NATIONAL BUDGET BRIEF
Fiscal Year 2017/18
Republic of South Sudan

UNICEF South Sudan
This budget brief examines government spending trends in South Sudan in recent years, including the underlying macroeconomic context. It looks at the size and composition of budget allocations to social sectors and agencies over the past two years as well as for fiscal year (FY) 2017/18. The main objectives are to synthesize budget information so that it is easily understood by different stakeholders as well as to present key messages to inform public financial decision-making processes. In terms of data, where time series macro-fiscal information is unavailable from national sources, the analyses use the latest estimates from the International Monetary Fund’s World Economic Outlook database (October 2017).

**KEY MESSAGES AND RECOMMENDATIONS**

- **Worrisome economic outlook:**
  The macroeconomic situation is characterized by volatile oil revenue, hyperinflation and negative growth, all of which are expected to continue over the next fiscal year.

- **Overreliance on oil revenue:**
  Around 60 percent of the budget is financed by oil earnings, which results in unpredictability and undermines budget planning processes. A near term priority should be diversifying revenue sources, with a special focus on the agriculture sector, as well as to continue to implement public financial management (PFM) reforms.

- **Hyperinflation:**
  Although slightly improving during the past year, inflation is estimated at 182 percent in 2017, which continues to have a devastating impact on the ability of families to provide for their children as well as the real impact of public investments. There is an urgent need to bring price levels under control by 2019 (i.e. within single digits).

- **Inadequate investments in sectors that matter for children:**
  The current budget allocates 13 times more to the security and public administration sectors than to all of the social sectors combined (education, health and humanitarian affairs), meaning that children remain fully dependent on foreign aid. Next year’s budget must give greater priority to social sectors, which remain gravely underfunded and can help address the extreme levels of poverty and vulnerability that characterize South Sudan. The government’s current commitment to social sectors further demonstrates that a demographic “nightmare” is highly likely unless its investment priorities radically and quickly change.

- **Low budget credibility further hampers social sector spending:**
  Unpredictable revenue flows undermine budget planning processes and result in severe overspending across government. The education and health sectors, however, are the lone exceptions, and the factors that drive continual underspending in these vital areas need to be addressed.

- **Donor spending outnumbers government spending by nearly two to one:**
  In the current fiscal year, IMF estimates indicate that the total state budget is less than US$1.0 billion, whereas official development assistance (ODA) is projected to be around US$1.75 billion. This has severe implications. On the one hand, any sudden reversal of donor resources will have disastrous consequences on children and vulnerable families. On the other hand, the majority of donor funding is off-budget and channeled to humanitarian efforts, which underscores the need to move donor flows on budget and to direct them beyond humanitarian efforts to strengthen the provision and quality of basic social services.

- **Fiscal space to invest in children:**
  Despite overall economic and revenue volatility, there are opportunities to increase investments in child-focused sectors. These range from channeling resources from the elimination of fuel subsidies, to redirecting budget allocations to the security and public administration sectors and demonstrating need and value for money cases to attract additional donor funding.
SECTION 1. MACRO AND SOCIOECONOMIC CONTEXT

Macroeconomic trends

South Sudan’s economy continues to be upended by shocks, including oil and inflation. Given the oil dependent structure, the decline in global oil prices coupled with progressively lower production have delivered severe blows. As oil fields are still maturing, the government has been unable to attract new investments, which largely stems from the high risks associated with the ongoing conflict. The economy has also been battered by hyper-inflation, with price levels spiralling out of control beginning in 2015 and reaching more than 700 percent in 2016 (Figure 1). There are indications, however, that inflation is slowly improving, with the latest IMF estimates suggesting that inflation will drop to 143 percent in 2017 and further fall below 30 percent in 2018. Nonetheless, the impacts continue to be widespread, not least among non-oil revenue, whose real value has been almost entirely eroded by changing price levels.

