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Policy Brief

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Understanding the Exchange Rate Regimes in South Sudan: A Non-technical Review

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Summary

This paper simplifies and discusses our understanding of the exchange rate policy regime in South Sudan. After independence in 2011, South Sudan fixed the value of its currency, the South Sudan Pound (SSP), to the U.S. dollar. This is a common practice for countries that depend heavily on a single export commodity, such as oil. In December 2015, South Sudan abandoned the fixed exchange rate and adopted a more flexible managed float regime. But without a manufacturing or export sector besides oil, South Sudan is an overly dollar-denominated economy, which largely depends on expensive imports. Most goods—including essential products such as foodstuffs, fuel and medicines—come as dollar-priced imports. This makes such a rather radical monetary policy change a risky business. The shift in exchange rate policy, though long overdue and a step in the right direction, faces serious implementation hurdles, largely because it has not been followed with complementary reforms in the monetary and fiscal sides, as well as key supporting institutional and regulatory arrangements. As a consequence, the managed float policy has reduced the purchasing power of the local currency without any immediate corresponding benefits in the general economy in the short-term. This situation has triggered headline inflation pressures, including the risk of hyperinflation and has further exacerbated poverty incidence among the poor. The government of South Sudan is now contemplating corresponding reform efforts but the adjustment in the exchange regime is becoming a hard sale to the general public, which is experiencing more economic pains than gains[2].

1. Introduction

One of the primary functions of macroeconomic policy in any country is to align the foreign exchange market so as to narrow the gap between the prevailing official rate and the black market exchange rate. For this reason, the choice of an exchange rate is one of the most important policy considerations in any country (Frankel and Andrew, 2002; Reinhart,

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[1]The views expressed herein are those of the authors' and do not necessarily represent those of the Sudd Institute or its funders. We are grateful to Democracy International for funding this work.

[2]Since the announcement of the new exchange rate, workers in the public sector have been calling for either policy reversal or increase in their wages to compensate for the abrupt general increase in prices.

2002; Dornbusch, 2002; Goldstein, 2002; Mundel, 1961). Policy analysts and policy-makers often keenly follow and assess the choices of exchange rate regimes and their linkages to macroeconomic performance, particularly the ensuing levels of inflation and economic growth. These considerations have often looked at the question of why different countries adopt rather radically different exchange rate regimes, ranging from rigid fixed exchange regimes to flexible exchange rate systems. If not set or chosen appropriately, an exchange rate can distort measures of economic performance, subsequently triggering or exacerbating grave social and political consequences.

So far, there is no consensus in the economic literature on the question of which exchange rate regime is most suitable for adoption by any country, but the free floating regime variants tend to be a better choice than the fixed exchange rate system in many cases (Frankel, 2003; Stockman, 1999).

After independence in 2011, South Sudan pegged its currency, South Sudanese Pounds (SSP), to a dollar, at an official exchange rate of 2.95 to 1 U.S. dollar. But this exchange rate policy would remain unchanged for the next four years, even when it was widely expected that it would be reviewed based on the changing fundamentals of the fledgling economy. The official fixed rate overvalued the SSP and most citizens were not able to access and meet their needs for dollars at this rate, as the demand for dollars far exceeded the supply. Consequently, a parallel market exchange rate higher than the official exchange rate developed. However, in December 2015, the government of South Sudan, through the Central Bank and the Ministry of Finance and Economic Planning, publicly announced and immediately abandoned the fixed exchange rate regime and adopted a more flexible regime known as a managed float. The floating of the pound, widely considered as long overdue, therefore, resulted from the urgency to stabilize the economy and to respond to a broadening public fiscal deficit. Using the new exchange rate, the government's sale of the US dollars to the central bank would raise enough revenue that is substantial to continue paying public sector employees, as well as maintaining the delivery of basic services.

The reform in the exchange rate realignment had been long overdue as the fixed rate artificially inflated the value of the SSP. But the new flexible managed float rate, with its noted benefits in economic literature, is equally running into a plethora of problems, chief among which is the sudden devaluation of the pound and the attendant headline inflation that is unraveling in the country at the moment. Prices, especially of essential goods and services, are rising with far reaching impacts on the poor who have limited means of coping with inflation. The situation is compounded by the fact that the country depends on dollar-priced imports for most of its consumption needs. This is due to low local production, essentially lending little use of the country's currency in the international markets. So, in the short-run, the policy exacerbates poverty for many households, especially those whose monthly earnings stand below 2,000 pounds. It also increases and amplifies poverty incidence in a nation where over 50 percent of the population lived on less than a dollar per day nearly 7 years ago when the country's economic conditions were rather favorable (NBS, 2009). This means that majority of the working South Sudanese are now poorer than they were nearly a decade ago.

