

Working paper

State Fragility  
initiative



**IGC**  
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# Fiscal federalism in Sudan



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## List of abbreviations

CPA	Comprehension Peace Agreement
HDI	Human Development Index
INC	Interim National Constitution of Sudan
JPA	Juba Peace Agreement
MPI	Multi-dimensional Poverty Index
NSSF	Northern States Subsidy Fund
OECD	Organisation for Economic Co-operation and Development
SPLM/A	Sudan People's Liberation Movement/Army

## List of tables

<i>Table 1</i>	<i>Subdivision of the Juba Peace Agreement</i> .....	26
<i>Table 2</i>	<i>Key responsibilities of different levels of government according to the 1998 constitution</i> .....	28
<i>Table 3</i>	<i>Key responsibilities of subnational government according to the INC</i> .....	29
<i>Table 4</i>	<i>Financial resources assigned to the different levels of government according to the 1998 Constitution</i> .....	34
<i>Table 5</i>	<i>Revenue sources assigned to states</i> .....	34
<i>Table 6</i>	<i>Indicators and weights for federal transfers (1997-2013)</i> .....	40
<i>Table 7</i>	<i>Formulas for budget allocation to localities</i> .....	41

## List of boxes

<i>Box 1</i>	<i>Terminology definitions</i> .....	12
<i>Box 2</i>	<i>Pillars of fiscal federalism</i> .....	12
<i>Box 3</i>	<i>Types of revenue decentralisation</i> .....	14
<i>Box 4</i>	<i>Types of transfers to subnational governments</i> .....	15
<i>Box 5</i>	<i>Measuring fiscal federalism</i> .....	17
<i>Box 6</i>	<i>Categories of transfers to states</i> .....	40
<i>Box 7</i>	<i>Elements of fiscal federalism</i> .....	48
<i>Box 8</i>	<i>Vertical decentralisation summary</i> .....	52
<i>Box 9</i>	<i>Horizontal decentralisation summary</i> .....	55

## List of figures

Figure 1	Sudan population trends (millions) .....	8
Figure 2	State population statistics .....	9
Figure 3	Real GDP per capita (SDG – constant 2020 prices) .....	10
Figure 4	Selected economic indicators.....	10
Figure 5	Human Development Index trends by state.....	11
Figure 6	Central government expenditure trends by category (SDG per capita – constant 2020 prices) .....	30
Figure 7	Total subnational expenditures across states (SDG per capita – constant 2020 prices).....	31
Figure 8	Subnational real expenditure per capita (SDG per capita – constant 2020 prices) average 2012-2018	32
Figure 9	Subnational development expenditure (% of total expenditure) average 2012-2018 .....	33
Figure 10	Central government revenue trends by category (% of GDP).....	36
Figure 11	Total revenues vs. expenditures across all states (SDG per capita – constant 2020 prices).....	37
Figure 12	State and local government revenue sources (% of total revenue) 2000-2018.....	38
Figure 13	Own source revenue breakdown (2005-2011 averages) (% of total own source revenues) .....	38
Figure 14	Subnational own source revenues (% of total revenue) average 2012-2018.....	39
Figure 15	Central government subnational transfers (% of total expenditure) .....	42
Figure 16	Federal transfers breakdown (% of total federal transfers) .....	43
Figure 17	Composition of states revenues (2017) .....	44
Figure 18	Actual federal transfer execution by state (% of budgeted federal transfers) 2017 .....	44
Figure 19	Federal transfers by state (% of total federal transfers) average 2012-2018 .....	45
Figure 20	Budget deficit and financial sources (% of GDP) .....	46
Figure 21	State and local government expenditure vs. central government expenditure excl. transfers (% of total combined per capita expenditure), 2000-2018 .....	49
Figure 22	State and local government revenues vs. central government revenues (% of total combined per capita revenues), adjusted population figures.....	50
Figure 23	Vertical gap – subnational own-source revenue sources (% of total subnational expenditure) ..	51
Figure 24	Vertical imbalance – subnational revenue sources (% of total subnational expenditure) .....	52
Figure 25	Horizontal gap – states’ own source revenue sources (% of total per capita expenditure) average 2012-2018	54
Figure 26	Horizontal imbalance – states’ revenue sources (% of total per capita expenditure) average 2012-2018	55
Figure 27	Subnational own source revenues (% of state GDP) 2018.....	56

## Table of contents

<b>1</b>	<b>EXECUTIVE SUMMARY</b> .....	<b>5</b>
<b>2</b>	<b>INTRODUCTION</b> .....	<b>7</b>
2.1	CONTEXT OF THE CURRENT WORK IN RELATION TO THE JUBA PEACE AGREEMENT.....	7
2.2	COUNTRY AND ECONOMIC CONTEXT .....	7
<b>3</b>	<b>CONCEPTUAL FRAMEWORK OF FISCAL FEDERALISM</b> .....	<b>12</b>
3.1	EXPENDITURE ASSIGNMENT.....	13
3.2	REVENUE ASSIGNMENT .....	14
3.3	INTERGOVERNMENTAL TRANSFERS.....	15
3.4	BORROWING.....	16
3.5	FEDERAL/NATIONAL INFLUENCE ON SUBNATIONAL/STATE DECISIONS.....	16
3.6	MEASURING FISCAL FEDERALISM .....	17
<b>4</b>	<b>FEDERALISM AS A PEACEBUILDING TOOL</b> .....	<b>18</b>
<b>5</b>	<b>EVOLUTION OF FEDERALISM AND DECENTRALISATION EFFORTS IN SUDAN</b> .....	<b>20</b>
5.1	EARLY DECENTRALISATION ATTEMPTS.....	20
5.2	MOVEMENT TOWARDS A FEDERAL REPUBLIC .....	21
5.3	FEDERALISM AS A PEACEBUILDING TOOL IN SUDAN .....	22
<b>6</b>	<b>FISCAL FEDERALISM IN SUDAN</b> .....	<b>27</b>
6.1	EXPENDITURE DECENTRALISATION IN SUDAN .....	27
6.2	REVENUE DECENTRALISATION IN SUDAN .....	33
6.3	INTERGOVERNMENTAL TRANSFER TRENDS .....	40
6.4	BORROWING MECHANISMS IN SUDAN.....	45
6.5	FEDERAL/NATIONAL INFLUENCE ON SUBNATIONAL/STATE DECISIONS.....	47
<b>7</b>	<b>MEASUREMENT OF FISCAL FEDERALISM IN SUDAN</b> .....	<b>48</b>
7.1	VERTICAL DECENTRALISATION MEASURES .....	48
7.2	HORIZONTAL DECENTRALISATION MEASURES .....	53
<b>8</b>	<b>FISCAL AND SOCIOECONOMIC LINKAGES</b> .....	<b>56</b>
8.1	ECONOMIC ACTIVITY AND REVENUE INTAKE .....	56
8.2	SOCIAL INDICES AND SUBNATIONAL EXPENDITURES .....	56
<b>9</b>	<b>CONCLUSION AND POLICY RECOMMENDATIONS</b> .....	<b>57</b>
9.1	SUMMARY OF KEY FINDINGS.....	57
9.2	POLICY RECOMMENDATIONS .....	58
<b>10</b>	<b>REFERENCES</b> .....	<b>60</b>

## 1 Executive summary

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**Federalism and decentralisation** in Sudan have long been central features of the country's political thought and recent history. Sudan is large and ethnically diverse, and federalism is seen as a way to increase subnational autonomy and address historical marginalisation and development inequities that lie at the heart of the country's internal conflicts. Since independence, there have been numerous decentralisation efforts – many of these have not been fully implemented, in part due to central resistance to losing control of the peripheries. As such, much work remains to be done to achieve greater fiscal federalism.

The **October 2020 Juba Peace Agreement (JPA)** offers a window of opportunity for sustainable reform. It stipulates adoption of a federal as a key term of the agreement. For the first time in its history, Sudan arguably has a central government willing to genuinely devolve more authority to subnational governments, making it more likely that, if properly implemented, the JPA could achieve positive outcomes for the country. However, JPA implementation will be an extremely complex and costly undertaking and Sudan does not currently have the resources needed for successful implementation. Lasting peace in Sudan hinges on the government's ability to deliver on the promises of the JPA and the 2018 revolution more widely – and achieving greater autonomy for the regions is a key element of this.

### Key findings

- **Highly centralised revenue management** – While relatively extensive expenditure and revenue responsibilities have been devolved to state and local governments in Sudan, poor tax bases and weak tax administration and collection capacity of most subnational governments have meant they collect little in terms of own source revenues and continue to rely heavily on transfers from the central government.
- **Lower federal transfers in recent years** – Fiscal imbalances at the central level have resulted in lower transfers to subnational governments in recent years. Subnational governments have been forced to significantly cut their expenditures as a result – per capita expenditures have fallen back to pre-CPA levels.
- **Discretionary transfer allocation and grant conditionality** – Transfers from central government to states appear to have been allocated with a degree of discretion in the past due to some lack of clarity in the formula-based allocation system. There has also been significant use of conditional transfers in the past, although this has changed recently and unconditional transfers now comprise around 69% of total transfers to states.
- **Per capita expenditure disparities across states** – There are large disparities across states in terms of revenue collection capacity due to some states having more limited administration and collection capabilities and noticeably poorer tax bases and more difficult to tax economies. Transfers have failed to achieve per capita expenditure equalisation, with some poorer states having low levels of own source revenues and relatively low levels of formula-based federal transfers. This has worsened inequalities across states.
- **Urban-rural inequalities** – Expenditure has favoured urban centres in recent years, which has worsened urban-rural inequities and failed to address very high levels of rural poverty.
- **Limited political decentralisation** – Political decentralisation was significantly undermined by presidential appointment of state governors, despite the 2005 INC stipulating that all levels of government should be directly elected. Such practices keep subnational governments under the influence of the central government and

make them less responsive to their own constituents, which undermines democracy, legitimacy, and accountability.

- **Weak implementation of peace agreements** – This has been a common feature of Sudan’s past peace agreements. The JPA is undoubtedly more complex and requires greater financial and institutional capacity to implement than any past peace agreement.

## Policy issues for consideration

The road to an effective fiscal federalism in Sudan will be a long one. The different components – expenditure assignment, revenue assignment, intergovernmental transfers, borrowing, and federal/central government influence over subnational/state decision-making – have to be tailored to Sudan’s current situation, including taking into account the formal and informal levers that influence the country’s political economy. Moreover, fiscal federalism efforts should be sequenced in a way that takes into account the capacity of states and local governments to administer their expenditure and revenue responsibilities.

Considerations to factor in when designing a fiscal federalism framework for Sudan include:

- **Ensure sufficient financial and institutional capacity for JPA implementation.** The resource requirements for this are considerable and early and continual attention needs to be paid to how to finance this, particularly given its notable complexities.
- **Bring greater clarity and coordination to the division of expenditure and revenue assignments** at different levels of government through a detailed fiscal federalism framework tailored to Sudan’s context.
- **Increase revenue collection at both central and subnational levels** from the current considerably low tax to GDP ratio of around 6%. Sudan’s existing subnational revenue powers are relatively extensive, however, they collect only a small portion of own source revenues, indicating a critical need to build subnational tax administration and collection capacity.
- **Ensure that states’ expenditure and revenue assignments align**, through greater mobilisation of own source revenues and more predictable federal transfers. This will enable subnational governments to deliver effectively on their responsibilities and will increase legitimacy and accountability of subnational governments.
- **Divide up the revenue pie more equitably and transparently among states**, both on a per capita expenditure basis, but also with a view to addressing historical development inequities in the country. An evidence-based, objective, and transparent system for the allocation transfers is vital.
- **Allow states greater autonomy in fiscal decision-making**, despite some degree of continued reliance on federal transfers, through greater use of unconditional grants and a more transparent and verifiable allocation procedure that minimises scope for decision-making for political control purposes. Ultimately, however, states must be empowered to raise own source revenues to support greater autonomy.
- **Improve transparency of revenue information, as well as data quality for evidence-based decision-making.** The paucity of reliable, timely, and publicly available data in Sudan limits evidence-based policymaking and constrains the ability of civil society and Sudanese citizens from monitoring revenue flows or holding government accountable.

Most importantly, the expectations surrounding fiscal federalism should be carefully managed – it is not a panacea. Rather, it can be a valuable part of a much broader reform programme to support Sudan’s transition out of fragility and towards more democratic and accountable governance.

## 2 Introduction

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### 2.1 Context of the current work in relation to the Juba Peace Agreement

Federalism has been a key element of political discourse in Sudan since before independence, with states pushing for greater autonomy from the centre and the centre largely resisting genuine devolution to subnational levels. A shift toward a more federal system of governance has been included as a key term in a number of peace agreements in Sudan over the years, as federalism is considered to be a way to improve basic service provision and address political marginalisation and development inequalities in the country, which are key drivers underlying many of the country's internal conflicts. However, the terms of these agreements have tended to not be fully implemented, resulting in muted progress toward political and fiscal decentralisation and, consequently, recurring tensions and conflicts.

Federalism in Sudan has come to the fore once again with the October 2020 [Juba Peace Agreement \(JPA\)](#), signed between Sudan's transitional government and the Sudan Revolutionary Front, an alliance of armed and unarmed opposition groups. As with several previous peace agreements, the JPA stipulates adoption of a [federal system of government](#) in Sudan as a key term.

Although previous peace agreements failed to achieve the envisioned levels of political and fiscal decentralisation, it is hoped that implementation of the JPA will be different. This time there appears to be a greater push for genuine political and fiscal decentralisation, enabled by a transitional process with a radically different government and a very engaged civil society determined to break Sudan's historical dynamic of decentralisation in theory but the centre resisting loosening its control over the peripheries in practice.

The JPA is, however, undoubtedly the most complex of all peace agreements signed in Sudan to date and implementation of its terms will need [considerable financial and institutional capacity](#). The JPA includes six bilateral agreements signed between the Sudanese government and different armed forces, with different terms under each, but all having national implications. Importantly, the JPA will reconstitute Sudan's 18 states into new regions and would see Sudan becoming an asymmetric federation, with some regions having greater powers than others. How this will play out in practice remains to be seen.

In an effort to support deliberations around how to shift Sudan to a more federal system of government, we focus on the [fiscal aspect of federalism](#) in this paper, exploring the existing international evidence base on fiscal federalism and looking closely at Sudan's past attempts at federalism and decentralisation and analysing the current extent of fiscal decentralisation in the country. We provide some recommendations and policy options to be considered to ensure that the shift toward federalism under JPA implementation is more successful than previous federalism attempts in Sudan. We have used what data we have been able to find from government and international sources as a base for our analysis.

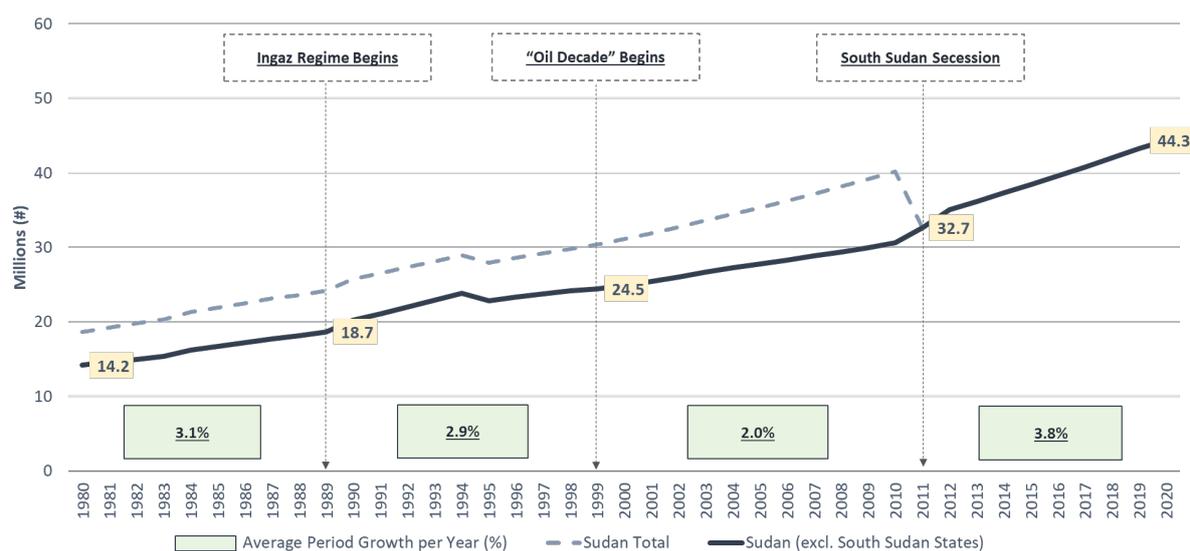
### 2.2 Country and economic context

*Political, economic, and social dynamics are deeply intertwined in Sudan, with population demographics and changes in revenue composition, degree of centralisation, and distribution patterns directly impacting the country's political economy and security situation, and inter-governmental transfers affecting class politics and political alliances. The austerity accompanying periods of economic reform in the past has affected basic service delivery, giving rise to social and political grievances. This section looks at these key political, economic, and social trends in Sudan to provide context for later analysis.*

## 2.2.1 Population

Sudan's population was approximately 44.3 million in 2020, following a high level of population growth over the last decade. These figures are expected to be an underestimate, given that a census has not been conducted since 2008 and there has been notable migration of refugees into the country. Sudan's population was estimated at about 40 million prior to the secession of South Sudan, with South Sudan accounting for close to 25% of the total population. Sudan has a relatively young population, with over 50% of the population under 20 years old, and only 5.6% of the population over 60 years old.

**Figure 1** Sudan population trends (millions)<sup>1</sup>



Khartoum and Gezira are the most populous states, with over 30% of Sudan's population residing in these two states. These are also the most densely populated states, with over 300 and over 200 people per km<sup>2</sup>, respectively (see Figure 2). At the other extreme, large land-mass states like Northern State, Red Sea, and North Darfur are much more sparsely populated with less than 10 people per km<sup>2</sup>, giving Sudan an overall average population density of about 22 people per km<sup>2</sup>. The fastest growing states over the 2008-2018 period were Khartoum, South Kordofan, Al Qadarif and Sennar, with negligible population growth in North Darfur, North Kordofan, and Red Sea over this same period.

<sup>1</sup> Multiple sources all referencing Sudan's Central Bureau of Statistics; IMF, 2020; [www.citypopulation.de/en/sudan/](http://www.citypopulation.de/en/sudan/); World Bank Databank for South Sudan population; period average growth rates calculated as geometric means.

**Figure 2** State population statistics<sup>2</sup>

States	Annualised growth (%)		2018	
	1993-2008	2008-2018	% of total population	Population density (per km <sup>2</sup> )
Khartoum	2.7	4.2	19.0	361.0
Northern	2.1	3.0	2.2	2.7
River Nile	2.4	3.0	3.6	12.4
North Kordofan	2.9	0.8	5.3	12.0
South Kordofan	-1.0	4.1	3.1	16.4
West Kordofan	2.4	2.2	4.2	15.8
Kassala	2.5	3.5	6.0	68.6
Red Sea	4.9	0.6	3.5	6.8
Al Qadarif	1.1	5.1	5.3	29.3
Blue Nile	3.3	2.9	2.6	24.2
Gezira	1.9	3.6	12.1	218.1
White Nile	2.3	3.7	5.9	82.0
Sennar	1.8	4.1	4.6	50.7
North Darfur	4.1	0.9	5.5	7.2
South Darfur	4.4	2.7	9.0	52.3
West Darfur	-0.1	3.1	2.4	44.5
Central Darfur	-0.1	3.1	1.8	22.1
East Darfur	4.4	2.7	3.8	28.9
<b>Total</b>	<b>2.5</b>	<b>3.1</b>	<b>-</b>	<b>22.8</b>

## 2.2.2 Economy

Sudan's economy was extremely fragile in the 1980s following multiple conflicts, an unstable fiscal situation, a spike in refugee inflows, and recurring droughts.<sup>3</sup> As a result, real GDP per capita contracted during that time by an estimated 1.3%. The situation remained unstable into the early 1990s with a depreciating currency and rapidly increasing inflation rates of over 100% per year. Through austerity measures, the inflation rate was contained by the mid-1990s and economic growth began to increase. Khartoum heavily dominated economic activity during these earlier periods, based on several indicators including manufacturing activity and petroleum consumption.<sup>4</sup> Khartoum remains the dominant economic state accounting for approximately 40% of economic activity.

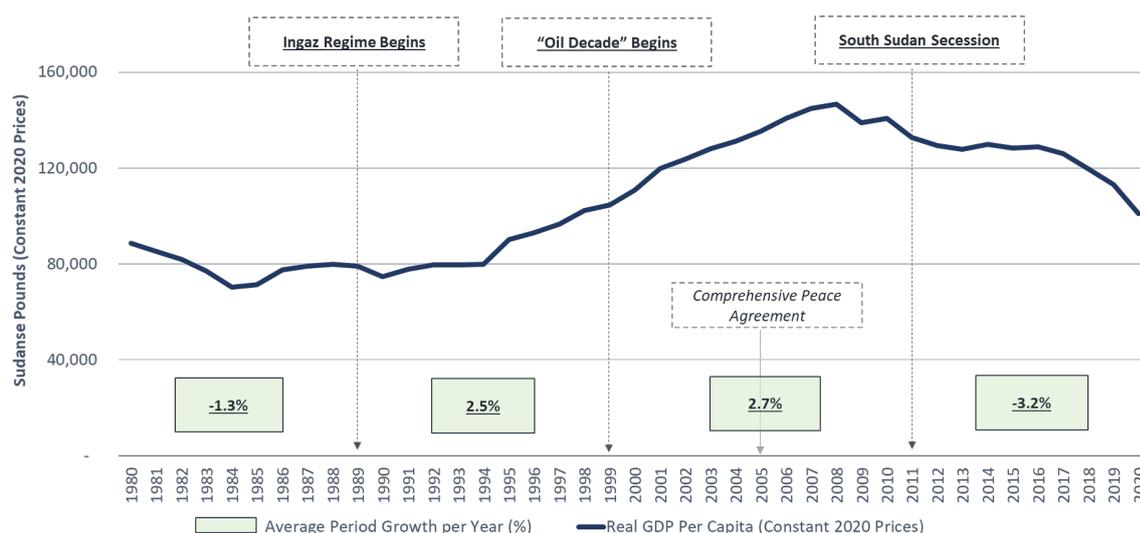
In the late 1990s, there was significant foreign direct investment and infrastructure development in the oil industry in Sudan. This led to the "oil decade", where the country experienced its highest levels of economic growth, averaging 5.3% of GDP growth between 1999 and 2010. Real GDP per capita (in constant 2020 prices) rose to a peak of 142,500 SDG in 2008, up from 80,000 SDG in 1994. The domination of the oil industry during this period is particularly evident when looking at composition of exports. Oil exports made up an average of 85% of total exports between 2001 and 2010, contributing to current account surpluses in several years. The oil boom, however, strengthened revenue centralisation and deepened fiscal inequities in Sudan, triggering grievances and laying the foundation for later rebel movements.