The various shocks have translated into negative economic growth. After booming at nearly 30 percent real growth in 2013, the economy quickly and steadily reversed course, contracting by around 14 percent in 2016 (Figure 2). This year the economy is expected to shrink by an additional six percent, which will only slightly improve but still remain negative in 2018; positive growth is not expected until 2019. Economic volatility has also profoundly impacted incomes. Real per capita income dropped from more than SSP 1,800 in 2013 to less than 1,200 in 2017, representing more than a 30 percent decline (Figure 3). Going forward, per capita income is expected to further drop in 2018 and 2019 before turning positive in 2020.
Social development trends

More than one out of every two South Sudanese live below the national poverty line. In addition to income poverty, the majority of the population, including children, faces extreme vulnerabilities due to a combination of droughts, floods, crop and animal pests, and diseases. Protracted conflicts have also prevented the world’s newest country from establishing stable government institutions that can deliver reliable, quality basic services, thus intensifying both poverty and vulnerability.

Overall social progress is captured by the country’s Human Development Index (HDI) ranking, which is among the lowest in the world. As depicted in Table 1, this reflects the alarming state of social indicators, from education and health to nutrition and protection, which have stagnated or digressed over time.

Table 1. Selected social development indicators (2017 or latest available)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Value</th>
<th>Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total population (in millions)</td>
<td>13.1</td>
<td>UNDESA</td>
</tr>
<tr>
<td>Population under 18 years old (as a % of total)</td>
<td>48</td>
<td>UNDESA</td>
</tr>
<tr>
<td>Population growth rate</td>
<td>2.8</td>
<td>UNDESA</td>
</tr>
<tr>
<td>Poverty rate based on national poverty line</td>
<td>51</td>
<td>UNDP</td>
</tr>
<tr>
<td>Multidimensional poverty rate</td>
<td>73</td>
<td>OPHI</td>
</tr>
<tr>
<td>Human Development Index (HDI) ranking (out of 188 countries)</td>
<td>181</td>
<td>UNDP</td>
</tr>
<tr>
<td>Under-five mortality rate (deaths per 1,000 live births)</td>
<td>93</td>
<td>UNICEF, WHO, UNFPA and World Bank</td>
</tr>
<tr>
<td>Proportion of out-of-school children of primary school age</td>
<td>59</td>
<td>UNESCO</td>
</tr>
<tr>
<td>Literacy rate (15-24 years)</td>
<td>37</td>
<td>UNESCO</td>
</tr>
<tr>
<td>Proportion of population practicing open defecation</td>
<td>74</td>
<td>UNICEF and WHO</td>
</tr>
<tr>
<td>Proportion of children under age 5 whose birth is registered</td>
<td>35</td>
<td>UNICEF</td>
</tr>
<tr>
<td>Proportion of women first married or in union before age 18</td>
<td>52</td>
<td>UNICEF</td>
</tr>
</tbody>
</table>
Amidst the backdrop of poverty and low human development, the population is remarkably young. In 2017, nearly one out of every two South Sudanese are children under the age of 18 (Figure 4). High population growth also means that the number of children will swell from around 6 million today to nearly 8 million in 2030, which amounts to a 33 percent increase in just over a decade. The current population structure further indicates that the country is in the midst of the demographic transition, which presents the one-time opportunity to benefit from the “demographic dividend,” whereby the size of the economically-active population increases relative to the size of the dependent (non-working) population. Currently, about 45 percent of the population is of working age, but this will steadily climb to around two-thirds by 2050 (Figure 5).

Whether the rapidly changing population results in a demographic “dividend” or “nightmare” fully depends on the investment decisions of the government, starting today. If resources do not adequately support the next generations, current poverty levels will be worsened, resulting in an unvirtuous circle of poverty and inequality, crime, violence, social and political instability, emigration, and so on. However, if social sector investments strategically target children and youth, the population boom can catapult economic growth, opportunities, and long-term peace and prosperity for the country and beyond.
Key takeaways

- Continuous negative economic growth coupled with hyperinflation erodes the disposal income of households and minimizes the impact of government investments.
- Alarming levels of poverty and deprivation call for a massive increase of public support to the most vulnerable populations.
- In the midst of a rapidly changing population structure, the government’s current investment priorities will dictate whether this is transformed into a demographic “dividend” or “nightmare; the current outlook is not promising.

