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# SUDAN

## State-level Public Expenditure Review

Meeting the Challenges of Poverty Reduction and Basic Service Delivery

*Volume 2 – Background Papers*

May 2014

Poverty Reduction and Economic Management Unit  
Africa Region



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## **CURRENCY EQUIVALENTS**

Currency Unit = Sudanese Pound (SDG)

US\$1 = SDG5.7

## **FISCAL YEAR**

January 1—December 31

## **WEIGHTS AND MEASURES**

Metric System

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## ABBREVIATIONS AND ACRONYMS

BHU	Basic Health Units	NBHS	National Baseline Household Survey
CBOs	Community Based Organizations	NGOs	None Governmental Organizations
CBoS	Central Bank of Sudan	NHIF	National Health Insurance Fund
CCT	Conditional Cash Transfer	NRF	National Revenues Fund
CEM	Country Economic Memorandum	NSWF	National Students Welfare Fund
CHW	Community Health Worker	OECD	The Organization for Economic Co-operation and Development
CIFA	Country Integrated Fiduciary Assessment	PER	Public Expenditure Review
CPA	Comprehensive Peace Agreement	PETS	Public Expenditure Tracking Survey
CPI	Consumer Price Index	PHC	Public Health Center
DHS	Demographic and Health Survey	PRSP	Poverty Reduction Strategy Paper
FFAMC	Fiscal and Financial Allocation and Monitoring Commission	SBDs	Standard Bidding Documents
FMoH	Federal Ministry of Health	SBP	Single Business Permit
GDP	Gross Domestic Product	SCoT	Sudan Chamber of Tax
GCT	Government Cash Transfer	SHHS	Sudan Household Health Survey
GFS	Government Financial Statistics	SMDF	Sudan Microfinance Development Facility
GNI	Gross National Income	SMoF	State Ministry of Finance
HI	Health Insurance	SSP	Social Support Program
HTRS	Hard to Reach and Stay areas	STRs	Student- Teacher Ratios
IMF	International Monetary Fund	TOT	Training of Trainers
ICT	Information and Communications Technology	VAT	Value Added Tax
INC	Interim National Constitution	UN	United Nations
MDTF	Multi-Donor Trust Fund	UNICEF	United Nations Children's Fund
MFIs	Microfinance Institutions	URT	United Republic of Tanzania
MFPs	Microfinance Providers	USAID	United States Agency for International Development
MFU	Microfinance Unit	WDI	World Development Indicators
MMR	Maternal Mortality Ratio		
MoFNE	Ministry of Finance & National Economy		

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## CHAPTER 1. OVERVIEW OF MACROECONOMIC AND FISCAL TRENDS

### A. MACROECONOMIC CONTEXT

1. **Sudan has the potential to become a dynamic economy and a bread basket for the Arab world and East-Central Africa.** The country is endowed with large oil and mineral endowments as well as tremendous under-utilized natural assets in agriculture (e.g. fertile land, labor force, water resources and irrigation infrastructure) that potentially provide a good basis for sustainable inclusive growth. Sudan is also located at the cross roads of the Arab world and East-Central Africa, and provides transit to the Red Sea maritime route. Strong markets for Sudan's products are in close proximity (e.g. livestock export from Sudan to the Middle-Eastern neighbors). In addition, Sudan has potential in terms of mineral wealth (e.g. oil, gold, etc.) for which there is high global demand.
2. **However, resource endowment is not sufficient to bring about sustainable growth and prosperity.** Sudan faces several development challenges, including regional conflict and issues relating to peace, poverty and unemployment, as well as severe disparities across the country in income and access to socio-economic opportunities. Success requires addressing technical issues and good management of resource endowment, both to encourage economic diversification and growth and to invest in the people as "owners of the resources".
3. **Sudan's macroeconomic conditions remain weak since the secession of South Sudan in 2011, despite some improvements.** Sudan has succeeded in sustained macroeconomic stability during the period from 1996 to 2010, and has performed satisfactorily under a subsequent IMF Staff Monitored Program. Prudent policies were implemented in line with advice provided in the context of several IMF staff-monitored programs. However, the South Sudan secession reversed this trend starting in 2011. As a result of this permanent shock, Sudan lost almost 75 percent of its oil production, nearly 55 percent of its fiscal revenues, and about two-thirds of its foreign exchange earnings. With very limited access to external financing assistance, this considerable shock and delayed policy responses created sizable macroeconomic imbalances in the post- secession period.
4. **The repercussions of the secession of South Sudan present enormous challenges for Sudan with respect to managing the macro-fiscal adjustment and promoting a structural re-orientation of the economy.** The main economic challenge facing the authorities is to devise and implement a consistent mix of macro-economic policies that can help Sudan weather the adjustment, while protecting the poor and laying the foundation for sustained inclusive private sector-led growth, particularly in agriculture.
5. **The authorities responded with a series of economic measures in June 2012 with a comprehensive package of corrective measures, followed by a second package of measures in September 2013.** These measures include

reduced subsidies on petroleum products, unification exchange rate and safety net measures. While these packages of corrective measures yielded some positive returns, it was not incisive enough to adequately tackle Sudan's deep-seated macroeconomic imbalances or build the basis for a rebound in economic growth.

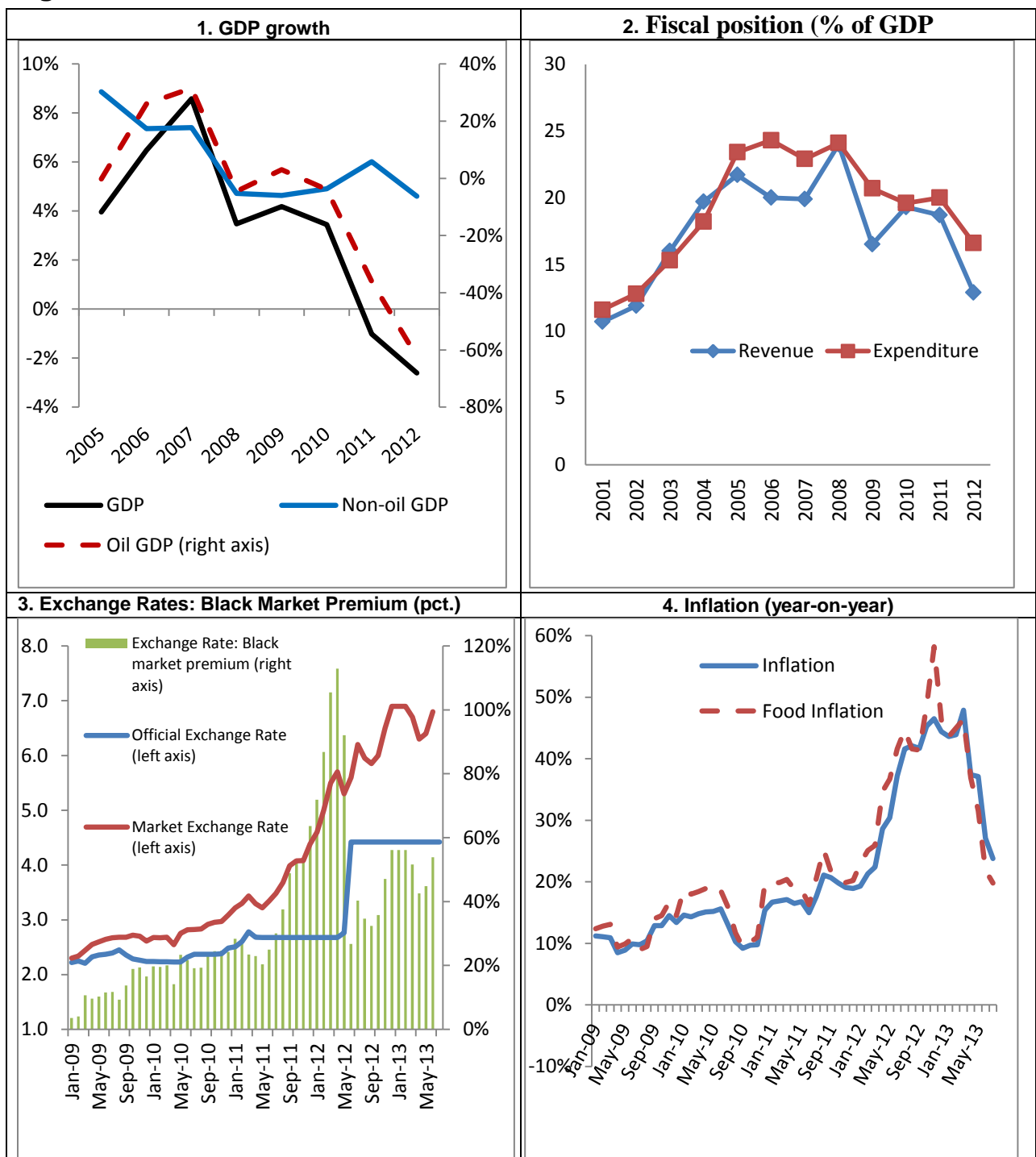
#### *Real GDP growth*

6. **Actual real GDP growth during the post-secession slowed to -2.6 percent, well down from double-digit before the secession;** reflecting the backdrop of both oil and non-oil sectors. Oil GDP growth shrunk by 62.4 percent due to heightened tensions and following suspension of oil production in South Sudan (Figure 1.1). Real GDP growth in 2013 was slightly positive after two year of in the negative. Thanks to the expected recovery in oil sector. Non-oil GDP growth decelerated from 6.0 percent in 2011 to 4.6 percent in 2012, reflecting a broad-based slowdown in economic activity on account of a slowdown in industrial and service activities and the shortage of foreign exchange.

7. **The signing in March 2013 of the implementation matrix of the agreement between Sudan and South Sudan provides some fresh financial relief to Sudan and creates a great opportunity for further policy reforms to address the post-secession challenges.** Sudan received US\$318.4 million in oil transit fees by November 2013 (72 percent of 2013 total oil transit fees projections), of which US\$109 million for oil companies share and US\$209.4 million as government share. The resumption of oil export will result in over \$1.5 billion a year in new revenue to Sudan from transit and other fees over the next three years and around \$0.5 billion thereafter. However, as a certain amount of time will be required to reach full projected oil flows and exports, the immediate financing to be expected is limited. Given that neither pipeline fees nor TFA were included in the 2013 budget, the oil fund flows expected to contribute to a short-term relief of the immediate fiscal pressures presented in the budget. If there were to be a focus on development expenditures, which were hard hit by the fiscal adjustment over the past year, the inflows of funding related to the re-established oil flow could allow the authorities to increase budgeted development expenditures.

8. **Looking forward, Sudan's growth strategy should involve policies aimed at improving the investment climate and broadening private sector-led growth,** and diversifying the economy toward non-oil sectors such as agriculture, industry, export, and local trade. Agriculture growth has markedly declined to 2.3 percent in 2012, compared to 4.2 percent in 2011; reflecting a decline in crop production growth from 6.2 percent to 1.8 percent. Services sector growth also showed slower growth rate of 3.2 percent in 2012 compared to 4.8 percent in 2011. Notable exception among the decelerated non-oil economy is gold mining. Gold, which now accounts for 4.2 percent of non-oil GDP, significantly expanded by 64.7 percent in 2012, compared to 10.4 percent in 2011. Although gold production is far below loss from oil production, gold mining industry is one of the few promising sectors in Sudan capable of earning foreign exchange.

**Figure 1. Sudan's selected Macroeconomic Indicators**



Source: IMF reports and CBoS annual reports

### *Exchange rate developments*

9. Shortage of foreign exchange from weak foreign oil exports, foreign direct investment and remittances have contributed to a rapid depreciation of

**the real exchange rate and imposed significant challenges on economic stability and financial balances.** The black parallel market rate hit over SDG 7.9 per USD in late 2013 up from around SDG 6.5 per USD in late 2012; reflecting weak foreign reserves following recent decline in foreign direct investment, and slowdown in remittances (Figure 1.3). The Central Bank of Sudan has adopted a number of intervention policies to reduce pressure in the foreign exchange market and close the gap between the official and parallel market rates. The official exchange rate was devaluated from SDG 2.6702 per USD to SDG 4.42 per USD on June 2012 and to SDG 5.7 per USD on September 2013. A significant premium still remains in the parallel markets widening the gap between the official and black-market rates.

10. **These exchange rate measures have provided a temporary “breathing space”, but have not addressed the source of the foreign exchange shortfall, which is likely to be structural in nature** (World Bank, Sudan CEM, 2009). Sudan needs to use a combination of structural, exchange rate and monetary policies to address its external imbalance problem. The country will have to diversify its economic base, expand its agriculture and domestic manufacturing sectors, and reduce its reliance on imports. This underscores the need to demonstrate exchange rate flexibility to commercial banks in foreign exchange transactions, and to move the official exchange rate closer to the market rate to rebuild foreign exchange reserves. Allowing the devaluation of the local currency could also provide relief to mounting pressures on dwindling international reserves. On the other hand, devaluation would put additional pressure on domestic prices through higher import bills, especially for food items.

#### *Inflation rate developments*

11. **Inflation rate remained at double-digits since the second-half of 2012 (three times the pre-secession rate of inflation)** (Figure 1.4), largely attributed to a surge in food prices and exchange rate pass-through effects. The poorest parts of the population are hit hardest by high inflation rates. In fact, in Sudan the poor face higher effective inflation rates than the richer population, a fact that can be observed in many countries; this is since the poor spend the majority of their income on food. Thus, in a situation where food prices drive up overall inflation, the poorer population is relatively more affected. This urges for greater attention to poverty reduction through better protection to the poor and vulnerable and providing effective mechanism to mitigate some of the adverse impacts of the subsidy reform measures.

12. **Inflation is largely driven by a vicious circle of weakening local currency in the parallel market**, fed by the monetization of the budget deficit, and aggravated by supply bottlenecks due to structural constraints on the private sector. The expansionary stance of fiscal and monetary and credit policies pursued in recent years was associated with a sharp increase in aggregate money growth. The expansion of money supply was increased from 17 percent in 2011 to 38 percent in

2012. This was largely attributed to a notable overall fiscal deficit, reaching about 3.6 percent of GDP, and was partly financed by the government borrowing from the Central Bank (1.5 percent of GDP).

13. **The exchange rate pass-through effects following the secession had a significant effect on imported consumer goods**, and also moderately affected the cost of locally produced goods, through higher costs of imported production factor inputs. The leading role of the exchange rate implies that the dynamics of Sudan's inflation are extremely sensitive to external shocks, underscoring the openness of Sudan's economy, which can lead eventually to enhancing competitiveness and improving the external current account (IMF, 2012).

14. **The signing in March 2013 of the implementation matrix of the agreement between Sudan and South Sudan provides some fresh financial relief to Sudan and creates a great opportunity for further policy reforms to address the post-secession challenges.** Sudan received US\$318.4 million in oil transit fees by November 2013 (72 percent of 2013 total oil transit fees projections), of which US\$109 million for oil companies share and US\$209.4 million as government share. The resumption of oil export will result in over \$1.5 billion a year in new revenue to Sudan from transit and other fees over the next three years and around \$0.5 billion thereafter. However, as a certain amount of time will be required to reach full projected oil flows and exports, the immediate financing to be expected is limited. Given that neither pipeline fees nor TFA were included in the 2013 budget, the oil fund flows expected to contribute to a short-term relief of the immediate fiscal pressures presented in the budget. If there were to be a focus on development expenditures, which were hard hit by the fiscal adjustment over the past year, the inflows of funding related to the re-established oil flow could allow the authorities to increase budgeted development expenditures.

#### *Sudan's external debt*

15. **Sudan's unresolved debt arrears have limited Sudan's access to concessional financing.** Sudan's external PPG debt as at end 2012 was US\$41.6 billion in nominal terms, which accounted for 69 percent of GDP and 744 percent of exports. Most of Sudan's debt – 87.5 percent – was in arrears without significant change in its structure since 2000.<sup>1</sup> 73.5 percent of outstanding debt was contracted with bilateral creditors. The distribution between Paris and non-Paris Club official bilateral creditors was 37.1 and 36.4 percent respectively. The largest bilateral creditor was Kuwait, holding 17.1 percent of outstanding PPG external debt, followed by France and Saudi Arabia with 8.5 and 7.9 percent of total external debt outstanding. Other significant bilateral creditors were the US and Austria, each accounting close to 6 percent of outstanding debt. Multilateral creditors accounted for 13 percent of total external PPG debt of which the IMF and IDA held more than

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<sup>1</sup> See latest DSA (SM/12/239, Supplement 2)

half of total multilateral debt. The remaining 13.5 percent of total external PPG debt were contracted with commercial creditors.

## **B. RESOURCE MOBILIZATION AND PUBLIC EXPENDITURE MANAGEMENT**

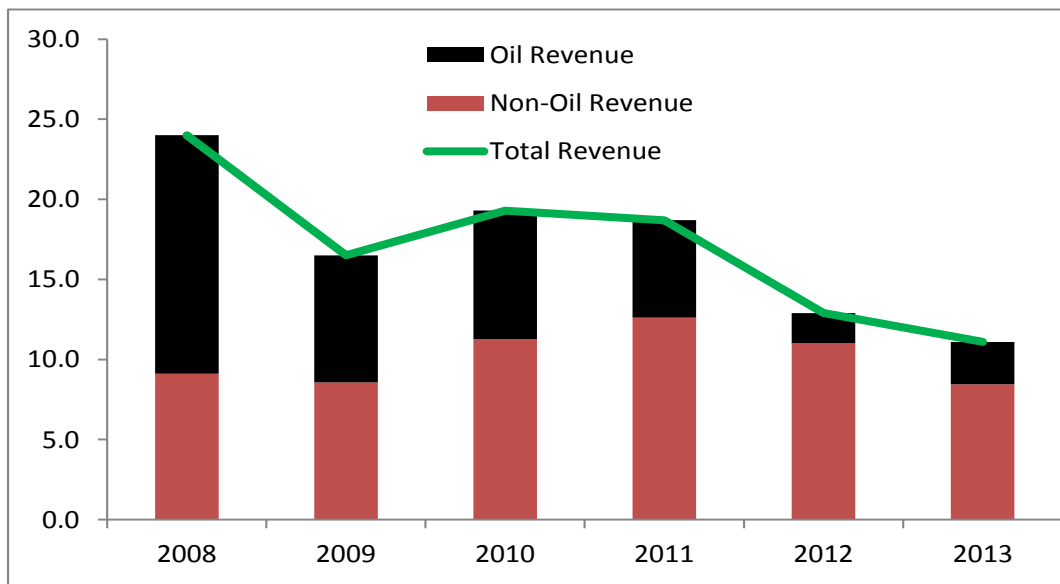
**16. Sudan's fiscal position markedly deteriorated since 2009, reflecting both revenue shortfalls and expanding expenditures.** The fiscal balance has remained slightly above 3 percent of GDP since the secession of South Sudan relative to a surplus of 1¾ percent of GDP in 2002–04. (Figure 1.2). The bulk of the deficit was financed by domestic borrowing especially monetized financing from the Central Bank and non-bank sector borrowing (e.g. Government Musharka Certificates or GMCs, and Government Investment Certificates or GICs and Sukuk), largely due to limited access to external financing. The increased fiscal reliance on monetized financing imposes considerable challenges on domestic price stability, the amount of credit available to the private sector, and the cost of financing over the short and medium-term.

### *Resource mobilization*

**17. Sudan's revenue mobilization generally remains weak, largely on account of oil revenue lost and the narrow tax base as well as sizeable tax exemptions and incentives for businesses** (Figure 2). Oil revenues account - for the first time since 2000 - for 14.6 percent of total revenue compared to 53 percent in 2008. Consumption-based taxes (e.g., a VAT) and taxes on trade are a major source of revenue with too many rates, while the income tax base is narrow. Domestic tax revenue mobilization has improved to 7.4 percent of GDP in 2013 compared 7.1 percent in 2012. The tax system currently accounts for 64 percent of total revenues in 2013 compared to 71 percent in 2012 and 45 percent in 2011. Sudan's tax system remains mainly rely on indirect tax (60 percent of total revenues); significant revenues are raised through a VAT (41 percent of total revenues). Indirect taxes account for 92 percent of tax revenue collected in 2013 compared to 91 percent of tax revenue in 2012 and 89 percent in 2011, specifically through customs, excises, and VAT. Income tax only accounts for 9 percent of tax revenue in 2013.

**18. Sudan effort to enhance non-oil revenue mobilization –in particular tax collections - nonetheless remains very low compared with neighboring countries reflecting in part exemptions and extensive tax incentives.** Sudan only collected 7.4 percent in 2013 compared to 7.1 percent in 2012, while the average tax revenue of regional peers is around 17 percent of GDP. Such a low revenue mobilization limits the fiscal space for ramping up physical and social infrastructure development that in turn is crucial to sustain economic growth and promote social fairness; given Sudan's limited access to external financing and the need to contain budget deficit monetary financing (IMF Sudan' SMP, 2013).

**Figure 2. Sudan's Revenue Performance 2008-2013 (as % of GDP)**



Source: MoFNE

19. **The rapid drop in oil revenue underscores the need for a concerted effort to expand the tax base on a more sustainable basis through tax policy and administration measures.** The authorities announced several tax measures in late June 2012 to enhance non-oil revenues including:

- increasing the VAT from 15 to 17 percent;
- increasing the development tax from 10 to 13 percent;
- increasing the business profit tax on the banking sector from 15 to 30 percent;
- increasing stamp duties on financial transactions and international flights;
- repealing the negative list used to limit imports and impose instead import tariffs; and
- enhancing revenue collection and lifting discretionary tax exemptions (for more details also see IMF, 2012).

20. **Key policy measures remain missing to broaden the tax base and enhance the system's efficiency.** Possible measures could include:

- reforming the personal income tax including removing exemptions to persons above the age of 50;
- tightening of VAT exemptions granted to imports of certain final goods and imports by certain entities;
- extending the VAT to domestic services (e.g. electricity and water usage, in-city transportation, commercial rentals, etc.); and
- raising excise duties on luxury items (e.g. cars, high-end consumer goods, etc.).



21. **Sudan expenditure trends prior-secession period strongly influenced by external factors**, especially the oil revenue windfalls, reflecting high oil prices in the global markets. Total government expenditures rose to 23.0 percent of GDP in 2007-2008 from 18.2 percent in 2004. This expansion was largely driven by increased obligations to sub-national levels of government. However, Sudan's government expenditure has declined sharply over post-secession period. Total government expenditure declined to 13.6 percent of GDP in 2012 from over 20 percent of GDP during 2005-2010. This contraction was largely driven by cut in federal transfers to states (from 7.7 percent of the GDP in 2010 to 2.6 percent in 2012) and the development spending (from 2.6 percent of the GDP in 2010 to 1.5 percent in 2012).

22. **Consistent with decentralization vision, the composition of federal expenditures continues to reflect increased share in fiscal decentralization transfers to the states**, reducing the federal government share of total expenditure (Figure 3). The federal spending share dropped from 94 percent of total spending in 2001 to around 75 percent since 2005. Transfers to states increased sharply from 6 percent of total spending in 2001 to over 20 percent since 2006. This is consistent with the INC devolving responsibility for basic service delivery to sub-national governments; though partially is due to reclassification of responsibilities. Transfers to states are discretionary, and the large increase in these flows reflects Sudan's commitment to the fiscal decentralization agenda. Nonetheless, equity and transparency of distribution across the states, as well as financial accountability on the use of the resources continue to be major concerns.

23. **These overall resources allocation shifts are of interest as an instrument to address regional disparities and support decentralized delivery of basic services**, given that most states are heavily dependent on federal transfers to finance more than one-half of budgetary assignments in wages and salaries. This in turn stymies pro-poor spending, as enacted in the INC, shifts expenditure responsibilities for most of the public sector activities that directly benefit the poor – primary health, basic education, and water – to the state and local levels. However, these overall resources allocation shifts also underscores the critical importance of addressing deficiencies in effective expenditure management at lower levels of government. With increased resource flows to sub-national levels increased concern for effective decentralization and resource use at the sub-national level that is subject to improvements in public financial management.

24. **Sudan budget credibility as well as execution volatility from approved budget remained relatively low and a challenge**<sup>2</sup>. Total actual expenditures in

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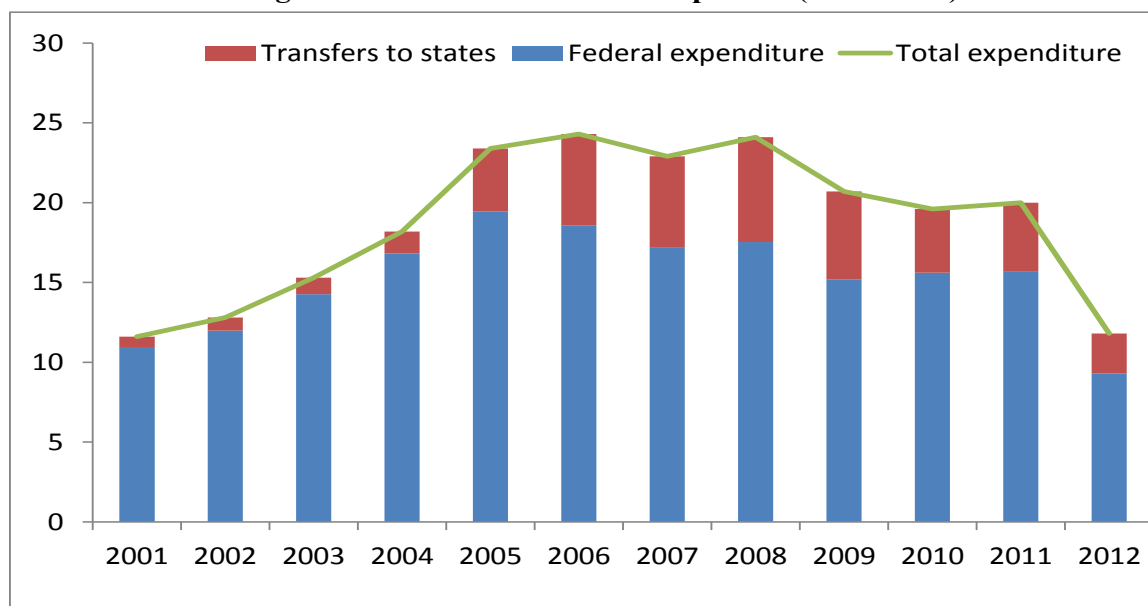
<sup>2</sup> Budget credibility is defined by the degree to which actual expenditures deviate from budgeted levels.

2013 experienced a low 91 percent execution rate due to oil revenue shortfalls, albeit it has improved slightly with a performance rate of 89 percent in 2010.

25. **Federal expenditures continue to reflect the strict priority for release of funds to these spending categories.** Federal expenditures persistently enjoyed over 90 percent of budgeted levels since 2005. The strong budget credibility on the federal government expenditures is largely due to the observed disproportionate redistribution in the budget priorities across the budget's three main parts, which favors the federal government level and reflects the significant under-performance especially for national development and development transfers. These overall federal resource periodization have significant implications for federal expenditures as an instrument to support diversified pro-poor economic growth, given tremendous infrastructure needs (e.g. irrigation, roads, railways, airports, power, agriculture and livestock services, etc.) especially in production and rural areas.

26. **Weak budget credibility continues as a serious challenge for national development and federal development transfers to states;** albeit slightly improved in 2008. This context implies a lower likelihood to protect development-items spending during resource envelope shortfalls, with development transfers the hardest hit area with 52 percent execution in 2012. This reflects a continuation of a major issue presented in the PER that budget credibility remains a major obstacle to effective fiscal decentralization. Weak budget credibility has a devastating effect for state budgets which rely on central transfers for a significant share of revenues. Without a predictable flow of resources to the states, execution of spending plans is hampered, and of particular concern, are the effects on financing of capital transfers.

**Figure 3: Sudan's expenditure trend has deteriorated, though trend in intergovernmental transfers has improved (% of GDP)**

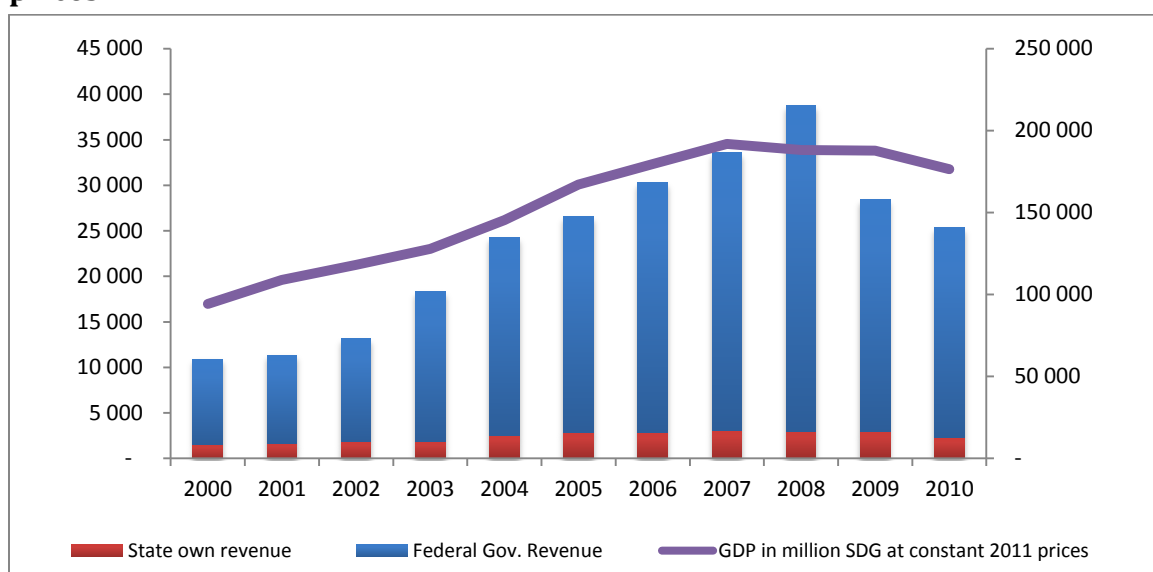


Source: MoFNE

### C. RECENT DEVELOPMENTS IN STATE LEVEL REVENUES

27. **The decline in oil revenues following the global financial crisis and the secession of South Sudan has had significant impact on the available resources to finance state level budgets** (Figure 1.4). This is evident from the significant decline in total federal level revenue since 2009, following years of annual increases, with increased GDP. It has resulted in declining federal transfers to states, which have not been fully offset by state own revenue mobilization, leading to a decline in the resources available to finance state level budgets. This trickle-down effect has also impacted locality level budgets.

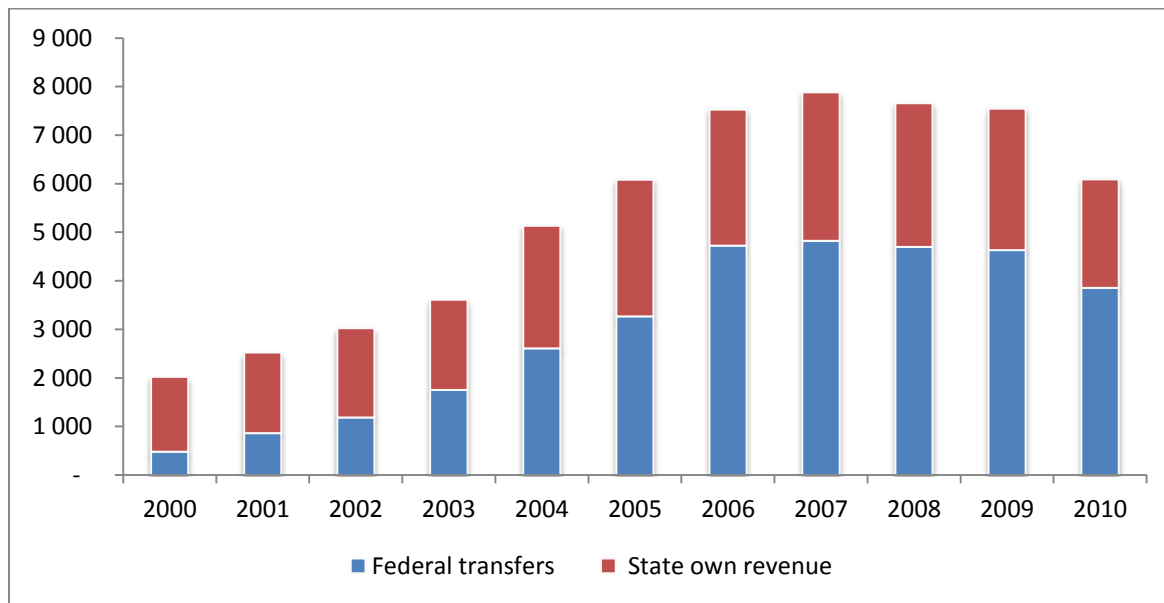
**Figure 1.4: Real GDP, Federal and State level revenue in SDG million at 2011 prices**



Source: State final accounts, MoFNE

28. **With a population growth rate of 3.4 percent there has been a declining trend in the overall resources available to meet the demand for public service delivery in recent years.** This is evident from analysis of aggregate data on state level expenditures, as well as for the four states sampled for more detailed analysis. For example, state level own revenues declined from 14 percent of federal and state level total revenues, to less than 9 percent in 2010, increasing dependency on federal transfers to finance state level public expenditures. A major share of tax and non-tax revenues has, throughout, been managed at federal level, while state own revenues have constituted less than 2 percent of GDP. Simultaneously, with a decline in real value of federal transfers, state own revenue has also declined, which in total has resulted in fewer resources available to finance state level public service delivery and investments (Figure 1.5).

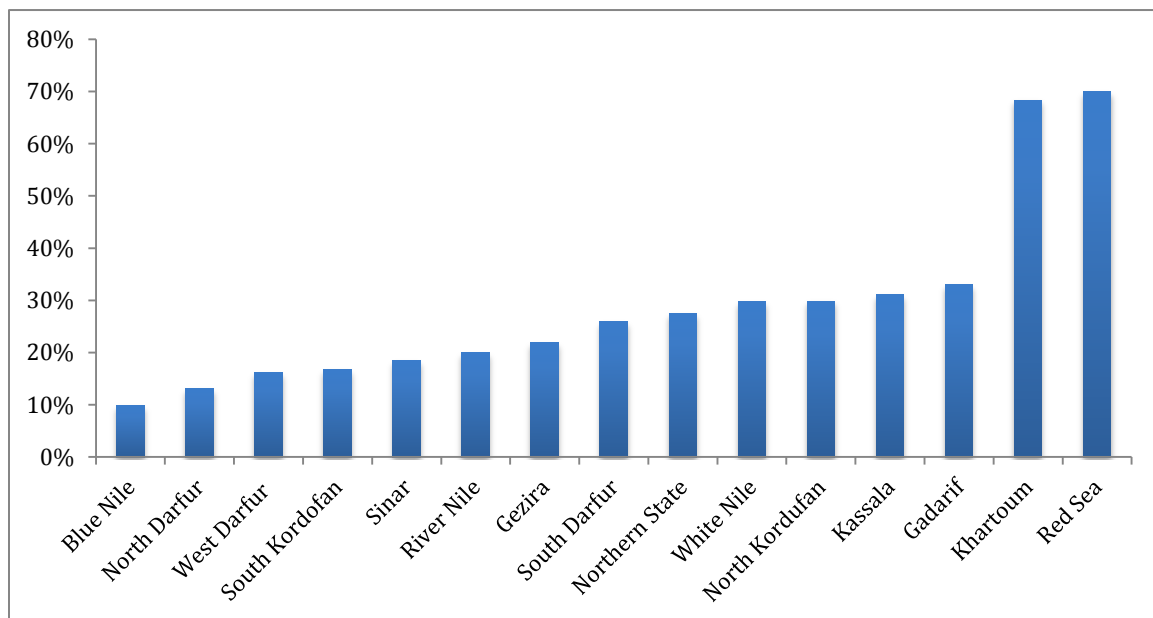
**Figure 1.5: State level revenue in SDG million at 2011 prices**



Source: State final accounts, MoFNE

29. **There are differences between states in levels of own revenue mobilization, as well as the allocation of federal transfers.** While states like Khartoum, Red Sea and Kassala mobilize significant own revenue to finance state level public expenditures, states like North and West Darfur, as well as South Kordofan and Blue Nile, have relied to a large extent on federal transfers (Figure 1.6). These variations in revenue mobilization and overall resource envelope to finance state budgets are partly due to differences in state level tax policies and administration and their differences in tax basis, as well as to differences and annual variations in federal fiscal transfers between the states. The observations illustrate how differences in revenue management and mobilization, combined with the significant disparities between states and years in allocation of federal transfers, impact on the actual resource envelope available for state level service delivery.

**Figure 1.6: Share of State own revenue to total revenue, average for 2005 - 2010**

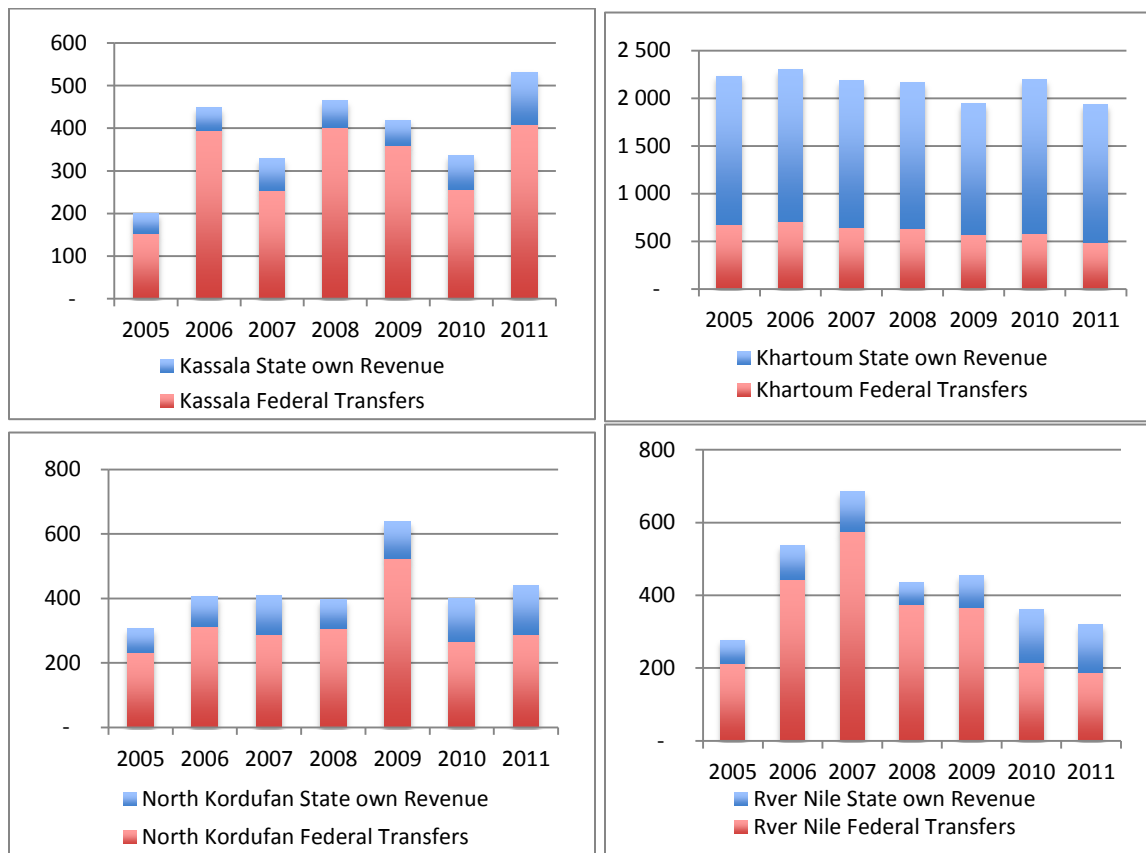


Source: State final accounts, MoFNE

**30. The unpredictability of federal transfers impacts on state level ability to plan investments and finance state level service delivery.** Federal transfers to the states do not appear to follow a consistent pattern, as evidenced by the significant variation over time in transfers to some of the states (Figure 1.7). The above observation is confirmed by analyzing state level own revenue and transfers of the four states of Kassala, North Kordofan, River Nile and Khartoum. Federal transfers to each of the four states display significant annual variations. The amount transferred appears not to be linked to state own revenue mobilization, as illustrated by the variation between tax and non-tax collection and federal transfers.

**31. The trend in state own revenue mobilization also varies between states.** Kassala state has, for some years, mobilized significant additional own revenue, with an annual real growth of tax revenue of more than 10 percent per year. However, this has for some years been more than offset by declining collections of fees and other charges, in particular by localities. For the state of Khartoum, total tax revenue in 2011 was 66 percent of its 2005 level, while non-tax revenues remained at the same level. Both have declined over recent years. For North Kordofan, tax and non-tax revenues have increased by 8 percent and 29 percent respectively over the 2005-2011 period. This is, however, less than the growth in population, with a resulting decline in own revenue per capita. Federal transfers to River Nile have varied significantly over the years, which has impacted on the volatility of funding for public service delivery, sometimes by federal transfers offsetting own revenue shortfalls.

**Figure 1.7: State own revenue and federal transfers SDG at 2011 prices**



Source: State final accounts, MoFNE

32. **Non-tax revenues in the form of fees and user charges are the main source of state own revenue.** The main source of this non-tax revenue stems from user charges on public service delivery including charges for education, health and other public services (see chapter 3). The high dependency of the states on non-tax revenues is attributable to several factors:

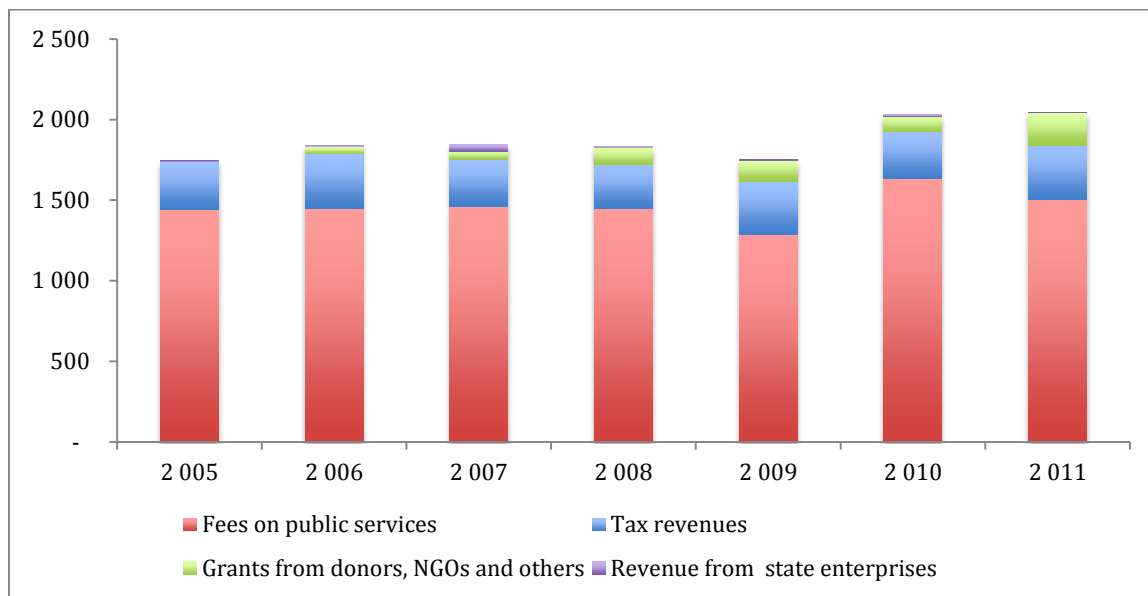
- Low tax revenue base, which is strongly influenced by the state's economic structure due to limited private sector development and the significance of informal trade activity. Lack of basic infrastructure (roads, bridges, railways, and electricity and power), and weak financial sector at state-level discourages private sector activity and thus income generation.
- Insecurity. In some states, the conflict has seriously affected the main productive and trade sectors, e.g. private investment, agriculture and livestock. Consequently, these states have lost substantial potential revenue bases as insecurity and conflict damaged agriculture and depleted livestock and deteriorated basic infrastructure for private sector development.
- Weak service delivery performance. This makes taxpayers unwilling to fulfill their tax obligations. For example, lack of veterinary services and other

evidence of benefits of public services discourage fulfillment of tax obligations.

- Poor databases on which to impose taxes equitably and manage collections.

33. Figure 1.8 displays the trend in tax and non-tax revenues in the four states in our sample. Fees on public services are predominantly departmental charges from, among others, health facilities, collected at state or locality levels. Fees on public services have constituted about 74-81 percent of total state own revenue during the years 2005 – 2011. Tax revenue has been the main other source of revenue, with a share between 14-19 percent during the same period. Revenue from state enterprises has, throughout, constituted a small and gradual declining share, from approximately 2 percent declining to less than 1 percent in 2011. The pattern is almost the same for all states in which user charges and fees on service delivery constitute the main source of own revenue, rather than tax revenue on income and assets. However, some states have for some years received additional donor/NGO grants as direct financial support for state level projects.

**Figure 1.8: State own revenue in million SDG at 2011 prices for Khartoum, Kassala, North Kordufan and River Nile**

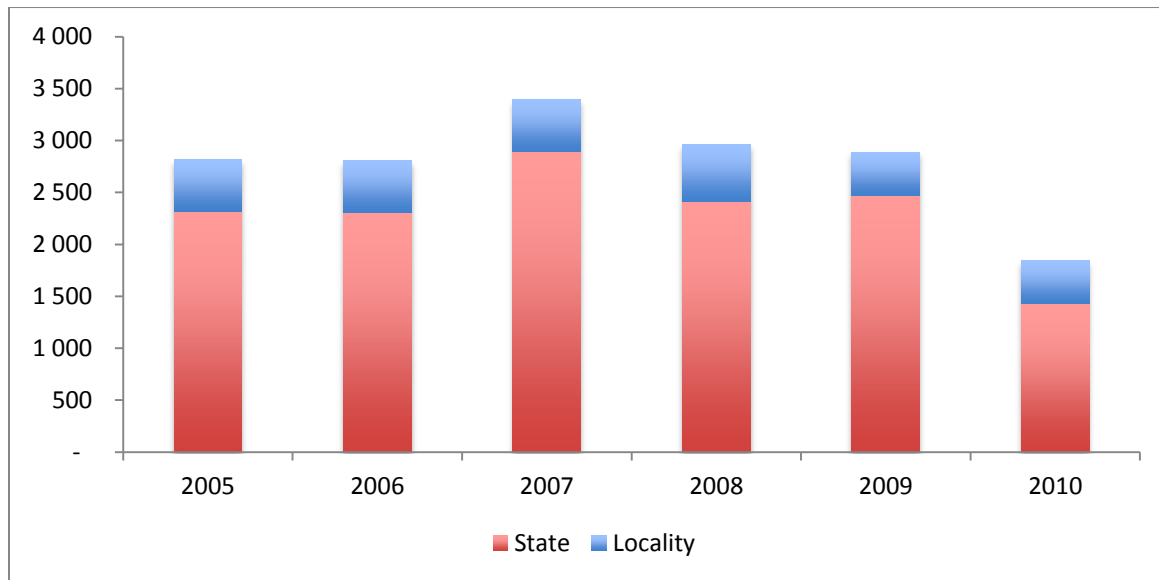


Source: State final accounts, MoFNE

34. **State revenues from locality level has constituted on average less than one-fifth of state own total revenues.** Locality revenue has decreased in value (measured at fixed 2011 prices), but increased to 18 -22 percent of total state revenues over the last few years. The higher share of locality revenue, as compared to total revenue collected in the states, is not a result of improved revenue performance, but rather declining overall revenue collection at state level. Locality level revenues constitute only 1.4 percent of total federal, state and locality level revenues i.e. Sudan continues to maintain a highly centralized system of revenue assignments. Taken together with the decline in oil revenues, it suggest an agenda

in the short to medium term of expanded state and locality level revenue assignments, as well as broadening of the tax base at these levels, to offset the reduction in federal transfers.

**Figure 1.9: State and locality level revenue in million SDG at 2011 prices**



Source: State final accounts, MoFNE

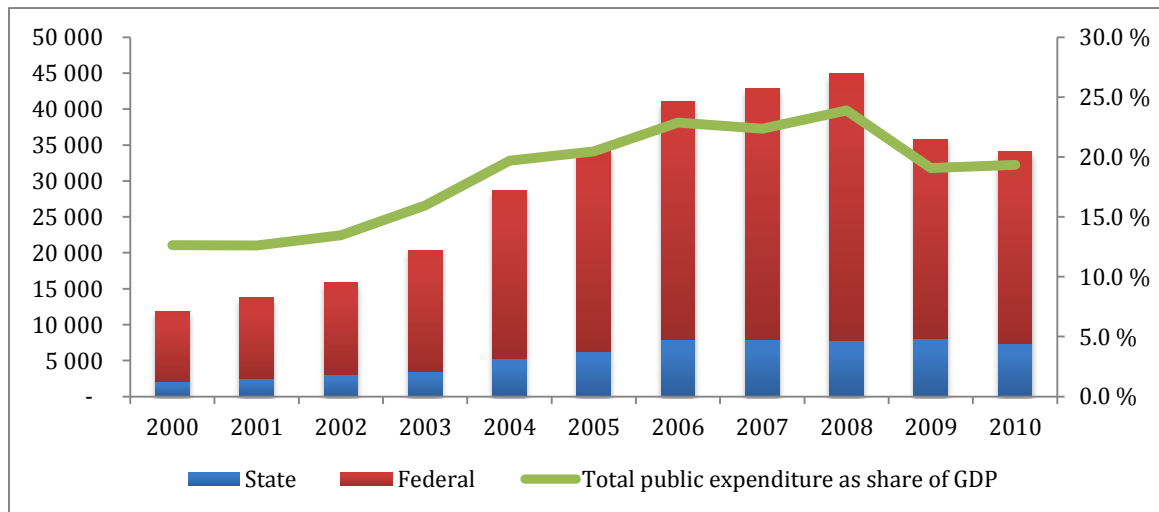
#### **D. RECENT DEVELOPMENTS IN STATE LEVEL EXPENDITURES**

**35. State level expenditure trends are impacted by the volatility of federal and state level revenue performance.** Total public expenditures increased significantly in real terms from 12.6 percent of GDP in 2000 to 23.9 percent of GDP in 2008, but in the following years declined to 19.4 percent of GDP in 2010. .