<sup>2</sup> Multiple sources all referencing Sudan's CBOS; [www.citypopulation.de/en/sudan/](http://www.citypopulation.de/en/sudan/). Note: Central Darfur used to be part of West Darfur, East Darfur used to be part of South Darfur; used 2008 proportions to split out 1993 in adjustment.

<sup>3</sup> Metz, 1991.

<sup>4</sup> Over 75% of large manufacturing establishments were based in Khartoum according to the World Bank's 2003 Industrial Survey. Measures of energy and petroleum consumption indicate that Khartoum consumed the majority prior to the 2000s.

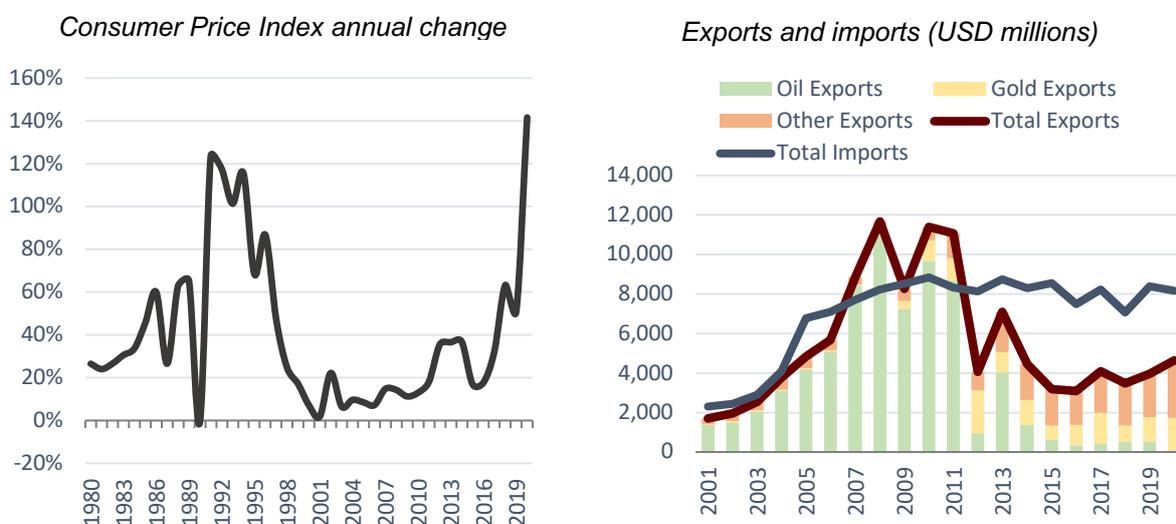
**Figure 3** Real GDP per capita (SDG – constant 2020 prices)<sup>5</sup>



The collapse of Sudan’s oil industry and South Sudan’s secession have had a profound impact on Sudan’s economy. Oil exports have significantly declined, with gold now replacing oil as the main export product. Current account deficits have averaged over 10% of GDP in recent years, driven in large part by extremely high subsidies on basic commodities. The share of manufacturing and industry in the economy has declined by 10% over the last ten years.

Real GDP per capita has fallen by 30% from its peak in 2008 to 101,000 SDG in 2020 and unemployment is rising steeply. In the last few years, the economic situation has become unsustainable, with growing deficits resulting again in a rapidly deteriorating currency and very high inflation rates (see Figure 4). The economic reforms undertaken by the transitional government in 2020 and early 2021 to remove fuel subsidies and unify the official and parallel exchange rates are expected to contribute tangibly to curbing these imbalances.

**Figure 4** Selected economic indicators<sup>6</sup>



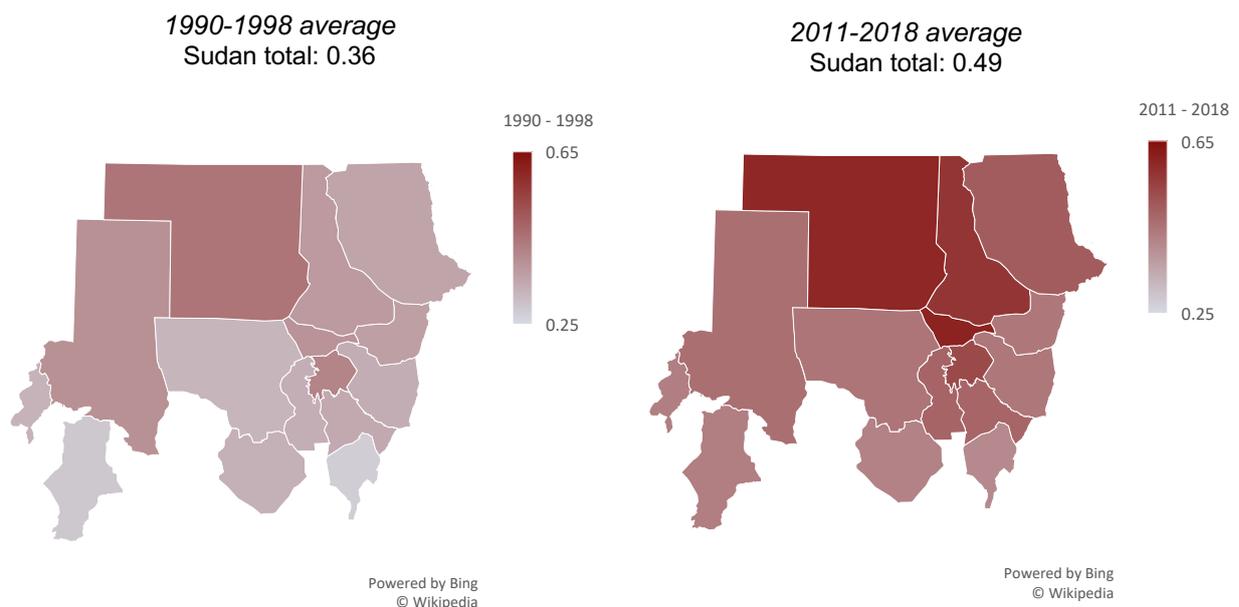
<sup>5</sup> Multiple sources all referencing Sudan’s Central Bureau of Statistics; IMF, 2020; [www.citypopulation.de/en/sudan/](http://www.citypopulation.de/en/sudan/); World Bank Databank for South Sudan Population; period average growth rates calculated as geometric means.

<sup>6</sup> IMF, 2020; IMF Article IV for 2011, 2019 & 2020; CBOS Annual Reports for all other years.

### 2.2.3 Social

The rapid economic growth in the 2000s corresponded with improvements in social outcomes. The Human Development Index (HDI) for Sudan rose from an average of 0.36 for the 1990-1998 period to 0.49 for the 2011-2018 period, however, these averages hide large differences in development status across the country. The highest gains were seen in education, followed by health. Income, on the other hand, remained relatively stagnant. Central and northern states were the primary benefactors of these improvements, with the Red Sea, Gezira, Khartoum, Northern and River Nile states obtaining a HDI of over 0.5. The HDI of states like South Darfur and the Blue Nile also grew rapidly, although from a lower base (see Figure 5). Measures for multidimensional poverty of both adults and children indicate similar patterns across the states.<sup>7</sup>

**Figure 5** Human Development Index trends by state<sup>8</sup>



<sup>7</sup> Ballon & Duclos, 2015.

<sup>8</sup> Global Data Lab. Note: West Kordofan used to be split between North and South Kordofan. Central Darfur used to be part of West Darfur and East Darfur used to be part of South Darfur.

### 3 Conceptual framework of fiscal federalism

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*The international experience with federalism, and fiscal federalism in particular, holds a number of guiding considerations for Sudan as a new federal system for the country is considered. In this section, we summarise a comprehensive literature review of the different aspects of fiscal federalism, including expenditure and revenue assignment, intergovernmental transfers, borrowing, and the extent of federal/central government influence over subnational/state governments.*

#### Box 1 Terminology definitions

**Federalism** generally refers to a constitutional **way of organising** public power, with **fiscal federalism** constituting a set of guiding principles that **define** financial relations between national and subnational levels of government. Fiscal federalism refers to the distribution of responsibilities, tax, and spending powers between different levels of government in a tiered system.

**Decentralisation** is a **way of exercising** public power where authority and responsibilities are devolved from the centre to subnational levels of government, and **fiscal decentralisation** refers to the **process of applying** the principles that define financial relations between national and subnational levels of government.

This paper primarily uses the term '**fiscal federalism**' as its focus is on the **guiding principles** that could be constitutionally established in Sudan to govern the implementation of a more decentralised system of governance in Sudan.

Devolving authority and responsibilities to subnational levels of government is thought to offer certain benefits, notably around improved public service delivery by bringing government closer to beneficiaries, allowing for better adaptation to local preferences and more tailored and equitable public services across a country.<sup>9</sup> However, these positive outcomes are not guaranteed – intergovernmental transfers to promote greater equity are needed and, if the system is not well implemented, decentralisation can also make intergovernmental fiscal frameworks more complex and risk reinforcing interregional inequalities.<sup>10</sup> Moreover, while decentralisation might be politically necessary, some argue it can result in higher corruption (or at least a shifting of corruption to the local level), excessive regulation, difficulties in introducing efficient tax reform and in maintaining macroeconomic stability.<sup>11</sup>

#### Box 2 Pillars of fiscal federalism

Intergovernmental fiscal frameworks vary widely across countries, but they have some key similarities. There are **four major pillars** that are common among many fiscal federalism systems:

- Expenditure assignment,
- Revenue assignment,
- Intergovernmental transfers, and
- Borrowing.<sup>12</sup>

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<sup>9</sup> Oates, 1999; Boadway & Shah, 2009.

<sup>10</sup> OECD, 2020.

<sup>11</sup> Tanzi, 2000.

<sup>12</sup> Oates, 1999; Tanzi & Zee, 2000; OECD, 2020

Boadway and Shah add an additional fifth pillar: the importance of **federal/national influence on subnational/state decisions**, which allows for an assessment of the level of autonomy that the subnational levels of government enjoy.<sup>13</sup>

### 3.1 Expenditure assignment

*Expenditure assignment refers to the way in which functional responsibilities requiring expenditure are assigned among different levels of government.*

In most federal countries, the constitution addresses the respective functional responsibilities of the central and subnational governments. The assignment of expenditure functions across levels of government is broadly similar across nations and has two important considerations: **efficiency** and **equity** in the delivery of public goods and services. This means that government functions should be assigned to the level that is most capable of efficiently undertaking the function while also taking into consideration implications for equity.<sup>14</sup>

Typically, the three levels of government are assigned the following expenditure responsibilities:

- **Federal government** – is assigned overall expenditure responsibilities for providing public goods and services that **benefit the whole country** (e.g., defence, foreign affairs, money and banking, and national infrastructure).<sup>15</sup>
- **Subnational/states** – are assigned the expenditure responsibilities for the provision of public goods and services, such as health, education, and welfare, that are **used within states** (e.g., roads and police protection).<sup>16</sup> The rationale for assigning responsibilities at this level is that preferences for how these services are provided differ by state and so both efficiency and equity of delivery can be improved by adapting provision accordingly. In addition, state-level elected officials and civil servants could be held to account directly by the beneficiaries of these services.<sup>17</sup>
- **Local governments** – are also assigned specific expenditure responsibilities for providing local public goods and services (e.g., local roads, water and sanitation, recreational facilities, etc.). The rationale for this is similar to that for the state level, following the principle that the closer the level of government to the people, the better it can identify their choices and preferences. There is a particularly strong argument for this approach in countries where certain regions might have a sense of being marginalised. As such, the way that local governments can empower local communities to determine their own priorities is considered a key positive benefit of fiscal federalism.<sup>18</sup>

There are other economic and non-economic principles also applied in the assignment of expenditure responsibilities among different levels of government, such as economies of scale, cost of decision-making, spillover effects, macroeconomic management, and institutional capacity.<sup>19</sup>

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<sup>13</sup> Boadway & Shah, 2007.

<sup>14</sup> Deng, 2016; Bongo 2019.

<sup>15</sup> Deng, 2016; Worku, 2016.

<sup>16</sup> Deng, 2016; Bongo, 2019.

<sup>17</sup> Deng, 2016.

<sup>18</sup> Bongo, 2019; Deng, 2016.

<sup>19</sup> Oates, 1972; Deng, 2016; Worku, 2016.

## 3.2 Revenue assignment

*Subnational levels of government must be given revenue-raising authority to enable them to contribute to financing the expenditure responsibilities assigned to them.*<sup>20</sup>

Fiscal capacity enables states to perform their basic functions, such as public service provision, and is also a cornerstone of state-building. When citizens pay taxes, they are more likely to engage in policy debates and to want to have a say in how their taxes are spent. Greater political engagement can strengthen the social contract between a government and its citizens, improving government accountability and state legitimacy.<sup>21</sup>

The extent of revenue assignment in federal systems has many implications and needs to be carefully considered. If subnational governments do not have sufficient independent sources of revenue, they lose their autonomy and become dependent on the central government.<sup>22</sup> At the same time, the central government needs to have enough revenue to effectively and equitably allocate transfers across states and ensure its macroeconomic stabilisation functions that benefit the nation as a whole.<sup>23</sup>

### Box 3 Types of revenue decentralisation

There are two types of revenue decentralisation:

- **full access** to broad-based taxes, such as income, sales, payroll taxes (e.g., Canada, India, Switzerland, and the United States)
- a system in which subnational governments have **limited discretionary access** to broad-based taxes (e.g., Australia and Germany).<sup>24</sup>

Subnational levels of government may also be allowed to **borrow** based on their own creditworthiness as a way of enhancing their revenue-raising opportunities.

While the assignment of expenditure responsibilities among different tiers of government is mostly similar in different countries, the assignment of revenue sources varies widely as it is dependent on the constitutional arrangements and revenue generation capacities of each country. The literature on fiscal federalism, however, sets some general principles by which to allocate taxes between federal/central and subnational/state governments:

- **Federal/central government** – collects the following taxes:
  - taxes that contribute to macroeconomic stability,
  - progressive redistributive taxes that minimise locational distortions of economic activities,
  - taxes on mobile factors of production in order to prevent distortions in the location of economic activity, and
  - taxes on natural resources which are very unevenly distributed throughout the national territory.<sup>25</sup>
- **Subnational/state government** – collects the following taxes:
  - taxes on immobile factors such as tax on low-income workers and property,
  - excise duties, and user fees and charges.

<sup>20</sup> Liberati, 2010.

<sup>21</sup> Bräutigam, 2008; Prichard, 2010.

<sup>22</sup> Worku, 2016.

<sup>23</sup> Bongo, 2019.

<sup>24</sup> Boadway & Shah, 2007.

<sup>25</sup> Shah, 1991; Liberati, 2010.

Assignment of some taxes to subnational governments allows these authorities some freedom to collect taxes and vary their tax rates while ensuring that certain taxes that could give rise to competition among subnational governments remain instead with the central government.<sup>26</sup>

### 3.3 Intergovernmental transfers

*Intergovernmental fiscal transfers are used to ensure that revenues match the expenditure needs of various levels of subnational governments.*<sup>27</sup>

Inter-government transfers are a dominant feature of subnational revenues in most countries and are used for revenue sharing/wealth redistribution purposes. Intergovernmental transfers are intended mainly to correct fiscal imbalances (both vertical and horizontal), adjust inter-jurisdictional spillovers, and ensure a minimum and more equalised national standard of public services.<sup>28</sup> Subnational governments are similarly expected to provide equalising transfers to local governments within their respective jurisdictions.

Corrections and adjustments are needed with the following:

- **Vertical fiscal imbalances** occur when the expenditure of subnational governments is not fully financed by their own revenue sources, i.e., when expenditure responsibilities are decentralised more than revenue responsibilities.<sup>29</sup>
- **Horizontal fiscal imbalances** occur when there is variation among subnational governments in the gap between their own revenues and expenditure.<sup>30</sup>
- **Inter-jurisdictional spillovers** arise when the benefits of a state's services targeting its own local community extend beyond the state borders and benefit the communities of other states.<sup>31</sup>

#### **Box 4** Types of transfers to subnational governments

There are two types of transfers to subnational governments:

- **Conditional transfers**, also known as specific purpose, block, sectoral, categorical, or earmarked grants.
- **Unconditional transfers**, also known as united or general-purpose grants.<sup>32</sup>

Conditional transfers enable the central government to exert greater influence over subnational government spending, forcing states to be more responsive to the desires of central government (rather than to their own electorates).

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<sup>26</sup> Shah, 1991.

<sup>27</sup> OECD, 2020.

<sup>28</sup> Boadway & Shah, 2009.

<sup>29</sup> El-Battahani & Gadkarim, 2017.

<sup>30</sup> El-Battahani & Gadkarim, 2017.

<sup>31</sup> Martinez-Vazquez & Boex, 2001.

<sup>32</sup> Bongo, 2019; World Bank, 2014.

### 3.4 Borrowing

*Some subnational levels of government may also be allowed to borrow based on their own creditworthiness as a way of enhancing their revenue-raising opportunities.*

There are various approaches to determining the extent to which different levels of government can borrow. Some federal countries do not allow state governments to borrow at all; others allow state governments to borrow domestically but not from international sources.<sup>33</sup> In Canada, the US, and Brazil, there is full autonomy for each level of government to borrow both internationally and domestically, as long as borrowing complies with budgetary and macroeconomic policies.<sup>34</sup>

The argument against state governments having the power to borrow is that if they default on a loan, the central government will become liable for repayment of the debt, which has broader macroeconomic implications.<sup>35</sup> Even if states can only borrow domestically, some states may be so large and politically important that the central government will be forced to step in and repay their debts if they are at risk of defaulting (i.e., they are 'too big to fail'). This creates incentives for state governments to overborrow.

Where safeguards and the regulation of subnational borrowing are not strong enough, it is more prudent for the central government to retain full control over public debt and avoid allowing subnational governments the authority to borrow until safeguards and regulatory frameworks can make this less risky.<sup>36</sup>

### 3.5 Federal/national influence on subnational/state decisions

*Whatever powers are decentralised, the federal government is almost always able to exert some form of influence over state and local government fiscal decision-making.*

This influence can vary in the extent to which it is intrusive. At its most intrusive, the federal government could have the ability to strike down state legislation or mandate specific actions. Less intrusively, the central government can achieve influence through imposing conditions on fiscal transfers. Being dependent on federal transfers forces states to be more responsive to the central government's interests.

This issue is a source of tension to some extent in most federal systems and can be an important source of inefficiency. Where the central government is particularly intrusive, it can detract from the benefits of federalism and decentralisation, particularly those associated with giving state and local governments discretion in their decision-making.<sup>37</sup> Limiting subnational autonomy too much can give rise to grievances. Conversely, giving subnational governments too much autonomy may make it difficult for the central government to effectively capture and redistribute revenues equitably across states.

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<sup>33</sup> Bongo, 2019; Deng, 2016.

<sup>34</sup> OECD, 2020.

<sup>35</sup> Tanzi, 1996.

<sup>36</sup> Rodden, 2006.

<sup>37</sup> Boadway & Shah, 2007.

## 3.6 Measuring fiscal federalism

### Box 5 Measuring fiscal federalism

The two most easily measurable components of fiscal federalism are:

- **Spending power** – describes the level of control that subnational levels of government have over public spending, including deciding how services are organised and how funds are allocated
- **Tax autonomy** – refers to the level of power that a subnational government has over tax policies, such as the right to introduce or abolish a tax, to set tax rates, and define the tax base.<sup>38</sup>

Intergovernmental fiscal frameworks vary widely across countries, but with some key similarities. For instance, in all OECD countries, **spending power** is more decentralised than revenue collection. Across the OECD, subnational government spending averaged one-third of total government spending and one-fifth of total revenue in 2015.<sup>39</sup> Subnational spending represents one-quarter of total public spending as a global average, with this figure falling to about 16% on average in African countries.<sup>40</sup> There is considerable variance across countries: for example, in OECD countries in 2014, subnational government revenue as a share of total revenue ranged from almost 50% in the case of Canada to less than 10% for Ireland and Greece.<sup>41</sup> In Africa, Ethiopia's subnational revenue amounted to nearly 60% of total revenue as opposed to 9.1% in Zimbabwe.<sup>42</sup>

In terms of **tax autonomy**, state/regional governments in OECD countries have, on average, full discretion over 70% of their tax revenue. Another 15% of their revenues come from shared taxes, where state governments have to consent to the formula for how these revenues are shared. Local governments have full or close to full autonomy over only 13% of their revenue, on average. For an additional 62% of tax revenues, on average, local governments retain some level of decision-making control, subject to some limitations from federal and state governments.<sup>43</sup>

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<sup>38</sup> OECD, 2020.

<sup>39</sup> OECD, 2020.

<sup>40</sup> Data available a subset of countries in Africa, see SNG-WOFI, 2020.

<sup>41</sup> OECD, 2020.

<sup>42</sup> SNG-WOFI, 2020.

<sup>43</sup> Dougherty, Harding & Reschovsky, 2019. These figures refer to the experience in OECD countries. However, the figures of tax autonomy and spending powers vary widely across countries and are dependent on multiple factors.

