

# Final Report

Robert Klitgaard

Notes based on a meeting with international partners of Southern Sudan, Nairobi, May 7, 2004

This two-hour meeting was attended by about 30 members of donor organizations and NGOs and about 5 members of the SPLM. I was asked to make a presentation about how donors could insure that aid to southern Sudan “do no harm.” This seemed an odd, or at least an incomplete, way to think about helping people. But there are classic examples of aid doing harm, or at least being perceived that way. In many countries, a large influx of relief and development assistance tends to be associated with:

- Local resentment about the NGOs and technical assistance people (their relative wages, lifestyles, and influence).
- Poor planning and coordination among donors and recipients leading to such phenomena collocated clinics, imbalance, and even contradictory policies.

These will probably also be issues in southern Sudan. But I spoke instead about two rarer but not unknown issues. In this final report, I will focus on the first.

## Do No Harm

### 1. *The Resource Curse*

A large inflow of aid money itself resembles “resource curse”—especially when combined with oil revenues. Large natural resource revenues are known to cause distorted fiscal policies, such as excessive spending on prestige projects, inappropriate social spending, excessively low income taxes, and bloated military budgets. In addition, abundant natural resources can trigger rent-seeking or myopic behavior of policymakers, eventually leading to weakened, unrepresentative, or corrupt governments.<sup>1</sup> Figure 1 (at the end of the paper) provides a schematic depiction of what has been labeled “the resource curse.” What might Southern Sudan do to avoid the resource curse?

One approach to insulating oil rents from political gaming is to establish a legally sanctioned “oil fund,” which is a method of transforming a non-renewable into a renewable resource by investing oil rents in financial assets. Typically, these funds are composed of a mixture of domestic and foreign financial assets, and are conservatively managed. Current examples of such funds vary in their purpose and the degree of government involvement, such as the Alaskan and Norwegian Petroleum Funds.<sup>2</sup>

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<sup>1</sup> Michael L. Ross, *Does Resource Wealth Lead to Authoritarian Rule? Explaining the “Midas Touch,”* World Bank Research Group workshop on “The Economics of Political Violence,” Princeton University, March 18-19, 2000.

<sup>2</sup> For a review of these oil funds, see Rognvaldur Hannesson, *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production*, Quorum Books, Westport, Connecticut, 1998, pp.123-140.

The most independent petroleum fund in the world is probably the Alaska Permanent Fund, whose investment and withdrawal rules are enshrined in the Alaskan Constitution. At least 25 percent of oil revenue must be deposited into the fund, after which only the real return on the fund can be disbursed every year. All Alaskan residents, including children, typically receive a \$1,000 annual check in the mail from the Fund. The Fund is independent of the state legislature, and the statutes that govern the Fund's management can be changed only by popular vote. The Fund is known for its conservative investment strategy and a small and effective administration, whose operating expenses are roughly 1.5 percent of its total revenue. The income from the Fund in 2010 is expected to reach the value of state oil revenues at their peak in 1981.

The Norwegian Petroleum Fund, established by law in 1990, is different from the Alaskan Permanent Fund. The Norwegian Petroleum Fund is simply an account in the Bank of Norway, with no independent administration. Whereas the Alaskan Permanent Fund emphasizes the independent and the "permanent" nature of its operations, the Norwegian Petroleum Fund was established to make the government's use of oil revenue more explicit and transparent. For example, government budgets that are passed with deficits are automatically covered by the fund's assets, so that the Fund had no positive balance until 1996. Although the Norwegian Fund seems to have been handled properly over the past decade, its future success will depend on the discipline of future legislators much more than the Alaskan Fund.

Oil funds also exist in Azerbaijan, Kazakhstan, Kuwait, and elsewhere. The Alaskan Fund is unique in its legal independence from both the legislative and executive branches of government. Different degrees of independence are possible. A Norwegian model—in which the transparency of a government's budget is ensured, at least with respect to its use of oil rents—could be a useful tool for many oil-producing governments in promoting fiscal discipline and transparency. Furthermore, the addition of an egalitarian dividend policy places valuable pressure on a government to use these public funds wisely.

A recent effort by researchers to establish a "typology" of states and the political-economy of resource management may be a good starting point.<sup>3</sup> For example, Botswana is considered a success story in the management of mineral revenues through prudent fiscal and exchange rate policies.<sup>4</sup> Botswana has been able to produce National Development Plans, voted by parliament, that determine its spending. Botswana has been able to avoid excessive spending and external debt, particularly in anticipation of low resource-revenue years.