**36. The share of state level expenditures to total expenditures has increased, though centralized management persists.** Furthermore, the increased dependency on federal transfers still limits the fiscal autonomy of states. This slight increase indicates a modest shift in the assignment of fiscal responsibilities to state levels (e.g. social sector expenditures and investments in state level infrastructure). State level expenditures fluctuated between 17-18 percent of total expenditures during 2000 -2005, but then increased in the years that followed to 21.6 percent of total expenditures in 2010 (Figure 1.10).



**Figure 1.10: Federal and State level expenditures in SDG million at 2011 prices and share of GDP**



Source: State final accounts, MoFNE

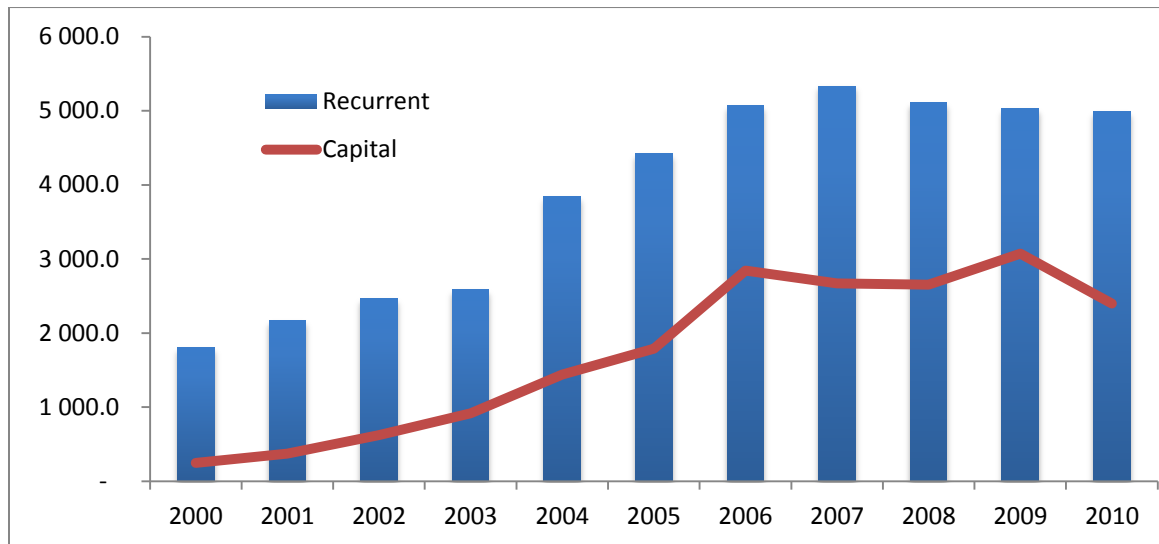
37. In Sudan, expenditures are classified by “purpose” i.e. Wages and Salaries, Goods and Services, Capital Services and Contribution, and Development Expenditure.<sup>3</sup> Until recently the classification was not in accordance with the conventional definitions of recurrent and capital expenditures, as per Government Financial Statistics (GFS) 2001. This limits the ability to analyze the sustainability of levels of public investment. However, for the purpose of these analyses, Wages and Salaries and Goods and Services categories are used as a proxy for Recurrent Expenditures, with Capital Services and Contribution and Development Expenditure as a proxy for Capital Expenditures. The analysis of the composition of expenditures draws on the aggregate fiscal data for all 18 states from 2000–2010, and detailed financial statements collected from the four states sampled, for a more detailed review for the period 2005 - 2011.

38. There has been a significant increase in public investment, which reached its peak in 2009, constituting 37.9 percent of total expenditure. This is a very high level of investments compared with the resources used for operation and maintenance. Questions can be raised as to future sustainability and efficiency in utilization of this high level of investments. As Figure 1.11 illustrates, there has been a significant growth in investments, which since 2006, has been at a high level as compared to recurrent spending. In a situation of volatility of public revenues, and in particular federal transfers, the ability to utilize these high levels of investments effectively may be at risk. Some recent social sector surveys appear to

<sup>3</sup> Development Expenditures include investment projects and associated recurrent costs required for their implementation as well as other development projects for capacity building and training which are considered recurrent expenditures as per standard definitions of expenditures. Segregation of recurrent from capital expenditure has only recently been made possible with the introduction of GFS standard of classification (since 2012).

indicate that investments in education and health are not fully utilized, evidenced by lack of staff to fill vacant positions at facility levels and limitations in non-wage inputs for effective service delivery<sup>4</sup>.

**Figure 1.11: Total state level expenditures in SDG million at 2011 prices**



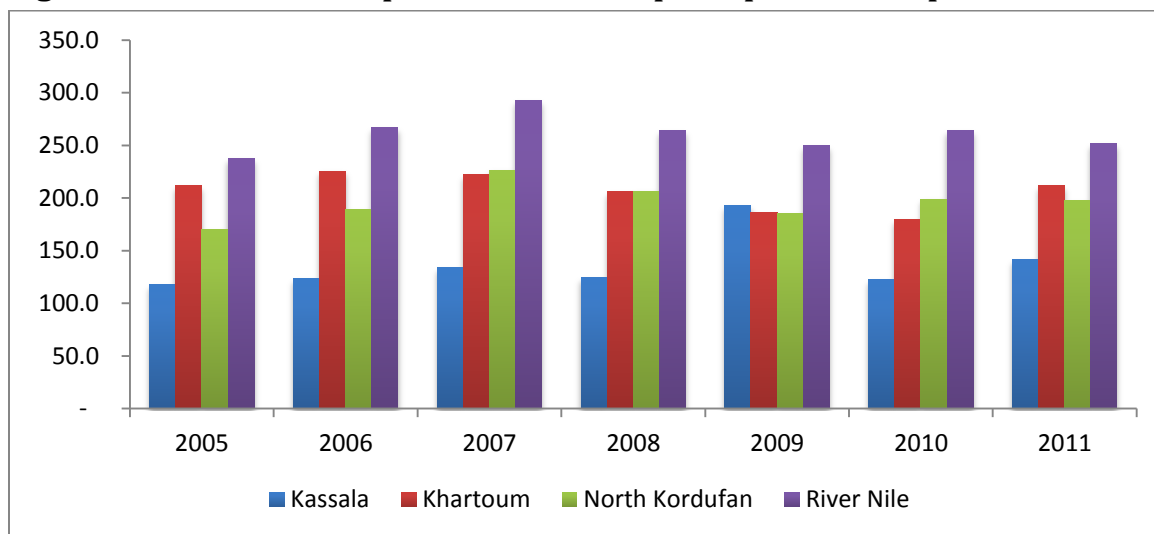
Source: State final accounts, MoFNE

39. **The states lack procedures for forward budgeting and medium term expenditure frameworks that would inform decisions makers on future recurrent cost implications of the proposed level of investments included in budget submissions.** While the four states included in our sample all have a process of longer term planning to guide their prioritization of future budget allocations, the future recurrent cost requirement to sustain levels of investment are not taken into consideration in the annual budget process. This general observation, from analysis of aggregate data for all states, can be further qualified from more detailed analysis of data from the four states selected for a more detailed review.

40. **Recurrent expenditures have been broadly maintained at the same level over the last 4-5 years for North Kordofan and River Nile, while increasing for Kassala and Khartoum.** Kassala state has been able to maintain spending levels, partly linked to its recent efforts in improving its mobilization and management of non-tax revenues, including, among others, more efforts in revenue administration and collection (Figure 1.12).

<sup>4</sup> Among others "Sudan Public Expenditure Tracking Survey (PETS) - Case Study of the Health Sector" World Bank, Report No. 67712-SD, December 2011 and "Sudan Education Sector Status Report, World Bank, 2011.

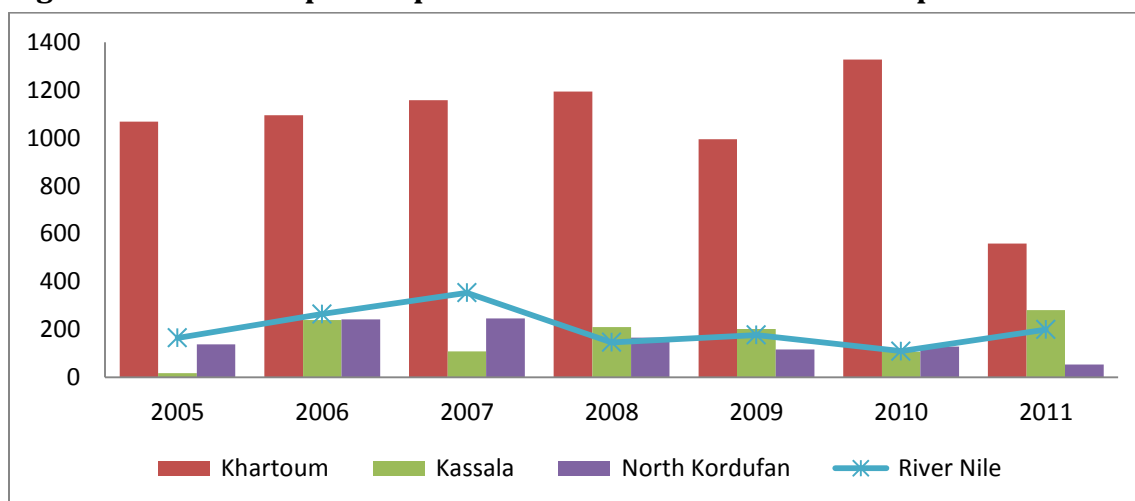
**Figure 1.12: Recurrent expenditures in SDG per capita at 2011 prices**



Source: State final accounts, MoFNE

41. **The state capital expenditures suggest significant variations between states and from one year to the next, reflecting differences in overall resource levels, but also differences in prioritization** (Figure 1.13). Capital expenditure has been throughout at a higher level in states like Khartoum and River Nile, as compared with North Kordofan and Kassala. The level of investments is closely correlated with the level of state revenue, including federal transfers. These levels of development spending have impacted on the ability to raise the level of investments for priority sectors like education and health, as well as state level infrastructure to promote a more conducive business environment. The ability of the states to maintain effectively the investments already realized is questionable, unless they can mobilize future revenue to raise levels of recurrent inputs to sustain these investments.

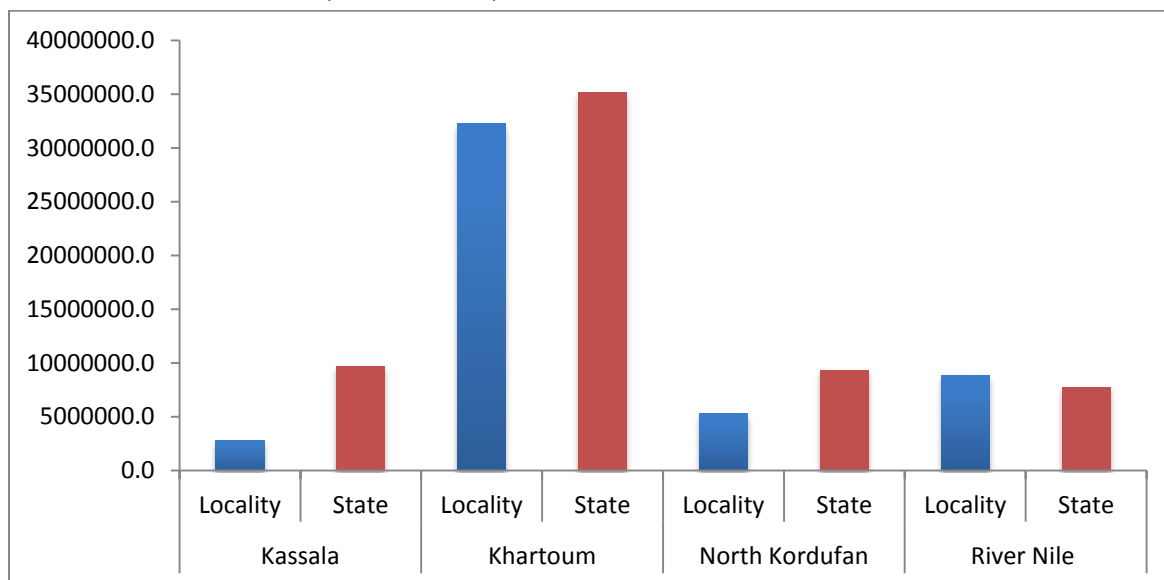
**Figure 1.13: State capital expenditures in SDG million at 2011 prices**



Source: State final accounts, MoFNE

42. **Resources for capital expenditures reached a peak in 2009 and have subsequently declined.** The decline in investments/development expenditures is by far the most significant impact on the overall decline in fiscal performance among the states. The most significant decline has been for investments in economic infrastructure, a situation that will have impact on future growth and revenue potential. On the other hand, for some states there has been a major increase in investments for public administration. Development expenditure varies between states, as illustrated by the four states in our sample. The level of investments in Khartoum has declined to an all-time low, while Kassala has been able to mobilize additional state level revenue, enabling them to maintain and even increase the level of investments.

**Figure 1.14: Capital expenditures by level in SDG million at 2011 prices for Kassala, Khartoum, North Kordufan and River Nile**



Source: State final accounts, MoFNE

43. **The assignment between state and locality levels of fiscal responsibilities for investments differs across the states.** In Khartoum and River Nile a major share of investments is charged to locality budgets, while Kassala and North Kordofan investment projects are largely managed by and charged to state level budgets.

44. **Sector-wise levels of spending (per capita) and priority (share of total) vary significantly between states.** Table 1-1 shows expenditures per capita in the states, distributed by broad sector categories, and an estimated average annual change over the period 2005–2011. Since the current government chart of accounts does not include functional classification codes, the sector definition applied is by the ministry charged for each particular expenditure<sup>5</sup>. For Kassala and North

<sup>5</sup> Public administration includes all ministries and state agencies for state level governance and general administration/services like state planning and finance ministries, security/police, judiciary and other general

Kordofan, expenditure on social sectors and economic services has increased on account of public administration. This situation reflects on the stated priorities in their development plans. For Khartoum the trend has been reversed. While states like Kassala and North Kordofan appear to have allocated additional federal transfers for priority sectors, Khartoum, with a reduction in federal transfers, has significantly reduced its resources for economic services, as well as for social sectors. This trend has occurred simultaneously with an increase in fees and user charges for the same services.

**Table 1-1: State recurrent expenditures per capita by sector in SDG million at 2011 prices**

	2005	2006	2007	2008	2009	2010	2011	Average annual change
<b>Public administration</b>								
Kassala	23.6	22.9	28.2	26.4	19.7	19.7	15.9	-4.6 %
Khartoum	44.0	45.5	36.5	33.4	38.7	53.4	46.0	0.6 %
North Kordofan	34.2	25.8	33.4	38.5	26.0	24.2	20.0	-5.9 %
River Nile	18.9	24.0	41.2	28.2	18.2	31.6	23.3	3.3 %
<b>Economic services</b>								
Kassala	6.5	7.0	7.6	6.7	6.2	6.3	7.1	1.2 %
Khartoum	17.8	18.7	20.0	17.7	9.4	5.3	2.9	-11.9 %
North Kordofan	6.2	7.4	10.5	8.7	9.4	9.3	8.6	5.5 %
River Nile	10.4	12.2	13.0	10.1	9.3	9.9	11.0	0.8 %
<b>Social sectors</b>								
Kassala	39.3	39.3	39.0	33.8	32.7	38.2	55.9	6.1 %
Khartoum	63.3	66.2	69.2	64.1	57.5	49.8	49.6	-3.1 %
North Kordofan	38.2	41.9	51.4	46.3	44.9	47.4	59.8	8.1 %
River Nile	63.2	74.7	79.9	76.6	71.8	78.2	82.7	4.4 %

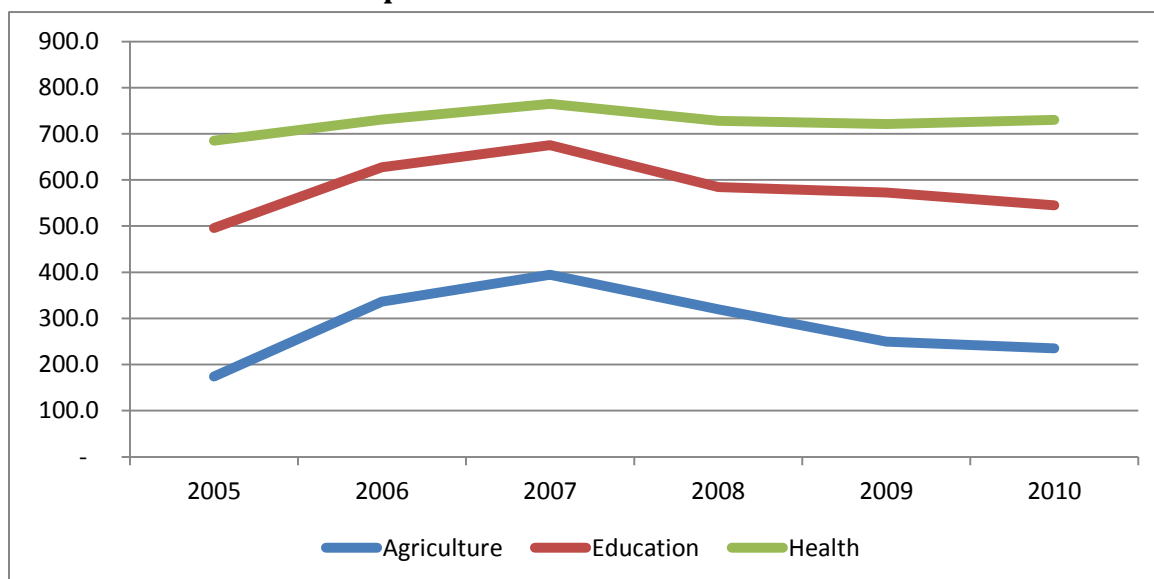
Source: State final accounts, MoFNE

45. **The lower level of state resources over the last few years has impacted on state level expenditures on priority sector such as health, education and agriculture.** While state expenditure on these sectors increased significantly up to 2007, it has declined by approximately 67.9 percent for agriculture, 24.0 percent for education and 4.7 percent health in real terms in 2010.

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administrative and statutory services. Economic services are those related to infrastructure and utility services like water, electricity, transport including rehabilitation, operation and maintenance of the same etc. It also includes charges by ministries and agencies providing agriculture extension services and promotes private sector development through investments and services to improve on investment climate. Social sectors include charges to ministries and agencies for education and health service delivery. It also includes smaller allocations for social welfare agencies and programs.

**Figure 1.15: Expenditures by selected priority sectors in SDG million at 2011 prices in total for all states<sup>6</sup>**

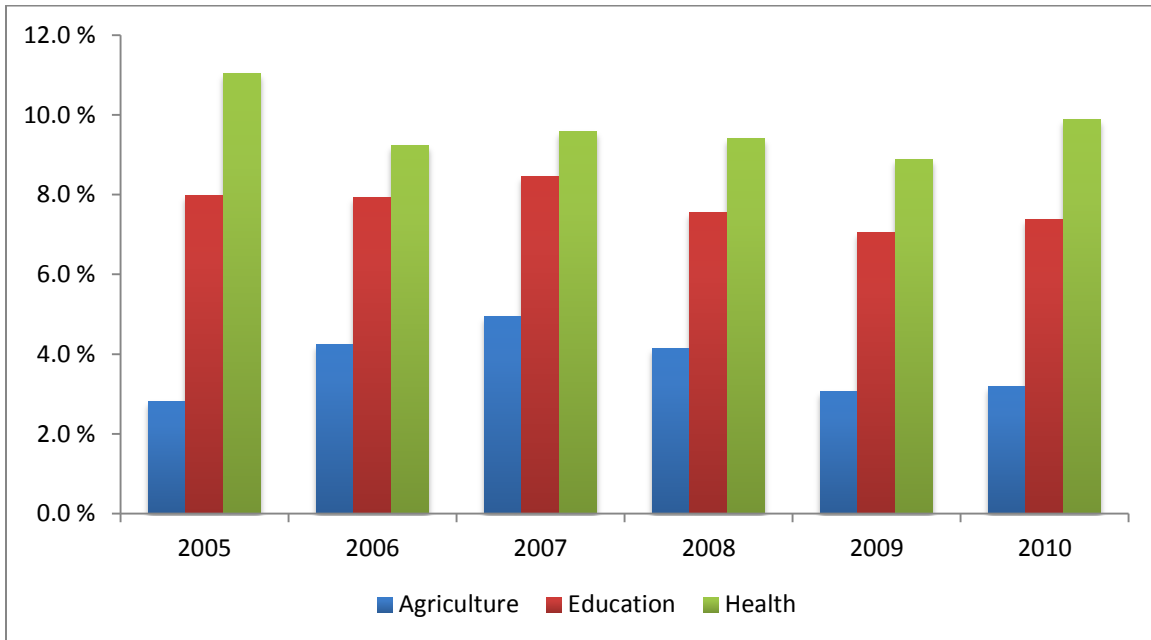


Source: State final accounts, MoFNE

46. **The sector shares of total expenditures have been broadly maintained for health during times of reduced revenues for the budget, but have declined for education and agriculture.** For education the sector share has declined from 8.0 percent of total expenditures in 2005, to 7.4 percent in 2010. For agriculture the share of total expenditures has declined from its peak of 4.9 percent of total expenditure, to 3.2 percent in 2010. The trend in sector shares indicate that the health sector is “protected” against major budget cuts during periods of lower than projected overall budget resources, with expenditures on health maintained broadly at the same level over the period 2006 – 2010.

<sup>6</sup> Sector expenditures are total expenditure by the State Ministries of Education, State Ministries of Health and State Ministries of Agriculture and Livestock respectively. It excludes Locality level expenditures since these are not segregated by sector/department in the final accounts published by MoFNE.

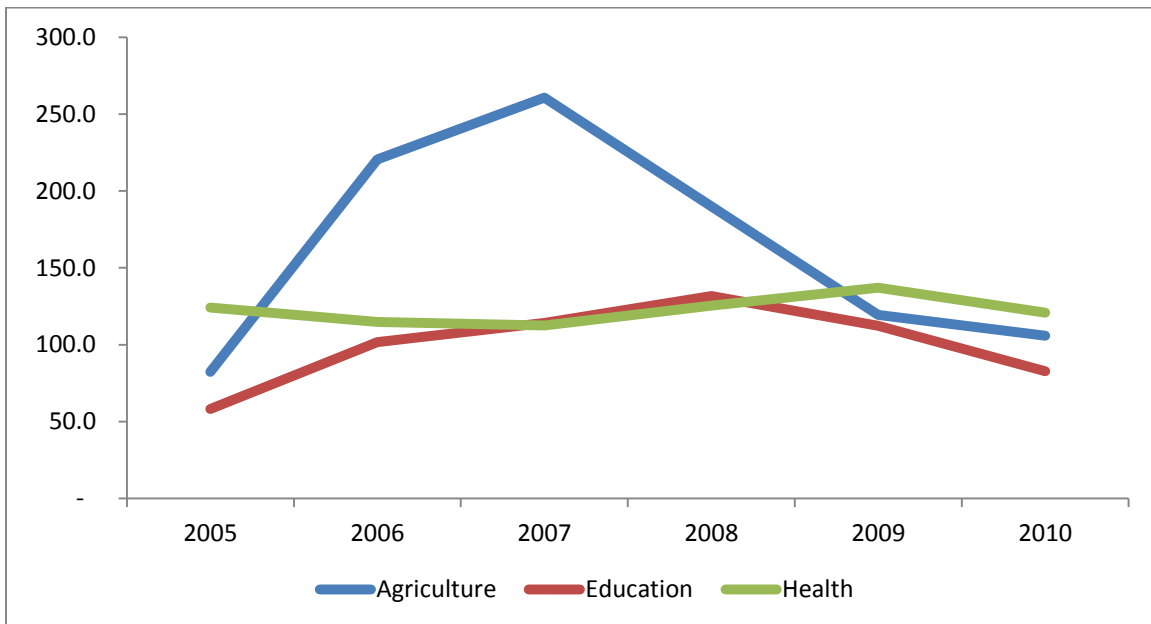
**Figure 1.16: State's sector share of total expenditures; 2005-2010**



Source: State final accounts, MoFNE

47. **The declining trend in spending on agriculture and education is first and foremost due to reduced investments.** As Table 1-2 illustrates, while the level of expenditure on development projects/investments in the health sector has broadly been maintained over the period, it has substantially declined for agriculture and education.

**Figure 1.17: Expenditures by selected priority sectors in SDG million at 2011 prices in total for all states**



Source: State final accounts, MoFNE

48. **The trends in sector expenditures differ between states and by type of expenditures.** As illustrated by the four states sampled for this PER, almost all of them have maintained recurrent spending on agriculture at almost the same level throughout the period, and have increased the levels of recurrent spending on health and education. Recurrent spending on education increased by an average of 11 percent for the four states, with 45 percent for North Kordofan and 38 percent for River Nile. Recurrent expenditure on health has increased, with 43 percent for River Nile and 22 percent for North Kordofan over the period, although it had declined from 2008 - 2010. The most striking observation is the adverse trend in education and health sector spending in Khartoum, also at locality level, i.e. the overall trend is a reduced resource envelope for state financed social service delivery, with more dependency on user fees and other revenue sources at school and health facility levels, to sustain funding for required inputs.

49. **While recurrent expenditure has been broadly maintained for most states, development/capital expenditures have declined significantly for some of the states.** For North Kordofan there has been a significant decline in the level of investments in agriculture, while Kassala has increased agricultural investments over the last two years. For health and education there have been only minor overall changes, although with significant changes from one year to another, which also reflect the volatility of funding for investment projects.

**Table 1-2: Expenditures by selected priority sectors in SDG per capita at 2011 prices for Khartoum, Kassala, North Kordofan and River Nile**

	2005	2006	2007	2008	2009	2010
<b>Recurrent</b>						
<b>Agriculture</b>						
Kassala	6.6	7.5	8.2	7.7	7.6	7.6
Khartoum	15.4	13.6	16.1	13.4	12.3	11.6
North Kordofan	4.7	5.5	7.7	6.4	7.6	6.6
River Nile	5.1	6.1	7.3	5.7	5.0	5.0
<b>Education</b>						
Kassala	21.3	23.0	24.7	22.5	22.5	25.0
Khartoum	121.6	130.3	133.5	126.9	128.7	117.2
North Kordofan	27.0	30.7	37.7	34.7	36.2	39.0
River Nile	29.4	36.2	37.6	41.8	38.6	40.6
<b>Health</b>						
Kassala	35.8	37.3	37.8	32.1	31.6	38.4
Khartoum	185.1	189.6	202.6	182.3	174.3	169.4
North Kordofan	31.0	33.0	41.0	35.7	35.9	37.7
River Nile	27.9	32.0	37.1	34.9	35.1	40.0
<b>Capital</b>						
<b>Agriculture</b>						
Kassala	0.5	0.9	0.4	0.7	24.5	6.8



Khartoum	14.5	25.9	18.5	29.2	18.5	29.8
North Kordofan	30.3	9.9	14.8	14.6	6.0	16.5
River Nile	4.7	126.9	153.2	12.1	33.6	4.7
<b>Education</b>						
Kassala	1.9	0.2	0.1	0.1	2.2	2.9
Khartoum	24.6	43.0	49.9	27.8	16.8	36.4
North Kordofan	4.1	18.4	14.8	5.0	4.8	5.4
River Nile	2.2	13.0	5.1	2.2	1.3	0.3
<b>Health</b>						
Kassala	-	-	-	-	2.6	1.5
Khartoum	72.5	67.8	49.7	44.2	56.7	84.4
North Kordofan	8.7	3.6	3.6	7.2	2.3	7.3
River Nile	9.9	4.2	4.0	7.6	1.2	0.8

Source: State final accounts, MoFNE

## CHAPTER 2. FISCAL DECENTRALIZATION ARRANGEMENTS AND REGIONAL IMBALANCES

50. **Sudan has undertaken political decentralization reforms since the early 1990s, in a federal government system with three tiers: federal, state and locality with elected legislatures at each level and elected state governors.** At the sub-national level there are now 18 states each with several localities. Sudan's decentralization is governed by a plethora of laws and agreements. These legal frameworks include: the Creation of Federal State, 1992; law for establishing the National State Support Fund, 1996; Local Government Act, 2003; Interim National Constitution (INC), 2005; state constitutions; the Local Government Act, 2006; and decree for establishing the Fiscal and Financial Allocation and Monitoring Commission (FFMC), 2006.

### A. WHY DOES DECENTRALIZATION MATTER FOR SUDAN?

51. **The Interim National Constitution (INC) and the Comprehensive Peace Agreement (CPA) of 2005 represented critical milestones for Sudan's efforts towards decentralization in an institutionalized system, especially for fiscal decentralization.** The two legal documents define the institutional framework and the normative principles for decentralization in the country (Box 2.1). Both documents commit to fiscal decentralization, to empower sub-national governments to align the use of resources more effectively with the need to address wide regional disparities and trace the root causes of conflict.

52. **The INC provides the legal framework for state and locality legislative assemblies in each state to oversee the functioning of the various levels of sub-national government.** The CPA established that decentralization and empowerment of all levels of government are cardinal principles of effective and fair administration of the country. At the same time, the CPA provided for a major reform to fiscal decentralization by the creation of the Fiscal and Financial Allocation and Monitoring Commission (FFAMC) to ensure a formula-based intergovernmental transfers system, though it remains unclear how this system is used in practice.

### Box 2.1: Sudan's decentralized system of governance and devolution of powers

(Article 24, INC for 2005):

Sudan is a decentralized State, with the following three levels of government: -

- (a) The national level of government, which shall exercise authority with a view to protecting the national sovereignty and territorial integrity of the Sudan and promoting the welfare of its people;
- (b) The state level of government, which shall exercise authority at the state level throughout the Sudan and render public services through the level closest to the people; and

(c) The local level of government, which shall be established throughout the country.

Source: The Interim National Constitution (INC) of 2005

53. **As Sudan is an extremely diverse and dispersed country, successful decentralization will be of paramount importance in overcoming disparities, improving the quality of governance, and promoting development outcomes** (Article 1-1, INC of 2005).<sup>7</sup> Fulfilling the vision of fiscal decentralization is a vital aspect of a unified and peaceful post-secession Sudan, potentially addressing regional imbalances and the root causes of actual or potential conflict. Decentralization is also essential for Sudan to improve efficiency in service delivery, address poverty and achieve a fair, decent, standard of life for all citizens.

54. **Sudan boasts a wide variety of natural endowments and levels of development** (World Bank CEM, 2009). In this context, regional disparities in natural endowments and economic opportunities, combined with the devolution of fiscal resources, can be associated with the risk of eventual disparities in poverty reduction and service delivery outcomes across the sub-national levels. In such an environment, fiscal decentralization could possibly lead to aggravation of imbalances. To counter such tendencies there is a strong need for a carefully designed inter-governmental transfers system, flanked by capacity building efforts at the sub-national level to generate own revenues .

#### **B. CURRENT EXPENDITURE RESPONSIBILITIES ASSIGNMENTS**

55. **Decentralization has devolved a number of key responsibilities to the sub-national governments; particularly vis-à-vis publicly funded pro-poor activities** (Table 2-1). According to the INC of 2005 Article 24-B, obligatory responsibilities for sub-national governments to include provide social services (e.g. education, health, and registration of persons); regulate businesses; manage land, others<sup>8</sup>. At the top of that system is the National Government, which has overall responsibility over functions such as foreign policy, defense, security, immigration, monetary affairs, and others.

56. **In reality, however, sometimes the division of responsibilities is less clear cut.** In health and education, for instance, the National Government is involved in funding service delivery in specific geographic areas (hard-to-reach) or to specific population groups (e.g. mothers, under five children). Therefore, equally important is building an understanding of respective responsibilities within a federal system. While the Federal Ministry has a revenue generation and financing mandate, it also has coordinating, monitoring and support (for poor performing states) functions, which it seems to have largely relinquished to lower levels of government for

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<sup>7</sup>INC 2005, Article 1-1: *"The Republic of the Sudan is an independent, sovereign State. It is a democratic, decentralized, multi-cultural, multilingual, multi-racial, multi-ethnic, and multi-religious country where such diversities co-exist"*.

<sup>8</sup> The Sudan Interim National Constitution, 2005.

service delivery. The result is that no one is held accountable for results and ultimately the burden of service provision falls on the intended beneficiary.

**Table 2-1: The Key Responsibilities of Sub-national Governments  
According to the Interim National Constitution**

<p>Economic management and planning provisions</p> <ul style="list-style-type: none"> <li>– State borrowing</li> <li>– Taxation and Revenue raising</li> <li>– Budget and finances</li> <li>– State Constitution</li> <li>– State Courts and the administration of justice</li> <li>– Traditional and Customary law</li> </ul>	<p>Service provision</p> <ul style="list-style-type: none"> <li>– Police and prisons</li> <li>– Reformatory Institutions</li> <li>– Airports and airstrips</li> <li>– Museums and heritage sites</li> <li>– Cultural matters within a State, libraries</li> <li>– State archives, antiquities and monuments</li> <li>– State Irrigation and Embankments</li> <li>– Service provision</li> <li>– Information, publications, telecommunications and regulations</li> <li>– Social welfare, including State pensions</li> </ul>
<p>Education service</p> <ul style="list-style-type: none"> <li>– Pre-schools</li> <li>– Basic schools</li> <li>– Secondary schools</li> <li>– Administration of schools</li> <li>– Tertiary</li> <li>– Education policy</li> </ul>	<p>Health service</p> <ul style="list-style-type: none"> <li>– regulation</li> <li>– hospitals</li> <li>– other health institutions</li> <li>– ambulance services</li> <li>– health policy</li> <li>– epidemics control</li> <li>– drug quality</li> </ul>
<p>Natural Resources</p> <ul style="list-style-type: none"> <li>– Agriculture</li> <li>– Animal and livestock control, diseases, pastures and veterinary services, animal drug quality</li> <li>– Natural Resources (incl. Forestry and quarrying)</li> </ul>	<p>Regulatory Activities</p> <ul style="list-style-type: none"> <li>– Public Utilities</li> <li>– Regulation of religious matters</li> <li>– Regulation of business, trade licenses.</li> </ul>

Source: The Sudan Interim National Constitution of 2005

### **C. CURRENT REVENUE ASSIGNMENTS**

57. **A sound revenue assignment system is an essential pre-condition for successful fiscal decentralization.** In certain fragile states, such as Sudan, the soundness of the sub-national revenue stream is factor of the share of revenues collected by sub-national entities, given the poor reliability of the transfers from the central to sub-national governments (Box 2.2). In addition to raising revenues, local revenue mobilization also has the potential to foster political and administrative accountability by empowering communities. Further, communities are likely to be willing to pay local taxes if the proceeds are used to provide local services.

### Box 2.2: Who levies what taxes?

There is no ideal assignment of revenue sources between central and lower levels of government. Still, a set of 'tax-assignment rules' has been developed in the traditional fiscal federalism theory (Oates 2005, 1972; Musgrave 2000; Bird 2010). These principles relate to the respective responsibilities of central and lower tiers of government in macroeconomic stabilisation, income redistribution, and resource allocation (Boadway *et al.* 2000). Furthermore, in developing countries the administrative capabilities of sub-national governments in revenue design (that is, deciding on revenue bases and setting rates) must be taken into consideration (Bird 1990). In large and diverse countries it is also important to address the issue of revenue harmonization between jurisdictions when assigning taxing powers.

The stabilization objective of the fiscal system calls for central control over the revenue instruments that may substantially influence central budget deficits or inflation. Thus, taxes on international transactions (customs duties) and a considerable share of income and general sales taxes (such as VAT) should be assigned to central government. If there are wide disparities in income and wealth across regions, as there are in many African countries, then local taxing powers may exacerbate these differences. Hence, the distributive function of government is an argument for centralized, progressive corporate income and wealth taxes. Sub-national governments by contrast require stable sources of revenue. Thus, lower-level governments should tax revenue bases with low mobility between jurisdictions. Property tax is therefore often labelled as the 'ideal' local tax. Moreover, if properly designed, user charges on services such as electricity, water, sanitation, and solid waste collection may be attractive local revenue instruments. The same applies to benefit taxes such as road and port tolls, and to various licenses, which also may have regulatory functions.

**58. Sub-national entities are empowered by the Constitution to collect own revenue.** Own revenues are one of the three sources of funding for states and localities, in addition to federal transfers and shared revenues. Table 2-2 summarizes the main types of revenues of States, ranked broadly by the level of autonomy sub-national governments enjoy over these revenues. Article 195 of the Interim National Constitution (RoS 2005) empowers states to collect own revenue from ten specific sources, and also allows them to introduce "any other tax as may be determined by law".<sup>9</sup> The states have the highest degree of autonomy in defining own revenues, including authority to determine rates.

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<sup>9</sup> Article 195 of the Interim Constitution also includes 'grants-in-aid and foreign aid', but since these are not 'own' revenues, they are not included in Table 4.1.

**Table 2-2: Own revenue sources assigned to states**

Revenue Type	Revenue Items	Determination of Collection/Allocation
<b><i>Own Source Revenues</i></b>	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
<b><i>Shared revenue</i></b>	2 percent of petroleum revenues by derivation	State share of revenue based on derivation basis (and other criteria), established by CPA
<b><i>Grants and Transfers</i></b>	<p><i>Current earmark transfers:</i></p> <ul style="list-style-type: none"> <li>– wages (Judiciary, Police, High Education)</li> <li>– operations (Judiciary, Police, High Education)</li> <li>– social subsidies transfers</li> </ul> <p><i>Current block transfers:</i></p> <ul style="list-style-type: none"> <li>– agricultural taxes compensation</li> <li>– Current transfers (largely for wages)</li> <li>– Emergency and Ad hoc transfers</li> </ul> <p><i>Development transfers</i></p> <ul style="list-style-type: none"> <li>– State development projects (local component)</li> <li>– State development projects (foreign component)</li> </ul> <p><i>Development and Reconstruction Funds for war affected areas.</i></p>	May be determined by formula, existing establishment costs (e.g., wages), or are in a sense ad hoc and discretionary.
<b><i>Borrowing</i></b>	Loans/borrowing in accordance with the Constitution	

Source: The Interim National Constitution (RoS 2005) and Source: Sudan PER, 2007

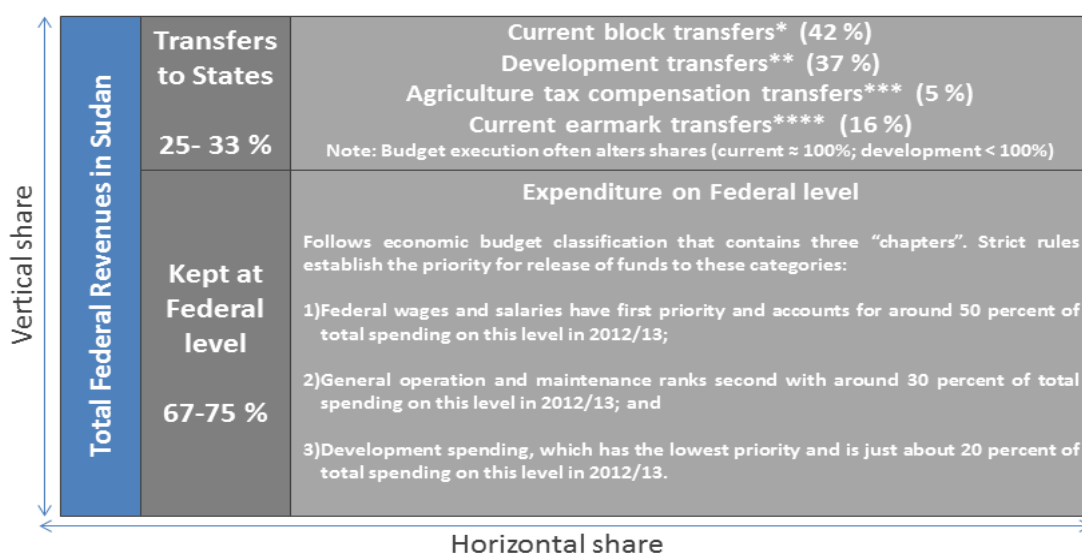
#### **D. INTERGOVERNMENTAL FISCAL TRANSFERS**

59. **The primary component of successful fiscal decentralization is a more equitable and transparent system of intergovernmental resource allocation across different levels of government.** The specific objective of a sound intergovernmental 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. 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 (Sudan PER, 2007). These include the overall efficacy of sub-national public service delivery and accountability, sustainable fiscal policies, and own source revenue mobilization.

60. **Federal transfers in Sudan have a vertical and a horizontal dimension.** Figure 2.1 depicts the principal intergovernmental transfers emerging from the CPA and ensuing legislation. The vertical allocation; i.e. all states' share of federal revenue is determined based on an assessment of the yearly performance of

revenue as well as expenditure. The horizontal dimension determines the distribution of the transfer among the states.

**Figure 2.1: Sudan's principal intergovernmental transfers**



Source: World Bank staff own visualization and estimates.

Notes: \* Theoretically based on formula with 8 criteria; actual allocation administered by FFAMC , but reflects some level of discretion.

\*\* Theoretically based on formula with 7 criteria; actual allocation administered by MoFNE; formula not applied in practice.

\*\*\* Not based on formula, but historical levels of agriculture tax determine allocations; usually increasing annually (8 percent in 2012).

\*\*\*\* Used for police, higher education, free health care for children under 5, etc. Transferred directly from MoF to federal line ministries/agencies; amounts not reflected in state budgets.

61. **The Fiscal and Financial Allocation and Monitoring Commission (FFAMC) was established with the Comprehensive Peace Agreement (CPA) in 2005.** The Commission has the responsibility for both vertical allocation of revenue between federal and state levels as well as for the horizontal transfers between the states. The FFAMC replaced the National State Support Fund (NSSF) that was previously responsible for allocation of resources to states.

62. **States receive different types of federal grants and transfers;**

- Current transfers (earmark and block).
- Development grants.
- Agriculture tax compensation replacing agriculture product tax abolished in 1999.
- Discretionary allocations like special social transfers, transfers for specific projects and emergencies.

*How vertical pool is determined?*

63. **The amount of vertical transfers is determined differently for the different types of transfers.** The aggregate vertical share for overall reported transfers are 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 vertical pool of the different types of transfers are determined as follows:

- a) Current non-conditional vertical pool is determined as last year share (historic share estimates) with 5 percent increase to accommodate employees' compensations and inflation rate developments. This implies that current transfers appear to be based largely on existing public sector establishment costs and are provided as 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.
- b) Current conditional vertical pool is determined as items that were previously on the national budget; including wages (Judiciary, Police, High Education), operations (Judiciary, Police, High Education), and social subsidies transfers. 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.
- c) Development transfer vertical pool is determined based on ongoing/under completion states' development projects and development projects that planned for the perceived budget year. The basis for the development transfers is not 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.
- d) The vertical pool as agriculture tax compensation is based on the estimated agricultural tax loss. 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 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).
- e) Discretionary, emergency and Ad hoc transfers are determined through a political process and are allocated for purposes like special social transfers or transfers for emergencies. Discretionary allocations like special social transfers, transfers for specific projects and emergencies.

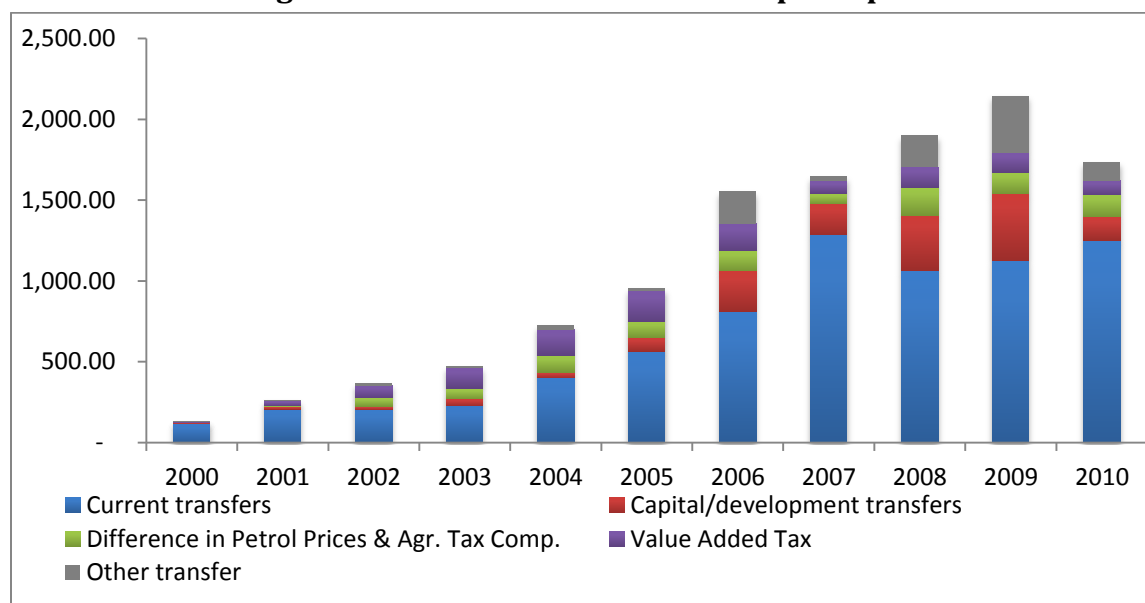


*An increased share of vertical transfers are formula based*

64. **When examining the equalizing nature of grants and transfers to individual states, the different types of transfers have different impact on equalization.** An increasing share of transfers is however guided by the FFMAC formula. Federal transfers have increased significantly over the years in per capita terms measured in SDG at fixed prices (Figure 2.2). Furthermore, the composition of these transfers has also changed from vertical discretionary allocations and tax/revenue sharing or compensation transfers to the more transparent formula based allocation system.

65. **The VAT, and in particular the agriculture compensation transfer, were intended to compensate states for foregone revenues because of elimination of certain taxes.** Accordingly they do not have same the redistributive impact as current transfers. Current transfers are on the other hand guided by formulas applied by the FFMAC.

**Figure 2.2: Federal transfers in SDG per capita**



Source; FMNOE

66. **Currently, the largest single source of federal funding for state budgets is the current transfer, of which a major share is allocations for state level civil service.** In 2010 such allocations accounted for 72 percent of total grants and transfers to the states. The second largest share is transfers for investments/development projects, which accounted for 8 percent of total grants and transfers in 2010. Prior to 2005 agricultural tax compensation, VAT, and various discretionary allocations, constituted a major share of federal transfers, but since the establishment of FFMAC transfers are to a large part guided by the above mentioned formula. There is one exception among the states; the state of Khartoum did not receive any notable current and development transfers during recent years,

but instead its share of VAT was a major federal source of funding, with between 63 percent and almost 100 percent of total state level share of VAT during 2007-2010.

*How horizontal allocations are determined?*

67. **Horizontal (i.e., inter-state) allocation criteria vary across the different types of federal transfers.** The amount of different types of transfers is determined on the basis of a number of criteria, ranging from formula based to purely discretionary<sup>10</sup>. The formula based transfers are made for equalization purposes taking into account expenditure responsibilities, the own revenue capacity of states and to reimburse states for certain costs. There is an additional Emergency Fund that is allocated to the states from the NRF and which is distributed by order from the Presidency or by recommendation from the FFMACC itself. The formula to guide allocation of federal transfers

68. **A formula based allocation system was introduced in Sudan as early as 1998, and has changed several times over the years.** The formula for horizontal distribution was revised in 2010, so as to incorporate ten criteria with weights that allowed for a more equitable distribution among the seventeen states. The current formula consists of ten different criteria and is applied as guidance for decisions on current transfers, while development/capital transfers follow a different procedure.

69. **The current formula applied for the 2012 budget takes into account various factors reflecting resource needs and revenue generating capacity (Table 2-3).** The various factors in the formula receive different weights. Each factor consists of a number of elements, each used to determine the score for each state for each of the dimensions (elements), which are then summarized to determine the overall score for one factor. It has developed into a very complex formula with several dimensions, all needs based, e.g. low fiscal performance and low income per capita give a higher score than indicators of improved revenue performance and higher income. The same applies to the various elements used to determine level education enrollment and health service outreach, i.e. needs based rather than performance based.

70. **The population criteria consists of two elements, population density and population size.** Of these two elements, low density but large population gives a higher score than large density but small population. These are two elements that in most cases will balance the score across states, i.e. high density is usually found in populous but smaller areas.

71. **The current transfer criteria remain undermined by several weaknesses:**

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<sup>10</sup> Information provided by FFMACC.

- The complexity of the formula creates a challenge in communicating the basis for deciding on distribution of federal transfers;
- Some of the elements used to determine a factor are subjective;
- There is a high level of inter-correlation between them, i.e. average income, population density and social service delivery are highly correlated. For states with low per capita income the tax base is lower and so are the overall resources available to deliver a particular service, i.e. service delivery indicators and resource availability are closely correlated;
- There are no performance related factors serving as an incentive to promote improved efforts in revenue mobilization and management, or to promote fiscal discipline, like containing budget execution within resource limits to reduce the risks of sustained levels of expenditures associated with accumulated budget deficits; and
- While it is not recommended to include needs and performance elements in one and the same formula, there is scope to consider segregation of the vertical allocation into needs and performance based federal transfer allocations.