## 4 Federalism as a peacebuilding tool

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*In addition to sharing administrative and fiscal powers among different levels of government and potentially providing more efficient and equitable service delivery mechanisms tailored to local preferences, federalism has increasingly been used as a **peacebuilding tool**, especially in countries affected by internal conflicts.<sup>44</sup> This section looks at the evidence on this and explores what factors appear key in ensuring more positive outcomes.*

Countries with a high degree of ethnic, religious, social, and cultural diversity are increasingly considering federal reforms as a potential compromise between a unitary state and secession, as a tool to maintain national unity while also accommodating minority aspirations.<sup>45</sup> Whether federalism is in fact better able to manage complex socio-economic, cultural, and political issues, as well as integrate diverging interests, autonomy movements, and territorial conflicts is debated. Certainly, peaceful coexistence achieved through a tiered system of government is by no means guaranteed.

**In favour** of federalism as a peacebuilding tool, Bermeo argues that federalism can peacefully accommodate minority groups, isolate conflicts, and enable a democratic response to ethnocultural tensions.<sup>46</sup> Hannum highlights that federalism can be the best political model in diverse, post-conflict societies because it allows for both majority and minority communities to feel appeased.<sup>47</sup> Subnational groups can get significant sovereign control over policy areas important to them, such as language or education policy, while also being able to influence and participate in federal-level decision-making processes. The federal government can be content that the federal model reduces the demand for secession.

**In opposition** to federalism as a peacebuilding tool, Snyder and Brancati claim that federalism has a terrible track record of conflict management and resolution.<sup>48</sup> They argue that it can reinforce ethnic identities and marginalisation of certain communities and allows subnational governments to adopt discriminatory laws. This may increase the potential for ethnic-based conflicts, including those over secession. Furthermore, Lewis argues that federalism is a very sophisticated system that (i) presupposes a stable democratic order that (ii) includes populations with compatible political cultures and that (iii) the government is amenable to devolution of power.<sup>49</sup> By definition, conflict-affected countries do not possess these qualities, making them less likely to be able to establish effective federal systems.

**In short, federalism will not prevent or end conflicts, but it may provide an institutional tool to deal with conflict more effectively and non-violently.<sup>50</sup>**

In this context, there are certain factors that we see to be particularly important for ensuring that federalism is **effective** and **successfully regulate conflicts** within a country:

- **Sufficient financial and institutional capacity** for effective implementation of federalism, including reform processes which are often very demanding on resources. Increasing the responsibilities of subnational governments requires them to have the capacity and capabilities needed to deliver effectively on these responsibilities. Sufficient financial and institutional capacity does not always exist, particularly in poorer and historically undeveloped states.

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<sup>44</sup> Gromes, 2010; Deng, 2016.

<sup>45</sup> Siegle & O'Mahony, 2019.

<sup>46</sup> Bermeo, 2002.

<sup>47</sup> Hannum, 2004.

<sup>48</sup> Snyder & Brancati, 2006.

<sup>49</sup> Lewis, 2014.

<sup>50</sup> Lewis, 2014.

- **Effective distribution of competences and responsibilities** – "Who decides on what and on what basis?" are pivotal questions for any state with an institutional design that transfers powers to lower levels of government. Since many conflicts in divided societies can be traced back to the struggle for more autonomy and legislative competences for minorities, a suitable distribution of responsibilities has the potential to contribute to sustainable conflict resolution.
- **Revenue responsibilities match expenditure responsibilities** at each level of government.<sup>51</sup> This enables all levels of government to function effectively and for electorates to be able to hold government accountable for performance.
- **Accountability of subnational governments to their citizens** – To the extent that violent conflict is often the result of governments not delivering for their citizens or being accountable to the public, federalism will not remedy a lack of accountability without complementary reforms to strengthen democracy and responsiveness to citizens.
- **High revenue transparency** – The importance of revenue transparency in ensuring that everyone has access to the same, full information on revenue flows and how revenues are spent is essential for mitigating tensions and maintaining stability. Civil society, the media, and others can only monitor and oversee government's performance if they have the information needed to fulfil these critical roles.

The ways in which federalism is adopted and implemented as a peacebuilding tool varies greatly from one country to another. In all cases, decisions need to be made about the fiscal aspects of federalism – expenditure assignments, revenue assignments, intergovernmental transfers, borrowing, and degree of central government influence over subnational governments – in the context of how these aspects will interact with the desire for local autonomy. Understanding what aspects are important for civil society, current/former rebel movements, and others and how this can be incorporated into a new system will shape what balance can be achieved between subnational governments and central government.

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<sup>51</sup> Gebeye, 2020.

## 5 Evolution of federalism and decentralisation efforts in Sudan

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*Since independence, Sudan has gone through several types of political regimes, ranging from multi-party democracy to authoritarian military rule. These shifts have resulted in changes in governance and federal frameworks that have, in turn, impacted the economic development, political and security stability of the country.<sup>52</sup> In this section, we outline some of the key federalism and decentralisation efforts in Sudan's history.*

Sudan has suffered various internal conflicts since independence. Some of the recurring grievances underlying these conflicts include **inequity in the level of development between states, the poor provision of basic services, and the lack of inclusivity in political power-sharing/decision-making, including ethno-linguistic and cultural marginalisation.**<sup>53</sup> To remedy the development imbalances and address these grievances, the government has at times agreed to shift to a more federal system of governance with more power devolved to states and local governments. While some states have undoubtedly been more marginalised than others, many grievances cut across ethnic lines, with a lack of inclusivity in political decision-making being a widespread issue and service provision problems existing even in the more developed states.

At times, greater federalism and decentralisation has been attempted, often after the signing of peace agreements and arguably as part of 'payroll peace' efforts, where new states, localities, and government positions have been created in exchange for peace from local rebel movements. **Even though both fiscal and political decentralisation have been enshrined in Sudan's legal framework, implementation has been weak and incomplete and a tendency towards centralisation has generally remained.**

Military regime periods in Sudan have generally seen greater governance system restructuring than civilian periods. Military rulers have been motivated to ensure central control over the peripheries for purposes of regime continuity, whereas civilian/democratic rulers have had less strong visions for restructuring power between the centre and the peripheries. The current drive to shift Sudan to a more federal system of government appears to be the first time in Sudan's history that a non-military regime has sought to introduce such substantial change into the country's system of government.

### 5.1 Early decentralisation attempts

**Colonial arrangements** – Prior to its independence in 1956, British colonial authorities attempted to create local government councils modelled on British local councils in an attempt to 'modernise' Sudan's peripheries. These local councils had legal corporate status and clearly defined responsibilities. They were to exercise authority over a large range of local activities and had responsibility for delivering some services and collecting some revenues.<sup>54</sup> Local councils were heavily dependent on transfers from the central government and the underlying motivation of these efforts was one of indirect rule, which explicitly sought to maintain the centre's control over the peripheries, rather than yield any autonomy to subnational levels of government.

**1971 People's Local Government Act** – This post-independence legislation introduced important decentralisation measures, dividing Sudan into ten provinces and devolving some

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<sup>52</sup> El-Battahani & Godkarim, 2017.

<sup>53</sup> Yasin, 2008.

<sup>54</sup> Bongo, 2019; El-Battahani & Godkarim, 2017.

functions like education and health to local councils, together with equivalent taxing powers.<sup>55</sup>

**1972 Addis Ababa Agreement** – After 17 years of conflict between Sudan’s north and south, the Addis Ababa Agreement was signed in 1972 between Sudan’s Nimeiri government and the Southern Sudan Movement (SSLM).<sup>56</sup> The Addis Ababa Agreement stipulated a federal structure for Sudan and was incorporated into the Southern Provinces Regional Self-Government Act of 1972 and retroactively into the 1973 Permanent Constitution.<sup>57</sup> Consequently, the Government of the Southern Region was formed and granted a substantial degree of autonomy, including the authority to levy taxes.<sup>58</sup> This created an asymmetric federation in Sudan, where the Southern Region had a level of autonomy not enjoyed by other regions. However, the 1973 Permanent Constitution gave Nimeiri the authority to override and then abolish the Southern Region, which he eventually did in 1983.<sup>59</sup>

**1980 Regional Government Act** – This introduced new regional governments representing groupings of states, however no additional taxing powers were given to these regions other than those already under the control of states as per the 1971 People’s Local Government Act.<sup>60</sup> Notably, under this legislation, regions were given far less powers than those conferred on the Southern Region under the Addis Ababa Agreement, likely as a result of northern Sudanese resistance towards regional autonomy, which many felt threatened national unity.<sup>61</sup>

## 5.2 Movement towards a federal republic

Despite some gains under earlier decentralisation efforts, Sudan remained under a model of unitary government until 1995. Since then, the shift toward federalism in Sudan can be observed in the following key developments:

**1995 constitutional decree** – In 1995, Sudan adopted the 12th constitutional decree to shift towards a federal system of governance.<sup>62</sup> The 1995 constitutional decree stated that Sudan was a federal republic with three tiers of government (federal, state, and local) to ensure popular participation, consultation, mobilisation, and to provide justice in the distribution of power and wealth.<sup>63</sup> The number of states were increased from 9 to 26 with expenditure and revenue responsibilities assigned accordingly. Ten of these states were in the south and were largely theoretical as the Khartoum government did not control most of this territory.<sup>64</sup>

State governments were given four sources of revenues, as set out in the constitution:

- Transfers from the federal budget through the Northern States Subsidy Fund (NSSF),
- Off-budget transfers from the federal government of 43% percent of VAT collections,
- 10% of public enterprise profits, and
- The direct collection of revenue through taxes, fees, and user charges.<sup>65</sup>

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<sup>55</sup> Bongo, 2019.

<sup>56</sup> Bongo, 2019.

<sup>57</sup> Ouma, 2005.

<sup>58</sup> Bongo, 2019.

<sup>59</sup> Johnson, 2014.

<sup>60</sup> Bongo, 2019.

<sup>61</sup> Johnson, 2014.

<sup>62</sup> Mohamed, 2020; Yasin, 2008.

<sup>63</sup> Article 1 of 1998 Constitution.

<sup>64</sup> Johnson, 2014.

<sup>65</sup> Mohamed, 2020; Ouma, 2005.

States were also allowed to borrow from domestic sources. Local government revenues were comprised of taxes on property, local transportation, local livestock production, and other local taxes or duties.<sup>66</sup>

**1998 Constitution** – Although it formally created a federal structure in Sudan, clarified responsibilities between the levels of government, and provided for certain fundamental rights, the 1998 constitution reflected a unitary system with strict Islamic ideologies and a federal government that exerted strong control over states.<sup>67</sup> In 1999, shortly after this constitution was adopted, President al-Bashir declared a state of emergency, dissolving the legislature and suspending important provisions of the constitution, including those related to the structures of the local government in the various states.<sup>68</sup>

**2005 Comprehensive Peace Agreement (CPA)** – The signing of the CPA between the government of Sudan and the Sudan's People Liberation Movement/Army (SPLM/A), the main rebel movement from southern Sudan, in 2005 introduced a set of institutional arrangements aimed at improving the existing federal system in Sudan and putting an end to Sudan's decades-long civil war.<sup>69</sup> The Darfur Peace Agreement, signed shortly afterwards in 2006, included some similar terms. The CPA gave birth to the 2005 Interim National Constitution.

**2005 Interim National Constitution (INC)** – The INC divided Sudan into 18 states, set the premise for the devolution of power and inter-governmental linkages, and maintained three levels of government (federal, state, and local levels) with elected legislatures and governors at each level.<sup>70</sup> Both the CPA and INC aimed to address regional disparities through more equitable wealth sharing, which had become a more acute issue in the context of rising oil revenues.

**2019 Constitutional Declaration** – Following the ouster of then-President al-Bashir in April 2019, a new constitutional charter/declaration was signed between the Transitional Military Council and the Forces for Freedom and Change on August 4, 2019. It maintains the same three levels of government (federal, state, and local) and requires a Sovereignty Council to govern Sudan for a three-year transitional period. The Sovereignty Council would appoint a new prime minister and cabinet. It repealed the 2005 INC and the constitutions of all Sudanese states and was partially amended in 2020 to reflect terms of the JPA.

**2020 Juba Peace Agreement** – On October 3, 2020, the transitional government of Sudan signed the Juba Peace Agreement (JPA) with the Sudan Revolutionary Front, an alliance of armed and unarmed opposition groups. The JPA once again reaffirmed the need to implement a federal system of governance in Sudan and is expected to pave the way for a new federal framework to be implemented following the current political transitional period.

### 5.3 Federalism as a peacebuilding tool in Sudan

Sudan has a long history of internal conflicts, with the struggle for greater autonomy and access to resources at the state and local levels being a common motivation of rebel movements. The first of these separatist movements began in 1962 in the south led by the Anyanya, but others followed. **It became apparent that any peace negotiations had to address the questions of wealth sharing and unequal development across states that led to these conflicts. A fairer and more transparent allocation of resources and better participation in political affairs became necessary ways in which the government**

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<sup>66</sup> Ouma, 2005.

<sup>67</sup> Ouma, 2005.

<sup>68</sup> International Commission of Inquiry on Darfur to the United Nations Secretary General.

<sup>69</sup> Bongo, 2019; Ouma, 2005.

<sup>70</sup> World Bank, 2014; INC, 2005.

**could end the conflicts.** These arrangements were articulated in the peace agreements that were signed between the government and different armed factions over the years.<sup>71</sup>

### 5.3.1 The Comprehensive Peace Agreement 2005

The signing of the CPA in 2005 brought an end to the conflict between the Sudanese government and the SPLM/A in southern Sudan. The CPA provided for a referendum to be held on southern Sudanese independence, which referendum took place in 2011 and led to the creation of independent South Sudan.<sup>72</sup> The CPA also included provisions that a federal system of government would be implemented in Sudan and recognised that revenue sharing should reflect a commitment to devolve power and decentralise decision-making in regard to development, service delivery, and governance.

**Central government transfers to states increased substantially post-CPA**, due in large part to oil revenues, with the aim to improve public service delivery and broader development outcomes. In addition, the INC stipulated that northern states (i.e., those not within Southern Sudan) had the right to enact laws raising revenue collection through a variety of local taxes and user fees. The federal government was assigned authority to collect customs revenues, business profit taxes, personal income taxes, and VAT. In addition, the federal government was to accrue non-tax revenues, mainly from oil.

The INC also established the following mechanisms:

- **National Revenue Fund (NRF)** – This aims to pool all revenues collected nationally for or by the national government and is administered by the National Treasury. The NRF covers all accounts and sub-funds into which monies due to the government are collected, reported, or deposited.
- **Fiscal and Financial Allocation and Monitoring Commission (FFAMC)** – This aims to safeguard transparency and fairness in allocating funds to the central government and the states, in accordance with established ratios or percentages. Its responsibilities include:
  - Ensuring that equalisation payments (grants) from the NRF are promptly transferred to the respective levels of government.
  - Guaranteeing appropriate utilisation and sharing of financial resources.
  - Ensuring that resources allocated to conflict-affected areas are transferred according to the agreed formula.

The CPA succeeded in bringing to an end two decades of military conflict in the southern region but was also problematic in some ways. Importantly, it did not fully resolve many of the underlying drivers of conflict, failing to address power-sharing between the different factions within Sudan or grievances at the heart of other conflicts that had broken out in the country, including in Darfur in 2003, in the Nuba Mountains of Southern Kordofan in 2002 (although conflicts in the Southern Kordofan can be traced back to 1984), and in eastern Sudan in 2006.<sup>73</sup> Some of the common grievances underlying these conflicts were political marginalisation, land dispossession, disparities in development across states, and the poor provision of basic services.<sup>74</sup> In an effort to quell these other conflicts, the Sudanese government signed two further peace agreements with armed factions in the country: the Darfur Peace Agreement with the armed movements in Darfur (signed in Abuja) and the

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<sup>71</sup> Yasin, 2008.

<sup>72</sup> Johnson, 2014.

<sup>73</sup> Yasin, 2008.

<sup>74</sup> Yasin, 2008.

Eastern Sudan Peace Agreement with the armed movements in the east of Sudan (signed in Asmara), both in 2006.<sup>75</sup>

The CPA and INC stipulated that state and local government authorities should be directly elected, however governors were directly elected only in the 2010 elections. In 2015, parliament passed a constitutional amendment allowing the president to appoint governors. **Presidential appointment of state governors limited subnational political autonomy and gave the central government greater control over the political affairs of states, undermining a fundamental principle of federalism.**<sup>76</sup>

With the CPA ultimately leading to the secession of South Sudan, it sparked fears about whether federalism in Sudan could in fact keep the country together or whether it would reinforce separatist tendencies and weaken collective/national identities. Power-sharing and fiscal federalism can either incentivise separatist movements or encourage greater subnational support for unity – which way this goes depends on the nature of the political settlement and governance arrangements.<sup>77</sup> Crucially, which outcome is achieved also depends on genuinely addressing the underlying drivers of the conflict, including through effective implementation of the peace agreement terms.

In theory, federalism allows for power-sharing and offers a likely basis for an eventual political settlement in the context of Sudan, where conflicts have erupted principally as a result of marginalisation and unequal development. The failure to implement all the provisions of previous peace agreements, however, including provisions requiring more equitable wealth sharing, has meant that past peace agreements have not achieved lasting peace in Sudan. Effective implementation could have mitigated grievances and potentially strengthened federalism within a united Sudan. Instead, weak implementation has resulted in the resurgence of conflict in different regions of the country.

### 5.3.2 The Juba Peace Agreement 2020

On October 3, 2020, the government signed the JPA with the Sudan Revolutionary Front. This is a notable achievement and a significant step towards ending a long period of conflict.<sup>78</sup> The JPA will serve as a foundation for Sudan's democratic transition and economic reform. It also marks the Sudanese government's recommitment to implementing federalism throughout the country, though what this future federal system will look like is still to be discussed and agreed.

The JPA includes several chapters covering a wide range of issues, including power and wealth sharing, land ownership, reparations and compensation, transitional justice and transitional security arrangements, and the return of refugees and internally displaced people.<sup>79</sup> The JPA also includes implementation matrices that set out implementation deadlines for a large number of issues. The first chapter of the JPA sets out an agreement on national issues, the next six chapters consist of bilateral agreements between the government of Sudan and different armed factions, and the final chapter covers general provisions of the agreement.

There is much attention given to **financial, taxation, and revenue sharing issues** in the JPA and certain institutions are to be established to oversee these aspects:

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<sup>75</sup> Yasin, 2008.

<sup>76</sup> El-Battahani and Gadkarim, 2017.

<sup>77</sup> Faguet, et al, 2015.

<sup>78</sup> Chatham House, 2020.

<sup>79</sup> EU Trust Fund for Africa, 2020.

- **National Revenue Fund** – Presumably this will closely resemble the NRF established under the INC, which aimed to pool all revenues collected nationally for or by the national government and is administered by the National Treasury.
- **National Revenue Commission** – The Commission is to ‘guarantee transparency and to remedy the various ways in which revenues are distributed through [a new distribution that is] horizontally and vertically equitable, [...] particularly in the regions/provinces that were damaged by war and historical injustices. The Commission also commits not to deny the federal government or any other side from obtaining its financial dues.<sup>80</sup> The Commission will have extensive powers to oversee and control all funds deposited into the National Revenue Fund, to allocate the shares of national revenue to the central government and to the regions, and to establish criteria according to which the allocation will be made.<sup>81</sup>

Implementation of the JPA will be **extremely complex**, given that it contains six different bilateral agreements between the transitional government of Sudan and the different armed factions, the terms of which are to be implemented concurrently. These bilateral agreements have national implications and it appears that the terms of each bilateral agreement may not be fully compatible with one another, which aspects may become more pronounced with time.

There are also several areas either lacking in sufficient clarity or that may raise potential grievances, which will need to be managed carefully. For example, the powers assigned to the regions under the bilateral agreements differ, e.g., Blue Nile and Kordofan are allocated more extensive powers than Darfur, creating several layers of asymmetry in Sudan’s proposed federation, with it being as yet unclear how regions not covered by the JPA are to be treated.<sup>82</sup> By way of another example, each region is to have its own transitional security arrangements, mechanisms, and institutions, but all armed groups are intended to be integrated into the same national security forces. How these types of arrangements are to be reconciled with one another is very unclear and, undoubtedly, it will be considerably difficult to manage in practice.

Implementation of the JPA will also require **extraordinary financial and institutional capacity**. The agreement’s scope is considerable and reforms envisioned are very onerous. Government is to be expanded to incorporate opposition and militia leaders, the national security force is to be enlarged through integration of armed militias. Refugees and internally displaced people are to be returned and transitional justice measures undertaken. Darfur is to receive USD 750 million annually from the central government to rectify underdevelopment in the region, and USD 348 million is to be given to the Reconstruction and Development Fund for Eastern Sudan.<sup>83</sup> Implementation will require a level of revenue capacity that Sudan does not have, nor is it likely to receive enough support from the international community to cover implementation requirements.

The complex and costly approach of the JPA will stretch already limited capacity and means that delays in the implementation of any one of the bilateral agreements or any perceived prioritisation of one region over another may trigger grievances that could result in a recurrence of conflict. Given the extent of terms to be implemented, the JPA is undoubtedly more vulnerable to implementation impediments than past peace agreements whose terms were often not fully implemented due to financial and institutional capacity constraints (as well as a lack of political will in some instances).

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<sup>80</sup> JPA 2020, Article 23; Article 14.2; Al-Ali, 2021.

<sup>81</sup> JPA 2020, Articles 15.1-15.3; Al-Ali, 2021.

<sup>82</sup> Al-Ali, 2021.

<sup>83</sup> JPA 2020, Darfur Agreement, Article 29.6; Eastern Front Agreement, Article 75.

Table 1 below highlights the content of the JPA chapters as well as their scope.

