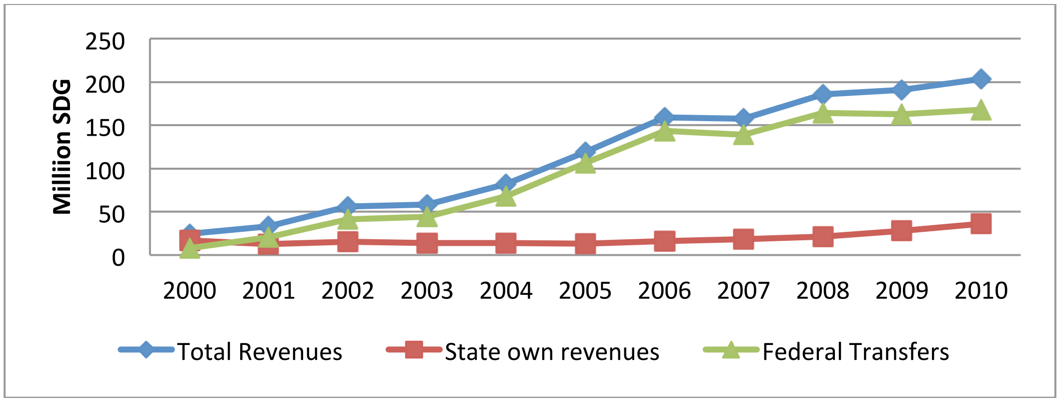
DJAM UPDATE
BUDGET TRENDS AND FISCAL MANAGEMENT
October 21, 2012

5 Darfur States since April 2012
The three states of Darfur became five by virtue of a law issued in April, 2012. North Darfur remains the same, whereas West Darfur was divided so as to allow for the formation of Central Darfur with its capital being Zalingei. South Darfur, on the other hand, was separated to form East Darfur with its capital Ed Da'ein. Localities remained the same in number, but were divided between the states. The divisions for new states are politically motivated and make little or no economic sense; the formation of two more states has meant two more state governments, each with 8 new ministries and 2 new state assemblies. This translates into a larger civil service for the region with more spending going into wages and salaries rather than development. This takes on an added significance given that the new states were formed around the same time as the announcement of austerity measures, at the federal level, constraining fiscal transfers to the states. Accordingly, the five states are expected to share the limited resources available to the region. It is still too early to assess the impact on state budgets and their spending, but what is clear is that the already poor states of South and West Darfur have now been transformed into four poorer states with a smaller economic base from which to collect revenues to sustain themselves. The historical budget trends in this analysis will focus on the previous three states of North, South, and West Darfur; given the inter-linked nature of the area, however, policy implications will be valid for all 5 States of the new administrative set-up.

Darfur States Revenues
Like other states, revenue sources in the Darfur states fall broadly into two major categories: own revenues and federal transfers. Federal transfers to Darfur, as to other states, include: (i) current and development grants to the state to fulfill its assignments for wages and development projects; and (ii) block grants (non-conditional transfers). Recent federal budgets have witnessed significant and absolute terms increases in transfers to all the states. However, two states, namely Khartoum and Gezira, predominate with more than one-third of federal transfers over 2000 – 2010. Darfur's share remained 14.3 and 13.7 percent in 2000 – 05 and 2006 – 10, respectively. It is important to note, however, that there is a significant number of federally funded development projects at the state level that are in excess of the federal transfers recorded in the final federal and state accounts, the source of the data used in this analysis. As a result, federal contributions to Darfur are most likely higher than the 14.3 and 13.7 percent share that the federal transfers indicate.

In general, revenues show a steady growing trend during 2000 – 2010, largely driven by rapid increases in federal transfers, especially between 2004 and 2006, resulting from the deepened fiscal decentralization prescribed by the Comprehensive Peace Agreement (CPA) and the Interim National Constitution (INC). While increasing federal revenues were and are needed to allow States to play their role as primary provider of basic services, the fiscal decentralization at the same time dramatically increased the dependence of States on the central government; this dependency trend may be aggravated in the new set-up with 5 Darfur States since April 2012. To add to the dependency problem, own revenue growth was flat between 2000 and 2010, with some years even seeing declining own revenues (**Figure 1**). These trends in own revenue mobilization may be the result of conflict-related disruptions, in both economic activities on which own revenues are levied in form of tax and fees, as well as administrative capacities to collect revenue in the Darfur states.

