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FISCAL DECENTRALIZTION IN THE SUDAN:

CONCEPTS AND CHALLENGES

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ABSTRACT

In May 2003 the Government of Sudan and the Sudanese People's Liberation Movement signed a series of peace accords ending the nation's 20-year civil war. The peace protocols set out a framework for peace, which will require a substantial restructuring of the federal system of government in the Sudan. The first section of this paper outlines the potential benefits of decentralization. The following section then discusses the implications of the peace protocols for the restructuring of the federal system in the Sudan.

INTRODUCTION

The Sudan is characterized as a federal country – there is a central government, a number of state governments, and local governments. The peace protocols ending Africa's longest running civil war, which were signed in Naivasha, Kenya in 2004, lay out a set of institutional arrangements that will significantly impact the nature of the federal system in the Sudan. The constitutional, legislative and policy initiatives undertaken over the next several years will greatly impact the nature and character of federalism in the Sudan. As a result, important questions arise that require identification and debate within the Sudan as a new federal system emerges.

Federalism is a structure, a process, and a culture. Federalism is often seen as a political solution to common problems facing a segmented population. Yet it is an answer to territorial segmentation of society, and is responsive to cultural autonomy of language, ethnicity, culture and so on, only to the extent that these cultures coincide with geographical boundaries of the territorial communities.[1]

The Power Sharing Protocol signed in Naivasha, sets out the institutional framework for the Sudan in the Interim period and after. In addition, the protocol sets out guiding principles for the distribution of powers and the establishment of governmental structures. The most important feature of the Power Sharing Protocol is the statement that the signatories to the protocol agree, "decentralization and empowerment of all levels of government are cardinal principles of effective and fair administration of the country." Section 1.5.1.1 states "There shall be decentralized system of government with significant devolution of powers, having regard to the National, Southern Sudan, State and Local levels of government."

The Wealth Sharing Protocol states that one of the guiding principles in the agreement on an equitable sharing of common wealth is that "revenue sharing should reflect a commitment to devolution of power and decentralization of decision-making in regard to development, service delivery and governance." Further elaboration of a system of revenue sharing in the New Sudan is discussed in the Protocol on the Resolution of Conflict in Southern Kordofan/Nuba Mountains and Blue Nile states. Specifically, Section 8.1 of the protocol says the national wealth shall be shared equitably between different levels of government so as to allow enough resources for each level of government to exercise its constitutional competencies. Section 8.10 makes reference to the development of comprehensive equalization criteria to be used in allocating intergovernmental grants.

The purpose of this paper is to briefly review the benefits of fiscal decentralization and the development of autonomous local self-governments and discuss some of the challenges to successful decentralization in transition countries. That is followed by a discussion of the various peace protocols and the implications they have for decentralization in the Sudan.

[1] See for example, Wolf Linder, ***Swiss Democracy: Possible Solutions to Conflict in Multicultural Societies***, Second Edition, Palgrave Macmillan, 1998 – especially Chapter 2 and pp. 153-66; and Advisory Commission on Intergovernmental Relations, ***The Condition of Contemporary Federalism: Conflicting Theories and Collapsing Constraints***, Report A-78, Government Printing Office, Washington D.C., August 1981.

RATIONALE AND BENEFITS OF DECENTRALIZATION[2]

Decentralization is a complex phenomenon that means different things to different people. Fundamentally, however, it is concerned about the relationship between the central government and subnational governments along a number of different dimensions – e.g., fiscal decentralization, political decentralization, administrative decentralization. Initiatives for decentralization along each of these dimensions proceed at their own pace and each has its own objective. While we are interested in fiscal decentralization, it is difficult to separate it from the other dimensions of decentralization. However, the following typology helps clarify the concept of fiscal decentralization:

- ***devolution*** involves independent subnational governments which are given responsibility for determining the level and quality of services to be provided, the manner in which those services will be provided, and the source of funds to finance the delivery of those services;

- ***deconcentration*** involves the decentralization of central government ministries with decision making authority either vested in the regional offices or maintained by the central office; and

- ***delegation*** of authority lies between devolution and deconcentration and involves independent subnational jurisdictions which are given service delivery responsibilities, but are subject to supervision by the central government regarding the level and quality of service to be provided, how the service is to be provided and/or how the service is to be financed.[3]

In the Sudan, the Power Sharing Protocol makes explicit reference to the ***devolution*** of powers to subnational governments.

In the final analysis, however, the nature of devolution achieved in the Sudan will reflect the outcome of what will be fundamentally a bargaining process between the central government and those interested in developing autonomous local self-governments as a new national constitution is developed and a model constitution is developed for state governments. In this context, it should be recognized that there are different degrees to the centralization/decentralization continuum; there is not a simple dichotomy between the two alternatives.[4] Decentralization proceeds in stages and must be understood in the context of other factors such as the state of the economy.