**Table 2-3: FFMAC federal transfer formula**

<b>Factor</b>	<b>Number of elements</b>	<b>Weight</b>
1. Population size	3	25
2. Agricultural requirements	2	15
3. Security	4	15
4. Education	3	13
5. Health	4	12
6. Financial performance	5	10
7. Distance from the center and the Port	3	8
8. Revenue other than transfers	1	2
<b>Total</b>	<b>25</b>	<b>100</b>

Source: FFMAC

*Does the formula based system work for Sudan?*

72. **While the Government of Sudan has taken major steps in applying more transparent equalizing procedures for distribution of federal transfers, the formula appears still to be used only partially.** The actual allocation seems to be impacted, in addition, by other considerations. Furthermore, the formula is complex with many elements, which are also inter-correlated. It may not fully serve an intended purpose of equalizing resource availability between states to address differences in needs and revenue capacity.

73. **While a formula based allocation appears to be underlying current transfers, it is not immediately possible to reproduce these allocations.** Implementation of the formula would have significantly reduced the share of the states of Khartoum and Gezira. However, the reductions in transfers envisioned for

the two states by the revised formula were not implemented. Rather, a gradual increase of transfers to the other thirteen states is planned so as to reach a more equitable distribution over a period of time.

**74. One of the main challenges reported by the states has been the low predictability of federal transfers, largely due to:**

- The state's officials believe that the formula applied to allocate the transfers is not considered to be applied consistently.
- The amount allocated (vertical allocation) is perceived as varying significantly, which combined with the above lack of transparency makes it difficult for the states to project future resource levels.
- Some elements of the formula add additional resources for a state which may initially have more resources than others per capita, but utilization does not translate into effective service delivery i.e. low productivity of service delivery in a given state will warrant added transfers as compared with others.
- The formula and elements used have changed significantly over time, which impacts on the predictability of estimates used by states when projecting federal transfers in the annual budget preparation process.

*Level of equalization*

**75. Disparities in actual allocations per capita for each of the states suggest that the current procedures for distribution of federal transfers do not fully achieve equalization among the states.** Actual allocations continue to vary between states and appear not to be linked to state level own revenue. Allocations have also varied significantly from one year to another for many of the states. This is illustrated in Table 2-4.

**76. Some states, like the Darfur states, North Kordofan and Gadarif, have low levels of own revenue mobilization and simultaneously relatively low levels of formula based federal transfers.** For several of the states there have been significant changes in federal transfers from one year to the next (as indicated by the standard deviation as percent of the state average), and in particular for states like West and North Darfur, as well as for South Kordofan.

**Table 2-4: Federal transfers and state own revenue in SDG per capita, average for 2005 – 2010 and standard deviation percent of average.**

State	Average Federal transfer	Average State own revenue	Federal Transfers STD % of average
Blue Nile	117.55	21.30	28 %
Gadarif	57.47	42.69	11 %
Gezira	85.75	33.49	15 %
Kassala	65.26	41.99	8 %
Khartoum	0.01	164.92	0 %
North Darfur	55.09	10.97	43 %
North Kordufan	65.53	31.47	6 %
Northern	128.10	73.66	16 %
Red Sea	33.73	167.40	3 %
River Nile	163.67	63.38	29 %
Sinar	95.16	25.81	16 %
South Darfur	36.61	14.13	16 %
South Kordufan	132.36	28.92	50 %
West Darfur	56.66	12.88	40 %
White Nile	91.97	44.63	11 %

Source: State final accounts, MoFNE

*Elements of a simplified and transparent formula*

77. **A key element in an intergovernmental fiscal transfer system is the assignment of fiscal responsibilities at different levels, both as concerns revenue and expenditure assignments, combined with intergovernmental transfer systems to promote equalization and serve as incentives for execution of the functions by lower level governments.** The latter establishes the basic incentive structure for state and local government spending. In Sudan, as in most federal systems, sub-national units are usually not able to raise sufficient revenues to finance their own capital and recurrent needs, and their revenue capacities vary, which requires transfers to equalize service delivery across sub-national governments.

78. **Transfer systems are used to promote federal (national) policy targets linked to functions executed by sub-national governments, by earmarking or other means, to ensure a minimum level of spending to meet basic service standards.** They also often include transfers with amounts determined by performance elements, to promote improved productivity in service delivery, revenue mobilization (matching federal transfers) or other improved management practices (as evidenced by various PFM or governance indicators).

79. **Transfer systems to promote different objectives usually require different types of fiscal instruments.** Transfers to promote one objective will not necessarily meet, and could undermine, others. Accordingly, most transfer systems are a mix of needs based and performance based grants, as well as a mix of general-purpose equalization grants and sector specific grants, to ensure a minimum level of public service in compliance with national policies and targets.

80. **The design of a transfer system is important, not only for ensuring adequate funding for local services, but also for providing incentives for efficient expenditure allocation and resource use.** The type of transfer will determine who controls the resources and what they are spent on, and establish the extent of state and local government autonomy and discretion. The literature on fiscal transfers to fund sub-national governments, and their service delivery functions, usually distinguish between four types of transfers, as illustrated in Table 2-5.

**Table 2-5: Types of fiscal transfers**

	<b>Earmarked (Conditional)</b>	<b>Block grants (Unconditional)</b>
<b>Needs based</b>	Require state/local government to spend for specific purpose but not linked to state/local government own contribution or indicators of performance.	Unconditional to equalize fiscal capacities and help state/local government financially enhancing the general welfare of the populations.
<b>Performance based</b>	Require state/local government to spend for specific purpose with the amounts determined as a ratio to state/local government own contribution and/or indicators of performance.	Unconditional to equalize fiscal capacities and help state/local government financially, which can be spent at state/local governments' own discretion. Amount transferred is, however, determined by level of revenue mobilization and/or indicators of performance.

81. **The transfer system in Sudan combines many purposes in one overall formula and transfer type i.e. one system is trying to promote multiple objectives simultaneously.** The federal transfers system combines several criteria to determine a “block grant allocation” in one formula, i.e. the amount transferred is allocated by the states, at their own discretion, from federal transfers determined by a combination of several factors related to sector needs and financial performance.

82. **In the states sampled for this PER none applied an allocation formula for determining transfers to the localities.** For all of them, salaries of localities were paid from the state payroll, while goods and services were partly paid from the state budget and partly from local revenue (of which, in some states, were revenues shared with the state), but more significantly were financed from user charges and other non-tax revenue.

**83. There are several dimensions to consider when deciding on elements to include in a formula based allocation system:**

- *Technical robustness:* The methodology and analysis undertaken in developing the factors used for determining amounts to be distributed must be transparent and credible;
- *Minimization of unintended incentives:* Any factor included in the formula should minimize incentives that conflict with others;
- *Simplicity:* - The overall model should be understandable to all;
- *Transparency and objectivity:* Any adjustments made to the formula should be made clear, and the model should be capable of objective assessment;
- *Use of reliable and up-to-date data:* As far as possible, the model should reflect data from the latest period available; and
- *Stability and durability:* The formula should demonstrate reasonable stability over time, to ensure predictability in allocation of resources over time supporting sub-national governments' medium term budgeting.

**84. Similar to many other federal systems, Sudan could consider the segregation of vertical transfers in general block grants for equalizing fiscal capacities, from amounts transferred based on performance (fiscal performance and/or other performance dimensions like governance/PFM related issues)<sup>11</sup>.** It could also consider segregation of general-purpose grants from sector grants targeting key public service delivery responsibilities of states, such as for health and education, to promote a minimum level of service delivery in compliance with national sectorial targets.

**85. States should consider introducing formula based sector grants for allocation of non-wage resources to localities, and in the longer term also consider devolution of payroll to localities.** Transfer of resources for priority sectors, like health and education, at locality levels could be based on specific transparent criteria (population to be serviced, enrollment targets, etc.) to promote a more equitable delivery of services among states.

**86. There are several types of elements that can be considered in a fiscal formula for equalization.** They often take into account one or a combination of the following:

- Distribution on per capita basis;

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<sup>11</sup> In some countries Governance/PFM performance elements are used as an incentive to improve on management practices. They may include changes over time in audit qualifications and improvements in internal control/audit practices and capacities. The information used to determine performance over time is sometimes based on independent reports, for example from the Auditor General and/or from a third party review/verification process.

- Revenue capacity;
- Needs as reflected by poverty levels, social indicators etc.

87. **The data requirements of the above criteria vary substantially, from using official population data for a per capita allocation criterion, to a consolidated set of indicators to measure difference in revenue capacities and needs.** Indicators of revenue capacity require data on actual revenue and the basis for the revenue collected. Needs are often reflected by several types of indicators, such as per capita income, poverty incidence, unemployment rates, population densities, area, infant mortality rates, life expectancy, school enrollment rates, number of school age children, length of roads, etc.

88. **In the following analysis a simulation of potential impact on federal transfers is presented.** The simulation is done to illustrate the likely impact of changes in the federal transfer system, in which all federal transfers are pooled and their allocation determined by a more simplified formula. Poverty level is used as an indicator, with the relative level compared with the national average as a factor to increase or reduce the allocation per capita. Empirical evidence suggests there is a strong correlation between income/consumption poverty levels and access to basic services, as well as revenue capacity of the state and localities within the state.

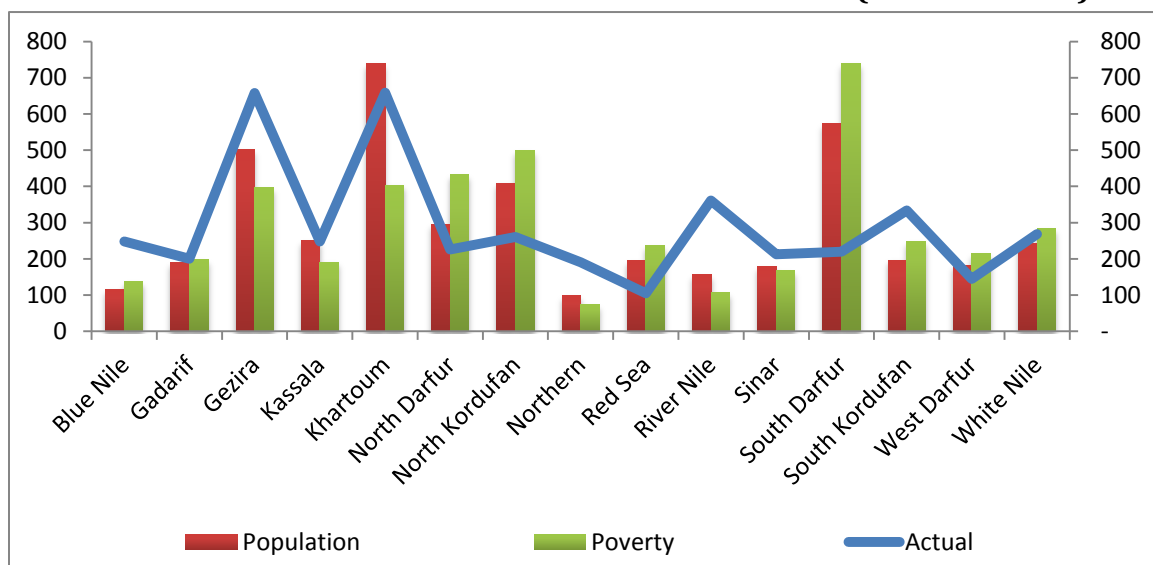
89. **Figure 2.3 illustrates different shares of total federal transfers under different allocation criteria:**

- The actual distribution of federal transfer, guided by current allocation formula using multiple criteria for decision on distribution between the states;
- An allocation that assumes same level of expenditure per capita; and
- Allocation adjusted for differences in poverty level, i.e. higher poverty incidence qualifies for higher per capita transfer.

90. **The current distribution of federal transfers deviates from a distribution of equal transfers per capita, as well as from a poverty-adjusted allocation.** Using the latter as a criterion for distribution of transfers would significantly change the allocation for a majority of the states. Figure 2.3 shows the different alternatives in allocation of federal transfers for the states. The criterion using equal per capita transfers suggests a major increase for states like North Kordofan, as well as North and South Darfur. Khartoum is a major beneficiary of VAT sharing. With the “population criterion” Khartoum would be eligible for an increase in transfers, over and above its current share of VAT. However, with the poverty criterion transfers to Khartoum would decrease and more of the VAT revenue would be “shared” with other states.



**Figure 2.3: Actual Federal transfers by state, average 2005-2010 and estimated transfers with different allocation criteria (in SDG million)**



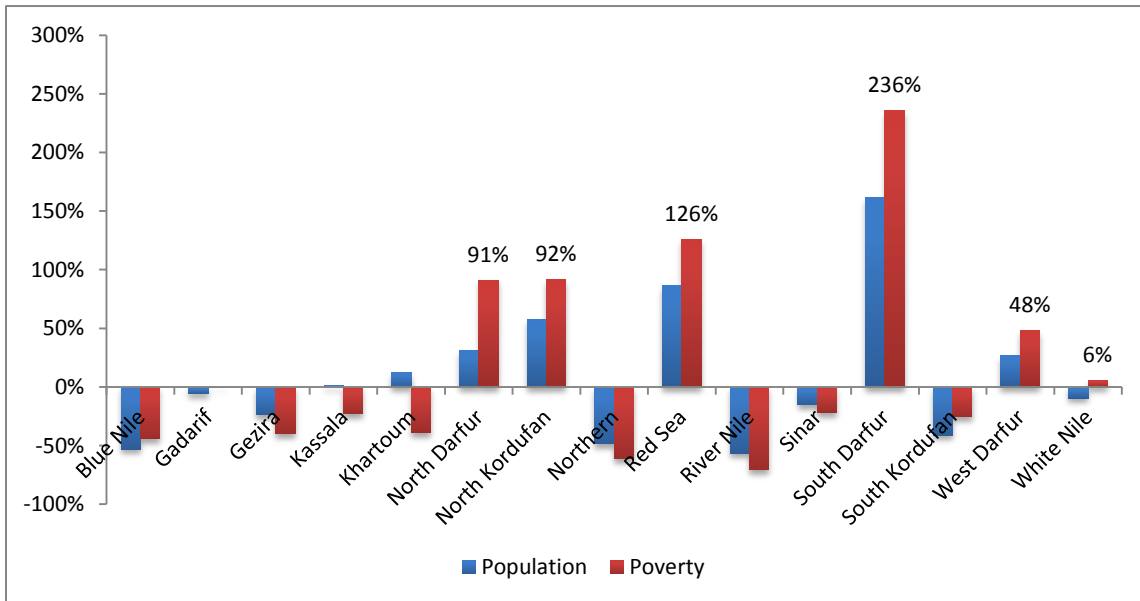
Source: State final accounts, MoFNE

91. Compared with the current distribution of federal transfers, a change in allocation criteria, with more emphasis on equalization per capita and poverty levels, would require adjustments for several states, as illustrated in Figure 2.4. For states like South Darfur, Red Sea, North Kordofan and North Darfur it would require significant adjustments, to reflect the difference in poverty rates between states.

92. In addition to the above, the cost of delivering services, due to specific geographical features of a state, could be factored in. Using population density as a proxy for unit cost of service delivery<sup>12</sup> would not have altered significantly the distribution between states. With one exception, Northern State. For South Darfur, Red Sea, North Kordofan and North Darfur it would have led to a further increase in share of federal transfers as compared with the estimates presented in Figure 2.4.

<sup>12</sup> Population density is also correlated with level of urbanization which assumed the unit cost of delivering a service is lower in urban as compared to rural less densely populated areas.

**Figure 2.4: Percent deviation of average 2005-2010 Federal transfers by state compared to transfers with different allocation criteria (in SDG million)**



Source: State final accounts, MoFNE

#### **E. STATE TRANSFERS TO LOCALITIES**

##### *Formula for allocation to localities*

93. **During 2005–2010 localities were allocated between 12 percent (Red Sea) and 30 percent (Gezira) of the total state budget.** For all localities between 71 percent and 83 percent of their budget is charged to salaries, often directly paid for from the state budget through the state consolidated payroll of civil servants. A major share of the other expenditures is for state level development projects/investments targeting specific localities. On average, localities have only discretionary authority over 11 percent of their budget (for other goods and services), the remaining 89 percent being charged to and spent from the state level budget under the authority of the state. This pattern has been almost the same throughout the 2005–2010 period.

94. **The resource levels for salary and non-salary inputs vary between the localities, and also within localities in the same state.** Some localities spend as much as 95 percent of their budget on salaries (charged by the state to the locality level budget). Others are able to raise more local revenue to finance other inputs for service delivery, some close to 30% of the total budget. Of the four states subject for detailed review, none apply a formula for allocation of transfers to localities.

95. **The procedures for allocation of budget resources to localities vary between states.** In Kassala, the state covers wages and salaries expenses for localities, with all locality employees on the state payroll. The localities collect their revenues to cover other costs, including development expenditures, with only one

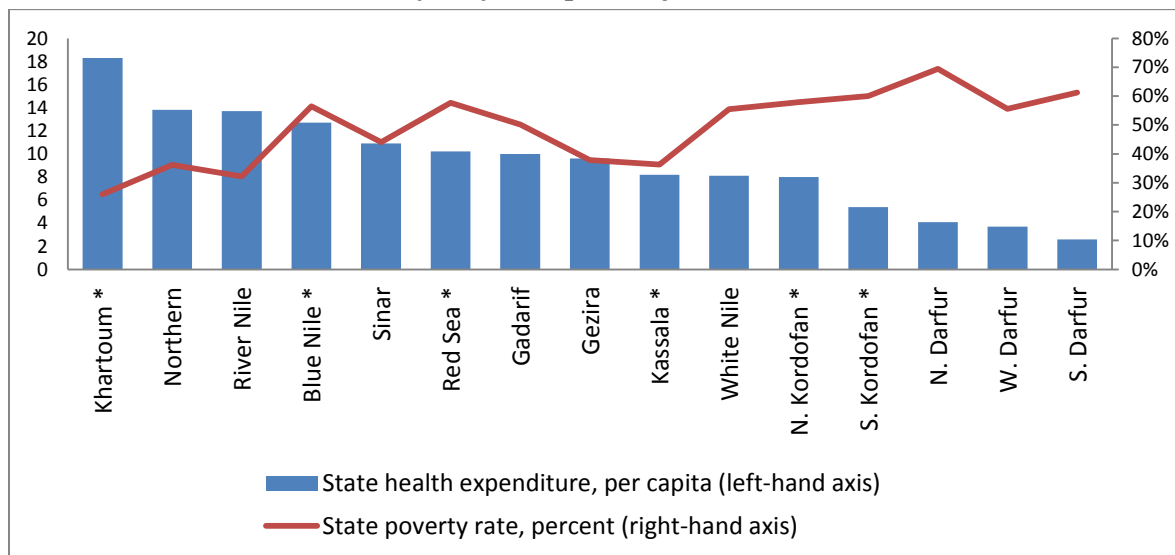
restriction: 45 percent of revenues are to be used for operational costs while 55 percent are to be allocated to development projects/investments. Additional state transfers for projects are based on requests from localities, appraised by a High Level Technical Committee consisting of representatives from key state ministries. A similar approach to state/locality revenue sharing is applied in Khartoum. The Local Government Act for Khartoum (2007) stipulates that of all state collected revenue, 25 percent is to be transferred to localities. This target has not been achieved yet and it is not clear as to whether it includes state level share of federal taxes and state level borrowing, as well as resources from state level ministries operating at locality level. As of now, the state covers all locality salaries from the state budget, while localities use their own revenue to finance all non-wage expenditure for service delivery. In North Kordofan, the state pays for locality salaries while non-wage inputs are financed from locality revenues. However, the localities also receive inputs for education and health facilities procured by the respective state ministry responsible for the sector.

**Table 2-6: Formula for allocation to localities**

Kassala	<ul style="list-style-type: none"> <li>○ State covers wages and salaries Expenses for localities with all locality employees on the State payroll.</li> <li>○ Additional State Transfers for projects are based on requests from Localities appraised by a High Level Technical committee.</li> </ul>
Khartoum	<ul style="list-style-type: none"> <li>○ State covers all locality salaries from the state budget while localities use own revenue to finance all non-wage expenditure.</li> <li>○ The Local Government Act for Khartoum (2007) stipulates that of all state collected revenue, 25 percent is to be transferred to localities. This target has not been achieved yet.</li> </ul>
North Kordufan	<ul style="list-style-type: none"> <li>○ State pays for locality salaries while non-wage inputs are financed from locality revenues.</li> <li>○ Localities also receive inputs for education and health facilities procured by respective state ministry responsible for the sector.</li> </ul>
River Nile	<ul style="list-style-type: none"> <li>○ State covers wages and salaries Expenses for localities while localities use own revenue to finance only purchase of goods and services.</li> <li>○ The State established in 2012 a Local Development Fund as a revenue sharing mechanism to allocate cement-imposed fees between localities and to be responsible for local development in all localities.</li> </ul>

96. **The analysis of the PETS data uncovered significant disparities in per capita health sector expenditures between states, between localities within states and between health centers and basic health facilities within localities.** It showed an imbalance between health expenditures and poverty rates with relatively higher spending in states with lower poverty rates as illustrated in Figure 2.5

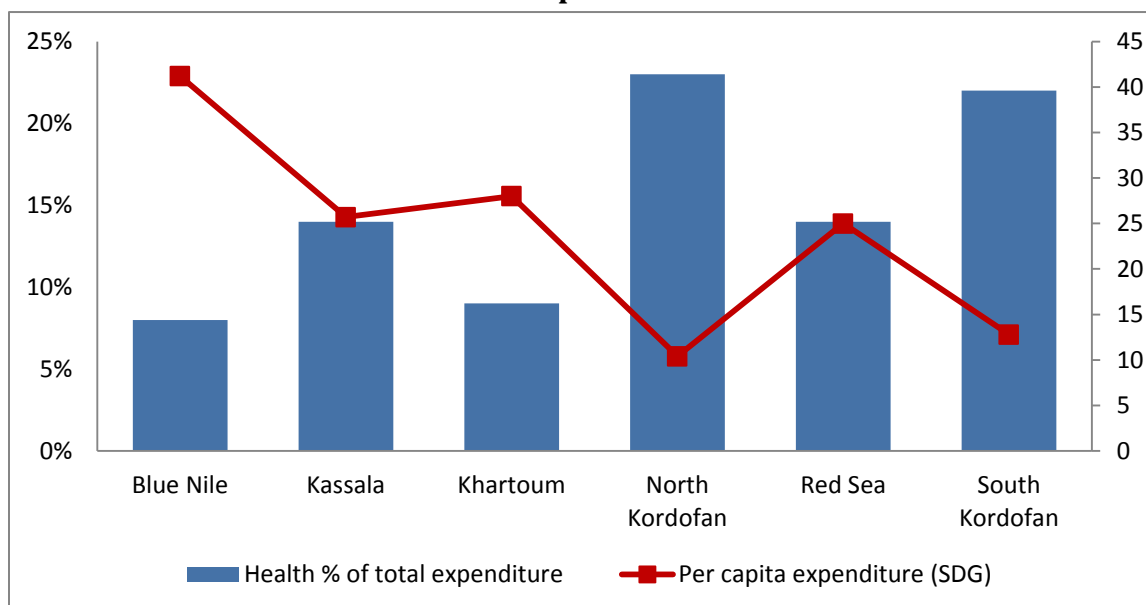
**Figure 2.5: Health spending, Northern States average per capita, 2000-09 (SDG) and poverty rates**



Source: PETS report. \* Indicate state in PETS survey.

97. **Data on aggregate expenditures at state level from the PETS survey displayed significant variations between states in level of spending on health both as shares of total expenditures and on per capita basis.** According to survey data, on average the PETS states spent 23 SDG per capita from their budget on health with Blue Nile at the high end with approximately 41 SDG and South and North Kordofan at the lower end with 10 and 13 SDG in expenditure per capita.

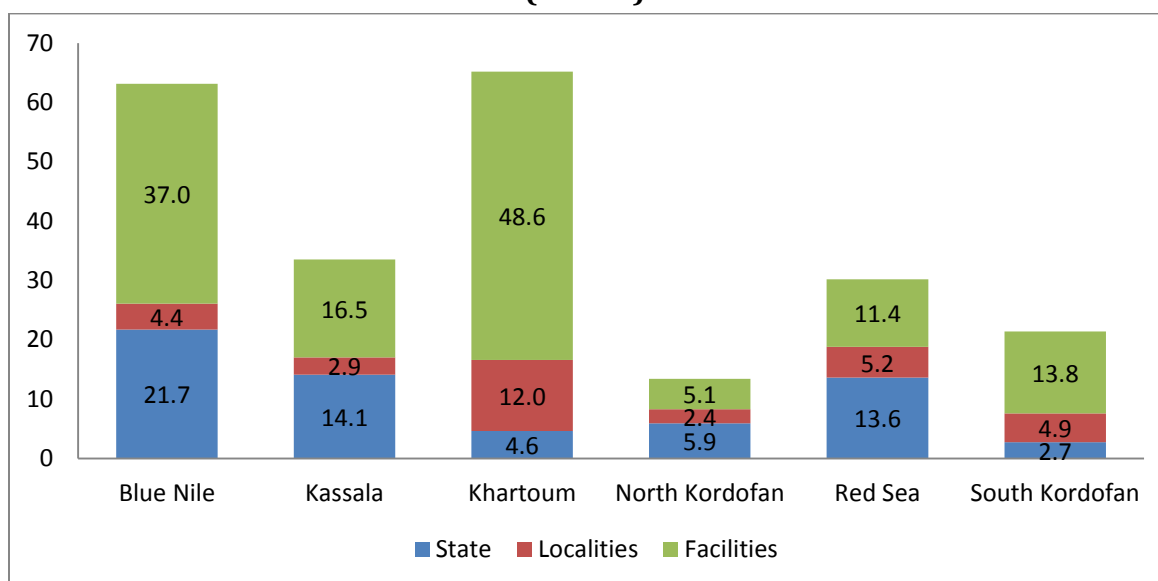
**Figure 2.6: State level expenditure on health: Per capita and percentage of total State expenditures 2009**



Source: PETS data

98. **Available resources for facilities depend on the extent to which the health sector budget is allocated to facilities and the allocation between types of facilities.** As displayed in Figure 2.7, levels of expenditures varied significantly between the states. Some states displayed a relatively high share of the budget allocated for facilities (like Khartoum and South Kordofan), while other states allocated a major share for spending at state and locality level (Red Sea).

**Figure 2.7: Per capita health sector expenditures by administrative level 2009 (in SDG)**



Source: PETS data

99. **In addition to the difference in available resources for service delivery is the extent to which facilities are able to generate own revenue in the form of fees.** For the PETS states in total, 35 percent of facility level funding was raised in the form of fees and 54 percent from federal, state and locality budgets, with the remaining 11 percent from others sources (Al Zakat, Health Insurance, donors/NGOs, etc.).

*Allocation of federal transfers*

100. **For the six states in the PETS sample, own revenue per capita was in 2009 almost nine times higher in Khartoum as compared with Blue Nile** (Table 2-7). Federal transfers “compensate” for the low revenue “capacity”, which could level out the difference as measured by total revenue per capita. As confirmed by analysis of PETS data, the allocation of federal transfers to the states determines to a large extent state per capita spending on health, but, being a mix of transfers with different allocation criteria, for some states it serves to level out differences in revenue capacity while for others it does not.

**Table 2-7: Source of revenue for sample of PETS states 2009 (in SDG per capita)**

	<b>Federal transfers</b>	<b>Own revenue</b>	<b>Total revenue</b>
Blue Nile	256.1	24.3	280.4
Kassala	87.9	76.3	164.2
Khartoum	80.9	212.5	293.4
North Kordofan	60.5	29.4	89.9
Red Sea	103.7	73.5	177.3
South Kordofan	93.5	54.6	148.1

Source: PETS data

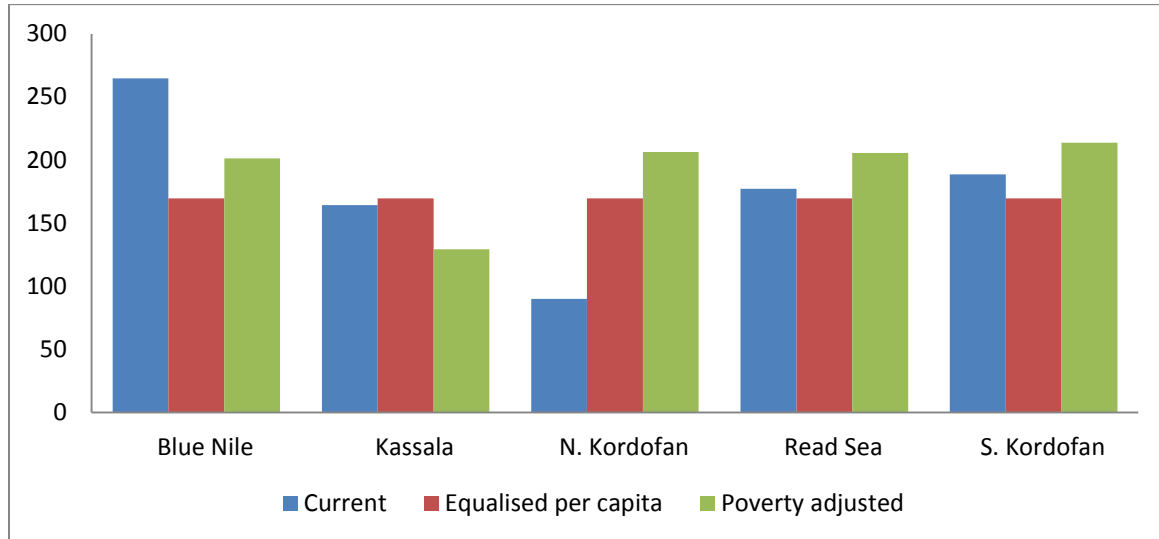
*Allocation of federal transfers*

101. **The disparity in state level per capita spending on health is first and foremost due to differences in resource envelope per capita, i.e. state level revenue capacity and federal transfers.** The significant disparity between states is partly due to the fact that the approach in allocation of federal transfers did not equalize resource levels, but also due to differences in prioritization for health among states, as reflected by the sector share of total state budget.

102. **Changing allocation to us fiscal capacity and poverty levels as the main criteria would have impacted significantly on the available budget per capita for the states.** The following compares actual transfers to the sample of PETS states with a model of all transfers made through a one formula based system. It simulates the impact by the use of two alternative formulas; a simple per capita equalization formula and a formula combining fiscal capacity and needs, by distributing the total pool of resources by these criteria, and then determining the federal transfers

required to fill the financing gap<sup>13</sup>. Actual revenue collected is used as a proxy for revenue capacity, and population and poverty level as “needs based” indicators, with the relative poverty level compared with the national average as a factor to increase or reduce the allocation per capita. Empirical evidence suggests there is a strong correlation between income/consumption poverty levels and access to basic services, as well as revenue capacity of the state and localities within the state.

**Figure 2.8: Total state budget per capita under different allocation criteria (in SDG)**



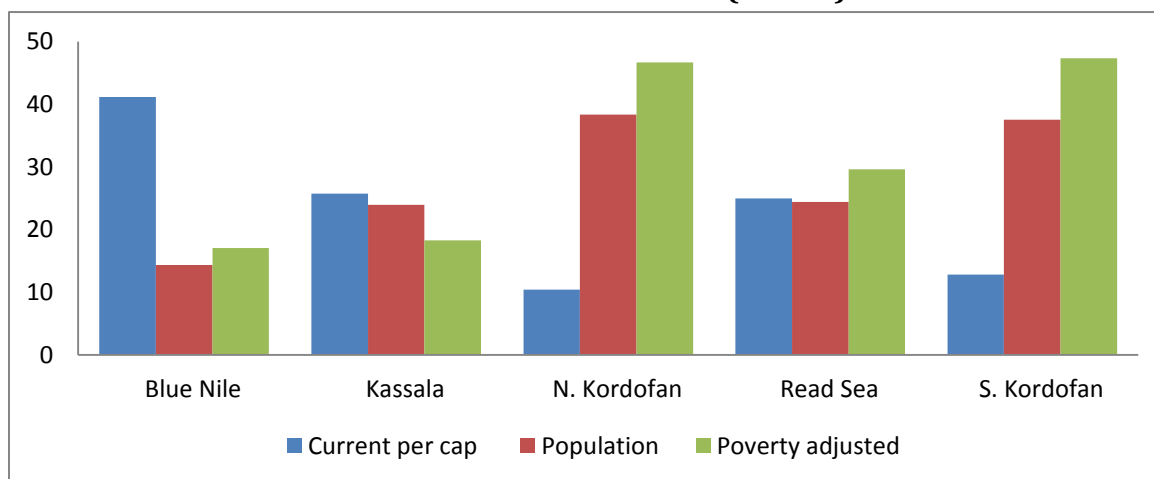
Source: PETS data

103. **All states, except for Kassala and Blue Nile, would have gained from a change to a formula taking into account poverty levels and/or other indicators reflecting needs<sup>14</sup>.** If assuming an increase in the overall resource envelope, but without any change in the health sector share of the state budget, the per capita expenditure for health would in total increase for the underserved population of states like North and South Kordofan. If the sector allocation within the state remained constant the changing level of per capita health sector expenditure would be as illustrated Figure 2.9.

<sup>13</sup> Obviously, determining a revenue collection target based on the assumed revenue capacity of the state is the preferred approach rather than filling whatever “gap” is due to shortfall in revenue collection. For purposes of the calculation, however, we use the actual revenue collected as a proxy for the current revenue potential.

<sup>14</sup> The high per capita level for Blue Nile in 2009 was due to an exceptionally high level of discretionary project grants (an increase of 83 percent in total federal transfers/grants compared with the previous year).

**Figure 2.9: State budget allocation for health per capita by different allocation models of federal transfers (in SDG)**



Source: PETS data

### *Allocation to facilities*

104. **One of the recommendations from the PETS was to adjust the system for allocation of state/locality transfers to facilities and consider a formula based system that takes into account size of population and type of facilities across the state.** A formula based allocation system could potentially reduce disparities and promote transparency and predictability in resource allocation for the facilities. The analysis of PETS data at state and locality level showed that different states use different approaches for funding of facilities, and many only make incremental adjustments to the allocations compared with the previous years' budget, which then maintains facility level imbalances.

105. **The total amount allocated to facilities depends on several factors. One key factor is the actual resources available for the state budget.** Another factor is the share of the budget actually allocated to health, i.e. the extent to which the state prioritizes health sector expenditure as compared with other priority expenditure. The amount of the health budget actually supporting facilities depends on the amount of the budget allocated to the different levels of the health system, i.e. the share of the total resources eventually transferred to facilities or used for procurement of goods and services provided to them as in kind contributions.



**Table 2-8: Federal, state and locality funding per state hospital bed 2009 (in SDG)**

State	Number of hospitals in the sample	Average funding per bed	St. Dev. percent of average
Blue Nile	7	5,591	89 %
Kassala	4	9,559	47 %
Khartoum	6	18,861	75 %
Northern Kordofan	7	5,413	57 %
Red Sea	8	6,464	100 %
Southern Kordofan	8	7,654	55 %

Source: PETS data

106. According to the PETS data there are significant disparities in availability of funds between the same types of facilities in a state, in the same way as for the same type of facilities between states. The difference is clearly illustrated in Table 3, which shows a standard deviation compared with hospital average of up to 100 percent in some states. Even for the states with lowest variance the standard deviation compared with hospital average was 47-57 percent. The same disparity in funding was also observed for primary level facilities, as illustrated in Table 2-9. The allocation per BHU appears not to be uniform and not to reflect a formula based allocation procedure.

**Table 2-9: Federal, state and locality funding per Basic Health Unit 2009 (in SDG)**

State	Number of BHUs in the sample	Average funding per BHU	St. Dev. percent of average
Blue Nile	27	28,293	59 %
Kassala	23	28,454	94 %
Khartoum	15	25,094	46 %
Northern Kordofan	33	11,929	76 %
Red Sea	39	15,498	102 %
Southern Kordofan	18	14,289	56 %

Source: PETS data

107. While overall coverage of basic health service facilities remains low, there are also significant urban/rural and regional disparities in the availability of health resources and services. The standards set by the health authorities for the population coverage of the different types of health institutions are: 100,000 – 250,000 for rural/community hospitals; 20,000 – 50,000 for health centers; and 5,000 for primary/basic health units. Data from the PETS survey indicate that the population coverage for hospitals and health centers is within the standards, but not for BHUs.

**Table 2-10: Population density by type of facility**

	Population	Number of facilities			Population per facility		
		Hospitals	HC	BHU	Hospitals	HC	BHU
Blue Nile	832,112	16	36	151	52,007	23,114	5,511
Kassala	1,789,806	23	86	199	77,818	20,812	8,994
Khartoum	5,274,321	59	370	181	89,395	14,255	29,140
N. Kordofan	2,920,992	29	72	349	100,724	40,569	8,370
Red Sea	1,396,110	23	55	136	60,700	25,384	10,266
S. Kordofan	1,406,404	13	103	222	108,185	13,654	6,335

Source: PETS data

108. **A unified formula based allocation system could potentially help raise resource levels and contribute to a more equitable delivery of services by facilities.** However, designing an allocation formula that reflects different dimensions, such as needs and revenue generating capacities, is more challenging for state level allocation systems. This is because the availability of disaggregated health, demographic and poverty data, as well as data on cost drivers and other information to compensate for differences in service delivery costs is more limited at locality, as well as facility, levels.

#### *Allocation to hospitals*

109. **The impact of unified unit cost per hospital bed depends on the current capacity within the state (number of hospitals and hospital beds), as measured by number of hospital beds relative to the population and the current level of allocations to the hospitals in each state.** Table 2-11 illustrates the budgetary impact for each of the states in the PETS sample of applying a unified cost allocation formula for hospitals. It assesses the impact of using the current average as well as the highest average for the states in the sample, as a norm for grant allocation to hospitals<sup>15</sup>.

110. **The impact of an allocation system based on cost unification for hospitals would require a major increase in budget allocation for hospitals in Blue Nile.** To accommodate the required budget increase, simultaneously with a change in allocation of federal transfers as illustrated above (for Blue Nile a reduced share of federal transfers), it will require a change in the share of the health sector budget allocated to facilities, which in Blue Nile is lower than for many of the other states.

<sup>15</sup> We do not have data to suggest a specific unit cost per hospital bed as a norm for what would result in an adequate quality of service; hence we use the average for the states at 6,700 SDG per bed, and the state with the highest average of 9,600 SDG, as proxies.

**Table 2-11: Cost per bed and impact of unification in unit cost per bed for hospitals (in SDG)**

State	PETS data			6,700 SDG per bed		9,600 SDG per bed	
	Beds per 100,000 population	Cost per bed in SDG	SDG per capita	Change in budget allocation	SDG per capita	Change in budget allocation	SDG per capita
Blue Nile	177	5,591	9.9	20 %	11.9	71.7 %	17.0
Kassala	127	9,559	12.1	-30 %	8.5	0.4 %	12.2
Northern Kordofan	40	5,413	2.1	24 %	2.7	77.4 %	3.8
Red Sea	101	6,464	6.5	4 %	6.8	48.5 %	9.7
Southern Kordofan	71	7,654	5.4	-12 %	4.8	25.4 %	6.8

Source: PETS data

**111. The state of Kassala has above average allocation per hospital bed and unification of allocations to state average would imply a reduction in the overall budget.** Kassala has the highest average expenditure per hospital bed from the outset and if used as the norm for all states with 9,700 SDG per bed, it will have no budgetary impact<sup>16</sup>.

**112. North Kordofan has from the outset a low health sector budget and budget for hospitals relative to its population, with the lowest coverage in terms of beds.** A change in allocation of federal transfers as illustrated above would more than compensate for the required additional funding. The same would apply to South Kordofan, while Red Sea would in addition need to allocate a higher share of its health budget for hospitals. South Kordofan has, like North Kordofan, limited coverage as compared with the average, but allocates more per hospital bed than North Kordofan and more than the average for the states in total.

#### *Health centers*

**113. Hospitals unification in the procedure for allocation to health centers budgets would imply an increase in budgets for the states which from the outset have lowest level of infrastructure (North Kordofan) and/or lowest allocation per unit compared with the facility level capacity (South Kordofan).** Health centers, like hospitals, vary in size and capacity with the different sizes of targeted population they are intended to serve. In some states health centers also offer a limited level of inpatient services, in others only outpatient services. For health centers the unit of account used is population catchment area based on information from each of the health centers included in the PETS data. We use the average for all states (excluding Khartoum) as the unit of account as a proxy to an assumed cost of a minimum package of health services from health centers. The same approach is used for BHUs. As with health centers, the average transfer per

<sup>16</sup> The 0.4 percent change is due to the benchmark unit cost rounded upwards to 9,600 SDG as compared to the Kassala average of 9,559 SDG.

type of facility is likely to be too low to meet basic health care needs and outreach to the target population.

**Table 2-12: Per capita allocation for Health centers and impact of unification of budget allocation (in SDG)**

State	PETS data		Per capita average 3.1 SDG		Per capita 6.7 SDG	
	Population per HC	Per capita expenditure	Change in budget allocation HC	Change in health sector budget	Change in budget allocation HC	Change in health sector budget
Blue Nile	23,114	6.7	-53 %	-6 %	-	-
Kassala	20,812	2.7	18 %	1 %	152 %	12 %
Northern Kordofan	40,569	2.0	56 %	8 %	233 %	35 %
Red Sea	25,384	3.9	-19 %	-2 %	74 %	9 %
Southern Kordofan	13,654	3.2	-3 %	-1 %	106 %	16 %

Source: PETS data

#### *Basic Health Units (BHU)*

114. **Using the same approach for BHUs will have the same impact on state budgets for North and South Kordofan, both with the lowest overall resource envelope.** For both the states an increase to the level of the state of Kassala would need to be accommodated by the change in federal allocation. For Blue Nile an increased allocation would require a change in budget allocation while for Red Sea it would be a combination of both increase in federal transfers and a higher share of the health budget allocated to facilities.

**Table 2-13: Per capita allocation for Basic Health Units and impact of unification of budget allocation (in SDG)**

State	PETS data		Per capita average 2.5 SDG		Per capita 4.1 SDG	
	Population per BHU	Per capita expenditure	Change in budget allocation BHU	Change in health sector budget	Change in budget allocation BHU	Change in health sector budget
Blue Nile	5,511	2.3	7 %	0 %	76 %	3 %
Kassala	8,994	4.1	-39 %	-5 %	-	-
Northern Kordofan	8,370	1.6	54 %	7 %	153 %	19 %
Red Sea	10,266	2.8	-11 %	-1 %	46 %	4 %
Southern Kordofan	6,335	2.1	21 %	2 %	99 %	10 %

Source: PETS data

115. **The illustrations above have considered only one dimension for hospitals (allocation per bed) and one for health centers and BHUs (population). Using size of population means assuming the same needs and cost impact across states and localities.** If data had been available on location of the different health centers, to assess likely cost impacts of lower density/higher geographical outreach, along with disaggregated health data to determine areas with assumed higher needs measured by, among others, burden of disease (e.g. expressed by under five year mortality rates), etc., then the allocation formula could have been expanded taking the above dimensions into account.

116. **If assuming facilities in urban communities have lower outreach costs than rural areas with lower population densities, it would impact on the above results, with higher unit costs for states like Red Sea, South and North Kordofan.** Key health indicators, like under-five mortality rates, could have been applied to adjust for differences in health status between the states and localities within each state. This would have impacted further on allocations for Red Sea, Blue Nile and South Kordofan.

#### **F. DID FISCAL DECENTRALIZATION HELP TO NARROW REGIONAL IMBALANCES?**

117. **Almost two decades into decentralization, progress to address the wide regional disparities is ongoing and development imbalances and variations in poverty levels are still significant across states.** Moreover, regional imbalances are mirrored by very significant differences in allocations of public finance in states, the revenue-generating capacity of states, poverty reduction outcomes, and basic service delivery progress.

*Poverty rates vary widely across states*

118. **Poverty in Sudan is widespread and rates vary significantly across States.** Official poverty rates based on consumption data, collected in 2009<sup>17</sup>, suggest that overall 46.5 percent of Sudan's population lives below the poverty line and cannot afford to purchase the minimum consumption bundle. There is tremendous variation the poverty rates across states. Poverty rates are substantially lower in Khartoum (26 percent), River Nile (32 percent), Kassala (36 percent), Northern (36 percent), and Al Gezira (38 percent) as compared with those in North Darfur (69 percent), South Darfur (61 percent), South Kordofan (60 percent), North Kordofan (58 percent), and West Darfur (56 percent) (World Bank, *A poverty profile for the Northern States of Sudan*, 2011).

119. **Computation of poverty statistics, based on a wealth index constructed using 2008 Census data, suggests a very similar spatial distribution of poverty within States in Sudan**<sup>18</sup>. Census data also allow estimation of poverty numbers at

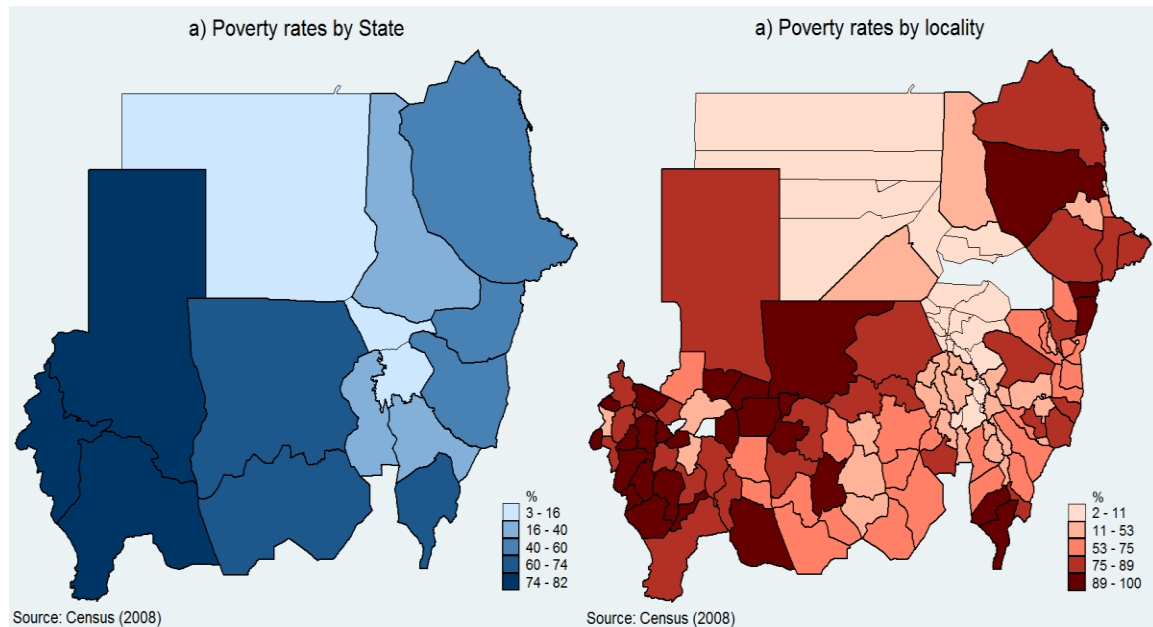
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<sup>17</sup> *Sudan National Budget Household Survey (NBHS)*, 2009.

<sup>18</sup> See Annex 1 for method used for estimating relative poverty rates at the locality level.

the locality level, which suggest inequality is largely a cross-state phenomenon. In particular, poverty levels across localities within states are quite homogenous and do not substantially vary, as compared with the levels observed across localities from different states (Figure 2.10, Panel b).

**Figure 2.10: Poverty rates by State and Locality (Percentage of households in lower 46.5 percent of the national wealth index distribution)**

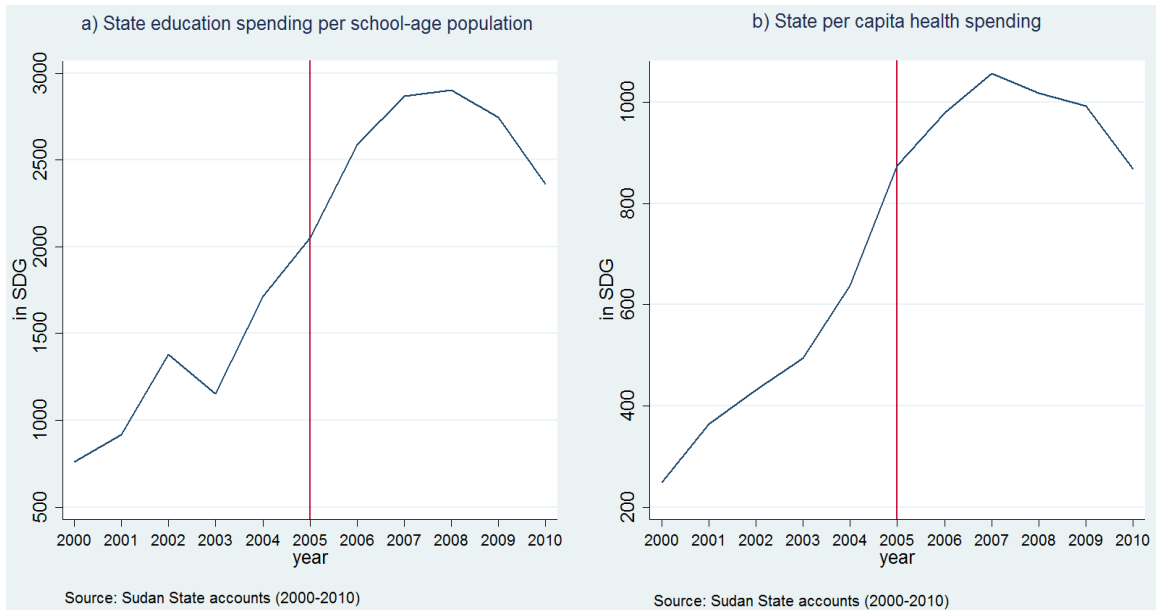


Note: Primary sampling unit identifiers are not available in the Census data and, therefore, estimates are not fully adjusted for sampling design (i.e. they are computed using sampling weights only). Poverty rates are calculated as the percentage of households in the bottom 45th percentile of the national household wealth index distribution based on the 46.5 percent official poverty rate estimate (National Baseline Household Survey, 2009). The boundaries shown do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries

### *Differences in fiscal spending allocations across in states*

**120. Fiscal decentralization has brought considerable extra resources to the States and substantially increased overall per capita social spending over the past ten years.** Federal spending in health and education at the state level has substantially increased over the past decade, particularly since the establishment of the Interim Constitution (INC) in 2005. In real terms, and after adjusting for population growth, education spending as per school-age population has grown by an average of 22 per percent per year, from 697 SDG in 2000 to 2,242 SDG in 2010. This suggests the government has put substantial efforts into expanding public education and increasing enrollment among school-age children (Figure 2.11, Panel a). Per capita health spending by the federal government at the state level has also followed a very similar trend. In real terms, and after adjusting for population growth, per capita health spending has grown by an average of 26 per percent per year, from 229 SDG in 2000 to 829 SDG in 2010 (Figure 2.11, Panel b).

