multiple bureaucratic layers and fiscally weaker administrative units. Therefore, the advantage of reverting back centers on the more robust fiscal capacity and leaner bureaucracy of the consolidated regions-cum-localities, compared to the state-cum-localities. However, there are risks. At issue is whether improved local fiscal capacity and bureaucratic efficiencies would increase the government's ability to enhance horizontal equity and correct the past historical injustices across the states. It seems plausible that six regions – mega states – would reduce the ability of actors to engage in ethnic mobilization if, collectively, they mitigate against a single dominant group holding power. In this case, one could make a compelling argument for Sudan to revert to the original regional governments. Simply changing the boundaries results in a slightly more equitable distribution of transfers but does not address the overall regressivity of the system. Figure 8 shows the highest share of total transfers shifts from Khartoum to Central (Panel A). On the other hand, Northern remains the state with highest per-capita transfer and GDP (Panel B). Any change, therefore, would require a re-thinking of the fiscal federalism system as well.

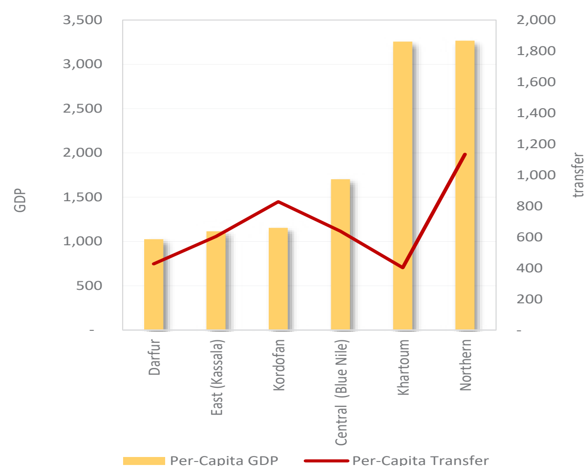
[5] We thank Ibrahim Elbadawi for raising the question.

Figure 8. Original Administrative Units

A: Share of Total Transfers



B: Per-Capita GDP and Transfers



Conclusion

After three revolutions and wars that extended for more than 60 years and cost treasure and lives, building the State in Sudan faces monumental challenges. At the root of conflict in Sudan is the vast regional gulf in resources. In that vein, policymakers would do well to set wealth-sharing priorities and design a fiscal transfer scheme consistent with that goal. Such a scheme would also need to address the poor targeting to states' level of need in the current system. Better alignment of the transfers formula with HDI indicators would most certainly improve social welfare.

More broadly, the government faces a consistent demand of the people across states and regions for better delivery of the most basic public services – clean water, electricity, and education. Meeting these priorities requires investment particularly in developing a system of fiscal federalism that will enable localities and states to raise their resources for local development. The current system with 18 states and more than 500 localities has birthed an unwieldly bureaucracy (with no improvement in service delivery or citizen engagement). We argue a strong case can be made for reverting to the original six regional governments – Darfur, Kordofan, Eastern Sudan, Khartoum, Blue Nile and northern Sudan – to shrink the bureaucracy and shift resources to more productive uses.

Reducing the number of states would arguably improve condition and facilitate more ethnic cohesion. We note the experience of the Darfur and Kordofan regions during the Numeri regime as an example. The caveat is that reviving the original six states in Sudan without addressing the regressivity of fiscal transfers would achieve little. Failing to offset the substantial inequities across states would undermine any gains in social cohesion. Moreover, raising the relative standard of living in lagging states requires more investment than any formula-based set of transfers.

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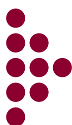

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