SOUTH SUDAN: POST-CONFLICT ECONOMIC RECOVERY AND GROWTH

AN AGENDA FOR USAID ENGAGEMENT

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FROM THE AMERICAN PEOPLE

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EXECUTIVE SUMMARY

Southern Sudan is in its fifth year of peace following the 2005 Comprehensive Peace Agreement (CPA) that officially ended the 22-year North-South civil war. The return of peace has allowed the resumption of normal economic activity, notably the informal sector of the economy in the urban and its surrounding areas of Southern Sudan. The sector has been thriving and growing during the past few years. However, Sudan remains fragile and vulnerable to reversion to conflicts, especially within the South itself. The fragile peace is further complicated and at risk because of the serious macroeconomic challenges facing the Government of Southern Sudan (GOSS). This is in part because of its weaknesses in macroeconomic management and fiscal governance – particularly, in its poor management of the windfall revenues from oil -- and in part because of external shocks from the rapid and drastic drop in the world oil prices and the global recession.

In July 2009, the GOSS and the donor community agreed to implement a reform program to address the current fiscal and economic situation under the Juba Compact. The Compact includes a Mutual Accountability Matrix that provides a policy framework emphasizing the importance of macroeconomic stability and sound economic management, especially in the area of public expenditure management. The role of private sector based growth is one of the key components in reform. The Compact calls for an acceleration of private sector led, inclusive growth and poverty reduction.

USAID assistance for Sudan has now reached one billion dollars per year, a new high. Nearly 70 percent of it is humanitarian assistance and relief (including food aid and Darfur), and a significant part of development assistance is earmarked for democracy and governance, largely for the general election in 2010. The transition from the relief and humanitarian assistance to a strategically focused development program is proving to be more difficult than initially thought. The Juba Compact with its emphasis on private sector growth and development provides an opportunity for USAID to transition its program from relief and humanitarian assistance insofar as peace and economic stability is maintained.

This report discusses and presents an agenda for USAID engagement in policy dialogue, reform in support of Southern Sudan's private sector based, sustainable, and inclusive growth as envisioned in the Accountability Matrix of the Juba Compact. The agenda takes into account Southern Sudan's post-conflict and fragility, and the emerging large macroeconomic imbalances – fiscal and external. The proposed agenda for USAID engagement, by emphasizing policy reform and private sector broad-based growth strategy, can also serve as an anchor for consolidating successes and lessons learned from past USAID/Sudan activities into a coherent development strategy.

An Agenda for USAID Engagement. Given the risk of reverting to conflict the overarching, immediate objective should be to ensure that such risk is managed and minimized. In addition to risk mitigation, the sustained economic recovery that Southern Sudan has witnessed since the CPA needs to be expanded beyond the informal and subsistence agricultural sectors into other sectors of the economy to generate a broad based and more inclusive growth.

A possible agenda for USAID/Sudan engagement in private sector based economic growth includes the following objectives:

1. Promoting sound macroeconomic management through policy dialogue and reform in order to respond appropriately to the current and emerging macroeconomic instability;

2. Encouraging efforts to promote an enabling environment for private sector investment, including exploring potential for public-private partnership;

3. Participating actively, and where possible join other donors' efforts in harmonizing resource allocation and use, in contributing to the Juba Compact goals of accelerating broad based, inclusive growth and poverty reduction; and

4. Considering transitional employment and economic opportunities to complement existing demobilization and reintegration efforts.

In terms of sequencing and the level of effort and assistance intensity, the macroeconomic management – particularly high-level political resolve on expenditure management, controls, transparency, and accountability should receive urgent, immediate attention, high-level policy dialogue, and assistance intensity. High-level of efforts are also required in exploring and put in place programs that support job creation and income generating opportunities to complement the disarmament, demobilization and reintegration into the new economy of ex-combatants. Mitigating the risk of reversion to conflict and a sound macroeconomic foundation are important in reducing uncertainty and risk to private sector broad-based growth. High level of efforts and intensity should also be considered to encourage policy and institutional reforms that remove barriers to small business and the informal sector, while a more thorough policy and institutional analysis is being undertaken. In the short to medium term, a state-by-state bottom-up growth strategy should be completed and a reform agenda formulated to establish an environment conducive to private investment and growth, including supportive legislation and institutions like the investment promotion act and the investment authority

USAID/Sudan can build on the successes of the current technical assistance activities under the Core Institutional Structure Project (CISP) by consolidating or refocusing in some areas if need be while expanding in others. USAID has a large technical assistance team in place, because USAID got off to an earlier start than other donors and presumably was responding to the opportunities and demands of start up at the time. As there are now more donor programs and the need for technical assistance is not decreasing – maybe, even increasing – as donor assistance rose significantly faster than the domestic absorptive capacity in the last few years, USAID should make a conscious effort to improve coordination with other donors. USAID should take on a more active role in aid coordination given the comparative strength and in-country experience it has accumulated. But for USAID to be able to do so, its own field Mission staff will have to expand, particularly in the area of economic and policy analysis.

INTRODUCTION

The effects of more than two decades of war and conflicts have exacted an immeasurable toll on the life of ordinary Southern Sudanese and the society. The physical infrastructure was devastated and is still very much in disrepair, the human capital growth mostly held back and decimated. Economic governance and institutions have been newly created, and some existing ones need reform. The 2005 Comprehensive Peace Agreement (CPA) officially ended the 22-year North-South civil war. Though its implementation has been uneven; several aspects of it are scheduled to be implemented over the remaining period of the six-year interim period, peace, and stability has been restored in most of Southern Sudan. The remaining key issues include: the resource-sharing and border demarcation issues of Southern Kordofan, Blue Nile, and Abyei, collectively referred to as the *Three Areas*; the upcoming general election in early 2010; and a referendum in 2011 to decide whether Southern Sudan will remain an autonomous region of the Republic of Sudan or an independent country.

The return of peace has allowed the resumption of normal economic activity, notably in the urban and its surrounding areas in the ten states of Southern Sudan. The informal sector of the economy has been thriving and growing during the past few years. Construction is booming, not in large capital-intensive sectors, but mainly in the construction of hotels and lodges, residential, and roads. Retail trading including cross-border trade from Uganda and Kenya, and transportation services have surged and are growing. Though there are no official statistics, casual observations and anecdotal evidence from traders, businesspeople, and long-time residents corroborated each other the observation that the informal and small sector of the economy is thriving. This is clearly evident in Juba and in other urban and semi-urban areas.

All of this happened in spite of a very difficult and at times unfriendly business environment. The overly regulated and *dirigiste* mindset remains. The government's lax fiscal discipline, in part fueled by windfall oil revenues and large inflows of international aid, has resulted in some questionable financial irregularities and leakages, some sign of "Dutch Disease" and rising inflation. The government has gone on a consumption binge piling up arrears. A fiscal crisis emerged in early 2009.

The role of private sector based growth is one of the key pillars of the Juba Compact recently agreed to between the Government of Southern Sudan (GOSS) and the development partners. The Compact includes a Mutual Accounting Matrix to be implemented over the next several years. The policy framework emphasizes the importance of macroeconomic stability and sound economic management, especially in the area of public expenditure management in the coming years. The third part of the matrix calls for an acceleration of private sector led, inclusive growth and poverty reduction.

This report discusses and presents an agenda for USAID engagement in policy dialogue and reforms that support Southern Sudan's private sector based sustainable and inclusive growth as envisioned in the Accountability Matrix of the Juba Compact. The agenda takes into account Southern Sudan's fragile, post-conflict situation and the emerging large macroeconomic imbalances – fiscal and external. The macroeconomic situation greatly complicates Southern Sudan's vulnerabilities, particularly as it approaches the general election in 2010 and the referendum on whether Southern Sudan will become an independent country in 2011. The report presents a framework and an agenda for USAID engagement. It is not intended to be a USAID country assistance strategy; instead, it offers possible options for USAID to consider.

The report does not address the critical role of basic social service provision such as health, education, clean water, nutrition, and sanitation; nor does it address the role of food aid and other humanitarian assistance.

POLICY REFORM AND ECONOMIC GROWTH: A NEW USAID APPROACH TO

POST-CONFLICT COUNTRIES

The emphasis on policy reform and economic growth at an early stage, concurrently with political and governance reform, represents a new USAID emphasis in the role of economic growth in post-conflict countries. It reflects good practices learned from experiences in other successful post-conflict transformation, such as in Mozambique, Rwanda, Uganda, and some Eastern European countries.

A familiar framework for donor assistance in a post-conflict situation generally involves four phases of sequencing of efforts along a continuum, each with characteristic program emphases: (1) relief and humanitarian assistance; (2) disarmament, demobilization and reintegration of soldiers, refugees and internally displaced persons into the warless economy and society; (3) reconstruction of physical infrastructure and institutions; and (4) the introduction of reforms in economic policy, governance, and institutions.[1] The sequential approach places policy and institutional reforms toward the end of the relief-to-development continuum. This is quite understandable given that reforms and institutional change require a period of consistent and sustained efforts in which to establish relationship and trust, effective dialogue, political commitment, and an adequate capacity to undertake reforms. It takes time and efforts beyond financial support and policy conditionality to implement and sustain reforms. Consequently, the urgency of restoring some sense of normalcy through relief, reintegration, and reconstruction takes precedence.

However, recent evidence and thinking raises the question of whether economic issues should be left alone until the last phase of the sequential approach. The USAID Bureau for Economic Growth, Agriculture, and Trade (EGAT) has recently addressed this question. According to USAID/EGAT in its *A Guide to Economic Growth in Post-Conflict Countries*: "The relief community already has begun to abandon this obsolete 'relief to development continuum' concept…many interventions geared to facilitate economic growth can and should be implemented at the very beginning of the rebuilding process, much earlier than traditionally has been the case."[2] A new approach is emerging which places less emphasis on a discrete, sequential approach and argues for overlapping sequence of categories of assistance, more specifically for early interventions in policy reform, economic recovery and growth while securing and maintaining peace.

The new approach is supported by a number of recent empirical findings which conclude that both assistance and policy reforms have been highly effective in the post-conflict context. Economic policies and accelerating economic growth and income turn out to be important for reducing the risk of reverting to conflict and as a means toward lasting peace. From an economic perspective, a combination of low income, lack of economic opportunities, and slow growth can be interpreted as lowering the recruitment cost for rebel groups or organizations. At the same time, slow growth implies fewer resources for security, defense, and peace building for the government.

Political reforms generally take precedent over economic issues in a post-conflict situation. There are, however, complementary effects between reforms that stimulate and support broad based economic growth and democratic governance. Democracy, by making government more accountable to its citizens, mitigates the causes for violent opposition. There are three likely mechanisms through which the accountability effect is more important as the economy grows and income increases. First, sustained economic growth is likely to affect the structure of the economy via a rising share of government spending. This increases the importance

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[1] See for example, Jonathan Haughton (1998), *The Reconstruction of War-Torn Economies*. CAER II Discussion Paper No. 23, Harvard Institute for International Development.

[2] The above quote is taken from USAID, Bureau for Economic Growth, Agriculture and Trade, *A Guide to Economic Growth in Post-Conflict Countries*, Draft Discussion Paper, October 2007. Final version of this Guide was published in January 2009.

of accountability which is presumed to raise the efficiency of government spending, and the demand for accountability and democracy increases. Second, as the economy grows, economic opportunities expand, so the recruitment cost for groups or organizations advocating violence increases. The opportunity cost of participating in violent opposition rises. This reduces the supply of rebels, other things being equal. Finally, citizens in a growing and richer economy give more weight to goals, such as that of democratic accountability, than to material reward from what Collier and Rohner call 'loot-seeking' opportunities. From their empirical analysis of various forms of political violence and income levels, Collier and Rohner conclude that the accountability effect of democracy, whereby the incentive for violent conflict can be reduced, is enhanced as income rises. In short, democracy becomes even more potent at reducing conflict when a country reaches a higher income threshold.[3]

Each country's nature of conflict and situation are, of course, unique, and therefore, sensitivity to and understanding of the context matters and is important. The long civil war and other conflicts in Sudan create a situation that is multifaceted and complex, it presents there are several important factors to consider. First, there is likely to be a new independent Southern Sudan in 2011, according to most observers who have followed its developments over the years.[4] A new country to emerge will be quite different than a post-conflict unification and rebuilding or reforming existing institutions. The building up of new economic and governance institutions, systems, and procedures could provide a window of opportunities for starting off on the right path. This may be distinctive from rebuilding failed institutions that were part of the causes of conflict to begin with. Second, in key economic institutions, such as fiscal and monetary institutions, there might be opportunities to break away from the old systems or old ways of doing things, such as in the areas of fiscal management and central banking and in policies governing financial institutions. Third, building up absorptive capacity will become more urgent and challenging as the existing capacity of the country is divided into half – less than half actually. This puts a premium on the ability of the new Southern Sudan to be able to attract all sources of capacity, including the nongovernmental, private sector. Finally, a new Southern Sudan in 2011 cannot simply rely on conflict and political victory to unite the country and provide legitimacy. Rather, the GOSS would have at least five years of track record to show and be held accountable in a democratic process. To maintain the government's legitimacy, past performance such as how well it has managed public sector resources entrusted to the GOSS, could be an important consideration. Though the six-year interim period has provided some space to learn, adopt, and grow, the end of the interim period is approaching and the challenge remains daunting for the GOSS and Southern Sudan.

[3] Paul Collier and Dominic Rohner, "Democracy, Development and Conflict" 2007. Collier and Roher found that democracy and political reform under post-conflict situation with very low income has no impact. Only at some higher income threshold that democracy and political reform becomes statistically significant in terms of conflict-prevention impact. They also recognized that promoting democracy can be inherently of value by itself.

[4] *The Economist* in its June 13, 2009 issue, for example, reports that in 2011 Africa is set to get a new country, South Sudan.

POST-CONFLICT ECONOMIC RECOVERY AND GROWTH

One area in which the peace dividend of the CPA has materialized is in increased economic activity in the informal and small services sectors. The return of peace has energized resourceful private entrepreneurs and unleashed the power of the market and the private sector. At a general level and at the risk of oversimplification, as there are no disaggregate economic data to verify this in the Southern Sudan context, the pattern of economic rebound to date is not atypical in a post-conflict situation. According to one World Bank study that analyzed growth performance from 1974 to 1997 in 62 post-conflict countries, it concluded that post-conflict recovery typically was marked by growth rebound in the first three years followed by above normal average growth rate over the next four to seven years if peace continued and security improved.[5] There are several reasons for this. First, at the onset of peace, improving security tends to attract new economic actors back to the economy. Second, increases in international aid flows and presence by aid agencies raises consumption demand.

The third source of post-conflict growth is increased demand driven by donor investments in a wide range of public goods.

The transition from recovery to sustained economic growth, however, will come from the resumption of growth-producing and job-creating private investment. A typical progression from peace to sustained economic growth may take up to ten years. Evidence also indicates that in this initial decade, the probability of setback and risk of return to conflict can be high. Collier, Hoeffler, and Soderbom estimated that the risk of return to conflict during this first decade of peace could be as high as 40 percent.[6] Though the 2005 CPA has generally achieved its initial, broad objectives over the past four years, there remain major challenges ahead and the risk of violent conflict restarting cannot be ruled out. The danger will be heightened as the general elections and the national referendum approached and more so if the macroeconomic imbalances and instability worsened.