From this background, this paper is a non-technical review of the recent exchange rate regime policy in South Sudan. In particular, it aims to summarize and increase our understanding of the policy regime by simplifying the prevailing public discourse on the matter. The new exchange rate policy is the center of much confusion, as it is seemingly less understood, with many people calling it devaluation, depreciation, free float, or managed float. A related question and a current preoccupation of many commentators, is whether South Sudanese were necessarily well off or less-off under the former fixed exchange system relative to the newly adopted exchange rate regime. What is the intention of this policy and what are its implications? These are the fundamental issues this paper attempts to address. In the sections that follow, we explore the traditional understanding of exchange rate regimes, map potential implications, and offer advice on how to best respond to the unintended consequences of the policy.

2. Exchange Rate Regimes

An exchange rate is the price of a domestic/local currency expressed in terms of a foreign currency, most often, the U.S. dollar. Put differently, an exchange rate is the price of South Sudanese Pounds (SSP) expressed in terms of U.S. dollars, such as SSP 2.95 per dollar according to the preceding regime or SSP 18.55 per dollar per the new exchange regime. An exchange rate is the most important and closely watched price in any country, as its value is generally linked to and affects the performance of the economy as a whole. The choice of an exchange rate regime can follow different paths, depending on the circumstances of a given country. It can be fixed to one or a broad basket of foreign currencies or it can be allowed to move freely as determined by the market forces of demand and supply of foreign and local currency in an economy.

The demand for foreign currency occurs when residents of a country, such as South Sudanese, buy goods and services from abroad, which are also known as imports, or buy assets from or lend to people from other countries. Conversely, the supply of foreign exchange happens when foreigners buy goods and services from the domestic economy, including South Sudan, using foreign currencies such as the SSP to complete these transactions or payments. In general, it can therefore be said that a country gets most of its foreign exchange from the sale of exports and reduces it foreign exchange reserves from the purchase of imports through official channels. In the case of South Sudan, the country does not export much of anything else besides oil, depending heavily on imports, particularly for most consumable goods, such as food, fuel, and medicines, which drive the demand for dollars.

Exchange rates come in many forms and the most commonly used include fixed or pegged exchange rate, flexible regimes which include free float, managed float, and other intermediate exchange rates which are hybrids between the fixed and flexible regimes.

In a fixed exchange rate system, the monetary authority such as the central bank chooses and fixes the value of domestic currency to the dollar or another foreign currency. This was the system South Sudan adopted after gaining independence from Khartoum and issuing its own currency, the Pounds. The Central Bank of South Sudan fixed the official value of SSP 2.95 to the U.S. dollar. At the time, the central bank was earning enough foreign exchange reserves from oil to defend the value of SSP at this official rate. In addition, the policy was desirable since the exchange rate at the parallel market, also called the black market, was almost non-existent or closer to the official rate. Lack of mature functioning banking and financial sector and limited capacity of the Central Bank of South Sudan to conduct and deliver complex macroeconomic policies played a role in adopting the fixed rate regime, as it is easier to implement.

One very important advantage of a fixed exchange rate is that it ensures the credibility of the monetary authority in the eyes of economic agents in stabilizing prices and keeping inflation at the optimal acceptable level. A fixed exchange rate can stabilize general price level, wages, and international capital flows, which is why most countries adopted it in the 1970s and 1980s (Frankel 1993; 2003). If it can be sustained and depending on the distinct economic conditions of a country, a fixed exchange rate can be a good non-inflationary monetary anchor, especially for small, open economies. However, if not well-managed and supported with adequate foreign exchange reserves and macroeconomic policies, a fixed exchange rate regime can easily lead to the overvaluation of the domestic currency; create excess demand of the hard currency, and the development of a parallel rate. Consequently, the export sector will deteriorate and so are the terms of trades and the balance of payments, eventually bringing the whole economy to a standstill.

However, pegging the exchange rate to the dollar is not the only available tool that a monetary authority can use to ensure its credibility and commitment in controlling inflationary pressures in an economy. Other possible nominal anchors include tighter monetary policies and fiscal discipline. By and large, the main argument against a fixed exchange rate regime is that it limits the effectiveness of the monetary policy to respond appropriately to the unique needs of the local economy as the monetary authority loses its independence and discretionary power to adjust the exchange rate to affect the economy appropriately under a fixed rate system.

Conversely, under a free float system, the market forces of demand and supply determine the value of domestic currency. This value is commonly expressed in terms of dollars, which can freely fluctuate without the interventions of the monetary controller beyond and above its supervisory role as a regulator of the financial sector. A monetary authority can still intervene to affect the level of employment and economic growth by increasing or lowering money growth and interest rates, as the currency automatically depreciates or appreciates in response to the prevailing market forces. When the local currency depreciates, that is when the value of domestic currency is weaker against the dollar or any other foreign currencies, domestic goods become cheaper to the rest of the world. This stimulates production in the export sector, thereby increasing the levels of exports. This makes a free float an attractive regime in commodity-exporting economies, which enable them to grow and diversify their economies, including the exports sector.