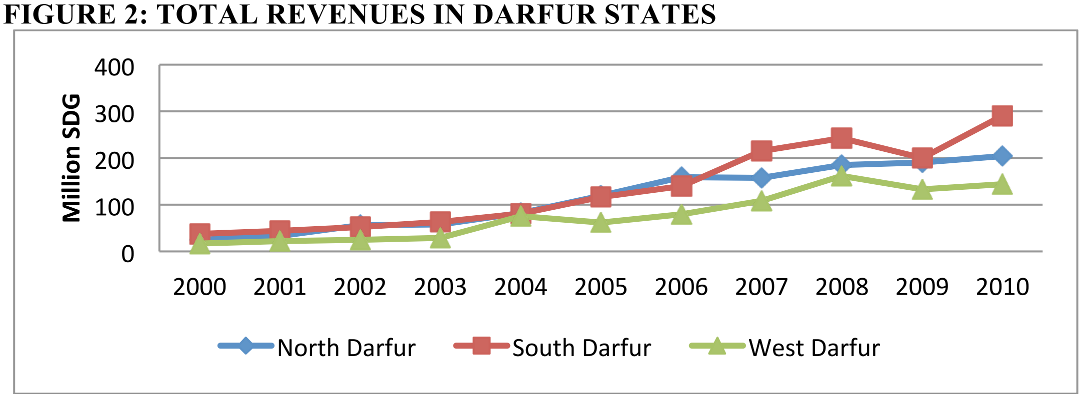
FIGURE 1: NORTH DARFUR: COMPOSITION OF REVENUES



Source: MoFNE, State Final Accounts Reports (2000-2010).

In terms of revenue, very significant increases are found, albeit from a negligible base in the early 2000s. In addition, amounts are broadly similar in each of the states through 2010 (**Figure 2**). In 2005, revenues in North and South Darfur rose significantly, whereas revenues in West Darfur dropped. In 2009, revenues in South and West Darfur dropped significantly whereas revenues in North were slightly increasing. This is most likely related to the effects of the 2008/09 global crisis and its negative impact on oil price developments, the main source that fueled federal transfers in Sudan at that time.

FIGURE 2: TOTAL REVENUES IN DARFUR STATES

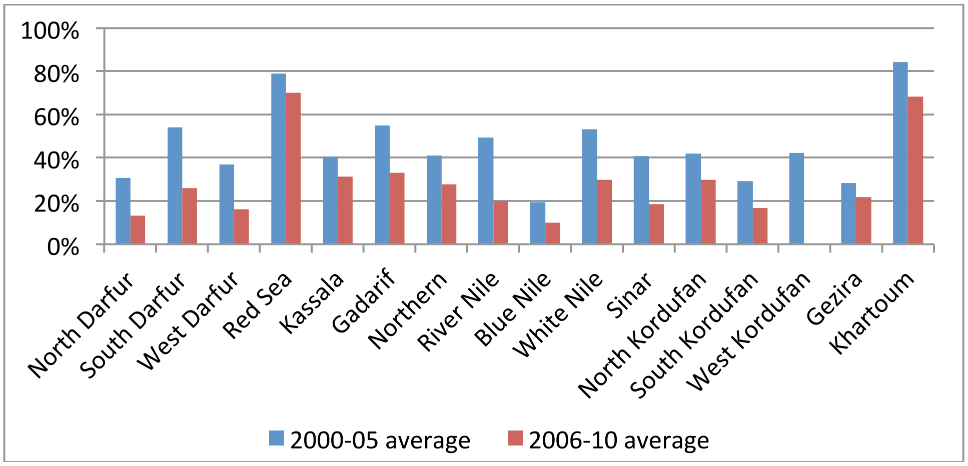


Source: MoFNE, State Final Accounts Reports (2000-2010).