While the informal and small business sectors have responded strongly to the post war climate of the past several years, their performance will not be adequate to sustain broad based growth into the remaining years of the first post-conflict decade. More investment, both private and public, to stimulate economic growth and jobs will be needed. This becomes even more critical as demobilization and reintegration efforts materialize and the supply of labor, mostly unskilled or semi-skilled, grows. Unless the demand for unskilled and semi-skilled labor rises adequately, through investment and growth to absorb the increase in the labor supply, the already high unemployment rate will grow. The rural sector – subsistence agriculture, livestock, and fisheries – can provide an outlet to absorb additional workers. But there are also those who may not want to go back to the rural area, particularly younger ex-combatants. The informal sector in urban areas may provide some outlet for these potential workers. Both outlets, however, will not likely be adequate. Additional investment in the formal sector – small and large, private or public or in combination – has to increase to accelerate growth and generate more demand for labor.

In the immediate, short term covering the next two to three years, employment creation should be of high priority along with the maintenance of peace and security. Initially, there will be a need for public investment to play a catalyst role and even, under certain circumstances, to directly create jobs. There should, however, be a clear exit plan in areas where public sector outputs do not represent a public good and where there is no

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[5] P. Collier and A. Hoeffler: "Aid, Policy and Growth in Post-Conflict Societies, (Policy Research Working Paper 2902, World Bank Development Research Group, 2002). See also World Bank (Operations Policy and Country Services), "Good Practice Note for Development Policy Lending: Development Policy Operations and Program Conditionality in Fragile States, June 2005.

[6] P. Collier, A. Hoeffler, and M. Soderbom: "Post-Conflict Risks" (Center for Study of African Economies, Department of Economics, University of Oxford, 2007).

market failure to justify government direct involvement. Over the medium and long-term the goal should be to provide a business and economic environment that is conducive to private sector growth and development. Removal of obstacles to both formal and informal economic activity should be taken at the earliest stage as possible. A continuing role for the GOSS would be to promote widely consultation between the private and public sectors in order to facilitate a better understanding of the constraints to private sector investment, employment, and growth.

PRIVATE SECTOR BASED ECONOMIC RECOVERY AND GROWTH: AN AGENDA FOR USAID ENGAGEMENT IN SOUTHERN SUDAN

Given the risk of reverting to conflict the overarching, immediate objective should be to ensure that such risks are managed and minimized. In addition to risk mitigation, the sustained economic recovery that Southern Sudan has witnessed since the CPA needs to be expanded beyond the informal and subsistence agricultural sectors into other sectors of the economy to generate a broad based and more inclusive growth.

A possible agenda for USAID/Sudan engagement in private sector based economic growth include the following objectives:

1. Promoting sound macroeconomic management through policy dialogue and reform outlined in the Juba Compact's Mutual Accountability Matrix in order to respond appropriately to the current and emerging macroeconomic issues;

2. Encouraging efforts to promote an enabling environment for private sector investment, including exploring potential for public-private partnership;

3. Participating actively, and where possible join other donors' efforts in harmonizing resource allocation and use, in contributing to the Juba Compact goals of accelerating broad based, inclusive growth and poverty reduction, in particular where USAID has comparative strength such as more emphasis in private sector led development; and

4. Considering transitional employment and economic opportunities to complement existing demobilization and reintegration efforts.

To date, the CPA has provided peace for Sudan, in spite of its uneven implementation at times. The risk of returning to the full-scale civil war of the past is relatively low, according to most observers. Southern Sudan however remains fragile and vulnerable to conflict, notably within the southern region. The risk of recurring and localized conflict within Southern Sudan cannot be ruled out.[7] In the immediate short term, the current macroeconomic imbalances need attention in order to maintain sound macroeconomic foundations and at the same time, to generate economic and employment opportunities, especially youth employment. For the medium and long term sustainable, broad based economic growth led by the private sector will be necessary. This will only be feasible when Southern Sudan's private sector expands and develops.

A. MACROECONOMIC MANAGEMENT AND GOVERNANCE

The Government of Southern Sudan does not have full autonomy when it comes to macroeconomic policies. To a large extent, Southern Sudan's macroeconomic situation is linked closely to and dependent on Sudan's overall macroeconomic developments and Khartoum policies. For example, the GOSS does not have control over the growth of money supply and credit, the change in monetary reserve requirements, or other monetary policy instruments. Neither does the GOSS have control over the exchange rate policy or the management

[7]Most observers believe that it is unlikely for a reversion to conflict of a full-scale guerilla war of the past. This would require giving up the material gains the leadership has so far enjoyed. The CPA and its peace dividends to military and political leadership have provided an economic incentive that reduces the risk of full-scale war between the north and the south. However, conflicts within South Sudan itself over equity, wealth and power sharing, and general security concerns of local banditries were more likely to continue if the peace dividends did not trickle down to ordinary southern Sudanese.

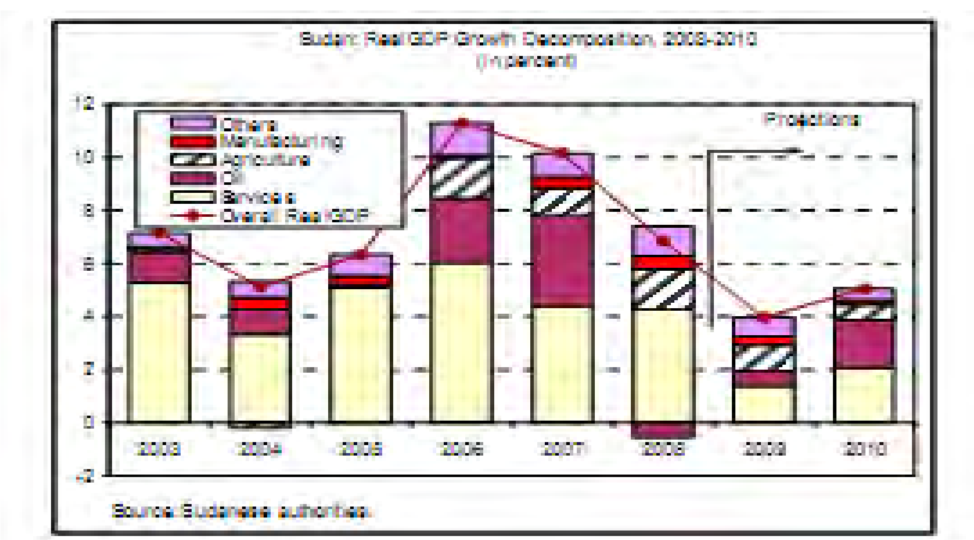
of international reserves. It does however have a greater degree of freedom in fiscal policy through its expenditure management and revenue collection and allocation.

Macroeconomic prices – inflation, exchange rate, interest rate (or its equivalent in the case of Islamic banking practice), and general wage level – are critical variables that affect decisions by private entrepreneurs and investors. Sound macroeconomic management that maintains price stability (low inflation), sustainable fiscal position (small budget deficit), and reasonably competitive, flexible exchange rate policy reflecting market forces are important indication of sound macroeconomic policy framework, and a more conducive and predictable environment for investment and growth. Macroeconomic stability is a pre-requisite for private sector growth and development, and it becomes more critical in a post-conflict situation as in Southern Sudan.

Until the second half of 2008, Sudan was riding on the crest of the oil price wave; the economy grew by 11 and 10 percent respectively in 2006 and 2007. Oil revenue soared, foreign exchange reserves rose, and foreign capital inflows surged. The oil price boom proved to be short-lived. The economy slowed down to about 7 percent in 2008 and is projected to come down to 4 percent in 2009 and recover to 5 percent for 2010, according to the IMF. The lower growth may last longer as Sudan is also negatively affected by the current global recession, largely through its impact from oil and trade. Foreign investment and private sector credit also declined. Inflation eased from the peak of 32 percent in July 2008 (driven mainly by world food prices) to 8 percent by the end of 2008. This followed the decline in domestic food prices. Figures 1 and 2 below highlight the recent GDP growth and inflation in Sudan.

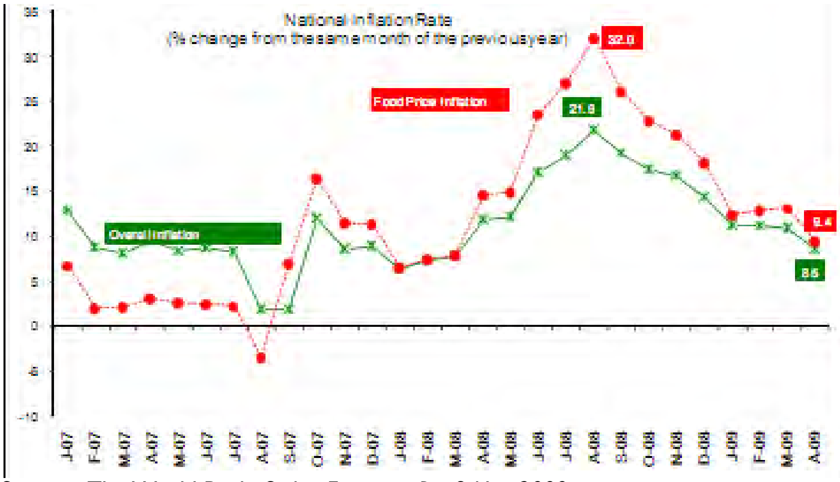
Sudan's Balance of Payments Position. Sudan's export pattern has shifted noticeably in recent years with oil accounting for more than 90 percent of its total exports. In 2007, oil exports in dollars terms increased by more than 60 percent and 54 percent in volume. Neither the GONU nor the GOSS saved its 2008 windfall revenues from the oil wealth. The boom from oil exports together with increased government spending mostly on imports, and large aid inflows put pressure on the exchange rate. Sudan experienced some symptoms of the "Dutch Disease" with the Sudanese pound appreciated by more than 20 percent between 2005 and mid-2008. This has weakened the competitiveness of non-oil exports.

FIGURE 1: REAL GDP GROWTH



Source: IMF, *Sudan: Staff-Monitored Program for 2009-10, July 2009*.

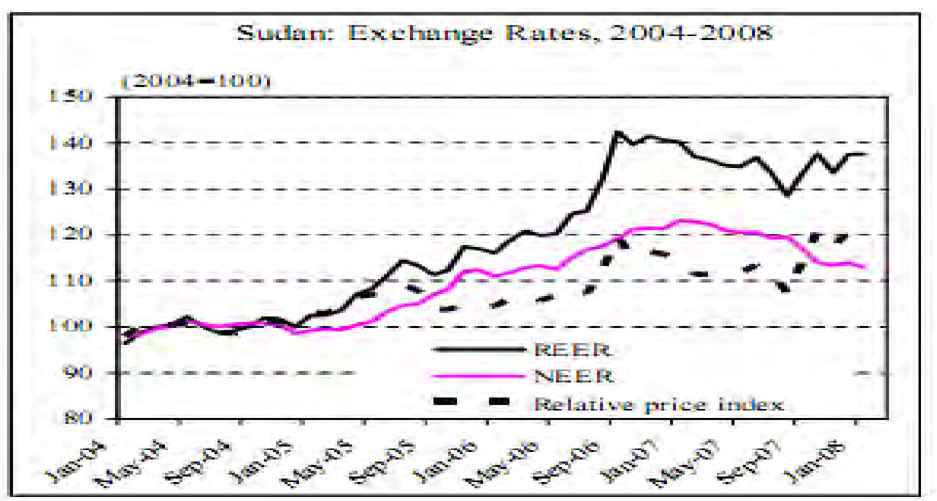
FIGURE 2: INFLATION



Source: The World Bank, *Sudan Economic Brief, May 2009*

Figure 3 below shows the exchange rate movement in recent years. Between 2005 and early 2008, nominal exchange rate appreciated by more than 20 percent and nearly 30 percent in real exchange rate.

FIGURE 3: EXCHANGE RATES, 2004-2008

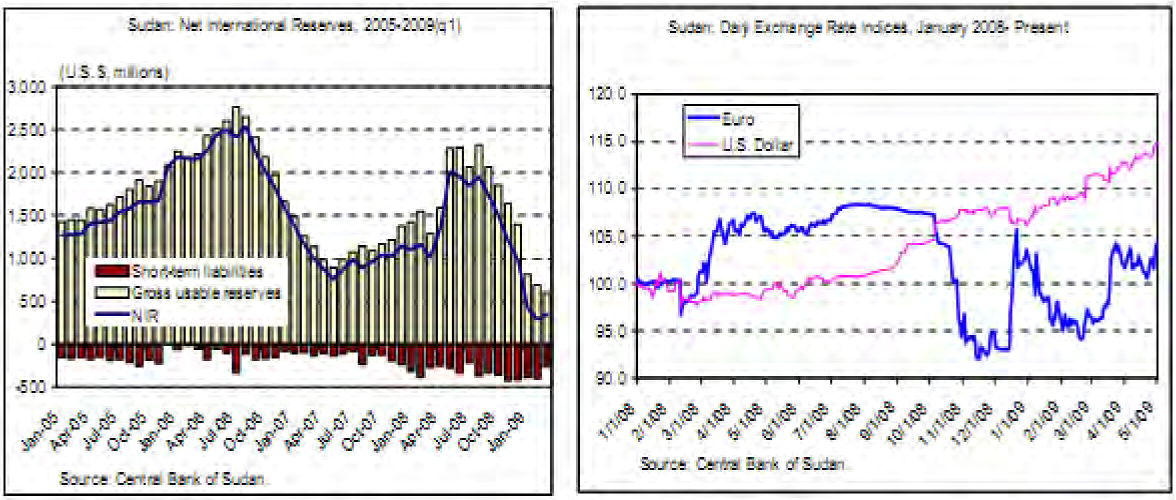


Source: IMF, *Sudan: First Review of Performance under the 2007-08 Staff-Monitored Program*, June 2008.

In spite of the foreign exchange windfall and increased aid flows, the Sudanese economy as a whole showed a current account deficit of nearly 10 percent. Non-concessional loans from China and India were used to finance the growing current account deficit as Sudan had no access to concessional borrowing from financial institutions such as the IMF and the World Bank. The foreign exchange situation is further aggravated by the decline in foreign direct investment and net private transfers, mainly remittances. Foreign direct investment fell by $500 million and private transfers by $800 million in 2007. By the end of 2008, net foreign exchange reserves fell below $1 billion (equivalent to 6 weeks of import cover), and to about $300 million by March 2009. The Central Bank of Sudan imposed restrictions on the use of foreign exchange in early 2009, including a 100-percent cash margin on most imports and limited foreign exchange allocations primarily to essential imports.

Figure 4 shows Sudan's international reserve position in recent years and its daily exchange rate indices.

FIGURE 4: NET INTERNATIONAL RESERVE POSITION AND DAILY EXCHANGE RATE INDICES



Source: IMF, Sudan: Staff-Monitored Program for 2009-10, Jul 2009.