2 This section draws, in part, from Michael E. Bell and Charles F. Adams, Fiscal Decentralization Indicators: Local Democratic Governance, Prepared for the Open Society Institute, Local Government and Public Service Reform Initiative, Budapest, Hungary, March 9, 1999.

3 Richard M. Bird, Robert D. Ebel, and Christine I. Wallich (editors), Decentralization of the Socialist State: Intergovernmental Finance in Transition Economies, The World Bank, Regional and Sectoral Studies, Washington D.C., 1995, op. 11-3.

Government has three important economic problems to resolve in a market economy -- to attain an equitable distribution of income, to promote and maintain a high level of employment with stable prices, and to facilitate the efficient allocation of resources in the face of market failure resulting from externalities. While the activities of local governments affect all of these objectives, local governments play a particularly important role in the allocation of resources in the face of market failure. In this context, public finance literature includes several economic arguments in favor of the devolution of spending and revenue raising responsibilities to subnational jurisdictions:

- Ø decentralization of service delivery and financing responsibilities (fiscal decentralization) makes the level and quality of services provided by government more responsive to the differences that exist across communities;

- Ø decentralization encourages experimentation and innovation in the provision of public goods and services which respond to the demands of their citizens -- and their unique economic, demographic, climatic, and topographic conditions; and

- Ø decentralization of service delivery and finance decisions provides the opportunity to more closely link the level and quality of service provided with the "price" paid by the local resident for those services, thereby improving governmental accountability, responsiveness and, ultimately, its legitimacy.[5]

The most common argument advanced in favor of fiscal decentralization is the attainment of allocative efficiency in the face of different local preferences for local public goods and services.[6] When local government provides public goods and services, tax and benefit packages should reflect the preferences of the community. If subnational governments can tailor their tax and service package to the preferences of their citizens, efficiency and social welfare are likely to be maximized.[7]

Fiscal decentralization, however, is not without its critics. For example, some argue that the efficiency argument for decentralization operates entirely within the paradigm of individual preferences – it ignores the possibility of the legitimacy of overriding "national interests."[8] Similarly, it is argued that the efficiency argument for decentralization ignores the possible legitimacy of other values such as equity and social integration.[9] Some argue that

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4 Harold Wolman, "Decentralization: What Is It and Why We Should Care," in Robert J. Bennett, Decentralization, Local Governments, and Markets, Clarendon Press, Oxford, 1990, p. 31.

5 Wallace Oates, Fiscal Federalism, Harcourt, Brace, and Jovanovick, Inc., New York, 1972; J. Owens and G. Panella (editors), Local Government: An International Perspective, North Holland, 1991; and Litvack, Ahmad, and Bird, Rethinking Decentralization, The World Bank, Sector Studies Series, Washington, D.C., 1998.

6 Litvack, Ahmad, and Bird, Rethinking Decentralization, p. 5.

7 Wolman, "Decentralization: What It Is and Why We Should Care," p. 30-1.

8 Ibid., p. 31-2.

9 Ibid., p. 32.

decentralization may compromise national macroeconomic goals.[10] Finally, some argue that the benefits of fiscal decentralization may not be realized, and efficiency and equity issues made worse, because of the domination of local political elites, corruption, and the lack of an adequate enabling environment at the community level.[11]

Unfortunately, there is not sufficient empirical information to verify or refute these suggested caveats of fiscal decentralization. In this context, much of the debate about decentralization reflects "a curious combination of strong preconceived beliefs and limited empirical evidence."[12] Much remains to be learned in this area involving research that would greatly benefit from the development of indicators of decentralization that are consistent across many different countries. There is, however, another important caveat to fiscal decentralization.

The efficiency benefits of fiscal federalism depend to a large extent on citizens making their preferences know to local decision-makers. Typically, there are two mechanisms for expressing those preferences. First, citizens express their preferences at the ballot box by voting for those candidates that they feel most accurately understand and represent their interests. Citizens may also make their views known through other mechanisms like public hearings. This is what Hirschman refers to as ***voice***.[13]

Second, families and businesses make location decisions based, at least in part, on consideration of the level and quality of services provided by individual jurisdictions and how those services are financed. If they do not like the package of local taxes and benefits provided they have the option to ***exit***, or vote with their feet, by leaving the jurisdiction for another jurisdiction with a preferred package of taxes and benefits.[14] This option, however, is only effective to the extent that sufficient alternative packages of public goods and taxes exist to satisfy the wide range in demands across all individuals.

