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'Advancing Critical Thinking and Innovation'

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Fiscal Federalism: A Framework for Addressing the Drivers of Fragility in South Sudan South Sudan[1]

EXECUTIVE SUMMARY

1. South Sudan is regarded as one of the most fragile states, the result of severe injustice; massive inequality; and persistent ethnic tensions;
2. Fragility can be overcome by introducing ***intergovernmental fiscal relations*** to augment the current political decentralization and administrative decentralization;
3. Well-designed fiscal federalism would tackle these problems by bringing efficient, effective, and equitable allocation of resources between the various levels of government;
4. Fiscal federalism has two important structural traits: (i) a vertical component that determines fiscal roles and decision-making power at the federal (both national and subnational) levels of government; and (ii) a horizontal component that defines interactions across sections of the government at a specific level;
5. These structures rest on two pillars: (i) the assignment of functions and expenditure responsibilities; and (ii) the means of financing expenditure responsibilities, which implies expenditure decentralization, revenue decentralization, and associated intergovernmental fiscal transfers;
6. Expenditure responsibilities between various levels of government concerns three components of: (i) macroeconomic stabilization; (ii) income redistribution; and (iii) fiscal resource allocation;
7. South Sudan should adopt the Ethiopian model of fiscal federalism and guided by the second-generation theory of fiscal federalism (SGTFF);

I. The Importance of Fiscal Federalism

This Policy Brief builds on the Development Policy Forum (DPF) discourse that was held on Saturday 28 October 2023 at the World Bank's ***Tukul*** in Juba. The topic of the discourse was on **Fiscal Federalism: A Framework for Addressing the Drivers of Fragility in South Sudan**. The discourse was organized with valuable financial and logistical support from the World Bank's Country Office for South Sudan. The discourse was organized around three questions: Why the

[1] Prepared by VEST, Ebony Center.

call for fiscal federalism (FF)? What is fiscal federalism? And which model of fiscal federalism is the most appropriate to tackle the drivers of fragility in the Republic of South Sudan.

The DPF Forum was justified on the awareness that the current federal system in South Sudan has inherent weakness in that it has ***decentralized*** management constrained by ***centralized*** financial and operating controls. Moreover, a legitimate federal system is normally composed of three components: (1) political federalism; (2) administrative federalism; and (3) fiscal federalism. The missing component in the case of South Sudan is ***fiscal federalism,*** which entails intergovernmental fiscal relations. This component is needed to tackle the three dominant reasons for—drivers of—fragility in South Sudan: (1) **injustice; (2) inequality; and (3) ethnic tensions/tribalism.** According to the IMF: "A ***fragile state*** can be thought of as having the following properties: (1) lack of a shared national identity; (2) absence of a sense of government legitimacy; (3) lack of the capacity to govern; (4) little confidence in its own future; (5) an under-developed private sector; and (6) significant exposure to political and economic shocks." [2]

It is now established, through empirical evidence, that fiscal federalism enhances socio-economic well-being of citizens within their respective levels of government.

> ***Fiscal federalism derives its nature and characteristics from constitutional provisions as well as the state of economic development, the pattern of income and resource distribution, and the institutional capacity of the system. The constitutional provisions define the framework within which decision-making would be exercised and establishes the vertical and horizontal structures that find meaning within the prevailing socio-economic environment of the system. The vertical structure defines the assignment of fiscal decision-making power between the federal and lower tiers of government. The horizontal structure outlines the nature of interaction across cross sections of government levels.*** [3]

In short, fiscal federalism is the intergovernmental fiscal relations in a federated system of governance with two key structures – vertical and horizontal structures as articulated in the above passage. It is different from fiscal decentralization in that the central government can, in a decentralized system, withdraw the devolved powers and responsibilities from the lower tiers of government. For instance, the president can dismiss elected governors of state and appoint new ones; a move that is not allowed in a truly federated system of governance in which governors and county commissioners are elected by the people. More importantly, fiscal federalism is focused on two tasks: (a) the assignment of functions and expenditure responsibilities between the various levels of government – federal/national/central, states, counties, and so forth; and (b) the means of financing expenditure responsibilities.

The task of assigning functions and expenditure responsibilities revolve around which level of government is responsible for: (1) macroeconomic stabilization function; (2) redistribution of income function; and (3) revenue allocation function. The second task is on the means of financing. There are numerous types of financing arrangements, e.g. revenue decentralization, equalizing transfers, borrowing based on the creditworthiness of each level of government, and so forth.