Fiscal Imbalance. In addition to the balance-of-payments situation, the largest adverse impact of the falling oil prices was on Sudan's fiscal position. The fiscal impact has been felt nationally, but most strongly in Southern Sudan, which has a very narrow revenue base and depends almost entirely (98 percent of the government revenue) on oil revenue sharing from Khartoum whose total revenue for the entire Sudan was 30 percent below budgeted in the first quarter of fiscal 2009. With limited foreign financing, the Government of National Unity (GONU) in Khartoum had to reallocate its budget among the three main categories of expenditure: federal, GOSS transfers, and transfers to northern states. According to the World Bank, the share going to GOSS took a 7-percent nondiscretionary cut, dictated by the oil revenue sharing protocol of the CPA.[8] Khartoum was also in arrears in the oil revenue transfers to GOSS. Since most of the revenue is used to pay salaries of government employees and the armed forces (SPLA – Sudan's People Liberation Army) which receive the largest share of the GOSS budget, this has resulted in suspension of salary payments. The early 2009 arrears for the most part have now been resolved. However, new arrears are emerging. The GOSS has adopted a fiscal austerity program.[9]

The implementation of the austere measures, however, has been weak. In particular, senior government officials starting with ministers have not provided good example for the rest of the civil service to follow, from procurement practices to committing funds on behalf of the GOSS by approving contracts for goods and services without following appropriate rules and procedures. General lax expenditure controls continue in spite of established systems, rules and procedures that were established for budget planning, execution, and payments. Financial irregularities related to contracts and procurement of goods and services have emerged and raised concerns with respect to the GOSS's commitment to financial transparency, accountability, and responsible stewardship of public resources entrusted by the public and development partners.

The fiscal crisis for the GOSS brought to the forefront four important issues. First, and the most obvious one, it shows how fragile and vulnerable Southern Sudan's fiscal situation is and its dependence on oil revenues with its curses of accompanied undisciplined government spending and rent-seeking opportunities. Southern Sudan is not atypical in this regard. What is somewhat unique in the Southern Sudan context is its

[8] World Bank, *Sudan Economic Brief, May 2009*.

[9] See Annex D for details.

near complete reliance on oil revenue sharing from Khartoum. Further complicate the situation is the role of Bank of Southern Sudan (BOSS), a branch of the Central Bank of Sudan (CBOS) which underwrites the GOSS spending and budget deficit with little or no coordination with CBOS.

Second, though the oil sector is still a modest part of Sudan's overall economic output, its effects on the external and fiscal imbalances are very significant. Oil accounted for 95 percent of Sudan's exports and 60 percent of revenue in 2008. Sudan also has a heavy debt ($38 billion in 2008).[10] It has been in arrears for its debt owed to the IMF and the World Bank. This prevents Sudan from concessional financing as a source for addressing the imbalances. Its current indebtedness is not sustainable, according to the IMF, in the absence of debt relief. The GOSS is likely to continue to face delays and arrears in revenue transfers as the current global recession will not go away any time soon.

Third, the fiscal crisis put to test some of the newly established fiscal infrastructure – systems and procedures in budget management, especially on the expenditure controls, budget execution, payments, financial and accounting.

Finally, the lax fiscal discipline on expenditure controls and general lack of respect for systems and procedures suggest the need for the highest level of commitment by the political leadership, without which no amount of technical assistance can have lasting impact. The lack of genuine commitment also undermines the integrity of technical assistance which for the most part the GOSS needs at this time and in the foreseeable future.

Options for USAID Engagement

Fiscal Governance. The first-order of priority is in the area of fiscal governance. The USAID/Sudan at the level of Mission Director and above in coordination with other donor agency heads should engage Southern Sudan's senior economic and political leadership to explore the level of commitment to the fiscal reform agenda outlined in the Juba Compact's Accountability Matrix. The words and letters in the matrix to which the GOSS agreed are only meaningful if they are matched by deeds. With USAID technical assistance and that of other donors, the Ministry of Finance and Economic Planning (MOFEP) has developed systems, policy, draft legislation, directives, regulations, process and procedures in various areas ranging from budget planning, review, budget execution including expenditure commitment and control, payments and financial management information and accounting systems. Many of these efforts have enhanced fiscal responsibility and public financial management. For example, budget planning and review through the institution of Budget Sector Group reviews and the Inter-Ministerial Appraisal Committee (IMAC) have gotten off to a reasonably good start though much remains to be done; and so are the payments and accounting systems.

To sustain the good beginning to date and to have a lasting impact, it has to be encouraged and championed by both economic and political leadership. One way to show support for the effort is for the leadership to follow the systems, regulations, processes, and procedures themselves with no exception – from the Office of the President to ministers, under secretaries, directors and other senior government officials, and the rank and file. The Juba Compact and its emphasis on mutual responsibilities should be a window of opportunity for a frank policy dialogue. The donor side of the mutual accountability equation is to deliver assistance in a timely, transparent, and effective manner. The GOSS side in return is to demonstrate how public resources entrusted by its citizens and donors are being allocated and used in a transparent and accountable manner. Though the criteria outlined in the Juba Compact's Accountability Matrix are not intended as *ex ante* conditions for disbursement of funds, they could be useful benchmarks for *ex post* performance. It can be an instrument for the high-level policy dialogue and future aid allocation.

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[10] IMF estimates. The World Bank estimates however put it at $34 billion.

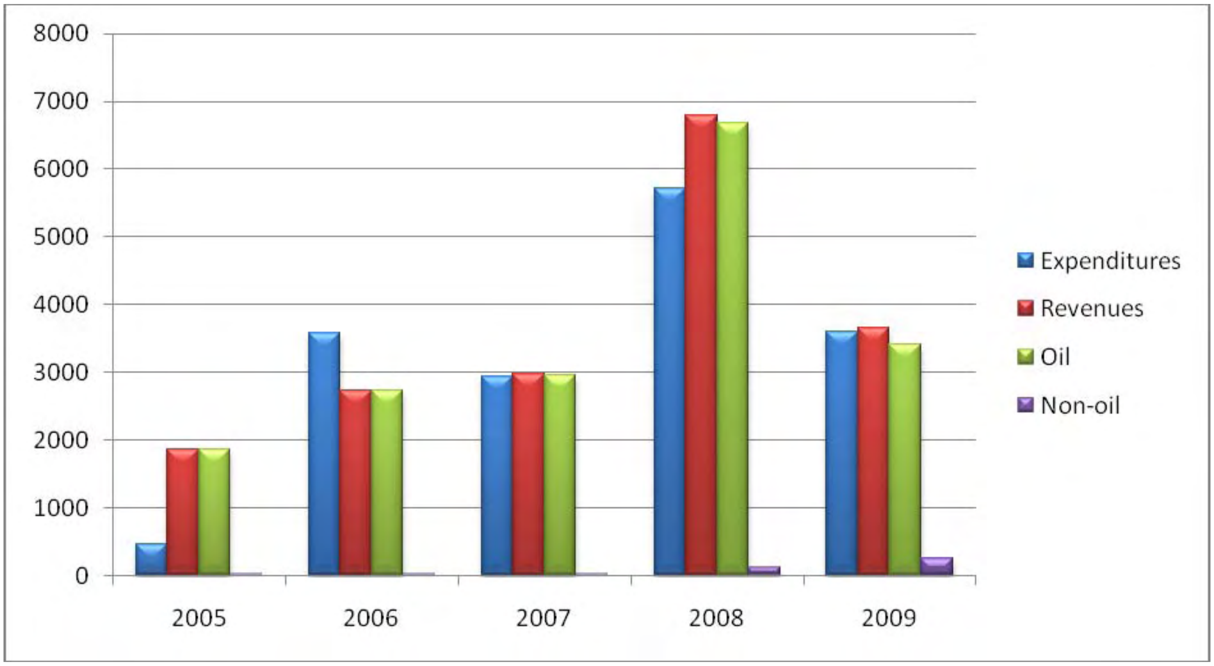
Second, USAID/Sudan should take the opportunity opened up by the joint donor and GOSS agreement on the Juba Compact to consider building on the progress and successes it had already achieved through the technical assistance team under the Core Institutional Structure Project (CISP). The technical assistance support provided under CISP has put in place and some are already functioning critical elements of the fiscal infrastructure and management following the CPA. They are quite consistent with good practices drawn from other post-conflict countries.[11] USIAD/Sudan may want to consolidate its achievements, fine tune and extend the effort to meet the present demand in coordination with other donors. One area that USAID can build on the success of CISP is in continuing to modernize and reform the GOSS fiscal infrastructure – defined narrowly as how government expenditure is managed, how revenue is raised, and support for fiscal policy analysis and making. There are several areas for consideration in the current context of building new or reforming existing Southern Sudan's fiscal infrastructure and governance.

Public Expenditure Management. Expenditure management is the immediate and arguably the most important area that the GOSS is now facing. Since the CPA, aid to Sudan averaged about $2 billion per year during 2005-2007.[12] More than 65 percent of it is humanitarian aid. The amount of aid to Southern Sudan was between $600 – 700 million in 2008 and 2009 and between 5 to 10 percent of it went to humanitarian programs.[13]

The Chart below shows the GOSS revenues and spending since 2005. The fiscal crisis in early 2009 is a result of nearly doubling spending (95 percent increase) by the government due to the large windfall revenues from oil that had more than doubled in 2008. The fiscal austerity program for fiscal 2009 simply brought down planned expenditure to the normal expenditure trend of earlier years (2005-2007). The austere budget of 2009 represents an increase of 23 percent over fiscal 2007 actual spending. This is more in line with the trend since 2005, if the GOSS maintains its fiscal discipline by restraining extra-budgetary spending. On the revenue side, non-oil revenues have increased from nearly nonexistent in 2005 to SDG 118 million (2 percent of total revenue) in 2008. It is projected to double to SDG 245 million in fiscal 2009.

[11] See, for example, USAID (2007), *Building Fiscal Infrastructure in Post-Conflict Societies,* November 2007.
[12] This is the latest figure available from OECD, http://www.oecd.org/dataoecd/63/52/1878796.gif.
[13] These are estimates from the government and they only indicate aid that is on the budget and does not include aid that is provided but not captured by the budget. See Government of Southern Sudan, Ministry of Finance & Economic Planning, *Approved Budget 2009* and *Donor Book 2009*.

GOVERNMENT EXPENDITURES AND REVENUES, 2005 – 2009 (IN MILLIONS OF SDG)



USAID-supported CISP has been providing technical assistance support to enhance fiscal responsibility through (a) strengthening budget management (Pillar 1 of the Matrix); and (b) strengthening revenue generation and management of oil revenue. The former include: establishing and implementing systems and procedures (circulars and Appropriation Act of 2009) to improve expenditure management to support the austerity measures; improving the commitment-control and contract management. The CISP has supported legislative work with the Audit Bill and Public Service Bill. The Mutual Accountability Matrix also calls for strengthening the revenue administration system and to lay the groundwork for an oil revenue management system. USAID assistance in this area should continue and if there was increased commitment from the economic and political leadership, and as more was learned from implementation, scaling up of assistance in coordination with other donors could be evaluated.

Tax Policy and Tax Administration. Tax policy and revenue mobilization efforts are important for post-conflict Southern Sudan, especially with its very narrow tax base and dependence almost entirely on oil revenues. In addition to a very limited tax base, tax administration and other supportive institutions are weak with a limited number of skilled cadres. At the same time, there is a great demand for large public spending programs. It is tempting to use fiscal policy to raise revenue given the fiscal crisis in early 2009. In fact, with the technical assistance from the CISP a revenue bill on income tax was enacted recently (Tax Act of 2009).

Though raising revenue and expanding the tax base is necessary for filling the budgetary gap, it may be counterproductive if it results in discouraging investment and economic activity, and eventually the tax base itself over the long run. Policymakers need to recognize the tradeoff between more revenue in the short run at the expense of private sector growth and investment. Tax policies also require selectively phasing in to be commensurate with the ability of the government to administer them and the economy to support them. Indirect taxes are generally preferable to personal or corporate income taxes. Indirect taxes also have the advantage of being not too obvious to the taxpayer and thus less resistance. The revenue raising objective ought to be weighed against its effects on growth and possible relative price distortions, especially at the early recovery stage such as the case now in Southern Sudan. The overriding objective of tax policy should be least harmful to growth. This may be an area where well coordinated technical assistance is useful. The first step may involve an assessment of the current system, its administration, and effectiveness. The immediate objective should be to lay the foundation for improving the efficacy and modernizing the tax administration.

This will be a long term effort that requires a relatively comprehensive assessment of current post-conflict Southern Sudan.

Under its Staff-Monitored Program for 2009-10, the IMF recommended that the Government of National Unity undertake a comprehensive review of the tax regime and structure to clarify the issues of tax jurisdiction at different sub-national levels, to reduce exemptions for value added tax, and to reform the personal income tax.

Central Banking. Sound macroeconomic management requires a professionally competent and effective Central Bank to complement the country's fiscal infrastructure. The Central Bank is particularly responsible for formulating and implementing sound monetary and exchange rate policies, monitor and manage the financing of fiscal deficit and national debt, as well as the foreign exchange reserve position to ensure investor and business confidence and support macroeconomic stability and noninflationary growth.

A dual banking was created in Southern Sudan following the 2005 CPA: Islamic banking in the North and conventional in the South. To accommodate this arrangement the Bank of Southern Sudan (BOSS) was established and operational in 2006. It becomes a branch of Khartoum's Central Bank of Sudan (CBOSS) and is headed by one of the deputy governors of CBOS who is also the President of BOSS. The BOSS was given the authorities to license and supervise conventional banking institutions in Southern Sudan and to provide internationally acceptable regulatory and prudential standards. However, the CBOS has the sole responsibility and independence in the formulation and implementation of monetary and exchange rate policies for both the North and the South.

USAID under the CISP technical assistance, in close cooperation with the BOSS, provided extensive advisory service, institutional and training support. The latter range from establishing a modern and functioning BOSS training center, to the issuance of banking laws and regulations, Prudential Banking Circulars that help clarify rules and regulations for commercial banks to support foreign commercial banks that have branches in Southern Sudan. There is also practical and targeted on-the-job training complemented by a curriculum of courses following a skill needs assessment. They include courses in bank supervision, international financial reporting standards, foreign exchange operations and foreign reserve management, and seminars and courses in money and banking and monetary policy economics.

The banking and financial sector in Southern Sudan is shallow with only seven commercial banks in operation and little intermediation;[14] but it seems to have received relatively little attention and support from the international donor community. Yet, it is an area where many critical issues need attention if Southern Sudan's private sector is to be the engine of economic growth, and in particular if Southern Sudan secedes and becomes an independent country following the referendum. A long list of critical issues awaits the BOSS if it is to become a full, independent Central Bank. To illustrate, this would include: setting up a currency regime and possibly with currency replacement; management of reserves and capital flows – especially to avoid capital flights or complete dollarization of the domestic economy; establishing accounts with other Central Banks; make arrangement to secure access to SWIFT; creating accounting system that currently owned and operated by CBOS; and provision of a necessary legislative framework, such as Banking Act and Banking Regulations.

The GOSS will need significant technical support, advice of good practices, and capacity development from international financial institutions, such as the International Monetary Fund. USAID technical assistance under CISP already in place and other U.S. government assistance working with the BOSS and other donors can facilitate and assist in planning and preparing the BOSS to respond to these challenges.

[14] The seven banks are: Agricultural Bank (long established, prior to CPA), Ivory Bank, Nile Commercial Bank opened in 2006 as a "showpiece" for the GOSS, mismanaged and currently in financial trouble), Kenya Commercial Bank (established in 2006), Buffalo Commercial Bank (locally owned, established in 2008), Equity Bank (Kenyan bank referred to as "people bank" in Kenya, is pursuing business in South Sudan aggressively), and Commercial Bank of Ethiopia (in the planning stage).