**Table 1** Subdivision of the Juba Peace Agreement<sup>84</sup>

<b>Title</b>	<b>Geographic scope</b>	<b>Scope</b>
<b>Chapter 1</b> The Agreement on National Issues between the transitional government and the signatory parties to the peace agreement	National	Power sharing; administration of the national capital; national commissions; the constitutional conference; the conference on system of government; judicial reform; elections; other issues (environment, Christians and members of other faiths, anti-racism legislation, etc.)
<b>Chapter 2</b> Peace agreement between the transitional government and the armed struggle movements - Darfur track	National North Darfur, South Darfur, West Darfur, East Darfur, Central Darfur	Power sharing; revenue sharing, permanent ceasefire; transitional security arrangements; transitional justice; compensation, etc.
<b>Chapter 3</b> Peace agreement between the transitional government and the Sudan People's Liberation Movement-North / the Revolutionary Front on the issue of Sudan in the Two Areas (Blue Nile and South and West Kordofan).	National Blue Nile, South Kordofan, West Kordofan	Allocation of responsibilities and financial resources; civil service reform; reconstruction and development; environment among others
<b>Chapter 4</b> Eastern Sudan track agreement between the transitional government and the Sudan Revolutionary Front	National Eastern region (Red Sea, Al Qadarif and Kassala states)	General principles of governance; basic rights and transitional justice; power sharing; social, health and economic issues
<b>Chapter 5</b> Agreement between the transitional government and the Sudan Revolutionary Front/ the Northern track	National Northern region (Northern state and River Nile state)	General principles of government systems; disputed territories/land; allocation of resources; cultural, economic and health issues
<b>Chapter 6</b> Peace agreement between the transitional government and the Revolutionary Democratic Front Party	National Central Region (Khartoum, Jazeera, White Nile, and Sennar states)	Agriculture and economic issues; national fund for development
<b>Chapter 7</b> Agreement on security arrangements between Sudan's transitional government and the Sudan People's Liberation Movement/Army-North/Third front	National Areas of the country where the SPLMA-N/ Third front are located	Permanent ceasefire; command and control of territories; police reform; demobilisation, disarmament and reintegration; return of IDPs and refugee
<b>Chapter 8</b> Final provisions	National	Status of the parties and of the agreements; binding nature of the agreement; status of new parties; dispute resolution

<sup>84</sup> JPA 2020; Al-Ali, 2021.

## 6 Fiscal federalism in Sudan

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*While fiscal federalism often aims to mitigate development imbalances across states, improve public service delivery, enable greater political participation, and harness support toward national unity, the motivations behind many of the federalism and decentralisation efforts in Sudan's history have seemingly been to create the illusion of greater decentralisation while in fact maintaining the centre's control of the peripheries. This section explores what this has meant for fiscal federalism efforts in Sudan.*

The INC addresses the intergovernmental fiscal relations between the different levels of government, determining which taxes should be collected by which level of government, what intergovernmental transfers are to be made, and how spending by different tiers of government is to be done. These elements are now covered in the JPA, although the terms vary under its different bilateral agreements. Despite being enshrined in the country's legal framework, resistance to genuine decentralisation of power in Sudan has resulted in expectations of federalism not being realised. In particular, fiscal decentralisation has not established an accountable and representative governance framework and has failed to lead to implementation of an efficient development-oriented or equitable service delivery mechanism.<sup>85</sup>

In this section, we explore the evolution of fiscal assignments between federal and subnational tiers of government according to past and current legal frameworks. We also present evidence on how these assignments have translated into practice through empirical analysis of fiscal trends from 2020 to back as far as 1962. We assess past federalism and decentralisation efforts by looking at expenditure assignments, revenue assignments, inter-governmental transfers, borrowing, and the extent of federal influence on subnational decisions in Sudan.

### 6.1 Expenditure decentralisation in Sudan

#### 6.1.1 Expenditure assignment

From independence to the early 1990s, Sudan was governed under a unitary system with expenditure responsibilities attributed to lower levels of the government, while revenue responsibilities remained at the centre, thus making subnational levels of government dependent on fiscal transfers from the centre to fulfil their duties.<sup>86</sup> Since 1998, a number of key responsibilities were devolved to the subnational governments, including the provision of social services such as education, health, and registration of persons; regulation of businesses; and management of land.<sup>87</sup> Table 2 outlines responsibilities assigned to federal and state levels, as well as those subject to concurrent powers, under the 1998 constitution, and Table 3 outlines subnational government responsibilities under the 2005 INC.

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<sup>85</sup> El-Battahani and Gadkarim, 2017.

<sup>86</sup> El-Battahani and Gadkarim, 2017.

<sup>87</sup> INC 2005, Article 24 (2).

**Table 2** Key responsibilities of different levels of government according to the 1998 constitution<sup>88</sup>

<b>Federal level</b>	<b>State level</b>	<b>Concurrent powers</b>
<p>(a) defence, armed forces, police, security and disciplined people's forces;</p> <p>(b) the Sudan international borders and settlement of border disputes between states;</p> <p>(c) nationality, passports, immigration and aliens' affairs;</p> <p>(d) foreign relations;</p> <p>(e) rules of general elections for constitutional, federal, state and local institutions;</p> <p>(f) advocacy;</p> <p>(g) general professions organized by federal laws;</p> <p>(h) currency, financial, fiscal and credit policies;</p> <p>(i) specifications, weights, measures and dates and times;</p> <p>(j) federal financial resources;</p> <p>(k) foreign trade;</p> <p>(l) national projects, corporations and companies;</p> <p>(m) federal lands and natural resources, mineral and subterranean wealth;</p> <p>(n) inter states waters;</p> <p>(o) national electricity projects;</p> <p>(p) federal air transport, inter states land and sea routes and inter states federal transport and communications</p> <p>(q) epidemics and general disasters ;</p> <p>(r) archaeology and archaeological sites.</p>	<p>(a) government and good administration of the State and care for its security and public order;</p> <p>(b) State's financial resources;</p> <p>(c) trade and supply;</p> <p>(d) State's lands, natural resources, animal and wild-life wealth;</p> <p>(e) non-transit waters and electric power;</p> <p>(f) State's roads, transport, means of communications and telecommunications;</p> <p>(g) missionary and charitable affairs;</p> <p>(h) registration of births, deaths and marriage documents;</p> <p>(i) matters as may be compatible with federal laws in affairs peculiar to the State including custom compilation and codification.</p>	<p>(1) Each of the federal organs throughout the Sudan and State organs, as to what concern the State, shall exercise power in the following affairs, in accordance with federal legislations:</p> <p>(a) public service;</p> <p>(b) public counsels and attorneys;</p> <p>(c) local government;</p> <p>(d) information, culture and means of publication;</p> <p>(e) education and scientific research;</p> <p>(f) health;</p> <p>(g) social welfare;</p> <p>(h) economic policy;</p> <p>(i) co-operation;</p> <p>(j) industry;</p> <p>(k) quarries;</p> <p>(l) border trade;</p> <p>(m) building development planning and housing;</p> <p>(n) survey;</p> <p>(o) statistics;</p> <p>(p) environment;</p> <p>(q) tourism;</p> <p>(r) meteorology.</p> <p>(2) There shall be established by a federal law, councils representing the federal and States' executive authorities to assume division and planning of lands and forests between the federal authority and the States.</p> <p>(3) The residual powers not mentioned in the division of federal and State or concurrent powers shall be deemed to be concurrent</p>

The 2005 INC introduced a much more complex system of decentralisation, compared to the 1998 constitution, expanding on the devolution of responsibilities to subnational government. According to the INC, the federal government has the overall responsibility to provide services and goods throughout the country, as well as responsibility over functions such as foreign policy and immigration; defence and security; monetary affairs; wages/salaries (for civil servants); and social subsidies. Table 3 outlines subnational government responsibilities under the INC – there is an evident increase in expenditure responsibilities compared to the 1998 constitution.

<sup>88</sup> 1998 Constitution, Articles 110, 111 and 112.

**Table 3** Key responsibilities of subnational government according to the INC<sup>89</sup>

<p><b>Economic management and planning provisions</b></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><b>Service provision</b></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><b>Education service</b></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><b>Health service</b></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><b>Natural resources</b></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><b>Regulatory activities</b></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>

Besides the provisions expressed in the constitutional documents of Sudan, however, there has never been a roadmap or a guiding framework for decentralisation, making some of the division of responsibilities less clear. In health and education, for instance, the federal government is assigned overall responsibility for funding service delivery but service delivery itself is supposedly the responsibility of subnational governments and we know in practice that much of this is funded by user charges applied at the subnational level.

It is critical that subnational governments have sufficient revenue to deliver on their expenditure assignments, otherwise they cannot deliver for their electorates, which impacts **legitimacy and accountability** on the subnational level.

### 6.1.2 Government expenditure trends

The central government was in a strong fiscal position following the CPA in 2005 and was able to support greater fiscal decentralisation. Wages, salaries, and social subsidies increased in both absolute and relative terms. However, the increase in transfers for development expenditure (i.e., transfers to states for development projects), a key development indicator, were modest and did not address the challenges faced by the most deprived parts of Sudan's population.<sup>90</sup> Furthermore, despite the shift of some responsibilities from federal to state level under the INC, **control of revenues has remained highly centralised**, with states having limited fiscal autonomy and remaining very dependent on transfers from the central government.<sup>91</sup>

<sup>89</sup> INC 2005 provisions (as set out in World Bank, 2014).

<sup>90</sup> El-Battahani & Gadkarim, 2017.

<sup>91</sup> World Bank, 2014.

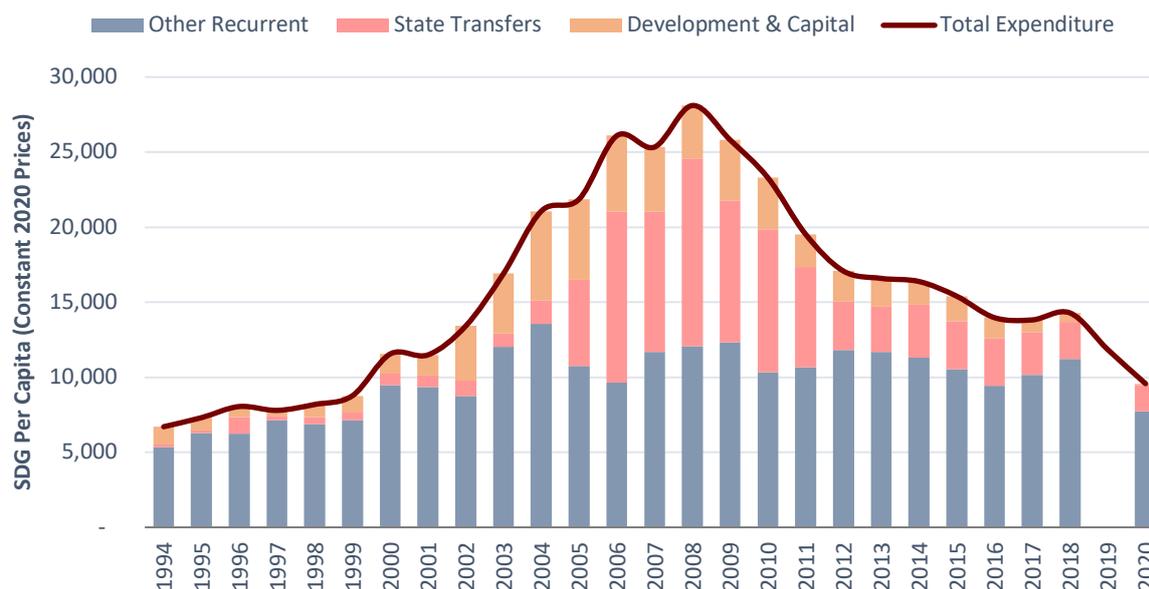
With South Sudan’s secession in 2011, Sudan lost much of its oil revenues and efforts to mobilise other revenue categories have not been sufficient to mitigate this revenue decline. Government’s financing options have been constrained by limited external and domestic borrowing options. Lower revenues and rising fuel subsidy expenditures meant little revenue has been available for spending on other items, including federal transfers to states.

The fiscal crisis became particularly acute over the 2018-2020 period, with high rates of inflation and a depreciating currency. Key macroeconomic reforms undertaken in 2020 and early 2021, including removal of fuel subsidies, exchange rate unification, tax reforms, and an increase in electricity tariffs are expected to create more fiscal space for the government. Nonetheless, the economic situation in Sudan remains extremely fragile and further reforms are needed.

### Central government expenditure trends

An increase in oil revenues from 1999 allowed for a rapid growth in overall expenditures, with real total expenditures (adjusting out the effects of inflation) growing by an average of 15.9% per year between 1999 and 2008. Expenditure per capita (constant 2020 prices) grew from SDG 6,702 (8.4% of GDP) in 1994 to a peak of SDG 28,101 (19.2% of GDP) in 2008 (see Figure 6). Expenditure categories increased across the board, with some growth in development and capital allocations and a pronounced expansion in state transfers over the 2005-2011 period. Transfers to states grew to account for 44.5% of total expenditures, while central government recurrent expenditures fell from over 83% of total expenditures in 1999 to 42.9% by 2008.

**Figure 6** Central government expenditure trends by category (SDG per capita – constant 2020 prices)<sup>92</sup>



<sup>92</sup> CBOS Annual Reports for 2018 and prior (most recent reports used where multiple reports exist); Economic & Financial Statistics Reviews for 2019; Ministry of Finance In-Year Execution Report for 2021 (Dec extrapolated based on 11-month outturns and likely an underestimate as final month of budget years generally see a spike in expenditures). Used GDP Deflator from IMF, 2020 to deflate (setting 2020 to base year). CBOS for population statistics.

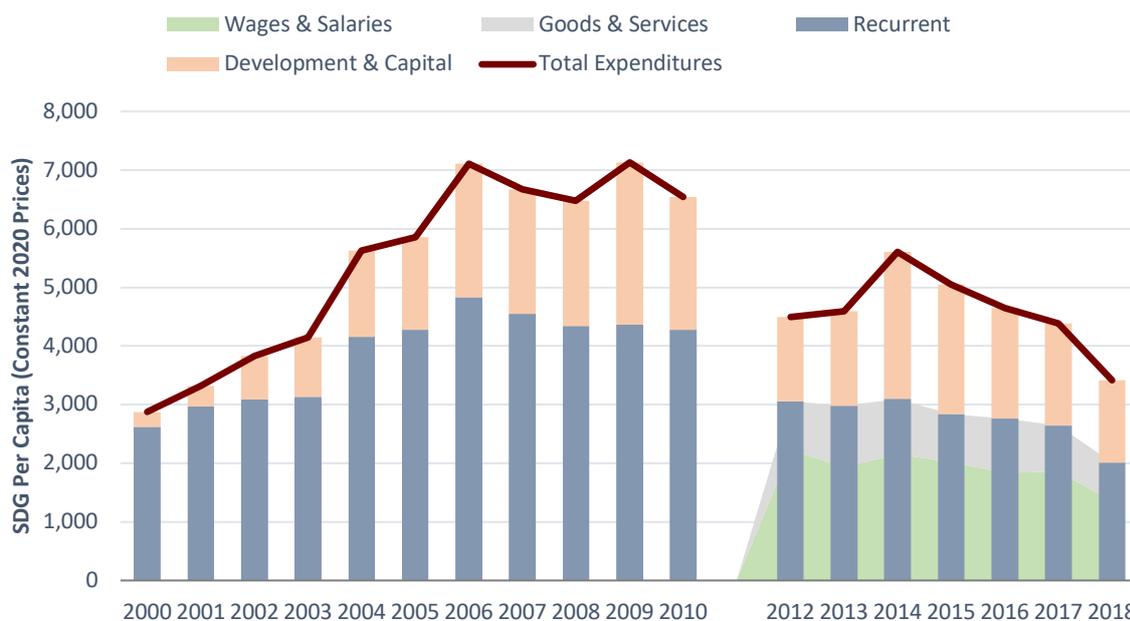
This boom time did not last, however, and total expenditures fell with (i) the decline in oil revenues after 2008 and (ii) South Sudan’s secession in 2011. **Lower revenues and higher subsidy costs resulted in a decline in transfers to states.** Real total expenditure per capita (accounting for the drop in population from the South Sudan secession) has fallen back to 2000 levels at approximately SDG 11,800 in 2019.

Development and capital expenditures fell to less than 9% of total expenditures between 2012 and 2018 and transfers to states fell to less than 20% of total expenditures. Meanwhile, subsidies on ‘strategic goods’ (primarily fuel subsidies) averaged over 20% in this period and reached 63% of total expenditures in 2019. IMF figures suggest these fuel subsidy figures are substantial underestimates given further implicit subsidies, including those resulting from the highly divergent official and parallel exchange rates prior to the February 2021 exchange rate unification and continuing distortions with Sudan’s customs exchange rate.

### Subnational government vertical expenditure trends

Expenditures at the state and local level have followed similar trends as central government total expenditure. Expenditure per capita (constant 2020 prices) more than doubled during the oil decade, growing from SDG 2,876 in 2000 to a peak of SDG 7,132 in 2009. The growth in recurrent subnational expenditures during this period was driven by a 133% increase in wages and salaries while there was no increase in goods and services expenditure.<sup>93</sup> The following decline in oil revenues and growing fiscal and economic crises had a profound impact at the subnational level. **Expenditure per capita has fallen to pre-CPA levels**, even after adjusting out the population of South Sudan for the 2000 to 2010 period comparison.

**Figure 7** Total subnational expenditures across states (SDG per capita – constant 2020 prices)<sup>94</sup>



<sup>93</sup> World Bank, 2011.

<sup>94</sup> \*Excluding South Sudan’s states. Chamber of Federal Governance for 2012-2018 expenditures, World Bank, 2014 & 2012 for 2000-2010 expenditure. Used GDP deflator from IMF, 2020 to deflate (setting 2020 to base year). CBOS for population statistics; South Sudan population excluded. Figures likely include both state and local authority expenditures.

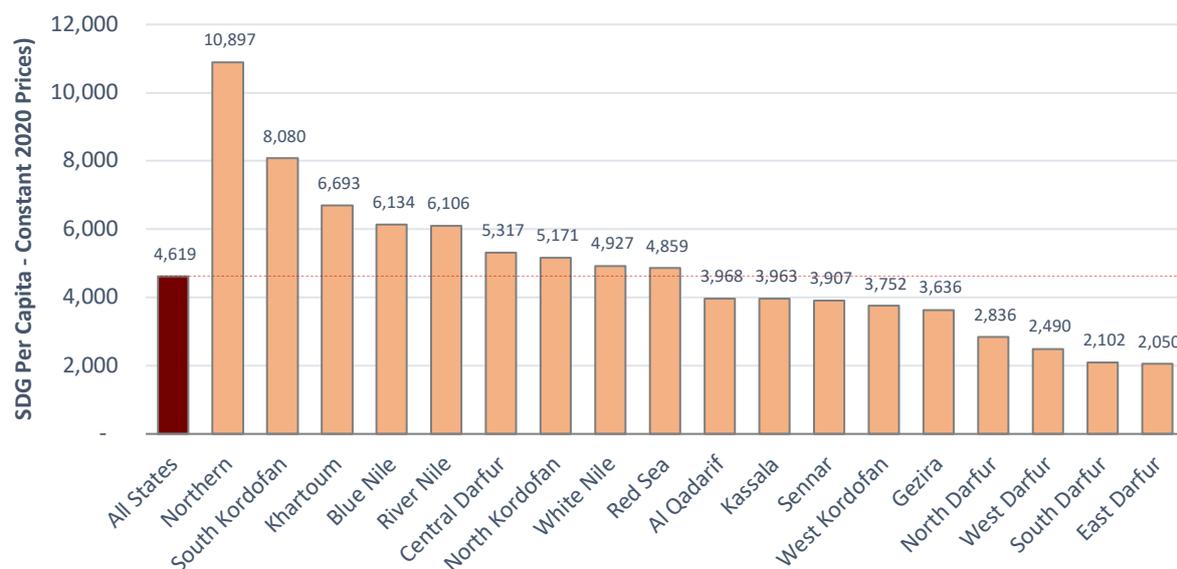
**Development and capital expenditures** have historically made up a sizable portion of total subnational expenditures in Sudan, averaging over 25% of the totals between 2000 and 2010. This mirrored the composition of central government expenditures in this period, after adjusting for transfers to states. However, while development and capital expenditures declined at the central government level in recent years, this category of expenditure has been the last to be cut at the subnational level. For instance, total expenditures in 2017 were 32.8% lower than 2010 levels, with the highest cuts on recurrent expenditures, which fell by 38.1%. Meanwhile, development and capital expenditures were just 22.8% lower and, as a result, now account for over 40% of subnational expenditures. Wages and salaries have been falling particularly rapidly in real terms, likely due to inflation outpacing cost of living adjustments.

World Bank analysis suggests that state expenditure allocations to the education, health and agriculture sectors accounted for an average of about 20% of total state expenditures between 2005 and 2010.<sup>95</sup> Of this, 7-8% was targeted towards education, 9-10% towards health, and roughly 3.5% towards agriculture. Nevertheless, sector allocations to agriculture surpassed the other two sectors when looking specifically at development and capital expenditures. The remaining expenditure allocations were spread across other public administrative, economic, and social services.

### Subnational government horizontal expenditure differences

When considering subnational expenditure *across* states on a per capita basis, we see great diversity in expenditures (see Figure 8). Northern State and South Kordofan have expenditure per capita levels well above the national average, whereas the Darfur states are markedly below the national average (Central Darfur is an exception).