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[2] Tohid Atashbar. 2023. How Nations Become Fragile: An AI-Augmented Bird's-Eye View (with a Case Study of South Sudan), International Monetary Fund, Working Paper WP/23/167, page 6.
[3] Abu Girma Moges, "An Economic Analysis of Fiscal Federalism in Ethiopia,"

Fiscal federalism has evolved from being underpinned by a single theory based on economic principles to a broad-based theory, which combines several disciplines. The single theory-based version is known in the literature as the First Generation Theory of Fiscal Federalism (FGTFF). The broad-based approach is, on the other hand, known as the Second Generation Theory of Fiscal Federalism (SGTFF). The FGTFF is grounded in the theory of public finance that provides a framework for the assignment, mainly on economic criteria, of functions and expenditure responsibilities between the various levels of government in a decentralized system. The FGTFF assigns macroeconomic stabilization and income redistribution functions to the federal/national government[4]. While allocation of resources function is shared between the various levels of government.

The SGTFF builds on the theory of public finance (or on FGTFF) by incorporating the following five (5) theories, to which we would add institutional economics so that they become six (6):

a) Economics of information, which treats information as a valuable resource underpinning knowledge that is power for ensuring transparency and accountability in the management of scarce resources in a decentralized system of government;
b) Theory of political choices, this helps framers of fiscal federalism to build into their models the basic fact that "the actions of the government are a function of the way it expects voters to vote and of the strategies of its opposition";
c) Theory of contracts, which ensures that fiscal federalism is enshrined in the constitution of a decentralized system, i.e. it provides the legal foundation for the assignment of functions and expenditure responsibilities between the various levels of government;
d) Organization theory, which guides how the various levels of government operate in a decentralized system of government;
e) Theory of agency, which provides a valuable analytical tool for ensuring a win-win outcome of the principal-agent (States government vs federal government in this case, but it could also apply to voters and politicians [principal vs agent]) relationship; and
f) Institutional economics, which lays the basis for institutional arrangements for fiscal federalism inherent in the "working rules of collective action in restraint, expansion, and liberation of individual action (s)"[5]

There are common elements of fiscal federalism among different federal systems.

1. Patterns of expenditure decentralization

There is a general agreement that the assignment of expenditure functions across levels of government is broadly similar across nations. This assignment has two important considerations—efficiency and equity in the delivery of public goods and services. For instance, three levels of government are normally given the following assignment of expenditure functions:

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[4] Ghebrehiwet Tesfai Baraki (2014): The Practice of Fiscal Federalism in Ethiopia: A Critical Assessment of 1991 - 2012 An Institutional Approach, Doctoral Thesis Presented to the Faculty of Economics and Social Science at the University of Fribourg (Switzerland)

[5] John R. Commons. 1990. **Institutional Economics: Its Place in Political Economy**, New Brunswick, NJ: Transaction Publ. (Vols. 1 and 2).

a) **Federal government:** is assigned the expenditure responsibilities (i.e. **macroeconomic stabilization function**), which entails public goods (e.g. defense, foreign affairs, money & banking, national infrastructure) on the one hand, and on the other some elements of social insurance (e.g. pension, unemployment insurance, etc.). Here macroeconomic stability is an overriding function of the federal government. However, the SGTFF has added an innovation to this by distinguishing macroeconomic management from macroeconomic stabilization policies. In this regard, fiscal policy instruments of a macroeconomic policy framework would be shared among the various levels of government.

b) **Subnational/states (SGs):** are assigned the expenditure responsibilities of the provision of public services, such as health, education, and welfare in addition to state/subnational public goods (e.g. roads and police protection). The typical argument here is that preferences are heterogeneous across jurisdictions to the extent that provision of local public goods and services to local people at this level would improve both efficiency and equity by responding to the preferences of the local population. Moreover, both elected officials and civil servants would be accountable to the local people. And as stated under point (a) above subnational governments could also have a role in macroeconomic stabilization function, especially those who have revenue-raising capacities.

c) **Local governments (LGs):** Also take part in the assignment of expenditure responsibilities (i.e. **resource allocations function**) of providing local public goods and services (e.g. local roads, water & sanitation, recreational facilities, etc.). This is on the argument that local governments are nearer to the people and are therefore able to identify their choices and preferences. There is a strong argument for this approach, especially in countries where some regions have a sense (perception or real) of being marginalized. Hence, empowering local communities to determine their own priorities through their LGs is considered to be one of the positive features of fiscal federalism. In our case, the SPLM call for taking town to the people in the rural areas was informed by these concerns.