Policy Analysis and Statistics. Relevant economic, financial, population statistics and social indicators are important for policy analysis and making. Reliable and timely statistics are necessary for assessing or forecasting policy and investment impacts. Currently, reliable, systematic and timely statistics are difficult to come by. Capacity development in these technical areas will take time and sustained investment. USAID has made initial inroad into the field of statistics with the ongoing national population census and recently with the household budget survey. In the process of carrying out these censuses, USAID technical assistance under CISP, in coordination with UNFPA, has contributed to the capacity development of the Southern Sudan Centre for Census Statistics and Evaluations. With respect to policy analysis and public administration, particularly in the area of public expenditure management, budgeting, tax policy and administration, and management of external resources such as international aid, capacity in the ministries and public sector will continue to be a challenge in the foreseeable future.

B. PRIVATE SECTOR DEVELOPMENT

While pursuing security improvement and supporting sound macroeconomic policies, developing an enabling environment to attract private investment is the most important strategic element for encouraging sustainable, inclusive economic growth and poverty reduction in the medium and long term. Transitional employment creation discussed below is also an important short-term requirement to keep the recovery going forward; but there is no substitute for longer term private investment and enterprise development.

One of the key challenges facing business and investors in Southern Sudan, as in most post-conflict economies, is the uncertainty and unpredictability of the laws and regulations governing doing business and the commitment and ability of the government to implement them in a transparent, accountable, and consistent manner. In the case of Sudan, it is further complicated by the uncertainty and possibly risk associated with decisions and outcomes following the elections and referendum respectively in 2010 and 2011.

Investors and business people want transparent and predictable rules to allow them to apply their cost-benefit calculus and risk assessment in their business decision. This places a premium on keeping burdensome regulatory, licensing, and tax requirements to a minimum. Simplicity and transparency are important. A good starting point could be to eliminate any impediments, especially those that create rent-seeking opportunities associated with economic activity in the informal sector. The cost and risk of doing business in Southern Sudan is already very high, a legacy of the war in terms of poor infrastructure and security risk. There is no reason to add more to it with cumbersome rules, and regulations, or other burdens on the emerging entrepreneurs in the informal sector, even if it means sacrificing potential revenues for the government. In the end increased government revenue can only be sustained in the long run when the economy expands and grows.

According to the World Bank *Doing Business 2009*, an annual, inter-country comparative report of 181 economies that evaluates government regulations and practices affecting business activity, Sudan is ranked 147 out of 181 economies in terms of ease of doing business. The Report uses ten sets of regulations to assess the ease or difficulty of doing business from starting to operating and closing businesses. They are measured in terms of the time and resources required to operate a business legally. Table 1 below shows Sudan's ranking and in comparison with a few selected countries. One of the notable things from this report is the change between 2008 and 2009. It shows that the overall business environment has actually declined.[15]

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[15] Though South Sudan is currently a sub-region and may become a separate economy following the referendum, one may argue that the ranking is not exactly applicable. However, for potential investors and businesses, they are likely to consider the entire Sudan rankings of different aspects of doing business as proxy indicators and assume rightly or wrongly some close relationship between South Sudan and the entire Sudan.

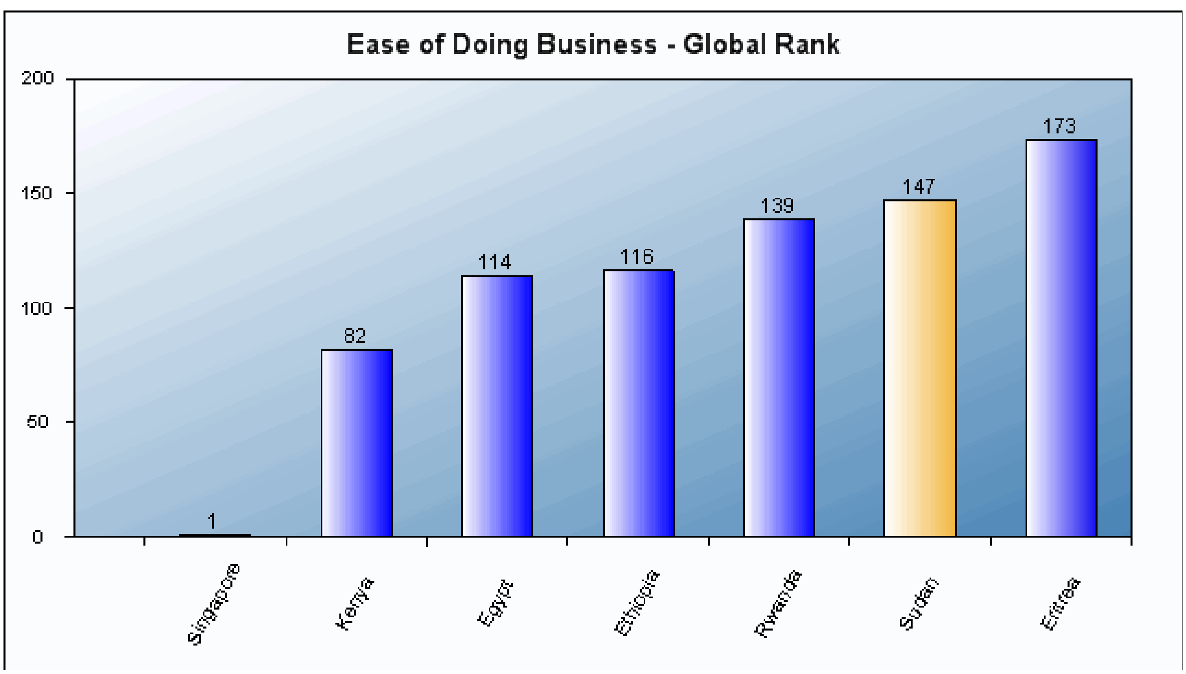
TABLE 1: SUDAN'S RANKING IN WORLD BANK DOING BUSINESS 2009

Ease of Doing Business	2009	2008	Change in Rank
Overall	147	142	-5
Starting Business	107	99	-8
Dealing with Construction Permits	135	132	-3
Employing Workers	144	144	0
Registering Property	35	33	-2
Getting Credit	131	126	-5
Protecting Investors	150	148	-2
Paying Taxes	67	66	-1
Trading Across Borders	139	140	+1
Enforcing Contracts	143	144	+1
Closing Business	181	181	0

Source: World Bank, *Doing Business 2009*.

Figures 5 to 10 below highlight certain aspects of Sudan's business environment – such as protecting investors, getting credit, enforcing contracts, employing workers, and closing a business – in comparison to other countries in the region and those that have more conducive business environment,. In all these measures of business environment, Sudan ranks in the bottom or near-bottom quintile. For example, in "Enforcing Contracts" indicator which measures the number of procedures in the case of dispute and number of days it takes to settle these disputes legally. In Sudan it involves 53 procedures and can take on the average 810 days. A related indicator to enforcement of contract has to do with closing of a business or bankruptcy procedures. Bottlenecks in bankruptcy can affect investors in terms of the risk they have to take. Sudan ranks last according to this indicator.

FIGURE 5: EASE OF DOING BUSINESS – COMPARATIVE GLOBAL RANKING



Source: World Bank: *Doing Business 2009*

FIGURE 6: PROTECTING INVESTORS

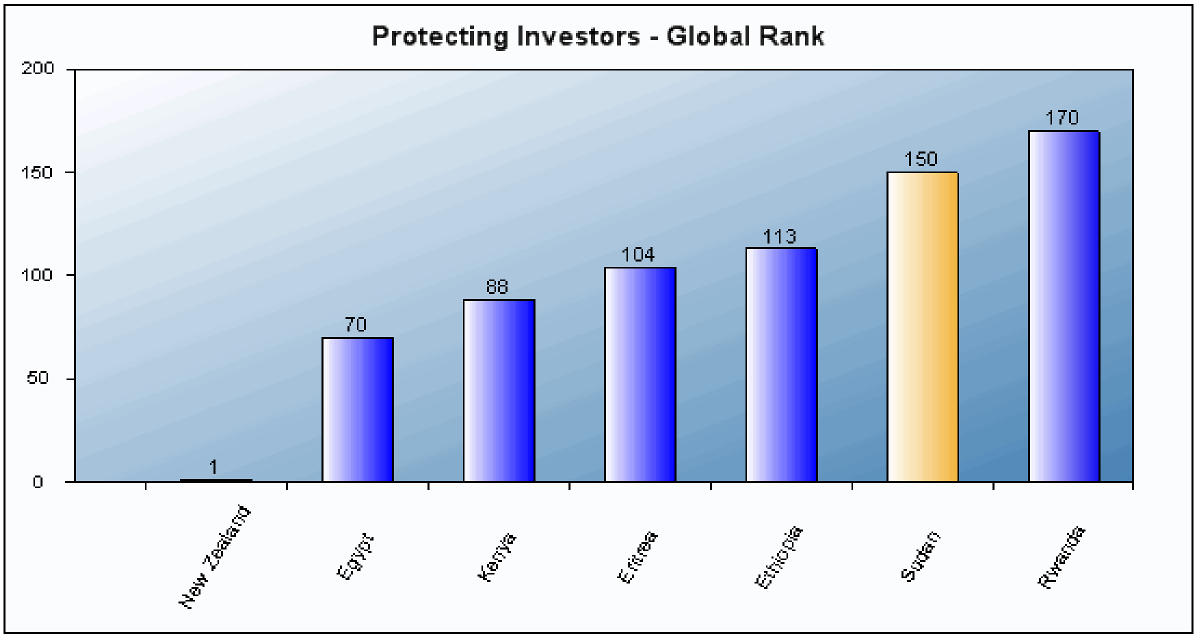


FIGURE 7: ENFORCING CONTRACTS

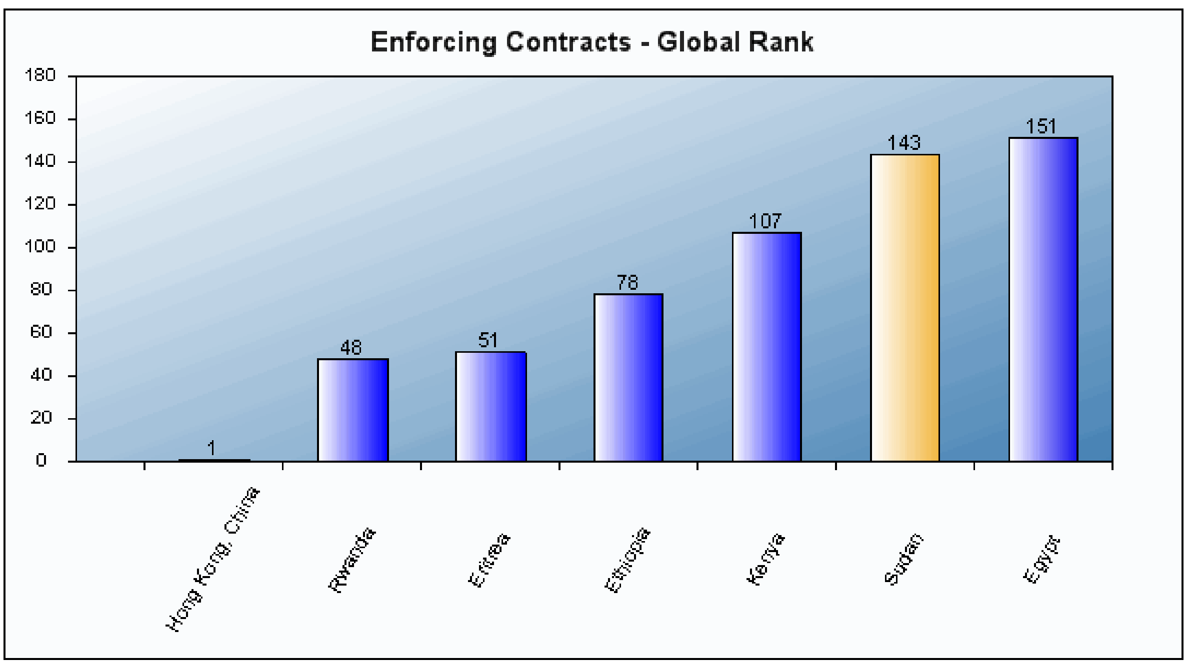


FIGURE 8: CLOSING A BUSINESS

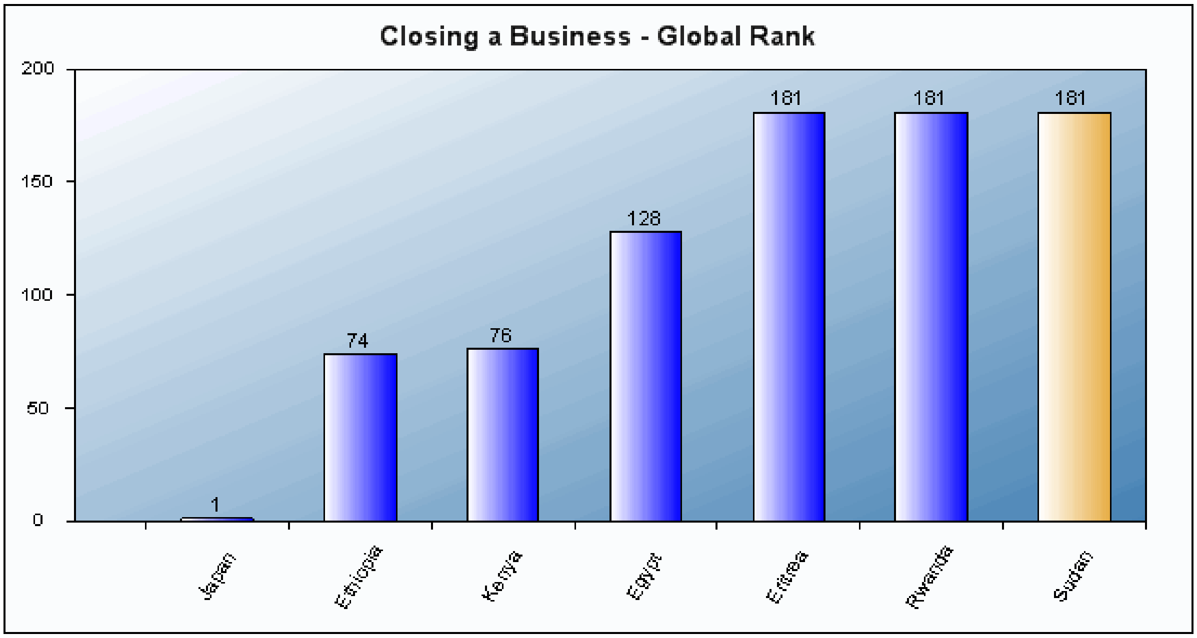
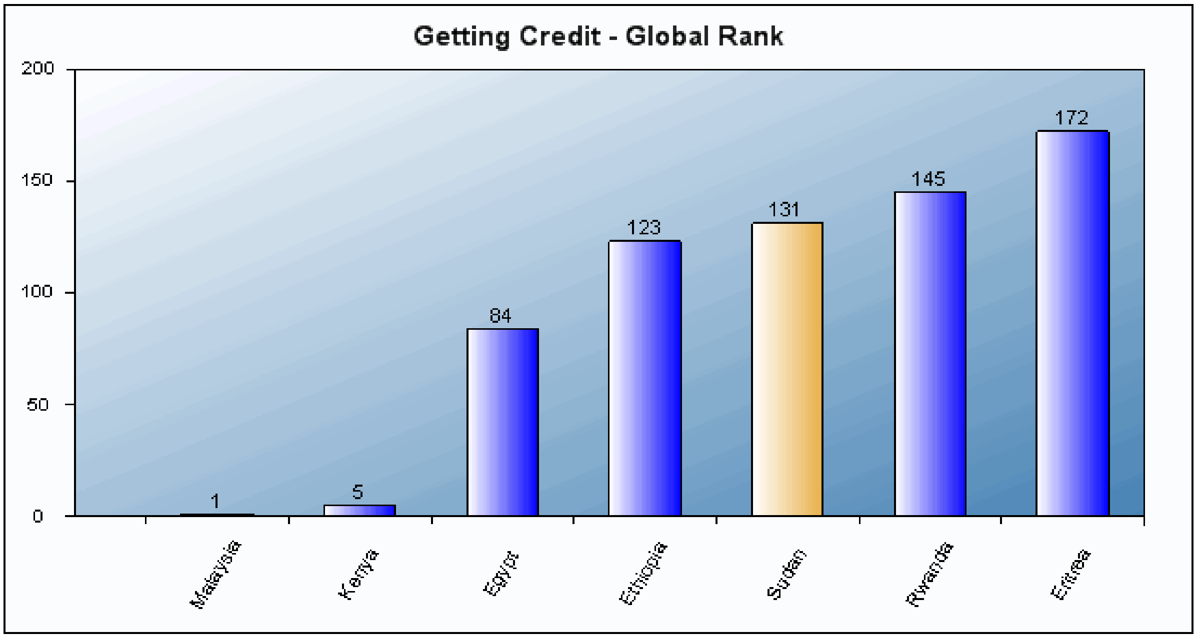