Mexico has also implemented innovative policies, such as hedging oil shocks by buying put options, selling oil futures and using oil swaps in order to ensure it received at least \$17 per barrel, for its 1991 budget.<sup>5</sup> One of the questions to be addressed is whether such a hedging strategy should be built into the budget process itself.

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<sup>3</sup> Benn Eifter, Alan Gelb, and N.B. Tallroth, "The Political Economy of Fiscal Policy and Economic Management in Oil Exporting Countries," World Bank Policy Research Working Paper 2899, October 2002.

<sup>4</sup> M. Sarraf and M. Jiwaji, *Beating the Resource Curse: The Case of Botswana*, *Environmental Economic Series*, Paper No. 83, October 2001.

<sup>5</sup> Eifter, 2002.

More recently researchers have proposed a more innovative version of the oil fund, as “virtual distribution”<sup>6</sup> or “direct distribution”<sup>7</sup> of oil revenues in order for oil money to “pass through the hands” of the population. For example, a government could mandate that all oil revenue be distributed as dividends to the population. However, this dividend would be taxable by the government, so that the government would retain some of this revenue for budget support, but the population would be able to hold the government more accountable, and the oil industry would be pressured to operate more efficiently. One researcher has proposed an Oil Revenue Distribution Fund for Iraq, along similar lines.<sup>8</sup>

In the case of “direct distribution” or “virtual distribution” oil funds, USAID could help Sudan evaluate the options, including implementation hurdles, potential administrative costs, and moral hazards. Who should receive the money? Every citizen? A possible consequence of an Alaskan-style oil fund is increased fertility rates if the dividend is also offered to children. Some have argued that such a dividend should be given to a subset of the population, such as women, or differentially applied to those regions that have suffered environmental (or other) externalities from natural resource production.

USAID and other Sudanese partners may help Sudan consider these various options.

What might the role of oil funds be in Sudan, particularly southern Sudan? What concrete lessons can the Sudanese learn from the experiences of Alaska, Norway, Kuwait, Azerbaijan, Kazakhstan, Mexico, and others? What are the advantages and disadvantages to constraining fiscal policy in such a way? For example, are there lessons from the successes and failures of budget earmarking in Ecuador and Columbia that could shed light on this? Should oil funds be allowed to provide budgetary support, targeted expenditures, or only pay dividends from returns on international financial assets in which the oil revenue is invested? Is there a reason why the revenues need to be invested in financial instruments only, rather than other types of investments that could be managed by private sector, or public agency?

## **2. Aid strategy and management**

In my two weeks of conversations, I heard a surprising amount of negative feedback from the Sudanese about aid. There are perceptions of corruption and mismanagement among the NGOs and contractors. There is unhappiness with the lack of transparency by the donor agencies—for example, in their budgets, their strategic plans, and their background documents about southern Sudan.

After I expressed this opinion at the workshop, some of the Sudanese leaders reinforced and explained these perceptions. Some donors responded, sometimes defensively. The conversation was lengthy and healthy. I believe two major points emerged.

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<sup>6</sup> Martin E. Sadbu, “Virtual distribution”: A proposal for alleviating the natural resource curse, Presentation at “Escaping the Resource Curse: Managing Natural-Resource Revenues in Low-Income Countries,” The Earth Institute, Columbia University, February 26, 2004.

<sup>7</sup> Arvind Subramanian, Directly Distributing Natural Resource Revenues, Presentation at “Escaping the Resource Curse: Managing Natural-Resource Revenues in Low-Income Countries,” The Earth Institute, Columbia University, February 26, 2004.

<sup>8</sup> Thomas I. Palley, “Combating the Natural Resource Curse with Citizen Revenue Distribution Funds: Oil and the Case of Iraq,” *Foreign Policy in Focus*, December 2003.

First, relief aid has been the norm till now. After peace, the mix may switch to more development aid. This will enable different relationships between donors and southern-Sudanese leadership. It will enable more permanent investments by the donors. It will enable less collocation of donor activities, which in the past was sometimes done for security purposes. Some of the tensions and problems perceived so far may be reduced in the transition from relief aid to development assistance.

Second, everyone agreed on certain principles for the future. Some were large and obvious principles, such as partnership and transparency. The donors should fit their abilities and plans into the broader strategic plans of the southern Sudanese government. Others were narrower principles. For example, when donors and their experts interview Sudanese, those interviewed seldom receive copies of the reports eventually produced; everyone agreed that they should. For example, the donors should be as transparent with their plans, budgets, and evaluations as they expect the southern Sudanese to be.

