



## Addressing the Urgent Fiscal Crisis in South Sudan

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### Executive Summary

- South Sudan still suffers from fiscal dysfunction and flawed management of scarce financial resources;
- Government agencies continue to disregard the legal Appropriations Acts by overspending or diverting funds to items that fall outside of approved budgets;
- Tax revenue in the Q3 of 2015 rose less than budget projections;
- Serious distortions persist in all markets—including currency;
- The economy must be diversified to escape the dangerous reliance on oil;
- Units of government should face future cuts to avoid overspending;
- Tax collections should be improved through administrative reforms; and
- Deficit financing should be eliminated or brought under control in line with the Bank of South Sudan Act 2011.

### I. The Problem Setting

South Sudan still greatly suffers from many deficiencies.<sup>2</sup> Principal here is the serious mismanagement of public finances, especially the flagrant disregard to Appropriations Acts.

Ubiquitous fiscal malfeasance is self-evident. Horizontal imbalances among spending agencies or sectors explicitly embody such fiscal malfeasance.<sup>3</sup> The recently released FY2014/2015 Third

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<sup>2</sup> Audit Chamber. (2011). Financial Audit Report for the Year Ended 31<sup>st</sup> December 2005.

<sup>3</sup> Audit Chamber. (2011). Financial Audit Report for the Year Ended 31<sup>st</sup> December 2006 & 2007; see, for example, p. 72.

Quarter Report continues to showcase this divergence and the gloomy state of national financial affairs.<sup>4</sup> Security sectors overspent their abundant budgets, while other agencies were forced to underspend. Careful analysis by researchers at the Ebony Center for Strategic Studies (ECSS), including the writer of this review, has discovered severe fiscal malfeasance throughout the Government of South Sudan.

While attempts have been made to curtail such bad practices, habituated inertia has been resistant to change.<sup>5</sup> Whether in war or peacetime, government agencies have consistently, and flagrantly, ignored the Public Finance Management and Accountability Act, 2011 (PFMAA 2011).

The drop in oil revenue has admittedly made it difficult for the Government to fund its entire approved budget. This means that external factors, including conflict and falling global oil prices, have had severe impacts on budget management. While non-oil revenue rose less than budgeted for, the Government has had to resort to serious deficit financing. This has put pressure on all market prices. For instance, a continued decline in revenue has led to further weakening of the SS pound against the dollar. As of 14 December 2015, one USD commands about SSP18 in the foreign exchange parallel market<sup>6</sup>.

Despite an unfavorable macroeconomic environment, poor fiscal management, particularly, irresponsible spending—or blatant disregard for the Appropriations Acts—persists. In this regard, the implementation of the Agreement on the Resolution of Conflict in South Sudan (ARCISS) would be an opportunity to put in place a robust system of public financial management (PFM).

## **II. Three Urgent Fiscal Problems**

I now consider three matters to be contributing to fiscal hardship: (1) fiscal malfeasance; (2) agency shopping; and (3) persistent deficit financing.

### **1. Fiscal Malfeasance**

All reports by the Audit Chamber point out that fiscal malfeasance is a persistent problem. This is in form of asset loss (some officials take Government properties such as cars or computers upon discharge), spending on items unbudgeted for or not properly reconciling accounts at the

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<sup>4</sup> MoFEP. (2015). 2014/2015 Third Quarter Macro-Fiscal Report.

