

**THE IMPACT OF SUDAN'S ARMED
CONFLICT ON THE FISCAL
SITUATION AND SERVICE DELIVERY**

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Acronyms

BPT	Business profit tax
CBoS	Central Bank of Sudan
EBS	Electronic Banking Services
FMGE	Federal Ministry of General Education
GBV	Gender-based violence
GDP	Gross domestic product
GMCs	Government Musharaka Certificates
HIPC	Highly Indebted Poor Countries Initiative
IDPs	Internally displaced persons
IPC	Integrated Food Security Phase Classification
MoFEP	Ministry of Finance and Economic Planning
MW	Megawatt
NHIF	National Health Insurance Fund
RSF	Rapid Support Forces
SAF	Sudanese Armed Forces
SAM	Severe acute malnutrition
SDG	Sudanese Pound
SFSP	Sudan Family Support Programme
SPLM-N	Sudan People's Liberation Movement- North
VAT	Value added tax
WASH	Water, sanitation and hygiene

OVER

6 MILLION

people have been displaced including about **three million children**



AN ESTIMATED

1 IN EVERY 2

children need urgent humanitarian assistance



OVER

3,130 ALLEGATIONS

of severe child rights violations reported in the country



ABOUT

19 MILLION

children are out of school

OVER

3.4 MILLION

children acute malnourished, including **700,000 severe acute malnourished** and at high risk of dying

AN ESTIMATED

4.2 MILLION

women and girls are at risk of GBV



I. The Context

On 15 April 2023, conflict erupted in Sudan between the Sudanese Armed Forces (SAF) and Rapid Support Forces (RSF). Since then, intense clashes have continued between the warring forces in Khartoum, Darfur and some areas of Kordofan states, as well as between the Sudan People's Liberation Movement- North (SPLM-N) Al Hilu faction and SAF in South Kordofan State. Prior to the conflict, the children of Sudan were already in a precarious situation with more than 6.9 million of school-going age out of school; three million children under-five years of age suffering from malnutrition; one third of the population in need of water, sanitation and hygiene (WASH) facilities; and more than three million women and girls at risk of gender-based violence (GBV).¹ Since the onset of the conflict, over six million people have been displaced including about three million children, nearly a quarter of whom have crossed to neighbouring countries. Over 3,130 allegations of severe child rights violations have been reported in the country. This is just the tip of the iceberg, with severe under reporting due to communications blackouts and lack of access. About 14 million children, or one in every two children, need urgent humanitarian assistance.² All schools in the country have been closed with 19 million children out of school. Additionally, an estimated 4.2 million women and girls are at risk of GBV.

II. Objective

The conflict, which has exacerbated an already challenged service delivery system characterized by low levels of public expenditure, is expected to worsen the fiscal and monetary situation and compromise the government's ability to deliver basic services including education, health, WASH, and social protection, thus deepening children's crises. The study sought to assess the potential impact of the conflict, and possible actions required by the government and stakeholders, with respect to the overall fiscal situation and its influence on (i) the budget implementation, budget deficit, and inflation; (ii) banking, money supply, liquidity and foreign exchange (iii) expenditure on the delivery of basic services related to children, (iv) adaptation of the delivery system to the conflict shock and (v) household incomes and food security.

The purpose of this assessment is to highlight the magnitude of fiscal loss to basic services and household incomes, specify operational limitations such as banking and financial transaction constraints and propose key recommendations for national and international development and humanitarian partners operating in the midst of the Sudan conflict.

III. Methodology

The study used a mix of secondary data, key informant interviews and focus group discussions. The secondary data was based largely on government directives and budgetary allocation and expenditure post-15 April; data from state authorities, Central Bank of Sudan, development partners and non-state actors. The interviews were conducted with government and sector technocrats as well as end users. The focus was national with specific reflections from three states: one representing those with active fighting; another with partial fighting, and a third for safe states with no fighting.

1 UNICEF Sudan, Annual Results Report 2022, and Children in Sudan: An overview of the situation of children in Sudan.

2 UNICEF Sudan, Humanitarian Situation Report, 11 July 2023 and UN OCHA Sudan, Humanitarian Situation Update, 31 August 2023.

The study faced a limitation of obtaining quantitative estimates or allocation from the states to sectors, thus the focus was on losses from federal allocations. Additionally, the federal MoFEP is working with core staff only and was unable to produce quarterly reports for the fiscal performance in 2023, which could have helped in accuracy of forecasting the fiscal performance for the year 2023. Therefore, the study resorted to the interviews with the concerned staff in MoFEP and their value judgment.



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IV. Impact of the Conflict on the Fiscal Situation

THE BUDGET FOR 2023

The budget for 2023 planned an increase in revenue to 12.4 per cent of gross domestic product (GDP) compared to 9.7 per cent in 2022. Public expenditure was projected to increase slightly from 11.2 per cent in 2022 to 13.8 per cent in 2023, thereby maintaining a budget deficit of only 1.4 per cent of GDP to support the reduced inflation target of 25 per cent³ and achieve economic stabilization. The ongoing conflict will have devastating effect on the fiscal situation and consequently on the stabilization goal of the budget.

³ In 2022 the actual inflation rate was 165.4 per cent.

REVENUE

The tax mobilization in the 2023 budget is mainly dependent on customs (13 per cent of total revenue), value added tax (VAT) 35 per cent of total revenue, of which about 70 per cent is being collected with customs at the importation stage, and business profit tax (BPT) 10 per cent of total revenue. The combined value of these taxes represent 58 per cent of the total budget revenue. The performance of these taxes is driven mainly by the private sector business activities such as imports, industrial production, trade, and other general business activities. During the first quarter of 2023 (January-March), prior to the conflict collection of revenues was normal. However, conflict, broadly destroyed the economic base and impeded private sector activities with severe impacts on revenue mobilization.

The Khartoum business community contributes the major share of customs, VAT, and BPT. Khartoum has been Sudan's primary industrial, commercial, and manufacturing hub, hosting two thirds of the country's manufacturing establishments.⁴ Out of 865 bank branches in Sudan, 384 (44 per cent are in Khartoum State⁵. However, most of the large businesses in Khartoum including factories (wheat mills, food, beverages, pharmaceuticals, car assembly etc.), warehouses, car dealers, all the main and small popular markets, shopping malls, electronic shops, and the gold market were looted or destroyed, with some burned to the ground, or forced to shut down. Therefore, demand for imported goods like finished industrial goods, industrial inputs, textile, transport means, and other businesses that generate most of direct taxes has reduced drastically.

Imports have also been affected by the logistics failures and infrastructure destruction resulting from the conflict, including the disruption of the banking payment system. Major sea and air freight companies have halted or limited their operations in the country, and Khartoum International Airport has sustained extensive damage and remained out of operation.

According to the Ministry of Finance and Economic Planning (MoFEP), most imports are currently confined to essential strategic commodities (oil products, wheat, medicines, agriculture inputs, goods from humanitarian agencies etc.). These imports are exempted from customs and VAT. Bank of Sudan abolished the nil value system (importers use their own sources of foreign currency outside Sudan to import commodities); and directed the limited foreign exchange resources to essential and strategic commodities, which are exempted from import duties and VAT, and as such they do not contribute to the public revenues⁶.

Business profit tax is expected to be affected by the destruction of the economic base. The Taxation Chamber is dependent on its large taxpayers unit for collection of BPT, however, most businessmen registered under this unit are affected by the conflict in Khartoum.

⁴ UNDP-Sudan, Macroeconomic Policies for Poverty Reduction, The Case of Sudan 2006.

⁵ CBoS, Annual Report 2022.

⁶ CBoS, Press Notice 5, July 2023 on the new regulations for financing imports.



decline in tax revenues between April and July 2023 compared to the budgeted figure

Non tax revenues likely to decline by

13%

Total revenue is expected to decline by

52%

of the planned revenues in the 2023 budget

Non-tax revenues contributing about 37 per cent of total revenues are affected by the conflict, but to a lesser degree. Revenue from oil sales and fees including transit fees of oil from South Sudan have not been affected since oil infrastructure has not been disrupted. However, certain revenues like that from public enterprises, administrative fees charged by federal government agencies, have been affected due to the suspension of many services delivered by government agencies.

It is estimated that from April to July 2023, the tax revenue, including customs and VAT, declined by 90 per cent compared to the budgeted figure and is likely to follow the same trend if the war continues until the end of the year⁷. Non-tax revenue, which constitutes about 38 per cent of total revenue, is likely to decline by 25 per cent⁸. Taking into account the normal tax collection during first quarter of 2023, in addition to a reduction of tax revenues by 90 per cent and non-tax revenue by 25 per cent; total revenue is expected to decline by 52 per cent of the planned revenues in the 2023 budget.