Countries such as Australia have prospered under flexible exchange rate policies. For example, between 1997 and 1998, at the peak of the Asian economic crisis, a region that is a major destination of Australian exports, the Australian dollar depreciated in keeping with the deteriorating levels of exports in the international markets (Frankel, 2003). This automatic adjustment in the exchange rate made Australian exports stay competitive and correspondingly, Australia was able to manage it economy well amid this external exports shock. Canada, New Zealand, and a number of other countries, including those within the Sub-Saharan region, which are also commodity-dependent, have been praised for superior economic performances after adopting free floating exchange rate systems, which enable automatic currency adjustments in response to weak exports performance in the international markets. Such kinds of automatic adjustments are very much limited under a fixed exchange system.

The exchange rate regime that has just been adopted by South Sudan is a hybrid between the fixed and free float exchange regimes. This is what is referred to as a managed float. Similar to a free float, in a managed float system, the prevailing exchange rate is determined by the market forces of demand and supply. But like a fixed exchange, the monetary authority sets the operating band within which the prevailing official exchange rate fluctuates. If the exchange rate falls below or rises above the established operating band, the monetary authority intervenes in the market to defend the reference official rate, usually by buying or selling the hard currency. The present auction system constitutes this form of intervention. If well managed, a managed float can better serve the needs of an economy than the fixed system because it has features of both fixed and free float regimes.

In theory, as in practice, there is no particular exchange rate regime that is a magic bullet for all economies. Various exchange rate regimes have their strengths and shortcomings, depending on a particular context. That is, the adoption of a certain exchange regime should be informed by contextual and structural conditions of a given economy. Above all, an exchange rate should not be implemented in isolation. It must be accompanied by complementary monetary and fiscal policies and empowerment of appropriate, supporting institutions. The general consensus in economic literature is overwhelmingly in support of adopting alternative exchange rate regimes based on the conditions and level of economic development, as well as the maturity of financial institutions. A choice of an exchange rate regime that is not based on this context often leads to myriads of economic misalignments and poor financial and economic performances, such as increase in the ratio of debt to growth domestic product (GDP), lower exports as share of GDP, and depletion of foreign exchange reserves, among others (Frankel, 2003; Mahle, Teferra, Khachatryan, 2013; Canales-Krlijenko, 2004).

2.1. The Evolution of Exchange Rate in South Sudan

After attaining independence from Khartoum in July 2011, South Sudan established its own currency, and adopted a pegged exchange rate regime fixed at the official rate of SSP 2.95 per U.S. dollar. At the time, the then Southern Sudan was enjoying abundance supply of petro-dollars. In addition, the country's financial sector was almost non-existent and so it was proper to adopt and defend a fixed exchange rate regime. However, this rate would remain unchanged for the next few years, even though it was supposed to be a stop-gap and a transitory measure intended to be assessed and evaluated as the circumstances of the economy changed.

As previously discussed, a common problem with a fixed exchange rate system is that it tends to artificially overvalue the local currency. The SSP was obviously and grossly overvalued at a fixed, official rate. This triggered rationing of hard currency at the official rate where preferential access than sound economic considerations guided the dollar allocations. But with enough hard currency reserves accruing from the sale of crude oil, South Sudan afforded this state of affairs.

Beginning in 2012, however, political tensions rose to a boiling point with Khartoum. Subsequently, oil production was shut down and soon South Sudan's foreign exchange reserves began to decline, and the Central Bank was gradually beginning to experience stress of fast depleting reserves. The Central Bank soon proved unable to supply enough dollars, hence defending the SSP at the fixed rate became untenable.

This situation led to the development of a thriving parallel foreign exchange rate market where the SSP was trading at a much high rate to a dollar. Although an exchange rate reform was considered in late 2013, the process was immediately clamped upon amid intense political outrage that bore little attention to the sound economic policy and the unique conditions of the budding economy. At that point and since then, it seemingly appears the independence of the Central Bank and its ability, as a credible and an independent monetary authority, have been in question.

Moreover, with record low world oil prices and corresponding dwindling oil receipts starting in 2014, South Sudan, which heavily depends on oil for much of its revenues and practically imports nearly everything, has been running low on foreign reserves. But the SSP continued to be overly inflated at the official fixed rate, which further widened the gap between the official and the black market rates.

In late 2015, the parallel market rate peaked at SSP 18.9 to the dollar or a black market premium of about 539 percent of the official rate. Since most prices, including for essential goods, are based on the parallel market price, inflation has also been increasing steadily. Finally, the situation became very unsustainable and by December 2015, the government of South Sudan through the Central Bank decided to abandon the fixed rate and adopted a managed float exchange rate system.