The increasing dependency on federal transfers is striking. Though it was lower than other states, own revenue was the major revenue source for all the three states at the beginning of the review period; Darfur states now highly depend on federal transfers to meet state budgetary needs (**Figure 3**).[1] Own revenue can be disaggregated by ministry and locality. All tax revenue and state centralized items are recorded under the state ministry of finance. The shares of revenue from ministries were increasing in North and South Darfur whereas decreasing in West Darfur over the review period (**Figure 4**). In the new 5-State structure, the latter would hence translate into decreasing ministry revenues in West and Central Darfur.

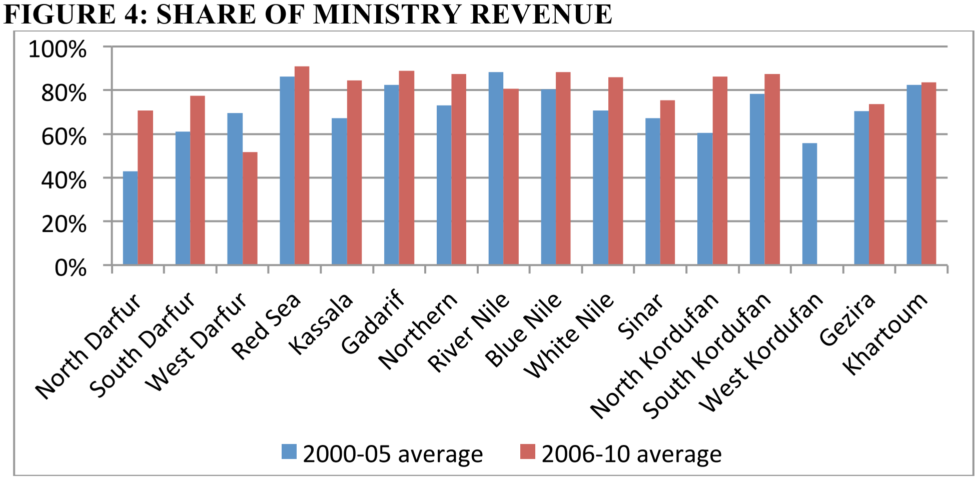
[1] Average share of own revenue was 40.5 and 46.5 percent in Darfur States and other states, respectively, in 2000-05 and 18.4 and 31.4 percent in 2006-10.

FIGURE 3: SHARE OF STATE OWN REVENUE



Source: MoFNE, State Final Accounts Reports (2000-2010).

FIGURE 4: SHARE OF MINISTRY REVENUE



Source: MoFNE, State Final Accounts Reports (2000-2010).

Meeting revenue collection targets in the current circumstances in Darfur is very difficult, due to both systemic factors and the impacts of the conflict. Among the former are unrealistic own revenue forecasts that may be driven by the required balanced budget, inefficient revenue collection and administration, and low capacity for own revenue mobilization.

The ongoing insecurity has adverse effects on revenue efforts. First, many people are removed from their usual situation and are not receiving services from their state public provider, if at all. It may thus be unclear to them why they should pay taxes. Second, the tax administration is disrupted by the relocation of both taxpayers and tax collectors. Third, the information base with which taxes are collected, the taxpayer data files (however kept), are often lost or destroyed. Fourth, while conflict continues, there are many 'unofficial' charges being levied. In all these circumstances, there is a much lower tendency to pay.

