

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: PIDA61830

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|---|---|
| <b>Project Name</b>                                   | Strengthening Sub-national Fiscal Policy Management (P156750) |
| <b>Region</b>   | AFRICA  |
| <b>Country</b>  | Sudan   |
| <b>Sector(s)</b>                                      | Sub-national government administration (100%)                 |
| <b>Theme(s)</b>                                       | Macroeconomic management (100%)                               |
| <b>Lending Instrument</b>                             | Investment Project Financing                                  |
| <b>Project ID</b>                                     | P156750   |
| <b>Borrower(s)</b>                                    | Ministry of Finance & National Economy                        |
| <b>Implementing Agency</b>                            | Ministry of Finance & National Economy                        |
| <b>Environmental Category</b>                         | C-Not Required  |
| <b>Date PID Prepared/Updated</b>                      | 10-Mar-2016   |
| <b>Date PID Approved/Disclosed</b>                    | 20-Jun-2016   |
| <b>Estimated Date of Appraisal Completion</b>         | 31-Mar-2016   |
| <b>Estimated Date of First Grant Approval</b>         | 08-Jun-2016   |
| <b>Appraisal Review Decision (from Decision Note)</b> |   |

**I. Project Context**

**Country Context**

1. Sudan is rich in terms of natural and human resources, yet the country is marked by deep poverty with significant variations in poverty levels across states. The country is endowed with large oil and mineral endowments as well as tremendous under-utilized natural assets in agriculture (e.g. fertile land, labor force, water resources and irrigation infrastructure) that potentially provide a good basis for sustainable inclusive growth.

2. Widespread poverty persists and remains serious problems. Poverty estimates set the average rate of poverty incidence at 46.5 percent (2009 National Baseline Household Survey), indicating that some 15 million people are poor. The poverty rate is significantly higher in rural areas (58 percent) than in urban areas (26 percent), and varies markedly across states, from 26 percent in Khartoum state to above 60 percent in peripheral states such as North Darfur, South Kordofan, and Red Sea.

3. Inequalities in access to basic service outcomes are wide between states and within states; between urban and rural areas and between war-affected and peaceful areas, with little evidence of improvements in social indicators such as educational enrolment or infant mortality (State-level

PER 2014). This is aggravated by Sudan's service delivery function which is still compromised by low levels of public spending, shortage of relevant personnel and dilapidated infrastructure.

4. Sudan's limited ability to manage natural resource rents, sustained and multiple conflicts, and weaknesses in public service provision contributed to meager outcomes in the areas of poverty reduction and human development (Sudan CEM 2016).

5. Weaknesses in public service provision. Progress in addressing the wide regional disparities in public service provision remains limited. Sudan ranked at 165th and 166th out of 187 countries in 2015 and 2014 respectively in the UNDP Human Development Index, falling from its 169th ranking in 2011. A number of individual MDG-related indicators remain a major challenge, with regional disparities in outcomes. Net primary school attendance rate is only 76 percent and this masks huge disparities across states and urban/rural areas. The child mortality rate (deaths per 1,000 births) is highest in Darfur (170) and lowest in Gezira State (63), while the national average is 111.

6. Access to safe water sources remains a problem throughout the country, although access is generally much better in the cities than in rural areas. On average, about 14 percent of households in Sudan in 2010 still relied on unprotected water sources for drinking (including unprotected wells or springs and unfiltered open water from rivers, streams and ponds), compared with 36 percent in 2006. However, large discrepancies across states still remain. For example, lack of access to improved drinking water sources in the three poorest performance states is almost more than five times worse than rates in the best three performance states. The cases of West Darfur (43 percent), Blue Nile States (33 percent) and South Kordofan (24 percent) are particularly striking, compared with the case of Sinnar (6 percent), Al-Gezira (3 percent), and Khartoum (zero percent).