2.2. Exchange Rate Reforms and Macroeconomic Landscape in South Sudan

Reforms in exchange rate regime are normally effective when conducted simultaneously with reforms in the monetary and fiscal policies. Tighter controls in money supply and fiscal discipline reinforce the credibility and commitment of monetary and fiscal authorities to a binding exchange rate regime and to keep inflation and other macroeconomic indicators within acceptable limits. Thus, adopting a managed float regime would entail that the government of South Sudan institutes monetary and fiscal strategies where spending levels and compositions of public expenditures are evaluated and controlled. Budget discipline is, therefore, the baseline from which reforms must begin in earnest. This does not seem to be the case in South Sudan. Fiscal authorities are yet to realize that the fiscal lavishness of the oil boom periods is no longer sustainable and must be abandoned forthwith.

Instead, on the fiscal side, the Government of South Sudan has been running large and persistent fiscal deficits as revenue collections have not been able to match up to the expenditures, especially given the reduced oil revenues and bloated public sector expenditure. In fiscal year 2015/16 alone, budget deficit is estimated at over SSP 12 billion (MOFEP, 2016). But deviations from the budget are widely expected to be much higher following the formation of a much-expanded transitional Government of National Unity (TGONU) and state governments where the central government would be under immense pressure to incur additional public spending.

The situation is causing worrying signals on the monetary side as well. With a limited scope for tax revenues and fiscal flexibility, GRSS has resorted to "seigniorage revenue" through printing of money and increased domestic borrowing to make up for lost revenues from oil and other sources. Money supply has increased by over 20 percent over a short time between the fourth quarter of the last fiscal year and the first quarter of the current fiscal year (MOFEP, 2016). This means much of the fiscal deficit is being and will continue to be financed through monetization or money creation where the amount of the local currency in existence has far exceeded the demand in the economy. Although reliable data on the balance sheet of the Central Bank of South Sudan are unavailable for the conduct of a nuanced assessment of monetary arrangements, the general trend points to a loose monetary policy which has resulted in an increasing devaluation of the Pound at both the official and parallel rates. Such haphazard macroeconomic conditions are negating the objectives of the exchange rate reforms and are instead fueling inflationary pressures in the general economy.

Closing the gaps between the official and parallel rates would require a well-coordinated and coherent monetary framework and fiscal discipline without which gains from new exchange rate regimes would be a budget improving mirage. Eventually the economy runs the risks of crumbling under the heavy weight of uncontrolled public expenditures, deficit-financing, and repeated episodes of devaluations of the local currency and hyperinflation.

2.3. Exchange Rate Regime Reforms: A Regional Comparison

In the 1980s and well into the 1990s, many countries in the Sub-Saharan Africa region, under the advice and guidance of the International Monetary Fund (IMF), began to liberalize their economies (Mahle, Teferra, Khachatryan, 2013). Chief among the many considerations and recommendations in the reforms was the need for liberalization of exchange rate regimes in these countries. A comprehensive review of the reforms commissioned by IMF (Mahle, Teferra, Khachatryan, 2013), as well as the findings of Reinhart (2002) on exchange rate regimes and macroeconomic performance in the Sub-Saharan region, indicate positive results for majority of the economies that undertook the reforms. Overall, most countries followed restrictive exchange rate policies before embarking on the reforms, resulting in wide-spread foreign exchange rationing, development of black market rates, and abysmal economic growth.

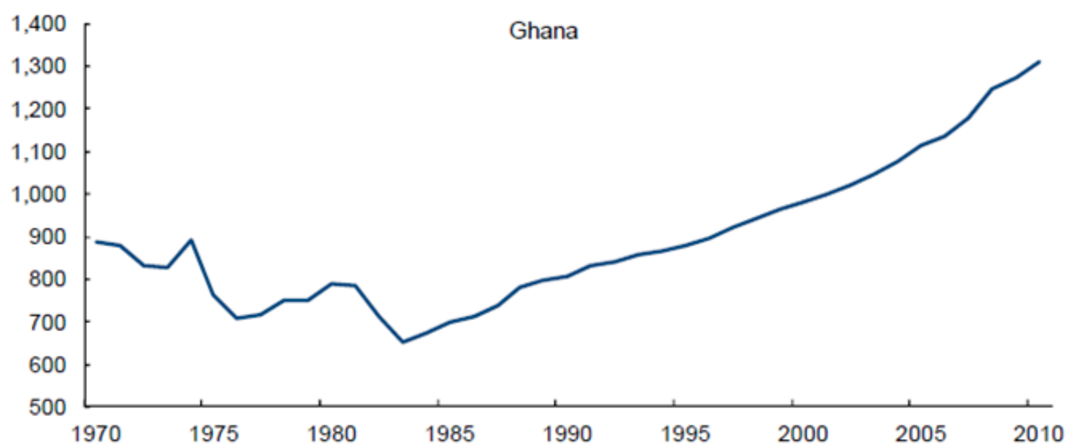
However, after the reforms, economic conditions for most countries have become radically different. In majority of these case studies, these countries have managed to close the gap between official and parallel market rates, which have been as high as 4,300 percent, realizing growth in their per capita incomes and other measures of economic growth and development (Reinhart, 2002). In contrast, countries that did not adopt flexible exchange rate regimes have since been plagued by dollar shortages, rationing, and ever increasing gap between the official and parallel rates (Mahle, Teferra, Khachatryan, 2013).