FIGURE 9: EMPLOYING WORKERS

FIGURE 10: GETTING CREDIT



Source: World Bank: *Doing Business 2009*

All these measures have limitations. They do not capture other aspects that are also important to investors and business, such as the quality of infrastructure services, physical security of property from theft and looting, the proximity to other markets in the region, the quality of government's macroeconomic management, and the underlying strengths or weaknesses of institutions. In the case of Southern Sudan, including these other measures are not likely to change the comparative standing in any significant way, particularly in improving its ranking. Policymakers in the GOSS could take these indicators as suggestive of how investors, especially international ones, perceive Sudan as a place for doing business.

Options for USAID Engagement

The overriding objective of nurturing private sector growth and enterprise development is to create an environment in which a reasonable degree of predictability exists and risk can be reduced or managed. In some post-conflict cases such as those in Eastern European countries, this can be done more quickly by building upon or reforming pre-conflict institutions. In Southern Sudan, there was hardly existing institutions prior to the long conflict. During the interim period following the 2005 CPA, ministries and other public institutions have been created. There are many areas in which Sudan's business environment needs significant improvement to create a private sector enabling environment. Because local absorptive capacity is limited, selectivity and priority setting will be necessary.

In the immediate to short-term, pragmatic and consistent measures by the government can send an important signal to build business trust and confidence. Among some of the trust and confidence boosting could be to assure that the government, especially the security force, has no business in economic activity when the private sector can do it better. The role of the public sector and public policy should be to protect and encourage private investment and its legitimate interests. In addition to maintain physical security and macroeconomic stability, the government could start by reviewing constraints to the informal sector which is where economic activity in post-conflict Southern Sudan has emerged during the last few years. The authorities ought to engage private sector actors, both in the formal and informal sectors, in dialogue in order to understand and appreciate the prevailing constraints and respond appropriately. It should not be in the business of direct production and distribution of goods and services in competition with the private sector if there were no market failures.[16] Some of the constraints and regulations can be removed quickly with the stroke of a pen by the government. USAID could facilitate the public-private learning dialogue. The goal should be to make it happen timely. This would mean some purposeful trade-offs have to be made, such as choosing effective, immediate solutions over the most economically efficient approach, or making trade-off between urgency and long-term legitimacy.

Another area that USAID could consider is in the banking and financial sector. Establishing financial intermediation would help private sector development. This will require more than filling the gap that some states in Southern Sudan has encountered – such as in the Upper Nile State which has a close tie with northern Sudan – as a result of the withdrawal of Islamic banks from the state, reacting a policy adopted by the GOSS too hastily. Appropriate legal and regulatory frameworks to encourage private investment in banking services will be needed. Such a policy and regulatory framework should aim at facilitating saving mobilization including remittances from Sudanese Diaspora as well as foreign savings. Moreover, the government should also support microfinance as it is the main source of financial capital for the informal and small-scale business in agriculture, retail trade, and other services. USAID could build on its considerable experience in microfinance in Sudan. There are several nongovernmental organizations, such as World Vision, Catholic Relief Services, and Oxfam that, could be used to complement the limited capacity of public organization, such as SUMI for the expansion of microfinance. This would help the informal and small business, smallholder farmers and to create employment opportunities. USAID may want to consider scaling up its current microfinance program.

Road infrastructure in Southern Sudan is dilapidated. This has added to the cost of doing business significantly and affected its competitiveness and labor productivity. More comprehensive efforts to develop intrastate and interstate linkages as well as improvement in the feeder road system are urgently needed. Given the extensive work needed in this area, investments should be prioritized. USAID might want to consider, in coordination with other donors, to support construction or rehabilitation of feeder road networks in selected states that could potentially support marketing of agricultural products and supply of agricultural inputs. Many nongovernmental organizations have had experience implementing public works program in feeder road infrastructure. USAID could also support the government in encouraging broader private sector participation in infrastructure and construction work with consideration for leveraging private sector resources through, for example, public-private partnerships.

Finally, creating a favorable foreign investment climate is important for Southern Sudan in the medium to long term. Since foreign investors are more sensitive to uncertainty and risks than local investors, it is important to address those issues identified in international comparative ranking and assessment reports, such as the World Bank influential *Doing Business*. Predictable and transparent rules and regulations enforceable by laws are important to investors and business since they affect profitability. The GOSS should take advantage of this influential assessment to improve its international competitiveness. USAID should support the development and passage of legislation that promotes internationally acceptable codes of investment. Under the Juba Compact, there is a plan to assist the government to promote investment promotion legislation. It could include provisions to address these concerns.

Careful and coordinated technical assessment should be given to avoid granting subsidies, tax exemptions, or other special preferences without proper appraisal of possible "second best" market distortion effects from subsidies or special preferences. Currently, several donors are providing technical assistance in this area. There is a need to coordinate this effort. In general, both the government and development partners should not be bounded by some artificial or bureaucratic timeline such as the December 31, 2009 set in the Juba

[16] For the whole Sudan, the size of the public sector is already big, nearly doubled over the last five years, from 20 percent of GP in 2003 to about 40 percent in 2008. In the draft Budget Sector Plan 2010-2012 presentation, the SPLA proposes to go into the business or food production and hotel services in addition to construction. This is not an area where the armed forces should be in.

Compact's matrix. It is better to have a greater "buy in" by stakeholders that include private and nongovernmental sectors, even if that takes longer to achieve. In this case, the trade-off is in favor of more careful assessment and legitimacy. This should not prevent the government from using its executive power to remove some of the more obvious impediments to private sector growth and development while preparing the way for the investment promotion codes.

C. GROWTH DIAGNOSTICS AND STRATEGY

Southern Sudan, whether it secedes from Sudan following the 2011 referendum or maintains the present status quo, has to reduce its dependence on oil. The region is relatively well endowed with not only oil but quality land and other natural resources for agricultural and livestock development. The Nile-Sobat Rivers Zone is rich in fishery resource (Nile Perch and Tilapia) and a source for potentially exportable fishery products, either in intra-Sudan trade with the North or cross-border trade. Because of decades of war, these potential resources were never developed. The gap between the current situation and unrealized potential is quite large, according to many agricultural and natural resource experts. Southern Sudan can become a bread basket for not only the entire Sudan but also for the region, according to these experts. Food security was an achievable goal if only the man-made conflicts could be overcome, policy and mindset reformed, and institutional impediments to private entrepreneurs and private sector removed. In this regard, the CPA offers an opportunity for Southern Sudan to explore the considerable resource base for economic growth and development. In this sense, Southern Sudan is in a better and more distinctive from many other post-country situations.

The Juba Compact rightly emphasizes the need to have a long-term vision to diversify Southern Sudan's economy from its dependence on oil. The development of a growth strategy as suggested in the Compact's mutual accountability matrix is an initial step toward articulating the long-term vision. The World Bank as part of its 2009 Country Economic Memorandum (CEM) has commissioned two studies at the state level (Upper Nile State and Eastern Equatoria State). The studies used a "growth diagnostics" approach,[17] a useful analytical framework for assessing, identifying, and prioritizing the most binding constraints to private sector based growth, and indicating which of the binding constraints the government might be able to address. It is different from the conventional approach of studying a selected sector with some pre-assumed agenda.

The growth diagnostic approach begins with the basic notion that growth is *episodic*, where economic progress consists of a series of transitions from one phase to the next in an episodic fashion. The second notion is that the essence of growth is a transition from a lower to a higher level of productivity for labor. To achieve higher productivity, it requires investment by economic agents, whether from individual entrepreneurs or government. The basic question that a growth diagnostic framework attempts to answer is why private investment and private entrepreneurial activity are low. It then follows by proposing factors (hypotheses) that may contribute to the problem. The task of the study would be to determine to what extent these factors are constraints that are critical and binding based on the evidence in a specific context; and which may be constraints but not binding for the time being so that not all possible constraints have to be addressed at the same time. The Decision Tree Diagram below summarizes the approach.

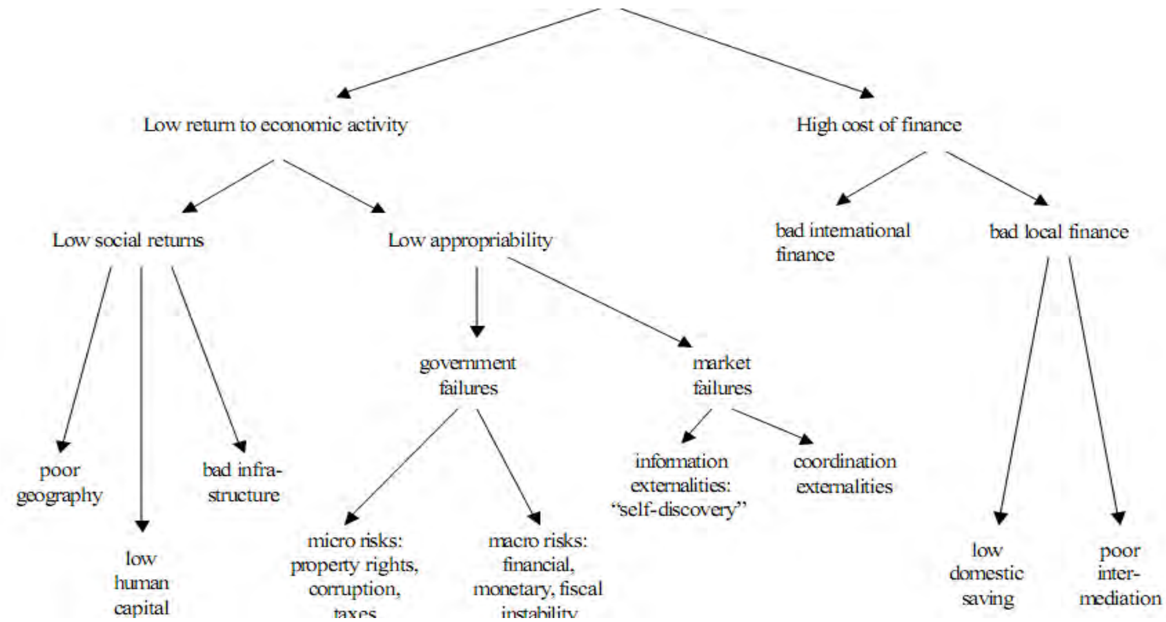
Some preliminary results of common binding constraints have emerged from the studies of the Upper Nile and Eastern Equatoria states. Common binding constraints that cause under- investment are: serious infrastructure shortcomings; uncertainty over the future given the 2011 referendum and remaining security concerns; and concerns regarding government policies related to its macroeconomic management and the lack of fiscal coordination regarding sub-national government entities' tax jurisdiction (states and counties, for example) hat resulted in multiple taxes and discouraged private investment. Access to credit has also been

[17]The approach was developed by Ricardo Hausmann, Dani Rodrik, and Andres Velasco, "G*rowth Diagnostics", Harvard University, Revised March 2005*.

identified as a serious constraint in varying degrees in all three sectors, agriculture, manufacturing, and services. There is inadequate financial intermediation due to the change from Islamic banking to conventional banking by the GOSS without adequate planning to take into account of the consequence of the policy change. This has resulted in withdrawals of existing banks from the state.

FIGURE 11: DECISION TREE FOR GROWTH DIAGNOSTICS

PROBLEM: LOW LEVELS OF PRIVATE INVESTMENT AND ENTREPRENEURSHIP



Source: Ricardo Hausmann, Dani Rodrik, and Andres Velasco (2005)

Options for USAID Engagement

As part of the growth diagnostic, the economic structure, in this case at the sub-national level, is analyzed and assessed. Since there is limited information and knowledge about Southern Sudan's economy, this is useful and appropriate. Two studies commissioned by the World Bank (Upper Nile and Eastern Equatoria), with financial support from DFID and African Development Bank, and one has been completed in draft. There is probably a need for undertaking similar studies in the other eight states, if not all of them at least several more. These studies together can form a basis for building up a national strategy for private sector based growth and development. Individually, each study can be a benchmark and help inform policymakers in each state of the nature and extent of the binding constraints in the state and what the government can do about them.

USAID/Sudan may want to consider support studies for other states if there is a demand for them. Since the World Bank has already overseen the studies for Upper Nile and Eastern Equatoria, the studies of other states can benefit from the earlier experience in terms of developing terms of reference, design and implementation of the studies. Findings from additional studies will provide additional information and knowledge that strengthens the national growth strategy.

D. TRANSITIONAL EMPLOYMENT AND ECONOMIC OPPORTUNITIES

Creating jobs and economic opportunities are a key challenge and responsibility for any government. In a post-conflict situation the problem is more acute. In addition to security concerns and the risk of reverting to conflict, unemployment is usually higher than usual because ex-combatants are now added to the unemployed pool. During this early post-conflict period, private investors and businesses face high risks and uncertainty because of the unclear and less predictable economic, commercial, and legal environment. Privative entrepreneurs are more cautious with their investment decisions. This would generally result in a longer lag in the recovery of private investment and job creation.