Resource allocation and use

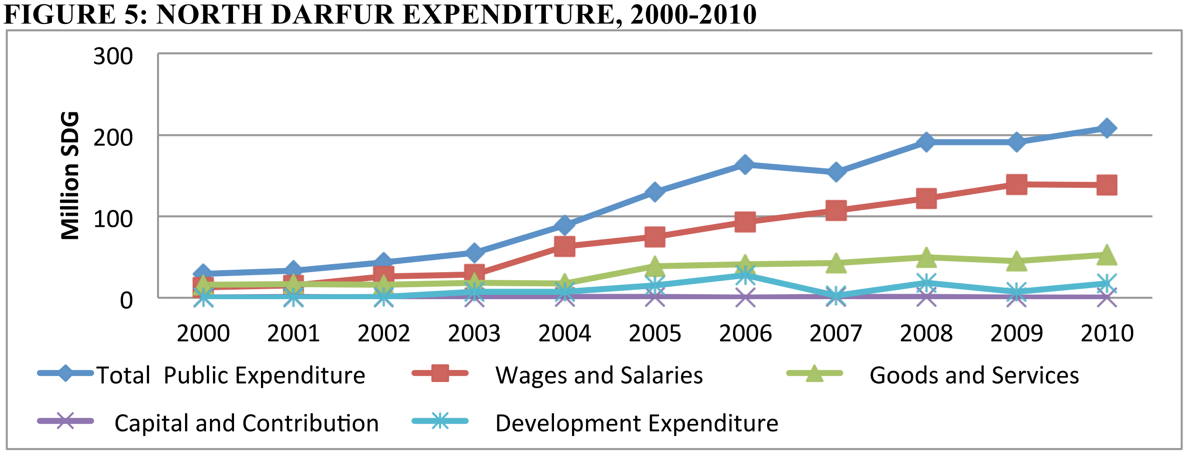
In the last decade, the increase in spending has been striking, albeit from a very low base **(Figure 5)**. Over the period 2000 – 05, there were larger increases in spending – by 348, 224 and 302 percent in

North, South and West Darfur, respectively. The spending increases in 2004 and 2005 follow the large increases of federal transfers shown in **Figure 1** above, which were the result of the decentralization drive prescribed in the CPA and the INC. Following the large increases in the mid-2000s, the following period 2006 – 10 saw a more moderate pace of increase – by 27, 90 and 89 percent in North, South and West Darfur, respectively.

In terms of composition, the budgets of the Darfur states follow an economic expenditure classification system similar to other states and the national budget, in four chapters: (i) public employees' wages and salaries; (ii) goods and services at ministry and locality levels; (iii) investment and capital contribution; and (iv) new or ongoing development projects.

The state allocations for development projects have proved to be very limited in the first half of the decade, though showing a slight rise in the second half. In 2000, the share of development expenditure to total spending increased from 0.4, 3.8 and 0 percent in North, South and West Darfur, respectively, to 8.3, 8.7 and 3.5 percent in 2010. Comparing the levels achieved between 2004 and 2006 around the time of the CPA and INC with 2010 data shows development spending has relatively decreased over the CPA period and until 2010. The low levels of development spending in all three states can be largely attributed to the high and rising share of resources allocated for current expenditure in particular wages and salaries, which are crowding out other activities (like development and maintenance) and the major source of the rapid increase in Darfur states' total expenditure.

FIGURE 5: NORTH DARFUR EXPENDITURE, 2000-2010



Source: MoFNE, State Final Accounts Reports (2000-2010).

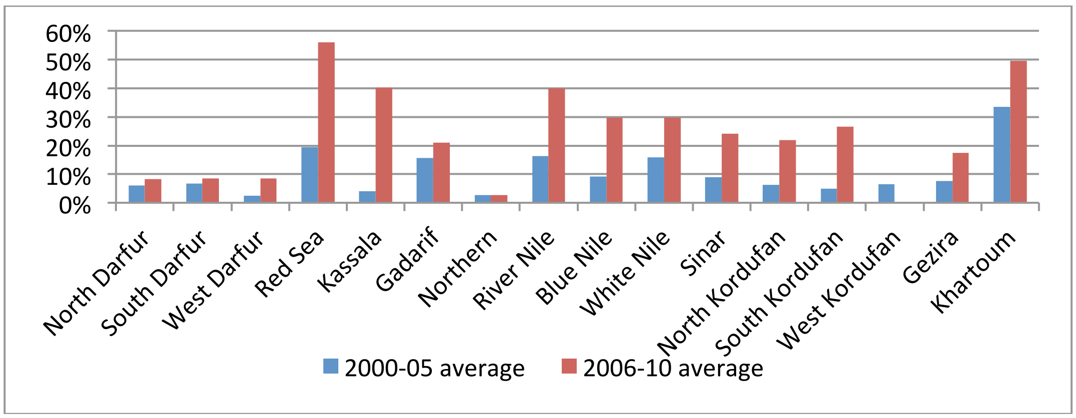
How do recent levels of development spending in Darfur compare to other states in the North? Figure 6 compares the share of development spending in total expenditure in Darfur states to other states in Sudan in the last decade. The data shows significant variation across the different states, with Darfur states tending to the lower end of the range. The average share of development spending in Darfur states in the periods of 2000 – 05 and 2006 – 10 is 5.2 and 8.4 percent, respectively, while in other states is 11.6 and 29.9 percent, respectively.[2] It has to be noted, however, that these figures do not include federally funded development spending or any allocations to the Reconstruction Fund, detailed data on which is not available.