In its current dire state of the economy, South Sudan is in a fortunate position to learn and benefit from the history of successes and failures of exchange rate and economic reforms within the Sub-Saharan region. What now follows is a review by Mahle, Teferra, Khachatryan, (2013) and Reinhart (2002) findings on the exchange rate and other macroeconomic policies in selected countries in the Sub-Saharan Africa region during and after the reforms.

Ghana: Ghana stands out as a star of the reform. Before 1983, Ghana was at a crossroads typical of a country within the Sub-Saharan Africa. It had very low fiscal revenue, depressed export sector, almost depleted foreign exchange reserves, high inflation and a parallel market exchange rate premium of over 4,000 percent. With worsening economic conditions, Ghana was a country destined for economic collapse. However, a reform in 1983, put the country on a path of economic recovery and prosperity ever since.

Ghana started the reforms with the devaluation of the Ghanaian currency by 800 percent followed by the streamlining of the monetary and fiscal policies to the need of the Ghanaian economy. The monetary and fiscal authorities were serious and sustained these policies despite the implementation challenges. Soon, the Ghanaian economy recovered, particularly the agricultural sector, which later became the backbone of the entire economy of the country. Exports, imports, forex reserves, and fiscal government revenue also increased, with inflation subdued over time as shown in **Figure 1** below.

Figure 1. GDP per capita, 1970 – 2010 (U.S. dollars in 2010 prices)



Source: IMF World Economic Outlook, 2013

To put this in the South Sudan context, although the Central Bank devalued the SSP by 84 percent, which is similar in magnitude with the devaluation in Ghana three decades ago, this policy has not been followed with corresponding structural reforms in the monetary and fiscal policies. Although not enough time has passed to appraise this policy, it is basically unclear how it will be sustained to realize the benefits without enlisting a series of practical bottlenecks.

Mozambique: Mozambique is a unique case. The country was in more or less similar economic situation as South Sudan. Like South Sudan, Mozambique was recovering from a decade of a protracted civil war in the 1980s when it considered economic reforms. The country faced overwhelming odds of astronomical inflation, depleted foreign exchange reserves to only 0.4 months of prospective imports, and a parallel market rate of over 50 times that of the official exchange rate. In comparison, the parallel market rate in South Sudan was just above 6 times the official rate at the time of the adoption of the managed exchange rate regime.

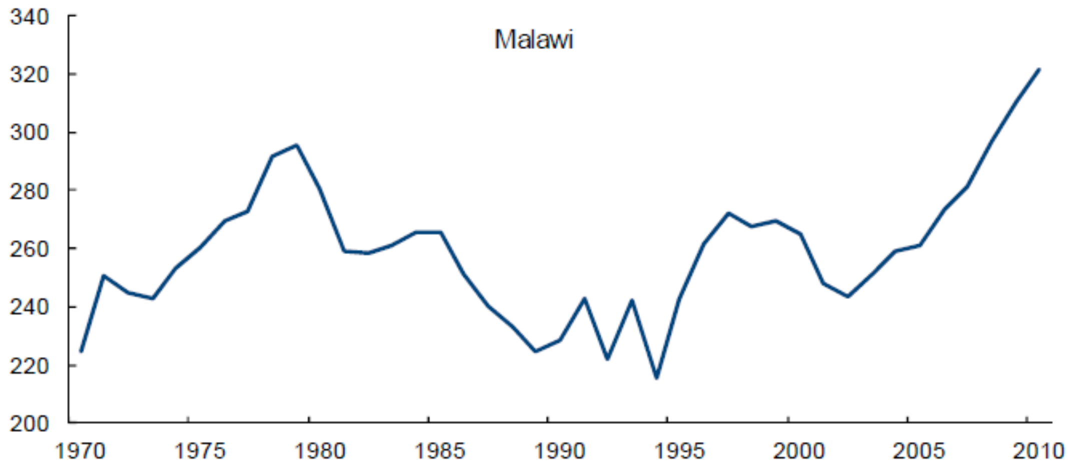
To stabilize its economy, Mozambique depreciated its currency and credibly enforced tighter monetary and fiscal policies, especially on loose money creation and wanton public spending. Exports soon recovered to 12.5% of GDP from almost zero percent. The country started building its foreign exchange reserves and achieved a per capita GDP higher than the pre-reform level.