EXPENDITURE

The government has rearranged expenditure priorities for 2023. A High-Level Emergency Committee was formed by the Acting Minister of Cabinet Affairs for Emergency and Management of Crises⁹. One of the tasks of the committee is to ensure the flow of goods and services and identify government priorities during the conflict. The committee identified the following spending priorities: (i) wages and salaries of the security sector; (ii) food, fuel, and other supplies for the army; (iii) provision of life-saving drugs and supplies (especially equipment for kidney dialysis, and medicines for cancer, and heart diseases); (iv) cost of transport and management of humanitarian assistance; and (v) spare parts and maintenance of water supply facilities.

7 Based on an interview with MoFEP key staff in Port Sudan and a note from the Director General of Finance and Administration MoFEP.

8 Estimates are based on informal interviews with staff in MoFEP and other experts.

9 Established by the Transitional Council of Ministers - decree 215 for 2023. Chaired by Acting Minister of Cabinet Affairs and its membership includes Ministers of Finance, Social Development, Trade, Telecommunications, Federal Affairs, Health, Governor of CBoS and Governor of Khartoum State, and representatives of the security sector.

Even with little or no spending for development, the 2023 budget is likely to exceed the planned allocations by about 12 per cent, given the considerable expenditure on security as a priority area identified by the Emergency Committee (26 per cent of the approved 2023 budget) and additional security sector expenditures (42 per cent of the adjusted budget for 2023), which translate to a 167 per cent increase in security allocation in absolute terms, in addition to payment of arrears accumulated since May 2023 amounting to 44 per cent¹⁰.

BUDGET DEFICIT AND INFLATION

With revenues expected to decline by 52 per cent, and expenditure increase by about 12 per cent above the budgeted allocations, there is an anticipated sixfold increase in the budget deficit (9 per cent of GDP) from the projections in the 2023 budget (see Figure 1).

The fiscal deficit during the previous years was primarily financed by monetization (printing money) in the absence of other non-inflationary sources. The market for government securities - Government Musharaka Certificates (GMCs) has declined considerably due to the low rate of return compared to the inflation rate along with the failure of the government to pay interest to the certificate holders in time. The GMC interest due in May 2022 was 25 per cent according to Sudan Financial Services Company of the Central Bank of Sudan (CBoS), whereas the inflation rate in the same month was 192 per cent. In addition, payments for certificate holders were not settled until the last week of June 2022. On the other hand, foreign finance, aside from humanitarian assistance, was not forthcoming as it was dependent on political reforms and a comprehensive debt relief operation based on the Heavily Indebted Poor Countries (HIPC) Initiative of the World Bank and the International Monetary Fund. Monetization therefore was the only option for the government. For example, in 2019 about 91 per cent of the budget deficit was covered by borrowing from CBoS, and in 2020, almost all the budget deficit was financed by borrowing from CBoS¹¹.



12%

increase above
planned allocations
of the 2023 budget



SIXFOLD

anticipated increase
in the budget deficit
to 9 per cent



200-700%

expected increase of
staple grain prices



167%

increase in security
allocation

10 The arrears in the adjusted 2023 budget will include wages and salaries for the civil sector which will be (10 per cent of the expenditure); current transfers to states (10 per cent), subsidies (9 per cent), social support (7 per cent), and about no more than 2 per cent of the total expenditure on urgent rehabilitation activities.

11 IMF-Sudan, Second Review Under the Staff-Monitored Programme and Request for Extension, June 2021.

The fiscal situation in 2023 is not far removed from the one in 2020. The end-period inflation in 2020 soared to 269 per cent from 57 per cent in 2019. This resulted from the budget deficit of about 6 per cent of GDP and monetization of all this deficit, leading to the rapid expansion of the monetary aggregates.¹² The conflict is expected to increase the budget deficit to 9 per cent of GDP, with full monetization causing a return to triple-digit inflation, from 87.3 per cent in December 2022 to a likely range of about 250-300 per cent by December 2023, unless monetization is avoided (*see Figure 2*).

There are already strong indications of price escalations. Substantial increase in prices of food and other basic goods have emerged since the beginning of the conflict. Prices of basic commodities have risen by 40-60 per cent in some areas¹³. Staple grain prices are expected to escalate 200-700 per cent above the five-year average over the coming year.¹⁴ This direction of triple digit inflation is supported by estimates from other organizations. World Food Programme indicates that 'inflation rates were not issued for the last five months of 2023, but with skyrocketing prices of goods and services, it is estimated to exceed 200 per cent by July.'¹⁵

The conflict will not only result in increased deficit and inflation, but may also cause budget restructuring. The budget after the conflict could be dominated by security spending which may increase to 62 per cent of the total government expenditure, compared to 26 per cent in the approved 2023 budget (*see Figure 3*). The conflict could also turn the budget into almost a recurrent budget, with minimal spending on development and more on emergency rehabilitation of facilities and buildings (*see Figure 4*).

Soaring inflation impact can weigh heavily on families and children¹⁶. Increased prices will have impact on access to food, health care and education and worsen an already dire humanitarian situation for children. For example, by June 2023, three months into the conflict, inflation was reducing the purchasing power of households; they could only buy about half the quantity of wheat flour, and three quarters of the quantity of sorghum that they used to buy in June 2022. The hike in inflation and the deteriorating food security will exacerbate an already precarious situation for Sudanese households, occasioned by the coronavirus disease 2019 (COVID-19), and climate shocks. Household resilience will be compromised, pushing more people into poverty. The government should therefore exert all efforts to avoid monetization of the fiscal deficit by financing this deficit from real resources.

12 See detailed analysis of causes of inflation in IMF, Sudan Article IV Consultation Report 2019 and IMF Sudan, Second Review Under the Staff-Monitored Programme and Request for Extension June 2021.

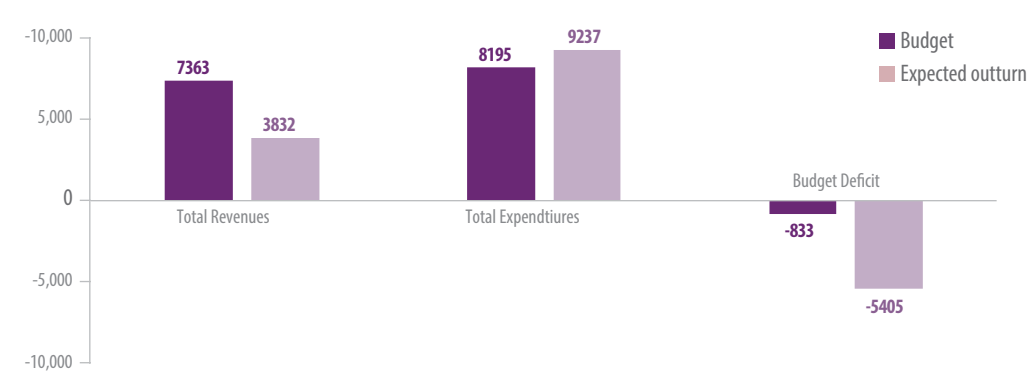
13 UNICEF-Sudan, Response to Sudan Crises 'Chapeau', 04 May 2023.

14 FAO, DIEM- Data in Emergency Situation Overview, June 2023.

15 WFP, Market Monitor Sudan, July 2023.

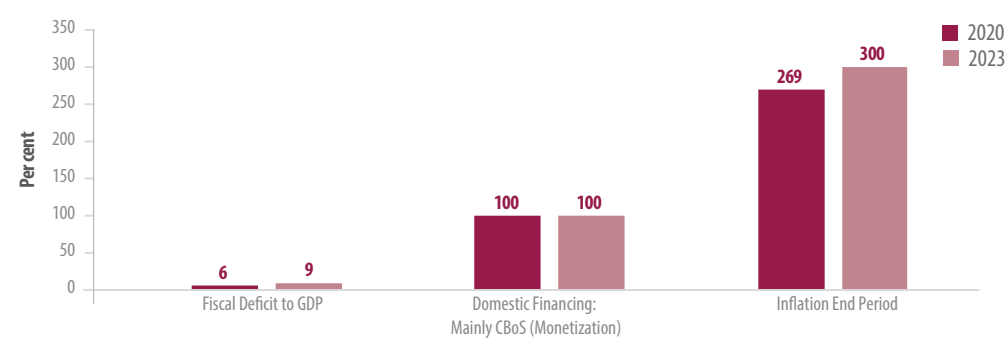
16 UNICEF, Prospect for Children in the Polycrisis; a 2023 Global Outlook.