**Figure 8** Subnational real expenditure per capita (SDG per capita – constant 2020 prices) average 2012-2018<sup>96</sup>

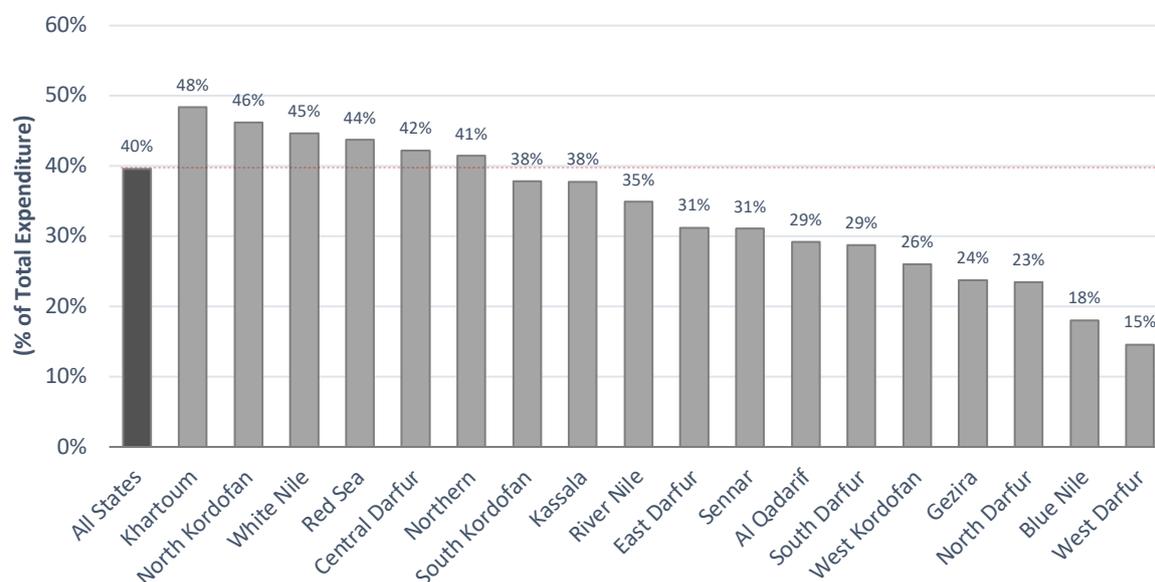


<sup>95</sup> World Bank, 2014.

<sup>96</sup> Chamber of Federal Governance for 2012-2018 expenditures. Population and deflators same as per previous notes.

The Darfur states and Gezira also had low shares of expenditures on development expenditures, with most of these states allocating less than 30% of their expenditures to development (see Figure 9). On the other hand, states like Khartoum, Northern, and Red Sea had development expenditure allocations of over 40%. It is not clear whether these figures adjust for cost differences across states.

**Figure 9** Subnational development expenditure (% of total expenditure) average 2012-2018<sup>97</sup>



Recent government expenditure has also been mainly concentrated in **urban centres**, where expenditure is more likely to be captured by politically connected elites.<sup>98</sup> Less expenditure in rural areas also worsens urban-rural inequalities, perpetuates Sudan's development disparities, and fails to address the increasingly concentrated poverty in rural areas.

## 6.2 Revenue decentralisation in Sudan

### 6.2.1 Revenue assignment

All three levels of government are empowered by the constitution to collect revenues in order to finance their expenditure responsibilities. States' own revenue sources is one of the three sources of funding for states and localities, in addition to transfers from the central government and shared revenues. The financial resources for each of the three levels of government as assigned in the 1998 Constitution are shown in Table 4 and as under the INC 2005 in Table 5.

Under the 1998 Constitution, state authorities could collect excise duties from state (but not federal) industries, retain profits from state-level projects, and collect non-tax revenues from licenses and fees. Subnational governments were able to borrow, but only from domestic sources. Localities' own source revenues included indirect taxes on sales, estates, and agricultural and animal production, as well as duties from local resources, such as transport routes.

<sup>97</sup> Chamber of Federal Governance for 2012-2018 expenditures. Population and deflators same as per previous notes.

<sup>98</sup> El-Battahani & Gadkarim, 2017.

**Table 4** Financial resources assigned to the different levels of government according to the 1998 Constitution<sup>99</sup>

<b>Federal level</b>	<b>State level</b>	<b>Local level</b>
(a) customs revenues and the revenues of international ports and airports; (b) companies' profits tax, personal income tax and stamp duty of federal and interstate dealings; (c) profits of national projects; provided that there shall be allocated to the states to which they extend a percentage as the law may specify; (d) federal industries' excise duty; (e) expatriates' taxes and foreign institutions and activities taxes; (f) any such other taxes or fees that do not affect the State's or the local government resources; (g) grants, loans and credit facilities.	(a) business profits tax; provided that there shall be a percentage allocated to localities by a federal law; (b) state's industries excise duty; (c) state's licences returns; (d) state's taxes and fees; (e) state's projects' profits; (f) internal grants, loans and credit facilities.	(a) estates tax; (b) sales tax; (c) agricultural and animal production tax; provided that there shall be allocated a percentage to the state by a federal law; (d) local land and river means of transport; (e) local industrial and artisan excise duty; (f) any other local resources.

Under the 2005 INC, states are permitted to collect their own revenue from ten specific sources and are allowed to introduce “any other tax as may be determined by law.”<sup>100</sup> The INC gives more revenue sources to states than the 1998 Constitution, and states are now empowered to raise land and property taxes, state personal income taxes, and to receive a share of national oil revenues. Business profits taxes was, however, removed from states' revenue sources under the INC. States also have autonomy in defining own revenues, including the authority to determine rates.<sup>101</sup> Table 5 summarises the main types of states' revenues, ranked broadly by the level of autonomy subnational governments enjoy over these revenues.<sup>102</sup>

**Table 5** Revenue sources assigned to states<sup>103</sup>

<b>Revenue type</b>	<b>Revenue items</b>	<b>Determination of collection/allocation</b>
Own source revenues	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; many other taxes as may be determined by law.	Combination of fiscal base and effort by individual states. Potential bases provided by Article 193 of the INC.

<sup>99</sup> 1998 Constitution, Articles 113, 114 and 115.

<sup>100</sup> INC 2005, Article 195.

<sup>101</sup> INC 2005.

<sup>102</sup> World Bank, 2014.

<sup>103</sup> INC, 2005; World Bank, 2014.

Shared revenue	2% of petroleum revenues by derivation	State share of revenue based on derivation basis (and other criteria), established by CPA
Grants and transfers	<ul style="list-style-type: none"> <li>• <i>Current earmark transfers:</i> Wages (judicial, police, high education<sup>104</sup>) Operations (judicial, police, high education) Social subsidies transfers</li> <li>• <i>Current block transfers:</i> Agricultural taxes compensations Current transfers (largely for wages) Emergency aid ad hoc transfers</li> <li>• <i>Development transfers:</i> State development projects (local component) State development projects (foreign component)</li> <li>• <i>Development and reconstruction funds for war affected areas</i></li> </ul>	May be determined by formula, existing establishment costs (e.g., wages), or are in a sense ad hoc and discretionary.
Borrowing	Borrowing in accordance with the INC	

Until 2009, non-tax revenue (primarily from oil, gold, etc) exceeded tax revenue – in some years even doubling it.<sup>105</sup> Since 2011, however, non-tax revenue has declined, corresponding to the loss of oil revenues after South Sudan’s secession and lower oil prices in recent years. In its place, VAT and customs duties have grown in relative importance, with VAT now contributing around 50% of overall government revenue in 2015.<sup>106</sup> However, these indirect taxes are mainly under the administration of the federal government and are arguably easier to collect than direct taxes which are mainly under the administration of states and local levels.

Taxes such as VAT and custom duties are often not pro-poor as higher rates can drive up the prices of goods and commodities and, since the poor spend a greater share of their income on consumption than do the rich, these taxes have a disproportionately negative impact on the living standards of poorer households in Sudan. Politically connected businesses and individuals have also frequently benefitted from exemptions, thereby reducing revenue collection from these sources.<sup>107</sup> In practice, however, the impact of VAT may be more neutral since the poor are mainly in the informal sector and customs duty exemptions often apply to basic goods, which makes this taxing less regressive (and possibly even progressive).

In comparison to indirect taxes, direct taxes (such as income and business profit taxes) contribute very little to Sudan’s government revenues, in part because they are more costly to administer in terms of calculation, collection, monitoring, and enforcement. If these were progressively structured, they could be important tools for income distribution adjustments and equitable redistribution among the different population groups and, consequently, positively benefit the poor. However, the low level of revenues from direct taxation limits the distributive potential of direct taxes in Sudan.<sup>108</sup>

## 6.2.2 Revenue collection trends

Although subnational governments have, in theory at least, been given **significant revenue-raising powers** and also have a **fair degree of autonomy over defining own source**

<sup>104</sup> Wages of primary and secondary school teachers are the responsibility of the states, whereas wages of high education staff are covered by transfers from the central government.

<sup>105</sup> El-Battahani & Gadkarim, 2017.

<sup>106</sup> El-Battahani & Gadkarim, 2017.

<sup>107</sup> El-Battahani & Gadkarim, 2017.

<sup>108</sup> El-Battahani & Gadkarim, 2017.

**revenues**, they do not raise notable portions of their revenue requirements and remain highly dependent on transfers from the central government. This indicates a constraint elsewhere, potentially that subnational governments have **limited tax administration and collection capacity** or that revenue generation is particularly difficult due to **high levels of poverty** and **difficult to tax economies** in some states.

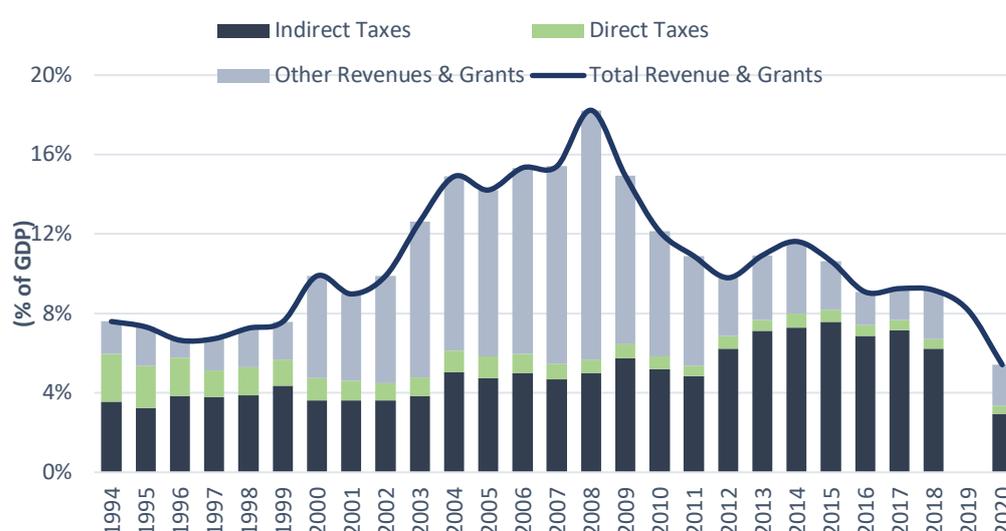
Additionally, states' abilities to impose and collect taxes differs considerably *across* states. Poorer states (with a smaller per capita tax base) raise less revenue at any given tax rate than richer states.<sup>109</sup> Per unit costs of providing public services also varies across states due to climate, geography, population density, and/or distance from urban areas. Therefore, providing a standardised level of services will require greater expenditure in some states than in others.

**Most Sudanese states rely heavily on central government transfers** as well as those from other states (horizontal transfers) to fulfil their mandates to provide public services.<sup>110</sup> This high reliance on federal transfers undermines the accountability of subnational governments toward their constituencies, as subnational governments are forced to be more responsive to central government than their own electorates.<sup>111</sup>

### Central government revenue trends

**Sudan's tax-to-GDP ratio, currently around 6%, is extremely low and well below comparator countries.** Moreover, direct taxes (e.g., individual income taxes, corporate profit taxes, etc.) have made up an average of just 10% of total revenue. 'Other revenues and grants', mainly oil revenues, have contributed 40% of total revenues on average and have been heavily volatile, peaking at 12.6% of GDP in 2008 during Sudan's oil decade and falling to just 2% in more recent years. The fall in oil revenues has only been slightly offset by measures that increased indirect taxes (e.g., VAT, customs taxes, etc.), including an increase in VAT rates, resulting in VAT contributing to over 50% of total revenue in recent years.<sup>112</sup>

**Figure 10** Central government revenue trends by category (% of GDP)<sup>113</sup>



<sup>109</sup> Bongo, 2019.

<sup>110</sup> World Bank, 2014; IMF, 2012.

<sup>111</sup> El-Battahani & Gadkarim, 2017.

<sup>112</sup> IMF, 2012 Article IV.

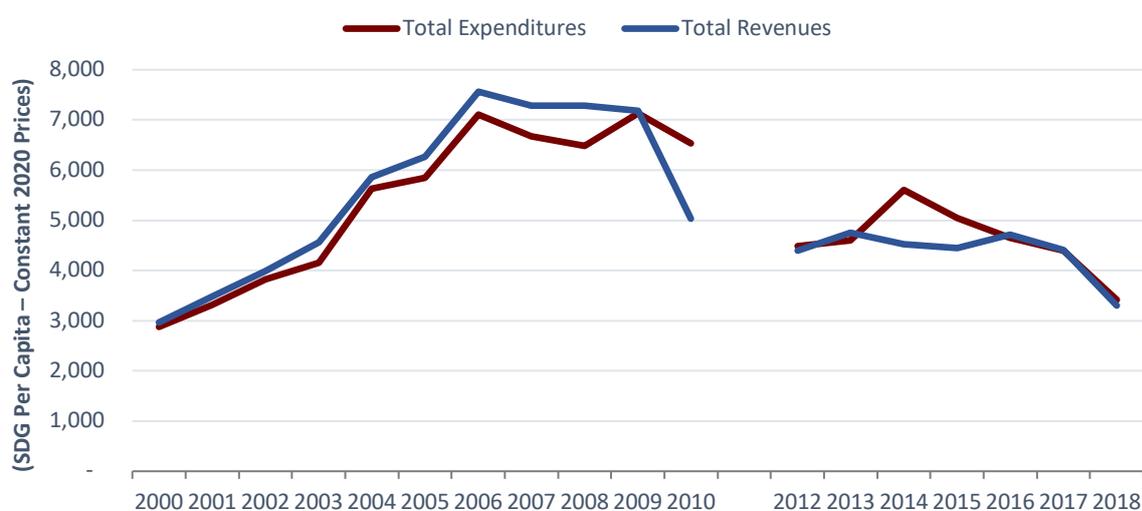
<sup>113</sup> CBOS Annual Reports for 2018 and prior (most recent reports used where multiple reports exist); Economic & Financial Statistics Reviews for 2019; Ministry of Finance In-Year Execution Report for 2021 (Dec. extrapolated based on 11-month outturns). IMF, 2020 for GDP figures.

In nominal terms, total revenue was approximately SDG 125bn in 2018, rising to almost SDG 250bn in 2020 due to high inflation rates and currency depreciation. Changes in revenue compositions and the uncertain economic situation will have made it difficult to forecast resources and plan accordingly, with actual expenditure deviating from budgeted figures by a relatively wide margin (12% average deviation). **These factors reflect a historically heavy reliance on volatile oil revenues, a narrow tax base that is increasingly being eroded, high inflation rates, and a limited and unpredictable fiscal space.**

### Subnational government vertical revenue trends

Subnational governments are generally more limited in their capacity to borrow than central governments.<sup>114</sup> This is true in Sudan, where limited borrowing options have meant that total revenues and expenditures have historically closely tracked each other, as can be seen in Figure 11.

**Figure 11** Total revenues vs. expenditures across all states (SDG per capita – constant 2020 prices)<sup>115</sup>

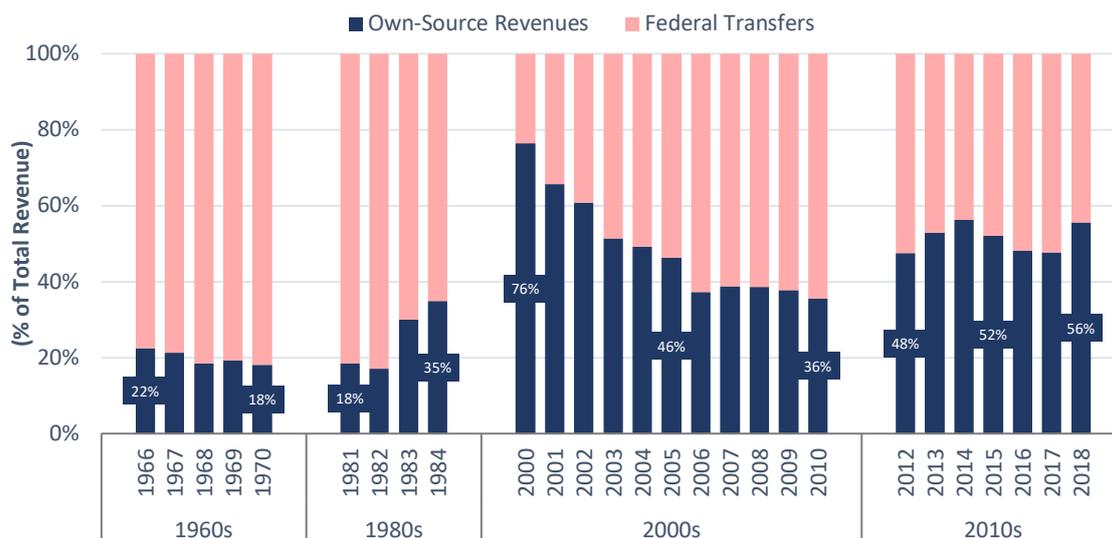


Given that subnational governments in Sudan fail to mobilise notable revenues from own sources and borrowing is limited, they have come to rely heavily on transfers from the central government in order to fund subnational expenditures. Federal transfers grew steadily during the CPA interim period, but since 2011, own source revenues have seen greater relative growth. Most recently, **the share of own source revenues and federal transfers have both averaged roughly 50%** (see Figure 12).

<sup>114</sup> Fjeldstad, 2016.

<sup>115</sup> Does not include states part of South Sudan. Chamber of Federal Governance for 2012-2018 fiscals, World Bank, 2011 & 2014 for 2000-2010 fiscals. Used GDP Deflator from IMF, 2020 to deflate (setting 2020 to base year). CBOS for population statistics; South Sudan population excluded.. Figures likely include both state and local authority fiscals.

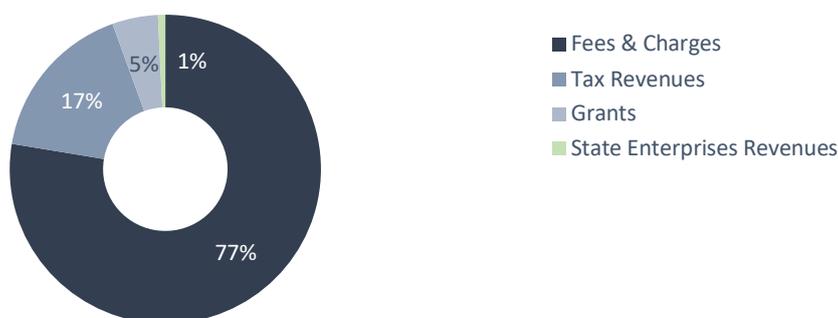
**Figure 12** State and local government revenue sources (% of total revenue) 2000-2018<sup>116</sup>



**The states are heavily reliant on non-tax revenues to generate their own source revenues.** A snapshot in Figure 13 of four states between 2005-2011 shows that, on average, over 77% of own source revenues were derived from fees and charges, while just 17% was generated from taxes. The remaining 6% was primarily made up of grants from donors and a small portion from state enterprise dividends. **The non-tax fees and charges are primarily user charges on public service delivery (e.g., education and health).** Khartoum was included in these four states and, being the state with the largest formal tax base, likely raised the tax average, hence it is probable that most states' revenue generation from tax is far less than the 17% average across these four states.<sup>117</sup>

Although **user charges** may be considered more efficient, they pose a **greater burden on the poor**, which is a notable concern given the significant poverty levels in Sudan, especially outside Khartoum. Service delivery implications should also take into consideration the privatisation of basic service delivery that has been going on in Sudan for the last two decades, particularly in health and education, which has raised the cost of basic services for Sudanese citizens.

**Figure 13** Own source revenue breakdown (2005-2011 averages) (% of total own source revenues)<sup>118</sup>



<sup>116</sup> Does not include states part of South Sudan. Chamber of Federal Governance for 2012 - 2018 Expenditures, World Bank, 2011 & 2014 for 2000 – 2010 Expenditure. Used GDP Deflator from IMF October 2020 WEO Database to deflate (setting 2020 to base year). CBOS for population statistics; South Sudan population excluded. Figures likely include both state and local authority expenditures.

<sup>117</sup> World Bank, 2014.

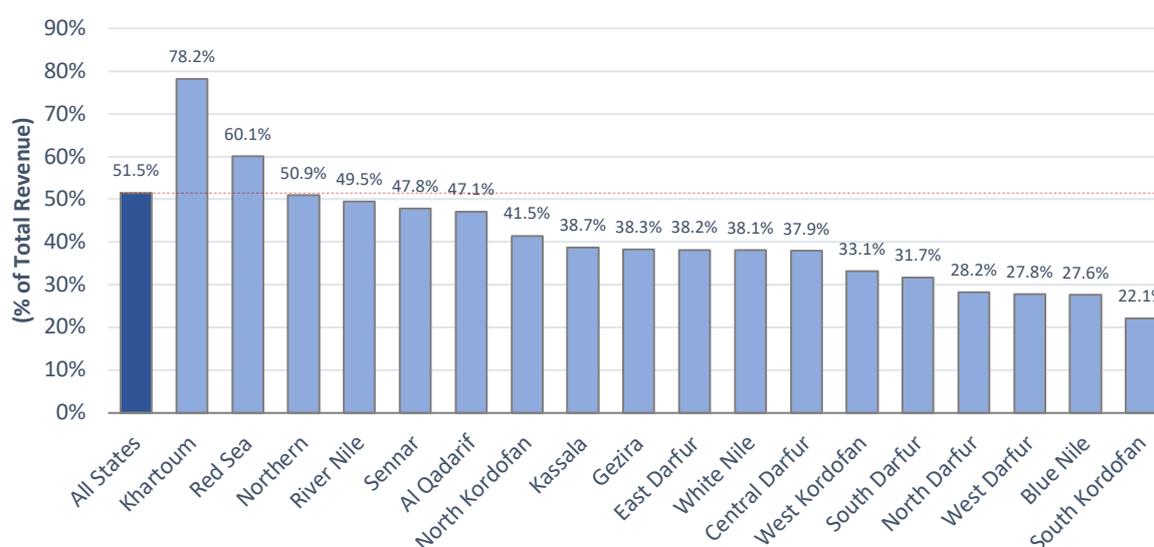
<sup>118</sup> World Bank, 2014. Note: only includes four states.