Uganda: Let's now take the story a bit closer to home and have a look at the reforms taken by South Sudan's neighbor, Uganda. In the late 1970s and early 1980s, Uganda was embroiled in political unrest and as a consequence, the country was in severe economic crises, fueled mainly by an overvalued Shilling, low foreign reserves, and a thriving parallel exchange market, with exchange rate premium peaking at 2,100 percent in 1981.

However, in 1981, Uganda attempted a poorly coordinated reform agenda. The Central Bank of Uganda depreciated the Shilling by 84 percent by adopting a floating exchange rate, but the policy lacked credibility and was not followed with consistent monetary and fiscal policies. In fact, money creation continued, thereby fuelling inflation. The situation soon proved unsustainable and further actions were required. In 1987, Uganda finally reformed its monetary and fiscal policies, ushering a long period of growth in exports, per capita income, foreign exchange reserves, and a significant decrease in inflation, which has since been kept within acceptable limits.

Malawi: Like South Sudan, Malawi has been relying on a single export commodity, tobacco, over an extended period of time. But repeated episodes of down swings in the world prices of tobacco led to reduced forex reserves, lack of policy credibility, and economic vulnerabilities in the country. Authorities there have been grappling with economic reforms, albeit on a "Stop-and-Go" basis with no noticeable, sustained sound economic performance over a long time. There were cases of policy trials where benefits of reforms were not realized, even though costs were already incurred to ensure these policies were up and running (Hadjimichael et al., 1996; Goldsborough et al., 1996). **Figure 2** below is a representation of these economic reforms that did not deliver desirable results to the Malawians.

Figure 2. GDP per capita, 1970 – 2010 (U.S. dollars in 2010 prices)



Source: IMF World Economic Outlook, 2013

As demonstrated by these case studies, exchange rate regimes alone do not work where they are implemented in isolation. Critical in making the exchange rate regimes effective are complementary macroeconomic reforms, such as tightening of monetary policy and ensuring fiscal discipline, and to some extent, instituting reforms across supporting institutions. Where countries experiment with partial reforms such as in Uganda and Malawi, success is limited and the small gains from the reforms are either reversed or short-lived. To succeed, exchange rate policies should be implemented in concert with other corresponding monetary and fiscal policies. This point cannot be overemphasized as it is of importance for South Sudan where the implementation of exchange rate policy is seemingly not backed by sound monetary and fiscal policies. Absent consistent complementary reforms in macroeconomic and financial sectors, the exchange rate policy risks not achieving its desired objectives. In fact, the policy might not be politically sustained in the long run.

2.4. Foreign Exchange Auctions in South Sudan

Soon after the official rate of SSP 2.95 to the dollar was abolished and a more flexible managed float was adopted where the market forces of supply and demand determine the prevailing rate. The Central Bank of South Sudan started to inject by selling hard currency to commercial banks through auctions. By the end of January 2016, three foreign exchange auctions were conducted where the Central Bank sold a total of 56,630,000 dollars to successful commercial banks. However, the gap between the official rate and that of the parallel market continues to widen, with the devaluation of the SSP and spikes in inflation contrary to expectations and policy intention.

Foreign exchange auction, in this context, is a process where the central bank or the monetary authority conducts sales or purchase of hard currency or currencies to and from qualified bidders or offerors. The rules and procedures governing the foreign exchange auction process are outlined and contained in the Bank of South Sudan's Foreign Exchange Rules and Procedures, 2015.

As stipulated in the auction rules and procedures, the Central Bank of South Sudan has technically instituted a two-way foreign exchange auction process where the Central Bank can sale or buy dollars from participating commercial banks. So far, however, there have only been sale auctions, where the Central bank sells dollars to participating commercial banks through bidding. The auction system uses a uniform price where all successful bidders (winning bids) are sold dollars at the same cut-off rate determined by the Central Bank. In the three auctions, the Central Bank obtained 1,036,518,800 SSP by selling roughly $60 million (See forex auctions data in **Table 1** below).