## **Do Great Good**

Apart from doing no harm, donors and southern Sudanese should think about how to do great good. The challenges in Sudan are not (just) incremental ones—not just a few more roads and a few more agricultural rehabilitation projects. Rather, there is the challenge of building effective self-government.

The broadest vision of the challenge facing southern Sudan might be expressed in the framework of Max Weber: the transition from a traditional form (or forms) of governance to what Weber called a rational form.

The former includes customary authorities as well as SPLA leadership. Over the period of the war, these traditional forms of authority have usually not had to be accountable. Their methods for raising and spending revenues have often been driven by emergency needs. These conditions are breeding grounds for mismanagement and worse. In the new Sudan, the SPLM leaders have said that a priority is moving governance to more accountability, predictability, and “rationality.”

Annexes 1 and 2 present materials I used at two workshops. One workshop had about 40 Sudanese leaders for two days in Rumbek, Sudan. The other included about 35 leaders for one day in Naivasha, Kenya. Annex 1 presents an imaginary news story dated 2007. This story describes southern Sudan as a success story. The story contains imaginary quotes from luminaries such as James Wolfensohn and from made-up experts and officials. At these workshops, participants were asked how southern Sudan might get from “now” to “then.” The exercises varied by workshop. In the Naivasha workshop, the leaders divided into three groups and came up with the lists of needed steps that appear in Annex 2.

In the discussion of these lists that followed, a major theme emerged, sometimes emotionally. I would say that this theme is exactly how to move from the traditional methods of governance necessitated by war to rational methods required by accountable, people-centered development.

Doing this will not be easy, but I was heartened by the evident sincerity and passion of Sudanese leaders to make the effort. The donors are also keen to enable good governance. The question is, how?

One way is what might be called the usual capacity-building strategy. It emphasizes training for the new officials of the southern Sudanese government, technical assistance in key areas of

administration, more computers, better record-keeping, and clear administrative rules and regulations. All of these are important, but they are not sufficient in the difficult context of southern Sudan.

So, at this workshop I floated several more radical ideas for discussion by donors and the SPLM leaders present. The objectives are:

- to sideline the SPLA and involve them in productive activities and not in government;
- to get cash into an almost cashless economy;
- to take steps that demonstrate to the citizens that things have changed and they are benefiting (in particular from the oil revenues and the international aid); and
- to create a core of qualified, well-paid government leaders who are financially able to withstand “forced corruption” (based on sheer need).

Ideally, after three years of aid we want things to look less like the first column of Table 1 and more like the second column.

**Table 1**  
**Scenarios after Three Years**

	<b>Undesirable Results after 3 Years</b>	<b>Desirable Results after 3 Years</b>
<b>Role of SPLA</b>	Leaders are widely involved in governance, including informally. Ex-soldiers resentful about lack of opportunities turn to crime.	Many leaders are pensioned off from the SPLA and with their nest eggs are engaged in farming and small businesses. Ex-soldiers are soaked up in public works (and private economic activity).
<b>Cashless economy retards growth</b>	Still a lack of liquidity. People perceive that only rich people and foreigners have cash.	Infusions of cash through transfer payments (oil fund), credit programs, and public works.
<b>Perceptions of self-government</b>	Nothing has really changed. Local economies are still stagnant. Leaders are distant and perceived as concerned with their own in-fighting. Oil revenues are pilfered or misspent.	A lot has changed: we see public works, we see cash at the grassroots level, and we have ample communication with our leaders. Oil revenues are transparently “locked up” on behalf of the people.
<b>Top civil service</b>	Cannot attract or retain highly qualified people for important roles. Government employment becomes bloated. Salaries are so low that people are forced to moonlight or be corrupt. Foreign advisers are resented, in part because their main job is not perceived to be capacity building.	Excellent pay and oversight create a cadre of highly qualified top officials. Government is kept lean. No one has to steal to feed his or her family. Foreign advisers focus on capacity building and are therefore valued.

How might the good results be obtained? Here is an overview of some ideas I raised for discussion at the May 7 workshop with donors and southern Sudanese leaders. Some of these ideas might be paid for with a trust fund for oil revenues, or with foreign aid.