**Figure 2.11: Federal health and education spending**



Note: Federal spending in health and education includes all federal spending in wages and salaries, goods and services, and development in the health and education sectors. These numbers can be considered under-estimates of the true amounts spent in education as they exclude all spending funded by State and local revenue sources. All numbers adjusted for inflation (CPI base=2000). Population estimates come from the WDI dataset. School-age population estimates are based on the 2010 population growth rate reported in the WDI dataset and estimated from the National Baseline Household survey (2009) data. In August 2005, the West Kordofan State was abolished and its territory divided between the North and South Kordofan States. The two states in the region of Kordofan are, therefore, excluded from all of the analysis involving cross year comparisons between 2000-2004 and 2005-2010. The boundaries shown do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

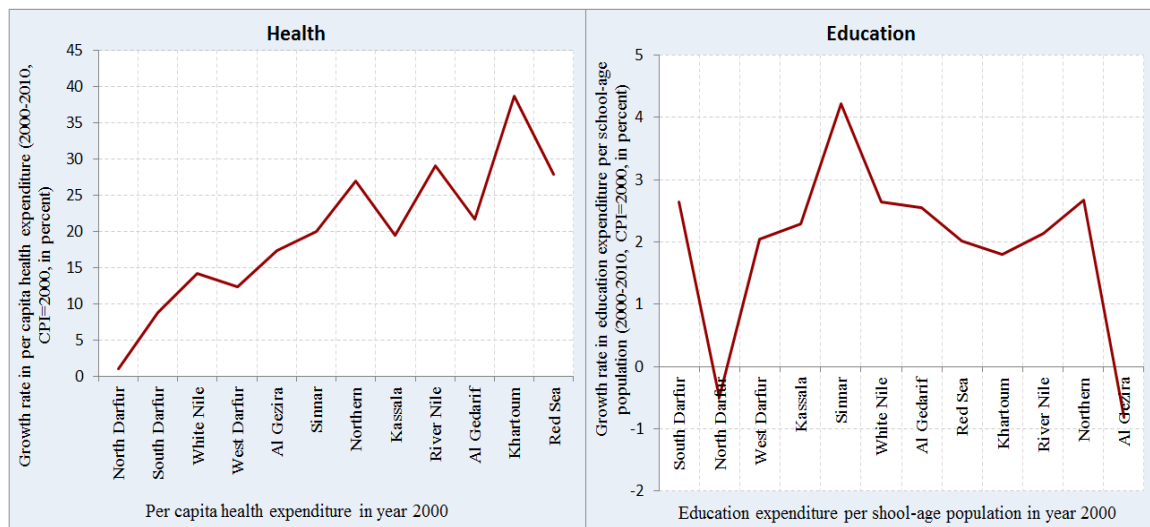
**121. The distribution of real growth in social spending between 2000 and 2010 shows significant difference between the health and education sectors, with education spending being more pro-poor and health spending disproportionately benefiting people from relatively richer states.** Figure 2.12 presents “growth-incidence curves” for health and education spending across states between 2000 and 2010, based on state accounts. These curves show the relationship between average growth rates in health and education spending as a function of baseline levels of health and education spending in each state. States located close to the origin are states with relatively lower levels of social spending per capita at baseline. This pattern would have required higher investments by the federal government over the past decade to counter some of the original unequal distribution of resources.

**122. The increase in health spending by the federal government has disproportionately benefited states with higher levels of health spending at baseline** (Figure 2.12, left panel). This means that states which were better-off at baseline, or relatively richer, have received substantially more resources from the federal government, as compared with those states which were receiving relatively



less resources at the baseline. This point can be illustrated by the case of North Darfur, South Darfur, and White Nile, which had the lowest levels of per capita investment in health in 2000, at 0.68 SDG, 0.85 SDG, and 1.97 SDG, respectively. On average, these three states have increased their per capital health spending in real terms by 54 percent per year. While this growth rate in health spending seems quite large, it is actually much lower than the 62 percent per year observed for the three with higher per capita health spending at baseline, i.e. Red Sea (4.84 SDG), Khartoum (3.93 SDG), and Al Gedarif (3.57 SDG). In contrast, the patterns of growth of education spending by the federal government have followed a more equal distribution of resources. In particular, the increase in education spending per school-age population, after adjusting for inflation and population growth, has benefited states more equally independently of their baseline education spending levels, especially as regards states in the middle of the distribution (Figure 2.12, right panel).

**Figure 2.12: Growth in spending per school-age population by State (2000-2010, CPI=2000)**



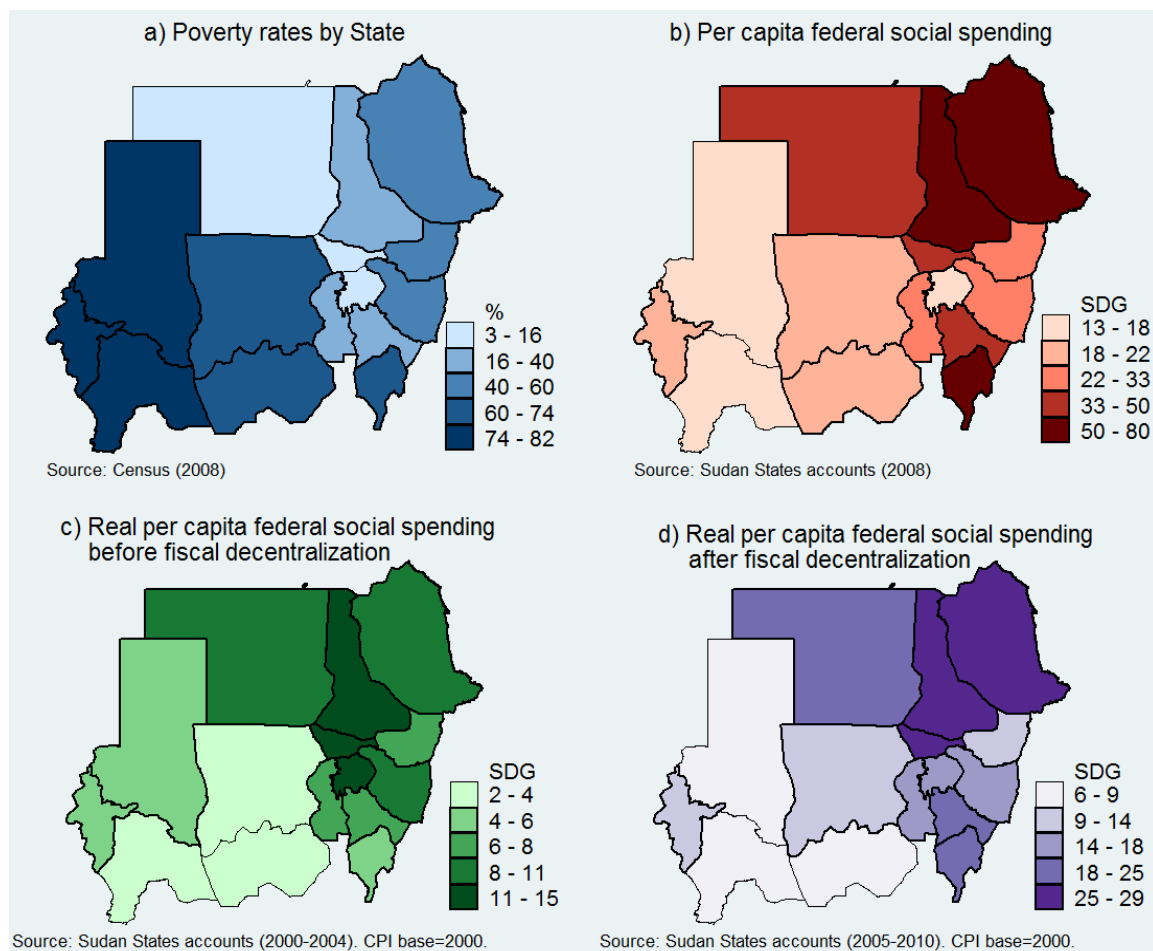
Note: The share of federal spending in health and education includes all federal spending in wages and salaries, goods and services, and development in the education sector. These numbers can be considered under-estimates of the true amounts spent in education as they exclude all spending funded by State and local revenue sources. All numbers adjusted for inflation (CPI base=2000). Per capita estimates are based on the 2010 national population growth rate reported in the WDI dataset and estimated from the National Baseline Household survey (2009) data. School-age population estimates are based on the 2010 national population growth rate reported in the WDI dataset and estimated from the National Baseline Household survey (2009) data. In August 2005, the West Kordofan State was abolished and its territory divided between the North and South Kordofan States. The two states in the region of Kordofan are, therefore, excluded from all of the analysis involving cross year comparisons between 2000-2004 and 2005-2010.

**123. The observed increase in social spending has not translated into a more balanced distribution of resources by the government to address inequality across states and reduce poverty gaps.** Public spending on social investments, as measured by per capita federal spending in health and education, is



disproportionately allocated across states, largely favoring states with low incidence of poverty as measured by census data (Figure 2.13, Panel a). In 2008, West, North, and South Darfur were the States with the highest poverty rates in the country (at 82 percent, 79 percent, and 78 percent, respectively). Yet, annual per capita social expenditure in these three states was on average only a third of that reported for the richest state in the country, Khartoum. (West Darfur, 22 SDG; North Darfur, 17 SDG; South Darfur, 13 SDG; Khartoum, 48 SDG) (Figure 2.13, Panel b). It also appears that fiscal decentralization has not had any observable effect in the way in which federal resources are allocated towards social investments by the states. Figure 2.13 (panels (c) and (d)) show the average real per capita spending in health and education before and after fiscal decentralization, with allocation patterns seeming to have remained largely unchanged.

**Figure 2.13: Poverty rates and per capita federal expenditure in health and education**



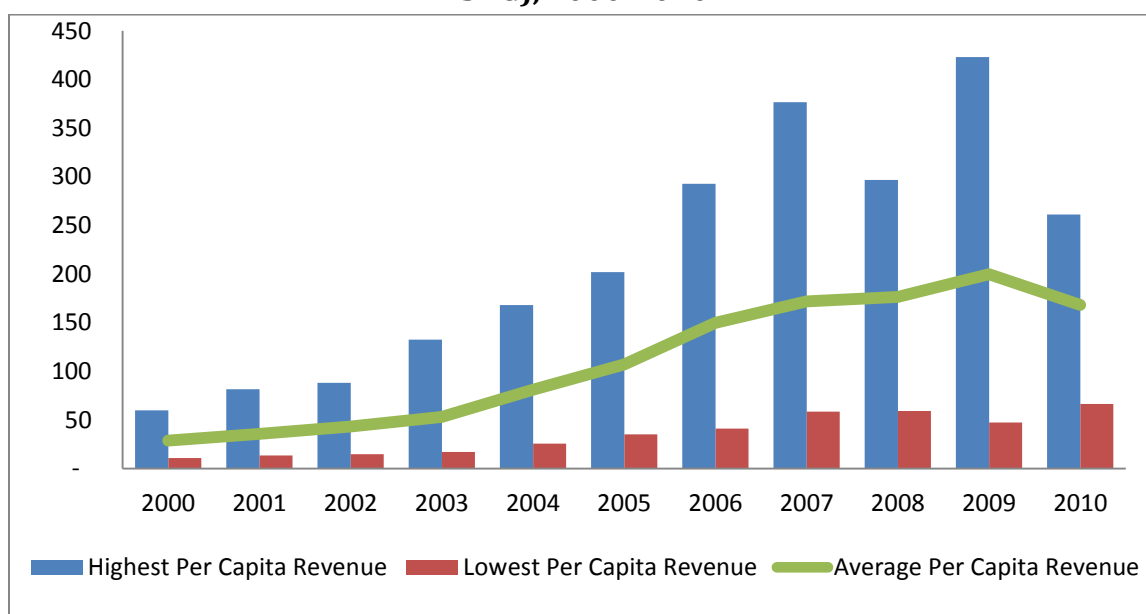
Note: Poverty rates are computed using the Sudan Census (2008). Poor households are defined as those in the lower 45% of the national wealth index distribution. Primary sampling unit identifiers are not available in the Census data and, therefore, estimates are not fully adjusted for sampling design (i.e. they are computed using sampling weights only). Poverty rates are calculated as the percentage of households in the bottom 45th percentile of the national household wealth index distribution based on the 46.5 percent official poverty rate estimate (National Baseline Household

Survey, 2009). The share of federal spending in health and education includes all federal money paid in the form of block grants to the States allocated to health and education wages and salaries, goods and services, and development by the States. These numbers can be considered under-estimates of the real amount spent in health and education as they exclude spending funded by local government revenue sources. In August 2005, the West Kordofan State was abolished and its territory divided between the North and South Kordofan States. The two states in the region of Kordofan are, therefore, excluded from all of the analysis involving cross year comparisons between 2000-2004 and 2005-2010. The boundaries shown do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

### *Significant differences in the revenue-generating capacity of states*

**124. Sudan's diversity in economic opportunity is mirrored in large disparities in the revenue-generating capacity of sub-national governments.** Since decentralization took off over the past decade, sub-national the revenue-generating capacity of sub-national governments has improved, but with growing disparities across the states. While per capita revenue of states has grown over five-fold since 2000, disparity in revenue-generating capacity remains remarkable and is even widening over time (Figure 2.14). Average state's per capita revenue varies from about 192 SDG in the highest revenue-generating capacity states, to 37 SDG in the lower revenue-generating capacity states.

**Figure 2.14: Disparities in States' revenue-generating capacity, (in per Capita SDG), 2000-2010**

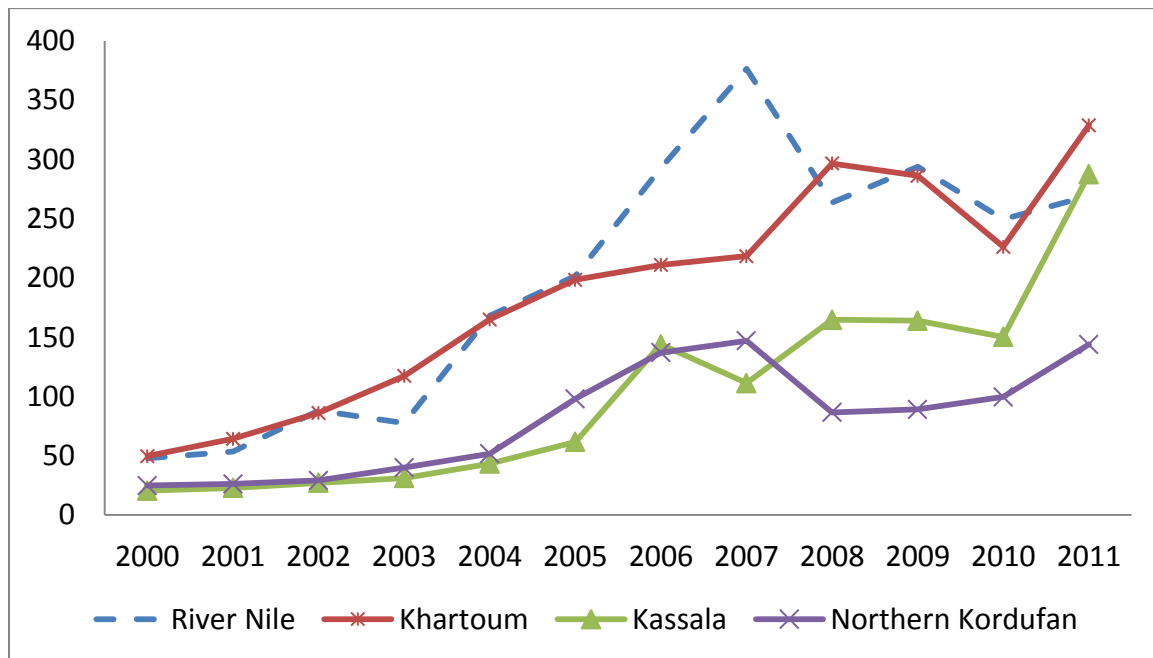


Source: State Final Accounts Report, MoFNE

**125. Disparities in revenue-generating capacity across states started to increase after the 2005 CPA and INC strengthened decentralization efforts; these imbalances reflect a wide variation across states in natural endowments, economic opportunities, and levels of development.** In the four selected states, data show that disparities in revenues have risen remarkably since 2005 and have

grown persistently over time (figure 2.15). On average, the per capita revenue of Khartoum and River Nile, two high economic opportunity states, is more than double that of Kassala and North Kordofan states. This supports the assumption that major urbanized states might be able to generate a substantial proportion of revenues from property taxes and levies on businesses, whilst less urbanized states may have little to no tax potential from these sources. Chapter 3 of this report discusses in more depth the key factors underlying these disparities in revenue-generating capacity across states.

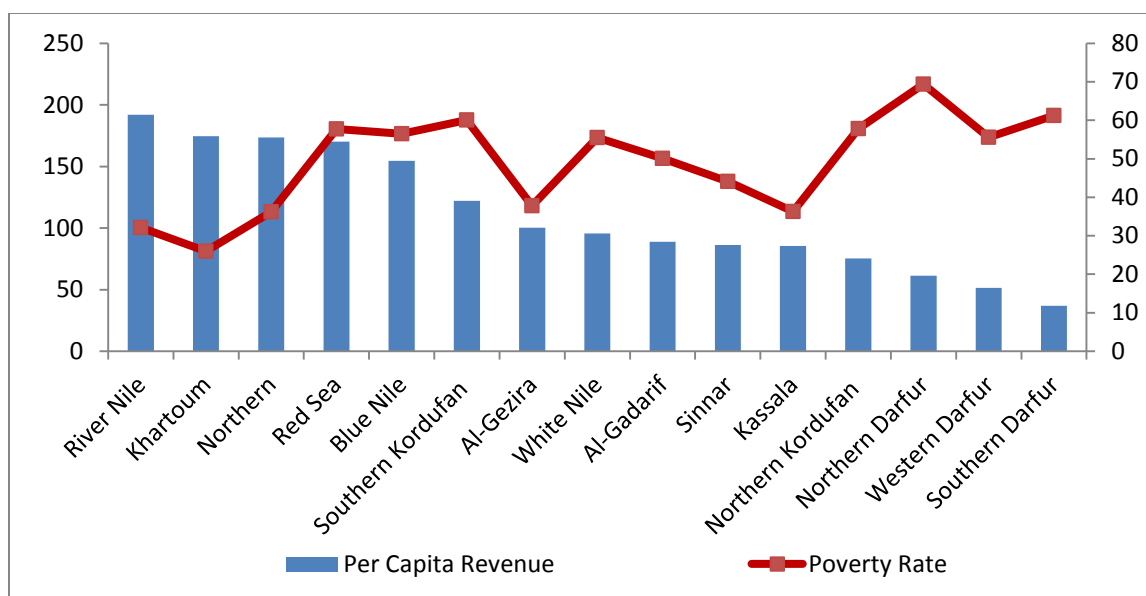
**Figure 2.15: Disparities in revenue-generating capacity in selected states, (in per Capita SDG), 2000-2010**



Source: State Final Accounts Report, MoFNE

126. **States that have lower revenue-generating capacity tend to be hardest hit by poverty.** This suggests the need for a more targeted inter-governmental transfers system, to balance the effects of lower fiscal revenue in some states. The relationship between poverty and fiscal revenues is strong, with negative strong correlation (coefficient -0.54). States that struggle with higher poverty rates have less per capita revenue (e.g. North Kordofan, North Darfur, West Darfur and South Darfur), while States with lower poverty headcount rates have relatively more per capita fiscal resources (figure 2.16).

**Figure 2.16: State's poverty rate and state's average per capita revenue, 2000-2010**



Source: Final Accounts Report, MoFNE

**127. To fulfill poverty reduction responsibility, lower revenue-generating capacity states need adequate resources to meet expenditures and address local needs.** The financial potential of these states to deliver on their responsibilities is tenuous, as they are heavily reliant on fiscal transfers from the federal government, at a time when a fiscal crisis is unfolding at the federal level. The system of federal transfers to states is discretionary, in the sense that while the INC of 2005 commits to decentralization and pro-poor development, simple formulas for implementation are neither enshrined in the INC nor fully enforced (Sudan PETS, 2011).

#### *Daunting challenges to basic services access*

**128. Political and fiscal decentralization coincided with a decade of economic growth, prior to 2011, fueled by oil revenues. This opened tremendous opportunities to accelerate progress towards the Millennium Development Goals and address the wide regional disparities in access to basic service outcomes.** However, these opportunities were largely missed (Box 2.3). Progress so far has been limited, with little evidence of improvements in social indicators such as educational enrolment or infant mortality. There are a number of recent representative income and non-income poverty outcomes data sources from which to generate population based social indicators for Sudan. These data sources include the 1989-1990 Sudan Demographic and Health Survey (DHS), the 2006 and 2010 Sudan Household Health Survey (SHHS), the 2008 Census and the 2009 National Baseline Household Survey (NBHS).

#### **Box 2.3: Sudan had missed a chance to build the foundations of a vibrant non-oil economy**

Looking back at the oil boom of 1999–2010, Sudan missed a chance to build the foundations of a

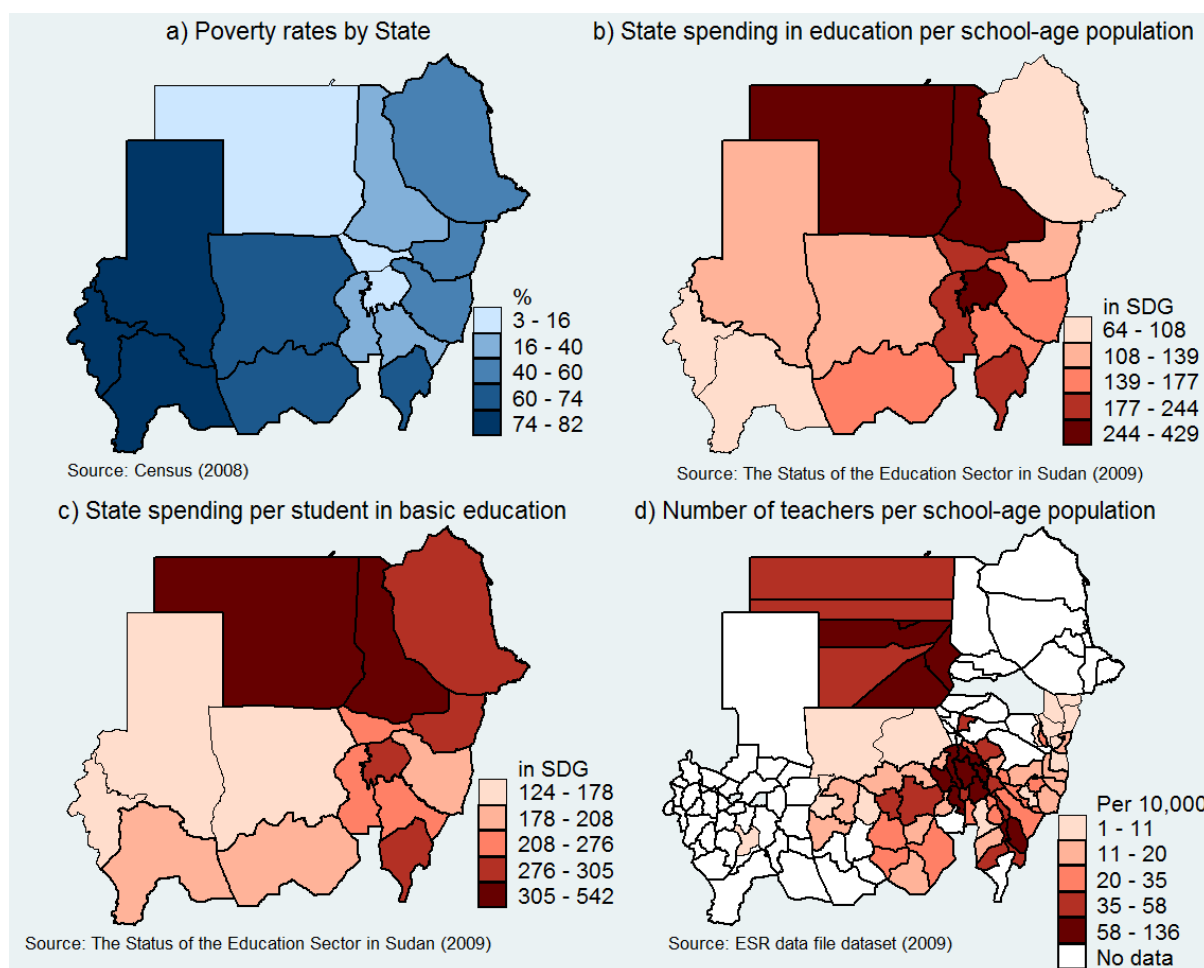
vibrant non-oil economy. Oil reserves were not converted into equivalent public investments in education and infrastructure. During the oil boom, Sudan was heavily reliant on the oil sector and failed to diversify its economy. The value of oil extracted far outweighed the resources used for public investment. After adjustment for the value of oil depletion, environmental degradation and education expenditures, national net savings were highly negative, averaging -7.4 percent of GNI for the period 2000 – 2010, which means the country as a whole was consuming away a large fraction of its wealth. In short, the oil boom masked the fact that the economy was geared towards consumption and imports, rather than production and exports, an unsustainable growth path. (World Bank: *Sudan Economic Brief*, January 2013.)

#### *Access to education services*

**129. Regional imbalances are consistently robust and clearly evident when looking at the state and locality-level education outcomes for different states** (Figure 2.17). The government's efforts to expand public education among school-age children can be measured by looking at state education spending per school-age population. Based on this measure, federal government investments across states are strikingly different, particularly favoring the expansion of basic education in relatively richer states. In 2009, state spending in education per school-age population in South Darfur (64 SDG), West Darfur (96 SDG), and North Darfur (115 SDG) was on average half of that in Khartoum (216 SDG), and a fourth of that in Northern (429 SDG), considered two of the richest states in the country. State education spending per student, which measures the government effort to improve the quality and access to education among children already enrolled in school, shows similar patterns. Exceptions are the Red Sea and Kassala states, where the government seems to be investing disproportionately more on improving quality and access to education among students, as compared with other states which have similar levels of poverty.

**130. Imbalances in education investments are also clearly apparent when looking at education outcomes at the locality level** (Figure 2.17). In particular, the number of teachers per school-age population is consistently far higher in localities with the lowest poverty rates in the country.

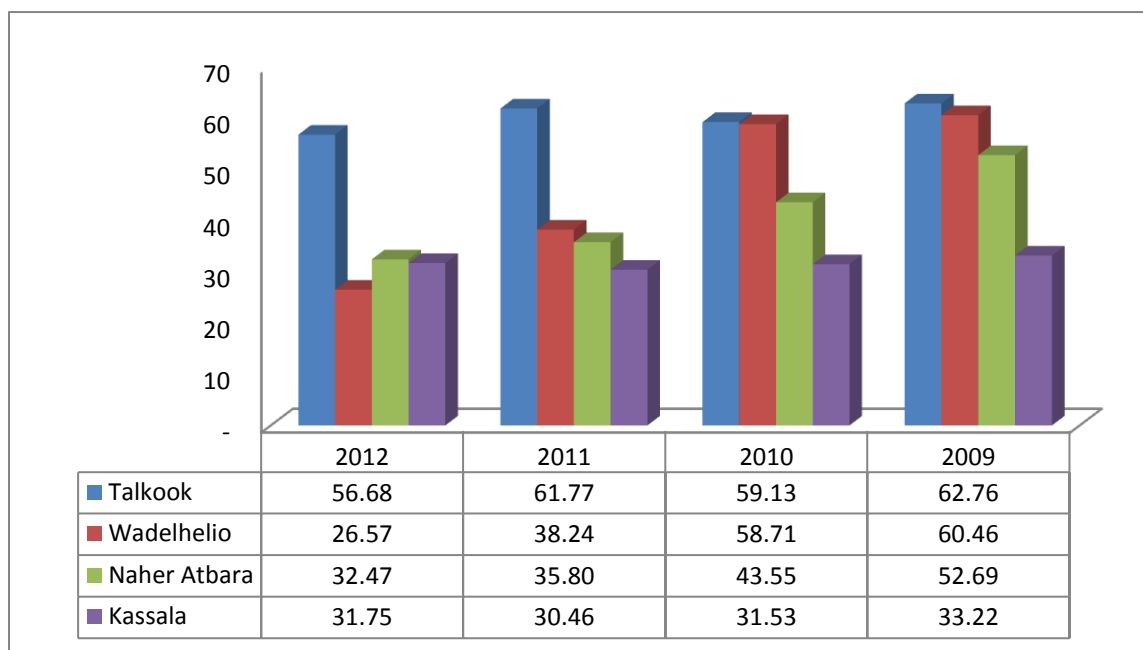
**Figure 2.17: Poverty rates and education outcomes**



Note: Poverty rates are computed using the Sudan Census (2008). Poor households are defined as those in the lower 45% of the national wealth index distribution. Primary sampling unit identifiers are not available in the Census data and, therefore, estimates are not fully adjusted for sampling design (i.e. they are computed using sampling weights only). Poverty rates are calculated as the percentage of households in the bottom 45th percentile of the national household wealth index distribution based on the 46.5 percent official poverty rate estimate (National Baseline Household Survey, 2009). Education spending data come from The Status of the Education Sector in Sudan (2009) conducted by the Human Development team of the World Bank. Number of teachers and pupils come from ESR data file (2009) provided by the Human Development team. The boundaries shown do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

**131. Disparities in teacher distribution are particularly evident when looking at the supply of teachers in urban, rural and remote schools** (Figure 2.18). For example, the average Student-Teacher Ratio (STR) in Kassala Locality (the capital of Kassala State) is 31, compared with 60 for Talkook Locality (a rural locality). Surprisingly, this is not the case in River Nile state, where the STR is almost the same across localities.

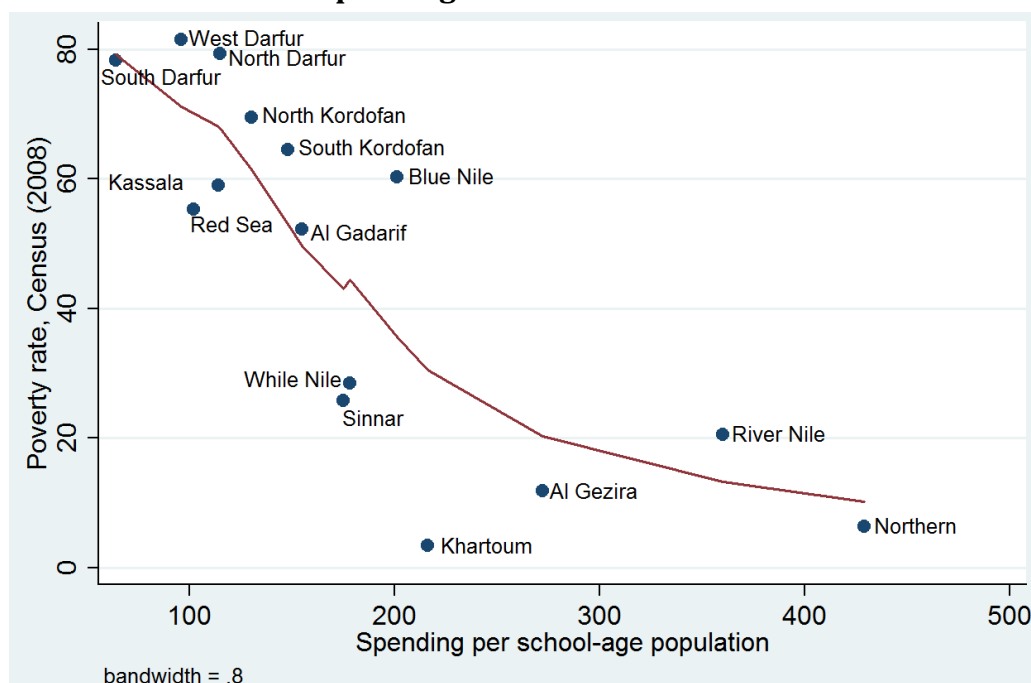
**Figure 2.18: Student- Teacher Ratios (STRs) across localities in Kassala State, 2009-2012**



Source: Ministry of Education-Kassala State

132. **The relationship between poverty rates and social spending is strongly negative, suggesting the existence of important imbalances in the way in which federal resources are allocated across states.** Regression analysis using education spending data as a case study confirms that the relationship between state-level poverty and social spending is strongly negative, which means that over time this allocation pattern is contributing to and perpetuating poverty gaps across states (Figure 2.19).

**Figure 2.19: Relationship between State poverty rate and per-student spending in basic education**



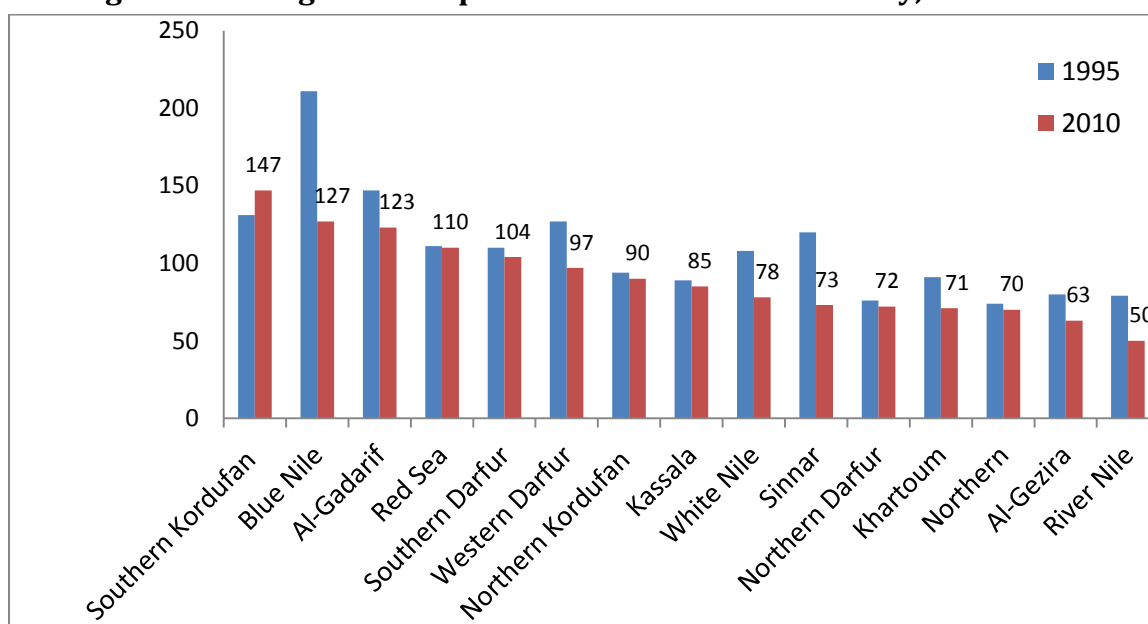
Note: Poverty rates are computed using the Sudan Census (2008). Poor households are defined as those in the lower 45% of the national wealth index distribution. Primary sampling unit identifiers are not available in the Census data and, therefore, estimates are not fully adjusted for sampling design (i.e. they are computed using sampling weights only). Poverty rates are calculated as the percentage of households in the bottom 45th percentile of the national household wealth index distribution based on the 46.5 percent official poverty rate estimate (National Baseline Household Survey, 2009). Education spending data come from The Status of the Education Sector in Sudan (2009) conducted by the Human Development team of the World Bank. Number of teachers and pupils come from ESR data file (2009) provided by the Human Development team. The graph shows results from locally weighted regressions (bandwidth=0.8).

### *Access to health services*

133. **Over the years, the commitment of sub-national government to improving the health sector has led to significant progress in reducing under-five mortality rate, but it still remains high, with large discrepancies between states** (Figure 2.20). For example, the under-five mortality in poor performance states is almost double the rates in the best performance states; ranging from above 126 under-five deaths per 1,000 live births in South Kordofan and Blue Nile states, to below 72 under-five deaths per 1,000 live births in River Nile, Al-Gezira, Northern and Khartoum. The introduction in 2008 of a national free health care initiative, financed from the federal level, for under-five children and pregnant women, may explain the recent improvements in the under-five mortality rate.



**Figure 2.20: Regional comparison of under-five mortality, 1995-2010**



Source: World Bank, A profile of maternal and child health in Sudan, 2012.

Note: Calculations were based on the 2006 and 2010 SHHS and 2008 Long Form Census.

States are ordered from lowest to highest according to under-five mortality levels 2010.

134. **The Maternal Mortality Ratio (MMR) (the number of maternal deaths per 100,000 live births) has also improved, but again with significant disparities between states.** Official estimates, based on the 2006 SHHS, indicated that the MMR in the states of Sudan ranged from 94 in Northern to over 1000 in West Darfur, South Darfur and Kassala. Sudan's MMR was estimated at 450<sup>19</sup> in 2005, compared with 900 for Sub-Saharan Africa and 200 for the Middle East and North Africa (see World Bank, *A Profile of Maternal and Child Health in Sudan*, 2012).

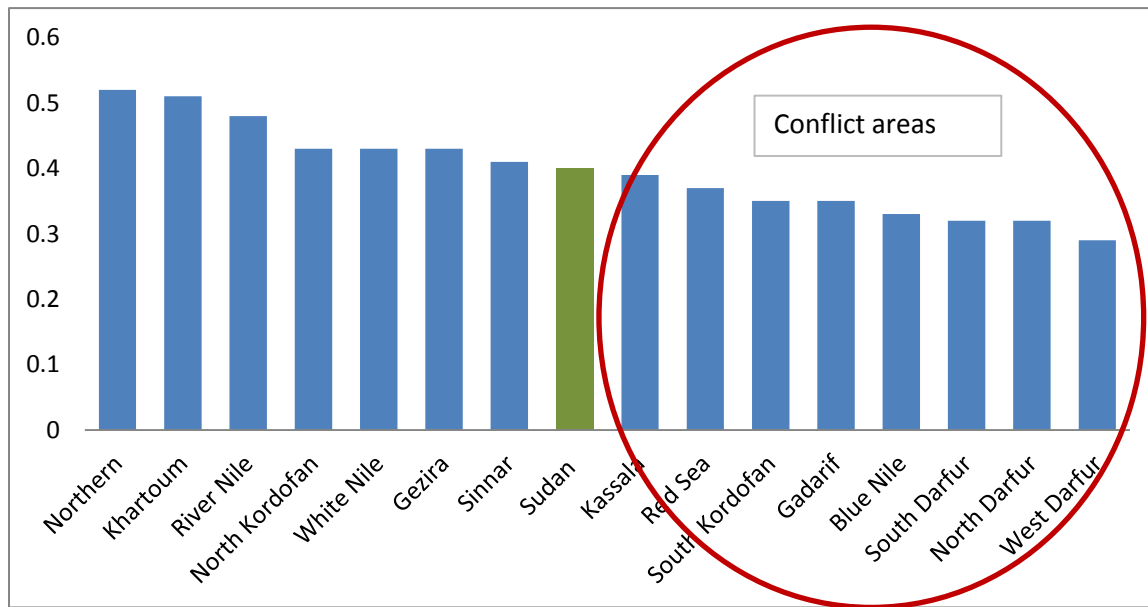
135. **A number of underlying factors have contributed to imbalances in health service outcomes among sub-national governments.** These factors include: (i) Regional conflict; ii. Funding of health sector services; (iii) Sequencing of investments; (iv) Availability of qualified health staff; and (v) High turnover of medical staff.

- i. *Regional conflict.* The adverse effects of the conflict are evident and reflected in low health outcomes (Figure 2.21); this calls for restoring peace and expanding access to primary health care services for the populations in need. Regional conflict has resulted in the destruction and abandonment of social infrastructure and it has exacerbated the structural weaknesses of public services in many ways (See World Bank, *Dimensions of Challenge for Darfur Report*, 2007). For example, the composite index coverage of access to

<sup>19</sup> The Maternal Mortality Ratio reported for Sudan is a model-based estimate derived from a regression model using information on fertility, birth attendants, and HIV prevalence. These estimates are developed by WHO, UNICEF, UNFPA and the World Bank.

evidence-based maternal care when needed ranges from 29 and 35 percent in conflict affected areas, to the highest coverage of 52 percent in peaceful states. These discrepancies may be explained Service-delivery interrupted by conflict or geographical distance to functional primary health care centers or hospitals.

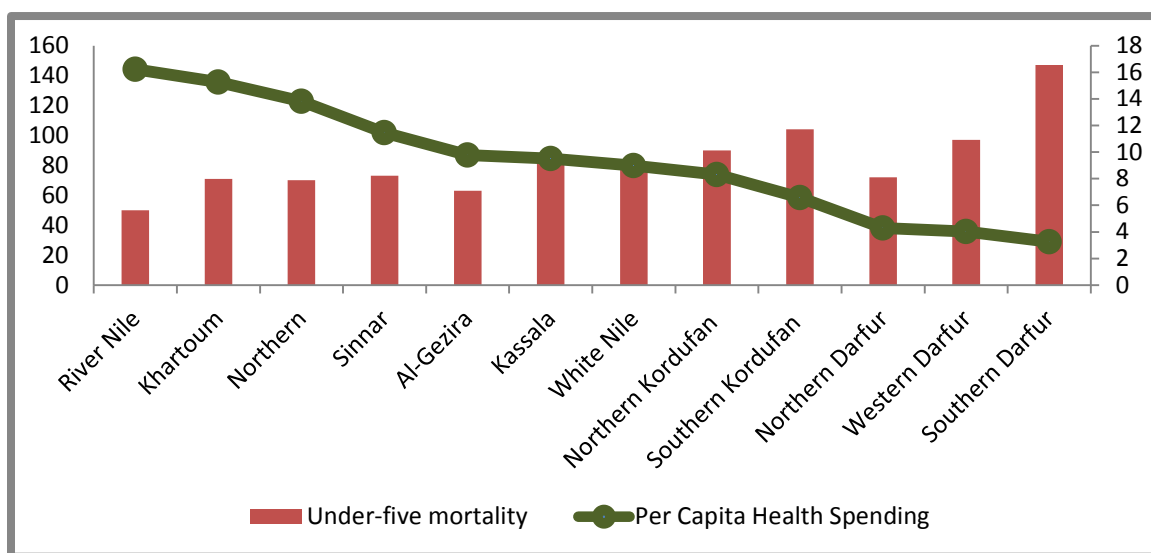
**Figure 2.21: Composite index of maternal intervention coverage by state, 2010**



Source: World Bank, A profile of maternal and child health in Sudan, 2012.

- ii. *Funding of health sector services.* The relationship between under-five mortality, as a health service outcome indicator, and funding of health sector services, is strongly negative, underscoring the way in which sub-national resources are allocated across different sectors. Regression analysis conducted using state-level per capita health spending data confirms this relationship. Figure 2.22 shows that five states have a per capita average spending on health of above 10 SDG, and at the same time, they have among the lowest under-five mortality levels (below 64 per 1,000 live births). Similarly, there are states such as North and South Kordofan, South and West Darfur, which have very low levels of funding of health sector services and the highest under-five mortality levels (above 90 per 1,000 live births). This may be aggravated by geographical location and related vulnerabilities.

**Figure 2.22: States average per capita health spending, 2000-2010 (SDG) and under-five mortality rates in 2010**

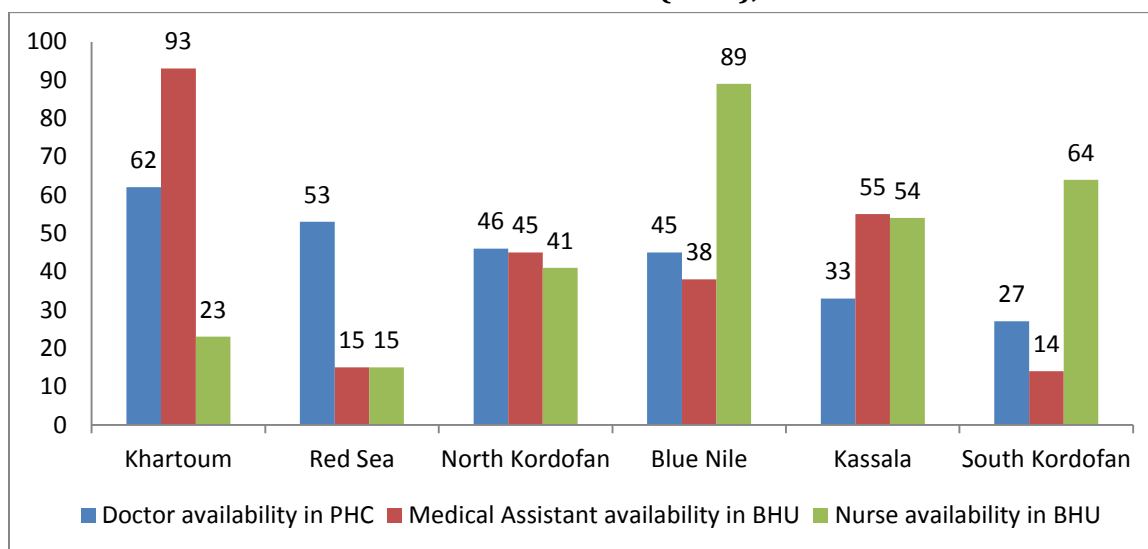


Source: World Bank, A profile of maternal and child health in Sudan, 2012.

- iii. *Availability of qualified health staff.* There are considerable discrepancies in the availability of health professional staff, more acute for front line public health center providers, as qualified staff cluster in urban areas and in hospitals (see Health care financing and service delivery, Federal Ministry of Health, 2012). The key public health center (PHC) human resources are Medical Assistants, but some facilities are still staffed by a nurse or a Community Health Worker (CHW). According to the Federal Ministry of Health (FMoH) staffing standards, hospitals should be staffed with medical specialists, public health centers should be staffed with doctors and basic health units should be staffed by medical assistants, in all cases supported by other health professionals. For example, the percentage of public health centers (PHC) having a doctor is particularly low in Kassala and South Kordofan (less than a third) and highest in Khartoum State (Figure 2.23). Similarly, the percentage of basic health units (BHU) having a medical assistant is highest in Khartoum State and lowest in South Kordofan and Red Sea (less than 20 percent).
- iv. *The sequencing of investments.* Ensuring better health service requires complementary factors which might be in short supply. For example, operating new health facilities requires training new medical staff, etc. In some cases, health facilities have been established without consultation with the Ministry of Health, eventually leading to more demand on qualified health staff and health cadre deployment.
- v. *High turnover of medical staff.* Lack of availability of qualified health staff may be attributed to high turnover of medical staff, as a reflection of migration attraction by the private sector, limited incentives, and low career

development. For example, the number of doctors in Kassala state decreased from 480 over 2008-2009 to 161 in 2011-2012. This may be attributed to the limited and unattractive incentives for professionals to work in remote and rural areas. Even newly graduated staff reject the offer when deployed to rural areas (see Sudan PETS 2011, Box 6: *Hard to Reach and Stay areas (HTRS) – A Typology of Solutions*).

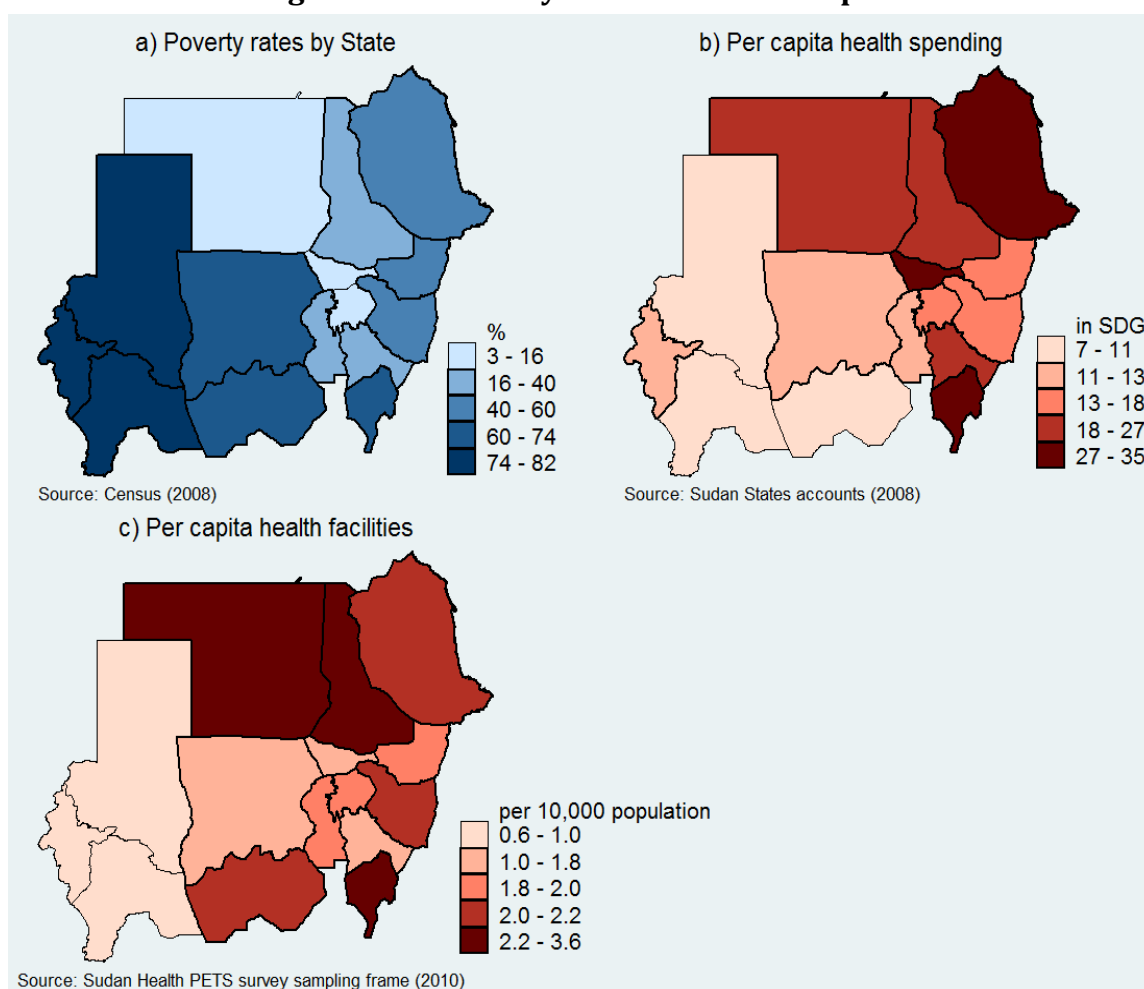
**Figure 2.23: Percentage of health facilities with at least one qualified health staff in selected states (in %), 2011**



Source: Health care financing and service delivery Report, Federal Ministry of Health, 2012.