Table 1: Foreign Exchange Auctions By Bank of South Sudan (BOSS), December 2015 – January 2016

BANK	OWNERSHIP	AMTRAUC1*	AMTRAUC2	AMTRAUC3
KENYA COMMERCIAL BANK	FOREIGN SUBSIDIARY	0	0	2000000.00
EQUITY BANK	FOREIGN SUBSIDIARY	0	0	2,000,000
CO-OP BANK OF SOUTH SUDAN	JOINT VENTURE	0	2,620,000	0
ECOBANK	JOINT VENTURE	0	0	2,000,000
CFC STANBIC BANK	FOREIGN SUBSIDIARY	0	4,000,000	0
IVORY BANK	DOMESTIC	500,000	0	0
AFRILAND FIRST BANK	JOINT VENTURE	2,000,000	0	2,000,000
BUFFALO COMMERCIAL BANK	DOMESTIC	2,500,000	0	2,000,000
ORBIT PLC BANK	JOINT VENTURE	0	0	450,000
COMMERCIAL BANK OF ETHIOPIA	FOREIGN SUBSIDIARY	3,900,000	0	0
QATAR NATIONAL BANK	FOREIGN SUBSIDIARY	0	0	2,000,000
KUSH BANK	DOMESTIC	1,350,000	0	2,000,000
LIBERTY COMMERCIAL BANK	DOMESTIC	1,000,000	0	2,000,000
AGRICULTURAL BANK	DOMESTIC	180,000	1,450,000	0
OPPORTUNITY BANK	JOINT VENTURE	0	750,000	0
NATIONAL CREDIT BANK	JOINT VENTURE	600,000	0	0
NILE COMMERCIAL BANK	DOMESTIC	150,000	0	0
SOUTH SUDAN COMMERCIAL BANK	JOINT VENTURE	100,000	0	0
CHARTER ONE BANK	JOINT VENTURE	0	4,000,000	0
INTERNATIONAL COMMERCIAL BANK	JOINT VENTURE	500,000	0	0
ALPHA COMMERCIAL BANK	JOINT VENTURE	3,000,000	4,000,000	0
REGENT AFRICAN BANK	JOINT VENTURE	100,000	0	0
PEOPLE'S PLC BANK	DOMESTIC	0	220,000	0
AFRICAN NATIONAL BANK	DOMESTIC	750,000	2,750,000	2,000,000
ROYAL EXPRESS BANK	DOMESTIC	0	210,000	1,550,000
CUT-OFF BID/SELLING RATE BY BOSS		**16.76**	**18.14**	**19.75**
TOTAL VALUE OF AUCTION (USD)		**16,630,000**	**20,000,000**	**20,000,000**
TOTAL VALUE OF AUCTION (IN SSP EQUIVALENT)		**278,718,800**	**362,800,000**	**395,000,000**

Source: Central Bank of South Sudan, Foreign Exchange Auctions, **December 2015 – January 2016**
Note: **AMRAUC*** is the Amount Received in U.S. dollars by successful bidders in auctions 1, 2, 3.

The average Central Bank cut-off rate, which is essentially the official rate, in the three auctions, is SSP 18.2 per dollar. Successful commercial banks in the auctions are required to trade with other banks or sell their proceeds from the auctions at the cut-off rate plus additional 2 percent, essentially implying an aspect of fixed exchange rate. In the three auctions, the Central Bank sold dollars to commercial banks at the rates of 16.76, 18.14, and 19.75, compared to the parallel market rates of 19, 22, and 31 at the same period, respectively. The parallel market rate, based on brokers' offer rate, averaged at SSP 24 in the same period or a parallel premium of about 27% compared to 539% before the policy shift. The policy has relatively closed the gap between the official and parallel market rates after the 84% devaluation in the value of South Sudanese pound. Enough time, as we note elsewhere here, has not passed since the announcement of the policy and the conduct of foreign exchange auctions, to be able to assess the achievement of this policy and whether it would be sustained. But a deeper look at the data in **Table 1** above reveals a few salient points about the foreign exchange auctions by the Central Bank of South Sudan. Much smaller domestic banks, making up a smaller share of banking market as measured by volumes of customer deposits, have been more successful in the auctions than larger foreign subsidiaries and joint venture banks, which serve a larger customer base. It would therefore be curious to know how these domestic banks are utilizing the foreign exchanges from the auctions and the impact in the market and demand for foreign exchange, but this important information is not available now.

2.5. Economic Performance following the Auctions

While the government's revenue has indeed been augmented since the dollar auction at the new exchange rate commenced, the economy remains extraordinarily weak, with potential for the emergence of other grave consequences, including hyperinflation. This is so because the policy of injecting more dollars into the market is instead plagued by a number of irregularities, making the economic rescue instrument ostensibly ineffective. First, the commercial banks that are winning dollars from the foreign exchange auction as a result of the new policy are not trading the hard currency to dampen the excess dollar demand. This situation creates foreign exchange shortage, leading to excess demand and rise in parallel market rates. For instance, while the average exchange rate at central bank stood at roughly 20 pounds per dollar towards the end of January, the black market rate rose to a high 31 pounds per dollar. This is as a result of Central Bank's restrictions on the official sales rates, as well as some local banks not complying with the stimulus policy objectives, claiming that the hard currency they presently receive from the auction compensates for the millions of dollars the Central Bank owes them. Secondly, the auction system reflects some elements of an insider trading, which retards the integrity of the monetary market by giving an unfair advantage to the financial institutions that might not have strong institutional capacity to support the policy. This is partly reflected in that many local banks, some of which have incredibly lower market size, are allowed to participate in the auction, subsequently succeeding and drawing millions of dollars that they may not adequately manage.