In addition, both Hirschman's exit option and Tiebout's voting with your feet option for revealing preferences for local services depend on the mobility of families and businesses. Unfortunately, however, these mechanisms for providing feedback to local officials and councilors may not be available in countries like the Sudan where housing and jobs are scarce and mobility extremely limited. Thus, to obtain the efficiency benefits of fiscal decentralization, political decentralization is critically important so citizens can exercise their voice option. So while decentralization is concerned about the relationship between the central government and

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10 Litvack, Ahmad, and Bird, Rethinking Decentralization, p. 5. An alternative perspective on this issue is provided by Robert D. Ebel and Serdar Yilmaz, ***On the Measurement and Impact of Decentralization***, The World Bank, Policy Research Working Paper, 2809, March 2002.

11 For a summary of these arguments see Jorge Martinez-Vazquez and Robert McNab, Fiscal Decentralization, Economic Growth, and Democratic Governance, School of Policy Studies, Georgia State University, Atlanta, Georgia, (no date), pp. 26-31.

12 Litvack, Ahmad, and Bird, Rethinking Decentralization, p. 3.

13 Albert Hirschman, Exit, Voice, and Loyalty, Harvard University Press, Cambridge, MA., 1970.

14 In addition to Hirschman, see Charles Tiebout, "A Pure Theory of Local Expenditures," Journal of Political Economy, Vol. 64, October 1956, pp. 416-24.

local government, local democratic governance is concerned about the relationship between the citizen and local government institutions, officials, and councilors.

But such fiscal decentralization faces many challenges in transition countries like the Sudan. For example, Remy Prud'homme[15] acknowledges that decentralization initiatives have enormous potential, but he is concerned that they must, however, be properly designed and implemented if they are to realize their potential efficiency benefits. In this context, Paul Smoke[16] argues that decentralization is an integrated exercise, so that institutional, political, and managerial reforms are essential for successful fiscal decentralization. Smoke argues that typical problems confronted during a process of fiscal decentralization include, but are not limited to:

1. The existing institutional framework within a country is often complex and poorly coordinated. Policies of sectoral ministries may not be consistent with fiscal decentralization.
2. There are rarely strong political or bureaucratic incentives for decentralizing.
3. There is often a critical lack of managerial and technical capacity at the state and local level to address new responsibilities under a system of fiscal decentralization.
4. There is often a serious lack of government accountability to local constituency.

Pranab Bardhan[17] identifies other issues that are important for creating an enabling environment for successful decentralization in transition economies like the Sudan:

- The crucial assumption of population mobility as a means of revealing preferences largely fails in poor countries.

- The information and accounting systems and mechanisms for monitoring public bureaucrats are much weaker in developing countries.

- The institutions of local democracy and mechanisms of political accountability are often weak in developing countries with local institutions often captured by elite groups or affected by corruption. However, if local governments are less prone to capture than the central government, decentralization may improve efficiency and equity.

- The general argument for decentralization rests with the efficiency benefits, but in developing countries the policy objective may be redistributive to benefit the poor.

- There often is only a tenuous link between revenue raising and spending decisions. In most countries the more powerful elastic revenue sources lie with

[15] Remy Prud'homme, *On the Dangers of Decentralization*, Policy Research Working Paper 1252, World Bank, Washington D.C., February 1994.
[16] Paul Smoke, "Strategic Implementation of Fiscal Decentralization in Developing Countries," National Tax Association, Proceedings of the 94th Annual Conference, Baltimore, MD 2001, pp. 48 – 56.
[17] Pranab Bardhan, "Decentralization of Governance and Development," *Journal of Economic Perspectives,* Fall 2002, Volume 16, Number 4, pp. 185-205.

the central government. Income and economic activity are concentrated in a few major cities.

In the final analysis, then, attention must be focused on creating an enabling environment at the local community level necessary for the successful devolution of responsibility to subnational governments. A well-developed legal framework is necessary, but not sufficient, to ensure good local government performance. Without increased accountability through local political reform, fiscal and administrative decentralization cannot ensure that local governments will be more responsive to their constituents. Without responsiveness to citizens, the potential benefits of decentralization are unlikely to be realized.

In addition to traditional interventions to build administrative and managerial capacity of local governments and promote accountability and transparency at the local government level, there are other key components of an enabling environment that must be addressed in order to fully achieve the potential benefits of fiscal decentralization. Among others, these additional key components of an enabling environment include:

1. Improving the level, quality, timeliness and availability of data for local decision makers.[18]
2. Interventions to empower citizens to become more proactive in identifying and addressing community concerns.[19]
3. Development of own-source revenues for local governments – especially a local property tax of some sort.[20]
4. Building of technical and human capacities at both state and local levels in areas of resource mobilization and management.