SECTION 2. AGGREGATE SPENDING TRENDS AND PRIORITIES

Government spending has increased dramatically in recent years due to inflation. Between 2015 and 2017, the government budget is estimated to have grown by an astonishing five-fold in nominal terms, reaching SSP 110 billion in the current fiscal year (Figure 6). However, once adjusting for inflation, the overall size of the budget shrinks by 35 percent over the same time period. This picture is very similar when looking at spending trends in current US dollars. In 2015, total expenditure was more than US$5.0 billion, but is estimated to be less than US$1.0 billion in 2017, which amounts to an 80 percent decline (Figure 7). This verifies a context where large spending increases are largely driven by printing new money, a trend which appears likely to continue over the near term.

Source: IMF World Economic Outlook (October 2017)
In terms of budget priorities, the security and public administration sectors are the main beneficiaries of spending, with limited and declining support to social sectors. Allocations to the security and public administration sectors amounted to nearly two-thirds of the budget in FY 2017/18, which marked a significant increase from the previous year when these combined allocations equaled half of the total budget (Figure 8). In contrast, allocations to the social sectors (education, health, and social and humanitarian affairs) consumed only five percent of the budget in the current fiscal year, which marked a decrease from 2016/17 when these sectors accounted for 6.7 percent of total budget allocations. This means that the government is investing 13 times more in security and public administration than in social services. Also noteworthy is that the current budget includes an allocation of SSP 4 billion (or 7.5 percent of the budget) to implement the peace agreement, which is proposed to cover humanitarian activities and support the transportation, feeding and return of displaced populations, among others.¹

The low priority of social sector investments is even more disturbing when compared to international spending targets. For FY 2017/18, budget allocations to education and health amount to 2.1 and 2.6 percent of the budget, respectively (Figure 9). These figures fall far below global benchmarks – the Education for All spending target is 20 percent of the national budget for education and the Abuja Declaration is 15 percent of the national budget for health. Moreover, per capita spending on education and health amounted to SSP 444 and SSP 81, respectively, in FY 2017/18, confirming a severe inadequacy of public investments in sectors that are critical to child well-being. When further zooming in on child-specific spending, the Ministry of Gender, Child and Social Welfare was allocated 0.07 percent of the budget in FY 2017/18. This should be interpreted as a symbolic amount, especially in a context where there is no functioning social protection measures to support children and poor families.

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¹ Republic of South Sudan, June 2017, "Fiscal Year 2017/18 Budget Speech," p. 14
Key takeaways

- The size of the national budget has declined significantly since 2015 once accounting for changing price levels, which further limits the ability of the government to support the most vulnerable children and families across the country.
- The overarching priorities of the budget are the public administration and defense sectors, which increasingly crowd out social sector investments.
- Despite the severe social needs of the population, there is no funding to support social protection interventions, which could go a long way to both building resilience and saving lives.
- The government’s current commitment to social sectors further demonstrates that it is not positioned to take advantage of the demographic dividend, with a nightmare scenario highly probable unless a radical policy change is urgently adopted.