FIGURE 1: BUDGET FOR 2023 AND EXPECTED OUTTURN (SDG BILLION)



Source: MoFEP: the federal government budget for 2023 and author's own calculations

FIGURE 2: COMPARISON OF FACTORS CAUSING INFLATION IN 2020, TO POSSIBLE OUTCOME OF 2023 BUDGET (PERCENTAGE)



Source: MoFEP actual performance of 2020 budget, CBS (inflation rate) and IMF-Sudan

FIGURE 3: CHANGE IN 2023 BUDGET STRUCTURE DUE TO CONFLICT

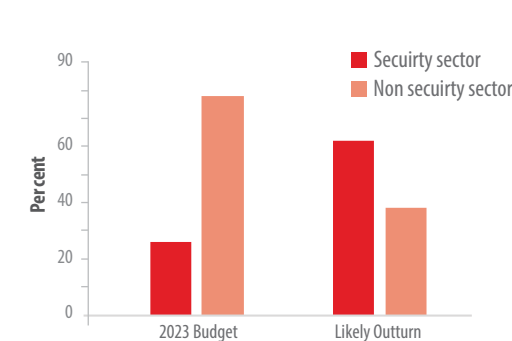
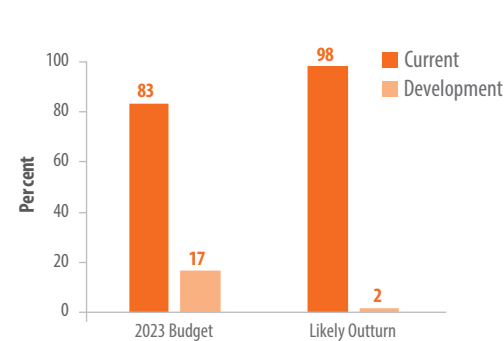


FIGURE 4: CHANGES IN CURRENT VERSUS DEVELOPMENT SPENDING DUE TO CONFLICT



Source: Author's own calculations



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V. Banking, Payment System, Liquidity and Exchange Rate

BANKING AND PAYMENT SYSTEM

The ongoing conflict poses significant challenges to the banking system, which was already characterized as fragile prior to the conflict¹⁷. Twelve banks (accounting for 25 per cent of banking system capital) have capital adequacy ratios below the regulatory 12 per cent minimum. A 2021 CBoS asset quality review and bank-by-bank stress test revealed significant levels of stress requiring restructuring the banking sector through liquidation and/or merger and acquisition¹⁸. The banking sector is highly concentrated; the five largest banks account for 55 per cent of the sector's total assets. Over half of the bank branches are located in only two states: Khartoum (44 per cent) and Gazira (11 per cent), while the remaining 16 states have 45 per cent of the total bank branches.

The key payment systems in Sudan are operated by the CBoS and the Electronic Banking Services (EBS) company, a technical arm of CBoS. The CBoS uses Sudan Real Time Gross Settlement (SIRAG) banking system linking all banks to the central bank, and a core banking system. The EBS operates a national switch; where banks can access a range of products and services such as Swift, automated teller machines, points of sale, cards, apps, and billers, and is also the operator of the banking system clearing house. Almost all banks are dependent on EBS for electronic services, except five (Bank of Khartoum, Faisal Islamic Bank, Alsalam Bank, Al Baraka Bank and Omdurman National Bank), that have their own switches. The CBoS electronic data system is housed in the headquarters, while its backup is housed in its Khartoum branch, near SAF general command building and the EBS main data sys-

¹⁷ IMF-Sudan, Request for a 39-month arrangement under the extended credit facility-June 2021.

¹⁸ IMF-Sudan, Second Review under Staff-Monitored Programme, June 2021.

tem server is housed in CBoS Khartoum branch, with its backup server located close to the CBoS headquarters. These locations are the epicentre of fighting. The systems became inaccessible shortly after the onset of the conflict, their power supply was cut off, and operating them via generator power was not possible. Bank-to-bank payments were cut off, preventing the transfer of money between accounts because electronic clearance was not functioning. Banks thus were not able to deliver any electronic payment services.

The conflict has also resulted in the destruction of banking system infrastructure with significant damage to buildings, furniture, computers, and electronic systems. In Khartoum, account holders in all bank branches have been unable to access their accounts as all banks were closed. Though banks outside Khartoum have been operational, a lack of inter-branch linkages due to the centralization of banking operations in Khartoum and heavy dependence on headquarters, has posed a challenge. Bank of Khartoum, which has its own independent switch, succeeded in accessing its server, providing it with stable power supply and managed to intermittently restore its systems online, since the early days of the conflict, to provide digital services to its customers including billing payments, and Western Union cash remittances. Since July, many other banks have been able to restore their systems.

Recently, CBoS managed to restore its core banking system, connecting about 23 out of the 37 banks in Sudan, however, it has not managed to restore the electronic clearance system, and money transfer between banks is not yet possible. Mobile money transfers, mobile payments and electronic banking applications are functional but with frequent system disruptions due to weaknesses in the communication networks, internet outages and frequent power cuts.

Evidently, the centralization of banking systems in EBS, and dependence on bank headquarters, have impacted the functioning of the whole banking system including CBoS and commercial banks. A major drawback in the payment system is that neither CBoS nor the individual banks have a business continuity or disaster recovery plan.



23 of 37

banks' connectivity restored, but not the electronic clearance system, and money transfers



75%

of the cash used in markets either sourced from personally stored liquidity, borrowed, or from informal cash transfer agents



An informal money transfer network has emerged, with fees ranging from

10% - 50%

of the transfer value

LIQUIDITY

Sudan is primarily a cash-based society, and the penetration of financial inclusion is low; with one of the lowest levels in Sub-Saharan Africa. According to the most recent available Global Findex data for Sudan (2014), only 15.3 per cent of Sudanese adults had a financial account at a formal financial institution. Women, with limited education, from rural areas are particularly unbanked¹⁹.

At the onset of the conflict, several banks in Khartoum, Darfur, and Kordofan were looted; including banknotes in bank vaults, and cash in automated teller machines. However, the cash looted is not likely to have any significant impact on the economy or the banks since a large percentage of money in circulation is already outside the banking system and a significant percentage of it is quasi-money²⁰ (see *Figure 5*). The cash in the banks represents a small portion of the bank's assets (see *Figure 6*) and is insignificant compared to the other assets of the banks. The impact of bank looting will mainly be reduced trust in the banks.

Accessing cash has been difficult for the affected population since the conflict erupted. Liquidity needed to manage the livelihood of families was constrained by closure of banks. People who were able to withdraw money from banks have been storing it in their houses, further affecting the overall circulation of cash. A survey in Khartoum State showed that around 75 per cent of the cash used in markets in Khartoum after the conflict was either sourced from personally stored liquidity, borrowed, or came from informal cash transfer agents²¹. Additionally, on 31 May the currency printing press under the control of the RSF in Khartoum was bombed to prevent the RSF from printing money to fund their operations. Despite gaining control of the printing press, the government does not seem to have full access to movement of materials in and out of the building, and hence not able to print any currency.

On the other hand, people's dependence on mobile money transfer services has increased since the conflict. However, network connectivity disruptions because of infrastructure damage have further hindered the ability to use the already limited online and mobile banking services.

Informal money transfers through mobile network operators have emerged, with substantial fees ranging from 10–50 per cent of the transfer value, depending on the location and availability of cash. Informal banking agents have also emerged to help address the need for cash withdrawal, but at a fee, 10 per cent and maybe more, for accepting selected bank transfers from individual accounts, like Bankak²², in exchange for cash.²³

19 Finmark Trust and World Bank, Sudan National Financial Inclusion Survey 2021.

20 Quasi-money means non-cash assets that can be converted to cash, such as treasury bills, gold certificates and deposits certificates.

21 ACAPS, www.acaps.org, August 2023.

22 Bank of Khartoum Mobile Banking Application

23 Individuals operating in markets and near government service units who normally have Bank of Khartoum accounts (and later also Fawry from Omdurman National Bank) and also carry cash. Those who need cash over and above the bank withdrawal ceiling, transfer the needed amount to the Bankak account of the agents and receive cash at a fee.

Liquidity constrained NGOs from providing cash humanitarian assistance, especially during the early months of the conflict²⁴. Those providing cash transfers adopted different means to transfer their cash assistance including transfers to the bank accounts of their staff based in certain localities, who would then transport the cash to affected individuals; others used private Sudanese entities outside Sudan which have the capacity to support transfer assistance programmes in the country; and others used local merchants as intermediaries based on certain conditions.