2. Types of revenue decentralization

Assignment of the expenditure responsibilities calls for corresponding revenue-raising powers. In this regard, there are two types of revenue decentralization – full access to broad-based taxes, such as income, sales, payroll taxes, and so forth, and a system in which subnational governments have limited discretionary access to broad-based taxes. Moreover, subnational levels of government are allowed to borrow based on their own creditworthiness as by way of enhancing their revenue-raising opportunities. Canada, India, Switzerland, and United States of America (USA) are considered to be examples of a full access to broad-based-taxes model of fiscal federalism. These countries also allow subnational levels of government to borrow from the banking sector. Australia and Germany are, on the other hand, examples of limited access to broad-based taxes.

3. Equalizing transfers

This is a system (**redistribution of income function**) in which the national/federal government makes higher per capita transfers to those subnational levels with lower revenue-raising opportunities and capabilities. Subnational/State governments are similarly envisaged to undertake equalizing transfers to LGs (i.e. counties, *payams*, and *bomas*) within their respective jurisdictions.

4. Federal/national influence on subnational/state decisions

The federal/national government would influence decisions at the lower levels of government through either more intrusive or less intrusive methods. An example of a more intrusive influence is the ability of the federal government to strike down state legislation and to mandate state actions.

II. Which model of fiscal federalism is appropriate for South Sudan?

The main challenge we have in South Sudan is that the debate has always been on federalism (i.e. political and administrative) without due attention to ***fiscal*** federalism. For instance, Jacob J. Akol of Gurtong Trust in commenting on Douglas Johnson's lecture at the University of Juba, summarized the debate on federalism as follows:

> ***In South Sudan there is no system of governance so popular – yet so little understood – as the federal system. Historically the demand for federation with North Sudan was seen as the way to keep Sudan united, and the absence of such a system was held up as one of the causes of the long wars between North and South. Now federalism is proposed as a panacea for problems of governance in independent South Sudan. But is it? And is the system any better understood now than in the 1950s? Douglas Johnson's paper – first delivered to a packed lecture hall at Juba University – is required reading for those who wish to see orderly discussion on the various federal systems before we rush into something which could lead to an even bigger problem.*** [6]

There is indeed an urgent need for "orderly discussion of the various systems" of federalism. Jacob Akol is correct in that there is a genuine knowledge gap on how a federal system operates. Hence, our contribution in closing this knowledge gap is in seeking a comprehensive understanding of the intergovernmental fiscal relations in a federal system. But we would first remind the readers about the thinking of the SPLM leadership in 2004; a thinking that is articulated by the following statement: "The proposed fiscal decentralization in the context of the peace process would simultaneously address issues of ethnic, cultural, linguistic and religious cleavages and their consequential disparities[7]." In this regard, we would argue that the SPLM leadership did internalize then the importance of fiscal federalism in addressing the drivers of ethnic-induced fragility of the state.

There is now an opportunity, as the country prepares for elections in December 2024, for a genuine discourse on the most appropriate model of fiscal federalism for South Sudan. We would like the debate to focus on the legal, economic, social, and institutional foundations of fiscal federalism. We only use the legal foundation to illustrate the point. This would then be followed by proposing the key pillars of fiscal federalism for South Sudan drawing heavily from the Ethiopian model of FF. South Sudan has, like Ethiopia, five (5) levels of government, which are: **national, state, county, Payam, and Boma**. But the Transitional Constitution of South Sudan (TCSS, 2011) only gives three tiers: national, state, and local governments.

The Legal Foundation

Fiscal federalism is stipulated in the TCSS (2011), specifically in Article 169 on equitable sharing of national wealth; Articles 177 and 178 on sources of revenue for national government;

[6] Quoted from the back cover of a booklet on: **Federalism in the history of South Sudanese political thought**, by Douglas H. Johnson (2014), Rift Valley Institute Research Paper 1

[7] From SPLM Strategic Framework for War-to-Peace Transition, (2004:65), published by the SPLM Economic Commission, August 2004.

and Article 179 on sources of revenue for SGs. But it is important to first place fiscal federalism in the wider context of a federal/decentralization system provided for in the Transitional Constitution of the Republic of South Sudan, 2011. We begin with classification of the country into levels of government. In this regard, Article 47 of the TCSS gives three levels of government stating that ***South Sudan shall have a decentralized system of government with the following levels:***

(a) the National level which shall exercise authority in respect of the people and the states;

(b) the state level of government, which shall exercise authority within a state, and render public services through the level closest to the people; and

(c) the local government level within the state, which shall be the closest level to the people[8].