SECTION 3. SPENDING IMBALANCES

When looking at government spending on recurrent and capital items, the budget remains heavily skewed toward salaries. Approximately 55 percent (or SSP 22.4 billion) of the 2017/18 budget is earmarked for salaries, including for the army and organized forces (Figure 10). The remainder is for transfers (23 percent), goods and services (14 percent), and capital expenses (8 percent). State and county transfers cover running costs, local development initiatives, salaries of teachers and health workers, and expenses related to state-level organized forces.²

Figure 10. Capital and recurrent spending, FY 2017/18 (as a % of total)

Key takeaways

- The bulk of public funds in the current fiscal year are earmarked for salaries and transfers, with very limited support to good and services or capital investments, which does not correspond to long-term economic or social development needs.
SECTION 4. BUDGET CREDIBILITY

Erratic and unpredictable revenue, largely driven by the conflict and volatile oil sector, has limited the ability of the government to budget and resulted in severe overspending. In FY 2015/16, for example, government agencies planned to spend SSP 10,304 million at the start of the year, but actual expenditure was SSP 6,565 million more than the original amounts or an overspend of 164 percent (Table 2). Transfers was the only major spending item that stayed close to the original budget, with salaries, operating costs and capital investments all significantly surpassing planned amounts.

Table 2. Budget execution by spending item, FY 2015/16 (in millions of SSP)

<table>
<thead>
<tr>
<th>Item</th>
<th>Planned</th>
<th>Value</th>
<th>Actual (as a % of planned)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries</td>
<td>5,463</td>
<td>7,487</td>
<td>137</td>
</tr>
<tr>
<td>Operating costs</td>
<td>1,672</td>
<td>4,208</td>
<td>252</td>
</tr>
<tr>
<td>Capital</td>
<td>266</td>
<td>2,099</td>
<td>789</td>
</tr>
<tr>
<td>Transfers</td>
<td>2,795</td>
<td>2,986</td>
<td>107</td>
</tr>
<tr>
<td>Other (including interest)</td>
<td>108</td>
<td>88</td>
<td>82</td>
</tr>
<tr>
<td>Total spending</td>
<td>10,304</td>
<td>16,869</td>
<td>164</td>
</tr>
</tbody>
</table>


All sectors benefit from overspending except education and health. Again looking at data from FY 2015/16, which is the latest fiscal year that has complete expenditure information available, the four biggest or priority sectors – security, accountability, public administration and rule of law – accounted for 94 percent of the total overspend (Table 3). Education and health, in contrast, stand out as being the only sectors that underspent their original budgets, by nine and 33 percent, respectively. In the process, the priority sectors, which originally consumed 82 percent of the total planned budget, increased their overall consumption by five percent following in-year spending changes. The social sectors went in the opposite direction, receiving just over ten percent of the original budget but only benefitting from six percent.

Table 3. Budget execution by sector, FY 2015/16

<table>
<thead>
<tr>
<th>Sector type</th>
<th>Sector</th>
<th>in millions of SSP</th>
<th>Over/underspend</th>
<th>as a % of total budget</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Planned</td>
<td>Actual</td>
<td>SSP as a %</td>
</tr>
<tr>
<td>Priority sectors</td>
<td>Security</td>
<td>4,580</td>
<td>6,410</td>
<td>1,830</td>
</tr>
<tr>
<td></td>
<td>Accountability</td>
<td>1,285</td>
<td>3,332</td>
<td>2,047</td>
</tr>
<tr>
<td></td>
<td>Public administration</td>
<td>891</td>
<td>2,853</td>
<td>1,962</td>
</tr>
<tr>
<td></td>
<td>Rule of law</td>
<td>1,580</td>
<td>2,009</td>
<td>429</td>
</tr>
<tr>
<td>Social sectors</td>
<td>Education</td>
<td>677</td>
<td>668</td>
<td>(9)</td>
</tr>
<tr>
<td></td>
<td>Health</td>
<td>316</td>
<td>283</td>
<td>(33)</td>
</tr>
<tr>
<td></td>
<td>Social/humanitarian affairs</td>
<td>92</td>
<td>98</td>
<td>6</td>
</tr>
<tr>
<td>Other sectors</td>
<td>Infrastructure</td>
<td>185</td>
<td>556</td>
<td>371</td>
</tr>
<tr>
<td></td>
<td>Natural resources</td>
<td>361</td>
<td>411</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>Economic functions</td>
<td>237</td>
<td>249</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>10,204</td>
<td>16,869</td>
<td>6,665</td>
</tr>
</tbody>
</table>

In the current fiscal year, overspending by some agencies is constraining the government’s ability to pay salaries and wages and disburse block grants to states. As of August 2017, the government could not pay salaries and wages for a fourth consecutive month.3 It had also fallen behind with transfers to state governments as well as to diplomatic offices.