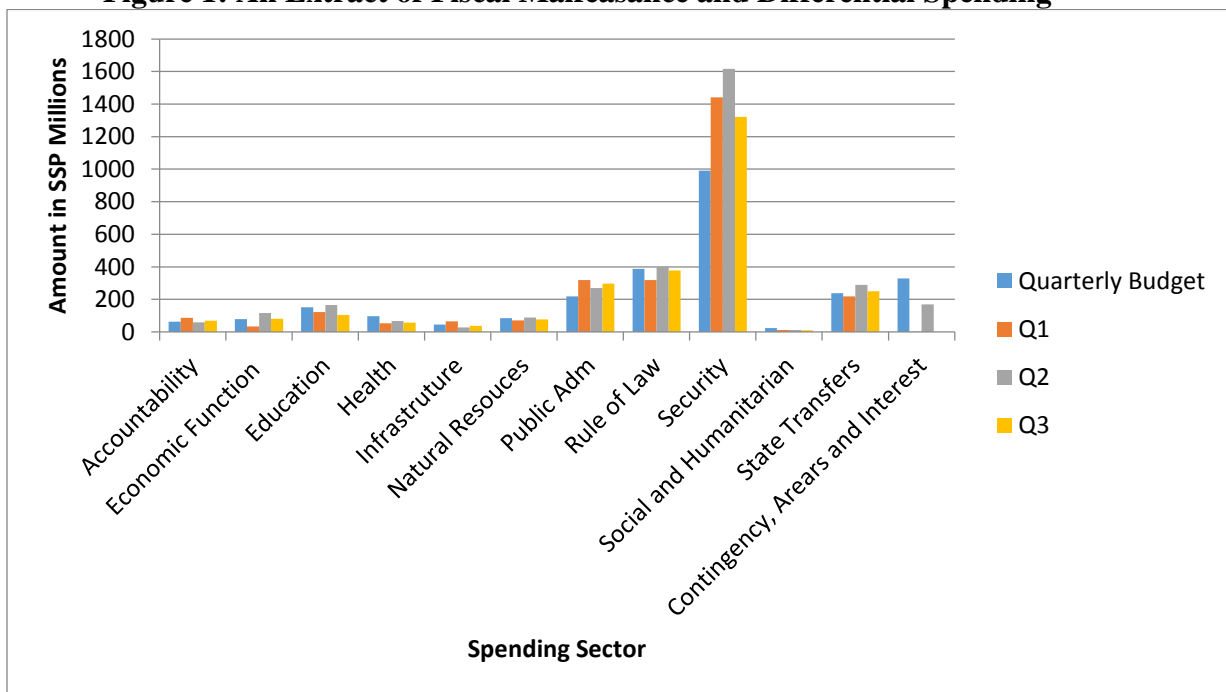
<sup>5</sup> Garang, James Alic. (2015). Quarterly Budget Reports for FY 2014/2015: Validating Fiscal Uncertainty and Habituated Behavioral Inertia, Ebony Policy Brief, No. 1/2015, p. 1-12.

<sup>6</sup> This was the day the Minister of Finance and Governor of Bank of South Sudan announced a new exchange rate regime (ERR) to be a market-based rate. The first market-based rate was determined on 21 December 2015 through an interbank market for foreign exchange. It is an auction system where commercial banks bid. The rate arrived on Monday 21 December 2015 was SSP16.76/USD.

end of the year. Take, for example, the discrepancy arising from nominal payrolls in the audit of 2005 Financial Statements. Of the total payroll cost amounting to \$14.5 million, \$1.9 million was paid without any record of corresponding services rendered in return (p. 47).<sup>7</sup> These discrepancies and many more in the audits have always led the Auditor General to issue his opinion in blistering tone, arguing that the Financial Statements of the Government do not represent the true and fair financial position of the institutions in a given year.

By way of example, misuse of public resources could be inferred from the ways in which some agencies overspend while others underspend. See, for example, the case in which public administration, rule of law and security’s spending go beyond approved quarterly budgets in the FY 2014/2015 (see Figure 1).

**Figure 1: An Extract of Fiscal Malfeasance and Differential Spending**



**Source: Ministry of Finance and Economic Planning, Third Quarterly Budget Report, 2015**

It is true that certain conditions were beyond the control of oversight body. As revenue declined the demand for hard currency remained steady or picked up steam. The demand for foreign currency/exchange in priority areas for food items, fuel, security expenditure, medical treatment abroad, and official foreign travel, has stayed high or increased as dollar revenues have declined sharply.

<sup>7</sup> See Audit Report (2011) for the Year Ended 31<sup>st</sup> December 2005.

Even with this dichotomy, one can still appreciate the role that MoFEP played in making efforts to secure operating funding for all agencies of the Government in the latter half of the FY2014/15.

## **2. Agency Shopping**

The same government function (such as allocation of credit to private sector) has been assigned to several different agencies through what we call agency-shopping process. The problem here is that, for instance, foreign exchange bureaus used to receive huge sums of hard currencies from Bank of South Sudan (BSS) to lend to the public to meet demand in priority areas such as medicine, fuel, and building materials, among others. This was a normal allocation from Bank to Forex as a way for enhancing economic activity of the economy. Some forex were accused of not lending enough through open process but chose to sell to black market players. This arrangement was later terminated. Some people abused this arrangement to enrich themselves.

Again, the letter of credit (LC) system was conceived and with support through credit line from Qatar National bank (QNB), BSS first managed the LC system, which was within its mandate. When this arrangement was hotly contested between graded rent-seekers, the allocation role was taken to the Executive under the Ministry of Trade, Industry and Investment.

In all these rounds, the Executive took upon itself the role of managing this facility, and placed it at the Ministry of Trade, Investment and Industry (MTII). When the LC system was alleged to have failed again, the activity was returned to BSS. Through this arbitrary process of finding the “right” agency to channel allocation of foreign exchange to the real economy, the Executive lost millions of dollars to unscrupulous players.