Low levels of development spending in Darfur States are mostly related to the impact of conflict: firstly, fighting has damaged existing development projects and infrastructure. In addition, insecurity has

[2] The high per capita results for the Red Sea state partly reflect its small population (less than one-half of North and West Darfur and roughly one-quarter of South Darfur).

interrupted the implementation of ongoing projects; it is reported that during conflict insurgencies federally funded development projects are usually put on hold. Thirdly, the emergency relief demand that grew out of the conflict has overridden any development planning priorities. Finally, security problems have lowered the ability to collect revenue, especially in localities hardest hit by the conflict where formal revenue collection has effectively ceased. In sum, it is important to note that while conflict has generally lowered the pool of available resources for public spending, conflict has affected development spending disproportionately given the structure of expenditure assignments. For instance, localities' expenditure is financed through their meager own revenues and mostly from State transfers; so while localities are responsible for their own development spending, their resources barely cover wages and salaries. Development spending at that level is left to be financed by localities' own revenues, which are flat or decreasing. The decrease in the already low levels of development spending at the locality level could not be fully offset by spending sponsored by the federal level for implementation at the state levels; hence the relative decrease.

FIGURE 6: DEVELOPMENT SPENDING SHARE OF TOTAL EXPENDITURES



Source: MoFNE, State Final Accounts Reports (2000-2010).

Development planning and management capacity

State budgets have received more resources from the federal government, and North and South Darfur are slowly putting proportionally more towards development efforts. Continued efforts are needed to channel more resources to development, especially for West Darfur. But the success of development efforts will eventually depend on the ability to manage these resources well. Development planning capacity at the state level is very poor and a major constraint to effective resource management in the future.[3]

The poor track record on development spending in Darfur has gone hand in hand with very limited capacity in the state to plan and maintain development projects especially under conflict. Poor capacity of development planning can be attributed to: decentralization of responsibilities without significant training; poor coordination on development efforts across various levels of government; lack of financing for past effort; and lack of ICT and equipment to do the job.

On the positive side, state officials were unanimously positive about the quality of identification of development priorities by localities. Specifically, proposals made by locality technical committees are

[3] The lack of capacity on the state level is usually a key explanation provided by the central government to assume direct involvement through federally funded activities at the state level. While this may seem justifiable given the realities on the ground, it is important to ensure mechanisms are in place for the central authorities to really be able to identify appropriate programs that cater to the needs States and localities.

regarded as appropriate. On the other hand, the localities lack the expertise for proper project appraisal, and quality feasibility studies are prohibited by the high cost.

Budget planning and execution

The budget preparation process in the Darfur states is similar to that of other states in Sudan: the fiscal year starts on January 1 and ends on December 31. The process begins with estimates of revenues and expenditures for the coming year. There is no specific formula by which the Darfur states make these estimates, which tend to be based on previous actual performance with some percentage changes that vary among the states. The national government issues a general budget directive with macroeconomic assumptions for budget planning.