**Key takeaways**

- The government’s budget is characterized by low credibility, which is driven by poor revenue forecasting coupled with the lack of adherence to formal budget planning processes that were instituted by the Ministry of Finance and Economic Planning in 2011.
- Overspending has become commonplace for all sectors except the social sectors, which is crowding out and preventing vital support from reaching vulnerable populations.

## SECTION 5. FINANCING THE NATIONAL BUDGET

**The national budget heavily relies on oil revenue.** In FY 2017/18, oil revenue contributes around 60 percent of all resources (or SSP 25.8 billion), with the other major share coming from non-oil revenue (about one-third of total resources or SSP 14.0 billion) (Figure 11). The remaining balance reflects a mix of donor project loans (the World Bank’s Local Government and Service Delivery Project, which equals SSP 2.2 billion), new government debt (SSP 0.8 billion) and donor grants (SSP 0.4 billion). However, it is important to recognize that SSP 11.1 billion of projected revenues have already been allocated to repay oil advances received during the previous fiscal year, which immediately lowers the amount of revenue that can be spent by government agencies from SSP 43.2 billion to SSP 32.1 billion.

![Figure 11. Financing sources of the 2017/18 budget (as a % of total; figures represent billions of SSP)](source: Republic of South Sudan, June 2017, “Fiscal Year 2017/18 Budget Speech,” pp. 10-11)

Looking at oil and non-oil revenue over time, there has been significant growth in recent years, though this is largely driven by inflation. In nominal terms (current prices), government revenues skyrocketed more than 13-fold between 2015 and 2017, and nearly tripled between 2016 and 2017 alone (Figure 12). However, after adjusting for inflation, actual growth was much more modest, with real revenues increasing by 50 percent between 2015 and 2017 and roughly 15 percent between 2016 and 2017. Relative to the size of the economy, revenues have varied from a low of 17 percent of GDP in 2013 to a high of nearly 40 percent in 2017. Based on IMF projections, total revenues are expected to slightly decline once factoring in inflation, hovering just above 30 percent of GDP over the 2018-20 period.

3 Ibid
One of the biggest challenges facing the government is that it loses a huge portion of oil revenue through compensation agreements and other expenses. In FY 2017/18, more than half of oil income will be paid directly to Sudan as part of the revenue sharing agreement, while an additional 22 percent will be shelled out to product suppliers and another two percent going to oil-producing communities (Figure 13). This means that only 20 percent of all oil income is actually available for the government to spend. If further accounting for the repayment of oil advances, which is also directly linked to this income stream, only 11.5 percent (or SSP 14.7 billion) of all oil revenue will be available for the government to invest in its people in the current fiscal year.

Turning to donor funding, despite being one of the highest recipients of ODA, the landscape has dramatically changed in recent years. Since the outbreak in 2013, the civil war has caused a severe humanitarian crisis across the country. As a result, both humanitarian and development partners shifted their programmes to support life-saving interventions, which resulted in a complete reprogramming of aid flows into the country. In 2014, donor funding increased substantially, reaching close to US$2.0 billion up from only 0.4 billion in 2011. Donor funding has continued to flow into South Sudan, which ranks among one of the largest recipients in the world in per capita terms (Figure 14).
One of the major findings of this brief is that ODA is significantly larger than the entire government budget. Using projections (since donor reporting remains incomplete for 2016 and 2017), ODA likely overtook the national budget in 2016 (Figure 15). Whereas ODA amounted to approximately one-third of the size of the budget during the 2011-15 period, this jumped to around 110 percent in 2016 and likely skyrocketed to 1.8 times the size of the budget in 2017. It is important to recognize that this is not the result of a significant increase of donor resources into South Sudan, but rather due to the deterioration of the real value of the budget since 2015. Nonetheless, this confirms the massive importance that ODA has on the economy and on the humanitarian sector, in particular.