In the end, though, those who received hard currency from the BSS or those who received LC from MTII, failed to meet the demand of the economy for critical imports. These failures have a bearing on budget implementation

## **3. Persistent Deficit Financing**

It is an open secret that authorities have not been able to enforce the BSS Act 2012. Borrowing ceilings have repeatedly been passed. This has resulted to continuous deficit financing, which together with skewed exchange rates have undermined price stability as the primary objective of BSS. Easy lending by the BSS has encouraged the Government not to pursue the fundamentals of fiscal discipline and integrity of its budget. Hence, in addition to burdening the future generations with debts through deficit financing (see Figure 2), the inability to restrain overspending of the public sector has compounded the current fiscal crisis facing the Government of South Sudan.

### **III. Why These Problems Matter**

First, fiscal malfeasance has made it difficult to implement the budget, and to survive fiscal shocks. The extravagant expenditures of the security sectors have starved other essential

government activities. Even known cases of fiscal malfeasance have been overlooked, thereby fostering a culture of impunity that further emboldens the responsible parties. Second, agency shopping – ministries taking over the management of letters of credit (LCs), instead of the banking sector - has enabled schemers to siphon off millions of United States dollars from the national economy. The consequence of which the economy has been deprived from getting scarce foreign exchange and essential imports for both consumption and production purposes. For instance, the report of the Auditor General to the National Legislative Assembly (NLA) shows that the total value of the LCs, during the period under investigation, is about US\$1.0 billion! Such an act would undoubtedly increase both domestic and external debts for the young nation. Moreover, the recent fuel crisis could, in part, be blamed on agency shopping.

Finally, persistent deficit financing is a function of the dwindling government oil revenues. The fall in global oil prices has made it difficult for the Government to receive enough revenue to execute the budget. External shocks have, therefore, played a negative role in this case. In addition, the violent conflict has led to interruptions in production before the drastic fall in the oil prices.<sup>8</sup> In the words of Dr. Lual Deng, Managing Director of ECSS, “the fiscal implication of the above stated shocks is quite telling (p.1).”<sup>9</sup>

Moreover, poor tax administration means that what has been collected does not always end up in the Treasury. These failures of the fiscal system continue to drain essential financial resources. Sadly, while non-oil revenues have increased—although below expectations—a number of firms have gone out of business due to difficult operating environment. Specifically, lack of foreign exchange (i.e. hard currency) thwarted their operations. Others, such as South Sudan Beverages Limited (SSBL), are threatening to close down by this December 2015 if the problem of access to foreign exchange is not immediately addressed.<sup>10</sup>

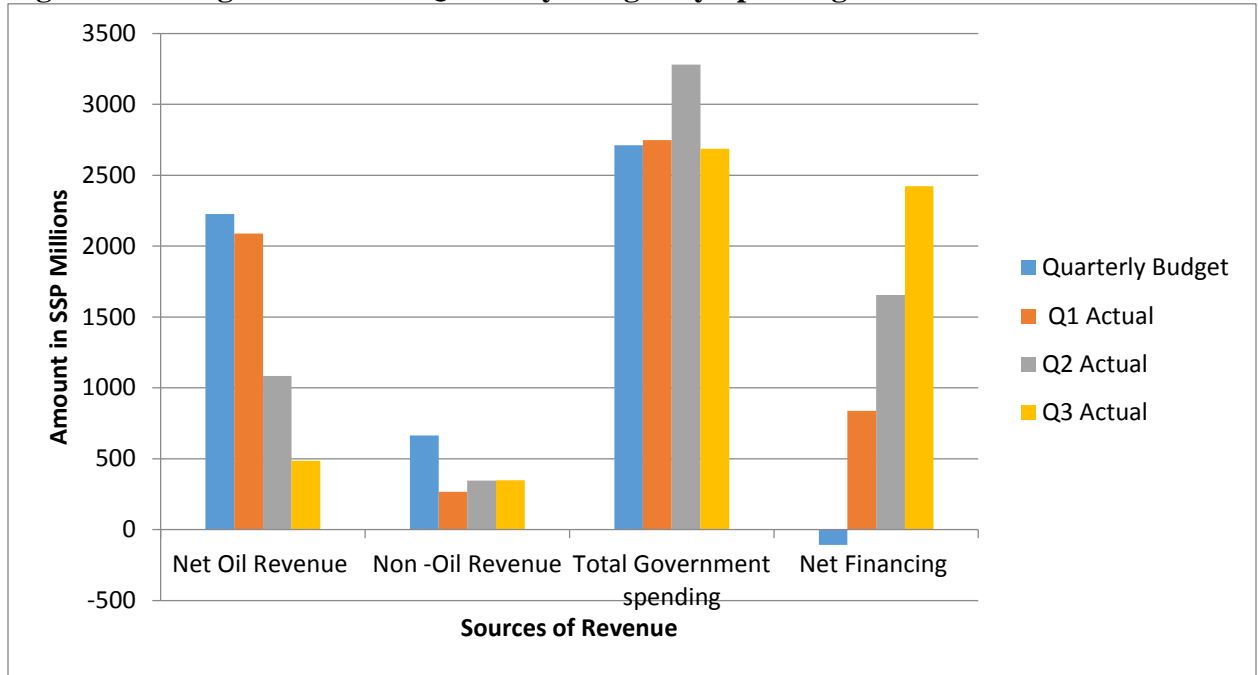
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<sup>8</sup> See Third Quarter Report, p. 3.