7. Ability to manage natural resource rents. Looking back at the oil boom of 1999–2010, Sudan missed a chance to build the foundations of a vibrant non-oil economy. While new flows of revenues from the rapidly growing oil resource rents and favorable weather helped to improve the broad macroeconomic situation, poverty has shown no signs of abating. The size of the Sudan's economy has grown fivefold—from \$10 billion in 1999 to \$53 billion in 2008. Overall revenue has grown threefold—from 6 percent of GDP in 1996 to 20 percent of GDP in 2008. Per capita income has increased from \$334 to \$532 (constant 2000 USD) over the same time period (Sudan CEM 2009). However, oil reserves were not converted into equivalent public investments in education and infrastructure. During the oil boom, Sudan was heavily reliant on the oil sector and failed to diversify its economy. In short, the oil boom masked the fact that the economy was geared towards consumption and imports, rather than production and exports, an unsustainable growth path. (World Bank: Sudan Economic Brief, January 2013.)

8. The heyday of the oil economy ended abruptly following the secession of South Sudan in 2011, and economic diversification is at center-stage again; the signs of natural resource rents have changed. With the secession, the country lost about 75 percent of its revenues and most of its predominant economic activity: crude oil exports. Sudan's post-secession adjustment was primarily managed via the fiscal side. Rising deficits were countered through fiscal austerity and central bank financing. The latter had a significant impact on inflation, which was further fueled by significant exchange rate adjustments in 2012 and 2013. Two subsequent rounds of nominal adjustments with a combined nominal depreciation of 100 percent pushed the exchange rate to 5.7 SDG/USD in 2013 thereby increasing the import bill and further fueling inflation.

9. Sustained and multiple conflicts. Violent conflict, especially rebellion against the center and armed response by the state, is a direct contributor to the extreme poverty in Sudan's conflict-affected areas in spite of Sudan's robust resource endowment (Sudan CEM 2016). Sudan has been in conflict for most of its independence history. The costs of conflicts have been heavy, especially on the civilian populations that have been denied social and economic development. The conflict has also caused large economic losses and loss of opportunities. Road infrastructure, water and electricity supply, schools, hospitals, public buildings, and so forth need to be reconstructed almost from scratch in the war-affected areas. Loss of opportunities is difficult to quantify, but it certainly poses large developmental opportunity costs. Alternative and more productive activities could have taken place if military costs had been reallocated; if institutions had not collapsed; and if trade routes, communication, and good governance had been normalized. While the defining conflict between the northern and southern regions was largely resolved by the secession of the latter to form the Republic of South Sudan in July 2011, tensions still remain. The peace dividend is therefore potentially large, in monetary and nonmonetary measures alike.

10. Debt burden and impact of economic sanction. Securing debt relief has the potential to open up new channels of finance to support the development agenda. Sudan's huge stock of external debt, most of which is in arrears, further limits the government's ability to provide basic social and economic services to the large number of poor and vulnerable people. Normalization with the rest of the world and debt relief would not only mean that Sudan could potentially access significant external assistance resources and sophisticated technology for factor inputs, but it could also improve Sudan's terms of trade and potential to explore currently closed external markets. Simulations carried out for the CEM using the DEC NMAMS model show that the welfare impact of normalization and debt relief is positive and increased household consumption would lower poverty by about 7 percentage points in 2030 compared to the base scenario. Normalization translates into a 16 percent increase in real household per-capita consumption in 2030, with the strongest impact from improved terms of trade, followed by debt relief and increased aid. The increases in household consumption bring about a 7 percentage point reduction in poverty in 2030 compared to the base scenario. But the envisioned HIPC debt relief process is slow and requires renewed emphasis of the Government on reaching out to creditors, normalizing relations with international financial institutions, and continuing to establish a track record of cooperation with the IMF on policies and payments.

### **Sectoral and institutional Context**

11. Sudan has undergone a process of decentralization since the early 1990s that assigned basic service provision to subnational levels. Fulfilling the vision of decentralization is vital to potentially address the weak record on human development outcomes and wide regional disparities, and relatedly, the underlying structural causes of conflict in a peaceful post-secession Sudan –which are required for:

- reducing poverty incidence;
- accessing basic services and reducing regional disparities in key human development outcomes; and
- attaining sustainable broad-based development and employment creation.

12. Decentralization has devolved a number of key responsibilities to the sub-national governments; particularly vis-à-vis publicly funded pro-poor activities. States have increasingly become the nation's key administrative level to deliver basic public services. The path to successful

fiscal federalism in post-secession Sudan would therefore depend heavily on the quality and direction of development, in particular at the state-level. There can be no sustained economic development without major public development commitments to social sectors and improvements in major infrastructure (e.g., ports, airports, telecommunications, internet, electricity, large-scale water and sanitation facilities, and major roads) in order to promote large-scale private investments needed for economic growth.