**136. Imbalances in the allocation of public spending are also quite apparent when looking at health inputs.** In 2008, state per capita health spending in three of the poorest states, South Darfur (7 SDG), North Darfur (9 SDG), and South Kordofan (10 SDG) was, on average, less than half the level reported in Khartoum (28 SDG). –This imbalanced health investment pattern is directly translating into significant differences in the per capita number of health facilities available for the population across states. Although, at an average of just two health facilities per 10,000 people in the country, availability is overall very low, access to health services by the population tends to be much more limited in poorer states compared with River Nile or Northern: West Darfur (0.6 facilities per 10,000 pop), North Darfur (0.8 facilities per 10,000 pop), South Darfur (10 facilities per 10,000 pop), River Nile (2.6 facilities per 10,000 pop), and Northern (3.6 facilities per 10,000 pop).

**Figure 2.24: Poverty rates and health inputs**



Note: Poverty rates are computed using the Sudan Census (2008). Poor households are defined as those in the lower 45% of the national wealth index distribution. Primary sampling unit identifiers are not available in the Census data and, therefore, estimates are not fully adjusted for sampling design (i.e. they are computed using sampling weights only). Poverty rates are calculated as the percentage of households in the bottom 45th percentile of the national household wealth index distribution based on the 46.5 percent official poverty rate estimate (National Baseline Household Survey, 2009). Per capita health spending computed based on data from States accounts collected for (2008) as part of the Health PETS survey. Health spending includes federal money paid in the form of block grants to the States allocated to health wages and salaries, goods and services, and development. Per capita health facilities computed based on data provided by the Federal Ministry of Health to construct the sampling frame for the Sudan health PETS survey conducted in 2010. The boundaries shown do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

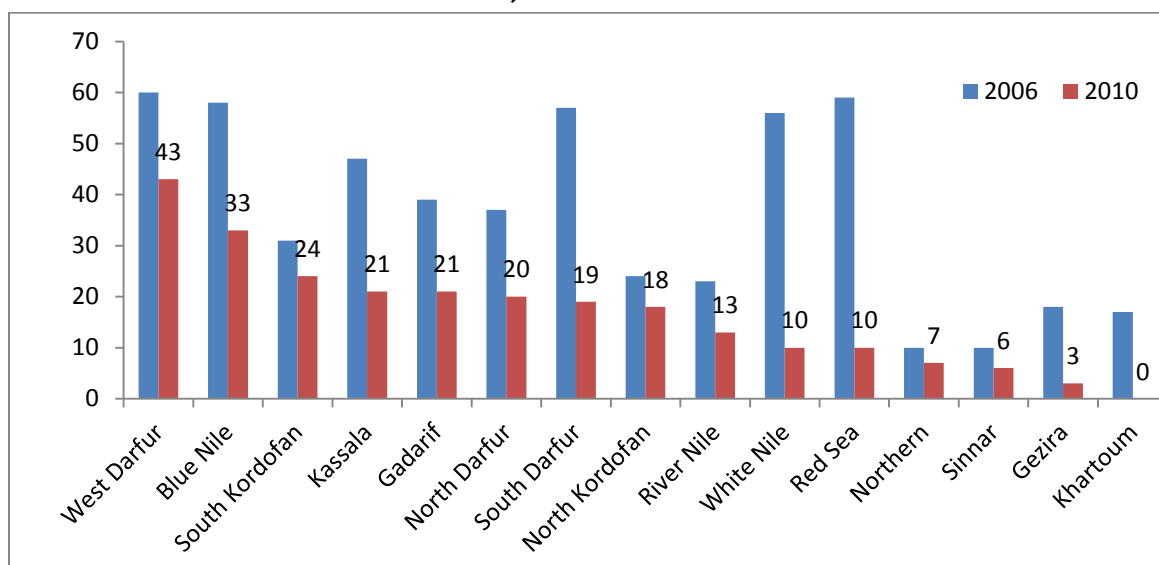
### *Access to clean drinking water*

**137. Access to clean drinking water sources has significantly improved, but still remains low, with large discrepancies across states (Figure 2.25).** On average, about 14 percent of households in Sudan in 2010 still relied on unprotected

water sources for drinking (including unprotected wells or springs and unfiltered open water from rivers, streams and ponds), compared with 36 percent in 2006.

138. **State-level data on access to clean drinking water sources show wide variations within the country.** For example, lack of access to improved drinking water sources in the three poorest performance states is almost more than five times worse than rates in the best three performance states. The cases of West Darfur (43 percent), Blue Nile States (33 percent) and South Kordofan (24 percent) are particularly striking, compared with the case of Sinnar (6 percent), Al-Gezira (3 percent), and Khartoum (zero percent).

**Figure 2.25: Percentage using un-improved sources of drinking water by states, 2006 and 2010**



Source: World Bank, A profile of maternal and child health in Sudan, 2012.

Note: Calculations were based on the 2006 and 2010 SHHS and 2008 Long Form Census.

States ordered based on largest average percentage point improvement in access to improved drinking water sources in 2010.

### CHAPTER 3. OWN REVENUE MOBILIZATION AT SUB-NATIONAL LEVELS

139. **Fiscal decentralization in Sudan poses a number of challenges to own revenue mobilization and management.** Some of these are illustrated in the Public Expenditure Review (PER) 2006/07, prepared jointly by the World Bank and the Government of Sudan (World Bank 2007).<sup>20</sup> The PER argued that inadequate own-revenues at sub-national levels and unpredictable transfers from the central government pose serious obstacles to the fulfillment of the vision of decentralization. These challenges are still major constraints for the evolution of fiscal decentralization in Sudan.

140. **Sub-national governments need adequate revenue to provide local services, but in Sudan the fiscal decentralization reforms that began in 1995 have led to a gap between revenues and spending needs.** According to IMF (2012: 56), “*spending decentralization has outpaced revenue decentralization, resulting in the emergence of vertical fiscal imbalance (VFI)*”. In 2010, for instance, the central government collected about 97 percent of total tax revenues and 86 percent of total tax and non-tax revenues combined. Thus, the central level has maintained control of the revenue collection while assigning greater expenditure responsibilities to state governments than the revenue transfers can finance. The loss of oil revenue is expected to widen the gap even further. Therefore, the fiscal tightening at the federal level will put stronger emphasis on own revenue mobilization by states and localities.

141. **Overall, own revenue mobilization at state levels is relatively low and varies greatly among the states.** In the last decade states have become more dependent on transfers from the central government to meet their responsibilities for service delivery. While transfers on average represented 25 percent of the states’ total revenues in 2000, this share increased to 70 percent in 2010 (IMF 2012). This implies that, on average, less than one-third of the states’ expenditures are funded by own revenue sources. However, there are large differences between states with respect to their dependency on federal transfers, varying from as low as 38 percent in Khartoum, to 86 percent in Blue Nile in 2010 (ibid.).

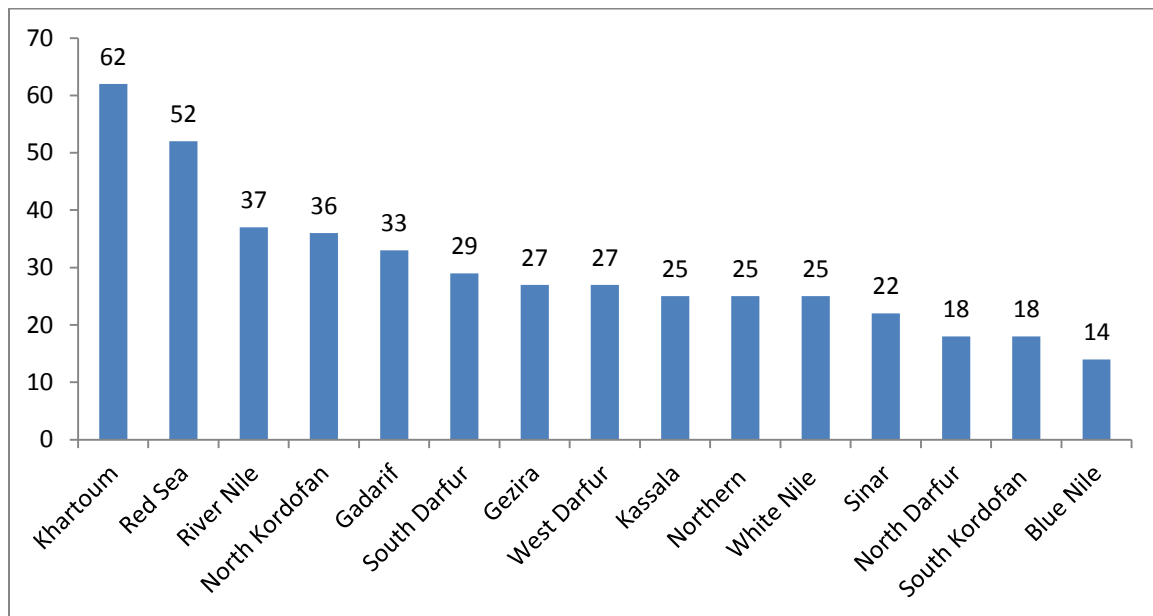
#### A. SUDAN’S SUB-NATIONAL OWN REVENUE SYSTEM

142. **Own revenue mobilization varies greatly among the states** (Figure 3.1). In 2011, it ranged from SDG 50 per person in North Kordofan State, to SDG 240 in Khartoum State. Furthermore, there are large variations in own revenues per capita between localities within states. In Khartoum State it ranged from SDG 15 per person in Jabal Awlia Locality to SDG 96.6 in Al Khartoum Locality.

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<sup>20</sup> A central focus of the PER 2006/07 was on the role of intergovernmental transfers and fiscal decentralization in the wealth and power sharing arrangements following the 2005 decisions.

**Figure 3.1: States' own revenues as share of total state revenues (2010)**

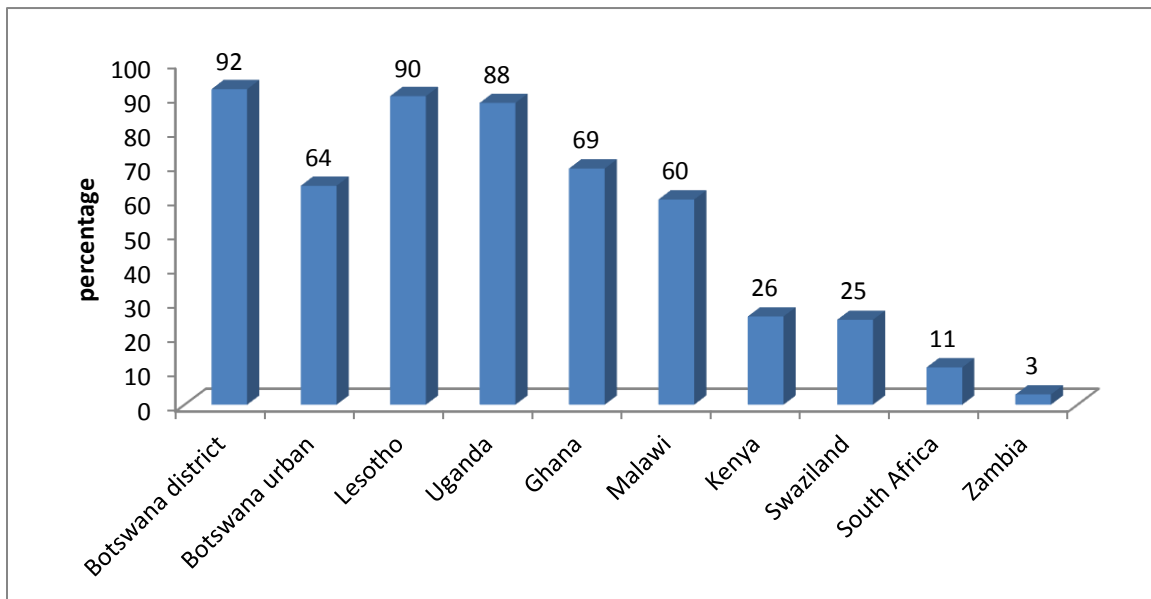


Sources: States' final account report 2010

143. **Strong reliance on transfers from central to sub-national governments is common in other African countries.** In some countries, such as Lesotho or Uganda, sub-national governments rely almost entirely on transfers from central government (Figure 3.2). **Error! Reference source not found.** The level of transfers varies also between rural and urban governments within individual countries in Africa (Chitembo 2009). In Botswana, for instance, rural councils received 92 percent of their total revenues from the central level in 2007, compared with 62 percent for urban areas. In contrast, some countries have very low levels of inter-government transfers. For example local governments in Zambia and South Africa received only 3 percent and 11 percent, respectively, of their total revenue from the central government in 2007. Sometimes the low level of inter-government transfers signals centralized provision of services, i.e. low level of decentralization.



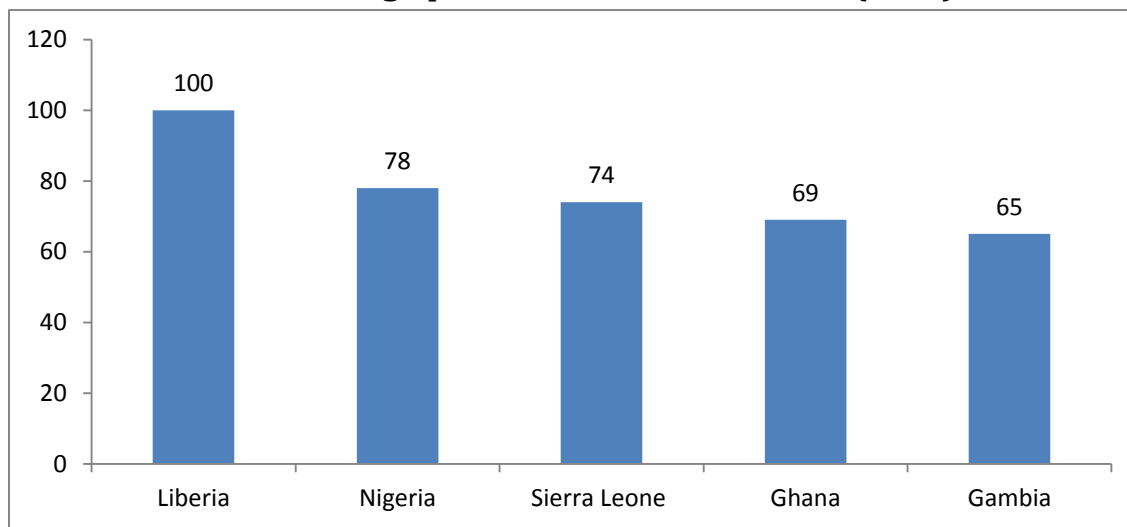
**Figure 3.2: Intergovernmental transfers in percent of total local revenues in selected African countries (2007)**



Source: Fjeldstad and Heggstad (2012), adapted from Chitembo (2009:11) citing Commonwealth Handbook 2007.

144. **Transfers and grants also constitute the largest share of total receipts to the local governments in Anglophone West-Africa (figure 3.3).** According to Jibao (2009: 43), local councils in Nigeria received on average almost 78 percent of their revenue from transfers, in Sierra Leone they received 74 percent of their revenue from transfers, in Ghana 69 percent, and in The Gambia 65 percent. In Liberia revenue collection is centralised and local councils rely 100 percent on transfers from the central government.

**Figure 3.3: Intergovernmental transfers in percent of total local revenues in selected Anglophone West-Africa countries (2009)**



Source: Jibao (2009: 43)

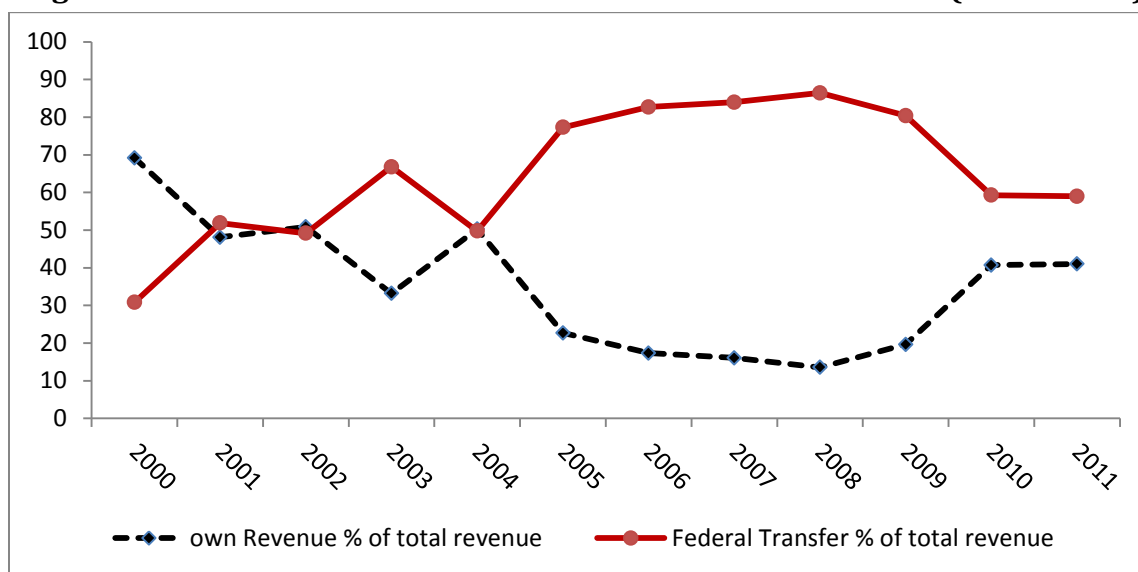
#### *Composition of own revenues at state level*

145. **There are some common trends in own source revenue across the four states.** Firstly, all four states witnessed a dramatic increase in revenues, driven by increase in transfers, during the last decade. However, the share of own revenue differs substantially between the states. Khartoum generated the largest share of own revenues, i.e. between 60 percent and 70 percent of the total revenues, while River Nile generated the smallest share, with between 10 percent and 35 percent of total revenues, in the period between 2008 and 2010. Non-tax revenue is by far the largest component of own source revenues in all the states throughout the period. The importance of non-tax revenues is partly a reflection of the states' narrow tax base and the fact that most of the productive and buoyant sources of tax revenue (e.g. income tax, VAT, and customs) are collected by the federal government (World Bank 2011: 34). Nevertheless, there seems to be a slight tendency of tax revenues gaining relative importance in Kassala, Khartoum and North Kordofan.

146. **Over the past decade, River Nile State's dependence on federal transfers to fund its expenditures has increased.** The state's own revenue sources contributed as much as 70 percent of total revenues in the year 2000, and thereafter decreased to 45 percent in 2005 and to only 13 percent in 2008, before increasing to 18 percent and 38 percent in 2009 and 2010, respectively. The share of total revenue attributed to tax has generally been low in the state. Between 2005 and 2010 it averaged about 2 percent, with the exception of 2009 when it reached about 7 percent. For non-tax revenue's share of total revenues a different pattern is observed, where its significance decreased dramatically from 2000 to 2009 and then increased again in 2010.

147. **Non-tax revenues, such as fees, permits and other user charges, are the major own revenue sources in River Nile.** Charges on cement are a relatively significant revenue source (54 percent of own revenues in 2010). According to state officials interviewed, most of this revenue is collected from five recently established cement factories which pay the state a fee of SDG 25 per ton produced. Revenues from cement charges are likely to increase due to expected increases in the production level. The state monitors the production closely by deploying some of its staff to the cement factories on a full time basis. Revenues from land sales and survey fees are the second highest revenue earner (15 percent of own source revenues in 2010). However, the contribution from the real estate tax is very low (only 1 percent of total own source revenues in 2010).

**Figure 3.4 River Nile State Federal transfers and own revenues (2000- 2011)**

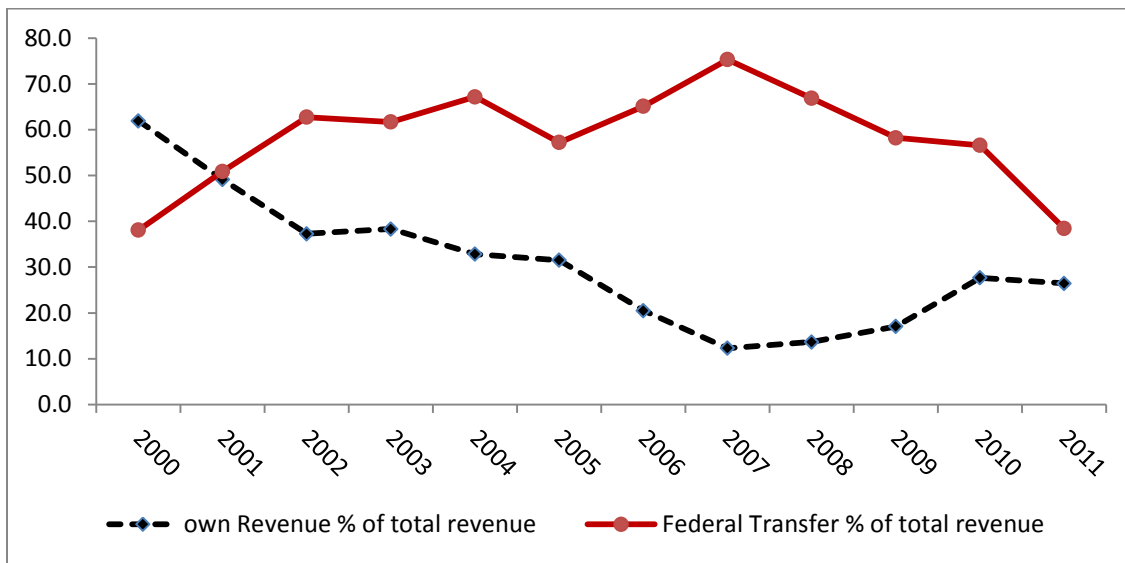


Source: River Nile State

148. **Kassala State is also heavily dependent on federal transfers** (Figure 3.5). Between 2000 and 2005 own source revenue decreased from about 60 percent to 22 percent. The share later increased to about 28 percent in 2011. Tax revenue's share of total revenues was modest throughout the period, and the dependency on federal transfers is a reflection of the high level of poverty, i.e. low taxation base.<sup>21</sup> Livelihoods in East Sudan have been undermined by war, climate change and environmental degradation (Ali 2012).

<sup>2121</sup> According to a UNDP survey of 2010, one third of the state's population live below the poverty line. [www.sd.undp.org/doc/MDG\\_percentSummery\\_percent20East\\_percentSudan.pdf](http://www.sd.undp.org/doc/MDG_percentSummery_percent20East_percentSudan.pdf) [accessed 28 March 2013].

**Figure 3.5: Kassala State Federal transfers and own revenues (2000-2011)**

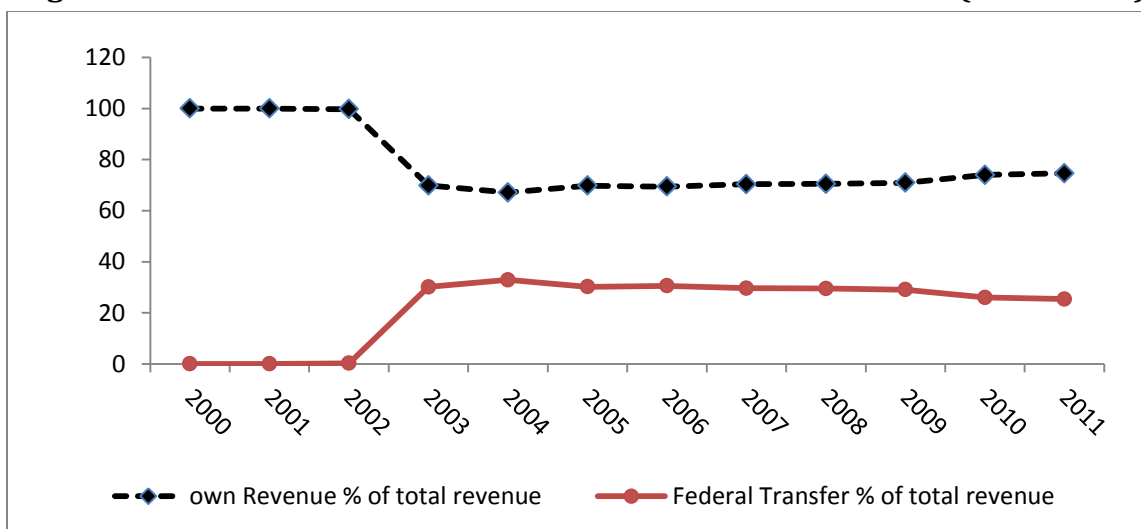


Source: Kassala State

149. **Property tax is one of the most important tax revenue earners in Kassala State.** In addition to real estate tax, it comprises taxes levied on property (including residences, arable land, endowments, inheritances, asset transfers). In 2001, this tax contributed 12 percent of taxes on goods and services, and 3 percent of total own revenue.

150. **Relative to the other states in Sudan, Khartoum's revenue come largely from own sources** (Figure 3.6). At the beginning of the 2000s, Khartoum State was financed solely by own revenues. As federal transfers started coming in, the share of own revenues declined to 62 percent in 2010, which is still higher than in any of the other states.

**Figure 3.6: Khartoum State Federal transfers and own revenues (2000-2011)**



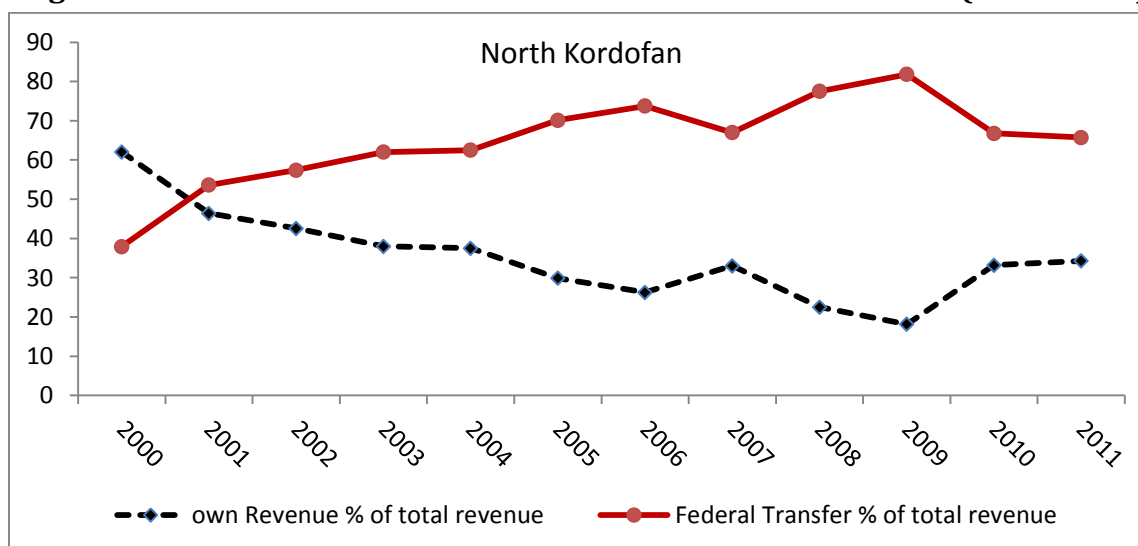
Source: Khartoum State

151. **As in other states, the share of own source revenue in North Kordofan State has declined over the past decade.** Nevertheless, own revenues, both tax and non-tax, have been growing continuously. Tax revenues account for an increasing share of total revenues and rose from about 3 percent in 2005 to around 13 percent in 2010. Non-tax revenue's share of total revenue similarly increased from 14 percent in 2005 to 22 percent in 2010.

152. **In terms of the composition of own source revenues, taxes accounted for a significantly larger share in the period 2008-10 than in 2000-05.** There seems to be a tendency of tax becoming a more important revenue source in the state. Total revenue grew throughout the decade and was eight times as large in nominal terms in 2010 as in 2000 (SDG 300 million compared to SDG 37 million).

153. **The major own revenue sources in North Kordofan are fees collected by state ministerial departments.**<sup>22</sup> In 2012, 43 percent of own source revenue came from state ministry departments and 25 percent from local government departments. The major state tax revenue sources in 2012 were taxes on goods and services (10 percent of total own revenues); state transferred taxes (8 percent of total own revenues); taxes on sugar and petroleum products (4 percent of total own revenues); and state stamp duty fees (3 percent).

**Figure 3.7: North Kordofan Federal transfers and own revenues (2000-2011)**



Source: North Kordofan State

#### *Composition of own revenues at locality level*

154. **In addition to the states, localities (or local governments) also have the authority to raise revenue.** Localities are financed by transfers from the states and own source revenues. With respect to own revenues, each state assigns taxing

<sup>22</sup> Source: North Kordofan State Fiscal Performance Reports (2005 - 2010).

powers to localities through local government legislation. While the main categories of local revenue sources are prescribed by law, the individual local government council decides on the revenue sources to be used and the tax or fee rates. Generally, own revenues collected by the localities are for their own use.

**155. Localities have a large menu of potential revenue sources to choose from.** Table 3-1 lists: (i) seven major categories of taxes; (ii) four major categories of licenses; (iii) twenty-nine groups of charges and fees; and (iv) three items listed as 'other' revenue sources. Of these, the most important sources of revenue for the localities are: (i) taxes on property; (ii) local transportation; (iii) local livestock production (40 percent of which is transferred to the state government); (iv) local trade and business licenses; and (v) a wide range of other fees, charges and duties levied on local economic activities.

**156. The large number of revenue sources creates ambiguities for both the authorities and taxpayers.** The distinction between taxes, licenses, charges and fees is often unclear. A number of levies are referred to as charges although they are in reality taxes, since no service is rendered directly and exclusively to the payer. In addition, a wide variety of fees for forms and permits exist. The primary purpose of such permits is regulation, although in many localities they have become mainly a source of local revenue rather than a control mechanism.

**157. The use of taxes, licenses, charges and fees varies between localities and sometimes does not correspond to economic realities.**<sup>23</sup> For example, more than 50 types of own revenue sources are listed in the accounts of Aroma, Kassala and Wad-al-Helew localities in Kassala State.<sup>24</sup> Several of these revenue sources have not generated any revenue in recent years. Localities in North Kordofan also levy more than 50 different categories of own revenue sources. These figures do not, however, take into account the various sub-groups of particular revenue bases. In Bara locality in North Kordofan, for example, more than 300 categories of businesses are listed for licensing, each facing different license rates depending on type and size of business, location, social impact, etc. However, according to officials interviewed in Bara, only around 100 businesses are registered in the locality, most of which are small shops.<sup>25</sup>

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<sup>23</sup> In year 2003, there were only 91 localities in Sudan. The number of localities is increasing. Due to attempts to equalize rates on some revenue bases among localities within the same state, some rates have tended to differ by regions.

<sup>24</sup> Source: Locality of Wad-al-Helew Final Accounts Reports

<sup>25</sup> Interview, Bara Locality, 20 February 2013.

**Table 3-1: Own revenue sources in localities**

<b>TAXES</b>	<b>NON TAX SOURCES</b>		
	<b>Licenses</b>	<b>Fees and Charges</b>	<b>Other Revenue</b>
1. Income tax on return	1. Business / commercial licenses	1. Cinema and entertainment fees	1. Rental of state-owned cultivated lands
2. Property tax	2. Commercial vehicle license	2. Livestock sale fees	2. Rental of various gardens, parks, cafeterias, shops, kiosks and properties of the locality
3. Advertising board levy (trade banners) levy	3. Building license and permit	3. Slaughtering fees	3. Rental of river transportation vessels
4. Livestock tax/tax on herds	4. Health license	4. Fees on pasture services	
5. Tax on agricultural land		5. Wandering sheep/camel shed fee	
6. Tax on fruit producing trees		6. Waste collection and removal fee	
7. Tax on entertainment facilities/amusement parks		7. Fee for cleaning the villages	
		8. Town improvement fee	
		9. Village organization fee	
		10. Fee on non-multi-story buildings	
		11. Residential land improvement fees	
		12. Financial forms fees	
		13. Residential plan fees	
		14. Engineering fees	
		15. Health card fees	
		16. Health fees	
		17. Vaccination center fees	
		18. Veterinary services fees	
		19. Veterinary medical examination fees	
		20. Planning of agricultural land fees	
		21. Crops services fees	
		22. Agriculture quarantine fees	
		23. Renewable activities fees	
		24. Village planning fees	
		25. Out-state departure fees	
		26. Administrative certificates fees	
		27. Labor permits fees	
		28. Investment fees	
		29. Water fees	

Source: Local government laws from various states.

**158. Another illustration of the complex local revenue system is the stamp duty.** In 2012, revenues from stamp duties generated on average 2.8 percent of total own revenues in localities in North Kordofan.<sup>26</sup> In localities in Kassala State stamp duties represented 2.7 percent of total own revenues in 2011.<sup>27</sup> The duty is imposed on about 500 public documents, including invoices, receipts, and title deeds (FIAS 2006: 152). It is charged at various rates, some fixed and some *ad valorem*, at rates of as much as 15 percent for certain kinds of advertising. Like in many other

<sup>26</sup> Source: North Kordofan State financial performance (2008 - 2012).

<sup>27</sup> Source: Kassala State - Ministry of Finance & Economy - Financial Performance Reports (2007 - 2012)

countries, the stamp duty is imposed on property transfers and financial transactions. Banks and insurance companies are therefore the largest contributors to the duty. With 500 dutiable transactions, Sudan has one of the most complex and comprehensive stamp duty systems in the world, and some of the highest rates (ibid.). Applications for an industrial license, or to alter an industrial license to increase production, or to introduce a new product line, are also subject to 1 percent stamp duty. Most business services, such as printing, insurance brokerage, photocopying, computer and secretarial training, and all media and journalism activities, are subject to 5 percent stamp duties, while all telecommunications are subject to a 1 percent stamp duty.

**159. The revenues from stamp duties are low as compared with the cost of administering them.** Stamp duties in Sudan can be seen not only as a source of revenue, but as a means of controlling financial or commercial transactions. As such, their effect on the business environment may be graver as an administrative barrier or inconvenience than as a business cost.<sup>28</sup> Serious attention should therefore be given to reducing the number of dutiable transactions and the rates imposed, or to abolishing stamp duties entirely.

**160. In spite of the large number of revenue sources, only a limited number matter for local governments.** Information on own revenue generation is not publicly available. For the purpose of this report, data was collected from selected localities in River Nile, Kassala, and North Kordofan.<sup>29</sup> The data shed light on the features and trends in own source revenue generation at the local level (Annex 3 presents information on the top five revenue sources for several localities).

**161. Fees represent the largest source of own revenue for localities.** In 2012, for instance, fees contributed 75 percent of total own revenues in localities in North Kordofan. Animal sales fees and market services fees were the most important from a revenue perspective. In localities in Kassala State (Aroma, Kassala and Wad-Al-helew), bus station service fees rank as one of top revenue sources. Crop services fees were also found to be an important source of revenue in two localities in North Kordofan (Al-Nohood and Bara). Commercial license fees are also among the top five revenue sources in most localities. Other important revenue sources in localities are rental (of agriculture land), taxes (on real estate, commodities, and services), and licenses. In some instances, sale of land brings significant revenue, and there is scope to increase the importance of this revenue source (see Box 3.1).

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<sup>28</sup> Annex 1 gives an overview of how Sudan is ranked compared with other countries with respect to various constraints facing investors, including constraints related to paying taxes, based on the World Bank/IFC “*Doing business*” and “*Paying taxes*” databases.

<sup>29</sup> Information on own revenue in localities Khartoum State was not available for the study.



### Box 3.1: The potential of raising revenue from land sale

Land sale for housing and commercial purposes is perceived to be a potentially high revenue yielding source by states and localities. Land is frequently one of the most valuable resources on the asset side of sub-national balance sheets in developing countries. This is also the case for sub-national government finances in Sudan. As described above, revenues from land sale is already a substantial revenue source in some states, for instance in River Nile. Land sale is managed by the State Ministry of Physical Planning and the Ministry retains 20% of the revenues to cover administrative and operational costs. Of the remaining amount, 60% is retained by the state and 40% transferred to the locality. Sale of land, however, is not without challenges. In some states it has led to disputes between the State Ministry and the Native Administration. For instance, in 2012 the sale of plots for housing in Bara Locality in North Kordofan was stopped due to such a dispute.<sup>30</sup>

The attractiveness of integrating land financing into the sub-national fiscal management framework can be examined from several perspectives (Peterson and Kaganova 2010: 1). Firstly, the sheer size of land asset transactions points to the importance of regulatory guidelines. Secondly, publicly owned land is in limited or fixed supply; decisions about land disposition, therefore, are difficult to undo, either for a specific land parcel or for public landholdings as a class. Thirdly, if land sales are relied upon to finance a significant part of local budgets, this source of revenue can suddenly disappear in the face of land market declines or exhaustion of public land supply. Fourthly, urban land values are generally highly volatile and commercial land development by public entities can be even more so.

162. **However, not all fees that are in place matter for revenue generation.** Many fees generate little revenue (e.g. residential land improvement fees, planning of agricultural land fees, cinema and entertainment fees, taxes on youth and sport, and water fees), and some fees do not generate revenues at all (e.g. fees on fruit producing trees, fees on forestry products and rain-fed agriculture services fees).

163. **The sources of own revenue seem to be stable across time.** In most localities, three out of the top five revenue sources are constant across the five year period for which data was collected. In many instances, the most important source of revenue is the same each year.

164. **The other source of revenue for localities is transfers from their states.** These transfers come as direct support for wages and salaries in localities, and as a share of taxes collected by the Sudan Chamber of Tax. The 2003 Local Development Act (Article 27, Chapter 7) identifies which of the taxes accruing to the state should be shared with the localities (Table 3-2)<sup>31</sup>.

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<sup>30</sup> Interview with senior officials in Bara Locality, 20 February 2013.

<sup>31</sup> Revenues shared between state government units and local government units are to be divided on the third day of each month based on actual flow of revenues as set forth in the Local Government Law of 2006 as amended in 2010.

**Table 3-2: Localities share of the state's taxes, fees and duties**

Revenue sources	Percentage to locality
1. Fees on vehicle licenses and driving licenses	60 percent
2. Real estate tax	60 percent
3. State's stamp duty	40 percent
4. Personal income (State) tax	40 percent
5. Land and river transportation fees	40 percent
6. Fees on the registration of clubs, societies, and associations	40 percent
7. Sale proceeds of investment lands	40 percent
8. Agricultural and animal production tax	60 percent
9. Service fees	60 percent
10. Fees on veterinary examination and fees on slaughtering and slaughterhouses	60 percent
11. Fees on residential plans, designation and allocation of lands for residential, commercial, agricultural, industrial, and investment purposes	40 percent
12. Fees on the State's forestry products	60 percent
13. Value added taxes	60 percent

*Source:* Local government laws from various states.

**165. In addition to the above, Local Government Laws of the States introduce “other revenue sources” for the localities:**

- The state subsidies;
- Grants, loans and credit facilities approved by the Government;
- Return on investments placed by the localities;
- Self-help and popular participation;
- Percentage of the oil and mining revenues as a percentage allocated for the state (by law);
- Percentage of the proceeds of governmental projects and national reserves (by law);
- Percentage of the revenues/proceeds of tourism (by law);
- Percentage of foreign grants and aid (by law);
- Percentage of the taxes and fees imposed for the state on cross-border trade in accordance with the national legislations (by law); and
- Percentage of any other taxes assigned under the Law for the state (by law).

**166. Of these sources “self-help and popular participation” contribute substantially to own revenues in some localities (see**

167. Box 3.2). For instance, in Al-Nohood Locality, North Kordofan, self-support contributed 24 percent of total own revenues in the locality in 2012.<sup>32</sup> The corresponding figure for Heikan Locality was 16 percent; for Sowdari Locality 12 percent; for Um-Rowaba Locality less than 2 percent; and for Bara Locality about 1 percent of total own revenues.

<sup>32</sup> Source: North Kordofan state financial performance (2008 - 2012).

### Box 3.2: Self-help financing of development at locality level

Self-help or Popular Support programs are development spending projects undertaken mainly by the people in the locality in socially essential services, like building of roads, electrification of groups of villages or neighborhoods, or building of schools or health centers. Citizens will raise funding for the projects through direct donations (in cash or in kind). A special development committee is formed to administer the development fund.

The locality will normally respond positively to the initiative by providing technical and/or engineering expertise. In most cases the locality will also provide about 20 percent of the total cost of the project in terms of cash as operating expenses to meet the daily expenses of the project. The people would directly supervise their development spending and mobilize popular support until it is successfully finished. This pattern of funding development projects is quite widespread in Sudan and has become a critical financing vehicle to development.

*Source: Ahmed et al. (2006) Sudan public expenditure review: the Gezira State case study 2006 (p. 22).*

#### *Revenue administration*

168. **The responsibility for the collection of state tax revenues is allocated to field offices of the Sudan Chamber of Tax (SCoT), while non-tax revenues are collected by other state institutions.** For instance, the SCoT collects property tax, tax on income and stamp duties. SCoT then transfers the collections to the State Ministry of Finance (SMoF), or shares the revenue between the state and localities, depending on the nature of taxes. SCoT has offices in all states and in many localities. In North Kordofan, for instance, it has eighteen offices, including the head office in the capital.<sup>33</sup>

169. **Interviews with senior staff of SCoT in various states indicate that they often experience substantial difficulties in collecting state taxes.** Some of the constraints include: widespread resistance and evasion by taxpayers; poor business registers; outdated databases of taxpayers and revenue bases. Not knowing the accurate size and extent of the taxpayer population is a major shortcoming that not only affects systematic taxpayer compliance management, but impacts on revenue forecasts and resource management in the revenue administration, such as planning and organizational structuring, staff skills development, planning for logistics, and the funding arrangements (Zake and Al Arabi 2011:7-8).

170. **There are also weaknesses in tax policy design.** Frequent changes in the legal framework, where, for instance duty and fee rates change annually, combined

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<sup>33</sup> Source: Chamber of Tax (undated). 'General administration.' Memorandum. North Kordofan. See also section 4.5.

with low service levels, contribute to taxpayer resistance and disputes with tax collectors.<sup>34</sup> Widespread tax exemptions also contribute to eroding the revenue base.

**171. The mechanisms of revenue collection vary between localities and states.**

At the locality levels, many agencies, including service delivery agencies, collect fees. Many public entities seem to look for ways and means of collecting their own revenue. There are no transparent guidelines clarifying roles and responsibilities among various government agencies involved in revenue collection at sub-national levels. This leads to a situation where revenue collection and administration are often non-transparent and uncoordinated between various public agencies and levels of government. Moreover, it may create a situation where sources of revenue remain largely “off budget” and, thus, outside the resource envelope, which impacts on the efficiency and effectiveness of budget management and the resource allocation process.

**172. Most taxes and fees are paid in cash.** Some taxes, fees and duties are levied on a daily basis, while others are monthly, biannually or yearly. In addition, stamp duties are imposed on individual “transactions”. Market fees are in general levied daily on people selling their goods at market places. Licenses are often issued on an annual or biannual basis. Spot-checks of businesses are used to control the payment of licenses. According to IMF (2012), cash management procedures in Sudan are weak and there is no systematic reporting. The lack of intergovernmental cooperation between levels of government and between government agencies also hinders revenue management by limiting sharing of functional information on taxpayers and revenue bases. Limited human capacity, compounded by institutional weaknesses, impedes the authorities’ ability to assess, collect and audit revenue mobilization.

*Administrative costs*

**173. One consequence of the current, complex sub-national revenue system is the high costs of tax administration.** For example, the revenues from stamp duties are low compared with the costs of administering them. Furthermore, the large number of these duties, charged at different rates, indicates that their effect on the business environment as administrative obstacles and inconvenience is large. Although data on the administrative and compliance costs of sub-national revenue collection is not available, studies from other African countries with similar systems suggest that these costs are high and may, in some cases, be major impediments for the development of small-scale enterprises (Box 3.3).

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<sup>34</sup> Interview with senior staff of Chamber of Tax, North Kordofan, 21 February 2013.

### Box 3.3: Features of local government tax systems in Africa

Many local tax systems in Africa are characterized by high levels of arbitrariness, coercion and corruption (Fjeldstad and Heggstad 2012). A widely found feature is the huge number of revenue instruments used by local authorities. Local governments seem to raise whatever taxes, fees, and charges they are capable of raising, often without worrying excessively about the economic distortions and distribution effects that these instruments may create.

A complicated and non-transparent local government revenue system is costly to administer and it facilitates corruption and mismanagement. Moreover, many local taxes have a distorting effect on resource allocation decisions, and, thus, an inhibiting effect on the start-up of new enterprises and the achievement of economic growth. These effects occur when effective rates vary greatly between different goods that are traded, or when license fees are set too high for start-up small-scale enterprises to survive. In a study of small and medium sized enterprises in Zambia, Misch *et al* (2011) found that the effective tax burden varies substantially between firms. Enterprises face a range of different taxes, fees and licenses, and the types of taxes that firms are subject to differ - not only between sectors, but also between firms within the same sector. Even among marketers in the same municipality the type of fees and levies differ substantially.

In addition, the levels and types of local revenue instruments by themselves can result in the tax burden falling more on the poor. A recent study from Uganda shows that small informal non-farm enterprises pay local taxes in a regressive way (Pimhidzai and Fox 2011). While the majority of the micro enterprises in the Ugandan sample were poor enough to be exempted from the national business taxes (i.e. the small business tax and VAT) they ended up paying a large share of their profits to local authorities - with the poorest paying the highest share of profits. This is mainly due to the basic design of the local revenue system and the way revenues are collected. Thus, a top-down drive toward more tax revenue from this sector through formalisation could be counterproductive, and would increase the vulnerability of this segment of informal enterprises.

**174. The costs of tax enforcement also vary between different revenue sources.** Some revenues are relatively less costly to administer because there are clear methods to deal with defaulters. For instance, water services may be disconnected if the user fails to pay the water fees. Similarly, a license may be withdrawn if business people fail to pay a license fee. Many taxes are, however, relatively difficult to collect. Revenue officers from the Chamber of Tax and collectors in localities considered business licenses on traders and livestock tax on moving cattle to be among the most problematic to collect due to taxpayer resistance, followed by property taxes and rental income tax. The many sub-bases with different rate structures add to the costs.

**175. High costs of revenue collection are a major challenge in many localities in Sudan.** According to the State Ministry of Finance in North Kordofan, the high collection costs are *“due to long distance between the headquarters of localities and the administrative units and the capital of the State, increasing prices of fuel and spare parts, and rising depreciation of vehicles and means of transportation”* (North Kordofan SMOF 2012:5). These administrative costs seem to be largely unrecognized

by localities. There is little appreciation of the opportunity costs of the staff employed by the locality. One might even argue that for certain small taxes and charges the collection costs are the reason for the levy. In other words, the purpose is to create employment or at least an income-earning opportunity for someone who might otherwise be unemployed. Furthermore, the way in which budgets are compiled, whereby tax revenues appear under one heading and the costs of the local revenue office under another, does not encourage cost-effectiveness. In addition, many costs are simply not made explicit, for instance the use of government owned buildings or the use of vehicles to collect certain taxes.

## **B. THE EVOLUTION OF SUDAN'S SUB-NATIONAL REVENUE SYSTEM**

**176. The sub-national revenue structure in Sudan is complicated and non-transparent, especially at the locality level.** There are also large variations among states and localities with respect to the number of revenue sources and rates. Revenues per capita vary significantly between states and localities indicating both differences in revenue potential and in the effectiveness of the sub-national revenue administrations. No clear pattern can be discerned as each state and locality has its own revenue structure. How did this revenue system emerge? There are four main reasons for this:

- abolishment of important own revenues sources, especially agricultural production tax;
- extensive tax exemptions granted to individual companies and specific sectors;
- lack of clear criteria for tax design that allows localities to introduce or change taxes and fees without proper consideration of efficiency and effectiveness;
- poor coordination between the various levels of government.

**177. The extensive reliance on user fees might be a response to the abolishment in 1999 of one of the states' most revenue productive tax, the agricultural products tax.** This was a sales tax imposed on farmers selling their crops in local markets.<sup>35</sup> The purpose of removing this tax was to encourage agricultural production and trade of agricultural products, and to increase farmers' income by reducing their tax burden. The agricultural production tax used to be collected at a 15 percent rate of the crop value and was collected by local governments.

**178. Agricultural compensation transfers from the federal government were introduced to neutralize foregone revenue from the abolished agricultural tax.** The historical levels of the agriculture tax determine the share of each state. Normally, there is an annual increase in the allocation, which was around 8 percent in 2012. However, the current allocation system of agricultural compensation transfers does not reflect the economic changes that take place across the state

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<sup>35</sup> While crop producers had their sales taxes eliminated they still pay local government taxes in primary markets near production areas and traders pay taxes at points of final sale which get passed back to the producers (World Bank 2009: 81).

governments, since it is based on the assumption that the size of the state's agricultural sector remains unchanged over time (Badawi *et al.* 2006: 30).