<sup>9</sup> Deng, Lual. (2015). The Impact of Exchange Rate Adjustment on the Economy of South Sudan. Ebony Policy Review, EPR.2/2015, p.1-8.

<sup>10</sup> These threats were made before the announcement of the policy to float the exchange rate. It may be the case now that SBBL can be able to access hard currency at the going market determined rate.

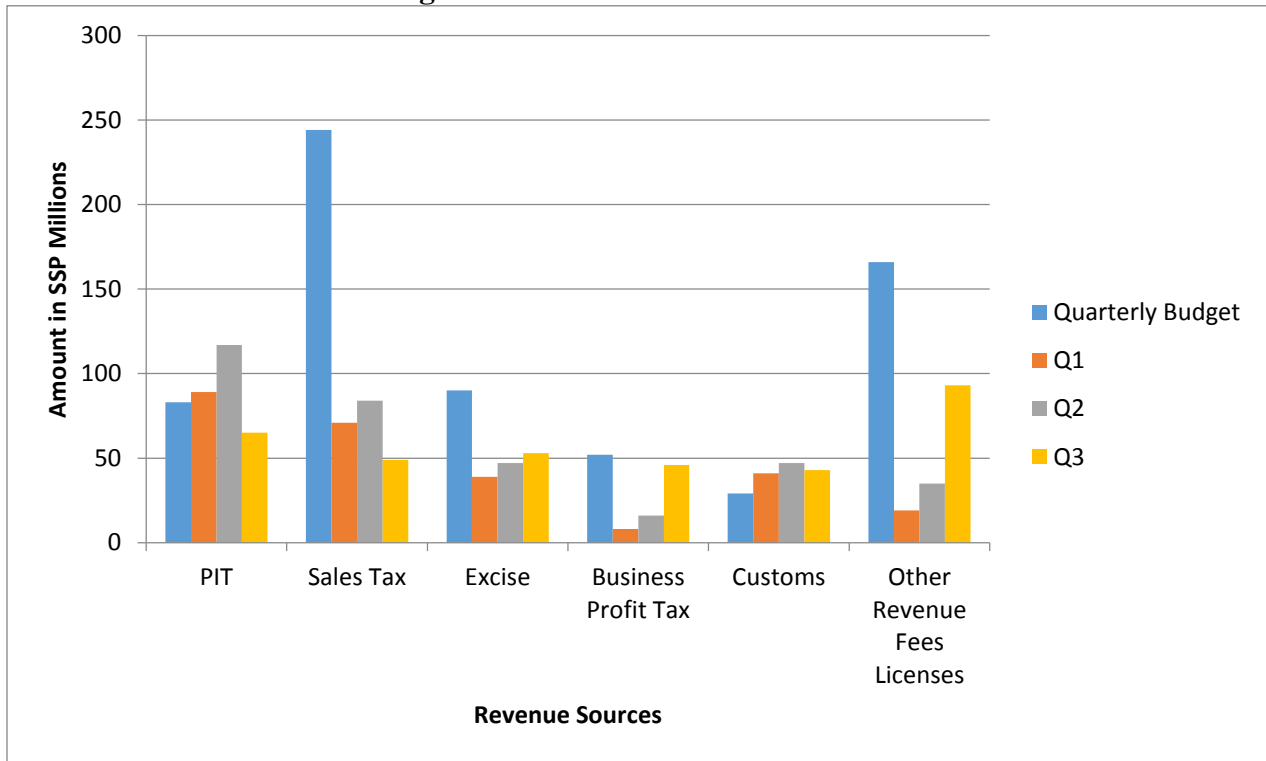
**Figure 2: Divergence between Quarterly Budgetary Spending and Actual Revenues**



**Source: Ministry of Finance and Economic Planning, Third Quarterly Budget Report, 2015**

One final point to note is that a quarterly budget is almost always smaller than the actual figures (see Figure 2). Blue keys indicate quarter projections while the other figures indicate different quarters. Equally glaring, a poor collection of non-oil revenues is reflected in the figure below where budget projections perform worse than actual. The exception is in customs and Personal Income Tax (PIT); (see Figure 3).