The assignment of authority between the three levels of government shows beyond doubt that South Sudan is a ***de facto*** federal system, though the framers of TCSS were determined not to use the term federalism. The powers (58 specific clauses on legislative and executive powers) of the national government (NG/FG) are given in Schedule A of TCSS. The exercise of these powers and associated institutions and structures for their implementation are, for the national government, delineated in Article 50 through Article 161 of TCSS. The powers (42 legislative and executive powers) of the States (SGs) are given in Schedule B of TCSS. The exercise of these functions of the State Governments (SGs) are stipulated in Article 162 through Article 165, while those of Local Governments (LGs) are found under Articles 166 – 168.

There are thirty-three (33) concurrent powers described in Schedule C. If there is, however, a conflict with respect to concurrent powers, Schedule E of the TCSS unambiguously states that: "If there is a contradiction between the provisions of National law and a state law on the matters that are concurrent, the National law shall prevail to the extent of the contradiction." Finally, the residual powers are given in Schedule D and the TCSS stipulates that:

> ***Residual powers shall be dealt with according to their nature. If the power pertains to a national matter, requires a national standard, or is a matter which cannot be regulated by a single state, it shall be exercised by the National Government. If the power pertains to a matter that is usually exercised by the state or local government, it shall be exercised by the state or local government[9].***

In the light of the legal foundation derived from TCSS (2011), we proposed the system of expenditure decentralization, revenue decentralization, equalizing transfers, and federal/national government likely influence in the rest of this section.

[8] Article 47 (page 15) of the **Transitional Constitution of The Republic of South Sudan**, 2011
[9] Schedule D (2011:81) of the **Transitional Constitution of The Republic of South Sudan**, 2011

Table 1: Proposed Expenditure Decentralization for South Sudan

Expenditure Responsibility	Level of Government		
	Federal Government (FG)	States Government (SGs)	Local Governments (LGs)
1. General Public Service	Yes	Yes	Yes
2. National Defense & Security	Yes	No	No
3. Police & Security	Yes	Yes	Yes
4. Fire Protection	No	Yes	Yes
5. Justice & Law	Yes	Yes	Yes
6. Inter-state commerce	Yes	No	No
7. Economic & social policy	Yes	Yes	Yes
8. Land & natural resources	Yes	Yes	Yes
9. Agriculture	Yes	Yes	Yes
10. Mining	Yes	Yes	Yes
11. Transport, Postal services and Communications	Yes	No	No
12. Roads	Yes	Yes	Yes
13. Monetary & financial policies	Yes	No	No
14. International relations	Yes	No	No
15. Revenue collection and Budgeting	Yes	Yes	Yes
16. Environmental protection	Yes	Yes	Yes
17. Housing development	Yes	Yes	Yes
18. Water supply	No	Yes	Yes
19. Street light	No	No	Yes
20. Recreation & culture	Yes	Yes	Yes
21. Preservation of culture and historical legacies	Yes	Yes	No
22. Science and technology	Yes	Yes	No
23. Health service	Yes	Yes	Yes
24. Education	Yes	Yes	Yes
25. Social protection	Yes	Yes	Yes

Source: Constructed by the VEST team from Baraki (2014), Table 5.1 pp. 121 - 135.

In Table 1 we have tried to simplify the presentation of expenditure decentralization, so as to allow farther debate within the South Sudanese policy community. For instance, the "Yes" is used in Table 1 to denote that the given tier of government has expenditure responsibility corresponding to its assigned functions and powers, while "No" indicates the tier does not have. In this regard, there are 25 assigned expenditure responsibilities of which we are proposing, consistent with

Schedule A of TCSS (2011), the national government (NG) is to have five (5) exclusive expenditure responsibilities with respect to the following:

a) National defense and security;
b) Inter-state commerce;
c) Transport, postal services, and communications;
d) Monetary and financial services; and
e) International relations.

Moreover, we are recommending that the three levels of government (i.e. NG, SGs, and LGs) share fifteen (15) expenditure responsibilities. While NG and SGs are to share two – science & technology and preservation of culture and historical legacies – expenditure responsibilities. SGs and LGs share two – water supply and fire protection – expenditure responsibilities. Finally, the LGs, just like the case of Ethiopia, have the exclusive expenditure responsibilities over the streetlights. According to the IMF GFS Manual:

Government units are unique kinds of legal entities established by political processes that have legislative, judicial, or executive authority over other institutional units within a given area. The principal economic functions of government units are to:

a) ***Assume responsibility for the provision of goods and services to the community or individual households primarily on a nonmarket basis;***
b) ***Redistribute income and wealth by means of transfers;***
c) ***Engage primarily in nonmarket production; and***
d) ***Finance their activities primarily out of taxation or other compulsory transfers***.