**179. According to officials at state and locality levels interviewed as part of this study, the abolition of the agricultural production tax had unfavorable effects for localities.** The loss of this tax revenue source resulted in: (a) considerable revenue losses, with negative effects on basic service delivery and investment planning; and (b) undermining of localities' fiscal autonomy. They argued that the abolishment of the tax failed to benefit farmers, since it did not contribute to improving the incentives for farmers to increase agricultural production. Consequently, in search for reliable and productive sources of revenue to compensate for lost revenues from the agricultural products tax, and to balance uncertainties around federal transfers, states have an incentive to look at non-tax revenues in the form of user fees, charges and licenses as alternatives.

**180. Another factor that has influenced the revenue system at the sub-national level is tax incentives.** Like many other countries, Sudan offers a number of fiscal investment incentives to investors. For instance, the *Company Act*, and more recently the *Investment Promotion Act* for Kassala State, provide "tax holiday" incentives to new investors. Tax exemptions impact the distribution of the tax burden by favoring new investors on account of existing and small scale enterprises. It is, however, questionable whether tax incentives are required to attract new investments (Box 3.4). Members of business associations in Kassala, interviewed as part of this study, argued that a transparent legal framework, a predictable tax regime, and access to finance are more important than tax incentives to encourage investments. These views are in line with findings of many business surveys in other countries (see Annex 2).

**181. While there is limited evidence that tax incentives are required to attract new investments in Sudan, tax exemptions have adverse impacts on revenue mobilization.** The Chamber of Tax in North Kordofan estimated in 2010 that the revenue loss due to tax exemptions, that should not have been granted if the legislation had been followed, was 6-7 percent of total annual revenue collection in the state.<sup>36</sup> Thus, a major challenge for building an effective, transparent and accountable tax system is the current tax policies on exemptions and tax incentives. Generous investment incentives to specific companies, institutions and sectors lead to large revenue losses and distorted competition (Keen and Mansour 2010). In addition to undermining the tax revenue base, a high occurrence of tax exemptions creates room for bribery and corruption, and increases the appearance of loopholes for tax evasion (Zee *et al.* 2002).

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<sup>36</sup> Interview with senior officials Chamber of Tax, North Kordofan, 21 February 2013.

### Box 3.4: Experiences on effectiveness of tax incentives

Proponents of tax incentives argue that it is imperative to provide tax incentives to attract investors, given the generally poor investment climate in poorer countries. However, using data from eighty countries, van Parys and James (2009) find that for countries that have a poor investment climate it is ineffective to lower the tax rate to compensate for the poor investment climate. Instead, they argue, countries should focus on improving the investment climate. A joint report by the IMF, OECD, UN and the World Bank (2011: 19) find that where governance is weak, corporate income tax exemptions may do little to attract investment, and when they do, this may well be at the expense of domestic investment. Challenges with tax incentives can be summarized as follows (Klemm 2009):

1. The benefits of investment tax incentives are widely exaggerated, while the costs are often underestimated or overlooked altogether;
2. Tax incentives can stimulate investment, but non-tax elements of the investment climate are generally far more important than tax incentives in determining the level and quality of investment flows;
3. Fiscal incentives do not effectively counterbalance unattractive investment climate conditions, such as poor infrastructure, macroeconomic instability, and weak governance;
4. There is evidence of harmful tax competition between countries reflected in (a) very low tax rates and (b) generous tax holidays;
5. Some investors play one country against the other as part of their strategy to gain tax incentives and other benefits from governments;
6. In many cases the final investment choice is already made without consideration of the tax incentives granted.

182. **The third factor that has shaped the current revenue system in Sudan is the legal framework on taxation.** Sub-national governments in Sudan have a high degree of autonomy in proposing tax legislation. The *Local Government Laws* of the various states<sup>37</sup>, the *Financial and Accounting Procedures Law of 2007*, and fiscal resolutions issued by the Council of Ministers of the State specify sources of revenue and procedures for imposing and collecting taxes. In principle, every activity located within the jurisdiction of a locality is taxable.<sup>38</sup>

183. **Just as states have large autonomy in defining own sources of revenue, localities are also assigned broad power to collect taxes and fees.** With respect to own revenues, each state assigns taxing powers to localities through local government legislation. While the main categories of local revenue sources are prescribed by law, the individual local government council decides on the revenue sources to be used and the tax or fee rates. The current legislation allows localities to introduce new taxes, duties and fees, and change rates frequently, without proper consideration of the revenue potential, economic efficiency, administrative and compliance costs. According to revenue officers in the Chamber of Tax in North

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<sup>37</sup> In North Kordofan this refers to the *Local Government Law of North Kordofan State of 2006 as amended in 2012*.

<sup>38</sup> Specific exemptions do, however, apply to publicly owned lands and buildings, cemeteries and burial grounds, charitable and educational institutions.



Kordofan, such changes in the legal framework contribute to taxpayer resistance and disputes between taxpayers and collectors.

**184. Some states are taking steps to “standardize” the tax system across localities.** In Khartoum the State Ministry of Finance aims to standardize the legislation on what sources of revenues localities can impose without compromising the legal and constitutional rights of the existing administration entities (Khartoum State 2012). The ministry has started to issue uniform revenue laws for similar activities, particularly those that apply to revenues for ministries and localities (licenses, charges, and various user fees). Such measures may contribute to a more transparent and predictable sub-national revenue system within the state.

**185. In addition to lack of standardization of types of taxes that can be introduced, the tax legislation also lacks in preciseness related to the design of taxes.** The Local Government Laws of the various states, the Financial and Accounting Procedures Law of 2007, and fiscal resolutions issued by the Council of Ministers of the State are not explicit about the criteria to be followed when proposing and approving new taxes, fees and charges, and/or rate changes.

**186. It seems the criterion of revenue generation is central to local government taxation, even though the tax system has multiple goals to consider including efficiency, equity, transparency, growth, stability, and simplicity.** The practice in Sudan shows that only implicit references are made with respect to other criteria, such as equity and ability to pay. Provision of graduated rates allows for considerations of ability to pay, and implicitly emphasizes the issue of vertical equity. Revenue transparency is addressed in the legislation in some states. For instance, the *North Kordofan Financial Authorization Law* of 2013 states that the rates of duties and charges should be advertised at the collection points in pursuance of transparency (North Kordofan State Ministry of Finance 2013). No clause in the legislation seems to encourage sub-national governments to take economic efficiency into consideration. Neither is there any reference to the administrative costs of the revenue system.

**187. In such an environment of a broad framework for taxation, decision-makers involved in revenue design pursue some criteria more rigorously than others, depending on the prevailing political economy.** Pursuing many, often conflicting, interests pushes the sub-national institutional arrangement to design a revenue system that points in many directions. Differences between the various stakeholders with respect to revenue design might be exacerbated by internal and external pressures that contribute to strengthening or altering their priorities and choices. Firstly, federal and state governments’ pressure on localities to raise revenue to finance (part of the) salaries of the staff will alter the relative importance of the revenue criterion at the expense of other criteria. Secondly, taxpayers’ pressure on politicians to lower taxes and/or grant exemptions will alter the relative weight between the ability-to-pay criterion and other criteria. Politicians are influenced by their constituents when proposing changes in revenue bases and

rates. In some localities this influence is reflected in the fine-tuning of the revenue structure, based on equity considerations. The large number of sub-bases and rates observed in some localities, for instance in Bara locality, North Kordofan, with respect to business licenses, may reflect the influence of local politicians in tax design. This implies that we may observe large variations in revenue design between localities.

**188. Finally, the last key determinant of the weaknesses in the existing tax system comes from the lack of coordination among stakeholders on tax policy matters.** It is unclear whether there is any act/legislation in place that requires localities to consult with the State Ministry of Finance when making such changes. Such an act is essential to ensure that inconsistencies between sub-national taxation and central government policies are avoided.

**189. Presently the relevant decision-making levels have limited tax expertise and resources for designing an appropriate tax system.**<sup>39</sup> At the locality level the serious shortage of qualified staff at the treasury and planning departments has been noted across most localities. Due to limited capacity and poor coordination between the state and localities only limited questions are raised at the state level on states' and localities' tax proposals. Therefore, the revenue systems in localities seem to have developed without much interference from the state. Furthermore, poor coordination between the central and state levels has led to duplication of taxes, and inconsistencies between taxes imposed by sub-national authorities (e.g., relatively high taxes, fees and licenses on smaller enterprises) and the national government's policy to encourage economic growth and employment creation. Granting tax incentives to specific sectors and companies is part of the problem, by creating economic distortions and undermining the revenue base.

**190. Some states are taking measures to address some of these challenges.** The Khartoum State Ministry of Finance has begun to standardize the source of revenues legislation without undermining the legal and constitutional rights of existing administration entities (Khartoum State 2012). The State Ministry has also started to issue uniform revenue laws for similar activities within the state, particularly those that generate revenues for ministries and localities (licenses, proceeds, and various user fees).

### **C. REVENUE GENERATING CAPACITY AND CONSTRAINTS**

**191. One of the key challenges for the states is the prevailing gap between budgeted and actual revenues.** Practically all state are faced with large gaps between what they plan to collect (both from own sources and from the federal

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<sup>39</sup> The necessary skills are knowledge to read, understand and interpret the tax statutes and central government guidelines, regulations and policy directions; availability of the relevant information for estimating accurately the budgetary requirements (both revenues and expenditures), tax bases and rates. They require substantial human resources such as statisticians, tax experts, including accountants, auditors, lawyers, etc.

government) and what they actually collect. The gaps come as a result of over-ambitious budgeting and inability to raise the potential revenue. Over-budgeting and under-performance in revenue collection have been a constant practice across all states throughout the years. Although data is not available for all states, the analysis for Kassala, Khartoum, North Kordofan, and River Nile states confirms that meeting revenue targets is a challenge across the entire country.

**192. The revenue gap has been declining over the last five years, though it remains a significant challenge.** The trend in reducing the gap is not uniform across states. For instance, in Kassala State budgeted revenues were 50 percent higher than actual until 2009, but then a sharp reduction in the gap followed, bringing it to 20 percent. North Kordofan has also recorded good progress in reducing the gap: from 120 percent in 2008 to around 10 percent in 2012. Khartoum State, which relies to a large extent on own revenue, was able to eliminate the gap in 2010, but then in 2011 a gap of around 15 percent re-appeared. River Nile State on the other hand continues to have a relatively high revenue gap, of over 30 percent.

**193. Keeping in mind that states have numerous pressing needs to address, the most important question is how to raise revenue collection up to its potential.** In this context, the following factors have been identified as most important for the under-performance in revenue collection:

- i. poor administrative capacity to enforce the taxes;
- ii. explicit and intentional tax evasion and resistance from taxpayers;
- iii. corruption, including embezzlement of revenues; and
- iv. negligence of government agencies paying taxes.

**194. Low administrative capacity is a major challenge for the entire country.** Many localities face a scarcity of revenue collectors to cover their major market centers. In such cases, revenue collectors must travel between market sites, making collection more occasional and difficult to enforce. Taxing moveable tax objects like livestock and traders is even more challenging. Lack of reliable transport may further exacerbate the situation. Given the complicated revenue system, already discussed above, it is justified to suggest that localities do not have adequate collection personnel, and that a substantial strengthening of staff is needed to administer the present revenue system. However, bearing in mind the large number of localities in the seventeen states, establishing adequate capacity will require more resources than are available in the short to medium term in Sudan.

**195. Improving administrative capacity should be accompanied by reforms in the tax system.** There is undoubtedly room for improved tax administration, but before considering the issue of capacity a more fundamental issue has to be addressed. This has to do with the rationale of squeezing additional revenues from poorly designed taxes. In other words, improved administrative capacity may increase the negative effects on the economy and society in general, and lead to

more inferior outcomes than the present system. Thus, the most urgent challenge may not be lack of capacity, but the revenue structure itself. This reasoning has implications for the sequencing of the reform activities to be discussed below.

**196. A second reason for the low revenue collection comes from the resistance of taxpayers to meet their tax obligations.** Interviews with officials at state and locality levels in Kassala, North Kordofan and River Nile suggest that many taxes, fees and charges are difficult to collect, partly due to taxpayer resistance. Interviews with private sector associations in North Kordofan confirm the unpopularity of the revenue system.<sup>40</sup> Poor infrastructure (roads and electricity) was listed as one of the major constraints facing enterprises.<sup>41</sup> One of the respondents argued that *“taxes and fees are used to finance public administration, not services and infrastructure”*, indicating that taxpayers see few tangible benefits in return for the taxes they pay. The deterioration of public services may increase taxpayers’ perceptions of exploitation from an unequal contract with government, and this promotes tax resistance.

**197. Taxpayers perceive the current tax system as unjust which in turn reduces payment discipline.** Although most taxpayers are unable to assess the exact value of what they receive from the government in return for taxes paid, it can be argued that they have general impressions concerning their terms of trade with the government.<sup>42</sup> In this context, it can be assumed that taxpayers’ behavior is influenced by their satisfaction or lack of satisfaction with the terms of trade with government (Levi 1988). Thus, if the system of taxes is perceived to be unjust, tax resistance may be considered as an attempt by the taxpayers to adjust their terms of trade with the government.<sup>43</sup>

**198. Fiscal corruption is also a major challenge in Sudan.**<sup>44</sup> Revenue collection is characterized by a general lack of transparency in enforcement of regulations,

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<sup>40</sup>Interviews with business associations, El-Obeid, 18 February 2013.

<sup>41</sup>There are huge differences between states with respect to infrastructure development and availability. Khartoum State has the most developed infrastructure, followed by River Nile State, which has witnessed massive infrastructure development in the recent years. However, Kassala and North Kordofan are among the least developed states in terms of infrastructure availability, poor transports, limited access to electricity and water.

<sup>42</sup>Survey research from Western countries also suggests that taxpayers make judgments about the fairness of particular taxes. See, for instance Smith (1992). Fjeldstad *et al.* (2012) provide an extensive review of research on taxpayer compliance in Africa.

<sup>43</sup>Non-compliance is sometimes an important political weapon. Scott (1985), for instance, argues that one of the most important ‘weapons of the weak’ is the ability to withdraw compliance. This can take a passive form, such as shirking, or an active form, such as rebellion. Historically, unwillingness of the population to comply with a tax that is deemed unjust has been a catalyst for political action. The Boston tea party and the Thatcher poll tax are illustrative examples. Bates (1983) provides some examples from Africa.

<sup>44</sup> Fiscal corruption is here defined as any action in which revenue collectors use their position to extort money from taxpayers or collude with taxpayers to defraud the treasury or find some other means to embezzle money from the revenue authorities.

which provides many opportunities for corruption and bribery. *Transparency International Global Corruption Barometer* (TI 2011) found that of those respondents who have had contact with nine public institutions (tax revenue, customs, police, education, judiciary, medical services, land services, registry and permits), 21 percent reported paying bribes. Citizens' experience with corruption was found to be significant in dealing with the police (where 29 percent of those in contact with the police reported paying bribes), customs (24 percent), tax revenue authorities (14 percent), and land services (12 percent). The majority of the Sudanese respondents reported having paid bribes in order "to speed things up" (40 percent) or to avoid a problem with the authorities (42 percent).

**199. Studies from other countries in the region suggest that fiscal corruption may take many forms.** Empirical literature shows that corruption varies by types of taxes, fees and charges, methods of revenue collection and location (Kolstad and Fjeldstad 2006). For instance, research from Tanzania and Uganda finds that although many cases of collusion between taxpayers and collectors are reported at the local government level, the most common type of fiscal corruption is embezzlement of revenues by revenue collectors and administrators (Fjeldstad and Semboja 2000; Iversen *et al.* 2006). Three factors have led to widespread embezzlement of revenues within the local authorities: (i) the low level of wages paid to staff; (ii) the complex nature of the revenue structure; and (iii) inadequate controls.

**200. The combination of low wages, a non-transparent tax system, and lack of controls promotes corruption.** This is illustrated by a survey on corruption in Tanzania where 78 percent of the respondents mentioned low salaries of public service workers as a major incentive for seeking and accepting bribes (CIET International, 1996:24). The characteristics of the local revenue system may also promote corruption. The combination of a complicated and non-transparent revenue system and poor administrative capacity may breed corruption and facilitate tax evasion. Furthermore, weak effective monitoring and audits facilitate unethical behavior.

**201. Finally, negligence, or noncompliance, by various government entities contributes to underperformance in revenue collection.** A common administrative problem faced by states and localities is the negligence of some government institutions in submitting the taxes and charges they owe to the state and localities. Local government officials cannot easily turn off the water supplies to schools and hospitals, and they cannot force central government ministries or other sub-national authorities to pay for such services. Although there is little data available to quantify this problem, it seems that the practice is widespread. Box 3.5 for purposes of illustration provides some examples of the mechanisms and scope of fiscal corruption in local governments in Tanzania.

### Box 3.5: Fiscal corruption in local government authorities in Tanzania

Most taxes in rural local governments in Tanzania are collected in the form of cash. The collector is supposed to deliver a receipt to the taxpayer, a copy (counterfoil) of which is retained for auditing. In principle, the tax collector is required to surrender the receipt books showing used counterfoils and unutilized receipts to the office before receiving new ones. In practice this procedure is often not followed. Fjeldstad and Semboja (2000) found evidence that large numbers of tax receipt counterfoils were not surrendered to the council headquarters as required by the financial regulations. In one local government authority they found that in total, 771 receipt books were not surrendered in the period 6 January 1995 to 26 February 1997. It is reasonable to assume that the counterfoils not returned are used to embezzle tax revenues.

For one revenue source (the head tax) it was estimated that the unaccounted counterfoils corresponded to more than 35% of the local council's actual revenues from this source. For other revenue sources such as crop taxes, livestock tax and market fees, it was difficult to estimate the amount embezzled in this way, since the receipts issued varied from one transaction to the other, depending on the specific tax item, rates and units. However, for 1995 more than 30 percent of the receipt books issued for such taxes were not surrendered.

Even those receipt books that are surrendered could easily be modified. One well-known method of stealing money paid in by taxpayers is through the use of *the carbon shipping system*: The taxpayer is given a receipt showing the amount paid. Since no carbon paper is put under the original receipt in the process of writing, the collector later enters a lesser figure on the copy and pockets the difference. Another method is to write receipts noting a lower amount than the amount paid by the taxpayer. This method is more common when dealing with illiterate taxpayers. In other cases, the carbon paper is placed in such a way that the counterfeit only registers a part of the figure written on the taxpayer's receipt, for instance, omitting some zeros.

Embezzlement also takes place through collusion between staff of the council's treasury department and bank officials. Bank officials issue a receipt on the correct amount to the treasury official. The receipt is brought back to the council's revenue office for control, and is consistent with the money remitted. However, only a part of the tax revenues is actually deposited into the council's account. The rest is shared between the bank officials and the collectors involved. This method can be sustained over time since what actually is deposited in the council's bank account is rarely controlled. One such case was brought to court in the late 1990s. It involved several staff members of the council's revenue department. The amount embezzled in this specific case during the first 6 months of 1997 corresponded to 10 percent of the total own revenues of that council in 1996. In early 1998, the Controller and Auditor General uncovered cases from 31 councils where cashbook-receipts were not reflected in the bank statements. The total unaccounted amount in these cases was TSh 1.1 billion, corresponding to 3.5 percent of the total recorded local government tax revenues in 1997.

Source: Fjeldstad and Semboja (2000)

#### D. SOLUTIONS TO SUDAN'S SUB-NATIONAL REVENUE SYSTEM: LESSONS FROM AFRICAN COUNTRIES

**202. It is clear from the above analysis that the sub-national revenue system in Sudan is in need of reform.** The weaknesses of the current sub-national revenue system are partly a result of tax design and weak administrative capacity for revenue collection, and partly due to poor coordination between the sub-national levels of government and between the federal and sub-national levels. Redesigning the sub-national revenue structure and building administrative capacity for

collection are required to reduce revenue losses caused by inefficiency, tax evasion and corruption. However, tax resistance is likely to continue (and increase) if service provision does not improve. Improvement in service delivery - a key objective of public sector reforms in Sudan - is therefore a necessary condition to improve taxpayers' compliance. The following paragraphs offer recommendations on how to address the above weaknesses, based on experiences of other African countries.

**203. While Sudan continues to struggle with the weaknesses in its sub-national tax system, several other countries in Africa have conducted comprehensive reforms of their sub-national revenue systems.** The main elements of these reforms have been: (i) abolition of unsatisfactory local revenue instruments that were costly to collect from administrative and political perspectives; (ii) improvements to remaining revenue bases by simplifying rate structures and collection procedures; (iii) building administrative capacity; and (iv) establishing better links between tax payment and service delivery. For instance, Uganda abolished the graduated personal tax (a head tax) in 2005 in response to its growing unpopularity and politicization (Fjeldstad and Therkildsen 2008). Tanzania has also demonstrated that substantial reforms of the local revenue system are possible (see Box 3.6).

**204. Cost-effectiveness should be a key filter when introducing new taxes or fees.** Generally, a fundamental requirement when redesigning sub-national revenue systems is greater emphasis on the cost-effectiveness of revenue collection, taking into account not only the direct costs of revenue administration, but also the overall costs to the economy, including the compliance costs to taxpayers. In addition, losses through evasion need to be reduced. Clearly, improved revenue administration cannot compensate for a bad revenue design. Thus, reforming the revenue structure should precede the reform of revenue administration, since there is not much merit in making a poor revenue system work somewhat better.

### **Box 3.6: Reforming the local government revenue system in Tanzania**

Until mid-2003, local authorities in Tanzania had more than 70 different taxes, fees, and charges. In addition, there were many sub-groups of specific revenue instruments. There were also large variations of the rates imposed by councils on similar revenue bases, which led to smuggling of tradable goods across council borders within the country.

In June 2003, a comprehensive reform of the local government revenue system was carried out. A large number of so-called nuisance taxes, which were costly to administrate and generated limited revenues, were rationalized. Thereafter, in June 2004, local business licenses were abolished based on the argument that they provided disincentives for the development of local enterprises. The Tanzanian reform demonstrates that radical changes of the local revenue system are possible. The longer-term impact of this reform on local government revenues, however, has been reduced fiscal autonomy and increased dependency on central government transfers.

Work initiated by the ministry responsible for local authorities focuses on reform of the current local revenue system and to identifying new revenue options. Among the proposals discussed are reforms of the property tax system and introduction of a unified business tax. As part of this work, business licences were reintroduced in July 2011. Moreover, many local government authorities have started to explore methods to reduce the financial gap caused by:

1. Outsourcing revenue collection to private collectors to increase revenues from existing sources;
2. Reducing costs (for example, by limiting the number of meetings and workshops and by retrenching surplus staff); and
3. Imposing more cost-effective spending (for example, on electricity and stationery).

Furthermore, co-production of services by councils and local communities is on the rise. For instance, an increasing number of primary schools are maintained and expanded via self-help schemes combined with technical support from the local government authorities.

Source: Fjeldstad and Heggstad (2012).

**205. Surveys in various countries indicate that citizens have a general appreciation of the necessity of taxation to support local service provision, but chose non-compliance due to lack of confidence in local government.** Studies from Tanzania also suggest that peoples' views on local taxation may change over time, with implications for policy design. Based on survey data from 2003 and 2006, Fjeldstad *et al.* (2009a) found that people were much more positive towards the tax system in 2006 compared with three years earlier. According to the authors, this was partly due to improvements in service delivery, particularly education, health, and law and order, and partly due to reforms which led to less oppressive revenue collection. There was also an increasing demand from citizens for more information on revenues collected and how the revenues were spent.

**206. Fiscal decentralization reforms are generally framed around three pillars** (see Box 3.7):

- the need for clarity of roles and responsibilities between different levels of government;
- a minimum degree of autonomy for sub-national governments on the expenditure and revenue side; and
- institution building: a prerequisite for successful decentralization is that sub-national governments possess the administrative capacity required to effectively carry out their responsibilities.

**207. In the Sudanese setting, the fundamental issues to be addressed in the context of reforming the sub-national revenue system are:**

- (1) to redesign the current revenue structure;
- (2) to build institutional capacity; and
- (3) to enhance tax compliance through improved service delivery.



### Box 3.7: Pillars of fiscal decentralization reform

Fiscal decentralization reform should rest of the following three pillars:

**The need for clarity of roles and responsibilities** between different levels of government. Clarity, transparency, stability and well-defined rules of the game are paramount for achieving accountability that efficient and sound decentralization requires. Given the interdependence among the various components of the system of intergovernmental relation, this requires a clear and effective delegation of functions by central government, with revenue assignments that are transparent, unambiguous, and commensurate with sub-national governments' expenditure responsibilities. It also requires transfers that are based on stable principles and specified by legal formulas that support hard budget constraints.

**A degree of autonomy** for sub-national governments on the expenditure and revenue sides is crucial for realizing the efficiency gains of decentralized government and supporting macroeconomic stability.

On the expenditure side, this requires sub-national budget flexibility to decide – within limits – expenditure priorities and the choice of both the output mix and techniques of production.

On the revenue side, this requires that sub-national governments have the authority to own-finance locally provided services at the margin. More complete revenue autonomy requires a minimum of authority to set tax rates and assignment of at least one significant tax source.

Sustainable autonomy and economic efficiency, however, also requires a reduction of vertical imbalances and some equalization of opportunity to allow sub-national governments to perform their assignment functions. This points to the importance of inter-governmental transfers in fiscal decentralization design.

While autonomy should be explicit and well-defined, it must also be circumscribed with respect to the access to borrowing by sub-national governments in order to support hard budget constraints and reduce moral hazard.

**Institution building** is a prerequisite for successful decentralization. Sub-national governments require administrative and technical capacity to effectively carry out their assignment responsibilities. Supporting institutions, including democratic representation, sound budget processes, sub-national revenue collection capacity, and mechanisms to ensure coordination and cooperation between different levels of government – both at the political and the technical level – are crucial for the functioning of a multi-tier system of government.

*Source: Dabla-Norris and Wade (2002)*

#### *Redesigning the current sub-national revenue structure*

**208. Proper design of the tax structure should be a first step towards improving the sub-national tax system.** There is undoubtedly room for improved fiscal and financial management both at the state and locality levels in Sudan as well as improved coordination between the different levels of government. However, attempts to squeeze additional revenues from poorly designed taxes may

exacerbate the negative effects of the tax system on the economy and the society in general.

**209. More attention is required to how taxes, fees, licenses and duties affect key policy objectives.** In particular, it is important to ensure that they do not adversely affect income distribution and impact economic growth. Raising the productivity of and income for small-scale farmers and enterprises are potentially the most important strategies to alleviate poverty. In order to suggest adjustment towards a more effective revenue regime, more analytical work is required to determine the impacts of tax, fees, and licenses on poverty and private sector development and growth.

**210. In reforming the revenue structure, the following options should be considered:**

- i. abolition of unsatisfactory local taxes;
- ii. improvements to remaining revenue bases;
- iii. cost recovery through user charges; and
- iv. revising the tax incentive and exemption regime.

**211. A reform program should include the abolition of several poorly performing sub-national revenue sources.** Several taxes, licenses and fees are generating little revenue (e.g. cinema and entertainment fees, taxes on youth and sport). Some fees do not generate revenues at all, e.g. taxes on fruit producing trees, and fees on rain-fed agriculture services, pasture services, and wandering sheep/camel sheds. These taxes simply have a high “nuisance value” and cost more to enforce than they yield in terms of revenues. Hence, they should be considered for abolition.

**212. Once the system is cleared of unnecessary taxes and fees, the next step would be to simplify the remaining ones.** Sudan probably has one of the most complex and comprehensive stamp duty system in the world, with five hundred dutiable transactions, and some of the highest rates. The revenues from stamp duties are low compared to the cost of administering them. Furthermore, their effect on the business environment may be graver as an administrative barrier or inconvenience than as a business cost. Serious attention should, therefore, be given to reducing the number of dutiable transactions, reducing the rates imposed, and/or abolishing some stamp duties entirely.

**213. There is also a need to simplify the license and fee structures by reducing the number of rates and coverage.** In Sudan, as in many other African countries, the standard mechanisms for mobilizing sub-national revenues from businesses have been through licensing. Although the original intent was regulatory, local business licensing has increasingly become simply a revenue source in most places. However, the business licensing system often has been unsatisfactory and inequitable, and has imposed huge costs on business, while generating relatively little revenue. Experience from other countries shows that it is possible to reform

the business license system in ways that contribute to both mobilizing more revenues and reducing the administrative and compliance costs. This also applies to property and land taxes that are attractive as local revenue bases, since they are imposed on immobile resources and are, therefore, in principle difficult to avoid,

### *Business licenses*

**214. Obtaining a business license typically involves multiple visits to various offices, sometimes over several days, with associated travel costs.** Failure to provide the correct license receipts may result in closure of the premises. Poor administration and lack of proper business registers often means that many businesses are not included in the license system. Some localities in North Kordofan, for example, operate with more than three hundred different categories of businesses listed for licensing, each facing different license rates depending on type and size of business, location, social impact etc. Weak financial management, however, will often imply that collection and enforcement provisions are rarely enforced. This erodes the tax base and introduces inequities into the system. Thus, the current business license systems in Sudan contain serious defects:

- high (potential) compliance costs to businesses, due to multiple licensing and complex procedures;
- tariff structures that are complicated and do not reflect ability to pay;
- a process loaded with ineffective regulatory requirements, which provide opportunities for rent seeking;
- poor administration and evasion, which reduce the tax base and generate inequities; and
- a revenue source that generates relatively little income for local governments.

**215. Several African countries (for instance, Kenya and Uganda) have reformed their local business licence systems to make them simpler, more transparent, and effective** (Sander 2003; USAID 2005). The main objectives of these reforms are to: (a) enable local authorities to collect significantly more revenues; and (b) to reduce the compliance burden on the businesses. In the late 1990s, Kenya pioneered a Single Business Permit (SBP) system, which has since become a model for other countries in the region (see Box 3.8). Although problems were experienced at the beginning, due to lack of communication between local authorities and the business community leading to initial resistance to the reform, most local governments experienced substantial increases in revenues. In some cases, this was due to improvements in coverage of the revenue base, but in most cases the increase was due to choosing higher tariff sets.

### Box 3.8: The Single Business Permit (SBP) in Kenya

The Kenyan business license reform has the following components:

1. Local business licensing is decoupled from regulatory requirements, since these are usually ineffective and create opportunities for rent seeking.
2. All economic activities within the local jurisdiction are, in principle, included in the base. The law was amended to broaden the base to comprise all businesses and trades, including professionals such as lawyers, doctors, and private consultants. It aimed to widen the revenue base and to improve equity, while at the same time minimizing the economic distortions of the license system. To avoid double taxation, the central government abolished its registration fees on professionals.
3. Businesses are only required to have one business permit per premise regardless of the range of activities carried out there, hence the name Single Business Permit (SBP).
4. Local authorities are required to establish 'one-stop-shops', at which permits will be issued on the spot in exchange for the appropriate fee. The philosophy is a more customer-oriented approach to business licensing.
5. A standardized rate structure is established. Businesses are classified into eight sectors, which are subdivided into broad categories reflecting the scale of profitability of the business. These size categories are based on easily identifiable and objective criteria. The system is based on self-declaration, but with the opportunity for official checking.
6. The tariff structure is designed to be progressive, with smaller businesses paying less than larger ones. The system provides a standard tariff structure for all local authorities, but still allows local government discretion over the actual tariff rates.
7. Measures are taken to improve the local administration of the system. This includes the design of simplified SBP registration forms. Training is provided to encourage local authorities to work with the local business community in choosing the SBP tariff schedule.

*Source: Devas and Kelly (2001).*

**216. In both Kenya and Uganda, the time required to obtain business permits has been substantially reduced due to the introduction of one-stop-kiosks** (Box 3.9). This has cut the compliance costs of the enterprises, though not necessarily the total costs since the tariffs have been raised. Although there is a need for improved financial management, the evidence points to towards a positive effect (Gamser 2003). The new system seems to enable local authorities to enhance revenues. At the same time, compliance costs on businesses are lowered and the opportunities for rent seeking and corruption are reduced.

### Box 3.9: Streamlining business registration in Entebbe municipality, Uganda

Before the reform, the business registration and licensing system in Uganda was very complicated and time-consuming. On average, it took 36 days to register a business. Hence, many small and micro-enterprises avoided the registration process and remained informal.

A one-stop simplified business registration and licensing system was piloted in Entebbe in 2002–2003. The results of the pilot included:

- The licensing process became cheaper and shorter. Overall, the compliance costs for enterprises were reduced by 75 percent (for example, registration time was reduced to 30 minutes).
- Compliance levels for registration improved by 43 percent.
- Total revenue collection increased by 40 percent.
- Administrative costs for the council were reduced. Administrative savings were 25 percent in staff time and 10 percent in financial resources.
- There were reduced opportunities for bribery.
- Relations between local authority staff and businesses were improved.

*Source: Sander (2003).*

### *Property taxes*

**217. Few fiscally significant taxes are more appropriate to local government administration than property tax.** This is due to the fact that real property is visible, immovable, and a clear indicator of wealth. Hence, in principle, property tax is difficult to avoid and, if well administered, it can represent a non-distortional and highly efficient fiscal tool (Alm 2013). Property tax is levied in many countries in Africa. Commonly it is a local government tax, levied mainly in urban areas. Property tax reforms have taken place in many African countries for more than a decade.

**218. Despite the long history of reforms, property tax revenue accounts for less than 0.5 percent of GDP in many African countries.** For instance, property tax accounted for 10–30 percent of ‘own’ revenues in urban councils in Tanzania (Fjeldstad *et al.* 2004), and around 20 percent in metropolitan councils in South Africa (Bahl and Smoke 2003). In Ghana, property tax accounts for about 14 percent of the total revenues of local assemblies.

**219. There are several reasons why property tax is not more heavily exploited as a sub-national revenue source in Sudan.** The main constraints are: property markets are not well developed;

- property registers and valuation rolls are often outdated or not in place;
- administrative capacity and equipment are often limited;
- the tax base is generally narrowed by extensive legal exemptions; and
- political support to enforce the property tax is lacking and there is political interference in revenue collection.

**220. The property tax has powerful political enemies.** The tax strikes directly at people with accumulated wealth, whose real properties to be taxed are obvious, and the levy itself is visible. People with substantial property wealth usually have considerable political power, and can use that power to thwart taxes that aim directly at their holdings. As Burgess and Stern (1993: 802) suggest, low utilization of property and land taxation “*reflects the success of the resistance of the rich and*

*powerful to measures which harm their interests.*" The result is that taxes are paid on a base that often bears little resemblance to the true level of property values (Franzsen 2007: 8-9).

**221. Lack of qualified valuers to prepare or maintain property valuation rolls is a challenge in Sudan, as well as in many other African countries.** This implies that valuation rolls are normally out of date. Some countries, for instance South Africa and Uganda, have introduced "mass valuation" as an alternative to discrete valuations of individual properties, or are considering this (e.g. Kenya). External quality control with regard to valuation rolls is generally not in place.

**222. Most African countries, including Sudan, apply different tax rates to different types of property.** Rates are generally determined annually, but in some instances are fixed by central government or municipal by-laws for a determined or undetermined period so rates may remain static for years. Where differential rates apply, the tax rates for residential properties tend to be significantly lower than the rates for commercial, industrial, and government properties, where these are taxable.

**223. There is generally a distinction between imposing tax on land or buildings.** Since land in many African countries is owned by the state, it is often only buildings that are included in the property tax base. This applies, for instance, in Ghana, Mozambique and Sierra Leone. Kenya is the only African country with a land value tax, while South Africa has a uniform, capital value tax. Nigeria is unique in having formally delegated the authority for property tax legislation to the 36 state governments, leaving the various areas in Nigeria with different approaches to estimating property tax (Franzsen and Youngman 2009:12).

**224. In theory, assessment of property value and revenue collection should be straightforward.** The first step is to conduct a cadastral survey that assesses the market or site value of each plot of land or property, and the next step is to send a tax bill to each owner. In practice, however, cadastral surveys are expensive and time-consuming (Bahl *et al.* 2003: 79), and the task is often beyond the financial and technical capability of many sub-national governments. Tax offices in Sudan, as well as in most other African countries are short on assessors.

**225. Unclear ownership and inadequate marking of properties also pose a problem.** Property registers and valuation rolls (cadastral systems) may work in areas with regular street patterns, named streets, and numbered houses. In the absence of this, tax bills are not deliverable, and penalties are unenforceable. Although revenue collection may also prove to be problematic in areas where the property map is in place, the absence or scarcity of clear ownership titles is a serious challenge facing this form of taxation.

**226. Expert opinion diverges on how to improve property taxation in developing countries.**<sup>45</sup> Some blame the excessive centralization of property tax policy. Others blame what they consider the almost total anarchy deriving from local government freedom in this field. There is also dispute over tax administration. Certainly, property taxes have many attractions as local bases, but they also have obvious weaknesses that need to be taken into consideration before heavy reliance is placed on them. Often the capability and capacity of the municipality are inadequate to administer the property tax at a low cost (McCluskey *et al.* 2003: 23). As noted above, these administrative weaknesses are manifested in problems of valuation and arbitrariness in tax assessment and enforcement.

**227. Foreign donors have funded many projects to reform the property tax system and build administrative capacity, but more is need to improve staff skills.** For property tax to play a greater role in municipal finances in Sudan, administrative and technical features of the system need to be improved. Technical assistance should, therefore, prioritize appropriate training of property valuers and upgrading relevant skills of municipal staff. The *Municipal Property Rates Act of 2004* in South Africa, however, shows that it is feasible to address some of these problems by stipulating nationally uniform mechanisms of assessment and a monitoring process to ensure assessment quality. Clearly, property tax has to be simplified to adapt it to the reality on the ground in Sudan. The use of simple parametric methods for the evaluation of property values is therefore recommended. Parameters could include the number of rooms, the quality of the building materials, and the area of the city where the building is located. Such parameters are transparent and, in general, easy to apply. Similar methods have been used in a number of countries (also in Western Europe) with satisfactory results. Administration could be left local, but the legal framework should be centrally provided. Research undertaken by the Africa Tax Institute<sup>46</sup>, however, argues that many African countries face major challenges if the property tax is to provide a reliable and adequate source of revenue for municipalities.

**228. Thus, experience advocates cautiousness when: (1) extending the present property tax to rural localities; and (2) imposing a commercial land tax in localities.** At this stage of the fiscal decentralization reform process in Sudan it is important to identify the fundamental causes of the problems experienced, in depth and with open minds, to avoid counterproductive biases. In particular, it is important to consider the administrative capacity to maintain assessments of property value seriously. Furthermore, the enforcement mechanisms must be carefully designed to avoid a mushrooming number of court cases and widespread resistance from property owners.

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<sup>45</sup> Dillinger (1991) provides an insightful summary of these challenges, which still is valid.

<sup>46</sup> Africa Tax Institute web page: [www.ATI.up.ac.za](http://www.ATI.up.ac.za) [last accessed 17.04.2013]

**229. Taxes are sometimes not the best mechanism for matching demand and supply of public services.** Better links can be achieved through cost-recovery charging systems, which tie the amount paid directly to the amount consumed. By providing a more direct link between citizens' contributions and service delivery, such mechanisms may become effective means to recover the costs of service provision, and to promote efficiency in the consumption of the service. Hence, most observers argue that user fees should play a prominent role in local government finance (Bahl *et al.* 2003: 76; Bird 2001).

**230. The main economic rationale for user fees is to encourage efficient use of resources within the public sector.** When properly designed, user fees provide information to public sector suppliers on how much clients are willing to pay for particular services, and ensure that the public sector supplies are valued by citizens. Free or subsidized services may result in over-consumption. Moreover, it may prove difficult to target the beneficiaries of free services (Box 3.10). Despite these advantages, experience from several countries, including Namibia and South Africa, shows that user charges can impose a heavy burden on lower-income service users, and exclude the poorer segments of the urban population from the services (Fjeldstad *et al.* 2005; McDonald and Pape 2002). Adjustments can, however, be made to offset such effects. For instance, user charges can also reflect differences in ability to pay by incorporating sliding scales for the type of user or the amount of usage (Rondinelli *et al.* 1989: 71), although this will require adequate administrative capacity.

**231. As opposed to subsidizing, user fees sometimes are higher than the cost of service, which in turn may have negative impact on efficiency.** User fees for water, electricity, sewage, and solid waste removal, are major sources of revenue in urban municipalities. This revenue is generated by a surcharge added to the cost of the utilities that the local authorities typically buy from the utility companies, or, if the authority itself produces the utility, added to the cost of producing it. A large share of these revenues is used to cover the cost of providing the service. However, in some municipalities a substantial surplus is left for general local government purposes. The tax component of the user fee is, therefore, hidden from ratepayers, and the "true level" of local government taxation is not transparent for citizens. This undermines the accountability of the local revenue system. Because the consumer price of the service (for example, electricity) is overstated by the amount of the implicit tax, this may also have negative impacts on economic efficiency.



### Box 3.10: Free services to the poor in South Africa

Improved service delivery to the poor is a priority for most African governments. In South Africa, for instance, the two pillars of this policy are to enable local governments to:

- make basic municipal services accessible to all citizens, and
- provide free basic services for poor citizens who cannot pay.

The challenge with respect to service delivery is foremost to ensure that poor households are the primary beneficiaries of the free services policy and associated resources. Since July 2001, every municipality in South Africa is supposed to provide at least the minimum free 'lifeline' supply to households of 6000 litres of water and 50kW of electricity per month.

Some observers have raised concerns with the manner in which this 'lifeline' policy has been designed and implemented. Firstly, it is argued that the quantity of the free services provided is too small. Secondly, since households are not means tested to see if they qualify for the free services, some middle- and upper-income households are benefiting more from the provision than poor households. Finally, there is the problem of delivering free services across the country, particularly in rural areas. Therefore, many municipalities have developed indigent registers to ensure that free basic services are provided to the poor.

Source: Fjeldstad (2004).

**232. Experiences from South Africa and Namibia show that there are a number of obvious constraints on user charges and other means of cost recovery.** These include equity considerations (i.e. ability to pay), collection and billing methods, the quality of the services provided, and persistent resistance to pay. These lessons point to the fact that dealing with the policy problem of revenue enhancement requires some understanding of the factors underlying the individual's decision whether to pay or evade paying service charges (and taxes).

**233. An increasing amount of evidence suggests that the rate of contribution to a public good is affected by factors such as citizens' trust in others and the trustworthiness of the government** (Slemrod 2003). Without trust there is little basis for social cooperation and voluntary compliance with laws and regulations that could potentially benefit everyone. In particular, three dimensions of trust seem to affect citizens' compliance: i. Trust in the government to use revenues to provide expected services; ii. Trust in government to establish fair procedures for revenue collection; and iii. Trust in other citizens to pay their share. Moreover, the attitude of local political leaders with respect to payment seems to be important; for example, they can legitimize non-payment through their own behaviour. This suggests that there are reasons and scope for innovation.

**234. Problems of non-payment of service charges should, therefore, be attacked on several fronts, including service delivery, better administration and payment schemes and community involvement.** Customer care must show that complaining will bring results. Citizens should be encouraged to report defaults such as leaking taps or non-functioning streetlights. The prompt redress of such complaints may help convince people that the municipality means business. Citizens' involvement in identifying problems and setting priorities may also motivate a greater sense of community involvement. Initially, it may be advisable to link

payment directly to visible improvements in services. Finally, the co-operation between government officials, councillors, and community leaders in setting common goals might be a crucial trust-enhancing device.

**Box 3.11: Improving compliance through shared private water taps in Ondangwa, Namibia**

Residents in the poor informal settlements in Ondangwa Town Council, Northern Namibia, generally prefer a pre-paid water system, since it offers the opportunity to economize water consumption and to control expenses, thus avoiding situations where bills cannot be paid and supplies are cut. However, communal taps frequently break down, often on account of misuse. Repair work is slow, often requiring spare parts that are not available in the country. In January 2004, for instance, Ondangwa Town Council ran twenty-five communal taps with pre-paid cards, of which ten did not work due to damages caused by vandalism. Residents relying on communal taps complained that vandals are usually non-residents.

In order to avoid heavy reliance on unreliable communal taps, residents of the informal settlements have been calling for private taps with the pre-paid system, which by then was only available in the formal settlements. Lacking this option, many residents of the informal settlements instead chose to pool resources and shared a private tap connection, even though it was not pre-paid. In this system, three, four or more households shared one private tap connection, located in and ascribed to one of the participating household. Sharing the bill, that is paying equal shares of the connection fees and the expenses related to water usage, reduced the average costs for each household. More importantly, it decreased the risk of disconnection due to non-payment, since all parties had an interest in keeping the supply running. Members in the arrangement who repeatedly failed to contribute to the water bills were eventually excluded. The concomitant loss of an assured water-source represented an effective regulatory and enforcing mechanism.

Source: Fjeldstad et al (2005).

**235. Recent experiences from North Kordofan suggest that compliance and revenues can be enhanced by using revenues from market fees to improve services.** In the case of North Kordofan, the collected revenue was used to provide weighting, calibration and sieving equipment and machines at crop and cattle markets (North Kordofan State Ministry of Finance, 2012). This may also contribute to establishing a virtuous circle, where improved market facilities and services attract more traders and thereby expand the revenue base. Improvement in water supplies (pits and dams), and veterinary services (stationary and mobile veterinary clinics, etc.) for livestock owners, may also contribute to enhanced willingness to pay for services provided by the state and localities.

*Reforming the tax incentive regime*

**236. Both the federal and state governments in Sudan offer a number of fiscal incentives to investors.** Experience shows that a high occurrence of tax exemptions reduces the tax base, creates room for bribery and corruption, and increases tax evasion. While there is some limited evidence to suggest that tax holiday is a required incentive for attracting new investments, it does have an

adverse impact on revenue mobilization. Members of business associations in Sudan, interviewed as part of this study, argue that a transparent legal framework, a predictable tax regime and access to finance are more important than tax incentives to encourage investments. However, a tax incentive regime that favors foreign investors, specific companies and sectors, may contribute to undermine the legitimacy of the tax system. These views are in line with findings of many business surveys in other countries as well.

**237. A recent study from Mozambique, Tanzania and Zambia finds that many taxpayers perceive the tax incentives to be unfair, since they favor large multinational companies** (Fjeldstad and Heggstad, 2011). In these circumstances, where the majority of (potential) taxpayers perceive the system to be unfair, it is difficult to build a tax-paying culture characterized by broad-based (quasi-)voluntary compliance. This would require policy makers and revenue administrations to seek more refined means of establishing or maintaining taxpayers' confidence in the tax system and its integrity. Without substantial reforms of the tax incentive and exemption regimes it is unlikely to achieve this in the foreseeable future.

**238. Policy changes with respect to the tax exemption regime will require a combination of measures, including more detailed estimates of revenue losses due to exemptions, and identification of who are granted exemptions, for how long, and for what reason.** In Tanzania, for instance, information on tax incentives has been used by the local non-governmental organization, Uwazi, to foster a broader public debate in the country on exemptions. Available data are collected in order to inform citizens, newspapers and parliamentarians (Uwazi, 2010). The stated objective is to enhance transparency and public accountability by making existing data more accessible and informative.

#### *Improving institutional capacity*

**239. The current environment, in which “every government agency turns into a tax collector”, is straining institutional capacity to collect revenue effectively.** The recommendation is to delegate the responsibility for collecting revenues to specialized revenue collection agencies, i.e. the Chamber of Tax and/or the revenue department of the State Ministry of Finance and their extended functions at locality level. This will facilitate more effective organization of the revenue collection process and will concentrate administrative capacity within fewer institutions.

**240. A major challenge facing sub-national revenue collection in Sudan is related to the assessment and forecasting of revenues.** Currently, revenue forecasting is conducted on an *ad hoc* basis, often based on expenditure needs and/or the previous year's reported collection. Comparing the difference between actual and budgeted revenues in the state budgets gives the impression of a systematic over-budgeting of revenues. It seems that revenue forecasts are made

without taking into consideration the revenue potential for individual revenue bases, e.g. by using data on the number of businesses from the State Company Registrar and other sources, and transactions of assets such as property and land. This implies that the revenue potential remains unknown. Introduction of simple, analytical tools to estimate revenues, with forecasting for a two-three year period, is required to strengthen public financial management, including the budgeting process.

**241. Improving revenue forecasting at the sub-national levels should ideally include the following components:** (i) development of baseline indicators; (ii) updating databases (registers) of service subscribers and taxpayers, through field surveys and self-reporting requirements; (iii) expanding street nomenclature to update addresses which are needed for billing and collection; (iv) updating property tax information; (v) establishment of minimum standards in the provision of municipal services; (vi) establishment of good metrics for services provided, including the unit cost; (vii) computing and sharing information on actual cost and expected cost.

**242. Introduction of Information and Communications Technology (ICT) should be part of this process, with a view to enhancing efficiency in revenue administration.** Electronic filing for state and locality revenue, computerized registers of taxpayers, including enterprises, motor vehicles and livestock owners, introduction of electronic cash registers for VAT etc., have the potential to become important tax administrative tools. Such initiatives are already being introduced. The Chamber of Tax in North Kordofan has computerized parts of its operations, but still operates with manual taxpayer registers and files as in most other states in Sudan. The effectiveness of ICT will, of course, depend on building and maintaining technical capacity to operate and maintain the systems. It is important that the ICT-based systems use an integrated framework, because of the technical and managerial challenges this approach poses. In the absence of integration, the use of the systems will remain sub-optimal.