DECENTRALIZATION ISSUES IN THE SUDANESE PEACE PROTOCOLS

The previous section discussed the general framework and potential benefits to be derived from an effort to devolve revenue raising and spending responsibilities to subnational jurisdictions. The discussion was general. The specific implications of such an initiative for the Sudan start to emerge from a close reading of the peace protocols signed in Naivasha, Kenya which presented a framework for ending the continent's longest running civil war. The peace accords have significant implications for fiscal decentralization and intergovernmental relations in the Sudan.

The ***Power Sharing Protocol*** defines the institutional framework for the Interim period and establishes agreed upon human rights and fundamental personal freedoms. A crucial feature of the protocol is the commitment to a decentralized system of government. A framework for such a system needs to be developed in the context of the culture, politics and history of the

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[18] See for example, Yilmaz, Hegedus and Bell (editors), ***Subnational Data Requirements for Fiscal Decentralization: Case Studies from Central and Eastern Europe***, World Bank Institute, 2003.
[19] See for example, John Field, ***Social Capital***, Routledge, 2003.
[20] See for example, Michael E. Bell, ***Designing and Implementing a Property Tax System: Policy and Administrative Issues***, prepared for the World Bank Institute, November 11, 2003.

Sudan. This is particularly important in the context of developing roles and responsibilities for local self-governments in the Sudan. The National Constitutional Review Commission may need support in drafting model constitutions for the states that create and empower local governments and their citizens.

In addition to developing a decentralization strategy, there is a need to invest in local communities so that they have the capacity to undertake their new responsibilities under a system of fiscal decentralization. There is a need to strengthen the enabling environment at the community level so that any system of fiscal decentralization will realize its full potential. This includes strengthening the role of the citizen in identifying and addressing community concerns and strengthening the accountability of local officials.

Similarly, one of the guiding principles in the ***Wealth Sharing Protocol*** on an equitable sharing of common wealth is that "revenue sharing should reflect a commitment to devolution of power and decentralization of decision-making in regard to development, service delivery and governance." In an effort to implement these guiding principles, there is a need for an explicit, well-articulated fiscal decentralization strategy that includes discussion of an intergovernmental grant program to address vertical as well as horizontal imbalances in the system. No such framework is included in this protocol.

The ***Wealth Sharing Protocol*** provides a detailed breakdown of own-source revenues for each level of government. However, to implement the responsibilities outlined in the various schedules all levels of government must radically reform their budgetary processes and will need significant capacity building in that regard.

The net result of the provisions of the Wealth Sharing protocol is that the Government of Southern Sudan will be entitled to revenues from

- A share of revenues collected by the Government of National Unity as spelled out in the section on equalization and allocation of revenues collected nationally;
- Revenue sources enumerated for state/regional governments; Southern Sudan Government taxes and service charges;
- The Southern Sudan Reconstruction and Development Fund;
- Oil revenues as described above;
- Taxes and levies on small and medium businesses;
- Southern Sudan personal income tax;
- Grants in aid and foreign assistance;
- Other taxes as agreed to from time to time; and
- Borrowing.

In terms of the Government of Southern Sudan, and the states in Southern Sudan, actually implementing these revenue sources, at least in the near term, there are important capacity issues. First, there are concerns regarding the capacity of state/regions and the Government of Southern Sudan to deliver services and conduct the revenue administration functions implicit in the implementation of this protocol. This is especially critical in the context of Section 12 of the

Wealth Sharing protocol that requires all levels of government to comply with generally accepted accounting standards and procedures.

Second, there is an issue of how well developed the bases for these various revenue sources will be – including the bases of taxes collected by the National Government and shared with the Government of Southern Sudan through the National Revenue Fund. Even if there were perfect revenue administration, these revenue sources may not generate sufficient revenues because of the current low level of economic development in the south. There is a serious question of how robust these own-source revenues will be for the Government of Southern Sudan and the states in the south.

In this context, David Nailo Mayo argues that the allocation of competencies between the Government of National Unity and the Government of Southern Sudan explicitly articulated in the Power Sharing protocol, in conjunction with the revenue assignments explicitly enumerated in the Wealth Sharing protocol result in what he describes as "asymmetrical fiscal federalism' or unequal power relationships between the National Government and the Government of Southern Sudan. The resulting vertical and horizontal imbalances in the system are a major concern especially in the Interim period.