FIGURE 5: MONEY SUPPLY COMPONENTS AS AT FEBRUARY 2023

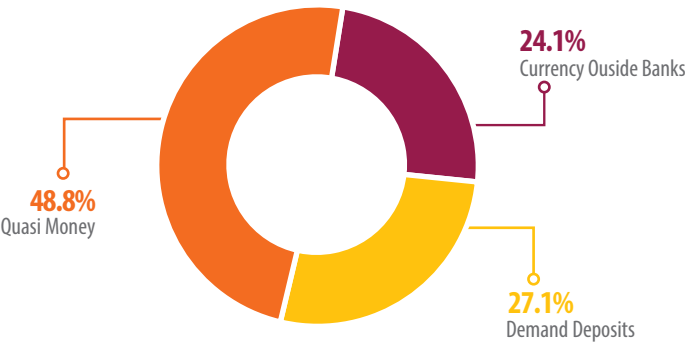
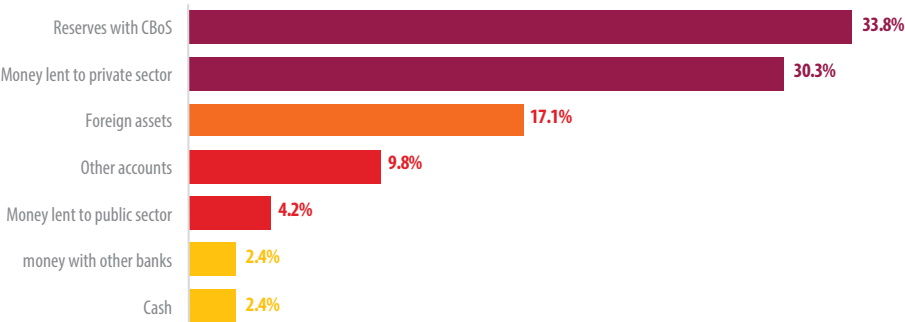


FIGURE 6: BANKS CONSOLIDATED BALANCE SHEET END 2022 (PERCENTAGE)



Source: MoFEP actual performance of 2020 budget, CBoS (inflation rate) and IMF-Sudan: Second Review Under the Staff-Monitored Programme and Request for Extension, June 2021

24 For examples of some cases see www.agenzianova.com, May 19 2023, and www.opb.org, Conflict in Sudan Impacts Portland-based Mercy Corps Relief Effort, May 10 2023.

EXCHANGE RATE

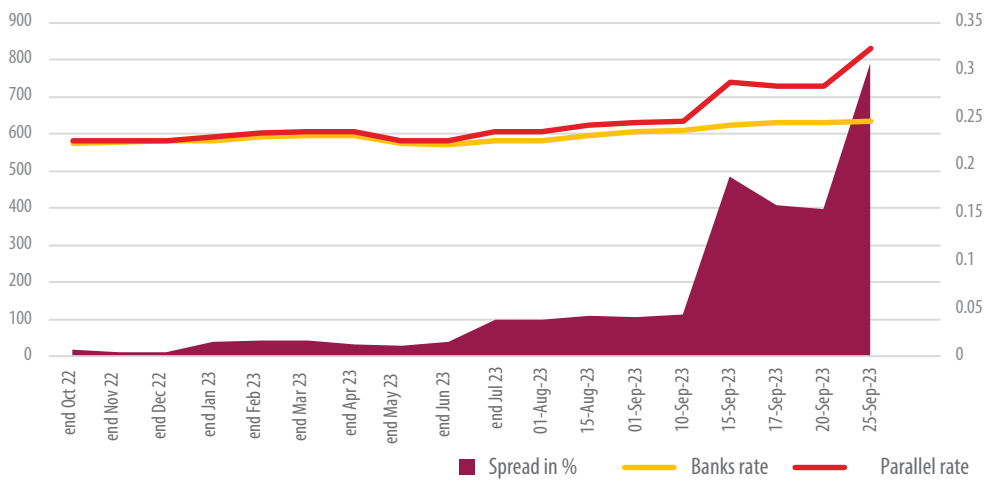
One of the major repercussions of the conflict is the instability that started to emerge in the foreign exchange market. For many years Sudan has maintained a multiple exchange rate regime which stunted export competitiveness, distorted economic incentives and discouraged flow of remittances through official channels. For example, in September 2020, the parallel market exchange rate quadrupled the official rate. However, on February 21, 2021, the government unified the official exchange as part of the agreement reached with the IMF in June 2021, on a 39-month arrangement under the Enhanced Credit Facility arrangement to support the structural reform programme so as to reach the HIPC Completion Point. Although the debt relief process was suspended due to the 25th October coup, the exchange rate market remained unified with a spread of one to four per cent between the banks' and the parallel rates, even after the conflict and up to August 2023.

Since the beginning of September 2023, the price of foreign exchange in the parallel market started to increase at a higher rate than the bank rate and the spread between the two started to expand. By 25th of September 2023, the parallel market rate reached SDG 838 per US\$, a 32 per cent spread between the bank rate and the parallel rate, being the highest since the unification of the exchange rate (*see Figure 7*).

A major factor that contributed to the emergence of strong parallel market, is the decline in the supply of foreign exchange in the face of increased demand resulting in external imbalances. The proceeds of foreign exchange from gold, a major export item, drastically reduced. By the third quarter of last year, Sudan exported about 11 tons of gold, generating 44 per cent of the total exports, whereas during the same period in 2023 total exports were only two tons (80 per cent decrease)²⁵. This has led to a sharp decline in the foreign exchange proceeds of exports. At the same time, demand for foreign exchange started to increase. The import of consumer goods (food items, medicines etc.) which were previously produced locally has increased, as local stocks were depleted and new production in Khartoum, the major production hub, stopped as a result of the conflict. The increased demand for imports coincided with a new additional increase in the imports of fuel due to recent closure of Khartoum Oil Refinery by the RSF. This has created more demand for oil imports by the private sector because the government has lifted restrictions on private sector fuel imports and allowed the private sector to sell imported fuel at market prices since February 2020. The situation has also been aggravated by the inability of the CBoS to maintain adequate international reserves. International usable reserves have been on a declining trend since 2011 from US\$ 1,317 million to an estimated US\$ 472 million in 2022. Shortages of foreign exchange and the opaque situation created by the conflict also triggered speculation that further drove the price of foreign exchange.

25 The CBoS, Economic and Financial Statistical Review Jan-Dec 2022, and a press release on the 14th of September by the Deputy Director of Sudan Mineral Resources Company.

FIGURE 7: OFFICIAL AND PARALLEL EXCHANGE RATE SDG/US\$ (END OF OCTOBER 2022— 25 SEPTEMBER 2023)



Source; CBoS, www.alin.com, www.sudanakhabar.com, and informal survey of parallel market





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VI. The Potential Impact of the Conflict on Service Delivery Financing

FINANCING SERVICE DELIVERY

The responsibility of basic services including general education, WASH, health, states social development, and environmental protection is assigned to the states. There are also few concurrent powers related to service delivery, to be exercised jointly by the federal government and the states, which include combating communicable diseases, mother and child care, natural disaster management and social protection²⁶.

²⁶ Powers of different level of government in details in Organization of Decentralized Governance and Intergovernmental Relations Act for 2020.

The states have different sources of financing for basic services; mainly state-owned revenues (tax and non-tax)²⁷ and transfers (current and development) from the federal government. The federal government provides states with non-earmarked and earmarked current transfers. The non-earmarked transfers which constitute the major share in the transfers are unconditional allocations and are mainly used by the states to complement state's own revenues to finance their expenditure. The earmarked current transfers (35 per cent of the total current transfers) are for financing specific items mainly in the health sector and cash transfers to the poor. The development transfers are project-specific allocations financed by the federal government from domestic and foreign resources for states projects, mainly in the area of basic services and infrastructure. The federal government also directly finances some of the expenditures related to the concurrent powers like social benefits and natural disasters.

Financing during the conflict period **affected payments of wages and salaries** for civil servants, financing of health services and addressing health hazards

The conflict has had a pervasive impact on the above-mentioned financing arrangements making service delivery extremely challenging. Specifically, financing during the conflict period affected the following items: payments of wages and salaries for civil servants working in basic service sectors; financing of health services including medicines, medical supplies, and addressing health hazards caused by floods; general education; WASH; and social protection. In addition, the conflict also affected the bank financing of agriculture production, which is integrally linked to food security.

Wages and salaries

Over the past years, states increased their dependence on the current transfers from the federal government to pay these salaries (see *Figure 8*). The states of Khartoum, West Kordofan, East Darfur, River Nile, Northern, Al Gadarif and Red Sea have own resources that cover more than 60 per cent of their wage bill. Khartoum State, being the capital, has by far the largest local tax base and enjoys high returns from its own investments, including land. The other states alluded to derive additional revenues from the natural resources in their states through federal arrangements. West Kordofan and East Darfur are the only states that have oil production, and according to the agreement with the government, receive 2 per cent of the value of oil produced in their states mainly from the fields of Hejlig, Balila, Deffra and Sofian, as additional revenues.