**243. The capacity of sub-national governments in Sudan is weak when it comes to tax design.** As the resource requirements for building this capacity are relatively high, it can only be done in the medium to longer run. In the short run, there is a need for support to develop clear guidelines for the design and assessment of sub-national revenue systems. The current system of approving new and amending existing tax legislation should be reviewed, including how to strengthen the coordination between the national and sub-national revenue regimes and policies. As a first step, an expert committee should be established, to advise both the Federal and State Ministers of Finance on revenue reforms, including how to secure coherence and avoid duplication and inconsistencies between the revenue systems at various levels of government. This committee should advise the ministers before revenue legislation is approved. The expert committee should not be a substitute for the work of staff at the locality and ministerial levels. However, since it will require more resources than are available in the short term to build

relevant capacity at the locality and state levels, the importance of such a committee cannot be overemphasized.

**244. A major challenge facing revenue collection at sub-national levels is related to the assessment of the actual revenue potential for various tax bases.** Currently, revenue forecasting is largely conducted on an *ad hoc* basis, often based on the previous year's reported collection. This approach provides incentives to systematic underestimation of the revenue potential and may imply that the actual collection is substantially higher than what is reported by the collectors. More realistic and transparent revenue assessment and regular updating of revenue data are required.

**245. It is vital to strengthen revenue forecasting and economic impact analysis capacity to enhance the quality of policy making at both national and sub-national levels.** Simple models of revenue forecasting and analysis at sub-national levels should be developed in the short run. In the medium term the skills and data required for more complex analysis should be developed. Developing this capacity will require joint effort and coordination between the Federal Ministry of Finance and National Economy and the State Ministries of Finance.

**246. Improved knowledge about the tax system can change taxpayers' attitudes and tax morale.** Non-compliance may be due to taxpayer ignorance, inability or intent. Thus, the revenue administration's approach to enhancing compliance generally has three main components: (i) taxpayer education and outreach to ensure that taxpayers are aware of their legal obligations; (ii) taxpayer services to secure that tax payment and processing are relatively simple and easy; and (iii) deterrence and enforcement, which implies credible deterrence and consequences for those who seek to avoid their obligations.

**247. A large proportion of the economically active citizens in Sudan belong to the informal sector, both in rural and urban areas.** This has affected "tax literacy" as many people are not able to comprehend the technical issues involved in tax administration and reform. The Chamber of Tax has undertaken taxpayer education interventions, but they have had a limited outreach, since most of them have been concentrated in the urban centers.<sup>47</sup> Similarly, some elites are probably also tax illiterate because they are not interested in tax issues. A challenge experienced in many countries is that elites regard taxation as a form of coercion and one that will erode their privileges. They, therefore, turn a deaf ear to the taxpayer education campaigns of revenue administrations. How to establish a constructive dialogue with elites on taxation and development remains an unsettled challenge in Sudan as well as in other countries.

**248. State authorities in Sudan sometimes take action to improve tax literacy.** Ministries of Finance in some states, and the Chamber of Tax, have initiated various

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<sup>47</sup> Interview with senior officials, Chamber of Tax, Khartoum, 25 February 2013.

measures. For instance, taxpayer education seminars and information leaflets are used by the Chamber of Tax to enhance taxpayers' compliance.<sup>48</sup> However, the effectiveness of such initiatives is questionable if the likelihood for non-compliers to be detected and punishment imposed is low, and/or if taxpayers see little in return, in the form of public services, for taxes paid.

**249. Performance indicators should be designed and pursued in a balanced manner.** Often the sole focus of the revenue administration is on achieving revenue targets "at any cost", to the detriment of other revenue collection goals. This may legitimize extortion and harassment of taxpayers, and transparency, accountability and customer friendliness are likely to suffer. Hence, there is a need for striking a balance between revenue and service targets. Performance indicators should be linked to taxpayers' satisfaction with the revenue administration, processing time for declarations, processing time for refund of VAT, the number of taxpayers enrolled in the tax bases, etc. If such a balance between revenue targets and other performance indicators is incorporated into the revenue administration's strategic and/or corporate plans, it is likely that this will impact over time on staff attitudes towards taxpayers.

*Enhancing tax compliance through improved service delivery*

**250. Surveys in many developing countries have shown that even the poorest taxpayers would be ready to pay more taxes if the services improved and if there were more transparency** (Garzon and Freire 2013: 163-4). Sometimes corruption is so common that taxpayers refuse to pay, because they believe that the resources will never be used to improve the living conditions of the population. A study of six African countries found that 30-70 percent more revenue could be collected at the local level if people obtain the services they paid for (Action Aid 2011).

**251. Studies also show that citizens in various countries in Africa have a general appreciation of the necessity of taxation to support local service provision, but choose non-compliance due to lack of confidence in local government** (Bahiigwa *et al.* 2004). Studies from Tanzania, for instance, suggest that peoples' views on local taxation may change over time, with implications for policy design. Survey data from 2003 and 2006, (Fjeldstad *et al.*, 2009) found that people were much more positive towards the tax system in 2006 as compared with three years earlier. This was partly due to improvements in service delivery, particularly education and health services, as well as law and order, and partly due to reforms which led to less coercive revenue collection. There was also an increasing demand by citizens for more information on revenues collected and how the revenues are spent.

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<sup>48</sup> Interview with senior officers at the Chamber of Tax, North Kordofan, 21 February 2013.

252. **A serious problem hampering collection, according to citizens' perceptions studies in several African countries, is that taxes collected are not spent on public services** (Fjeldstad *et al.* 2012). A major challenge is to secure better links between taxes paid and public service provision. This involves asking the question: "*Why should people pay taxes?*" For taxpayers, paying taxes to the state is a *quid pro quo*; that is, they expect public services to be provided. It is basically "tax for services". People are more likely to pay for local service charges if they feel that the government is providing services equitably, collecting revenue fairly and using the revenue to provide services. In Sudan, as well as in many other African countries, the provision of public services is, however, unfortunately generally unreliable and regarded to be of poor quality. The weak link between taxes paid and services provided is likely to erode citizens' trust in government. In this perspective, the use of revenues to build essential infrastructure and finance the provision of basic public services may enhance citizen trust in government and over-time enhance tax compliance.

## CHAPTER 4. PUBLIC FINANCIAL MANAGEMENT AT SUB-NATIONAL LEVELS

253. **With increasing responsibility for providing basic services at the sub-national level, a sound public financial management system is even more essential to ensure effective basic services delivery and poverty reduction, and to mitigate risks of corruption.** As increased resources reach the sub-national levels of government, their institutional and administrative capacity in strategic budgeting and execution must be strengthened, to enhance the efficiency and accountability of resource use. Financial resources alone are not sufficient to make an impact on the efficiency of public resource utilization and reduce unit costs of public service provision. A sound decentralized system and results-oriented public financial management are fundamental prerequisites to allowing oversight by citizens to improve accountability of the budget system for service delivery.

### A. BUDGET FORMULATION AND APPROVAL PROCESS

254. **Sudan has made reasonable progress in implementing a well-observed budget calendar, underpinned by an adequate statutory and regulatory framework at federal level.** The enactment of the Sudan Interim National Consultation 2005, State Government Acts, and the Local Government Acts are significant steps towards bringing Sudan's budget preparation and approval processes into line with the most orderly and streamlined processes practice in Africa. The budget calendar is clearly specified and well respected, resulting in timely processing and passing of annual appropriation legislation<sup>49</sup>. This aspect of the budgetary system has been replicated at all government levels in Sudan, with strong mapping of sub-national processes to national ones. The specific steps of sub-national budget preparation and approval are outlined in Box 4.1.

255. **All the states surveyed have robust legislative frameworks, underpinned in each state by a Local Government Act.** All states also follow roughly similar processes and calendar. Sub-national governments have made a number of efforts to improve the budget formulation process, including restructuring the budget to reflect functional classification, a computerizing budget performance reporting system, training on functional budget classification, and establishment of a high level committee to help ensure budget allocations and monitoring of government resources in line with budget priorities.

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<sup>49</sup> CIFA, paragraph 15



#### **Box 4.1: Insights on Sub-national budget formulation and approval process**

##### ***Budget Formulation and Approval Process at State Level:***

- The budget process is typically triggered by the receipt of the Federal Budget Circular in late August, which sets out general guidance on policy priorities and accounting for macroeconomic outlooks. At this time the Federal Ministry of Finance & National Economy calls in State Ministers of Finance and State Governors to discuss the general guidance on policy priorities of the budget process;
- The Federal Budget Circular will then be used by State Ministries of Finance as a basis for its own circular/budget framework, which then is distributed to State Ministries and localities in September. A negotiation timetable for the state is also often set at this time, to ensure that the various levels of negotiation (within ministries, between ministries, and within the legislature) can take place so as to meet the statutory budget deadline;
- Each state line ministry will then formulate its budget, both of expenditure and revenue. Exact details for this varies from state to state, with some being more streamlined than others, but in all states there was evidence of strong guidance from SMOFs, and early consultation with relevant committees of the legislature;
- By November a process of budget consolidation is embarked upon by the SMOF, which will, in consultation with line ministries, refine the budget;
- The consolidated budget is then discussed by the State Council of Ministers; and
- Once a revised consolidated budget is approved by the State Council of Ministers it is tabled before the State Assembly. The draft budget is debated, and, once amended and agreed is passed into law as that year's budget law. This always takes place by the end of the December prior to the beginning of the new financial year on 1st January.

##### ***Budget Formulation and Approval Process at Locality Level:***

- Locality Finance Offices are often consulted by SMOFs whilst the State circular/budget framework is being formulated;
- Localities receive State circular/budget frameworks in September (and in at least one state, North Kordofan, these circulars include indicative budget ceilings) and begin the process of formulating their own budgets, usually by means of splitting into sectorally themed working groups;
- Budgets are then consolidated by Locality Higher Technical Committees, typically comprising key directors within the finance function and representatives of health, education and physical planning;
- The consolidated budget is then sent to the Commissioner of the Locality;
- The Commissioner will meet with key departments, and, where necessary, will revise the budget, before discussing with the Locality Executive Cabinet and approving it;
- The budget will then be sent to the SMOF, and then to the State Council of Ministers and the State Assembly. In effect it is State Assemblies, not bodies at locality level, that finally pass locality budgets.

**256. State assemblies have strong powers over ex-ante debate and approval of the annual budgets of sub-national governments, as well as involvement in the ex-post budget cycle.** In respect of approving the budget, each state has a dedicated time-period to allow for legislative scrutiny. Deliberations in the State

Assemblies tend to focus on line items, as opposed to overall allocations and political priorities and achievement of results. In the absence of legislative or regulatory bodies at locality level it is State Assemblies that effectively play political oversight functions. This shows that some aspects of Sudan's decentralization are not well advanced.

**257. In practice, the State Assemblies debate the budget “line by line” “and reject or approve each line item.** In addition, the State Assemblies have the power to change both revenue and expenditure estimates and overall assumptions upon which the budget is based. A number of members of State Assemblies themselves reported that some significant changes were made to the budget. Unfortunately the team was not able to verify this, as the original draft budgets presented to the legislature for debate were not made available. Localities reported that their budgets are also significantly altered.

**258. Once the budget is passed, State Assemblies continue their involvement.** For example, the State Assembly in Nile River State is involved in budget reviews and in constant monitoring of the budget execution. It receives quarterly reports from the Executive. In North Kordofan in-year reports are discussed at each of the functional Assembly committees.

**259. State Assemblies and the Audit Chamber appear to enjoy close collaboration.** Audit reports are received and debated fully in the State Assembly. In North Kordofan the Deputy of the Assembly takes overall responsibility for the follow-up of the audit reports. Both here and in Khartoum State there was evidence that officials were called to account by the Assembly.

#### **Box 4.2: Involvement of the State assembly in the budget process**

As enacted in the Interim National Constitution (INC) of 2005 Article 178 (1), there shall be a legislative organ (Assembly) at state level which shall function in accordance with the Constitution and the relevant State Constitution. As the Constitution gives the National Legislature the power to authorize annual allocation of resources and revenues and approve the annual national budget (Article 91 (2) (C), and (3) (C)), it gives the state legislature the power to do the same at the state level. According to the INC, the state legislature shall have law-making competence in respect of the development, conservation and management of state natural resources, as well as financial and economic policies and planning in general and the state budget in particular (Article 178 (3) and Schedules C (21 and 37) and Schedules D (20).

Each state has its own Constitution in which the legislature's power is determined. For example, as in River Nile State Constitution Act (43), the State Assembly is responsible for approval of the state budget and the related local laws, as well as monitoring the executive authority. The State Council has a specialized committee to deal with economic and financial affairs.

**260. While the sub-national budget formulation and approval process is orderly, a significant number of key deficiencies remain.** In this area, there are four significant symptoms of severe challenges that explain the difficulties in efficient public financial management: (i) weak strategic planning and budgeting; (ii) compressed budget timetable for State Assembly discussion; and (iii) coordination problems between finance and planning functions. These have significant implications, and ultimately adversely affect the credibility of the budget.

*Strategic planning and budgeting*

**261. There is a lack of a medium term approach to budgeting and weak linkages between budgeting and policy making at sub-national levels, requiring focused attention by the authorities.** A three to five year plan certainly exists at all sub-national levels, in some cases costed, setting out state-wide and sectoral objectives, policies and specific projects. The fact that these costed plans exist is in itself promising, and can potentially form a basis for moving to more strategic budgeting. However, as things stand, all budgeting is currently single year. In theory there should be a direct effective linkage between overall policy objectives set at national level and activities reflected in strategic plans, which should then form the basis of the budget at both state and locality level.

**262. In practice the sub-national budgets are essentially prepared on an incremental basis (adding a percentage to last year's estimates) without reviewing whether the activities being funded should be continued.** Typically current in-year budget data are used as an indicator for next year. Fiscal outlooks are usually estimated based on the previous year's figures and current year's expenditures and revenues to date (usually for the nine month period elapsed by the budget preparation time). This incremental process, rather than a formal process of budget ceilings, is the main determinant of potential resource envelopes. In an informal sense it also seems to be a strong determinant on the setting of priorities.

**263. Across the jurisdictions visited it is clear that the on-going sub-national Five Year Strategic Plan priorities are not consistently linked to the availability of resources through a medium-term fiscal framework.** The strategic planning processes are largely paper exercises with limited impacts on allocation decisions. The formulation process puts greater emphasis on control of inputs and less on the need to improve sectoral budgeting performance. Some projects in the Strategic Plan are, therefore, not funded, and the link between policy implementation and the budget is not established. Development expenditures and operating expenses are sometimes driven by the vested interests of the state/locality in the revenue collection (i.e. spending on activities or areas that contribute directly to increased collection at the state level). For example, since agricultural revenues are no longer retained by the state, the states have less incentive to spend on developing this sector, even if expansion in this sector represents a strategic priority for the country.

264. **There are some serious issues with development budgeting at state level.** It is not clear whether the recurrent implication of capital expenditure is properly factored into budgeting processes at sub-national levels. For instance, the development budget in North Kordofan is prepared separately from the recurrent budget, therefore the recurrent costs arising from the development programs are not provided for.

265. **Similarly, some capital expenditure has scant justification.** For example, the SMOE in Kassala indicated to the team that some schools are built with no justifying enrollment, especially secondary schools which, by law, have to be built to accept all students who pass the final level of basic education. However, as the trends confirm serious drop outs in the first year of the secondary stage, the excessive expansion in building secondary schools, in an environment of scarce capital resource, does not necessarily seem justified.

*Budget timetable allowed for State Assembly discussion*

266. **In all states there are problems over the allocation of adequate parliamentary time for budget discussion.** In Khartoum State the Assembly usually gets a draft budget by early November and has until the end of December to debate, amend and sign the budget off, first by scrutinizing it in the five functional committees of the House, then by full debate in the Assembly. Assembly members expressed the view that this does not allow sufficient time to absorb all the information. Similarly, in North Kordofan the Assembly is effectively given between seven and ten days to debate the budget, also felt to be insufficient.

267. **The annual audits of state accounts are received by the state assemblies late in the following year, after the national accounts have been passed by the national assembly at federal level.** This delay compromises state assemblies in their oversight role. Given this situation, interim updates on audit findings during the course of the fiscal year could be useful.

*Coordination between finance/implementation and planning functions*

268. **A series of World Bank reports over the last five years came to the conclusion that coordination in project planning and implementation at sub-national levels is weak** (PER 2007, CIFA 2010, PETS 2011). For instance, responsibility for providing basic services lies at the sub-national level, while the federal level still controls the majority of government resources and states have limited revenue-raising authority.

269. **A consistent message from the current case studies is the weak communication between the state and federal ministries (including functional line ministries) regarding development projects.** This underscores the need for guidelines to clarify the specific roles of each level of government, in terms of planning, execution, and monitoring development projects. For example, in the

health sector, investments in health infrastructure require strong coordination between the federal and state ministries of health.

**270. The management of some development programs by federal bodies results in potential disconnect between the federal and state levels in planning and supervision of the activities and in subsequent operating of projects/assets. In some cases, state finance officials do not have knowledge of national development projects which are under implementation in their own states.** In some cases, state finance officials do not have knowledge of national development projects under implementation in their own states. The Kassala State Assembly cites the “East Development and Construction Fund” as an obvious example of such a disconnection. This lack of coordination between some donors’ development programs and the state ministries (for example, in education and health sectors) results in facilities being built without staff and supplies to operate them. This situation highlights the need for a more strategic overall public investment program.

**271. The State Assembly in Kassala indicates that it lacks information about the revenue allocation formula and criteria applied by the FFAMC.** It indicates that it no longer receives a copy of the transfers made from the federal level to the state, which limits the State Assembly’s monitoring mandate. The State Assembly also complains about the control of the significant part of the state development budget by the federal government, in the case of projects implemented through the “East Development and Construction Fund”.

## **B. BUDGET CREDIBILITY AND COMPREHENSIVENESS**

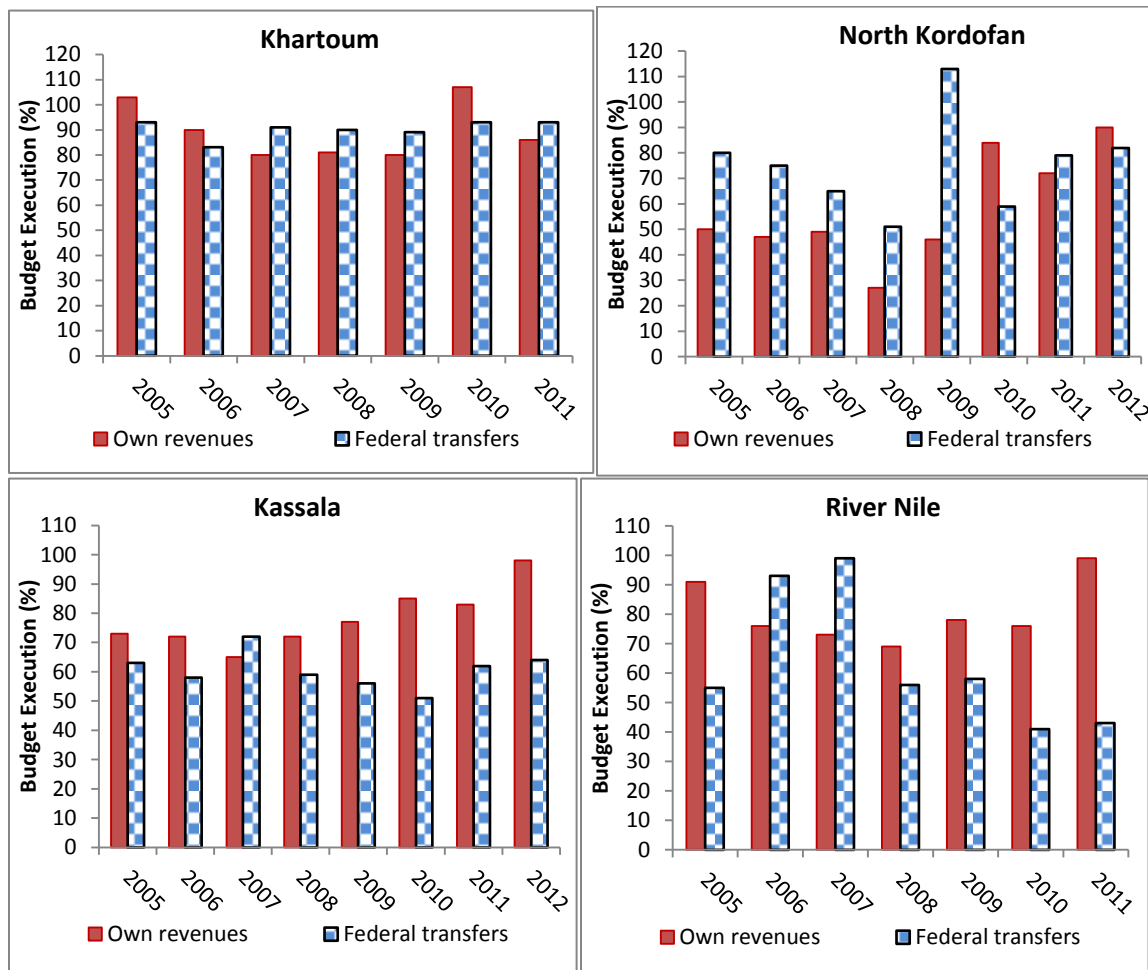
### *Budget Credibility*

**272. While the sub-national budget formulation process is orderly, budget credibility remains a major concern, increasing the risk of fiscal targets not being achieved.** A credible budget means that the budget outturns regularly match the budget as approved (e.g. the budget is realistic and is implemented as intended). In Sudan there are considerable variations in the aggregate outturns of sub-national budgets, as well as in the internal composition of outturns of both revenues and expenditures from the approved.

**273. Sub-national revenue outturns have consistently deviated from budgeted levels, reflecting significant challenges in mobilizing the revenues forecasted by states.** A comparison of total actual receipts against the original budgeted figures indicates that, in aggregate, sub-national budgets have not been successful in forecasting the actual revenue receipts. When looking at the percentage difference between actual and budgeted revenues for Kassala, Khartoum, North Kordofan and River Nile, the state budgets give the impression of a systematic over-budgeting of revenues. Both federal transfers and own source revenues are systematically overestimated, though the figures show that the overestimation has

decreased in size over time. For most of the years under review the revenue outturn has been far below revenue forecast, for both estimated level of federal transfers and state level non-tax and tax revenue.

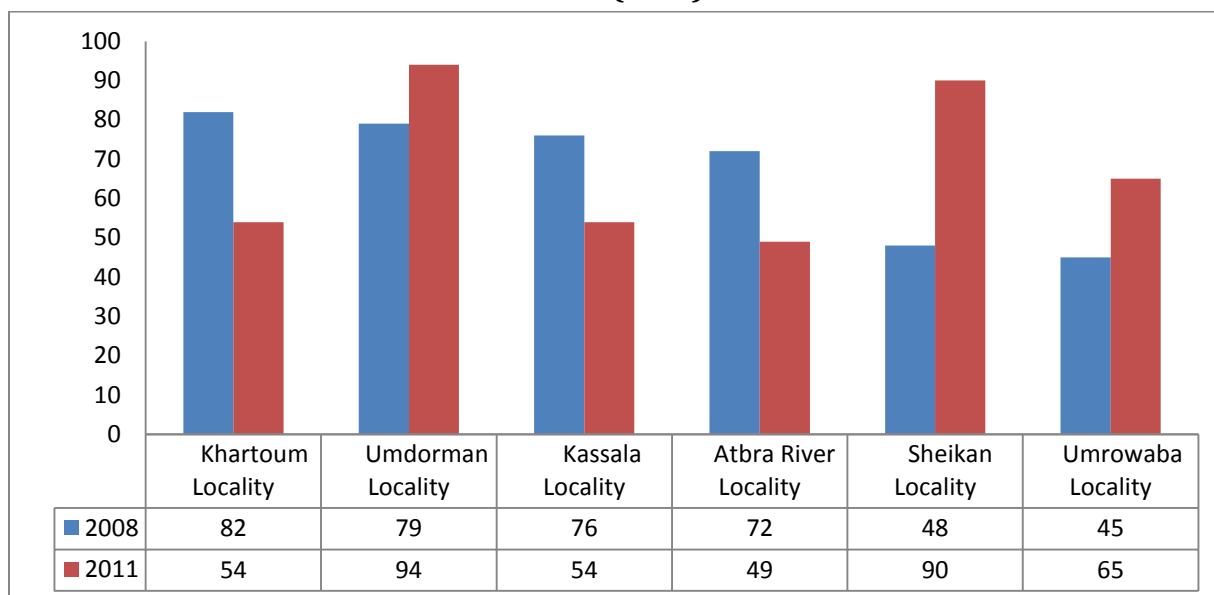
**Figure 4.1: State revenue outturns compared with original approved budget for Khartoum, Kassala, N. Kordofan and River Nile States (in %)**



Source: State Final Accounts Reports, MoFNE

274. **The capacity of local governments to raise their own-source revenue is important to their fiscal sustainability and their ability to promote the basic services of their local communities.** Local government own-source revenue budget outturns, however, indicate that revenue projections are often unrealistic and are not collected as intended. There is a large variation in own-source revenue budget credibility of local governments, as indicated in Figure 4.2. These revenue shortfalls have major consequences for the ability of local governments to provide services that directly affect the poor, including primary health, basic education and water.

**Figure 4.2: Local Governments Own revenue outturns compared to original approved budget for selected localities in Khartoum, Kassala, and North Kordofan (in %)**



Source: State Final Accounts Reports, MoFNE

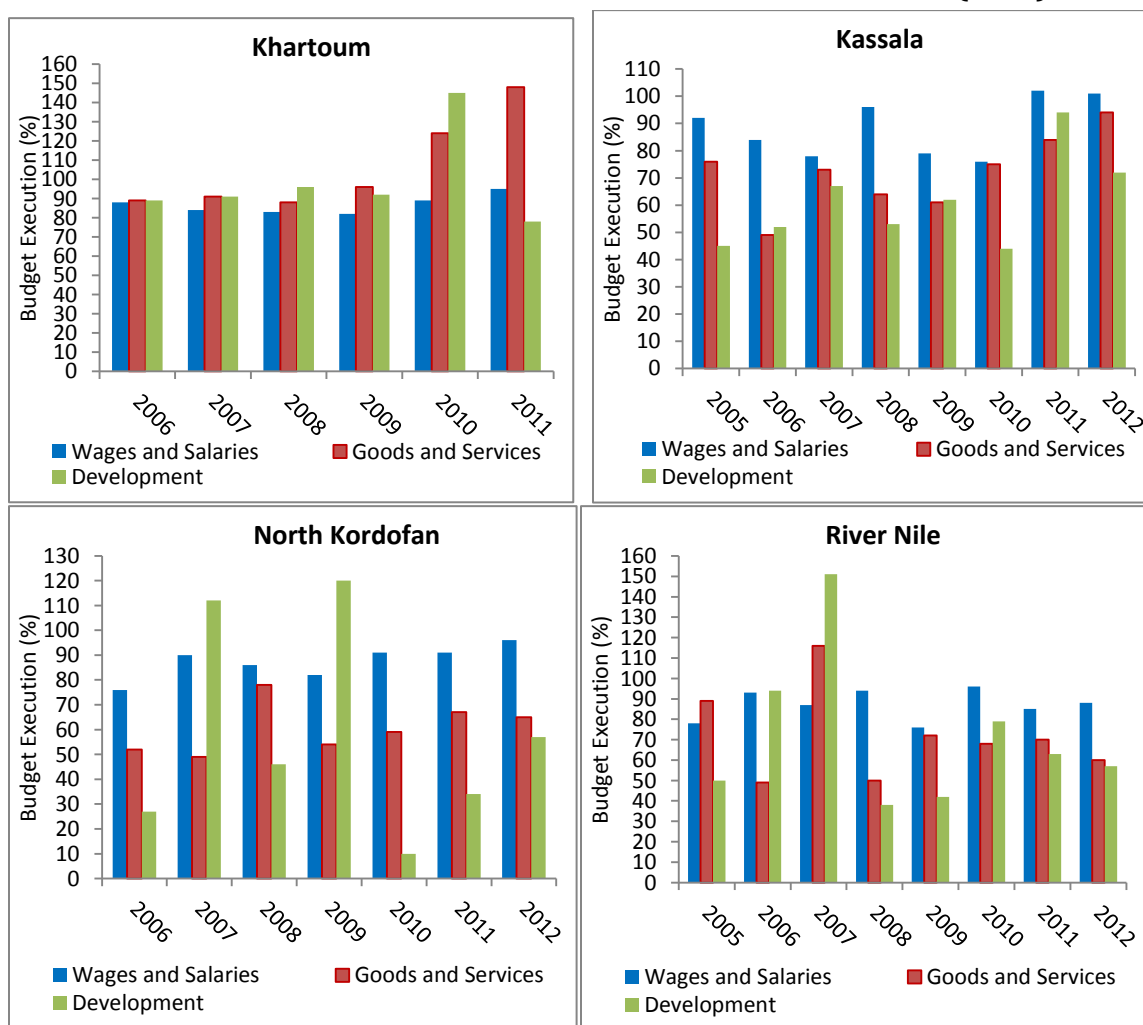
**275. Maintaining expenditures within the available resource envelope to finance the budget remains a challenge for states.** Some of the explanation is due to weak revenue forecasts and unpredictable federal transfers, which undermine the predictability of the budget as a tool for effective public expenditure management. Sub-national expenditure outturns have consistently deviated from budgeted levels; reflecting under-utilization of the originally approved budget during the course of the year. The low predictability of revenues, weaknesses in forecasting of non-tax and tax revenues, as well as weaknesses in controls of commitments, are among the causes of weak expenditures execution.

**276. The four states in the sample, and in particular North Kordofan, River Nile and Kassala, show significant challenges as concerns the predictability of the budget.** However, budget credibility has been consistently high in Khartoum, with over-spending in 2010 and 2011, and around 90 percent of budgeted level throughout 2007-2009. This is probably because federal transfers to Khartoum State seem to be more consistently near to what has been budgeted than in other states.

**277. Sub-national expenditure outturns reflect strict priority for release of funds to recurrent spending categories, especially wages and salaries.** Recurrent spending categories persistently enjoy better budget credibility, in all the four selected states. The strong budget credibility on the current expenditures, in particular wages and salaries, is largely due to the consistent revenue shortfalls, which force a misalignment between expenditure assignments and resource allocations, with development expenditures the hardest hit area.

278. Most notably, significant variations in development budget execution remain a serious challenge, implying a lower likelihood to protect development spending during resource envelope shortfalls. This reflects the continuation of a major issue presented in the PER 2007; budget credibility remains a major obstacle to effective fiscal decentralization, slowing the achievement of a genuine increase in poverty-reducing expenditures. Vulnerability of public pro-poor expenditure items underscores the strong need for strategic preparation for fiscal adjustment.

**Figure 4.3: State expenditure out-turn compared to original approved budget for Khartoum, Kassala, N. Kordofan and River Nile States (in %)**



Source: State Final Accounts Reports, MoFNE



279. **The key causes of poor budget performance appear to be threefold:**

- i. *Key data limitations.* This includes a lack of information on state-level economic activity and, thus, on sources of own-revenue, as well as poor quality data bases on which to base state and locality tax imposts. In addition, there is a lack of timely and accurate information from higher levels of government on expected transfers, and of coordination between states and central authorities.
- ii. *Predictability of transfers between jurisdictions:* Predictability in budget execution is, of course, very much related to the predictability of transfers between jurisdictions. Without a predictable flow of resources to spending units, execution of budget plans is hampered, especially financing of capital expenditures. The current practice of simultaneous preparation of state and local budgets gives neither the states nor localities a reliable estimate of federal and state transfers in time for budget formulation. The analysis indicates that federal transfers to the states are consistently below what was budgeted. North Kordofan, for instance, reported that transfers were never in accordance with their budgeted profile. Similarly, at locality level in Kordofan, it was reported that transfers from the state are not often made in accordance with the budget and locality staff reported that the absence of timely resource transfers sometimes necessitates the cancellation of works and moving activities to future years. In Kassala and Nile River State it was also noted that there were significant delays in fund availability, resulting in increases in the total costs of implementation. However, other states (notably Khartoum) suggested that the transfers from the Federal Government were predictable and in line with what had been budgeted.
- iii. *Optimistic revenue projections and expenditures:* Overly optimistic revenue projections and expenditures across budget categories having little or no relationship to the amounts budgeted. 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. Analysis of the budget has shown that estimates of collection reflected in the budget are often unrealistic. Excessive over-estimations of the state own revenues reduce the credibility of the approved budget and make implementation difficult.

*Comprehensiveness and Transparency of the Budget*

280. **Whilst both State and Locality budgets appear to be comprehensive, there is a major area which constitutes a considerable loophole which represents a serious concern that can affect proper planning and control of resources.** There are instances where locally generated revenues are effectively off-budget. For example, one locality in Khartoum State reported that some teachers are paid by local contributions, but that these are not recorded anywhere in the books of the government. There were similar issues in Kassala and Nile River states.

Revenues raised by some government entities (e.g. schools and hospitals) should be properly tracked to ensure their completeness.

**281. It also appears that revenues from in-kind charitable contributions are not consistently included in the state financial reports.** While these revenues are tracked by the planning department in the state ministry of finance, the linkage with the financial report is not ensured which affects the comprehensiveness of the financial reports and final accounts. In the absence of a comprehensive budget, the use of these funds may not be governed by the applicable budget rules and may not be subject to the expenditure controls governing the approved budget.

**282. Given the extensive involvement of NGOs in the delivery of services, sub-national budget records are often not a reliable indicator of the cost of 'public' service provision.** In some states – particularly North Kordufan – funding gaps are severe.<sup>50</sup> In terms of health provision in North Kordufan, for example, transfers from federal government to state, and then state to locality are barely sufficient to meet salaries, meaning that all the recurrent costs of health care needed to be met from user fees and licenses. But these too were often not sufficient; the State Health Ministry indicated that NGOs invariably filled gaps, particularly at locality level where the struggle was most acute. As a result, the concept of public service provision is being severely stretched – certainly, in nearly all instances, service provision is seldom free, even to the poorest.

**283. Transparency in the revenues accrued to different parts of government represents another** challenge. The state ministry of education (SMoE) in Kassala, for example, was not clear about its share due from fuel sales that accrue from SMoF to the “Education support fund” managed by the SMoE. In the absence of proper flow of information and reports, the perception of fair allocation of resources is hampered.

**284. In all States, it was announced that GFS has been adopted and is being rolled out to localities.** On closer scrutiny it emerged that although the GFS budget classification is followed in budget presentation, full implementation is far from complete. Although the final accounts are presented per the GFS classification, the expenditure classification has not fully moved to GFS classification at the recording stage. Furthermore, little progress has been made in some localities, making overall budget consolidation difficult. Other requirements of GFS classification have not been adopted yet such as the application of accrual basis and the application of fair value of non-financial assets. It was noted that at State level one of the benefits of having adopted GFS was not being exploited. Given that GFS allows for the allocation, recording and accounting of resources across a functional classification of government activities, it can be used to target priority areas of expenditure. There

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<sup>50</sup> The PETS (2011) showed that NGOs are not a significant source for service provision and funder of public services in total, but in some states/localities they do make a significant impact. Since their contributions are “off budget” the issue then becomes apparent in those states.

was no evidence that this, as opposed to incremental budgeting, was being done, however.

**285. In all states budgets are passed into law, and basic budget information is then published as a legal instrument.** The extent to which the budget can then be said to be in the public domain, however, is limited. Similarly, locality budgets are not formally published separately. They might be shared with local communities and citizen's groups but the extent to which they are in the public domain is limited.

### **C. BUDGET EXECUTION**

**286. It is very important for any budgetary system to operate effectively that the agreed budget is implemented in an orderly and predictable manner, and that there are appropriate arrangements in place for the proper control and stewardship in the use of public funds.** This includes ensuring that there are appropriate arrangements to ensure competition (and thus value-for-money) in procurement processes, and that there is an internal audit function able to assure and advise management on the strength of internal controls.

#### *Controls around budget execution*

**287. The Government Resource Planning (GRF) financial management information system that has been rolled out at federal level has not yet had any sub-national roll-out.** Systems for recording transaction at state and locality level are in the main manual. States use spreadsheets, but these are less commonly used in localities. Neither states nor localities use commitment accounting to help ensure that expenditure remains within budget and available cash limits. A regime in which checks are made against existing cash levels before payments are made also appears to be lacking. This has resulted, at least in Khartoum State, in the build-up of some arrears. State officials expressed the view that this inevitable, as payments occasionally need to be made to key suppliers even when revenue sources (either federal transfers or locally raised revenue) were insufficient to cover payments.

**288. There appear to be efforts to strengthen control of the administration payroll.** Personnel records and payment records are maintained separately (although in the case of some states, e.g. North Kordofan, they are not reconciled very frequently). All additions and changes to the payroll data for the previous period needed to be verified and backed up with supporting documentation. At locality level it was reported that payment to staff members was only made on the production of valid ID, thereby reducing the chance of "ghost workers". There is a need for further strengthening of controls over non-salary expenditure. . Opaque compensation practices involving non-salary payments represent an area that needs strengthened governance and monitoring arrangements.

**289. The absence of clear rules and controls on the distribution of collection incentives among revenue collection staff is another area of concern.** In all

states revenue collection staff is, as per local regulations, entitled to a percentage of total revenue collected. Incentive rates distributed to staff against revenues collected range between 2 percent and 5 percent. However, the distribution of the collection proceeds is not governed by specific formulae, but rather by bylaws that provide “distribution based on the exerted effort”. This does not ensure fair distribution among the different managerial levels, is not transparent and can result in lower collection rates.

#### **D. PROCUREMENT**

**290. As the procurement law has only recently been passed at national level, there is still very much work in progress at sub-national level.** The Public Procurement Act of 2011 has modernized the procurement system, but there are still challenges remaining in terms of implementation.

**291. As part of the ongoing process of rolling out the new legislative framework, a Public Procurement Manual and Standard Bidding Documents (SBDs) have been developed<sup>51</sup>, and training in their application has been given to all appropriate officials in state Ministries of Finance (SMoF).** The manual is available online, and both manuals and standard bidding documents reflect internationally recognized good practice. These are important steps. The manuals ensure that a uniform approach, in line with the legislation, is taken in all instances. The SBDs also help to ensure uniformity. Together these steps help to ensure that unwarranted “discretion” is not shown by civil servants, and that procurement processes are predictable and transparent, but oversight of their application is will be critically required.

**292. The review has shown that procurement bye-laws are in place in all states and are based on the national legislation.** Procurement committees meet at State level to ensure probity on transactions above a particular threshold (e.g. 30 million SDG in North Kordofan). However, some generic issues around the national procurement legislation remain, and are also relevant at sub-national level. These issues relate to the institutional arrangements at federal level. The Public Procurement Department, which has both operational responsibility and oversight mandate, does not assure the separation of roles and independence necessary to enforce the procurement regulations and ensure that appropriate provisions are in place to encourage competition, including bidding from foreign contractors. Other challenges include encouraging the involvement and participation of the private sector and civil society in the management and enforcement of the procurement regulations. In addition, despite recent training initiatives, there remains a need to ensure that appropriate trained officials are in post.

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<sup>51</sup> The development of these instruments (and training in their application) has been facilitated with support from the MDTF-N’s Public Sector Reform, Decentralization and Capacity Building Program (PSCAP).

293. **In some states the procurement function is highly centralized, so that localities have little control over procurement relating to development expenditure.** Although there may be savings realized by centralized procurement in some cases, excessive control by the SMOF of the development budgets of localities is likely to increase the associated transaction costs. It also undermines the accountability of localities; while they lack direct control over managing funds, they are perceived as the direct service providers in the eyes of the communities and beneficiaries.

#### **E. INTERNAL AUDIT**

294. **While the internal audit function exists in all states and localities visited, it is very much an “inspection function”, and is often embedded in sectors (e.g. in Khartoum).** It is more focused on the ex-ante reviews of expenditures, with little or no effort in reviewing the systems and the operational efficiencies affecting the achievement of overall objectives. For revenues attention seems to be more on comparing actual revenues with approved estimates, though. The completeness and accuracy of those estimates does not seem to have received similar attention. The review team could not identify the existence of any special measures taken to verify the completeness of estimated revenues.

295. **In terms of reporting, at state level the internal audit function falls under the State Minister of Finance in each state.** Consolidated internal audit reports are produced and considered by a Financial Control Committee, as in North Kordufan, or a similar body, as in Khartoum, chaired by the Minister of Finance. At locality level, the internal audit function typically falls under the Executive Director. Monthly/ quarterly reports on, performance are also copied to the Accounts Chamber and the Internal Auditor at State level. In most cases it appears that, whilst Internal Audit Reports can result in some remedial action, the recommendations often relate to individual transactions, rather than to system weaknesses and the potential strengthening of fiduciary systems.

296. **There is now a need to modernize the internal audit function.** International good practice reflects a number of principles that might be adopted: (i) Internal Audit should be appropriately independent, which means that the function should not fall under the Minister of Finance; possible options include having Internal Audit report directly to the State Governor. (ii) The audit function needs sufficient breadth in its mandate, and access to information. (iii) Professional audit methods are required, including risk-based audit, where attention is devoted to high risk issues with systemic importance relating to financial information integrity, efficiency and effectiveness in operations and compliance of government entities with the legal framework.

## **F. RECORDING AND REPORTING**

297. **In-year reporting has fixed routines in different states.** In Khartoum in-year reports are produced every month and discussed at the State cabinet. In North Kordofan reports are made every three months, and discussed by the State Assembly. At locality level reports are typically monthly and quarterly reports and are reviewed by locality cabinets and senior management teams. They are also sent to the State Ministry of Finance.

298. **Year-end accounts appear to be produced very rapidly by all the states surveyed.** Typically state accounts, incorporating locality accounts, are closed, consolidated and formatted between one and one and half months after the end of the financial year. Consolidated accounts are sent to the Federal Ministry of Finance, as well as to the Auditor General. Localities typically close their accounts in the first two weeks of January, though in at least one case closure of accounts happens by January 5.

## **G. EXTERNAL AUDIT AND SCRUTINY**

299. **While the National Audit Chamber of Sudan is responsible for auditing the final accounts, closer discussion revealed that much of the focus of the external audit function is similar to that of internal audit, with a focus on individual transactions.** In some states, such as North Kordofan, staff of the Audit Chamber work as ‘implants’ within the regional government, at both state and locality levels. This enables a form of continuous audit process and ensures timely final audits, as accounts are, in effect, audited throughout the year on a rolling basis. External (Audit Chamber) staff embedded at locality level focus on evaluation of the strength of the internal audit function in place, which is in line with external audit good practice; in as much as it helps external auditors identify risk. However, additional focus is needed on systems performance and “value for money”, to identify high risk areas and operational inefficiencies. While training plans and quality control developments are progressing at the National Audit Chamber, attention also needs to be paid to the Chamber’s staff at the state levels.

300. **Audit reports for the consolidated state accounts, including locality accounting information, are sent to state legislative assemblies within six months of the closure of the financial year.** Common issues brought up in state audit reports relate to the following of recognized procedures, subversion of general controls and lack of appropriate supporting documentation. A common finding in respect of locality accounting information is deviations in the development budget.

301. **In all states there is evidence of the State Assembly debating the report and follow up of recommendations by the State Cabinet, in line with good practice.** Audit findings are discussed in the public domain and followed up rigorously by the State Assemblies (see section on State Assembly involvement). However, audit reports at the locality level appear to go only to the Locality

Executive. Locality audit reports are not in the public domain; in one state (North Kordofan) when the review team asked to see the reports of localities visited they were told that the reports were “secret”.

## CHAPTER 5. POLICY CONSIDERATIONS

302. **Thorough attention needs to be given to the nature of the fiscal decentralization that Sudan wishes to further and implement.** On the face of it, localities have a lot of responsibility in the current architecture, not least for primary service delivery, the rationale being that things are best decided at community level. But aside from the obvious lack of resources flowing through the system, localities face a number of challenges. Whilst extensively they appear empowered, they are in fact heavily controlled. More discretion for localities in managing their budgets is crucial to make them accountable for performance and service delivery.

303. **Localities currently have no councils, which may explain why it is State Assemblies that can alter locality budgets at budget hearings.** This, however, will soon change providing the opportunity to re-consider the role played by state government in the budget management of the localities. Rather than scrutinizing locality budgets line by line, they could consider setting what budget ceilings or financial constraints might be in play, and set the strategic priorities of the state and some expected standards of service, with responsibility being given to the localities to determine how they will deliver on these mandates. Such reform will not happen overnight, and will need to be supported from all levels of government, but it would help to deliver on the vision of decentralization as being a driver of local empowerment.

304. **The following are key recommendations emerging from this PER.**

305. **First, reforming the federal fiscal allocation mechanism to overcome regional imbalances.** Fiscal decentralization is an appropriate institutional set up to further service delivery in Sudan, but its current implementation needs to be readjusted to improve the quality of governance and promote development outcomes.

306. **There is a need to design appropriate policies to smoothen and equalize widespread imbalances in Sudan.** Poverty rates, social service outputs and fiscal resources available at the sub-national level vary significantly across the states and localities of Sudan. While fiscal decentralization has brought lot of extra resources to the states and substantially increased overall per capita social spending over the past ten years, these additional resources have not been adequately allocated and used in ways to smoothen the social and financial imbalances observed. For example, health and education indicators from 2000-2010 suggest that isolated and under-served areas were particularly disadvantaged by the consequent drop in federal responsibility for basic services.

307. **There is considerable scope that is available to improve the system for federal transfers to ensure more equality in distribution and predictable allocations.** A starting point would be to subject all or the majority of federal



transfers to the states to objective formula-based allocations. This would allow to better account and compensate for differences in state level revenue potential and poverty levels. Much more, it should be considered to segregate the federal transfers into a need based and performance based allocation. There is also a crucial need to more widely disseminate and follow-through on the fiscal allocation formula to improve the states' ability to make more realistic revenue forecasts.

**308. Federal development transfers are discrete in their application, but have a strong impact on state-level development outcomes.** This is for instance seen in the case of River Nile State, host of the Merowe Dam project. This project was financed through the federal level and brought about roads with bridges over the Nile and electricity to large parts of the State, which in turn triggered a thriving cement industry. That expenditure should be aligned with other federal transfers to ensure an overall equalizing nature of federal spending in States.

**309. Second, strengthen revenue mobilization at state level through both streamlining tax and non-tax measure with due emphasis to the cost-effectiveness of revenue collection.** This would need to taking into account not only the direct costs of tax administration, but also the overall costs to the economy, including the compliance costs to the taxpayers. It is important, however, to note that sub-national own revenues are a necessary but not a sufficient condition for fiscal decentralization. In most states and localities in Sudan, own sources are not sufficient to develop and supply adequate services for the fast-growing population. The reality is that many sub-national governments will continue to be dependent on fiscal transfers from the federal government.

**310. The fundamental issues to be addressed in the context of reforming the sub-national own revenue system are threefold:** This analysis has shown that there is need: (1) to redesign the current revenue structure; (2) to build institutional capacity; and (3) to enhance tax compliance through improved service delivery.

**311. When reforming the revenue structure the following options could be considered:**

- a) **Abolition of unsatisfactory local taxes**, especially those revenue sources that generate very little revenues (e.g. cinema and entertainment fees, taxes on youth and sport etc.) or no revenues (including taxes on fruit producing trees, wandering sheep/camel shed fees).
- b) **Improvements to remaining revenue bases**, in particular the stamp duty and business license system ought to be simplified by reducing the number of duties, licenses and fees, and the rates applied. Further, in the medium term technical assistance should prioritize appropriate training of property valuers and upgrading relevant skills for property tax collection in municipalities.

- c) **Cost recovery through user charges should aim to establish clear links between payment and public service provision.** Recent experiences from North Kordofan suggest that compliance and revenues can be enhanced by using revenues from market fees to improve services at crop and cattle markets through provision of weighting, calibration and sieving equipment and machines.
- d) **Revising the tax incentive and exemption regime.** A high occurrence of tax incentives has negative impacts on revenue mobilization and creates loopholes for tax evasion. The benefits of investment tax incentives are generally exaggerated, while the costs are often underestimated or overlooked altogether. Although tax incentives in some situations may stimulate investment, the non-tax elements of the investment climate are generally far more important than tax incentives in determining the level and quality of investment flows. Fiscal incentives do not effectively counterbalance unattractive investment climate conditions such as poor infrastructure, macroeconomic instability, and weak governance. Further, it is important to ensure that incentives are granted transparently. All tax incentives should be in the relevant tax legislation.
- e) **When redesigning the sub-national revenue system greater emphasis on the cost-effectiveness of revenue collection is required,** taking into account not only the direct costs of tax administration, but also the overall costs to the economy, including the compliance costs to the taxpayers.
- f) **Losses through tax evasion need to be reduced.** To achieve these aims, there is a need to simplify the business license, stamp duties and fee structures by reducing the number of rates and coverage. Moreover, sub-national taxes and licenses should be harmonized with the federal government's revenue bases, to avoid double taxation and conflicts with national development policies, such as job creation and private sector development. The establishment of one-stop-shop Single Business Permit systems is promising for future reforms.

**312. While the current potential for most rural localities to raising substantial own revenues is limited, the potential for revenue enhancement in urban localities is better.** However, one major administrative problem for many states and urban localities today is their inability to fully collect the revenue due to them fully. Huge gaps are observed between reported and forecasted revenues. This is due to: (1) poor administrative capacity to assess the revenue base; (2) poor administrative capacity to enforce the payment of taxes, fees and charges; and (3) explicit and intentional tax evasion and resistance from taxpayers. In this setting, fundamental issues to be addressed in the context of sub-national fiscal reforms are to redesign the current revenue structure and to strengthen financial management. In addition, measures are required to enhance taxpayers' compliance and to improve the accountability of revenue collectors and elected councilors. This cannot be achieved without substantial and consistent political support from the federal and state governments.

**313. It is vital to strengthen revenue forecasting and economic impact analysis capacity to enhance the quality of policy making at both national and sub-national levels.** Simple models of revenue forecasting and analysis at sub-national levels should be developed in the short run. In the medium term the skills and data required for more complex analysis should be developed. Developing this capacity will require joint effort and coordination between the federal Ministry of Finance and National Economy and the State Ministries of Finance.