In the Southern Sudan context, the Disarmament, Demobilization, and Reintegration (DDR) policy is expected to release 9,000 ex-combatants into the existing labor force in 2009. They are mainly women and children associated with the Sudan's People Liberation Army (SPLA), disabled and elderly ex-combatants. According to the SPLA Affairs Ministry, donors are planning to spend about $25 million for the DDR program. Some 748 candidates (527 male and 221 female) have already enrolled in the program which involves skill and vocational training to prepare them to be reintegrated productively into the economy.[18] One of the challenges that the GOSS faces is how to deal with newly demobilized soldiers and former combatants without raising the risks that they will engage in destabilizing behaviors, crimes, and other violent acts. The initial 9000 persons may not be of high threat, but as more young ex-combatants are released from the SPLA, the risk will rise. As the DDR efforts are further implemented, the pool of potential workers will expand. These additional new entrants to the labor pool are likely to be young. The agricultural sector as a candidate for absorbing and reintegrating these workers will not be adequate. Some of these new entrants may not want to go back to the rural area and prefer city, nonfarm jobs. Under the circumstance, there is a role for the public sector to accelerate job creation and other economic opportunities in the immediate short run.

Options for USAID Engagement

USAID/Sudan may want to consider providing support to a few selected nongovernmental organizations, for example Catholic Relief Services (CRS), World Vision, and Oxfam, who have experience working in Southern Sudan and are interested in moving from relief and humanitarian assistance to development. These organizations can support and supplement the work of DDR by through the development of skills and employment and income generating economic activities in the agricultural sector as well as nonfarm employment. This will complement the agricultural development program that USAID/Sudan is currently planning.

In the discussion for this report, CRS mentioned that it has a number of employment and income generating projects in the works as part of its support for the GOSS DDR program and its desire to move from relief into development focus. It has identified a number of potential activities including: the installation of treading pumps for micro-scale irrigation where sources of water are nearby; and the development of fisheries and horticultural farming in Central Equatoria. Still other schemes target the use of seed vouchers and seed fair; the saving and internal lending community; bee-hives and bee-keeping; lulu tree products and related ointments; and timber processing, and crafts and furniture making in Western Equatoria. CRS in Sudan already has a network of branch offices located in the three Equatoria states that the USIAD/Sudan agricultural program plans to target its activities. USAID/Sudan may want to consider support for CRS in some of these activities. Some may involve initial piloting activity and others might include building human capital through vocational skills and apprenticeships. There are other nongovernmental organizations such as World Vision and Oxfam that could be candidates as well.

The Ministry of Commerce and Industry has a division that is intended to facilitate the development of market infrastructure, microfinance and small enterprises, and private sector development in general. USAID/Sudan may want to explore the possibility of working more collaboratively to support its mission and to explore the potential for public-private partnerships.

[18] Government of Southern Sudan, "Draft Budget Sector Plan 2010-2012," Security Sector, July 2009.

TOWARD PROGRAM CONSOLIDATION AND DEVELOPMENT FOCUS

Southern Sudan is in its fifth year of peace under the CPA. However, peace is fragile and remains vulnerable to reversion to conflicts, especially within the South itself. Moreover, the government is facing serious macroeconomic challenges: in part because of its weaknesses in macroeconomic management and fiscal governance, particularly its poor management of the windfall revenues from oil, and in part because of the external shocks from the rapid and drastic fall in the world oil prices and the global recession.

In hindsight it is easy to see how the GOSS has missed the opportunity to use its extraordinarily high oil revenues better and to avoid the "curse of natural resources" trap. Government expenditure nearly doubled its budgeted level or about $1 billion in fiscal 2008[19] Oil revenues for the entire Sudan are projected to rise by only 4 percent in 2010, approximately $3.6 billion at current exchange rate, according to the IMF estimates.[20] The foreign exchange reserve position is also very precarious. Reserves were down to about $300 million (equivalent to two weeks of import cover) as of March 2009. This implies that the source for foreign exchange for Southern Sudan is likely to be limited to the parallel market and the BOSS (one of the branches of Central Bank in the South) which technically is supposed to turn over its foreign exchange to the Central Bank in Khartoum but has not.

Macroeconomic adjustments are urgently needed both for the entire Sudan and Southern Sudan. The GOSS has already begun to implement austere measures to respond to the fiscal crisis. Its implementation is weak and uneven. It has yet to demonstrate its political resolve and commitment to respond to the challenge.

A kinder interpretation of this picture of fiscal mismanagement and missed opportunity is to attribute this to weaknesses in governance, accountability, the political economy of national security, and the nature of a nascent government with limited capacity. In either view, it would be a mistake on the part of donors to rely on democratic governance – elections and referendum – as a primary means of addressing these issues for post-conflict Southern Sudan. There is no way of getting around the simple fact of very poor fiscal discipline on the part of the GOSS leadership, fueled to some extent by aid inflation and excessive emphasis on disbursement and over-reliance on the government on project implementation. While democratic governance has its own merit and is a worthwhile goal in itself, experience elsewhere in post-conflict recovery as indicated in the USAID/EGAT guidance[21], it is not adequate and in fact, not a primary factor in determining the success of transformation from a post-conflict situation to a sustainable development path. Collier, Heffler, and Soderbom concluded from their statistical analysis that "….political design does not appear to reign supreme as the mechanism for post-conflict peace."[22] Increasingly, international experience suggests a critical role for the private sector in generating employment and economic opportunities, and revenue for the government for necessary public goods that can help sustain peace. Policy reform and broad based economic growth are more important in sustaining peace and transition from relief and aid dependence to the path of sustainable development focus.

USAID assistance for Sudan has now reached one billion dollars per year, a new high. Nearly 70 percent of it is humanitarian assistance and relief (including food aid and Darfur), and a significant part of development

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[19] Oil revenues nearly doubled from about $1.3 billion in 2007 to $2.5 billion in 2008. In 2009, it is expected to receive $1.3 billion. Government spending in 2008 went from the budgeted level of SDG 3.4 billion ($1.3 billions.) to SDG 5.7 billion ($2.3 billion). Total revenues collected in 2008 was SDG 6.77 ($2.7 billion), still leaving a surplus which was carried over as reserve for 2009. It was quickly used to fill the shortfall of first-quarter revenues in 2009.

[20] This is slightly less than half of that in 2008. IMF, "Sudan: Staff-Monitored Program for 2009-10", July 2009.

[21] USAID/EGAT (2009), *A Guide to Economic Growth in Post-Conflict Countries*

[22] Collier, Hoeffler and Soderbom (2006), "Post Conflict Risks." See also Collier, Elbadawi, et. al., *Breaking the Conflict Trap: Civil War and Development Policy,* World Bank, Oxford Press, 2003.

assistance is earmarked for democracy and governance, largely for the general election in 2010.[23] The transition from the relief and humanitarian assistance to a strategically focused development program is proving to be more difficult than initially thought.

The proposed agenda for USAID engagement, by emphasizing policy reform and private sector broad-based growth strategy, can also serve as an anchor for consolidating successes and lessons learned from past USAID/Sudan activities into a coherent development strategy.

In terms of sequencing and the level of effort and assistance intensity, the macroeconomic management – particularly high-level political resolve on expenditure management, controls, transparency, and accountability should receive urgent, immediate attention, high-level policy dialogue, and assistance intensity. High-level of efforts are also required in exploring and put in place programs that support job creation and income generating opportunities to complement the disarmament, demobilization and reintegration into the new economy of ex-combatants. Mitigating the risk of reversion to conflict and a sound macroeconomic foundation are important in reducing uncertainty and risk to private sector broad-based growth. High level of efforts and intensity should also be considered to encourage policy and institutional reforms that remove barriers to small business and the informal sector, while a more thorough policy and institutional analysis is being undertaken. In the short to medium term, a state-by-state bottom-up growth strategy should be completed and a reform agenda formulated to establish an environment conducive to private investment and growth, including supportive legislation and institutions like the investment promotion act and the investment authority

Certain aspects of the private sector broad-based growth and other activities in the USAID portfolio can complement and reinforce each other. For example, having a reasonably functioning infrastructure to provide such basic services as roads, electricity, and telecommunications can improve fiscal operations. Currently, payment of salaries requires that money be moved from one location to another in bulk and administered by an array of ministries at the location. The GOSS has no guarantee that payments are for the intended purposes. If payments could be made directly through banks, fiscal control would be enhanced. Strengthening financial management such as through the Financial Management Information System at the Finance Ministry, once established and functioning, can help improve the transparency and accountability of line ministries in their financial operations such as education, health, and SPL affairs.

USAID/Sudan can build on the successes of the current technical assistance activities under the Core Institutional Structure Project (CISP) by consolidating or refocusing in some areas if need be while expanding in others. USAID has a large technical assistance team in place, because USAID got off to an earlier start than other donors and presumably was responding to the opportunities and demands of start up at the time. As there are now more donor programs and the need for technical assistance is not decreasing – maybe, even increasing – as donor assistance rose significantly faster than the domestic absorptive capacity in the last few years, USAID should make a conscious effort to improve coordination with other donors. USAID should take on a more active role in aid coordination given the comparative strength and in-country experience it has accumulated. But for USAID to be able to do so, its own field Mission staff will have to expand, particularly in the area of economic and policy analysis.

[23] USAID, http://www.usaid.gov/locations/sub-saharan_africa/countries/sudan/index.html

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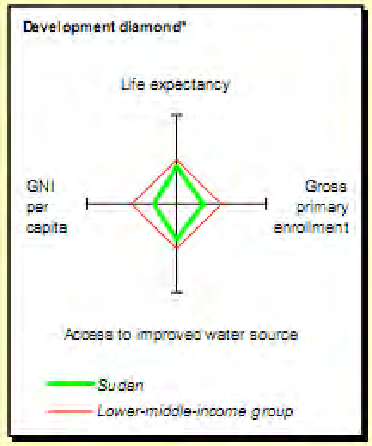
ANNEX A: SUDAN: KEY SOCIOECONOMIC INDICATORS

Sudan at a glance

9/24/08

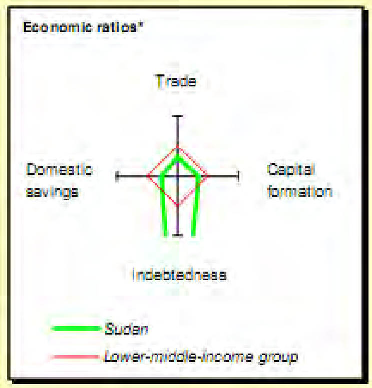
POVERTY and SOCIAL	Sudan	Sub-Saharan Africa	Lower-middle-income
2007			
Population, mid-year *(millions)*	38.6	800	3,437
GNI per capita *(Atlas method, US$)*	950	952	1,887
GNI *(Atlas method, US$ billions)*	36.7	762	6,485
Average annual growth, 2001-07			
Population *(%)*	2.1	2.5	1.1
Labor force *(%)*	2.7	2.6	1.5
Most recent estimate (latest year available, 2001-07)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	43	36	42
Life expectancy at birth *(years)*	58	51	69
Infant mortality *(per 1,000 live births)*	61	94	41
Child malnutrition *(% of children under 5)*	..	27	25
Access to an improved water source *(% of population)*	70	58	88
Literacy *(% of population age 15+)*	..	59	89
Gross primary enrollment *(% of school-age population)*	66	94	111
Male	71	99	112
Female	61	88	109



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

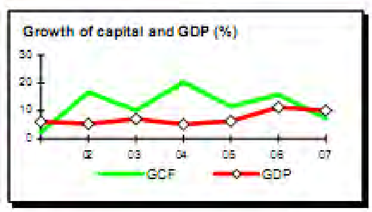
	1987	1997	2006	2007
GDP *(US$ billions)*	20.6	11.7	36.4	46.2
Gross capital formation/GDP	15.1	15.8	24.8	24.2
Exports of goods and services/GDP	5.5	5.3	16.5	20.1
Gross domestic savings/GDP	9.5	8.6	13.9	20.5
Gross national savings/GDP	12.0	9.5	9.7	11.9
Current account balance/GDP	-2.1	-6.3	-15.1	-12.4
Interest payments/GDP	0.1	0.0	0.1	..
Total debt/GDP	54.5	139.8	52.6	..
Total debt service/exports	12.0	9.0	4.8	..
Present value of debt/GDP	..	..	56.4	..
Present value of debt/exports	..	..	336.4	..

	1987-97	1997-07	2006	2007	2007-11
(average annual growth)					
GDP	4.2	6.6	11.3	10.2	8.8
GDP per capita	1.7	4.3	8.9	7.7	7.3
Exports of goods and services	-1.2	21.7	0.4	33.6	..

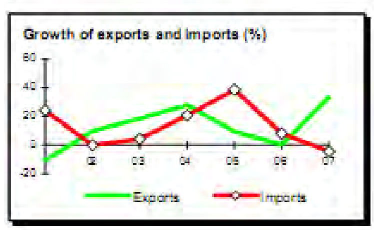


STRUCTURE of the ECONOMY

	1987	1997	2006	2007
(% of GDP)				
Agriculture	32.8	46.8	30.1	28.3
Industry	16.3	14.6	29.2	30.7
Manufacturing	8.8	8.8	6.3	6.1
Services	50.9	38.6	40.8	41.0
Household final consumption expenditure	77.8	86.0	69.4	64.8
General gov't final consumption expenditure	12.8	5.4	16.7	14.8
Imports of goods and services	11.1	12.5	27.5	23.9



	1987-97	1997-07	2006	2007
(average annual growth)				
Agriculture	4.7	2.0	4.4	3.1
Industry	4.8	12.5	16.4	20.0
Manufacturing	4.5	3.4	1.5	6.0
Services	3.0	8.2	14.1	10.0
Household final consumption expenditure	3.6	4.7	11.4	1.4
General gov't final consumption expenditure	1.3	11.4	11.7	-3.0
Gross capital formation	10.5	11.7	15.9	7.4
Imports of goods and services	3.4	14.6	8.2	-4.4



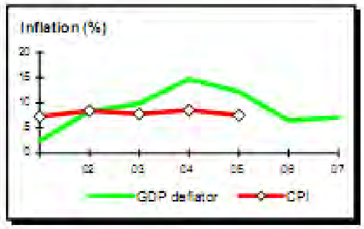
Note: 2007 data are preliminary estimates.

This table was produced from the Development Economics LDB database.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

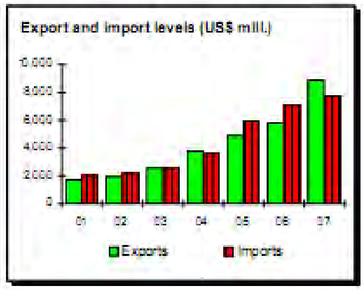
PRICES and GOVERNMENT FINANCE

	1987	1997	2006	2007
Domestic prices				
(% change)				
Consumer prices	20.6	46.7	..	..
Implicit GDP deflator	25.9	47.6	6.5	7.0
Government finance				
(% of GDP, includes current grants)				
Current revenue	11.1	5.8	20.0	19.9
Current budget balance	-11.0	-0.2	-0.4	1.0
Overall surplus/deficit	..	-0.7	-4.4	-3.1



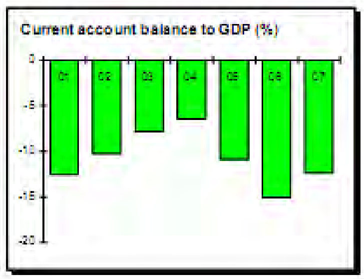
TRADE

	1987	1997	2006	2007
(US$ millions)				
Total exports (fob)	265	594	5,813	8,902
Sesame	..	..	5,244	8,443
n.a.	..	..	..	..
Manufactures	..	..	..	..
Total imports (cif)	832	1,422	7,105	7,722
Food	140	243	656	723
Fuel and energy	184	299	364	256
Capital goods	189	261	3,785	4,099
Export price index *(2000=100)*	..	93	..	..
Import price index *(2000=100)*	..	104	..	..
Terms of trade *(2000=100)*	..	90	..	..