27 Taxes jurisdiction for the states include agriculture and livestock charge, charges on the state services, commercial licenses, land rent, levies on tourism, stamp duty, share of the state in the business profit tax.

The recent arrangements in the artisanal gold mining sector also gave the producing states significant share in local taxes, and these resources have benefited River Nile, Northern, Red Sea and Al Gadarif states.

Due to the conflict, which caused a sharp drop in federal revenues, the government has been unable to make any current transfers to the states since March 2023. States therefore have not paid wages, and civil servants have not received their salaries for almost five months.

Weaknesses in the fiscal federalism has been known to the government and well documented even before the conflict.²⁸ The current conflict has demonstrated the structural weaknesses in fiscal federalism in Sudan. Despite establishment of the federal system in 1991, with the objective of devolution of more fiscal powers to the lower level for efficient service delivery, states have been unable to mobilize adequate own revenues to cover their wage bill. The degree of centralization in Sudan as measured by the revenue and expenditure assignment, and dependence of the subnational government on federal transfers; measured by vertical fiscal imbalances is high. In 2021 the federal government collected 93 per cent of total general government revenues, 94 per cent of the general government taxes, and assigned about 20 per cent of the general government expenditures to states²⁹ (see Figure 9). States were dependent on the federal transfers to finance 69 per cent of their own expenditure.

One of the main reasons for the high dependency of states on the federal government is their weak revenue mobilization capacity. States collect little in terms of own revenues. The low tax base in the states is mainly influenced by: (i) the limited private sector development and the significant informal trade activity; (ii) weak compliance, as subnational taxes are mostly based on services related to households and small businesses who receive poor service in return; (iii) difficulty in collecting multiple taxes, being at the household level and the informal sector; (iv) lack of government accountability to local taxpayers in the absence of elected state legislators for several years; (v) continuous conflicts in some states, seriously affecting the main productive sectors, disrupting markets and trade, with negative impacts on tax collection; and (vi) weak tax administrative capacities.

Furthermore, there is also an apparent weakness in the fiscal transfers to states. The government is applying a horizontal equalization formula³⁰ which has been subject to frequent adjustment, the latest in 2019 where nine criteria were used for the current transfers; with different weights assigned to each: population (30), health (12), education (10), security (10), agriculture requirements (10), labour force (10), financial performance (8), average distance to the capital and the port (8), and own revenues (2). However, the use of this criteria does not

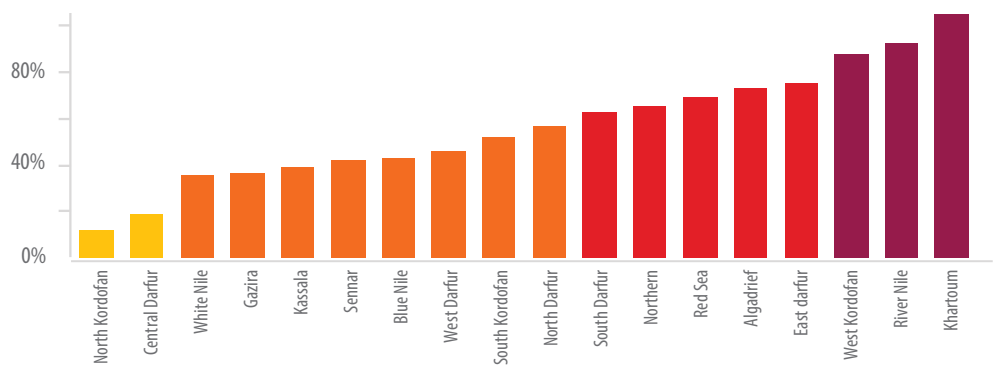
28 See for example: IMF 'Fiscal Decentralization: Trends, Challenges, and Perspectives in Sudan', Selected Issues Paper, PP. 53-61; 2012, World Bank, 'Sudan: State-Level Public expenditure Review'-Volume 2 background papers, Washington DC 2014, USAID 'Improving Subnational Domestic Revenue Resource Mobilization' 2021, El Shibly, Mekki M., 'Assessment of the Existing Inter-Governmental Fiscal Transfers System in Sudan', 2013.

29 General government taxes revenues and expenditures is both federal plus states.

30 Horizontal equalization formula is a formula with specific variables and weights that is used to allocate federal transfers between states.

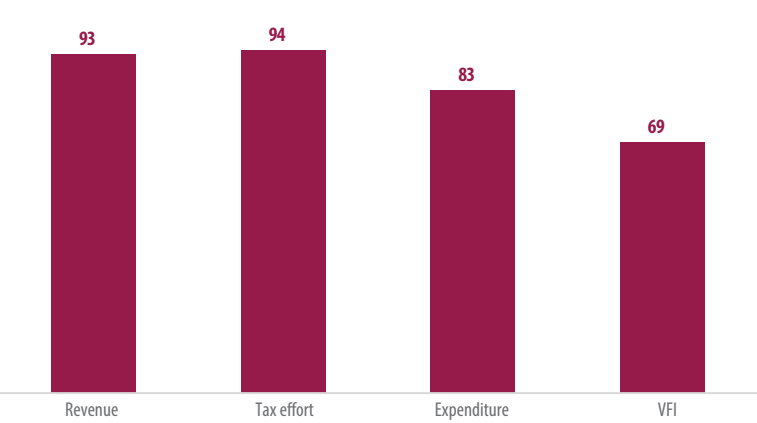
seem to have reduced inequalities between states in service delivery. Generally, the poorest states are also those who receive fewer transfers.³¹

FIGURE 8: PERCENTAGE OF STATE WAGES COVERED FROM OWN STATE REVENUES IN 2022



Source: States report of final accounts for 2022 National Chamber of Accounts.

FIGURE 9: FEDERAL GOVERNMENT EXECUTION OF SELECT FISCAL INDICATORS (PERCENTAGE)



Source: National Chamber of Accounts, states annual audited accounts 2021

31 IMF, ‘Fiscal Decentralization: Trends, Challenges, and Perspectives in Sudan’, Selected Issues Paper, PP. 53-61, 2012.



Acute shortages
of medicines and
medical supplies



Frequent and lengthy
electricity cuts have
damaged significant
quantities of medicines



83%

of hospitals in
Khartoum were
out of service as at
August 2023



1.7 million
children under-one
missing critical
lifesaving vaccines

The health sector
has lost close to
SDG 600 Bn
equivalent to
11% of the total
government budget

Health

Health services, medicines and medical supplies

The earmarked current transfers to states in the 2023 budget covers allocations specifically for free medical care in hospitals, free medical care for children, free medicines for children under five, programmes to reduce maternal and infant mortality rates, and support to kidney dialysis centres. However, the federal government was unable to make any earmarked transfers to the states since April 2023 because of the conflict. This has resulted in several states facing shortages of medicines and medical supplies, including life-saving drugs, and constrained free medical care in public health facilities.

The federal government also allocated 9 per cent of current expenditure in the 2023 budget for social benefits, of which about 24 per cent is mainly allocated to lifesaving drugs and free medical treatment in emergencies. However, the MoFEP could only make small payments for the supply of lifesaving drugs and kidney dialysis equipment, amounting to about SDG 25,000 million or 25 per cent of the allocated amount, resulting in shortages of medicines for chronic diseases.

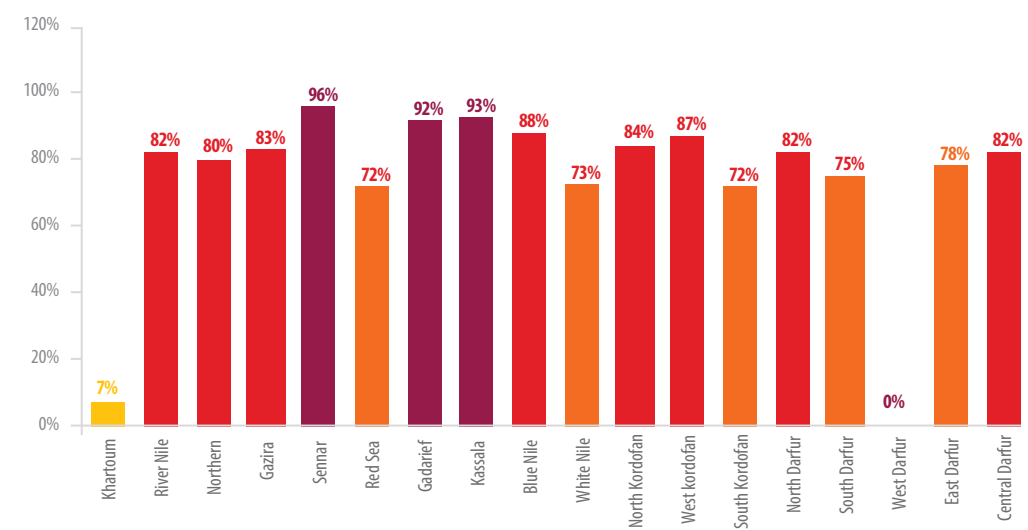
States unaffected by the conflict, despite low revenue mobilization, are using their limited own resources to provide health services. However, additional pressure has been put on these states by the large number of internally displaced persons from war-affected zones, straining already limited supplies. Shortages in financing of health services were more prominent in some states with active conflict like Darfur and Kordofan regions because their own revenues declined sharply due to looting of markets, banks, and supplies, destruction of infrastructure and equipment, road blockages, reduction in gold taxes, and frequent closure of government offices especially those related to revenue collection.