The process follows a bottom-up approach in that it starts from the localities where a committee established by the locality commissioner (*Mutamad*) proposes revenue and expenditures. The state line ministries also establish committees to estimate their revenue and expenditures for the next year's budget. All localities, line ministries and other institutions submit their proposals to the state ministry of finance; this committee revises the estimates received, and summarizes these into a consolidated state budget proposal.

The consolidated proposal is then submitted to the State Council of Ministers (SCOM) for review, revision and approval. Upon approval, the budget proposal is submitted to the state Legislative Assembly where specialized committees review the proposed budget. The objective of this stage is to assess whether the proposed budget meets the state's socio-economic goals. The chairs of the specialized committees present their findings and recommendations to the assembly, which then comes up with an agreement on the final budget. Upon the legislative approval, the state consolidated budget becomes law. A copy of the state budget is delivered to the Chamber of General Auditing, and to the state MOF for execution.

On the budget process, deviations of actual revenue from budgeted amounts were high during the decade under consideration. This constitutes huge shortfalls necessitating large cut-backs in expenditures and deviations from the approved budget. For instance, one the revenue side, both own revenues and federal transfers were poorly budgeted. One of the problems relating to federal transfers is that of timing – the so-called fiscal calendar – whereby the states are expected to have their annual budgets finalized before the federal transfers are known. This mechanism is administered and sponsored by the FFAMC **(Box 1)**.
4

This creates discrepancies between state expectations and what is likely to be funded. As regards own revenues, underperformance is a major issue. In South Darfur, which was relatively better off before it was divided to form East Darfur, own revenues under performed by 62% on average over the period 2007 – 2011. Such deviations result in significant under-execution of budgeted expenditures occurring, at both the state and locality level, with both wages and salaries, as well as having an effect on development spending. For instance, in South Darfur on average only 18% of development spending was executed over the period 2007 – 2011[5]. In West Darfur, however, average spending on wages and salaries fell short of budget by almost 48% over the period 2009 – 2011[6]. This has serious consequences as the shortfall in wages and salaries creates a serious credibility issue as to what are the actual spending needs.

---

[4] Cluster 2 on Governance provides additional analysis and insights on the fiscal allocation process.
[5] Data provided by South Darfur Ministry of Finance.
[6] West Darfur Final Accounts.

Box 1: The Fiscal and Financial Allocation and Monitoring Commission (FFAMC) and other institutions for managing fiscal mechanisms in Darfur

The Comprehensive Peace Agreement invoked the establishment of the Fiscal and Financial Allocation and Monitoring Commission (FFAMC). This Commission was provided with broad terms of reference with responsibility for both vertical‖ transfers, allocating Sudan's total resource envelope between the GNU, its Northern states, and GoSS, and for horizontal‖ transfers between the Northern states themselves. These functions are specified under Article 195 of the Interim National Constitution. The FFAMC replaces the National State Support Fund (NSSF) that was previously responsible for allocation of resources to states. The institutional framework that it oversees is complex. The functions of the FFAMC have been further amplified in Republican Decrees issued from time to time, the most recent being the Republican Decree Number 31, 2007 [4(1) (a)-(f)], which sets out the following FFAMC responsibilities:

- Ensuring transparency and equity on what is related to the allocation of funds collected at the national level, GoSS, and state level;
- Monitoring the support offered by the National Revenues Fund and verifying the realization of equity therein, as well as prompting its transfer to the concerned governance levels;
- Making sure and guaranteeing the prompt transfer of the allocated resources to the war-affected areas according to the approved formulae and guarantee of their prompt transfer;
- Ensuring transparency and equity in allocating the revenues to GoSS and the states according to the rates or percentages provide for in the Wealth Sharing Agreement;
- Proposing the formulae and criteria of wealth sharing; and
- Reviewing and updating the bases, percentages, and criteria at least once every three years.