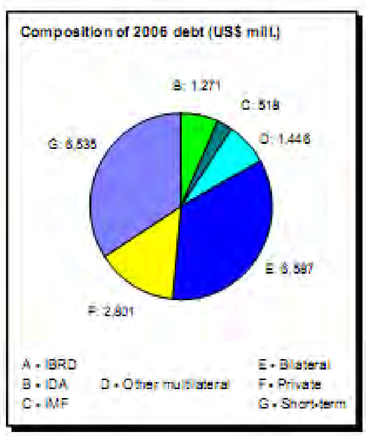
BALANCE of PAYMENTS

	1987	1997	2006	2007
(US$ millions)				
Exports of goods and services	450	624	6,015	9,287
Imports of goods and services	923	1,462	9,995	11,041
Resource balance	-474	-838	-3,980	-1,754
Net income	-629	-345	-2,898	-4,546
Net current transfers	676	452	1,390	582
Current account balance	-427	-731	-5,489	-5,718
Financing items (net)	176	754	5,519	..
Changes in net reserves	250	-23	-30	..
Memo:				
Reserves including gold *(US$ millions)*	77	82	..	..
Conversion rate *(DEC, local/US$)*	1.76E-3	1.6	2.2	2.0



EXTERNAL DEBT and RESOURCE FLOWS

	1987	1997	2006	2007
(US$ millions)				
Total debt outstanding and disbursed	11,249	16,326	19,158	..
IBRD	49	6	0	0
IDA	688	1,198	1,271	1,307
Total debt service	97	58	292	..
IBRD	8	0	0	0
IDA	8	0	3	0
Composition of net resource flows				
Official grants	564	118	1,776	..
Official creditors	160	5	93	..
Private creditors	0	0	0	..
Foreign direct investment (net inflows)	12	98	3,534	..
Portfolio equity (net inflows)	0	0	-35	..
World Bank program				
Commitments	49	0	0	0
Disbursements	62	0	0	0
Principal repayments	8	0	2	0
Net flows	55	0	-2	0
Interest payments	8	0	1	0
Net transfers	46	0	-3	0



The World Bank Group: This table was prepared by country unit staff; figures may differ from other World Bank published data. 9/24/08

ANNEX B: JUBA COMPACT BETWEEN GOVERNMENT OF SOUTHERN SUDAN AND DEVELOPMENT PARTNERS

Juba Compact between the Government of Southern Sudan and Development Partners

1. Introduction

1.1 Following the signing of the Comprehensive Peace Agreement (CPA) in 2005 the Government of Southern Sudan (GoSS) and its donor partners have, for the past four years, been working closely together to deliver peace dividends and improve the lives of the people of Southern Sudan.

1.2 This Compact between GoSS and its partners represents a new higher level of cooperation and commitment to these objectives. In particular, the Compact represents agreed measures to address the current fiscal and economic situation and focuses on important adjustment measures and reforms. The Compact is formulated as a mutual accountability results framework, with the GoSS and donors pledging to monitor progress jointly against the benchmarks outlined in the accompanying policy matrix.

1.3 By this Compact, GoSS and its donor partners reaffirm and rededicate themselves to joint efforts to create a secure, peaceful, democratic and prosperous Southern Sudan. In this regard, the GoSS will pursue, and partners will support, policies and programs which will ensure that the Sudan Peoples Liberation Army (SPLA) develops into a force which is affordable and effective in relation to its agreed mission, as outlined in the SPLA White Paper. The GoSS also commits to fight corruption at all levels and partners pledge to provide direct support to assist with these efforts.

1.4 The focus of this Compact is on GoSS achieving fiscal sustainability by the end of the Interim Period as set out within the CPA. Recent fiscal difficulties have highlighted the need for GoSS to take concerted action with the support of its donor partners to resolve the present situation and avoid similar situations in the future. Therefore, it is agreed that over this time horizon GoSS and donor partners will work jointly, and fully commit themselves to achieve three key objectives:

- enhance fiscal responsibility;
- strengthen public finance management systems; and
- accelerate private sector-led development, inclusive economic growth and poverty reduction.

2. Commitments by the Government of Southern Sudan

2.1 Specifically, the GoSS reconfirms that by the end of 2009 it will:

2.2 <u>Enhance fiscal responsibility by</u>:

2.2.1 Ensuring strict adherence to the Appropriations Act of 2009.

2.2.2 Submitting a request to the Southern Sudan Legislative Assembly to temporarily reduce block transfers to oil producing states.

2.2.3 Implementing selected austerity measures to reduce expenditures to stay within available resources.

2.2.4 Freezing temporarily all new contracts including contracts relating to strategic food reserves and putting in place an effective commitment control and contract management system.

2.2.5 Assessing the technical feasibility of a sustainable, multi-year oil revenue management system.

2.2.6 Strengthening revenue administration and mobilizing greater non-oil revenues.

2.3 <u>Strengthen public finance management systems by</u>:

2.3.1 Deepening advocacy efforts on the importance of the following key public financial management laws, to include fast-tracking their submission to the Southern Sudan Legislative Assembly and preparing for their immediate implementation upon approval:

a. revenue;

b. public financial management;

c. audit;

d. procurement;

e. public service.

2.3.2 Confirming an Auditor General in post, appropriately staffing and funding the Anti-Corruption Commission and preparing and disseminating audit reports on time.

2.3.3 Establishing an automated and standard payroll system and improving the payroll across the public sector for all employees, including uniformed personnel, and conducting regular audits of GoSS payrolls.

2.3.4 Deciding on an appropriate pension plan for GoSS employees.

2.3.5 Reviewing the numbers, functions and size of Ministries, Commissions and other bodies at both GoSS and State levels.

2.4 <u>Accelerate private sector-led development, inclusive economic growth and poverty reduction by</u>:

2.4.1 Developing a Growth Strategy by the end of 2009 which incorporates policies aimed at ensuring food security and agriculture-led growth.

2.4.2 Developing a long-term Poverty Reduction, Reconstruction and Development Plan by September 2010 which builds on the growth strategy, budget sector plans, the household poverty survey and the census and through the Plan, working towards a long-term shift in allocation of GoSS' resources from payroll and pensions towards productive sectors.

2.4.3 Resolving the current crisis at the Nile Commercial Bank and improving regulation and oversight by the Bank of Southern Sudan of commercial banks and micro finance institutions.

2.4.4 Promoting private sector investment through effective implementation of the Investment Promotion Act and support for micro-finance.

3. Commitments by Donor Partners

3.1 Specifically, donor partners, each operating with their own rules, procedures, and normal counterparts, and subjected to availability of funds, will:

3.2 Contribute significant resources to support the main objectives of the Compact by:

3.2.1 Providing a minimum of USD 600 million per annum in support in the remaining years of the Interim Period as defined in the CPA.

3.3 Provide rapid support to meet urgent budget and high priority needs by:

3.3.1 Meeting the GoSS counterpart requirement for Phase I of the Multi-Donor Trust Fund (MDTF) in the amount of USD 58 million.

3.3.2 Using MDTF resources for road maintenance and emergency repairs utilizing rural labor wherever possible in the amount of USD 25 million for the first year and possibly USD 15 million for the second year.

3.3.3 Using MDTF resources for the reintegration of former combatants who fall into the category of Special Need Groups, and women associated with the armed forces, in the amount of USD 40 million, provided coherent plans for implementation are in place.

3.3.4 Providing funding to support the upcoming elections and referendum.

3.4 Support the reforms implemented by the GoSS by:

3.4.1 Using the Capacity Building Trust Fund (CBTF) to help support the establishment of a payroll system for all GoSS employees including uniformed personnel.

3.4.2 Ensuring existing technical assistance is focused on the implementation of the GoSS austerity package.

3.4.3 Providing additional resources for technical assistance in priority reform areas including contract management, legal affairs, essential legislation and management of oil revenue.

3.5. Increase aid effectiveness by:

3.5.1 Reorienting the aid architecture, in mutual agreement with GoSS, to ensure that allocations to pooled funds reflect the strengths and comparative advantages of different partners and instruments.

4. Consulting and Reporting

4.1 The GoSS will appraise the Governors of the ten Southern States of the current fiscal situation and of the measures that are being undertaken to tackle it, highlighting those interventions that affect, or require their co-operation. GoSS will also inform the Government of National Unity (GoNU) about the Compact and the issues that require GoNU's cooperation. GoSS will regularly inform the public of the current situation and their endeavors to improve living conditions and governance and seek the support of the population in the reform process.

4.2 The GoSS and donor partners will consult at least quarterly on progress under this Compact through the GoSS Donor Forum. GoSS will provide complete and verifiable information on the results of the registering and reviewing contracts, and the drafts of proposed legislation. In addition, the Ministry of Finance and Economic Planning, after fulfilling its expenditure reporting requirements to the Council of Ministers and the Southern Sudan Legislative Assembly, will make available relevant financial reports. In turn, donor partners will provide detailed information on their level of commitments and disbursements on a project by project basis to the GoSS as requested by the Ministry of Finance and Economic Planning.

4.3 Donor partners will regularly assess the level and mechanisms of their support depending on the complete and timely implementation of the Compact and the specific steps outlined in the accompanying matrix, and in line with the changing context in Southern Sudan.

4.4 For purposes of this Compact, the GoSS will consult with donor partners in order to ensure that the measures enshrined in this Compact are reflected in the GoSS budget as appropriate through 2009 and subsequent fiscal years.

Endorsed in Juba, Southern Sudan, by the Government of Southern Sudan and the Development Partners (June 30, 2009).

ANNEX C: MUTUAL ACCOUNTABILITY MATRIX

MUTUAL ACCOUNTABILITY MATRIX FOR THE COMPACT BETWEEN THE GOVERNMENT OF SOUTHERN SUDAN AND DONOR PARTNERS

Actions	Key Steps	Implementing Agency	Donor Support	Timeline	Fiscal Savings
Pillar 1: Enhance Fiscal Responsibility					
Section 1: Strengthen budget management **Rationale: The Government of Southern Sudan's (GoSS) obligations far exceeds available resources. There is a need to reaffirm that the budget is the central tool for managing resources and the Appropriation Act is the instrument for reinforcing budget discipline. There is also a need to minimize current expenditure in line with available resources and to put in place an effective commitment-control and contract management system.**					
1. *Ensure strict adherence to the Appropriation Act of 2009*	A circular will be issued to all GOSS agencies stating that no expenditure from or commitments against the Consolidated Fund should be made except as authorized by the Appropriation Act. Spending agencies will be required to adhere to the 2009 Budget Execution circular and 2009 Payment and Petty Cash procedures.	MoFEP	Not required	July 15 2009	
2. *Reduce block transfers to oil producing states*	A request will be submitted to the Assembly to reduce block transfer to the oil producing states by 10% for the year 2009.	MoFEP	Not required	July 30, 2009	SDG 6.5-8.8m
3. *Implement austerity measures for immediate expenditure management*	A circular will be issued to all GoSS agencies informing them that only petty cash allocations and existing contractual obligations that will be deemed eligible by the Council of Ministers (CoM) are to be guaranteed for the reminder of this year. The circular will also inform all GoSS agencies that petty cash replenishment will only be replenished when previous petty cash expenditures are accounted for based on approved procedures. The circular will also identify specific items outside petty cash that will be eligible for payment. A monthly budget execution report will be presented to the CoM within 30 days of the end of each month and then made publicly available.	MoFEP	Not required	July 15 2009	SDG 100m
4. *Establish an effective commitment-control and contract management system*	All new contracts will be temporarily put on hold (exceptions to be determined by CoM). All existing contracts, including contracts relating to strategic food reserves, will be registered. All existing contracts will be verified.	MoFEP MoLACD	US Gov UN MDTF JDT	June 30 2009 –April 30 2010	SDG 200-300m

Actions	Key Steps	Implementing Agency	Donor Support	Timeline	Fiscal Savings
	A report on the status of GoSS' contractual obligations will be prepared and made public. The report will be reviewed and future corrective actions will be issued by the CoM. All non-compliant contracts will be subjected to a legal review. The temporary ban will be lifted once an effective commitment-control system is in place.				
Section 2: Strengthen revenue generation and management of oil revenue **Rationale: There is a need to broaden the non-oil revenue base, strengthen tax administration and put in place an institutional arrangement for management of oil revenue.**					
5. *Lay the groundwork for a oil revenue management system*	A task force will be established to examine the feasibility of options for a sustainable, multi-year revenue management system for GoSS' share of the oil revenue. The recommendations of the Task Force will be presented to the CoM.	MoFEP	Donor Partners	Oct 31 2009	
6. *Strengthen the revenue administration system*	Drawing on the studies by the ADB, WB and USAID consultants, various options will be assessed for greater mobilization of non-oil revenues for GoSS as well as the ten states. The IMF will undertake a study on reforming custom administration and enhancing the management of the national taxes collected in the south.	MoFEP	USAID ADB WB TBC	Sep 31 2009 Dec 31 2009	
Pillar 2: Strengthen Public Financial Management Systems					
Section 1: Promulgate effective laws and strengthen existing institutions **Rationale: Many of the existing PFM rules and regulations are based on decrees and circulars but need legislative approval.**					
7. *Promulgate and immediately implement the Revenue Bill*	• Bills will be technically reviewed and vetted to conform to international best practice in a post-conflict environment. • The Council of Ministers will agree to a schedule for fast-tracking the submission of the Bills to the Southern Sudan Legislative Assembly, and will request the Assembly to prioritise their passage. • Bills will be issued by Presidential Decree if the Assembly goes into recess on	MoFEP MoLACD	USAID WB IFC	July-Sep 30, 2009	
8. *Promulgate and immediately implement the Public Financial Management Bill*		MoFEP MoLACD	ADB WB UN	Sep-Dec 30, 2009	
9. *Promulgate and immediately implement the Audit Bill*		MoFEP MoLACD	USAID UN	Sep-Dec 30, 2009	
10. *Promulgate and immediately implement the*		MOFEP	ADB	Sep-Dec 30,	