In addition to the fiscal constraints stated above, states in the war zones, particularly Khartoum, were severely hampered by the physical destruction of the health facilities, ambulances, warehouses, medical stores, cold chains; shortages of electricity, fuel, and water; as well as attacks on health personnel. Frequent and lengthy electricity cuts damaged significant quantities of medicines in hospitals and pharmacies. Khartoum's health system has also been facing staff shortages due to the migration of medical staff outside the state for safety reasons. The Ministry of Health

estimated that in Khartoum, as at August 2023, 83 per cent of hospitals were out of service and around 95 per cent of primary healthcare facilities were also not functioning, (see Figure 10).

Shortages of medicines, medical equipment and supplies, and lack of access to health services may lead to outbreaks of infectious diseases. Disease outbreaks—including malaria, measles, dengue and acute watery diarrhoea—that had been under control before the conflict have been on the increase with a measles outbreak reported in 28 localities across 11 states. Dengue fever cases have also been confirmed. Lack of fully functioning immunization services and cold chains will result in about 1.7 million children under-one missing critical lifesaving vaccines and leaving them at significant risk of disease.³²

FIGURE 10: FUNCTIONALITY OF HEALTH FACILITIES (PERCENTAGE)



32 UNICEF Sudan, Humanitarian Situation Report 11 July 2023; and UN OCHA Sudan, Humanitarian Update 28 July 2023.

Mitigation of the health hazards of floods

Floods were the most frequent climate hazard in Sudan putting increasing burden on the health sector. There already have been reports that people are affected by heavy rains and flooding in the states of White Nile, Northern, North Darfur, and heavy rainfall was forecasted in 5 out of 18 states between June and September 2023. Floods lead to the destruction of the hygiene and sanitation situation, and increase the risks of vector-borne disease outbreaks such as cholera, dengue fever, rift valley fever, and chikungunya.³³

The 2023 budget allocated SDG 114.8 billion (8.6 per cent) for emergencies, to mitigate the impacts of floods and heavy rains in affected states. However, the challenging fiscal situation created by the conflict deprived affected states of these resources; as no payments were made by the federal government towards preparedness for these natural disasters. Capacities of states to manage the impact of flooding and heavy rains have been largely reduced in the absence of federal assistance, leading to the increase of diseases. Failure to address the health hazards of the rainy season and floods will aggravate the situation of outbreaks of the diseases and likely to claim more lives.

Overall, the health sector lost close to SDG 600 billion (about US\$900 million) due to the conflict, equivalent to 11 per cent of the total government budget (*see Table 1*).

TABLE 1: HEALTH SECTOR-ESTIMATED FINANCIAL LOSS DUE TO THE CONFLICT BASED ON 2023 BUDGET ALLOCATIONS*

ITEM	AMOUNT (BN SDG)
National federal health institutions: goods and services	186
Federal social support for free care and lifesaving drugs	164
Current earmarked transfers (lifesaving drugs, primary health care)	94
Mitigation of health impacts due to floods**	115
Development (federal and states)	83
Total health	642
Total government federal budget	5,779
Percentage of health to total government federal budget	11%

*Does not include wages

** The item mainly covers health issues but it may also include other non-health items

Source: Author's estimations, and 2023 approved government budget

33 UN OCHA, Sudan Situation Report, updated 17 August 2023.

Education

Education in Sudan was already facing immense challenges before the conflict. There were extended school closures due to political instability in the country, COVID-19, and teachers' strikes.

The conflict resulted in early closure of schools and teachers have not been paid salaries for about five months. At least three million children have been displaced³⁴ and most of them could be deprived of education leaving them at high risk of dropping out of school altogether. Initial estimates suggest that 10 per cent of school buildings in safer zones are used as shelters for internally displaced persons (IDPs) fleeing the war zones. These schools remained closed at the beginning of the new academic year in September, though a few states such as River Nile State announced the reopening of schools in November. The schools being used as shelters may require significant financial resources for rehabilitation and yet due to the systemic effect of the conflict, states may not have the necessary resources for the preparation of the new school year. School certificate examinations were postponed and may result in freezing the whole academic year and disruption in the education system, further increasing school dropouts and related consequences.

The estimated cost of education loss is equivalent to US\$ 26 billion³⁵, assuming the losses resulting from backward loss in educational attainment in addition to the loss of momentum that was achieved by the country towards sustainable development goals.

WASH

Financing the running cost of water supply is the responsibility of the water corporation in each state, paid from water charges. However, most states provide subsidies from their budgets to the water corporations to cover shortfalls in their revenues in order to avoid raising water charges or retrenching of staff and the resulting political and social tensions. The billing system of the urban water corporations is linked to the electricity prepayment. However, due to the collapse of the electricity billing system, households connect their power supply directly from the source, bypassing the metering system and consequently, water is not billed. This will deprive the water corporations of important financial resources and increase their dependence on the states which are suffering from shortages of financial resources.

³⁴ UNICEF: Press Release, Port Sudan 9 October 2023.

³⁵ UNICEF estimates, cost of inaction assessment for Sudan's conflict September 2023.



Schools were closed early and teachers have not been paid salaries for about five months

School buildings have become emergency shelters due to lack of funding to host IDPs



US\$ 26 billion is the equivalent estimated cost of education loss



War zone areas have suffered **acute water shortages** due to the destruction of water supply facilities



Federal government financing of most water development stopped for all states

Khartoum and other areas in the war zone have suffered acute water shortages due to the destruction of the water supply facilities. All states have also suffered water shortages due to electricity outages and fuel shortages needed to operate the water supply stations. Furthermore, the unavailability of water purifying materials also has deterred the operation of water corporations for clean water supply. The loss of purifying materials is either due to access and security issues or insufficiency of financing to import needed materials given the looting and destruction that affected the warehouses of the Water, Environment and Sanitation Unit and water corporations.

Financing of most water development is provided by the federal government through capital transfers (SDG 66 billion in 2023 budget or 14 per cent of total capital transfers) which has stopped for all states because of the conflict.

Social Protection

The government has set up an extensive social protection system, involving several institutions including Ministry of Social Development, Poverty Reduction Commission, Zakat Fund, Pension Fund, Social Security Fund, National Health Insurance Fund (NHIF), and the Micro-finance Unit of CBoS. The programme involves direct cash transfers, support to health services and health insurance, as well as support to poor students and pro-poor programmes. The social protection system suffers from certain weaknesses: there is no one single comprehensive national social protection policy; coverage is low with geographical inequalities; and coordination remains a daunting challenge in view of poor capacities in most of the institutions concerned.

The conflict has created a shock for the already problematic social protection system compounded by the lack of financial resources from MoFEP and the constraints of the banking system. Most of the social protection systems are either not functioning or delivering at a low rate.

Pensions: The government was only able to make payment for the pensions in the safe states for only two out of five months. Pensions in Khartoum State, Darfur and Kordofan regions have not been paid since April 2023.

Cash transfers: The Sudan Family Support Programme (SFSP) mainly financed by international partners, was launched in October 2020, with the aim of providing cash transfers using mobile money to reach 16 million people. It had made direct cash transfers to approximately 4.7 million people³⁶ by 2021. However, on October 25, 2021, the military takeover caused development partners to pause the programme. To partially compensate for the freezing of SFSP, the MoFEP budgeted for cash transfers in 2023 as part of the social support budget line, but no payment has been made since April 2023.