As the newest country, South Sudan has one of the lowest debt stocks in the world but very high domestic arrears. In 2017, the IMF estimates total government debt at SSP 63 billion, which amounts to 19 percent of GDP (Figure 16). This figure includes borrowing from commercial banks, direct borrowing as well as a recapitalization claim from the Bank of South Sudan, outstanding oil advances, and external loans to the World Bank and China. Importantly, however, this excludes domestic arrears, which are estimated at USD 400 million, which, once included, push the total to around 55 percent of GDP. Given the high levels of combined obligations, the government has instituted a ceiling for new concessional borrowing but is still planning to issue new Treasury Bills to finance the current budget deficit.
Key takeaways

- The government budget is mainly financed by oil revenue, which remains volatile due to global prices and the impact of the civil war on production.
- The majority of oil revenue is lost to compensation agreements and other oil-related expenses, whose actual value is further eroded by inflation.
- The non-oil sector, including agriculture, remains unexploited for revenue potential.
- South Sudan heavily relies on ODA, which appears to be nearly two-times larger than the size of the entire 2017/18 national budget.
- Despite the large volume and overall importance of ODA to the economy, it is mainly off-budget and channeled to humanitarian efforts, which means it is not supporting the development of direly needed social services.
- Once accounting for domestic arrears, the government’s current debt position is at a dangerous level, which leaves very limited scope to issue new debt to finance spending on priority sectors.

SECTION 6. NEW DEVELOPMENTS IN PFM

The government recently introduced several PFM reforms that could strengthen budgeting processes and improve social sector investments. In FY 2017/18, the government announced its intentions to improve the management and use of public funds as well as expand the current tax base. Regarding the use of funds, the government has:

- Restricted borrowing from the central bank to SSP 2.2 billion per year;
- Introduced measures on non-priority operating expenditures, including on medical and travel claims;
- Cancelled all outstanding cheques;
- Closed its accounts in commercial banks;
- Introduced a public procurement bill to improve contracting procedures; and
- Established an arrears management committee to oversee the stock taking process of the existing arrears alongside an arrears clearance plan to eliminate false claims.

Each of these reforms should be strongly encouraged, as they are expected to improve the management of revenue and expenditure and contribute to overall PFM efficiency gains, which will both directly and indirectly have a positive impact on social sector investments.
The government has also introduced reforms to support resource mobilization efforts. This includes introducing air departure and sole proprietor personal income taxes as well as removing the 85 percent fuel subsidy in the current budget, which will allow those resources to be directed to other areas. All efforts to support greater revenue should be applauded, as long as they are designed progressively. However, the removal of fuel subsidies should be viewed with caution, as they are likely to increase transportation fares as well as the cost of doing business in general. As a result, the government must ensure that this measure does not further erode the already very limited disposable incomes of the poorest households by introducing compensatory measures (e.g. cash or in-kind transfers, transportation vouchers).

Key takeaways

- The introduction of the package of PFM reforms could enable the government to better manage its finances and improve its capacity to plan and deliver public services throughout the country. The government should move swiftly ahead with this agenda.
- The air travel and income taxes are to be applauded, and the government should continue to assess the potential of other revenue sources, including in the agriculture sector.
- Scaling back fuel subsidies is a bold reform that will free up a large amount of fiscal space. However, the government must assess the potential negative impacts of this reform, especially on children and the most vulnerable families, and establish appropriate social protection mechanisms to mitigate harmful consequences. The government is strongly encouraged to redirect the subsidy savings into establishing a social protection system.