Actions	Key Steps	Implementing Agency	Donor Support	Timeline	Fiscal Savings
Procurement Bill and revised regulations	account of elections. • Rules and regulations will be drafted and issued in order to make Acts effective.	MoLACD	MDTF	2009	
11. *Promulgate and immediately implement the Public Service Bill*		MoLPSHRD MoLACD	USAID MDTF JDT UN	Sep-Dec 30, 2009	
12. *Strengthen accountability*	• An Auditor General will be appointed. • The audit report for 2006 and subsequent years will be prepared and disseminated. • The Anti Corruption Commission will be appropriately staffed and funded. • Staff in line ministries will be trained on anti-corruption systems and procedures.	MoCA MoFEP	JDT MDTF	Sep 30 2009 Dec 31 2009	
Section 2: Accelerate payroll and pension management and civil service reform **Rationale: Many of the existing PFM rules and regulations are based on decrees and circulars and will therefore benefit from a stronger legislative backing.**					
13. *Improve payroll systems*	• A human resource information system will be established and piloted in the MoLPSHRD. • An automated payroll system will be established. • A multi-stakeholder Payroll Audit Committee (PAC) will be established to continuously audit GoSS payrolls. Monthly reports and actions taken by the line ministries will be presented to the CoM. • All personnel will be screened against the required qualifications in their grade and those found to be under qualified will be re-graded or given an opportunity to achieve the required qualifications.	MoFEP MoLPSHRD	USAID CBTF UN	June 30 – April 30 2010	
14. *Lay the groundwork for a fiscally sustainable pension plan*	• A decision will be taken on the type of pension plan that will be introduced for GoSS employees.	MoLPSHRD	JDT MDTF USAID	April 30 2010	
15. *Review the numbers, functions and size of Ministries, Commissions and other bodies at both GoSS and State levels*	• A review of the functions of GoSS Commissions and State Ministries will be undertaken. • A detailed functional review of key GoSS ministries will be undertaken to ensure that their structures and resourcing are appropriate to their functions.	MoLPSHRD	USAID MDTF CBTF UN	April 30 2010	
Pillar 3: Accelerate Private Sector-Led Development, Inclusive Economic Growth and Poverty Reduction					
Rationale: The current fiscal crisis has demonstrated the need for non-oil growth and economic diversification. This is also an opportunity to bring more					

Actions	Key Steps	Implementing Agency	Donor Support	Timeline	Fiscal Savings
strategic coherence to GoSS budgetary allocations and donor-funded activities.					
16. *Develop a growth strategy*	• A Growth Working Group (GWG) will be established. • Drawing on the recommendations of the GoSS growth seminars, and the ongoing work of the CEM and the GWG, MoFEP will prepare a strategy for private sector development and broad-based growth with a particular focus on ensuring food security and agriculture-led growth. • As part of this exercise, studies will be undertaken to identify areas/sectors with economic potential including their costs and benefits. • The Growth and Development Strategy will be adopted by the CoM.	MoFEP MoCA Infrastructure Ministries	WB Donor Partners	Dec 31 2009	
17. *Develop a poverty reduction, reconstruction and development plan*	• Using the growth strategy, Budget Sector Plans, household survey data and census, a long-term poverty reduction, reconstruction and development plan will be prepared.	MoFEP MoCA	WB Donor Partners	Sep 30 2010	
18. *Restructure the Nile Commercial Bank*	• The NCB will be temporarily put under the joint control of BoSS and MoFEP. • A consultant (financial/banking restructuring expert) will be appointed to advise on various restructuring options. • CoM will chose the restructuring option to be adopted by the GoSS.	BoSS MoFEP	MDTF USAID	Oct 31 2009	
19. *Promote private sector investment*	• Adequate support will be given to the recently established Investment Authority to execute its mandate as per the Investment Act. • Statutory regulations and instruments will be adopted.	MoIC MoFEP	IFC	Dec 31 2009	
Pillar 4: Provide significant donor support to the reform package					
Section 1: Contribute significant resources to support the main objectives of the Compact **Rationale: The GoSS will require significant financial support to meet the objectives in the Compact of delivering peace dividends and improving the lives of Southern Sudanese.**					
20. *Provide a minimum of US$ 600m per annum to Southern Sudan for the remaining two years of the Interim Period*	• Donor partners will aim to provide this funding, each operating on the basis of their own rules, procedures, and normal counterparts, and subject to availability of funds. • Donors will aim to provide funding to the upcoming elections and referendum.	Various	MoFEP	Annually	
Section 2: Provide rapid support to meet urgent budget or high priority items **Rationale: In order to relieve pressure on the budget, donors will redirect resources into areas that help to mitigate reduce budgetary commitments.**					
21. *Waive GoSS MDTF contributions for the*	• The waiver will be initiated by the formal adoption of the Compact by GoSS.	MDTF donors via	MoFEP	30 July 2009	US$58m

Actions	Key Steps	Implementing Agency	Donor Support	Timeline	Fiscal Savings
remainder of Phase 1		the MDTF OC			
22. *Support road maintenance and emergency repairs*	• MoTR and WFP, in support of budget allocations made to the MoTR, will submit a project in the amount of approximately US$25 million directly to the MDTF Oversight Committee (OC) for rapid approval for year one with the potential of additional US$15 million for year two. The proposal will cover road maintenance and emergency repairs and will include capacity building for the MoTR. The expectation is that GoSS will assume responsibility for funding and managing this key activity by the end of the Interim Period.	WFP MDTF OC	MoTR	July 2009	US$25m
23. *Support the reintegration of Special Needs Groups (SNG) being disarmed and demobilized*	• UNDP, in response to an appeal by the GoSS, will submit a request to the MDTF Oversight Committee to approve a Fiduciary Principles Accord for administration of the reintegration programme for the amount of US$40 million.	MDTF donors via the MDTF OC	SSDDRC	Nov 2009	US$40m
24. *Support the elections and referendum*	• Donor partners will aim to provide funding for these key activities on the basis of agreed operational plans.	Various	NEC	August 2009	To be agreed
Section 3: Support the reforms being implemented by the GoSS **Rationale: The GoSS will require direct support to implement the reforms outlined in the Compact including reforming the payroll, increasing the non-oil revenue base, improving tax administration and strengthening the institutional arrangements for management of oil revenue.**					
25. *Support payroll reform*	• CBTF will accelerate support to GoSS to create a payroll system for all GoSS employees including uniformed personnel.	JDP	MoFEP MoLPSHRD	December 2009	US$15m
26. *Ensure existing technical assistance is focused on the austerity package*	• Donors will ensure that existing technical assistance in various institutions across GoSS and in the SPLA assists with implementing the reforms outlined in the Compact.	Various	MoLA BoSS MoFEP	July	
27. *Provide additional technical assistance*	• Several donors will provide additional assistance for many of the reforms outlined in the Compact and on the basis of requests from the GoSS by the end of July 2009 including assistance for contracts, legal affairs and essential legislation. • Several donors will provide technical assistance to plan expenditure, appropriate savings levels, and investment policy from oil revenues.	Various Norway WB JDT	MoLA SSLA MoFEP MoEM	September 30, 2009	
Section 4: Increase aid effectiveness **Rationale: Given tight donor budgets and the need to fast-track peace dividends and reforms during the remainder of the Interim Period, donors will need to ensure that their support is aligned directly with GoSS priorities, is coordinated and channeled through appropriate instruments on the basis of their comparative advantages.**					

Actions	Key Steps	Implementing Agency	Donor Support	Timeline	Fiscal Savings
28. *Reorient the aid architecture*	• Donor allocations to pooled funds will be realigned to reflect the strengths and comparative advantages of different donors and the respective pooled funds. • MDTF Oversight Committee will base MDTF Phase II allocations on an assessment of Government priorities, comparative advantage and disbursement capabilities, while maintaining the quality and sustainability of the projects. • The working group on MDTF Implementation and the MDTF-TS will advise the MDTF Oversight Committee on modalities for rapid disbursement. • The MDTF-TS will develop FPPs, taking into account (i) the indicative phase II allocation (ii) the findings on MDTF Implementation working group. • To re-affirm the principle of counterpart contributions, the GoSS will propose an indicative unallocated Phase 2 commitment of $50 million - $100 million and will review the feasibility of this commitment with the OC, and identify areas in which it might be allocated, at the end of 2009.	JDP All MDTF Stakeholders MDTF-TS	MoFEP	July 30 2009	

ANNEX D: GOSS COUNCIL OF MINISTERS: RECOMMENDATIONS OF THE MINISTERIAL COMMITTEE ON THE MANAGEMENT OF THE FISCAL CRISIS

GOVERNMENT OF SOUTHERN SUDAN
MINISTRY OF REGIONAL COOPERATION

Ref: MRC/GOSS/MO/I/1.A.1 Date: 22 April 2009

To: All Development Partners

Dear Development Partners,

RE: **UPDATE ON AUSTERITY MEASURES BEING PUT IN PLACE BY THE GOVERNMENT OF SOUTHERN SUDAN IN LIGHT OF THE CURRENT FINANCIAL CRISIS**

I would like to take this opportunity to sincerely appreciate your continuous support to our Government since its inception subsequent to the signing of the Comprehensive Peace Agreement (CPA). I particularly note with gratitude the speed at which you all rallied behind our Government, especially during this difficult time when the whole world and our Government in particular, is facing financial challenges.

With regard to the above mentioned subject matter, I am happy to inform you that the Government of Southern Sudan has formed a Ministerial Task Force charged with the responsibility of formulating modalities of managing the current Fiscal Crisis. In this regard, please find herewith attached the blind copy of the approved GOSS Council of Ministers' austerity plan that is aimed at cushioning the present financial crisis.

This draft is being sent to you all as an unofficial document for your perusal as a prelude to the plan of H.E Gen Salva Kiir Mayardit, President of GOSS to address you in the nearest future on the same issue.

Accept the assurances of my highest consideration.

Dr. Barnaba Marial Benjamin,
Minister

GOSS Council of Ministers

Recommendations of the Ministerial Committee on the management of the fiscal crisis

STEP.I: POLITICAL ENGAGEMENT WITH GOVERNMENT OF NATIONAL UNITY		
RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
1. Restructure the Central Bank of Sudan (CBS) in such a way that both the Islamic and the conventional banking windows (BOSS) operate concurrently. 2. GONU to repay the arrears it owes to GOSS & to stop accumulating arrears henceforth. 3. GONU to repay GOSS and Abyie their share of the oil revenue arrears.		• GOSS President to engage the Presidency to direct the CBS re-structuring. • Joint National Committee on Economic Crisis to follow up on progress. • GOSS Ministry of Finance to pursue matter and report progres to Task Force.
4. GONU to stop making deductions from GOSS oil revenue share for elections and to refund deductions already made.		• Joint Political Executive Committee to bring the GONU Ministry of Finance & National Economy to respect CPA provisions on Elections funding

STEP.II: IMPROVING REVENUE GENERATION		
RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
5. NOT to draw any funds from the GOSS reserve to meet any recurrent costs excepting dire necessity.		• Task Force to request GOSS President to authorise such actio in the event of the dire necessity
6. Implement past Council of Ministers resolutions on non-oil and non-tax revenue collection 7. Expedite passing of the Revenue Bill into law. 8. National non-oil revenues collected in the South to be remitted to the joint GONU-GOSS revenue account including the 50% share of telecommunication services.		• Task Force to oversee implementation of the agreed or any new measures on revenue collection. • Task Force to follow up on the passing of the Revenue Bill with the SSLA. • GOSS members in the Joint National Committee on economic crisis to resolve matter with GONU counterparts.

STEP.III: GOSS FOREX RESERVE		
RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
9. All GOSS oil revenue to be paid in FOREX currency and the FOREX which accrues to BOSS from MFEP purchase of local currency is kept as conventional banking window reserve (by BOSS).		• GOSS President to engage with the President of the Republic to operationalize the conventional banking window as per CPA provision. • GOSS members in the Joint National Committee on economic crisis to resolve matter with GONU counterparts.

STEP.IV: BUDGET CUTS & CONTRACTS		
RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
10. Reduce operational costs budget by 50% with the exception of petty cash and for emergencies approved by Task Force.		• Ministry of Finance to effect the adjustment and keep Task Force informed of progress.
11. Reduce block transfers to oil producing States by 10%.		• GOSS President to issue directive to Concerned States
12. Review performance of the food security reserve strategy.		• MOFEP to appraise Task Force of outcome
13. Funding for prioritized roads should continue. Development partners (USAID and WB) advised to pave the Juba-Nimule and Juba-Kaya roads. GOSS to secure funding for the Juba-Nadapal road.		• Task Force to engage MDTF and USAID. • GOSS to outsource funding for the Juba-Nadapal road.
14. Conduct audit of all GOSS and States procurement contracts, 2007-2008.		• MOFEP to submit report to Task Force.

RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
15. Freeze signing of new contracts by all GOSS institutions until crisis is resolved		• Task Force to enforce the measure with few exception
16. Create a register for all contracts and review all existing contracts for conformity, with the view to renegotiating, cancelling or amending as necessary.		• Task Force to identify a technical team to conduct the review of all procurement contracts and advise accordingly. • Task Force to solicit external consultant(s) to conduct the review.

STEP V: GOSS GENERAL STRATEGIC APPROACH TO THE CRISIS

RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
17. Accelerate and generalise payroll cleansing across all public sector employees inclusive of uniformed personnel and establish standard payrolls.		Task Force to support Ministry of Labour & HRD in the on-going Public Sector Reform
18. GOSS to develop a unified rolling strategic reconstruction & development plan (3 years)		Ministries of Cabinet Affairs & Finance to supervise the process.
19. GOSS to expedite implementation of the Investment Promotion Act.		Ministries of Finance, Industry and the Investment Authority & Reconstruction Fund to work jointly.
20. GOSS to keep the public informed about the fiscal crisis and on resolutions measures.		Ministry of Information to implement the measures.
21. GOSS to review and adapt development assistance package towards resolution of the fiscal crisis		Task Force to engage with development partners.
22. Place Nile Commercial Bank under the joint control of BOSS and MFEP with a view to resolving current management crisis at the Bank.		Task Force to monitor the intervention of Bank of Southern Sudan and Ministry of Finance in the take-over and reform process at NCB.
23. Revisit the number, functions and size of Ministries and Commissions and others at both GOSS and States levels.		Task Force to conduct exercise with support of international Consultants.

STEP VI: ROLE OF DEVELOPMENT PARTNERS

RECOMMENDATION	TIME FRAME	IMPLEMENTING PARTY
23. GOSS to request Donors to frontload their 2009 MDTF contributions. MTDF to fund 100% of planned projects in 2009-2010.		• GOSS President to engage MTDF contributors and other development partners on the matter. Task Force to follow-up on the President's intervention
24. Solicit development partners to increase funding to the Capacity Building Trust Fund, to enable GOSS to develop standardised payroll for all public sector employees.		• Ministry of Labour, Public Service & HRD to follow up

25. Request development partners to provide timely funding to support the immediate DDR of the first 35,000 combatants		• DDR Commission to engage with partners, monitor progress and report to Task Force.

MODALITIES FOR FISCAL CRISIS MANAGEMENT

It is recommended to form a Ministerial Task Force to manage the economic crisis.

1. **Composition of the Ministerial Task Force:**

1. Cabinet Affairs	Chair
2. SPLA Affairs	Member
3. Finance and Economic Planning	Secretary
4. Legal Affairs & CD	Member
5. Labor & HRD	Member
6. Parliamentary Affairs	Member
7. Agriculture & Forestry	Member
8. Energy & Mining	Member
9. Commerce & Industry	Member

2. **Secretariat:**
   - Undersecretaries of the Ministries of Finance and Regional Cooperation
   - Consultant (To be vetted by Task Force)

3. **Terms of reference of the Ministerial Task Force:**

- Oversee and monitor all GOSS expenditure, contracts and emergency funding
- Devise effective methods of collecting & securing all forms of revenue
- Solicit reputable experts to undertake specified assignments
- Review quarterly financial performance reports from all GOSS institutions
- Engage with development partners for increased funding to mitigate impact of crisis
- Co-opt individuals (local or international) to assist the Task Force as appropriate
- Coordinate activities and share findings on revenue and expenditure with State Governors
- Brief GOSS President weekly and report to GOSS Council of Ministers quarterly.
- Prepare budget for the Ministerial Task Force activities.
- Perform any other function assigned by the GOSS President or Council of Ministers.