Zakat: Zakat had not been functioning during the early months of the conflict. It recently

36 World Bank 2022, Sudan Transition and Recovery Support (STARS) Trust Fund Annual Report.

started to function but without the needed resources.³⁷

Health insurance: The NHIF has its own health facilities, and it also purchases services from the private sector health institutions. However, the NHIF was already facing immense problems before the conflict including poor health packages offered, and unavailability of medicine on the insurance list and subscription arrears. Failure of many states to transfer subscriptions of insured employees created substantial arrears. The MoFEP is the major contributor in the financing of the NHIF and allocated about 4.4 per cent of total government current spending in the 2023 budget (representing 47 per cent of the social benefits allocations) to support the NHIF. In addition, the federal government also allocated earmarked transfers to the states for health insurance in 2023 budget. However, these payments have stopped due to the revenue decline of the federal government as a result of the conflict. Also, health insurance premiums from government employees at federal and state levels could not be deducted because of the unpaid wages. Revenues from subscriptions declined to 47 per cent of planned revenues as of 10 September 2023. Due to the conflict and the associated financing problems, the service declined partially in 772 out of 2,969 health units (26 per cent) and in 114 out of 367 hospitals (31 per cent), while 354 health facilities were directly affected, and services halted for 252 out of 615 centres (40 per cent).³⁸

In response to the shortages of financing from the federal government, the NHIF in May 2023 imposed a mandatory payment of 25 per cent of the cost of the service to be paid by the insured as a temporary arrangement because of the conflict. This decision is considered as an additional burden particularly for the poor families, and could deprive many poor families of access to health care. Households in Sudan already pay a considerable amount of out-of-pocket expenses for health services, amounting to 74 per cent of total expenditure.³⁹



Cash transfers to families ceased in April 2023.



Pensions in Khartoum State, Darfur and Kordofan regions have not been paid since April 2023



47%

decline in revenues from health insurance subscriptions as of 10th September 2023

40%

Health insurance services have been halted for 252 out of 615 centres

37 Zakat system is based on a compulsory religious tax on incomes and wealth with specific rate and threshold, to be paid by all Muslims and it has to be spent mainly on the poor and needy and other specific vulnerable categories. Expenditures could be in cash or kind or projects including spending on health, education, water, social protection, livelihood etc. Zakat is organized by law and Zakat Chamber in Sudan, an independent institution, is the responsible body for administering Zakat.

38 Director General Planning and Policies, NHIF, snapshot of the paper presented to the workshop of intercessions needed to improve health services in Meddani, accessed via www.sna.gov.sd, on 9 September 2023

39 WHO, Global Health Expenditure Database for 2018.

Traditional mechanisms: The traditional social protection mechanisms in local communities such as youth organizations, resistance committees, and remittances of Sudanese in the diaspora, played the major role in providing the social protection compared to the official institutions.⁴⁰

The conflict has worsened the situation of the social protection interventions in Sudan by depriving institutions working in the delivery of social protection from needed public resources. Based on the 2023 budget, social protection is expected to lose about SDG 696 billion equivalent to 12 per cent of the total budget (see Table 2).

TABLE 2: SOCIAL PROTECTION- ESTIMATED FINANCIAL LOSS DUE TO THE CONFLICT BASED ON 2023 BUDGET ALLOCATIONS*

ITEMS	AMOUNT (BN SDG)
Social development institutions: goods and services	101
Cash transfers	99
Federal support to health insurance	330
Social development (federal and states)	165
Total social protection	695
Per cent of social protection to total budget	12%

*Excluding wages and salaries

SUMMARY OF FINANCIAL LOSS

The financial loss to the states, excluding wages and salaries is significant and amounts to one quarter of the total public expenditure (see Table 3).

TABLE 3: SUMMARY OF FINANCIAL LOSS OF BASIC SERVICES FROM 2023 FEDERAL BUDGET RESOURCES (EXCLUDING SALARIES)

	SDG BILLION	PER CENT OF TOTAL BUDGET
Health sector	642	11
WASH	66	1
Social protection	695	12
Education	67	1
Total	1,470	25

40 More details are in 'Observations on the Situation of Social Protection Amidst the Sudanese War', Medani Abbas Medani, in Arab Reform Initiative, August 2023.

SERVICE DELIVERY ADAPTING TO THE SHOCK

The safer states have basically taken the role of central government in ensuring the continuation of an acceptable level of economic activity and services in light of the deteriorating role of the federal level given the intensified conflict in Khartoum. The safer states have covered the increasing need for the provision of services not for its population only but for the increased flow of IDPs from active conflict states. These adaptive measures in health, education and WASH, despite their modesty and the challenges associated with the continuation of services given the delays in salary payments and narrow revenue bases, have prevented a total collapse of the Sudanese states.

Health

The health sector adopted several means to continue delivering its services amidst the challenging conditions of the conflict. States outside the war zone rearranged their priorities and increased spending on health from their own resources to provide medicines and medical supplies. This effort was largely supplemented by the generous support of the health partners in the provision of significant medical supplies and medical services including those that the government was unable to meet because of the conflict especially for children and other vulnerable groups. These include, provision of critical and lifesaving services for children with severe acute malnutrition (SAM), lifesaving drugs, distribution of routine vaccines to the states, primary health care services for women and children, materials like oxygen supplies and x-ray films, and medical consultations through a mobile health clinic. In some hospitals, NGOs even paid wages and salaries for staff.

To ensure continuity of health services, patients are being moved from the facilities disrupted by the conflict, to those in safe locations around the country. For example, kidney dialysis patients were transferred from Khartoum to the kidney dialysis centres in Gazira and River Nile states. Some hospitals in safe areas extended their facilities and services to cope with an emerging demand by patients affected by the conflict; for example, the Turkish Hospital in Khartoum added surgical services capacity and the Italian Emergency Hospital in Soba, Khartoum refitted a part of the existing cardiac hospital to create an emergency surgery centre for victims of the conflict. Dialysis centres also reduced the number of treatments for patients when the stock of dialysis supplies was running low.



Health partners have provided support and significant medical supplies



The government has abolished basic education examinations for states affected by the conflict



The government has abolished basic education examinations for states affected by the conflict



WASH partners are trucking drinking water, and supporting the operation and maintenance of critical water supply systems and access to sanitation services.

Health staff were relocated from war zones to safer areas to continue providing their services. In war zone areas, health facilities used volunteers in the different fields of health to compensate for the shortages in medical and non-medical staff. Some of the health staff in safe states who had not been paid salaries for months, moved to the private sector. In safe states, medical doctors fleeing the war in Khartoum were allowed to open private medical clinics and in return devote part of their time to public hospitals to reduce the pressures caused by the IDPs, though the full benefit is constrained by lack of equipment and facilities. The states have benefited from the presence of many specialists fleeing the war in Khartoum in new/ previously non-existent specializations, like brain and neurology surgery, spine surgery, etc. The Ministry of Health also allowed house officers who started their training in Khartoum and other states in the war zone to proceed with their training in other safe states; many joined the training in safe states and are helping lift the pressure from the public hospitals in the capitals of the states. To maintain staff, ministries of health in states used alternative ways to partially compensate their employees for unpaid salaries, like using the hospital's proceeds to pay daily subsistence allowances in some states.

Education

To avoid losing a whole school year, the Federal Ministry of General Education allowed students in war-affected states to be transferred directly to the higher grades without end-year exams. It has also abolished basic education examinations for states affected by the conflict, and the students will be transferred from the sixth grade to the intermediate level in the new school year. Students sitting for Sudan school certificates from war zones will be allowed to take this exam in any safe state so as not to repeat a whole academic year. Some states used alternative means to partially compensate education employees for the unpaid salaries from states meagre resources, by giving them loans equivalent to less than one month's salary. In some states, food baskets containing basic items were provided for civil servants in the education sector. Though helpful, these measures have still been unable to compensate for the unpaid salaries.

On the front of non-state adaptation initiatives, UNICEF e-learning platform is being used widely by students across the country and outside it including in hot zone states in Darfur, to ensure continuation of learning on the public curriculum.

WASH

In some states, the water corporations started to collect fees manually given the loss of revenue/ fees linked to electricity bills resulting from the disruption of the national grid payment system.

Various WASH partners have extended assistance to households by trucking drinking water, and helping in the operation and maintenance of critical water supply systems and access to sanitation services. The partners also have supported clearance and transportation of a water treatment chemical (polymer) from Port Sudan to major cities.



VII. Household Income and Food Security

HOUSEHOLD INCOME

Before the conflict, incomes in Sudan were significantly affected by COVID-19 and the associated lock-down resulting in business closure, and loss of employment. About 38 per cent of households had experienced decline in their income while 27 per cent of employees received no income. Households were also affected by the decline in the transfers due to the pandemic. Around 36 per cent of households experienced a reduction or total loss of their remittance income during June–July 2020.⁴¹

The conflict has disrupted income sources. Agriculture remains as a major source of income in Sudan especially in rural areas where two-thirds of the population lives. Agriculture accounts for 37 per cent of employment and at least 39 per cent of the total income of the rural poor comes from agriculture. Agricultural income is expected to decline because of the conflict and poor preparation for the agriculture season. The insecurity situation will affect farmers who depend on traditional agriculture and animal husbandry especially in Darfur and Kordofan regions. The displaced labour also is expected to result in decreased production and farmer incomes.⁴²

41 World Bank, Sudan, High-Frequency Phone Survey of Households (HFS) during June 2020–August 2022.

42 FAO, GIEWS Country Brief, The Republic of Sudan, 14-August-2023.



Agricultural income is expected to decline because of the conflict and poor preparation for the agriculture season.