Moreover, a government unit may borrow, based on its creditworthiness, from domestic and/or external sources to finance some or a portion of its activities during a given period of time. In addition, resource-rich countries can earn revenues through the rent of such resources without necessarily resorting to compulsory transfers.

2. Proposed Revenue Decentralization for South Sudan

We have stated earlier that there are sufficient constitutional provisions in the TCSS (2011) for a South Sudanese model of fiscal federalism. It is also important to distinguish between management of resources and sharing of revenues/wealth. In this regard, we would recommend that readers should revisit the relevant Articles in the TCSS (2011) as by way of ensuring a common understanding when discussing the most appropriate system of revenue decentralization for South Sudan.

We start with Article169, which stipulates 10 guiding principles for equitable sharing of national wealth. The issues of land ownership and tenure system are addressed under Articles 170, 171, and 172. In addition, the guiding principles for petroleum and gas development and management are contained in four Articles: 173, 174, 175, and 176. But revenue decentralization in South Sudan derives its legality from three Articles 177, 178, and 179.

Article 177 (2) states that "The National Government shall legislate for raising revenue or collecting taxes from the following sources:

(a) petroleum, Gas/oil, mineral, and other natural resources;

(b) national personal income tax;
(c) corporate and business profit tax;
(d) customs duties and import taxes;
(e) airports, rail, road, and river transport revenue;
(f) service charges, fees and fines;
(g) national government enterprises and projects;
(h) value added tax or general sales tax on goods and services;
(i) excise duties;
(j) loans and borrowing from the Bank of South Sudan and the public;
(k) grants-in-aid and foreign financial assistance;
(l) fees from nationality, passports, immigration and visas;
(m) royalties; and
***(n) any other tax or revenue as may be determined by law*.”**

In addition to the above fourteen (14) sources of revenue for the National Government (NG), Article 178 stipulates the formula for sharing of oil revenue. This sharing is only between NG and oil producing states and communities. It also stipulates establishment of Future Generation Fund (FGF) from the share of NG.

There are fourteen (14) sources of revenue for SGs and LGs stipulated in Article 179. This Article states that "The states shall legislate for raising revenue or collecting taxes from the following sources:"

(**a) state land and property tax and royalties;**
(b) service charges for state services;
(c) licenses issued by the state;
(d) state personal income tax;
(e) levies on tourism;
(f) at least two percent of net oil and other mineral revenues for each producing state;
(g) state government projects;
(h) stamp duties;
(i) agricultural production taxes;
(j) grants-in-aid and foreign aid;
(k) excise duties;
(l) other state taxes, which are not within the exclusive jurisdiction of the National Government;
(m) loans and borrowing in accordance with Article 184 (2) and (3) of this Constitution; and
(n) any other tax as may be determined by law."

The above constitutionally provided provisions for South Sudan FF system would, if operationalized, be classified as having a full access to broad-based taxes, such as income, sales, payroll taxes, and so forth. The NG has, however, four (4) exclusive sources of revenue: custom duties and import taxes; airports, rail, road, and river transport revenue; value added tax; and nationality, passports, immigration and visa. The SGs have three (3) exclusive sources of revenue: tourism; stamp duties; and agricultural tax.

3. Proposed Equalizing transfers System for South Sudan

We would recommend the Ethiopian system of equalizing transfers to be adopted initially in South Sudan. In fact, South Sudan has some elements of equalizing transfers, such as conditional grants through the line ministries, Constituency Development Fund, and County Block Grant. Two elements – **conditional grants and road fund -**from the Ethiopian system could be added to what we already have in South Sudan.

4. Federal/national influence on subnational levels

We are inclined to recommend that the NG should keep off from influencing how SGs and LGs address their principal economic functions. Our preference would be to use persuasion tactics to influence and pressure, but not force, subnational levels of government into adhering to desired policy outcome (s). Such tactics should be closed-door meetings with community leaders and other stakeholders combined with appeals to community spirit and vague threats.

III. Conclusions

The objective of this Ebony Policy Brief is to trigger sustained discourse in search of the most appropriate fiscal federalism for South Sudan. The search for fiscal federalism that would address the three drivers – injustice, inequality, and tribalism – of the South Sudanese state fragility is underpinned by the conviction that it would enhance transparency and accountability in the management of public resources. A brief comparative analysis of the legal foundation of Ethiopian model of fiscal federalism has revealed that there are sufficient constitutional provisions in the TCSS (2011) for designing a system of intergovernmental fiscal relations in South Sudan, which is economically, socially, and institutionally viable. The envisaged viability is premised on the inherent transparency and accountability underpinning fiscal federalism.