Section 8 of the Wealth Sharing protocol creates the Fiscal and Financial Allocation and Monitoring Commission (FFAMC) but this section outlines primarily monitoring duties and responsibilities for the FFAMC. Section 8.2.1 makes reference to the FFAMC's responsibility to "Monitor and ensure that equalization grants from the National Revenue Fund are promptly transferred to respective levels of government." Section 8 also makes provisions for the FFAMC to ensure appropriate utilization and sharing of financial resources. While this responsibility is not elaborated on here, it does get clarification in the protocol on South Kordofan/Nuba Mountains and the Blue Nile states where the FFAMC is tasked with allocating current transfers to Southern Kordofan/Nuba Mountains, Blue Nile and other war-affected areas and least developed areas according to the specific criteria.

Each state will be represented on the Fiscal and Financial Allocation and Monitoring Commission (FFAMC), which shall ensure transparency and fairness in the allocation of national resources to the states. The FFAMC shall allocate current transfers to Southern Kordofan/Nuba Mountains, Blue Nile and other war-affected areas and least developed areas according to the following criteria

- Population;
- Minimum expenditure responsibilities;
- Human development index – social indicators;
- Geographical areas;
- Fiscal effort; and
- The effect of war factor.

Thus, there needs to be more discussion of the equalizing grants referred to in Section 8 of the Wealth Sharing protocol – e.g., there needs to be some discussion of which governments actually will receive such grants, how the allocation of such grants will be determined, how such grants will be funded, by which level of government, etc. What sort of vertical and horizontal equalization is intended and how will it be achieved?

In addition, a National Reconstruction and Development Fund (NRDF) is created to develop war affected areas and the least developed areas in the Sudan with the aim of bringing them to the national average standards and level of development. In allocating the funds to war-affected areas, NRDF shall use the effects of war and level of development as the main criteria. The allocation of these funds among the areas affected shall be determined during the Pre-Interim period by the Joint National Transition Team (JNTT). More work needs to be done on how these funds should be allocated across states.

A special case exists for the areas of Southern Kordofan/Nuba Mountains and the Blue Nile, which are treated as two independent states in the peace protocols. Given the service delivery and revenue raising responsibilities assigned to these two states by the peace protocols, a number of critical public finance and intergovernmental issues emerge which must be dealt with immediately for this protocol to be successfully implemented. For example,

- Legislation needs to be developed in each state to establish the organization and proper functioning of local governments in that state. Such legislation will have to deal with the allocation of service delivery and revenue raising responsibilities as well as intergovernmental transfers to local governments – both for equalization and development purposes.
- State and local governments need to develop revenue administration systems that deal with policy formulation; budget development, execution and monitoring; financial management, procurement and accounting; asset management; and internal controls to avoid corruption.
- The national government needs assistance in developing a system of intergovernmental grants that will be equalizing and take into consideration expenditure needs, fiscal capacity and fiscal effort.
- State and local governments will need to mobilize own-source revenues, which include the development and implementation of a local property tax.
- The FFAMC and the JNTT will need assistance in developing allocation criteria and formulas for the various funds that are to be distributed to these two states.

SUMMARY AND CONCLUSION

In summary, implementing the peace protocols requires a modification and fine-tuning of the system of fiscal decentralization in the Sudan. The peace protocols stress the need to distribute funds equitably across states and consider many factors in the allocation formula including the tax effort of state and local governments.

A system of intergovernmental grants is part of a larger, more comprehensive, system of fiscal decentralization. To realize the equalization and efficiency objectives of a revised intergovernmental grant system, the overall system of fiscal decentralization must be implemented effectively. To realize the potential benefits of a system of fiscal decentralization, it is assumed that there is in place at the community level a certain enabling environment that facilitates the effective and efficient devolution of revenue raising and spending responsibilities to local governments. Research has shown that it is important to have a vibrant civic society at the local level. Putnam and others have shown that nurturing social connections among citizens and linkages among citizens, governments, and non-governmental organizations is a critical step in building the social fabric that under girds public and private institutions in robust democracies and strong economies. In order for the institutions of government to work effectively and efficiently, there needs to be a strong civic society at the local level.[21]

While initiatives should be undertaken to strengthen civic society, there are other critically important elements of the enabling environment that also must be in place. Specifically, a first step to be taken is to ensure that state and local governments are able to collect the maximum amount feasible from their current system of own-source revenues. A second step is to ensure that the limited funds collected by state and local governments from own source revenues are spent as effectively as possible. Step 1 requires strengthening revenue administration and strengthening the role of the local property tax. Step 2 requires strengthening the local budget development, execution and monitoring process.

[21] For a fuller discussion of these issues see John Field, ***Social Capital***, Routledge, London and New York, 2003.