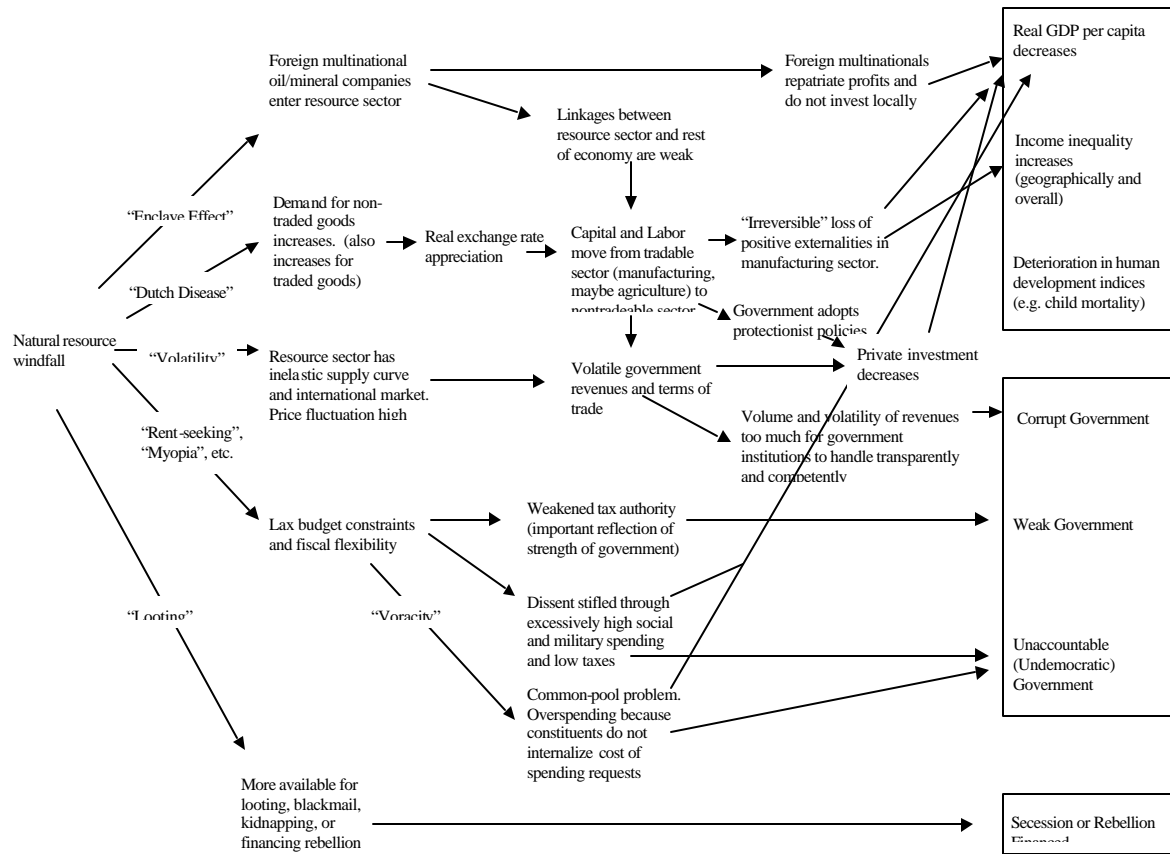
**Pensions and Buyouts for SPLA.** Would it be possible to decommission many or most SPLA leaders and soldiers with attractive, service-based pensions, training funds, and investment funds?

**Direct transfusions of cash to “spontaneous institutions.”** These institutions include a subset of indigenous NGOs, those involved in economic activities—herdsmen’s associations, women’s coops, traders’ groups, credit associations, and so forth. They might also include more formal NGOs, such as women’s organizations originally formed to aid families affected by war deaths. The idea is to give them money on the sole conditions that (1) they agree to decide what to do with the money in open meetings and (2) they agree to an open evaluation after one year of how the money was spent.

**Emergency Social Fund analogies.** Many countries have followed Bolivia’s example and created Emergency Social Funds. These funds create a mechanism for centralized funding and evaluation of decentralized proposals for local works. We discussed at some length how these might work.

**Solving the pay conundrum for top leaders and technical people.** A classic, failed pattern in other countries is a bloated civil service with many low-level people earning salaries above wage levels in the private sector and few high-level people earning salaries well below private-sector pay for jobs of similar responsibility. In the discussion here, we agreed on two points. First, it is essential for the civil service to avoid the temptation of becoming an employer of last resort. Second, top jobs require top pay (otherwise, the risk is poor performance and corruption). We talked about problems of paying salaries higher than those in the north of Sudan(GOS). We talked about how in the GOS salaries are often very low and are supplemented by large allowances (cost of living, transport, housing, etc.) and undesirable side payments off the books (e.g., from the ruling party in the north). Any comparison should be of totals. If salaries are restricted, could the southern Sudan and its foreign partners create temporary, innovative programs analogous to those used to attract teachers and professors in the United States? For example, what about forgivable loans that could be used for housing, with the forgiveness depending on good performance over a five-year period?