The FFAMC is one of four permanent commissions, instituted by way of the CPA. After the secession of South Sudan in July 2011, its role remained the same as originally established in the CPA (and stated above), of course with the exception of FFAMC vis-a-vis its role with South Sudan. It is noteworthy, however, that the pool of resources from which the vertical distribution to the states takes place, the National Revenues Fund (NRF), has suffered dramatically in the post-secession era (July 2011) with the exit of oil revenues and thus the loss of more than 40 percent of the nation's wealth. The austerity measures announced for the budget in June 2012 that this translated particularly into significant cuts to development transfers, while current transfers are largely protected.

Darfur, like other states in Sudan, is represented in the Council of Trustees of the FFAMC with one representative for each of the five states (usually the state Finance Minister). In 2010, the FFAMC revised its formula for horizontal distribution so as to incorporate nine criteria with weights that allowed for a more equitable distribution of the nation's wealth among the fifteen Northern states. Implementation of the more equitable formula for horizontal distribution would have greatly reduced the share of the states of Khartoum and Gezira giving the other twelve states greater shares. The large 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 the envisaged more equitable distribution over a period of time. The Darfur states, like all others, get their share in accordance with this system, which lacks transparency as to how resources are actually distributed. 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 FFAMC itself. The governance arrangement around this Fund remains unclear, yet it seems evident that funds are not transferred to the state but rather directly to the contractor implementing the project in that state. This is an indication of the precautionary measures taken at the federal level to ensure its ability to control use of these funds.

The formation of two additional states in Darfur has meant a revision of transfers to West and South Darfur to accommodate East and Central Darfur resulting in an overall incremental increase in aggregate transfers to the Darfur region[7]. This is to accommodate the newly formed state government and assemblies. Budgets for the establishment of each of the two new states has recently been completed and submitted to the Ministry of Finance and National Economy that is expected to fund them from the federal budget. This translates into further increases in current spending; given the limited resource envelope, such an increase is most certainly at the expense of the already drastically curtailed development transfers.

The Darfur Regional Authority (DRA) is financed from the federal budget. Likewise, resources for the Darfur

Reconstruction Fund (DRF) are supposedly allocated directly by the Federal Ministry and donors; although the Fund is yet to receive these resources. While the FFAMC is linked with the DRA through its membership in high-level committees, it also coordinates development work with the DRF through three yearly meetings. The concrete relationships between the FFAMC, the DRF and the DRA remain unclear and need clarification going forward.

Source: World Bank, Sudan Country Integrated Fiduciary Assessment (2010); and interviews with FFAMC Secretary General (October 14, 2012) and General Directors of Ministries of Finance of South and West Darfur (October 15, 2012)

Conclusion

This situational analysis of the fiscal situation in the states and localities of Darfur provides an update for the relevant chapter in the 2007 Darfur Joint Assessment Mission (DJAM). It shows that the fiscal situation in Darfur is very much similar to that in other states except that it is more acute because of years of lack of capacities, poverty and civil conflict. Large increases in current spending have crowded out development spending – a situation that is expected to be aggravated by the formation of two additional states, totaling number of Darfur states at five. In the wake of austerity measures at the federal level, fiscal transfers to the states are not expected to increase substantively and it becomes paramount to develop the States' own resources. However, own revenue mobilization in Darfur is severely constrained by the security situation and the extreme underdevelopment in the region.

Moreover, lack of transparency in the allocation of fiscal transfers continues to be a problem placating officials in their budget planning capacities. But this is not a problem exclusive to Darfur; it is rather a nationwide problem that needs to be addressed with reforms at the federal level and specifically with regards to the functioning of the Fiscal Financial Allocation and Monitoring Commission (FFAMC).

The unsatisfactory situation in executing state budget has not improved so as to uphold the 2007 DJAM conclusion in this regard , i.e. "the extent of deviation of actuals from plans is so massive and persistent that the credibility and value of the budget itself is called into question. It appears that significant reforms and changed practices are needed so that the budget is a credible tool of policy, planning and implementation".

The DPA, and subsequently the DDPD, documents recognize many of the weaknesses in budget and fiscal management in Darfur, but the implementation of reforms stated therein is missing. It will, therefore, be important for the DJAM to build on the stated reforms by building capacities for their implementation at both the national and sub-national levels in Darfur.