### Subnational government horizontal revenue differences

**States vary significantly in their ability to generate own source revenues.** Khartoum, in particular, stands out with close to 80% of revenues derived from own sources between 2012 and 2018 (see Figure 14). Red Sea State, potentially boosted by port activities, also had above average own source revenues. At the other extreme, Blue Nile State and the Kordofan and Darfur states have much lower own source revenues at 20-30% of total revenues, and therefore rely more heavily on federal transfers.

There are a variety of potential reasons for these discrepancies, including weaker local economies, tax bases that are more informal and more difficult to tax, lower compliance, and weaker tax administration and collection capacity in these states. It is likely no coincidence the states most reliant on federal transfers – Blue Nile, South Kordofan, and the Darfur states – are also the areas most affected by grievances over marginalisation, underdevelopment, and a lack of subnational autonomy. Federalism will not necessarily resolve these grievances as long as they remain so dependent on federal transfers.

**Figure 14** Subnational own source revenues (% of total revenue) average 2012-2018<sup>119</sup>



### Subnational government local-level revenue snapshot

**Local government revenue generation made up only 18% of average local government revenues between 2005-2011 and just 1.4% of total combined revenue collection across all levels of government.**<sup>120</sup> There is an exceptionally large number of taxes, fees and charges at the local level and reliance on these varies greatly across localities.

Administering and collecting such a high number of taxes is inefficient and collection costs for certain tax categories likely exceed the revenues secured from these categories, resulting in a net loss. Local level revenue sources should be carefully evaluated and rationalised and collection capabilities strategically targeted to the tax categories with greatest potential. Further, there are likely many forms of revenues that are not adequately captured, including non-cash forms of taxes, fees, and charges.

World Bank sampling of a few localities suggests that **fees make up the vast majority of local own source revenues** (e.g., 75% in localities in North Kordofan). The majority of revenues collected at the local level are kept at the local level for own expenditures. Local

<sup>119</sup> Chamber of Federal Governance for 2012-2018 revenues. Population and deflators same as per previous notes.

<sup>120</sup> World Bank, 2014.

governments receive transfers from states, much of which is earmarked for wages and salaries and some of which is based on revenue-sharing agreements for certain taxes and fees.<sup>121</sup> State transfers to localities reportedly accounted for roughly 74% of total revenues for local government health expenditures specifically.<sup>122</sup>

### 6.3 Intergovernmental transfer trends

The resources that the central government transfers to states is made up of shared revenues, grants, and other transfers.

#### Box 6 Categories of transfers to states

States receive the following federal transfers and grants in Sudan:

- current transfers (earmarked and block);
- development grants;
- agriculture tax compensation; and
- discretionary allocations such as special social transfers, transfers for specific projects and emergencies.

#### 6.3.1 Formula-based federal transfers

The 1995 constitutional decree stipulated establishing the Northern States Subsidy Fund (NSSF) with the main objective being to **transfer resources from the centre to the states on a fair and equitable basis**.<sup>123</sup> In allocating transfers to the states, the NSSF identified nine indicators to be used in a formula to achieve a fair and equitable system of transfers. The weighting given to the nine indicators was changed slightly in 2006.<sup>124</sup> In 2017, a system of eight indicators was adopted, with relative weightings as shown in Table 6.

**Table 6** Indicators and weights for federal transfers (1997-2013)<sup>125</sup>

Indicators	Weight (%) (1997-2005)	Weight (%) (2006-2013)	Weight (%) (2017- )
Financial performance	20	10	10
Population size	10	10	25
Human resources	10	10	
Natural resources	10	15	
Infrastructure	10	10	
Education	10	10	13
Health	10	10	12
Security	10	15	15
Per capita income	10	10	
Agricultural requirements			15
Distance to centre and port			8
<i>Total</i>	<i>100</i>	<i>100</i>	<i>100</i>

<sup>121</sup> World Bank, 2014.

<sup>122</sup> World Bank, 2011.

<sup>123</sup> 1995 Constitutional Decree, Article 16.

<sup>124</sup> El-Shibly, 2013.

<sup>125</sup> El-Shibly, 2013 quoting States Subsidies Fund report, June 2006; Sudan Poverty Reduction Strategy Paper, 2021.

While this indicator and weighting system provides a formula for determining transfers, there are some notable problems with the system. First, how the indicators themselves are calculated is not clear. It appears that the criteria used to calculate indicators consist of both formula-based and discretionary factors, creating the risk that the **allocation of transfers could be influenced by subjective judgement**.<sup>126</sup> Second, it is seen as a complicated matrix that is not always strictly adhered to, making transfers vulnerable to political manipulation. There have been significant variations in transfers received by states from the central government from year to year, which impacts the implementation of development projects across states. Third, some feel that the share of state population living in rural areas should be included as an indicator, as poverty is most concentrated in rural areas. The transfer allocation process indicates a **high degree of centralisation in public financial management**. As a result of these concerns, a number of states have been dissatisfied with the formula and have repeatedly requested reform.

The procedures for the allocation of budget resources to localities vary across states and also between localities within the same state. Table 7 below shows the procedures for these allocations in four of the 18 states.

**Table 7** Formulas for budget allocation to localities<sup>127</sup>

Kassala	State covers wages and salary expenses for localities with all locality employees on the state payroll. Additional state transfers for projects are based on requests from localities appraised by a high-level technical committee.
Khartoum	State covers all locality salaries from the state budget while localities use their own revenue to finance all non-wage expenditure. The Local Government Act for Khartoum (2007) stipulates that of all state-collected revenue, 25% is to be transferred to localities. This target has not been achieved yet.
North Kordofan	State pays for locality salaries while non-wage inputs are financed from locality revenues. Localities also receive inputs for education and health facilities procured by respective state ministry responsible for the sector.
River Nile	State covers wages and salary expenses for localities while localities use their own revenue only to finance purchase of goods and services. In 2012, River Nile established a Local Development Fund as a revenue sharing mechanism to allocate cement fees between localities and to be responsible for local development in all localities.

### 6.3.2 Equalising wealth sharing

The principle of equalisation was introduced in the 2005 INC in an attempt to address differences in the states' revenue generating capabilities. It reflects one of the guiding principles in Sudan's 2004 Wealth Sharing Protocol that was agreed upon in preparation for the CPA.<sup>128</sup> It stipulates that national wealth should be shared equitably between different levels of government to allow enough resources for each level of government to exercise its constitutionally defined duties.<sup>129</sup> The INC further provides for distribution of resources for the development of the country, stating that the sharing and allocation of wealth emanating from Sudan's resources shall ensure that the quality of life, dignity and living conditions of all citizens should be promoted without discrimination on grounds of gender, race, religion, political affiliation, ethnicity, language, or region.<sup>130</sup>

<sup>126</sup> Sudan Poverty Reduction Strategy Paper, 2021.

<sup>127</sup> World Bank, 2014.

<sup>128</sup> Bongo, 2019.

<sup>129</sup> El-Battahani & Gadkarim, 2017.

<sup>130</sup> Inc 2005, Article 185.

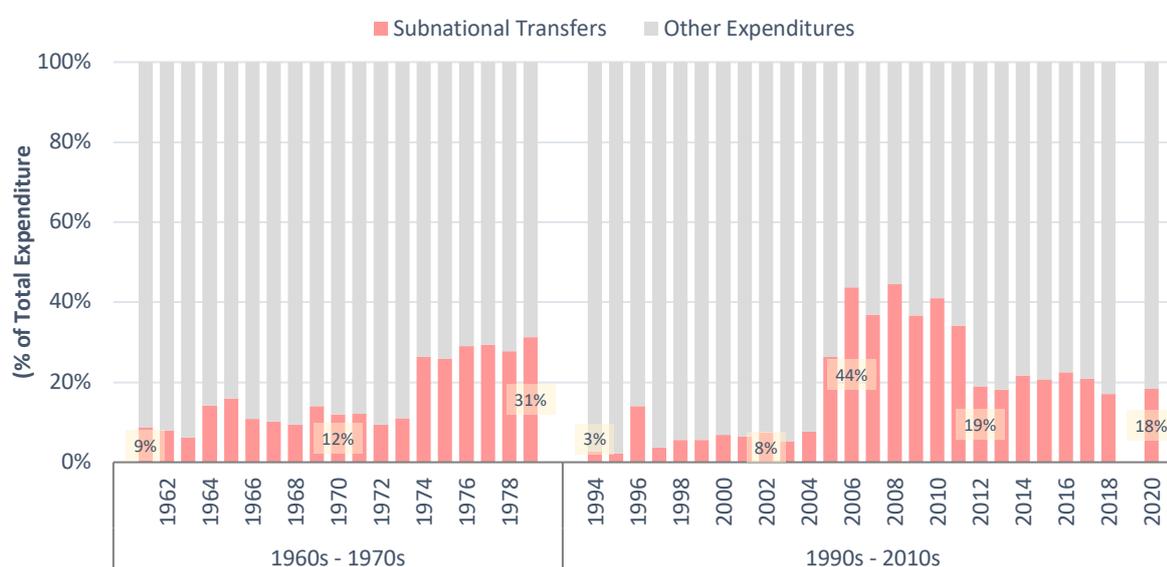
If one of the aims of Sudan’s intergovernmental transfer system is equalisation across states, this is not being achieved. Some states, like the Darfur states, North Kordofan and Al Qadarif, have low levels of own revenue mobilisation and, simultaneously, relatively low levels of formula-based federal transfers, which suggests that **the current procedure for allocating federal transfers does not achieve equalisation among the states.**<sup>131</sup>

### 6.3.3 Federal transfers from the central government perspective

The proportion of subnational transfers as a percentage of total central government expenditures has varied greatly from the 1960s to now, from as low as 3% in the early 1990s to close to 45% after the CPA in 2005. When transfers to states have been low historically, this has been mainly due to centralised expenditure responsibilities rather than self-reliant subnational governments with large own source revenue bases. In Sudan, subnational revenue collection is weak, seemingly due to **weak tax administrative and collection capabilities** and tax base challenges, including high levels of poverty and difficult to tax economies in some states.

Several measures of decentralisation took place in the early 1980s and subnational own source revenues increased, resulting in a slight fall in subnational transfers as a percentage of total expenditure. Declines in subnational transfers since 2011, due to lower revenues as a result of South Sudan’s secession, declining oil revenues, and higher subsidy costs, have brought down the share of subnational transfers in recent years (see Figure 15).

**Figure 15** Central government subnational transfers (% of total expenditure)<sup>132</sup>



### 6.3.4 Federal transfers from the subnational government perspective

On average, between 2000 and 2010, 63% of federal transfers were current transfers earmarked for subnational recurrent expenditures and/or driven by a formula.<sup>133</sup> VAT transfers, based on a revenue-sharing agreement, made up the next largest portion at 13%, although the vast majority of these VAT revenues were allocated to Khartoum. Transfers for capital and development expenditures averaged 10% of the total in this period. Other

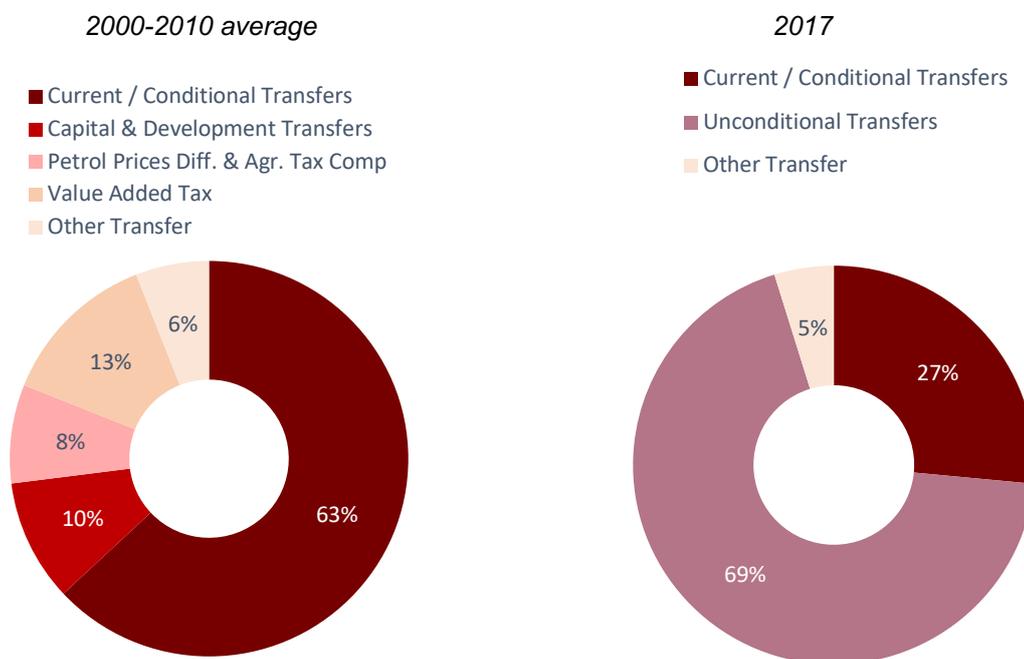
<sup>131</sup> World Bank, 2014.

<sup>132</sup> 1994-2018: CBOS annual reports, 2020: Ministry of Finance budget execution report, 1960s-1970s: El-Battahani & Gadkarim, 2017.

<sup>133</sup> World Bank, 2014.

transfers, including an agriculture compensation transfer to compensate for previously eliminated taxes made up the final 14%, on average. These breakdowns varied greatly across the states, but VAT transfers made up almost all the federal transfers to Khartoum.<sup>134</sup>

**Figure 16** Federal transfers breakdown (% of total federal transfers)<sup>135</sup>



A snapshot of federal transfers in 2017 shows how these transfers may have shifted in more recent years. It suggests that, by 2017, **the domination of conditional / transfers as a percentage of total federal transfers had declined. Instead, unconditional transfers (likely including development transfers) had grown to make up 69% of transfers.** Further transfers came primarily from gold and oil revenue-sharing agreements.

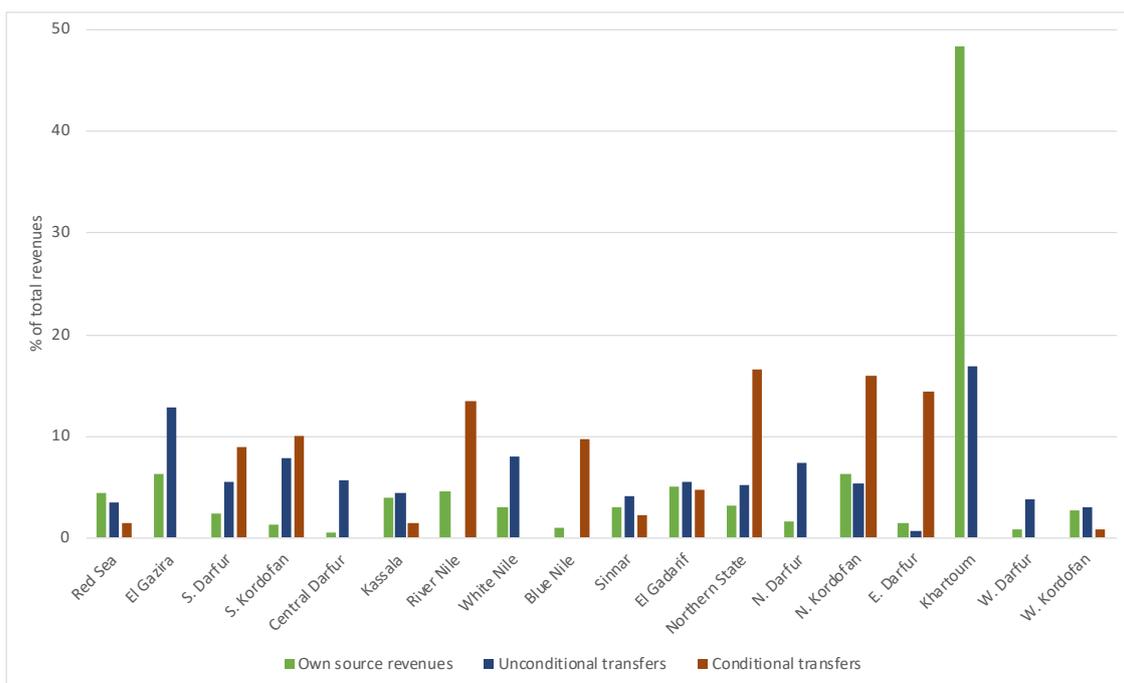
There was a large variance in the 2017 data across states, with conditional / recurrent transfers making up over 14% of total transfers for Northern State, North Kordofan, and East Darfur while 0% of total transfers to Gezira, Khartoum, and Central Darfur were conditional (see Figure 17).<sup>136</sup>

<sup>134</sup> World Bank, 2014.

<sup>135</sup> 2000-2010: World Bank, 2014; 2017: Chamber of Federal Governance.

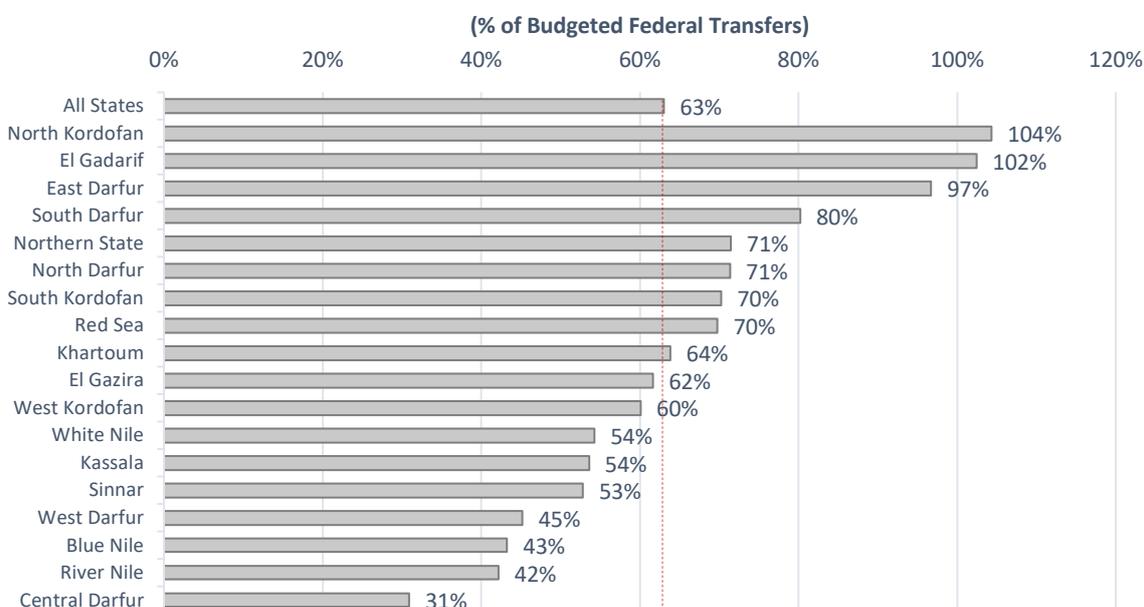
<sup>136</sup> Note: some data points were missing, including for unconditional transfers for East Darfur, Blue Nile and River Nile.

**Figure 17** Composition of states revenues (2017)<sup>137</sup>



Across all states, actual federal transfers were just 63% of budgeted federal transfers, indicating that states spend less in practice than they intended to, i.e., have low execution rates (see Figure 18). This may be due to a combination of factors, including states receiving transfer information after state budgets had been formulated, transfers being unpredictable, inflation eroding the value of transfers, and some states having weak spending capacities. There was also a wide variance in executed federal transfers across states, with less than 50% execution for the Central Darfur, West Darfur, Blue Nile and River Nile states, whereas North Kordofan, Al Qadarif and East Darfur had near 100% execution.

**Figure 18** Actual federal transfer execution by state (% of budgeted federal transfers) 2017<sup>138</sup>

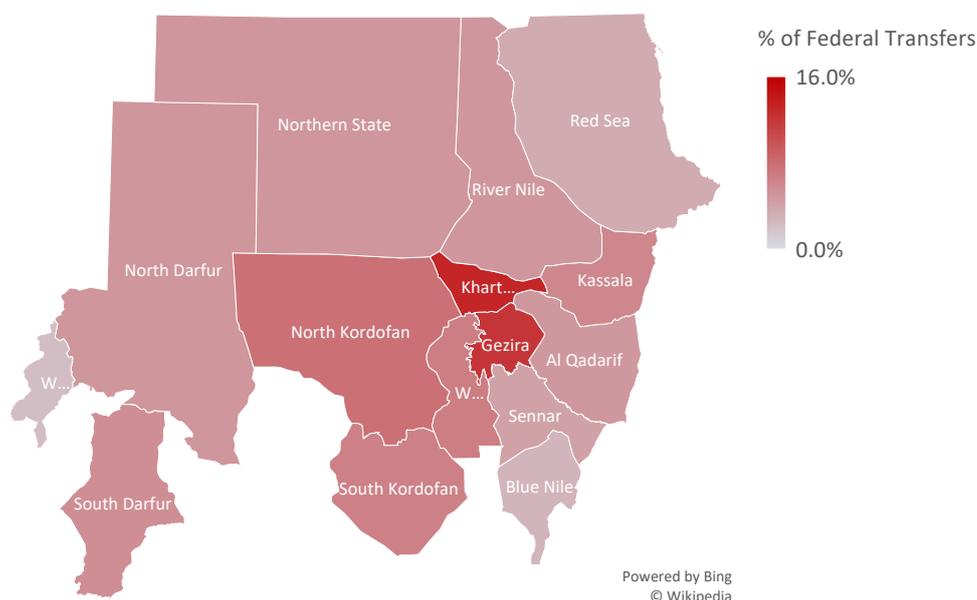


<sup>137</sup> Chamber of Federal Governance.

<sup>138</sup> Chamber of Federal Governance.