At the end of the workshop, I mentioned four areas of priority for anti-corruption work in southern Sudan: oil revenues; road building and other infrastructure programs; revenues such as taxes and customs; and banking and credit.



**Figure 1**  
**Overview of the Resource Curse**

## Annex 1

*An imaginary press report from 2007*

### **Southern Sudan's Remarkable Success**

New Site, South Sudan, April 2007 (AP) - Last week someone asked former World Bank President James Wolfensohn what has been the developing world's most remarkable turnaround. His answer began: "Southern Sudan."

What a change from three years ago. Skeptics said the accord between the Sudan People's Liberation Movement and the Sudanese government would not last. They predicted that the region would soon erupt again in civil strife.

Even if peace prevailed, development was thought to be almost impossible. Continuous conflict had devastated the infrastructure and towns. Thousands of displaced persons were pouring back across the borders. The civil service was archaic. Foreign investment was virtually nil. Although there would be foreign aid, skeptics worried that the money would be wasted or lost to corruption.

But Southern Sudan has surprised the skeptics. It has made the most of its advantages. The economy has grown at almost 10 percent per year. Conflict has not erupted. Foreign aid has been effectively utilized to meet the most urgent development needs. A highly motivated, comparatively well-paid civil service is in place, working well with international experts. Transparency International rates Southern Sudan one of the least corrupt countries in sub-Saharan Africa.

As Wolfensohn said, "The most important thing is that new government in Southern Sudan has been committed to development on behalf of all the people."

#### ***Agriculture, a Solid Success***

Even from an elevated 2003 base, Sudan has enjoyed large increases. Agriculture production rose another 25% in 2004 and then 30% more in 2005. Southern Sudan has instituted a satellite-based surveillance system to track acreage in production, with an annual target of 10% growth.

Minister of Agriculture William Abu credits "strong regional programs, the spirit and vigor of the Sudanese farmers, and outside productive investment."

"We have employed some very capable regional managers, trained them with outside help, paid them well, and provided additional compensation based on their region's performance," Abu says. "Once peace prevailed, many of our citizen farmers applied new vigor to their fields, feeling confident that their efforts would go to fruition."

#### ***Oil Development***

Petroleum is dangerous for development. George Soros says, "The 'resource curse' afflicts most countries rich in oil and other extractive resources. It distorts the economy. Corruption flourishes when natural resources are abundant."

But Southern Sudan acted early to avoid these problems. As Timothy French, of *World Oil and Gas*, notes, "The government made many good decisions: their use of outside experts to help negotiate sound oil development agreements, their progress in developing their reserves, and



especially the transparency in their petroleum business. It is clear that the cash flow from these reserves is building the country's base economy."

Today, revenues from the Southern Sudan oil reserves are approaching the three-year annual target of \$1.2 billion.

### ***Foreign Aid***

In 2004, donors were poised to enter, but only if the new leadership could develop both a strategic plan and an administrative structure that would guarantee the aid would be well used.

"Our government employs relatively few people, compared to other parts of Africa. We have emphasized quality," notes Edward Luk, Minister of the Interior. "They are well paid, carefully evaluated, and they care deeply about their work. We have taken advantage of foreign aid, not only to get the resources we needed but also to train southern Sudanese to take over."

"They used foreign experts ruthlessly," agrees the UNDP's Jurgen Frommer. "They took advantage of strategic help in areas like oil and social audits. They reconceptualized the whole idea of foreign advisers, instead thinking of them as teachers and capacity builders."

### ***Serving the People's Interests***

After decades of civil war, the population's spirit was depleted. Some still had a warfare mentality. Chairman John Garang adopted an extensive communications program to the people, deploying radios and newspapers to communicate new expectations for the citizens.

In particular, the government put great emphasis on the development of the legal system and property rights. "This was critically important in supporting investment in the agricultural community," notes Jean-Louis Perrin of the French Cooperation. "It was even more important in beginning the process of resolving thousands of local and regional disputes, thereby slowly diminishing some of the historic conflict emotions."