13. Consistent with the Sudan’s Interim National Constitution (INC) devolving responsibility for basic service delivery to sub-national governments, federal transfers to states increased sharply from 6 percent of total spending in 2001 to over 25 percent since 2015. These overall resources allocation shifts are of interest as an instrument to address regional disparities and support decentralized delivery of basic services, given that most states are heavily dependent on federal transfers to finance more than one-half of budgetary assignments in wages and salaries. With more resource been transferred down to states, tremendous opportunities have been opened to accelerate progress toward the Sustainable Development Goals and address the wide regional disparities in access to basic service. This in turn stymies pro-poor spending, as enacted in the INC, shifts expenditure responsibilities for most of the public sector activities that directly benefit the poor – primary health, basic education, and water – to the state and local levels.

14. While political decentralization progressed, fiscal decentralization has lagged behind (State-level PER 2014). This has had a negative impact on state level governments to addressing widespread poverty and improving the quality of life of its citizens. While fiscal decentralization has brought considerable extra resources to the over the past ten years, these additional resources have not been adequately allocated and used in ways to smoothen the social and financial imbalances mostly due to weaknesses in public financial management system at the sub-national level. Available resources need to be managed well, both to encourage economic diversification and invest in the “owners” of the resources.

15. The distribution of real growth in social spending between 2000 and 2010 shows significant difference between the health and education sectors, with education spending being more pro-poor and health spending disproportionately benefiting people from relatively richer states. Figure 2 presents “growth-incidence curves” for health and education spending across states between 2000 and 2010, based on state accounts. These curves show the relationship between average growth rates in health and education spending as a function of baseline levels of health and education spending in each state. States located close to the origin are states with relatively lower levels of social spending per capita at baseline. This pattern would have required higher investments by the federal government over the past decade to counter some of the original unequal distribution of resources.

## **II. Proposed Development Objectives**

The development objective of the project is to improve the efficiency and effectiveness of state-level’s fiscal policy management and financial accountability processes, including credibility and transparency in the use of public funds and reduced opportunities for corruption in piloted states (Red Sea, River Nile, Sinnar, and North Kordofan).

## **III. Project Description**

### **Component Name**

Promoting greater equity in public resource use

**Comments (optional)****Component Name**

Improving efficiency of public resource use

**Comments (optional)****Component Name**

Promoting greater transparency and accountability in public resource use

**Comments (optional)****Component Name**

Promoting state-level revenue collection and management capacities

**Comments (optional)****Component Name**

Technical support to project management and implementation

**Comments (optional)****IV. Financing (in USD Million)**

|                                 |      |                       |               |
|---------------------------------|------|-----------------------|---------------|
| Total Project Cost:             | 5.00 | Total Bank Financing: | 0.00          |
| Financing Gap:                  | 0.00 |                       |               |
| <b>For Loans/Credits/Others</b> |      |                       | <b>Amount</b> |
| Borrower                        |      |                       | 0.00          |
| Single Purpose Trust Fund       |      |                       | 5.00          |
| Total                           |      |                       | 5.00          |

**V. Implementation****VI. Safeguard Policies (including public consultation)**

| <b>Safeguard Policies Triggered by the Project</b> | <b>Yes</b> | <b>No</b> |
|--|------------|-----------|
| Environmental Assessment OP/BP 4.01                |            | <b>x</b>  |
| Natural Habitats OP/BP 4.04                        |            | <b>x</b>  |
| Forests OP/BP 4.36                                 |            | <b>x</b>  |
| Pest Management OP 4.09                            |            | <b>x</b>  |
| Physical Cultural Resources OP/BP 4.11             |            | <b>x</b>  |
| Indigenous Peoples OP/BP 4.10                      |            | <b>x</b>  |
| Involuntary Resettlement OP/BP 4.12                |            | <b>x</b>  |
| Safety of Dams OP/BP 4.37                          |            | <b>x</b>  |

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|--|--|---|
| Projects on International Waterways OP/BP 7.50 |  | x |
| Projects in Disputed Areas OP/BP 7.60          |  | x |

**Comments (optional)****VII. Contact point****World Bank**

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