In terms of the actual allocation of federal transfers, **Khartoum and Gezira received the largest shares of total federal transfers between 2012-2018, together accounting for a quarter of federal transfers** (see Figure 19). A number of factors may be driving these shares, including the underlying formula for transfers. For instance, Khartoum and Gezira are the states with the largest population sizes. Only since 2017 has distance from the centre or a port been included as an indicator in the formula, and proportion of a states' population living in rural areas (where poverty is more concentrated) is not currently factored into the formula. A new formula is to be developed now to govern transfer allocations after Sudan's political transition period.

**Figure 19** Federal transfers by state (% of total federal transfers) average 2012-2018<sup>139</sup>



## 6.4 Borrowing mechanisms in Sudan

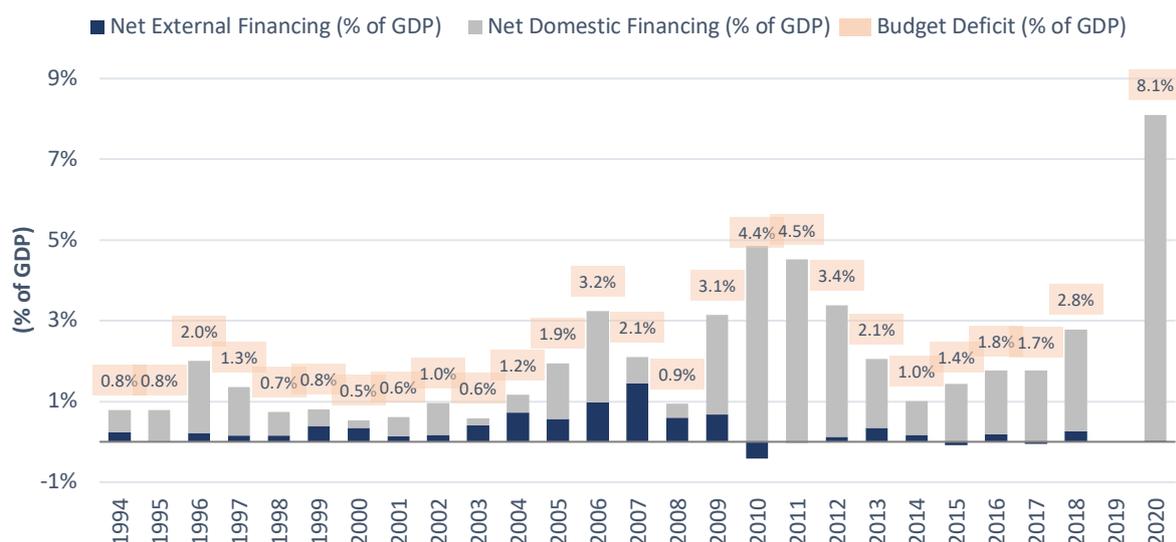
The need for borrowing arises when a government's expenditure requirements exceed its available revenues and grants. The INC does not provide for borrowing mechanisms and it seems in practice that only the federal government has the authority to borrow from both external and domestic sources, with state and local governments only able to borrow from domestic sources. The federal government could in theory channel part of the money it borrows to state and local governments through its transfers and grants mechanisms.

### 6.4.1 Central government borrowing

In the past, Sudan has had limited access to external financing due to US sanctions and historical arrears with external creditors. This has resulted in the government relying primarily on domestic financing sources to finance the deficit over the last few decades (see Figure 20). Sudan's domestic credit sector is constrained and this historically kept budget deficit levels relatively low, averaging roughly 2% per year until 2008. Since 2009, however, government's domestic borrowing has grown steadily and the budget deficit reached over 8% in 2020. Much of this borrowing was to cover costly off-budget fuel subsidies and was financed by the Central Bank printing money, which led to high inflation rates and currency depreciation.

<sup>139</sup> 2000s: World Bank, 2011 & 2014; 2010s: Chamber of Federal Governance.

**Figure 20** Budget deficit and financial sources (% of GDP)<sup>140</sup>



Sudan’s total public debt is one of the highest in the world and is expected to have reached 260% of GDP in 2020.<sup>141</sup> The external debt has persisted despite extremely limited external borrowing in the last few decades due to debt servicing arrears comprising most of the debt. In early 2021, considerable progress has been made on reducing Sudan’s external debt through a number of countries forgiving bilateral debt owed by Sudan and the international community helping to clear Sudan’s debt arrears to multilateral development banks. This will pave the way for Sudan to access external financing for the first time in many years.

#### 6.4.2 Subnational government borrowing

Subnational governments in Sudan have been able to borrow from domestic sources and have done so more frequently in recent years. Where previously domestic claims on subnational governments were almost non-existent, these claims now make up close to 7% of all claims on non-central government entities (i.e., including private sector, public entities, and subnational governments).

Unlike previous peace agreements, the JPA includes specific provisions on borrowing for the states/regions. For example, under the Blue Nile and Kordofan Agreement, the state/regional governments have been given exclusive powers to (i) borrow money for the purposes of development and construction from national bodies with the guarantee of the state/regional government and (ii) to exercise the right to borrow loans with the Sudan Central Bank or the state/regional government securing the collateral.<sup>142</sup> The Darfur Agreement stipulates loans, domestic and foreign borrowing in accordance with the credit rating and in line with the national economic policy under sources of exclusive revenue for the state/regional government of Darfur.<sup>143</sup>

Allowing subnational governments to borrow, even from domestic sources only, must be approached with much caution as irresponsible borrowing by subnational governments may

<sup>140</sup> CBOS Annual Reports for 2018 and prior (most recent reports used where multiple reports exist); Economic & Financial Statistics Reviews for 2019; Ministry of Finance In-Year Execution Report for 2021 (Dec extrapolated based on 11-month outturns and likely an underestimate as final month of budget years generally see a spike in expenditures). IMF, 2020 for GDP figures.

<sup>141</sup> IMF Article IV 2019, 2020.

<sup>142</sup> JPA 2020, Blue Nile and Kordofan Agreement, Chapter 3, Articles 1.1 and 1.2.

<sup>143</sup> JPA 2020, Darfur Agreement.

fuel debt crises and macroeconomic instability that affects the entire country.<sup>144</sup> Sudan's macroeconomic situation is already very unstable and greater subnational borrowing would be very risky in the current context. What borrowed funds will be used for, however, makes a big difference – while borrowing to finance budget deficits drives inflation, borrowing to finance productive investments could be considered more favourably. In any event, **strengthening regulatory frameworks, developing domestic debt markets, and building capacity in government officials are important steps to mitigate risks associated with subnational government borrowing.**

## 6.5 Federal/national influence on subnational/state decisions

The relationship between central government and subnational governments in Sudan appears to be quite intrusive, with the central government holding the majority of political and fiscal power. A number of instances have demonstrated central government's influence over subnational governments, including state and locality boundaries being regularly changed over the years and emergency laws used to dissolve subnational governments.

The lack of full clarity and transparency regarding allocation of transfers for the states and continued use of conditional transfers for some states gives central government discretion over transfer allocation and the ability to enforce certain rules and spending arrangements on states. This reflects the limited level of autonomy that subnational levels of government currently enjoy. Furthermore, the Sudanese fiscal federalism system is characterised by a high level of vertical imbalance that makes the subnational levels highly dependent on transfers from central government which, in turn, retains central government's control over subnational governments.

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<sup>144</sup> Faguet, 2014.

## 7 Measurement of fiscal federalism in Sudan

In section 6 above, we looked at historical trends of the various elements of fiscal federalism in Sudan – expenditure assignment, revenue assignment, intergovernmental transfers, borrowing, and influence of federal/national government over subnational/state decisions. In this section we use several measures to determine the extent of fiscal decentralisation in Sudan.

### Box 7 Elements of fiscal federalism

**Vertical decentralisation** measures compare expenditure and revenue responsibilities **between the central government and subnational governments** as a whole.

**Horizontal decentralisation** measures compare expenditure and revenue responsibilities **across subnational governments**.

### 7.1 Vertical decentralisation measures

*Vertical decentralisation measures compare expenditure and revenue responsibilities between the central government and subnational governments.*

To investigate the trends and degree of **vertical decentralisation**, we examine four measures:

- **Subnational expenditure share** – We calculate the **share of subnational expenditure as a percentage of total combined subnational and central government expenditures** to give a sense of overall expenditure responsibilities at the two levels. For central government total expenditure, we exclude state transfers as this is captured within subnational level expenditures. Further, we calculate expenditures on a per capita basis to control for the impact of South Sudan's secession, adjusting the population figures accordingly.
- **Subnational revenue share** – We calculate the **share of subnational own source revenue generation as a percentage of total combined subnational own revenue and central government revenue** to give a sense of the overall revenue generating powers at the two levels. For central government revenue, we also split this by revenues kept at the central government level and those transferred to the states. We calculate revenues on a per capita basis to control for the impact of South Sudan's secession, adjusting the population figures accordingly.
- **Vertical gap** - A vertical gap is generally defined as the **percentage of subnational expenditure that is not accounted for by own source revenues**.<sup>145</sup> We present own source revenue as a percentage of total subnational expenditure trends to illustrate this.
- **Vertical imbalance** – A vertical imbalance measures **whether, given a certain level of vertical gap, federal transfers were adequate to meet subnational expenditure requirements**. We present federal transfers on top of own source revenues as a percentage of total subnational expenditure trends to illustrate this.

Examining vertical gaps and vertical imbalances allows us to see **whether subnational revenues are adequate to meet states' expenditure responsibilities**. There is subjective judgment in what constitutes 'expenditure responsibilities.' We provide two potential

<sup>145</sup> Boadway & Eyraud, 2018.

definitions for expenditure responsibilities when comparing the revenue sources to expenditures:

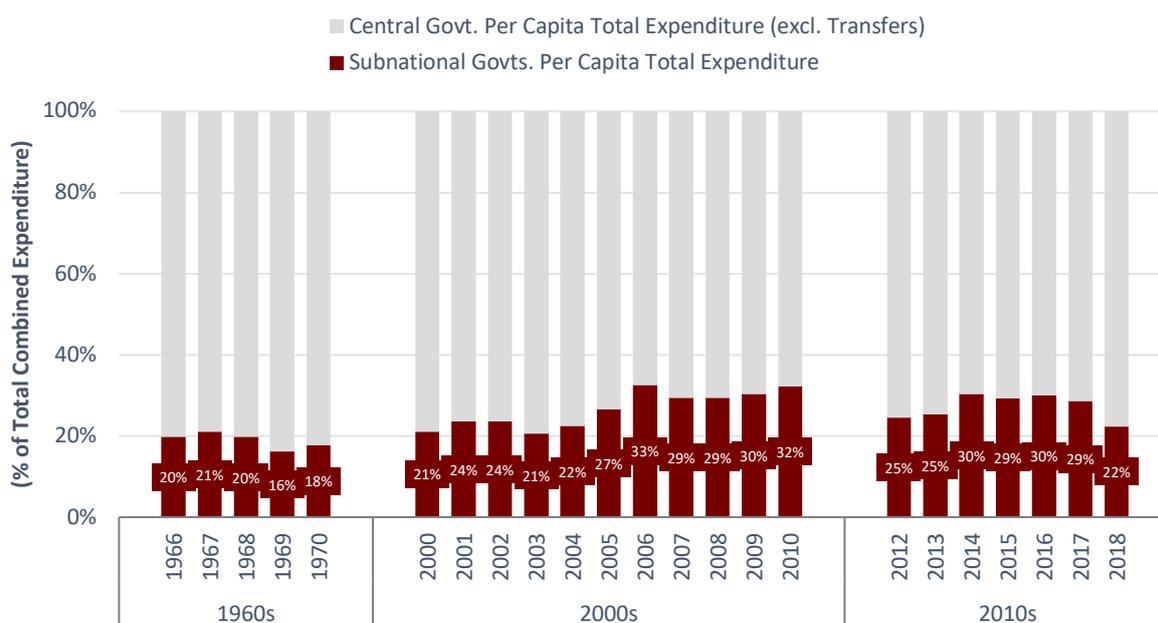
- **Total expenditure** for the current year in which revenues are being measured.
- **Average real total per capita expenditure 2000-2018**. Ideally, service delivery would be kept constant, with expenditures rising due to increasing costs. Inflation and population growth are two of the primary cost drivers. This measure aims to control for these and to take an average of expenditure across the period to represent 'average service delivery' of the states over the two decades. This is then used as the benchmark to assess whether revenue sources have been sufficient (or excessive) to maintain service delivery.

### 7.1.1 Subnational expenditure share

Here we look at subnational expenditure as a percentage of total combined subnational and central government expenditures to give a sense of expenditure responsibilities at the two levels of government. The higher the subnational expenditure share, the greater the extent of fiscal decentralisation.

The CPA had a focus on fiscal decentralisation, and we see the **subnational expenditure share** rising accordingly after 2005. Subnational expenditures had historically made up less than 25% of the combined government's total expenditures – after 2005, it rose to over 30% on average. Following the secession of South Sudan, revenues declined and federal transfers were heavily cut, with subnational expenditure shares falling back to 25%. The subnational expenditure share appears to currently be falling to historically low levels, reflecting less spending on the subnational level (see Figure 21).

**Figure 21** State and local government expenditure vs. central government expenditure excl. transfers (% of total combined per capita expenditure), 2000-2018<sup>146</sup>



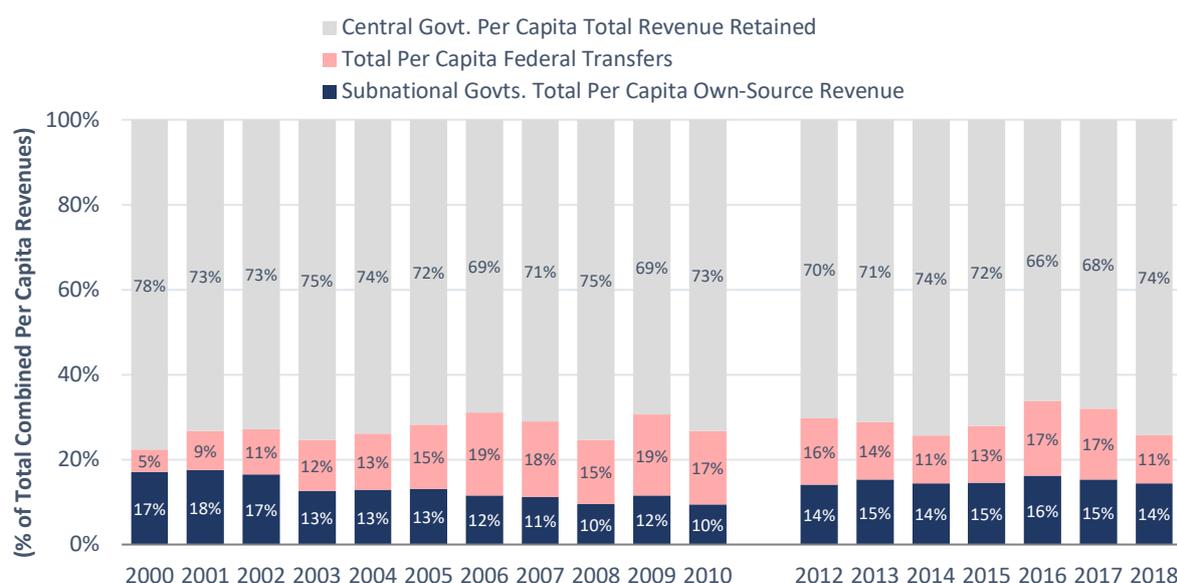
<sup>146</sup> Does not include states in South Sudan. 1960s Subnational & Central: El-Battahani & Gadkarim, 2017; 2000s Subnational: World Bank, 2011 & 2014; 2010s Subnational: Chamber of Federal Governance. 2000s & 2010s Central: CBOS Annual Reports.

### 7.1.2 Subnational revenue share

Here we look at the share of subnational own source revenue generation as a percentage of total combined subnational own revenue and central government revenue to give a sense of the overall revenue generating powers at the two levels. The greater the subnational revenue share, the greater the extent of fiscal decentralisation.

While expenditure responsibilities of subnational governments had grown relative to the central government in the 2000s, the **subnational revenue share** declined from 18% in 2001 to just 10% by 2008. This was due to an increase in central government revenues from oil and increases in associated taxes. Federal transfers to states increased during this time of higher revenues, but later declined with South Sudan's secession and the collapse in oil revenues. In recent years, the subnational revenue share has stabilised at about 15% (see Figure 22).

**Figure 22** State and local government revenues vs. central government revenues (% of total combined per capita revenues), adjusted population figures<sup>147</sup>



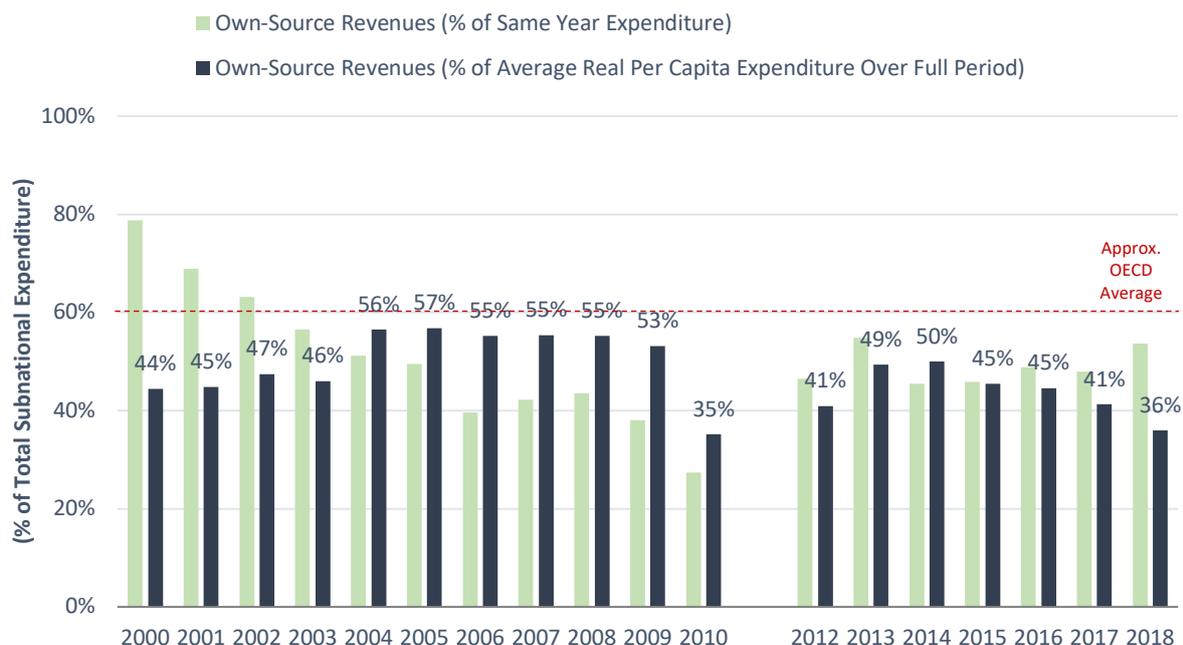
### 7.1.3 Vertical gap

The vertical gap is the percentage of subnational expenditure that is not accounted for by own source revenues. A larger gap signifies greater reliance on transfers from the central government and, consequently, a lower level of fiscal decentralisation.

The **vertical gap** measure indicates a relatively large gap in Sudan, with a high share of subnational expenditure not funded by own source revenues (see Figure 23). The gap was particularly large during the fall in subnational revenue shares in the 2000s when transfers from the central government increased. Subnational own source revenues have not been sufficient to keep up with expenditure increases, which have been driven in large part by high inflation.

<sup>147</sup> Does not include states in South Sudan. 2000s Subnational: World Bank, 2011 & 2014; 2010s Subnational: Chamber of Federal Governance. 2000s & 2010s Central: CBOS Annual Reports

**Figure 23** Vertical gap – subnational own-source revenue sources (% of total subnational expenditure)<sup>148</sup>



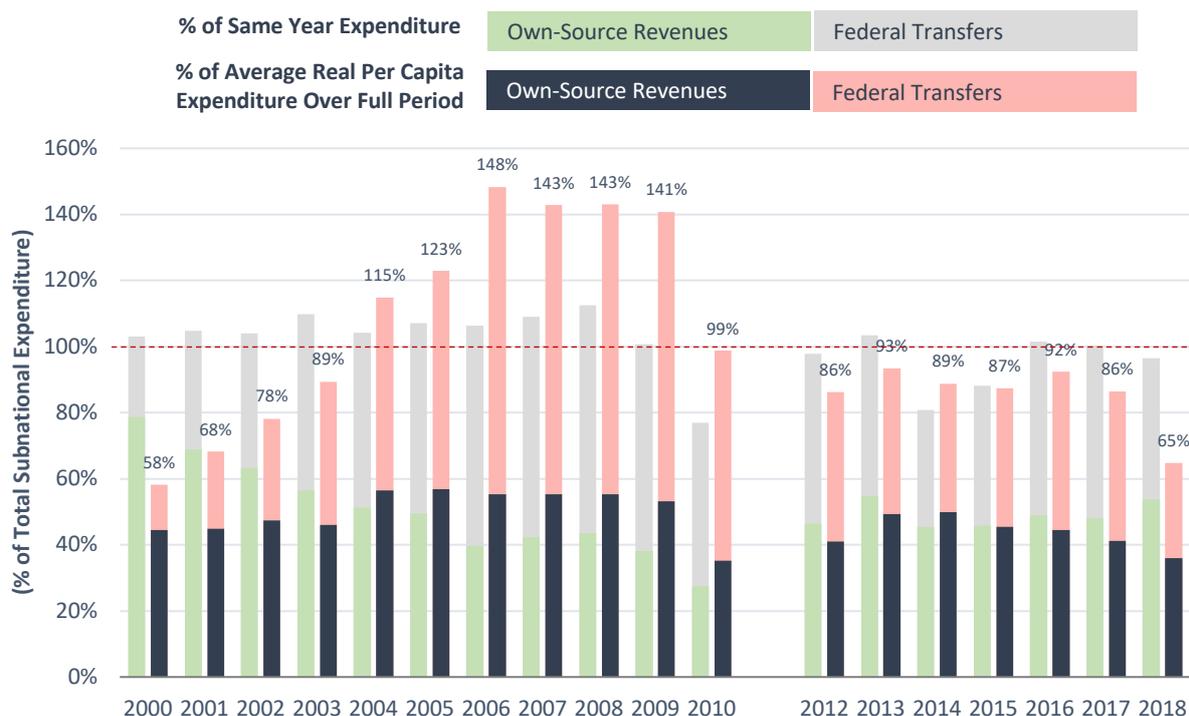
#### 7.1.4 Vertical imbalance

*A vertical imbalance measures whether, given a certain level of vertical gap, federal transfers were adequate to meet subnational expenditure requirements. The larger the imbalance, the less able subnational governments are to meet their expenditure requirements.*

Looking at the subnational expenditure and revenue trends above, we see that transfers from the central government were generally sufficient to meet subnational expenditures until recently, mainly because subnational governments limited their expenditures to available revenue given few borrowing options. Recently, federal transfers have become insufficient for subnational governments to maintain previous average levels of service delivery. The imbalance is about 10% (see Figure 24).