**Figure 3: Non-Oil Revenue Sources**



Source: Ministry of Finance and Economic Planning, Third Quarterly Budget Report, 2015

#### **IV. What must be done?**

The war on fiscal malfeasance will not be won unless authorities take drastic actions to curb the scourge. Without claiming to be exhaustive, we highlight the following policy options:

First, there is a need to diversify the economy through the prism of working hard to implement peace agreement. This gives the nation a fiscal space to devote resources to development. Peacetime will accord South Sudan an opportunity to enhance production, relocate resources away from war, especially to development and to support the diversification strategy.

Second, the Government should follow through with recommendations of the Audit Chamber.<sup>11</sup> Doing nothing is not an option because it has made the situation worse and gives culprits a sense of invincibility. After all, ARCISS gives South Sudan another chance to reform vital institutions

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<sup>11</sup> National Audit Chamber. (2012). Presentation of the Report of the Auditor General on the Financial Statements of the Government of Southern Sudan for the Year Ended 31<sup>st</sup> December 2007: To the President and the South Sudan National Legislative Assembly, June 27<sup>th</sup> 2012, p. 12.

such as Anti-corruption Commission and National Audit.<sup>12</sup> These institutions can fight graft to the fullest if they are copiously reformed, better staffed and given legal teeth and political cover to fight the corrupt lords. That is, erring officials must be punished, and if their godfathers intervene, they should be shown the full arm of the law. This can go a great length to clamp down on rent-seeking activities and the full blown agency-shopping.<sup>13</sup>

Third, the Government should take a hard look at the debt brakes and adherence to the principles outlined in the Bank Act, including deficit ceilings.

Finally, fiscal malfeasance can be addressed through many ways, including relevant specialized committees of the National Legislative Assembly (NLA) doing their oversight job seriously. The effectiveness of the specialized committees can be enhanced by hiring professional staffers as well as through the appointment of an independent, from the budget execution, budget controller, to oversee spending function.<sup>14</sup> One reason for divergence in what agency requests and ends up spending could be poor forecast besides willful disregard of the law by spending agencies. If the specialized committees of NLA have qualified staffers, these professionals could be used to do many things: crunching the numbers correctly, researching into any issue and preparing NLA members for informed and healthy debates on matters of fiscal malfeasance or integrity.

## **V. Conclusion**

In summary, fiscal malfeasance has persisted in South Sudan for quite some times now. From the time of the Comprehensive Peace Agreement (CPA) to independent South Sudan, certain agencies continue to disregard Appropriations Act while the NLA has chosen to do nothing.

Unfavorable macroeconomic environment such as falling global oil prices, the oil shutdown and the recently concluded violent conflict, have had negative impact on Government revenues. Nonetheless, four factors, in our view, have worsened the fiscal crisis in the country. Constant irresponsible spending flanks these four factors, doing nothing approach, agency-shopping, and failure to adhere to deficit ceilings. These fiscal problems can urgently be addressed through:

- i) Holding agencies accountable for misuse of scarce public resources;

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<sup>12</sup> See ARCISS, Chapter IV, Sub. Article 2.5.

<sup>13</sup> It is reported that the most comprehensive audits reports was that of 2012, and it is comforting to hear that MoFEP has greatly welcomed more audits of the pending financial statements. Now it is up to the National Audit to complete the remaining years.

<sup>14</sup> Similar to Office of Budget of Controller (OBC) we have in the neighboring countries, such as Kenya, this would-be OBC should be an independence body. It is not a structure within parliament nor is it an office within the executive but rather an independent body charged with tasks to oversee budget implementation, disbursement of funds and it monitors fund transfers at different level of government and in accordance with the law.



- ii) Curtailing agency-shopping to stop Government from insolvency;
- iii) Scrapping doing nothing approach; and
- iv) Strictly adhering to Bank of South Sudan Act when it comes to debt brakes and other ceilings intended to preserve central bank independence and maintenance of sound financial system.

Finally, inculcating a culture of fiscal discipline in the management of scarce resources in South Sudan requires all authorities to muster political will to act. Authorities must act now otherwise, This culture of fiscal malfeasance will continue to destabilize the macroeconomy down the line, Say, a decade later.



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