**314. Improved information supplied to the public on budgets and accounts may improve the opportunities for citizens to exercise their voice and demand accountability from sub-national authorities.** This is among the lessons that can be drawn from decentralization reforms in other countries. It is, however, important to stress that encouraging citizens to engage in fiscal and financial monitoring at the local level does not imply that such measures should replace formal auditing and accounting mechanisms (see Chapter 4 of this report). Nor does it imply that such measures will weaken the formal accountability mechanisms. On the contrary, it can strengthen the legitimacy and standing of sub-national authorities in the communities by contributing with complementary measures to improve the control of revenue collection and expenditures.

**315. More realism is also required when it comes to the implementation of a well-functioning property tax system in Sudan.** Property tax has many attractions as a local revenue base since it is imposed on immobile assets and therefore is difficult to avoid – at least in principle. It has also some obvious weaknesses that need to be taken into consideration before heavy reliance is placed on it. In particular, problems of valuation and tax enforcement often occur due to political interventions and administrative weaknesses. The municipalities' capacity and capability to administer the property tax have in general proved to be inadequate. It has therefore been difficult for municipalities in Sudan to maintain the current property valuation registers, let alone to continue the property valuation initiatives. It is therefore a need to reassess the basis of the property tax in urban councils and to implement a simpler and more coherent approach to the valuation provision, which takes into consideration administrative capacity and capability constraints facing the urban councils. A pragmatic policy approach is required, which may imply centralization of certain issues, such as management of property titles, valuation assessments, etc.

**316. Should the agricultural production tax be reintroduced?** Officials at state and locality levels interviewed as part of this study argued that the abolition of the agricultural production tax had unfavorable fiscal and real effects on localities. The federal transfers introduced to compensate for revenues lost have proved not to be sufficient. Businesspeople interviewed argued, however, against this option. Should the tax be reintroduced? Answering this question requires an in-depth study of the marginal effective tax rate in the agriculture sector and a political-economy analysis of whether reintroducing the tax is feasible in the specific local context.

317. **Third, there are several critical challenges in budget preparation, budget execution and audit/oversight that must be addressed to improve the budgeting practices of state and local governments.** Sub-national governments urgently need to ensure a sound PFM system that integrates long-term planning and focuses on results and outcomes for providing effective and efficient basic services delivery. A sound PFM system is far more than simply an exercise in budgeting revenues and expenditures for a series of line items one year at a time. Best practice budgeting is strategic in nature and is based on a forward multi-year fiscal framework that allocates resources on the basis of identified strategic priorities.

318. **To accomplish broader poverty reduction and effective and efficient local service delivery, sub-national budget cycles should have a logical sequence and timing and build on the planning framework.** The budget should also reconcile development goals and policy priorities with a realistic assessment of fiscal constraints, rather than encourage a “shopping list” approach. Sub-national governments often focus on achieving fiscal discipline at the expense of effectiveness and efficiency. The following areas are starting points for improving the budget formulation and approval processes at the state and locality levels:

- *Ensure stronger poverty-motivation in the budget through strategic thinking, especially sector planning, and a culture of accountability for use of resources.* Efforts to improve upstream strategic planning and budgeting activities, particularly the Medium-term Expenditure Framework and revenue forecasting, may provide the best short term gains. The Poverty Reduction Strategy Paper (PRSP) process should contribute significantly, if adequately linked to the budget (e.g. monitoring of pro-poor expenditures in the budget and spending);
- *Take into account both current and capital expenditures in budget allocations and link them to policy anchors, such as the on-going Five Year Strategic Plan.* This might be through clarifying the roles of the different levels of government in resource management; and fostering the involvement of line ministries, legislatures and the private sector in the budget process;
- *Enhance the effectiveness of development planning* through better coordination between the federal, state and locality levels; and
- *Ensure sufficient time for State Assembly discussion,* with a realistic timetable for budget deliberations and the approval, and a focus on spending policies and priorities.

319. **The most pressing issue relates to strengthening the credibility of the budget.** A credible budget is a fundamental requirement of effective PFM. Work is required at federal, state and locality levels on better estimating resources to be used for transfers. Over-estimation of transfers at federal level has a domino effect on all other jurisdictions. Budget realism for estimation of transfers and of sub-national revenues, as well as expenditures needs strengthening. A number of fundamental reforms can be considered to improve budget credibility, including:

- a) *Making the budget more strategic, through a sound forward planning horizon coupling robust resource inflow forecasts with the medium-term budget framework, to provide greater predictability of policies and funding.* Currently the relationship between budgets and strategic plans is overshadowed by a prevalence of incremental budgeting (basically taking the previous year's budget and adjusting for inflation). Not only does this mean that the budgetary mistakes of previous years have a propensity to be repeated, but also that budgets run the risk of not reflecting the strategic priorities set by legislatures at national or state level. Initiatives need to be taken to better connect strategic planning processes to the budget, and ultimately develop budgets that have a multi-year dimension;
- b) *Strengthening the transparency of expenditure prioritization and predictability of budget execution,* including checks on any significant spending beyond budgeted allocations, and monitoring and reporting of arrears;
- c) *Ensuring more transparent intergovernmental revenue sharing.* 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. Federal government is aware that this is still an area that needs to be clarified, and it should be given priority, across all jurisdictions;
- d) *Making the budget more performance orientated* to encourage strategic allocation of resources at all levels, with an emphasis on efficiency and effectiveness in use allocation of resources;
- e) *Ensuring that the budget is comprehensive.* All revenues need to be brought into the budget process. It is vital that budgets, particularly at locality level, reflect both the costs of providing services and the sources of funds used; and
- f) *Institutionalizing a mid-year budget revision process.* The study has noted that the process of budget revision half way through the fiscal year seems to be ad hoc, at best. A formal budget revision process, involving legislatures, would boost budget credibility, not least by highlighting where budgeting estimates have not reflected particular realities. This would also help to strengthen the transparency of the budget system.

**320. Particular effort needs to be given to transparency and participation.**

Financial data is often not available to everyday people, including, annual audit reports the case of localities. Involvement of citizens groups in the budget process, and in discussing budget performance, also appears limited. A series of reforms that could address this issue over time could include: (i) Publishing information in the public domain including web based disclosure; (ii) Involvement of civil society organizations, consumer groups and programs beneficiaries in budget discussions and oversight; (iii) Community level disclosure of project budgets and use of community notice boards.

**321. Progress has been made in putting in place a modern legal framework for procurement.** A manual and Standard Bidding Documents (SBDs) have also been

developed and disseminated in May 2013. It is now important to ensure that training in the use of manuals and SBDs is given to all relevant staff at both state and locality level. A review is needed of the oversight of the procurement function. This should take into account international good practice and should involve elected bodies where possible. Continuing initiatives are being taken to make procurement transparent at all levels, including making public all procurement awards. Finally, procurement planning needs to be properly integrated into the budget and planning process.

**322. The internal audit function is in need of reform.** Currently it is limited to a traditional inspection function. Whilst this has some value, it could be argued that a more valuable function for management, at both locality and state level, might be reviewing systems and assessing risk. Particular reforms that can be considered are: (1) Adopting a risk based approach to audit, where high-risk issues relating to transaction probity and institutional efficiency & effectiveness are prioritized. At the same time the Internal Audit function should manage a transition away from transaction based audit; and (2) Enhancing internal audit independence by changing reporting lines to State Governors/Locality Executives rather than having Internal Audit as part of the Finance function.

**323. As part of an initiative to hold sub-national governments accountable, agreed recommendations appearing in the External Audit Report have to be fully implemented.** There are some recommendations that have not been fully implemented and are outstanding or which the sub-national governments do not intend to implement. States Assemblies now have information to determine which recommendations are outstanding and, in some cases, why the recommendations are outstanding. This information should provide the States Assemblies with additional oversight tools. States Assemblies need to play pro-active role to examine whether public agencies have implemented accepted recommendations from internal and external audits and whether any changes in practice or performance have occurred in response to these audits.

**324. Fourth, the federal government social safety program seems to be overly ambitious in scope and poorly designed and implemented.** The program components are administered by a number of agencies, both governmental and non-governmental. While the government utilizes data from the High Institute for Zakat Sciences to identify target beneficiaries for the GCT-SDG100, other actors use different methods to identify their targets, determined by availability of information. The involvement of many agencies complicates program management and hampers coordination, which leads to issues such as multiple targeting and frequent overlap of the different programs. Hence, a number of households have access to multiple transfers while others receive none.

**325. Lack of key infrastructure, such as information and payments systems, jeopardizes the implementation of the social program.** These challenges include lack of adequate information systems to allow for the identification of potential

beneficiaries, lack of an adequate network of payment centers (particularly affecting people in remote areas), lack of adequate funding for the construction of an appropriate sampling frame to be used as the basis for the targeting mechanism tool, lack of transparency in the eligibility criteria, and selection rules, and lack of monitoring and evaluation tools to reduce incentives for capture by local elites.

**326. Monitoring and evaluation of the social safety net needs critical strengthening.** Problems relating to leakage and misallocation may go undetected because of inadequate program monitoring, stemming from both a lack of technical resources and the inadequacy of financial resources to cover administration costs, particularly in government institutions. For example, the Ministry of Welfare allocates funds to cover its supervisory and monitoring role, but this contribution is far below the actual amount of funds needed, diminishing the effectiveness of the program.

**327. Areas where the social support program design and implementation could be improved upon include the following:**

- a) ***A more transparent and objective targeting mechanism is needed:*** A combination of income and nutritional status would be more appropriate for selecting targeted households, taking into consideration their own coping mechanisms (informal loans, remittances, etc.). To further improve the process, dwelling characteristics should also be considered to further reduce misallocation of benefits. This approach would help ensure that targeting criteria are consistent across all programs.
- b) ***A combination of monitoring systems is critically needed to ensure routine program monitoring:*** This could be, for example, through random monitoring by an external agent who will assist with building Monitoring and Evaluation (M&E) capacity in the implementing institutions. The system should monitor beneficiary satisfaction with the implementation process, through parameters such as: any deviation from the defined benefit; timely delivery of benefits; beneficiary access to benefits and any reliance on intermediaries; and the overall quality of the benefit package. The system should allow for the channeling of feedback into the planning process to inform decisions on any necessary program redesign. Consideration should also be given to designing alternative qualitative or participatory monitoring systems, as a means of securing the effective engagement of beneficiaries in the monitoring and planning process.
- c) ***It is important to minimize the effects on social support benefits during the current fiscal pressures.*** All government levels are struggling with public finances and most are implementing austerity measures. As a result, social support benefits might be targeted for reduction in an attempt to reduce public expenditure. It is important to balance the objective of stabilization of the economy and economic growth with social protection considerations.
- d) ***Reinforce health centers to play a crucial role in providing affordable, high-quality, community-based care to vulnerable populations, especially in rural***

***areas.*** Health centers can play a crucial role in maximizing outreach when health coverage opportunity is more broadly extended. As health insurance expands, it would be important to promote health facilities to provide a consistent level of service across the country.



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## ANNEXES

### **ANNEX 1. ESTIMATING RELATIVE POVERTY RATES AT THE LOCALITY LEVEL: *CONSTRUCTION OF A HOUSEHOLD WEALTH INDEX USING CENSUS DATA***

1. Poverty numbers presented in this report use a relative poverty line approach to classify households into poverty status but poverty estimates are overall largely consistent to those obtained using the Sudan official national poverty line. In general, poverty rates are calculated using consumption or income data from household surveys. Once an aggregate expenditure or income measure is defined, the next step is to estimate a poverty line to classify households or individuals. A poverty line is just a cut-off separating poor from the non-poor households or individuals. There are basically two main ways of setting a poverty line—in a relative or absolute way. Absolute poverty lines are normally anchored to a standard of what households should be consuming to satisfy their basic needs and are often estimated using what it is called the cost of basic needs method. This method consists of calculating the cost (in monetary terms) of obtaining a consumption bundle typically consumed by poor households, which it is adequate to satisfy their basic consumption needs at local prices.

2. In the particular case of Sudan, the official national poverty line is estimated using household consumption data from the National Baseline Household Survey (NBHS) and it is based on this cost of basic needs method. An alternative way of setting a poverty line is constructing some sort of composite measure of households' cumulative living standard and to define the relative position of each household in relation to the overall distribution of households in the country.

3. Poverty rates in this report are calculated using census to estimate poverty rates at the locality level. The NBHS data is only representative at the State level. In contrast, census data in Sudan allows for the estimation of poverty rates at the locality level, providing a much better overview of the distribution of poverty in the country. Also, for this particular exercise, there is strong interest in computing poverty estimates at the locality level to be able to compare locality level education outcomes and assess the extent to which they correlate with poverty rates.

4. The estimation of relative poverty estimates in this report is based on the construction of a national household wealth index using principal components analysis. The national household wealth index used in this report is a composite measure of different measures of household's cumulative standards. The index is calculated using data from the "Housing Characteristics" module available in the census questionnaire. This module collected data on household's dwelling characteristics and asset ownership, all of which were used to construct this household wealth index. This included: (i) dwelling type; (ii) per capita number of rooms; (iii) main source of drinking water; (iv) main source of lighting power; (v) main source of energy used for cooking; (vi) type of toilet facility; (vii) means of transportation ownership; (viii) asset and livestock ownership; and (ix) main

livelihood activity. Each of these assets was then assigned a weight or factor score using principal components analysis and the resulting factor scores standardized in relation to a standard normal distribution with a mean of zero. After this exercise, each household was then assigned a standardized score for each asset, where the score differs depending on whether or not the household owned that asset (or, in the case of sleeping arrangements, the number of people per room).

5. Using this national household wealth index constructed, households are placed on a continuous scale of relative wealth and individuals ranked according to the total score of the household in which they reside to construct poverty rates estimates. To mirror official poverty rates estimates computed using household survey data, the cut-off to classify households as poor was set in the 46.5 percentile of the national household wealth index distribution. This means that all individuals living in households with a wealth index below that at the 46.5 percentile of the national household wealth index distribution are classified as poor while households with a wealth index above this number are considered to be non-poor individuals.

## ANNEX 2. DOING BUSINESS AND PAYING TAXES IN SUDAN

1. The *Doing Business* database (<http://www.doingbusiness.org/>) provides measures of business regulations and their enforcement (Doing Business 2011). It indicates the regulatory cost of business, and includes a wide range of countries and topics. The countries are ranked in terms of the ease of doing business, which is an overall ranking of 10 elements relevant to the business environment. The individual elements in ‘ease of doing business’ are (1) starting a business, (2) obtaining and renewing licenses, (3) employing workers, (4) registering property, (5) getting credit, (6) protecting investors, (7) paying taxes, (8) trading across borders, (9) enforcing contracts, and (10) closing a business. Table A2.1 shows the overall ranking of countries in terms of ease of doing business. The right column describes the ranking on ease of paying taxes which is one of the ten elements of which the ease of doing business entails.

**Table A2.1: Worldwide rank of ease of doing business and paying taxes**

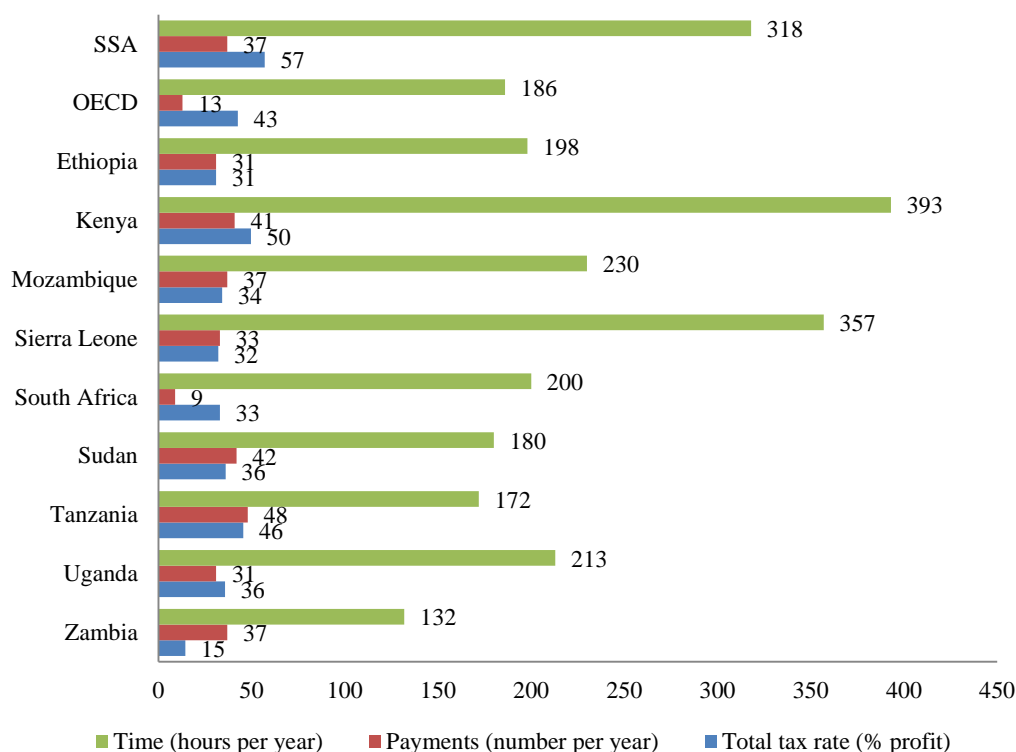
	Doing Business	Paying taxes
South Africa	35	44
Zambia	84	47
Kenya	109	166
Ethiopia	111	40
Uganda	123	93
Tanzania	127	129
<b>Sudan</b>	<b>135</b>	<b>103</b>
Mozambique	139	107
Sierra Leone	141	76

2. Sudan ranks among the bottom third among the selected countries in terms of ease of doing business, and in the bottom half in terms of ease of paying taxes. For the overall indicator, ease of doing business, South Africa is rated highest, and Mozambique and Sierra Leone lowest of the selected countries. In terms of ease of paying taxes, on the other hand, Ethiopia is ranked highest, and Tanzania and Kenya lowest. Thus, many of the countries are performing much better on one ranking than the other. The difference was largest for Ethiopia which is ranked as 40<sup>th</sup> on the ease of paying taxes worldwide, but is rated as low as 111. Most of the selected countries rank higher on ease of paying taxes than on the overall ease of doing business, with the exceptions of South Africa, Kenya and Tanzania.

3. Figure A2.1 gives a graphic presentation of the three components of the ease of paying taxes indicator discussed above, namely the average of the total number of tax payments, the total number of hours spent on preparing taxes and complying with rules and laws, and the total tax rate (measured as share of commercial profits), for medium-sized companies each year (Doing Business 2010: 53). The figure includes selected African countries, as well as the regional and OECD average.



**Figure A2.1: Time spent paying taxes, number of payments and total tax rate on profits in selected countries**



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4. The Figure shows that the total tax rate on profits is lower than the SSA average rate (57 percent of profit)<sup>53</sup> in all the selected. Zambia is by far the country with the lowest tax rate on profits (15 percent). However, also Sudan (36 percent), together with Ethiopia (31 percent), Sierra Leone (32 percent), South Africa (33 percent), Mozambique (34 percent), and Uganda (36 percent) has a tax rate on profit below the OECD average of 43 percent. Tanzania (46 percent) and Kenya (50 percent) are the only countries in the sample with tax rates on profits between the OECD and SSA average.

5. The average number of payments made by firms is more than three times the size in SSA than in the OECD region (37 vs. 13 payments). Among the countries in the sample, only Kenya (41), Sudan (42) and Tanzania (48) lie above the regional average. Mozambique and Zambia have numbers equal to the regional average. South Africa is the only country where the number of payments is lower than the OECD average.

<sup>53</sup> It should be noted that this average is heavily affected by the tax rates in the Comoros, the Democratic Republic of Congo and The Gambia where tax rates are 218 percent, 340 percent and 284 percent, respectively. When these three countries are excluded from the sample, the SSA tax rate average is 41.5 percent, i.e. lower than the OECD average.

6. The variation in time spent on paying taxes and complying with rules and laws is large. While the number of hours spent on paying taxes annually in Kenya is 393, firms in Zambia only use 132 hours on paying taxes every year. Kenya (393) and Sierra Leone (357) are the only ones of the selected countries that are rated above the SSA average (318 hours) in terms of this indicator.

7. Though Zambia has the lowest tax rate of the countries in the sample (14.5 percent), figures from the Enterprise Survey shows that tax rates are seen as the top constraint by firms in Zambia (see Figure A.2.1). The Doing Business and the Enterprise surveys are inadequate to explain why the perception of firms are so strongly opposed to the level of the tax rates, even though the Doing Business numbers suggest them to be far below the regional and OECD average.

### ANNEX 3. GOVERNMENT SOCIAL PROTECTION PROGRAMS

1. **In 2011 the Federal Government created an overall framework for an ambitious multi-dimensional social support program (SSP) that targets poor households.** The framework, which came about through a Presidential Decision, is the cornerstone of social protection activities in Sudan and incorporates the largest form of direct government support to the poor. The SSP is administered by the Federal Ministry of Welfare, in collaboration with other partners at the federal level, particularly the National Pension Fund, the Social Security Fund and the Zakat Chamber.

#### A. SOCIAL SUPPORT PROGRAM MAIN COMPONENTS

2. **The federal framework for the SSP program includes a number of main components, which are provided independently from each other.** Lack of coordination suggests that they have not been designed as a comprehensive and cohesive package (Annex 3. Table 1). With the exception of the cash transfer component, the SSP does not provide for a well identified targeting mechanism in reaching out to the poor; furthermore, analysis is constrained by the fact that the information available is very limited. The main components of the SSP appear to be:

- *Non-conditional cash transfer:* This non-conditional cash transfer program targets 500,000 of the 2,289,000 poorest families, identified by the *Zakat Chamber* for outreach over a 4-year term (2011-2014)<sup>54</sup>. The Program's target for the first year, 2011, was 100,000 families. The cash component (SDG100/month/family) is by far the largest component of the federal government sponsored SSP non-contributory transfers, comprising 57 percent of the total cost of these components.

- *Conditional cash transfer:* This program provides cash transfers to poor families, conditional upon certain behaviors, such as ensuring that children regularly attend school. Its primary objective is to reduce the vulnerability of households in the short term through cash transfers, and to promote long-term investment in human capital by encouraging the use of education and health facilities.<sup>55</sup> The main providers of these transfers are the National Pension Fund, the National Social Security Fund and Zakat.

- Health-related programs:

- *Social health protection (the National Health Insurance Fund (NHIF)).* The NHIF was set up in 1994 as a mandatory social health insurance. It was originally created under the FMOH but was recently attached to the Ministry of Social Welfare. The NHIF provides services to a number of groups and

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<sup>54</sup> *Zakat* is the giving of a fixed portion of one's wealth as a tax, generally to the administration or government and is one of the Five Pillars of Islam.

<sup>55</sup> Andrews, *Social Safety Nets in World Bank Lending and Analytical Work*

their families (e.g. public sector; private sector; informal sector students; poor households; martyrs' families; widows; independents).

- *Non-contributory health insurance (HI)*, which is the second largest component, co-financed by the Federal Ministry of Finance & National Economy (FMoFNE) and the Zakat Chamber. The services under this component target those designated for outreach by the government, in addition to other specific target groups, including widows, divorced individuals and orphans. Government expenditure on contributory and noncontributory health insurance was 31 million SDG for all states in 2011.

- *Free primary health care* is another form of support aiming at reducing the cost of health services, including maternal child supplements. The federal government spent SDG 70 million on PHC services for all states, in 2011, mainly to cover salaries of the staff. Most of the costs of other important requirements for delivering health services, such as essential medicines and operations and maintenance are generated through user fees and external funding, at the rate of 40 percent and 60 percent respectively (see PETS, 2011).

- *Asset transfer through microfinance*: Livestock and productive tools are provided to the poor with productive capacities, mainly through microcredit programs. The main actors are microfinance institutions and NGOs as well as the National Fund for Employment of Graduates, and Zakat. This microfinance program also provides technical training for the poor. The Family and Saving Bank is the transfer channel of choice, while NGOs transfer non-contributory assets directly to poor households and individuals. Asset value differs considerably between the programs, ranging from SDG 1,000 for rural women to SDG 20,000 for graduates. Some programs provide larger livestock (cattle), while others provide goats, sheep, or hens. The asset package can also vary considerably even within a program, from small tools like manual grinders to tractors (mainly for groups of farmers), for up to SDG 100,000.

- *Other smaller social protection initiatives include:*

1. *National Students Welfare Fund (NSWF)*. This program started in 1999 as a cash transfer tool administered by the NSWF. It includes a monthly transfer of SDG 50 for each poor university student. The NSWF now reaches 97,878 students all over the country<sup>56</sup>.
2. *Rural women empowerment project*. This project targets 7,500 rural women in each state, with 1,500 covered in its first phase. To date, start up and business management training of trainers (TOT) has been conducted, with 100 trainers in each of the states of River Nile, Kassala, and North Kordofan. The cost of the training is SDG 80,700. Additional SDG 1,000,000 was

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<sup>56</sup> <http://studentwelfare.sd/kafala.php>

allocated for each of the three states, to provide productive assets to some targeted rural women.

3. *Child protection.* The main source of finance of this program is UNICEF, in addition to NGOs. The initiatives cover the implementation of a number of activities targeting children in special circumstance, in particular children with disabilities, those without parental care, street children and child soldiers. Activities under child protection include awareness building on child rights in general and provision of food and shelter, as well as aid devices, for instance mobility and hearing devices, to support children with disabilities.
4. *School feeding.* The main provider of school feeding in Sudan is the World Food Program. The total number of students covered by the program is 40,500 in Khartoum, 43,676 in Kassala and 196,013 in North Kordofan State. Meanwhile, the River Nile State Program, supposedly funded by the government, has been suspended due to the implementation of fiscal austerity measures and cuts in the education budget

**Annex 3. Table 1: Main components of the Federal Social Support Program Framework**

Main Component	Benefits	Main targeted beneficiaries	Main source of finance
Non conditional cash transfer	SDG 100	Poorest HHS identified through Poverty survey conducted by Zakat	Federal Ministry of Finance and National economy (FMoFNE)
Noncontributory health insurances	Health services	Poorest HHs	Provided by National Health Insurance and financed by FMoFNE and Zakat chamber
Conditional Cash Transfer (CCT) to individuals of pensioners (students and elders)	Cash and in kind support (boarding houses to poor students)	Individuals of pensioners HHs particularly elders and students	National Pension Fund and National Social Insurance Fund own revenue through investment in private sector
Microfinance	Productive Assets	Poor households and individual for instance un employed graduates	Family and Saving Bank and Social Development Cooperation (Microfinance Institutions)

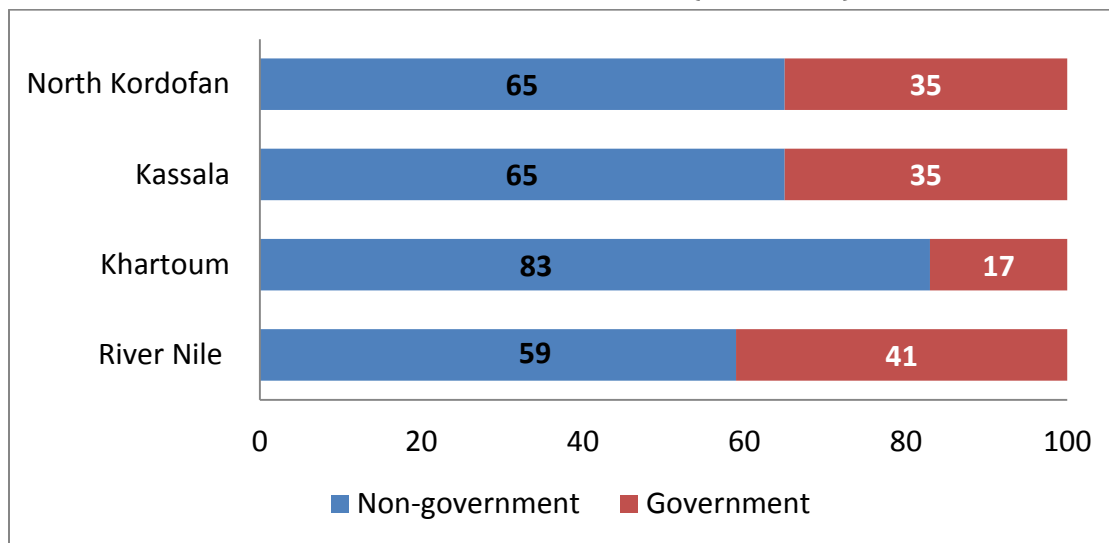
Source: State Ministry of Welfare and Social Security in River Nile, Khartoum, Kassala and North Kordofan States.

## **B. SOURCE OF FUNDS FOR SOCIAL PROTECTION PROGRAMS (SSP)**

3. **There are a variety of sources of financing for the SSP and a consolidated view remains unclear.** As a share of total expenditure on SSP, the federal government contributions are not very high across states, with 29.5 percent of total expenditure on average. Most public expenditure on SSP is channeled through social insurance programs, which include the Zakat Chamber. Social funds

institutions contribute 68.5 percent on average (Annex 3. Figure 1). With the implementation of the federal government cash transfer program in 2011, government expenditure has significantly increased, but still remains small. For instance, in River Nile State, government expenditure has increased from 0.2 million SDG in 2010 to 4.5 million SDG in 2011. However, the federal government's contribution to SSP remains modest against the sizable poverty rates in the states. A poverty assessment conducted by High Institute for Zakat Sciences in the River Nile State indicated that poverty increased from 32 percent in 2008 to 46 percent in 2011.<sup>57</sup>

**Annex 3. Figure 1: Sources of funds for Social Protection Programs including cash and in kind transfer (% of total)**



Source: State Ministry of Welfare and Social Security, *Annual Performance Report 2011*

### C. SOCIAL SUPPORT CASH TRANSFER PROGRAM

#### *Cash transfers program targeting mechanism*

4. **The targeting mechanism used by the social support cash transfer program to identify poor households consists of a proxy means test, administered by the Zakat Chamber at the federal level, and implemented by the Zakat Committees at the local level.** The targeting mechanism consists of three steps: (i) Potential beneficiary households are nominated by local Zakat Committees, using community level inputs on the relative poverty status of households and their own perceptions on the economic position of each household relative to the community as a whole. (ii) All locally nominated households go through the process of participating in a household survey, conducted by the Zakat Chamber, to provide information on their basic demographic and housing characteristics and asset levels. This survey was expected to be collected every year,

<sup>57</sup> These figures are not comparable to the poverty figures reported in chapter one. The methodology of the Zakat measurements remains unknown. However, the increasing trend in poverty is noteworthy and realistic.

based on the annually revised lists of households prepared by the local Zakat, but so far it has only been collected in the year 2011. (iii) The Zakat Chamber computes a poverty score for each household at the federal level and determines cut-off values to classify households across poverty status, based on availability of funds. Eligibility is then determined by comparing households' poverty scores against these predetermined cut-off values. The poverty score is constructed based on a number of demographic and household characteristics, including household size and composition (dependency ratio), asset levels, education level, access to health services, household characteristics (type of construction materials, ownership, number of rooms per capita, and type of toilet), and access to basic services such as water and electricity.

**5. The targeting mechanism design employed by the social support cash transfer program has important weaknesses:** (i) the lack of clear objective measures to nominate households at the local level creates incentives for the misallocation of the benefits of this program in favor of local elites. (ii) The lack of an adequate funding scheme to allow for collection of household level data on a more frequent basis and to update listings of households introduces important limitations in the effectiveness of the targeting mechanism. (iii) The training of enumerators and data collectors, led by the Zakat Chamber in 2011, took place in a very short time frame, which did not allow for a proper training and piloting of the survey instrument.

#### *Social support cash transfer program coverage*

**6. The coverage of the social support cash transfer program is overall quite low.** On average, only 3.7 percent of households estimated to be poor benefit from the program (Annex 3. Table 2). There is some variation in these estimates by State, with River Nile having the largest share of poor households covered, at 3.9 percent, North Kordofan and Kassala covering 3.6 percent of their estimated poor households, and Khartoum 2.8 percent of these households.

**Annex 3. Table 2: Social support cash transfer program coverage, 2011**

State	Estimated number of poor households based on Zakat Chamber data	Number of beneficiary households	Number of beneficiary households as percentage of poor households
River Nile	93,300	3,639	3.9
North Kordofan	241,114	8,701	3.6
Kassala	121,090	4,367	3.6
Khartoum	367,964	10,634	2.8
Total Sudan	2,291,789	85,798	3.7

Source: Social Development and Saving Bank, Head Office, Khartoum

7. **The channels through which households can cash out the benefits of the social support cash transfer program are limited, and often introduce important barriers for eligible households in accessing the benefits they are entitled to.** The Savings and Social Development Bank is the main entity in charge of channeling these transfers from the federal to the locality level, but it generally only operates in relatively bigger cities, with very limited branches available for remote locations. Beneficiary households in remote areas, therefore, face high costs in cashing out the benefit, or have to rely instead on community members with better access to these locations to cash out the benefits on their behalf. Another important barrier many households face is the lack of an identification card by the head of the household, required to cash out the benefit. In many cases, identification cards might be unaffordable and hard to get for people living in remote areas, where the larger percentages of poor households in the country are concentrated. In a survey conducted by the Federal Ministry of Welfare and Social Security, on average 64 percent of eligible households report facing important constraints when trying to cash out the benefits of this program, including high transportation costs and lack of identification documentation.

**D. EVIDENCE ON THE IMPACT OF THE GOVERNMENT SSP PROGRAM**

8. **The federal Ministry of Welfare and Social Security conducted a survey to assess the economic impacts of the social support cash transfer program one year after its introduction.** The survey covered a sample of 874 households<sup>58</sup>. The findings presented in the assessment report are mixed. On the one hand, results show that 80 percent of the interviewed households thought the program was helping them in meeting their basic needs, in particular as related to the education and feeding of their children. Moreover, 53 percent of households felt the program allowed them to increase their level of consumption<sup>29</sup> percent of the surveyed households reported using the transfer income to construct and maintain their homes, while 33 percent used it to purchase capital assets. On the other hand, 43 percent of the interviewed households reported that the transfer received from the program did not have any effect on their consumption levels. The results of this assessment should be interpreted with caution as the methodologies used for sampling of respondents and for data collection are not clear.

9. **In addition, there seems to be considerable misunderstanding and dissatisfaction at the way in which the government is targeting beneficiaries.** The same assessment survey conducted by the Ministry of Welfare and Social Security to assess the effectiveness and efficiency of the program, shows that 76.7 percent of the 874 interviewed households expressed dissatisfaction with the targeting mechanism used by the government. Furthermore, around 80 percent of

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<sup>58</sup> Federal Ministry of Welfare and Social Security, "Assessment of the Social and Economic Impact of the Social Support Project" December 2012.



interviewed households suggested there seems to be an evident problem of inclusion and exclusion errors in the first stage during the targeting process. That is, many poor households seem to have been excluded from the nomination lists prepared by the local Zakat Committees, in favor of relatively better off households which presumably have some local connections with community leaders.

#### **E. HEALTH INSURANCE SERVICES**

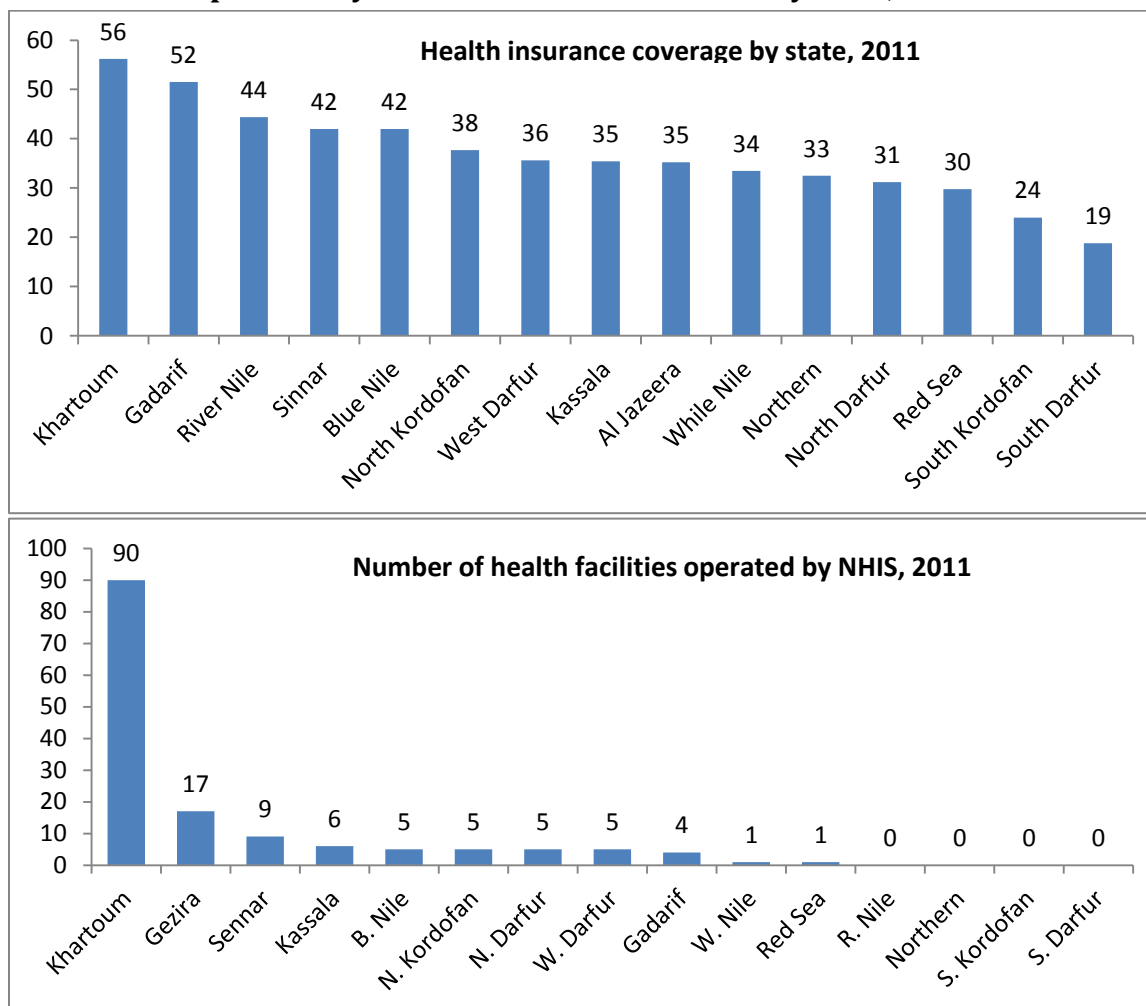
**10. The health insurance contribution premium is 4 percent of employee's salary, while the employer contributes 6 percent of the employee's salary, in both private and public sectors.** The contribution premiums for martyrs' families, poor households, and University students are covered by the Martyrs' Fund, Zakat Chamber and Student Support Fund respectively. Workers in the informal sector and independent workers (farmers, advocates, etc.) pay a lump sum of 25 SDG per month. In 2010, 47 percent of enrollees were from the formal sector, 11 percent from the informal sector, and another 11 percent independent workers, while 31 percent received assistance (of which 6 percent were martyrs' families, 4 percent students and 92 percent poor households).

**11. The National Health Insurance Fund (NHIF) coverage is very low, with significant variations across states.** The NHIF only covers 38 percent of the total population, as its mandatory registration is only enforced in the public sector (Annex 3. Figure 2, upper panel). The current legal framework for mandatory registration lacks institutional enforcement in both formal private & informal sectors.

- (a) The low coverage of the NHIF may be attributed to the unsatisfactory benefits packages and the low quality of services it provides. Limitations include the following: Beneficiaries are obliged to register in the nearest Health Centre, which should be contacted first when health services are needed, with few exemptions in case of emergency;
- (b) The NHIF service does not cover dental care (except for extractions), chronic diseases care (e.g. dialysis), and complicated care (e.g. open-heart surgery), making its benefits package limited and hampering the health insurance overall objectives;
- (c) While the cost of medical services is covered entirely by the NHIF, insured persons should purchase medicines at government pharmacies, paying 25 percent of the drug cost as a co-payment, irrespective of their nature. The list of drugs includes 513 medicines;
- (d) The lack of availability of health care facilities outside urban areas hampers the coverage of health insurance in rural areas. The health insurance fund operates about 148 facilities (Annex 3. Figure 2, bottom panel);
- (e) A high dropout rate has followed enrolment campaigns among the poor population, with non-payment of renewal premiums by newly enrolled

households. Partner organizations which had committed to pay premiums on behalf of certain segments of the population were not able to meet their commitments. Some of these negative effects were offset by attempts to mobilize community participation, and through community-based initiatives to provide insurance and health protection. Weak collaboration between NHIF and FMOH, especially in medicine pricing policy. For example, health workers in Health Insurance Facilities are managed outside the FMOH.

**Annex 3. Figure 2: Health insurance coverage and number of health facilities operated by the Health Insurance Fund by state, 2011**



Source: National Health Insurance Fund

## F. MICROFINANCE SECTOR

12. **The Government of Sudan has endorsed microfinance as a crucial component of the SSP.** The Central Bank of Sudan (CBoS) commissioned a situational analysis of microfinance in the country in 2006, which laid the foundation for the National Vision for the Development and Expansion of the Microfinance Sector in Sudan. In pursuing the Vision, a series of strategies were

agreed upon and a comprehensive work plan adopted, which included the issuance of specific microfinance regulations and licensing for banks and non-banks.

**13. The CBoS has introduced a number of policy reform measures to support the development of the microfinance sector.** Key among these are the following:

- Development of a Microfinance Strategy in 2007, which is being updated in 2013.
- Establishment in March 2007 of a dedicated Microfinance Unit (MFU) to oversee implementation, fully responsible for executing the strategy. The (MFU) is responsible for regulating and supervising MFIs, and formulating policies in support of the development of the sector. The CBoS-MFU has established reporting standards for MFIs, who are required to submit monthly reports, and also conducts onsite supervision. MFIs request a mandatory deposit of 10 percent of the loan amount from clients to serve as security for the loan.
- Establishment of Sudan Microfinance Development Facility (SMDF), in 2008, to be an apex funding and capacity building provider for the emerging industry, as co-funded by the Multi-Donor Trust Fund (MDTF). The mandate of the SMDF is to provide technical support in addition to funding. There is no microfinance law, but the SMDF project assisted the CBoS-MFU in developing the regulatory framework for microfinance. This has been completed and policy directives have been developed and adopted by the Board of the CBoS. The regulatory framework was developed for both deposit and non-deposit taking MFIs, though, so far the CBoS-MFU has only granted non-deposit taking licenses to MFIs.
- Establishment of Kafalat, a wholesale insurance company, to ensure smooth outsourcing of funds from commercial banks to microfinance institutions.
- Mandating banks to lend 12 percent of their total loan portfolio to the microfinance sector, to speed up the development of the microfinance sector. The CBoS also provides incentives to banks with generous amounts of subsidized capital (the Microfinance Pilot Project).

**14. However, the microfinance sector in Sudan remains at the infancy stage.** As of end-2012, banks have been able to lend only about 5 percent of their loan portfolio to the microfinance sector. In addition, there are numerous NGOs and CBOs providing microfinance services. Based on the latest figures from the Microfinance Unit of the Central Bank, the outreach of microfinance has reached 491,600 people, including 302,000 served by commercial banks and 189,600 by MFIs. Microfinance providers supported by SMDF have a total of 8,588 active loan accounts, with 47.2 percent. There are currently 12 licensed microfinance institutes (MFIs) operating in Sudan, and 6-10 potential organizations in the process of applying for an MFI license at the CBoS Microfinance Unit (CBoS-MFU). Currently,

over 200,000 clients are benefiting from microfinance, served by MFIs and commercial banks. At end-2012, MFIs had issued loans in the amount of SDG 173 million (about US\$29 million).

**15. The MFI sector remains underdeveloped and faces significant capacity constraints.** MFIs confirm that there is very high demand for microfinance, but they are limited by their funding constraints. MFIs are heavily dependent on CBoS loans and credit lines from donors to fund their activities. The CBoS, donors, and the Sudan Microfinance Development Facility (SMDF) have been providing financial and technical assistance to MFIs since 2007. Some banks also provide wholesale financing to MFIs to on-lend to their clients. Going forward, substantial technical assistance will be necessary to enhance their capacity, in terms of managerial skills development, financial analysis, best practices in microfinance, market research, business plans, IT, etc. The SMDF can play an important role in continuing to support MFIs with financial and technical assistance.

**16. Several immense challenges account for the modest performance of Sudan's microfinance sector:**

- Limited market information flows discourage market entry and formalization, particularly for subsistence farmers and rural micro entrepreneurs;
- For Microfinance Providers (MFPs), the cost of reaching people is high. The technological solutions available to overcome some of these constraints, e.g. mobile phone marketing and M-banking, have not yet been introduced in the industry;
- There is need for establishment of a central database and performance monitoring system for MFIs;
- Most banks consider the new market segment unprofitable, unfamiliar and risky; and
- The supportive infrastructure for the finance sector is lacking, including whole-sale lenders, technical service providers, as well as facilitating public infrastructure, such as mobile phone networks.

# ANNEX 4. TOP FIVE SOURCES OF REVENUE IN SELECTED LOCALITIES

**Table 4.4: Abu-Hamad Locality, River Nile State**  
**Largest own revenue sources**

Rank	2005	2006	2007	2008	2009	2010	2011	Jan-Jun 2012
1	Charges on ferries	Diversified revenue items	Charges on ferries	Diversified revenue items	Diversified revenue items	Diversified revenue items	Health licenses	Services fees
2	Diversified revenue items	Charges on ferries	Services fees	Charges on ferries	Health licenses	Health licenses	Diversified revenue items	Diversified revenue items
3	Services fees	Services fees	Diversified revenue items	Services fees	Charges on ferries	Charges on ferries	Charges on ferries	Charges on ferries
4	Agricultural services fees	Agricultural services fees	Agricultural services fees	Agricultural services fees	Rental of agriculture land	Rental of locality's properties	Rental of locality's properties	Commercial Licenses Fees
5	Rental of agriculture land	Commercial licenses fees	Commercial licenses fees	Commercial licenses fees	Rental of locality's properties	Services fees	Services fees	Rental of locality's properties

**Table 4.5: Aroma locality, Kassala state**  
**Largest own revenue sources**

Rank	2007	2008	2009	2010	2011
1	Bus station services fees	Bus station services fees	Bus station services fees	Bus station services fees	Bus station services fees
2	Other diversified revenue items	Public service fees	Animal sells markets	Animal sells markets	Animal sells markets
3	Animal sells markets	Animal sells markets	Public service fees	Rental of locality's properties	Public service fees
4	Commercial	Sloughing fees	Commercial licenses fees	Commercial	Residential
5	Public service fees	Other diversified revenue items	Arable land, fees	Public service fees	Forestry

**Table 4.6: Kassala Locality, Kassala State**  
**Largest own revenue sources**

Rank	2005	2006	2007*	2008	2009	2010**	2011
1	Bus station services fees	Bus station services fees	Bus station services fees	Bus station services fees	Bus station services fees	Bus station services fees	Residential plan
2	Tax on commodities and services	Tax on commodities and services	Tax on commodities and services	Tax on commodities and services	Tax on commodities and services	Tax on commodities and services	Tax on commodities and services
3	Commercial licenses fees	Rental of locality's properties	Rental of locality's properties	Rental of locality's properties	Rental of locality's properties	Residential plan	Bus station services fees

4	Rental of locality's properties	Tenders	Tenders	Commercial licenses fees	Commercial licenses fees	Rental of locality's properties	Rental of locality's properties
5	Commercial licenses fees	Commercial licenses fees	Commercial licenses fees	Tenders	Commercial licenses fees	Administrative fees (land documentation)	Residential

**Table 4.7: Wad-Al-helew Locality, Kassala State**  
**Largest own revenue sources**

Rank	2010	2011
1	Licensing of small stores	Tax on commodities and services
2	Livestock fees	Animal sales fees
3	Bus station services fees	Licensing of small stores
4	Tax on commodities and Services	Bus station services fees
5	Commercial licenses fees	Animal drinking water facilities

**Table 4.8: Al-Nohood Locality, North Kordofan State**  
**Largest own revenue sources**

Rank	2008	2009	2010	2011	2012
1	Self-support	Self-support	Self-support	Self-support	Self-support
2	Animal sales fees	Animal sales fees	Commercial licenses	Crops services fees	Market services fees
3	Commercial licenses	Commercial licenses	Animal sales fees	Commercial licenses	Animal sales fees
4	Crops services fees	Crops services fees	Crops services fees	Animal sales fees	Villages planning fees
5	Animal tax and its arrears	Market services fees	Villages planning fees	Villages planning fees	Commercial licenses

**Table 4.9: Bara Locality, North Kordofan State**  
**Largest own revenue sources**

Rank	2008	2009	2010	2011	2012
1	Animal sales fees	Animal tax and its arrears	Crops services fees	Investment	Investment
2	Animal tax and its arrears	Animal sales fees	Animal tax and its arrears	Animal tax and its arrears	Development and services fees
3	Market services fees	Villages planning fees	Animal sales fees	Animal sales fees	Crops services fees
4	Other	Crops services fees	Goods and services subsidy	Villages planning fees	Animal sales fees
5	Commercial licenses	Goods and services subsidy	Trade banners	Crops services fees	Animal tax and its arrears

**Table 4.10: Sheikan Locality, North Kordofan State**  
**Largest own revenue sources**

Rank	2008	2009	2010	2011	2012
1	Out-state departure fees	Real estate	Real estate	Real estate	Real estate
2	Real estate	Out-state departure	Investment	Out-state departure	Investment

		fees		fees	
3	Locality's rentals	Locality's rentals	Locality's rentals	Locality's rentals	Out-state departure fees
4	Labor permits fees	Investment	Out-state departure fees	Investment	Locality's rentals
5	Fees on internal bus station	Fees on collection and transport of waste	Fees on internal bus station	Fees on internal bus station	Animal sales fees