MORE THAN 400 establishments in the food industry and various other fields in Khartoum **have shut down** due to vandalism



The shortage of inputs like fuel, fertilizers, and seeds will lead to **reduced yields and production.**



A hike in inflation could increase prices, making **essential food commodities unaffordable** for an increasing number of households

The industrial and service sectors, which provide employment to large numbers in urban areas, have been devastated by the conflict. Businesses in Khartoum have ceased because of the destruction and looting. More than 400 establishments operating in the food industry and various other fields in Khartoum have shut down due to vandalism from the ongoing fighting. Markets, shop and restaurants have closed and trade and logistics services ceased. Many companies have taken drastic measures including laying off staff, giving employees leave without pay in line with a reduced production capacity⁴³. Displacement of populations has also contributed to the disruption of significant income as almost all of the nearly five million displaced million people have lost their income sources..

FOOD SECURITY

About 20.3 million people were expected to be food insecure between July-September, at least half of them being children as shown in the report of the Integrated Food Security Phase Classification (IPC) in Sudan. With continuing conflict, the mortality rates among the up to 700,000 children with severe acute malnutrition, will rise⁴⁴. A major concern for food security from the supply side is the financing of the cropping season for 2023. Failure of the agriculture season will largely contribute to further deterioration of the food security situation and put many lives at risk. Agriculture is the largest recipient of domestic credit compared to other sectors, receiving on average about 25 per cent of the total banking credit during 2015-2022⁴⁵. However, the areas unaffected by the conflict witnessed the banking sector collapse which prevented large scale farmers from accessing financial resources during the critical time for crop preparation. There were also reports of shortages of inputs like fuel, fertilizers, and seeds which will lead to reduced yields and production. In addition, the insecurity situation particularly in the war zones like Darfur and Kordofan regions, made fields inaccessible and will also result in decreased production⁴⁶. In irrigated agriculture,

43 For example: Dal Engineering, a subsidiary of the large conglomerate Dal Group, gave its employees unpaid leave while Hajar Foundation, a major business establishment, announced cessation of its operations in Sudan.

44 UNICEF press release, 24 August 2023.

45 CBoS Annual Reports 2015 to 2021 and Financial and Economic Bulletin Jan-Dec 2022.

46 FAO, GIEWS Country Brief, The Republic of Sudan, 14-August-2023.

inability of MoFEP to finance irrigation maintenance (canal clearance), and electricity outages affected irrigation pump stations which will in turn reduce planted areas for the summer crops, and threaten the winter crops.

The government has exerted efforts to create a conducive environment for the success of the summer cropping season. The CBoS issued a new regulation to facilitate financing of the agriculture season due to the difficulties facing the banking sector and the farmers.⁴⁷ The new regulations give more authority to the bank managers to assess credit risks, with permission to exceed the credit concentration ceiling. The CBoS has also permitted banks to accept the client's personal declaration when investigation for clients by the Credit Information and Scoring Agency (CIASA) is impossible. Farmers with outstanding liabilities from previous financing are permitted to receive new credit upon recommendation from their farmer's organization. These have been complemented by development partners' support, especially for smallholders in rural areas who have been given cereal seeds, and livestock pastoralists _livestock services and inputs.

From the demand side, a hike in inflation due to the likely monetization of the fiscal deficit could increase prices, making essential food commodities unaffordable for an increasing number of households, especially vulnerable groups. The situation will be aggravated by disruption of agricultural markets in several states and high transport costs because of the conflict, leading to increased food prices. These impacts are expected to reduce consumption and access to food significantly.



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47 CBoS, Circular dated 28 May 2023, Temporary regulations for extending credit.

VIII. Recommendations

Generally, in terms of financing, substantial resources will be needed to address the impact of the conflict, when resolved. This will require fiscal support to households, incentives to businesses and concessional financing for destroyed small and medium enterprises (SMEs), and increased public investment to repair infrastructure. However, the following recommendations are mainly confined to addressing lessons learned from the conflict regarding the financing and payment aspects of the service delivery. They aim at: formulating recommendations to mobilize more resources for spending on education, health, and WASH, creating an enabling environment for public finance that benefits the poor, and implementing measures to reform the banking and payment system to strengthen the social protection system; which all directly concern child well-being.

STRENGTHEN THE FISCAL FEDERALISM SYSTEM.

The conflict has exposed the structural problems that characterized the fiscal federalism arrangements for financing basic service delivery. Service delivery in Sudan is likely to improve with a strengthening of the fiscal federalism system. A major step in this direction is to enhance revenue mobilization at subnational level. Without increasing revenues and strengthening public financial management in the states, the chances of subnational governments being able to improve basic services are slim. States and localities must have a substantial source of own revenue they control to at least cover the running cost of the service provision (wages and goods and services). It is essen-

tial to undertake diagnostic studies for ways of expanding the tax base and tax assignment of subnational governments including the feasibility of reinstating the agriculture tax taking into consideration its impact on agricultural production. The equalization formula needs to be revisited to align federal transfers with poverty trends and disparities in access to social services like basic education, primary health, and water supply.

THE GOVERNMENT MUST AVOID MONETIZATION OF THE INEVITABLE FISCAL DEFICIT IN 2023 THAT WILL CAUSE INFLATION TO MOUNT.

The government must avoid monetization of the inevitable fiscal deficit in 2023 that will cause inflation to mount. The MoFEP should strive to extensively use government securities to finance the budget deficit. Due to meagre chances of marketing these securities to the public, participation should mainly be from banks and social security funds (pension funds and the social security fund).

THE CENTRAL BANK OF SUDAN SHOULD DEVELOP A PLAN FOR BUSINESS CONTINUITY AND DISASTER RECOVERY AND ENSURE THAT COMMERCIAL BANKS HAVE THE SAME

The conflict exposed the structural weakness of banking and the payment system as reflected in their very centralized systems. Dependence on the centre, Khartoum, in banking and payment systems needs to be addressed. The CBoS needs to develop a plan for business continuity and disaster recovery and ensure that commercial banks have the same. This will require strengthening the information technology and the

payment system departments in CBoS, and extending supervision to the electronic payment systems of the banks, which are weak. Generally, most banks in Sudan are fragile, and the CBoS suffers from major weaknesses as explained above. Priority needs to be given to reforming CBoS and restructuring the banking sector through bank resolution, liquidation and/or merger and acquisition, in line with the IMF recommendations as reflected in Sudan request to the IMF for a 39-month arrangement under the extended credit facility in June 2021.

ENHANCE FOCUS ON DIGITIZATION AND FINANCIAL INCLUSION

The impact of the conflict on cash availability points to importance of digital payments and financial inclusion. Cash transfer programmes by development partners (UNICEF, World Bank, European Union, WFP) represent an opportunity to expand to digitalization, within the country's plan for financial inclusion. Some preparatory work has been completed through the Sudan Financial Sector Assessment Programme that was conducted in 2019; Sudan's first Financial Inclusion Survey in 2022 under the overall supervision of the CBoS with the participation of FinMark Trust & World Bank; a mobile money assessment and the Mobile Payment Regulations that were approved on 6 January 2021. These were important steps in the CBoS plan to develop a National financial Inclusion Strategy with the participation of all stakeholders among whom organizations providing cash transfers should be included.

REFORM STATE WATER CORPORATIONS TO MAKE THEM SUSTAINABLE.

State water corporations providing urban and rural water supply at subnational level proved to be fully dependent on the state governments for covering their running expenses, despite the water fees they collect. These corporations need serious reforms to make them sustainable including addressing the problems of over staffing and the low water rates.

INCLUDE COMMUNITIES IN DESIGN OF SOCIAL PROTECTION AND RESILIENCE PROGRAMMES

In designing social protection and resilience programmes, consideration should be given to communities and local committees especially youth and women committees as they have proven highly effective in extending social protection compared to official institutions.

MAKE SUBSTANTIAL INVESTMENTS IN SOLAR ENERGY TO REGULARIZE SUPPLY OF ELECTRICITY

Electricity has been proved to play a crucial role in the service delivery of health, WASH, cash transfers, especially during the conflict with power interruption as a major constraint to service delivery. Destruction of power infrastructure during the conflict has further exacerbated various challenges. The available capacity of electricity is only 2,799 megawatts(MW), compared to a peak demand of 3,800 MW, leaving a shortfall of 1,000 MW thus leading to major load-shedding. Additionally, 46 per cent of the population does not have access to electricity. Substantial investments in solar energy would considerably reduce the impact of power losses on all these sectors. Solar energy remains a viable option to be considered in the different programmes, where relevant.

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