## Annex 2

### May 6 Workshop of Leadership Council and Others

Naivasha, Kenya

Notes taken by Robert Klitgaard

*Exercise: What steps would get us from now to the imaginary success story in 2007?*

#### **Group 1**

Peace has been signed, and southern Sudan is implementing a new government worthy of the aspirations of the people who have fought for more than 20 years.

The government must have a constitutional base, so that it is legitimate. It should have a clear separation of powers, with democratic elections. Should be a simple and strong government, with clear objectives and simple administrative and financial systems.

Rule of law and effective judiciary, plus well-trained law enforcement agencies (not necessarily strong but efficient—a strong thing may be a wrong thing). No one is above the law. Accountability.

Define employment criteria to keep out nepotism.

Clear political legislation—how parties come to exist.

Good economic legal foundation. Property rights, taxation system, business law, etc. should protect the consumers as well as the investors.

Private-sector based on free markets.

We must develop human resources internally. We can have the aid of a few experts, without the burden of expert-opinion overload.

Information sharing. This system is vital. A government in S.S. would need to sponsor vast issues, to teach people to forgive and not to have violence. We need this for peace. Other examples are HIV/AIDS.

Need an empowered civil society, so that they can contribute to good government and can empower themselves.

All of these things require political will.

#### **Group 2**

What are the critical challenges and opportunities to be faced by the S.S. government?

IDPs

Sustainable peace

Civil service

How to encourage investment when we now have none

Foreign aid (also corruption here)

Corruption

Opportunities

What are the real objectives of this new government? Development that is people-centered, agriculturally based, and fueled by the oil revenues. Government that is lean, democratic, efficient, and accountable to the people.

Here are some sectors where are important challenges. Look at justice, credit, and property rights, especially in agriculture. Property rights presents dilemmas. Communal ownership, public ownership (statutory ownership), and private ownership.

Creating a competitive environment for investment. What legal system will enable investment to flourish. Especially so as to motivate the farmers.

Access to credit should be transparent, simple, and readily available to farmers.

Oil development. The government is aware about the danger of oil. We need effective, efficient, and transparent management of the oil—revenues, contracts, environment. The management of reserves might include an investment fund that helps the future generations. And the sustainability of the reserves. The volatility of the oil proceeds can cause trouble, and corruption may arise also.

Foreign aid. We know this is a potential but like oil it could down or weaken our institutions if we are not careful. These windfalls are dangerous. We need a clear strategic plan. Foreign aid should be linked to capacity building. Sudanese should own the process. These steps will avoid dependency. We should conceptualize the foreign experts as an asset—as capacity builders and teachers rather than advisers.

People's expectations. The government must pass along information about the peace process in understandable ways to the people. Let the government be very clear and transparent in sending simple messages to the people—this will need a lot of work in communication. The media are important. It can be used to include the opinions and ideas of ordinary people.

Property rights are crucial at this stage.

Accurate data, so that we can plan any policy based on knowledge. We have few statistics, and we need to sort that out.

Rigorous evaluation, so that objectives are met by outcomes.

Foreign aid—evaluation of the political and economic and social impact, including costs. We have to manage foreign aid.

### **Group 3**

Durable peace and its implementation, with international community.

Constitution must be established, with human rights guaranteed, democratic pluralism. We want a transparent, accountable government and good elections.

Create an enabling environment for development and growth of civil society, especially the empowerment of women because of our patriarchal dominance.

Lean civil service that is highly competent and well motivated.

Lean and representative government that takes into account S.S. diversity.

Adopt and implement the Millennium Development Goals.

Empower private sector through conducive policies that include gender mainstreaming.

Diversify economy through industry and services.

Fiscal infrastructure to support the economy, including a bigger budget for agriculture and livestock.

Budget should be monitored and evaluated.

Farmers will be motivated through extension, research, credit, and market infrastructure.

Information and communication technologies are important, including two-way flows of information.

Develop energy and power.

Protect environment.

Water for irrigation—better water management and control.

Social services. Free primary education, and secondary and tertiary education aimed at socioeconomic development. Science for development. Sound health policy sets up an infrastructure focusing on HIV/AIDS and other endemic illnesses.

Oil. Policies to encourage investment. Manage revenues wisely. Environmentally friendly.

Property rights. Clear legislation that protects both statutory and customary rights.

Credit and financial institutions should be accountable and non-discriminatory.

Independent judiciary—well-trained, well-equipped, highly motivated, including law enforcement.

Efficient local government.

Foreign aid should be specific, targeted, and used efficiently.

Regional and international economic integration so S.S. doesn't remain an island unto itself.

Vigorous anti-corruption measures for government and civil society.