<sup>148</sup> 2000s: World Bank, 2011 & 2014; 2010s: Chamber of Federal Governance.

**Figure 24** Vertical imbalance – subnational revenue sources (% of total subnational expenditure)<sup>149</sup>



**Box 8** Vertical decentralisation summary

- **Subnational expenditure share** was between 25-30% since 2000, but as of 2018 it has fallen to historically low levels (around 22%), indicating a decrease in spending at subnational government compared to central government.
- **Subnational revenue share** has been stable at around 15% since 2012, with notable variance in federal transfers year to year.
- **Vertical gap** is quite large, with subnational governments covering a small portion of their expenditures from their own source revenues, meaning that they have to rely on transfers from central government to fund their expenditures. High inflation rates have made it harder for subnational governments to cover their increasing expenditures with own source revenues.
- **Vertical imbalance** has grown recently to about 10%, with federal transfers being insufficient to enable subnational governments to maintain previous average levels of service delivery.

<sup>149</sup> 2000s: World Bank, 2011 & 2014; 2010s: Chamber of Federal Governance.

## 7.2 Horizontal decentralisation measures

*Horizontal decentralisation measures compare expenditure and revenue responsibilities across subnational governments.*

Regardless of the degree of vertical decentralisation between the central government and subnational governments as a whole, significant differences are likely to exist across states in how effectively they are able to perform their revenue and expenditure responsibilities. Capabilities and cost of service provision also varies across states. The levels of federal transfers to different states may also differ for a variety of reasons.

We illustrate two measures to assess the average degree of horizontal decentralisation and heterogeneity between 2012 and 2018:

- **Horizontal gap** – This measures the **degree to which own source revenues cover ‘expenditure responsibilities’ of each of the states**. The overall average horizontal gap for the period between 2012 and 2018 is included, to assess which states have fallen above or below the average gap.
- **Horizontal imbalance** – This measure illustrates **whether federal transfers for each state were sufficient to close the gap between own source revenues and expenditures** over the period.

Per capita indicators are used to adjust the measures to be more comparable across states. Two definitions of ‘expenditure responsibilities’ are used for both of the measures:

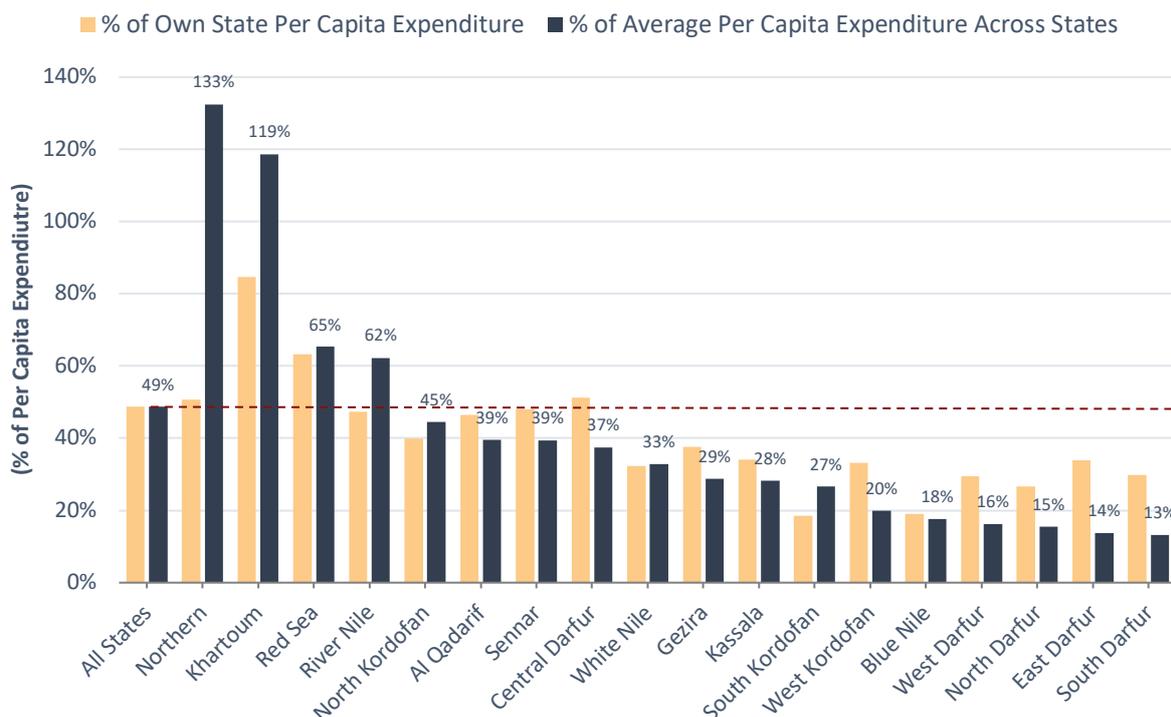
- **Own state per capita expenditure** – This **compares states’ per capita revenue sources against their own per capita expenditures** over the period. This may be more difficult to gauge in instances where states have constrained their expenditures when their own source revenues are not adequate.
- **Average per capita expenditure across states** – This **compares states’ per capita revenue sources against the average per capita expenditure across all states** over the period. This provides a more standard definition of ‘expenditure responsibilities’ or service delivery across all states. Some care must be taken with this measure as external factors (e.g., geographic factors) can result in varying costs of providing the same level of services across states.

### 7.2.1 Horizontal gap

*The horizontal gap measures the degree to which own source revenues cover expenditure responsibilities of each of the states. The smaller the gap, the more able the state is to cover either own state per capita expenditure or national average per capita expenditure from their own source revenues; the larger the gap, the more dependent the states are on transfers to meet these expenditure levels.*

Khartoum and the Northern State have notably high ability to cover national average per capita expenditure levels from their own source revenues (see Figure 25). However, half of the states can cover less than 30% of national average per capita expenditure levels from their own source revenues. The Blue Nile State and the regions of Kordofan and Darfur have particularly high gaps compared to the average gap across all states. Own source revenues for some of these states was only sufficient to meet about 30% of the states’ own per capita expenditures and less than 20% of the national average per capita expenditures.

**Figure 25** Horizontal gap – states' own source revenue sources (% of total per capita expenditure) average 2012-2018<sup>150</sup>



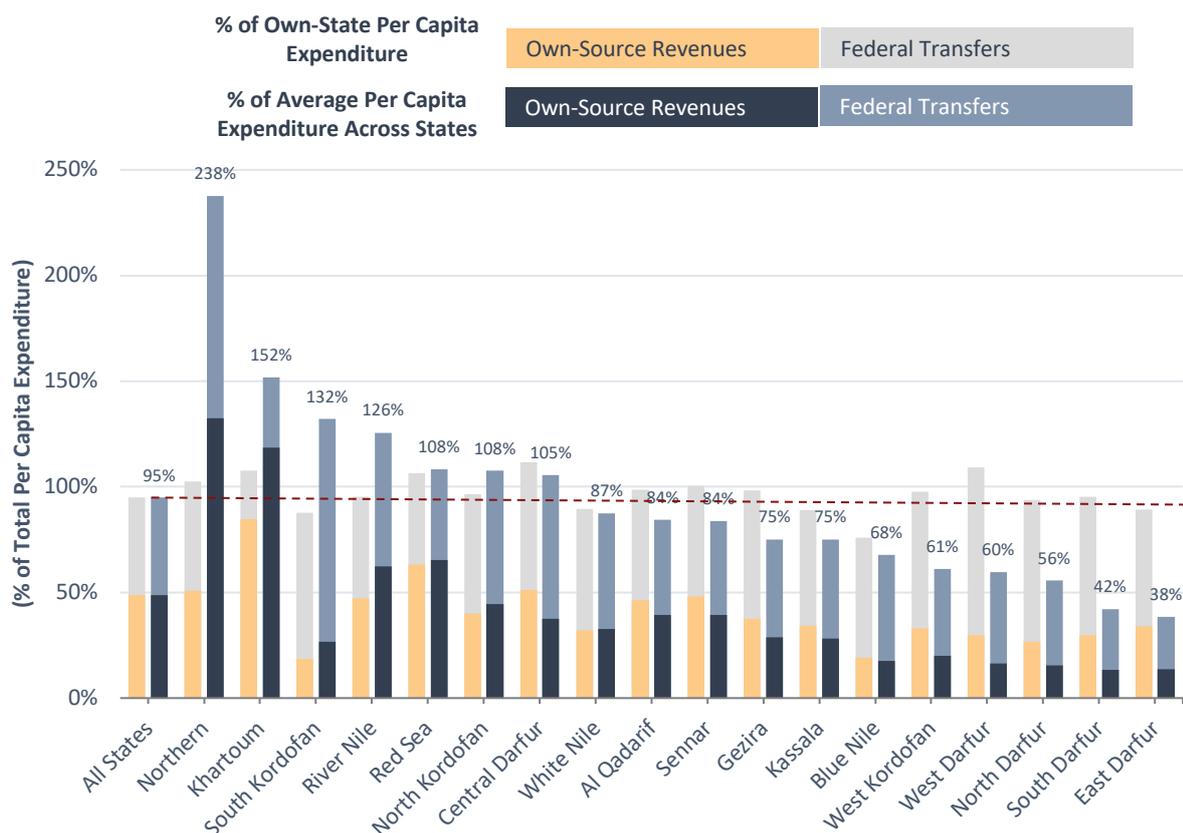
### 7.2.2 Horizontal imbalance

*The horizontal imbalance demonstrates whether federal transfers for each state were sufficient to close the gap between own source revenues and expenditures. The larger the imbalance, the less able subnational governments are to meet their expenditure requirements.*

We see a wide disparity in levels of own source revenues across states when comparing against national average per capita expenditure levels (see Figure 26). Federal transfers are used to help states meet national average per capita expenditure levels, however, it appears that some states receive more in federal transfers than they need in order to reach this threshold, while other states receive less than they need. If the goal is to equalise per capita expenditures across states, this is not happening in practice. The Darfur region in particular mobilises very little in own source revenues and receives far less than they need in federal transfers to meet national average per capita expenditure requirements.

<sup>150</sup> Chamber of Federal Governance.

**Figure 26** Horizontal imbalance – states' revenue sources (% of total per capita expenditure) average 2012-2018<sup>151</sup>



**Box 9** Horizontal decentralisation summary

- **Horizontal gap** – for most states, the gap is large. Half of the states can cover less than 30% of national average per capita expenditure from their own source revenues. However, Khartoum and Northern State collect enough in own source revenues to pay twice the national average per capita expenditure. The result is most states are highly dependent on transfers from the central government to meet national average per capita expenditure level.
- **Horizontal imbalance** – federal transfers for some states are greater than is needed for them to meet national average per capita expenditure levels and are far too low for other states (particularly the Darfur states). If the goal is to equalise per capita expenditures across states, this is not happening.

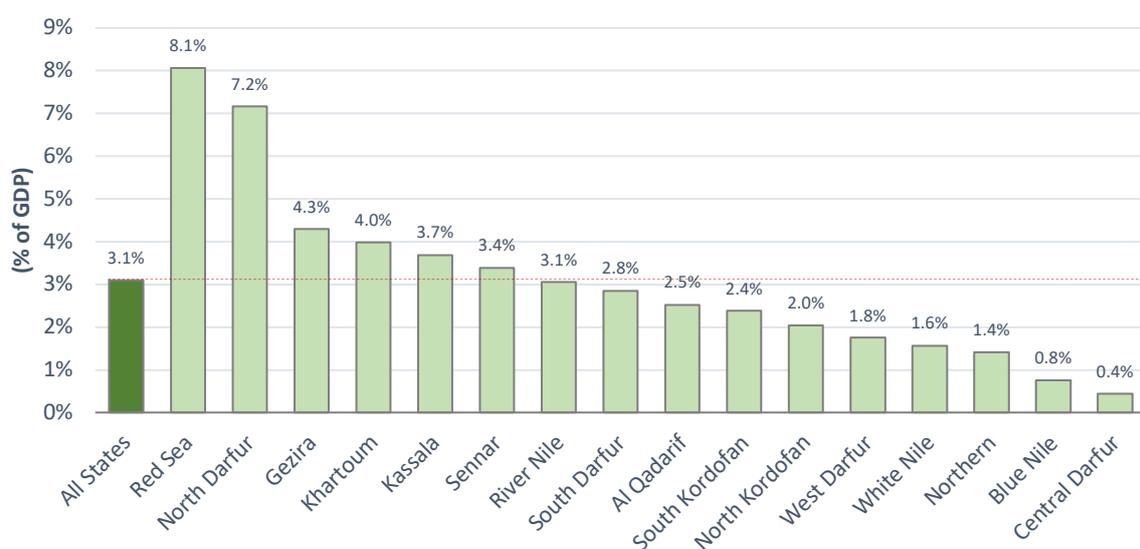
<sup>151</sup> Chamber of Federal Governance.

## 8 Fiscal and socioeconomic linkages

### 8.1 Economic activity and revenue intake

When looking at economic activity in each state, we see substantial variation in states' own source revenue collection as a share of state GDP. States like Red Sea, Gezira, and Khartoum have a much higher than average own source revenue intake as a percentage of state GDP, although even these leading figures are relatively modest. North Darfur is also above average, but this may be more reflective of a weaker economy (i.e., a smaller state GDP estimate) rather than strong tax compliance. The states with lower shares of own source revenue to state GDP potentially have more informal and difficult to tax economies. Other factors influencing these differences could be the types of economic activity occurring in each state, the types of taxes and fees levied, and the level of compliance enforcement each state has.

**Figure 27** Subnational own source revenues (% of state GDP) 2018<sup>152</sup>



### 8.2 Social indices and subnational expenditures

Limited data availability and a failure to fully implement federalism and decentralisation measures in the past means that it is very difficult to assess the impact of decentralisation on social outcomes with any detail in Sudan. Many factors also influence both social outcomes and the ability of subnational governments to spend.

States with higher expenditures are also the richer states and so are more likely to have better development outcomes. Unsurprisingly, there is a connection between higher per capita expenditures and higher Human Development Index (HDI) and lower Multi-dimensional Poverty Index (MPI) scores.

<sup>152</sup> Chamber of Federal Governance for fiscals, Sudan Central Bureau of Statistics for GDP figures.

## 9 Conclusion and policy recommendations

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There is a sharp dilemma facing policymakers, the international community, and the people of Sudan today. On the one hand, the country's conflicts are triggered in no small part by grievances among marginalised and impoverished communities, and federalism is held up as a **mechanism** to address these grievances. On the other hand, the history of fiscal decentralisation in Sudan has not been positive.

### 9.1 Summary of key findings

Key findings from the analysis in this paper include:

- **Highly centralised revenue management** – While relatively extensive expenditure and revenue responsibilities have been devolved to state and local governments in Sudan, poor tax bases and weak tax administration and collection capacity of most subnational governments have meant they collect little in terms of own source revenues and continue to rely heavily on transfers from the central government. Sudan's low tax administration and collection capacity is particularly evident with higher reliance on indirect taxes, notably VAT and customs duties, and little mobilisation of direct taxes, such as business profit taxes or personal income taxes. In practice, these factors have combined to create a revenue management system in Sudan that is highly centralised.
- **Lower federal transfers in recent years** – Fiscal imbalances at the central level have resulted in lower transfers to subnational governments in recent years. Subnational governments have been forced to significantly cut their expenditures as a result – per capita expenditures have fallen back to pre-CPA levels.
- **Discretionary transfer allocation and grant conditionality** – Transfers from central government to states appear to have been allocated with a degree of discretion in the past due to some lack of clarity in the formula-based allocation system. There has also been significant use of conditional transfers in the past, which allows the central government to control subnational expenditure. However, this practice has changed recently, and unconditional transfers now comprise around 69% of total transfers to states. However, use of conditional transfers varies across states, with Northern State, North Kordofan, and East Darfur subject to greater conditionality than Khartoum and Gezira, for example.
- **Per capita expenditure disparities across states** – There are large disparities across states in terms of revenue collection capacity due to some states having more limited administration and collection capabilities and noticeably poorer tax bases and more difficult to tax economies. Transfers have failed to achieve per capita expenditure equalisation, with some states, including the Darfur states and North Kordofan, experiencing both low levels of own source revenue mobilisation and relatively low levels of formula-based federal transfers. This has worsened inequalities across states.
- **Urban-rural inequalities** – Expenditure has favoured urban centres in recent years, where the more affluent have been able to benefit from expenditure. This has worsened urban-rural inequities and failed to address very high levels of rural poverty.
- **Local level tax line review needed** – Local governments rely on a very large number of taxes, fees, and charges for own source revenues. Stretching limited revenue collection capacity across many tax lines in this way means that it is likely

that some tax lines are resulting in a net loss, with collection costs being greater than revenues from some tax lines. It is essential that these tax lines are reviewed and revenue collection capacity directed only to the highest potential tax lines.

- **Limited political decentralisation** – Political decentralisation was significantly undermined by presidential appointment of state governors, despite the 2005 INC stipulating that all levels of government should be directly elected. Such practices keep subnational governments under the influence of the central government and make them less responsive to their own constituents, which undermines democracy, legitimacy, and accountability.
- **Weak implementation of peace agreements** – This has been a common feature of Sudan's past peace agreements and has resulted in recurring tensions and conflicts. The JPA is undoubtedly more complex and requires greater financial and institutional capacity to implement than any past peace agreement. For example, it will create an asymmetrical federation in Sudan, with some regions having more powers than others, which will be very difficult to manage in practice.

## 9.2 Policy recommendations

Fiscal federalism in Sudan should perhaps be seen as the end of a process rather than the beginning. There are some deep problems in Sudan that need to be addressed before fiscal federalism can deliver on its promises – notably greater political inclusion, democracy, and political accountability at all levels of government.

Considerations to factor in when designing a fiscal federalism framework for Sudan include:

- **Ensure sufficient financial and institutional capacity for JPA implementation.** The resource requirements for this are considerable and early and continual attention needs to be paid to how to finance this significant shift in Sudan's system of governance, particularly given its notable complexities.
- **Bring greater clarity and coordination to the division of expenditure and revenue assignments** at different levels of government through a detailed fiscal federalism framework tailored to Sudan's context. This detailed framework has not existed in the past, which has led to a lack of clarity on some issues. The fact that the JPA introduces different arrangements for different regions will make management and implementation of this in practice extremely complex, but clarity and coordination in assignments remains critical.
- **Increase revenue collection at both central and subnational levels** from the current considerably low tax to GDP ratio of around 6%. Sudan's existing subnational revenue powers are relatively extensive and subnational governments have a degree of autonomy over determining own source revenues and setting tax rates. However, they collect only a small portion of own source revenues in practice, indicating a critical need to build subnational tax administration and collection capacity. It will only be through increasing subnational own source revenues that dependence on transfers from the central government can be reduced.

Attention should be paid to the impact of various taxes and fees on the poor and the potential to redistribute wealth through pro-poor tax policy. Sudan's current heavy reliance on indirect taxes of VAT and customs duties could potentially disproportionately impact poor households who spend a greater portion of their incomes on consumption, undermining the tax system's redistributive potential.

- **Ensure that states' expenditure and revenue assignments align**, through greater mobilisation of own source revenues and more predictable federal transfers. This will

enable subnational governments to deliver effectively on their responsibilities and will increase legitimacy and accountability of subnational governments.

The JPA foresees greater subnational government borrowing powers, but this must be approached with caution as irresponsible borrowing could jeopardise the entire country's macroeconomic stability. Until sufficient safeguards and regulatory frameworks to govern subnational government borrowing are in place, allowing borrowing is very risky. In any event, borrowing to finance budget deficits should not be allowed, as this fuels inflation, but borrowing for productive investments should be viewed more favourably.

- **Divide up the revenue pie more equitably and transparently among states**, both on a per capita expenditure basis, but also with a view to addressing historical development inequities in the country. An evidence-based, objective, and transparent system for the allocation transfers is vital. The establishment of the National Revenue Commission to ensure revenues are shared transparently and in an equitable manner (both vertically and horizontally) is a critical element.
- **Allow states greater autonomy in fiscal decision-making**, despite some degree of continued reliance on federal transfers, greater use of unconditional grants for all states will minimise scope for the central government to enforce rules and requirements over subnational expenditure.
- **Improve transparency of revenue information, as well as data quality for evidence-based decision-making**. The lack of reliable, timely and publicly available data in Sudan limits evidence-based policymaking and constrains the ability of civil society and Sudanese citizens to monitor revenue flows and hold government accountable for performance. Improved collection and availability of fiscal data at all levels of government would go a long way to improve decision-making, as well as transparency and accountability.

The road to an effective fiscal federalism in Sudan will be a long one. The different components – expenditure assignment, revenue assignment, intergovernmental transfers, borrowing, and federal/central government influence over subnational/state decision-making – have to be tailored to Sudan's current situation, including the formal and informal levers that influence the country's political economy.

Moreover, fiscal federalism efforts should be sequenced in a way that takes into account the capacity of states and local governments to administer their expenditure and revenue responsibilities. Finally, and most importantly, the expectations surrounding fiscal federalism should be carefully managed – it is not a panacea. Rather, it can be a valuable part of a much broader reform programme to support Sudan's transition out of fragility and towards more democratic and accountable governance.

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