3. Implications

Much ado with the floating of a national currency rests with how the policy impacts on the general economic performance and the standards of living of the population. The following section explores the impacts of this newly introduced monetary policy on poverty. The new exchange rate policy exacerbates inflation, with far reaching consequences on the country's poor who have limited coping means. Our emphasis on poverty results from a number of crucial points. First, poverty subjects individuals to poor health conditions and accelerates mortality. Secondly, poverty encourages crimes (economic or otherwise), which now seem to be on a rise since the nation's economy commenced to weaken in 2012. Thirdly, poverty impairs individuals' productive capacity, hence less economically productive nation. Finally, poverty fans political conflicts, especially in youthful settings where the delivery of basic services is incredibly inadequate.

3.1. Poverty Prevalence in South Sudan[3]

Over half of the South Sudanese population or roughly 51 percent, according to the National Bureau of Statistics (2009), live below the poverty line. That is, as many as 4 million South Sudanese based on the 2008 official statistics, lived on less than a dollar per day nearly 7 years ago. This number has dramatically increased in light of the large scale conflict that befell the country since 2013 and may be exacerbated by the currency floating and it might get worse with steadily increasing inflation. In 2009, 72.9 pounds or $1.29 per day was the point at which an individual South Sudanese supposedly broke with poverty. Seventy-three pounds is now equivalent to 688 current pounds, which is the average income for those receiving minimum wages. Presently, this amount is well below the average cost of living, a sign of deteriorating livelihoods in the country. Given this example, a three-member household now needs about 3,000 pounds per month to retain a decent living. Thus, many of the households earning 2,000 pounds or less have now dropped into the poverty segment, placing majority of the South Sudanese under a situation of impoverishment.

3.2. Managed Float Exchange Rate and Wages in South Sudan

Following the shift in the exchange rate regime, the cost of a dollar went by 6 times, but the wages remained constant during this period leading to a reduction in the purchasing power of households. Let's look at this relationship more closely. A wage of 700 pounds per month before the floating represented $236.50. Following the roll out of this new policy the same wage now stands at $37.84 or less, placing those earning this much under humiliating economic circumstances. If this inflation were to be exactly reflected in essential wages, a salary of 700 pounds then translates into 4,375 current pounds. Thus, any policy response from the authorities will need to thoroughly evaluate this basic relationship to generate adequate remedial measures.

A basic food basket[4] for an average South Sudanese household per month, according to our December 2015 assessment, contains flour, cooking oil, beans or lentils, a few vegetables, meat, rice, tea, and sugar. A conservative sample of those basic food items shows that a bag of 50kgs worth of flour now costs 700 pounds, 20 litters of cooking oil 600, 10kgs of onion 300, 50kgs bag of beans 1,100, a kg of meat 100, and 50kgs bag of rice 1,000. The cost of these goods has since mounted. Holding all else constant and considering the household purchases at least a kg of meat per week, in addition to all these other basic food supplies, then its monthly cost of living stands at least 4,100 pounds.

Recently, the government, as a mitigating strategy, announced a 300 percent increase in wages for nearly 300,000 public employees who are at the lower end of the remuneration spectrum, with the policy taking effect as of February 1, 2016. In particular, the intervention, more proximately, responds to the drastically diminishing purchasing power of the civil servants in grades 10 through 17, and non-commissioned police and SPLA officers. This policy, however, does not extend to those employed in the private and NGO sectors. Although this is certainly a

[3] The section on impacts was originally published by the Sudd Institute as a weekly review.
[4] This basket was last updated in December 2015 and prices might have increased since then.

well-intentioned poverty mitigation strategy, radical increases in wages have unfortunately the potential to produce hyperinflation, depressing the local currency's strength even further.

3.3. Poverty, Health, Mortality, and Economic Production

Economic deprivation has grave consequences for one's health. It means recurrent exposure to health problems and limited access to quality healthcare services. It elevates morbidity and mortality, hence relatively low life expectancy in many of the low-income societies (Montgomery et al, 2005). Due largely to abject poverty, South Sudan's child and maternal health experiences have remained the worst in the region for the last decade, with average years of life at birth in the country not exceeding 60. Similarly, health and economic development are inextricably linked. That is, poor health leads to low economic production (Bloom et al, 1998). Therefore, the floating of currency that has little emphasis on wages and other mechanisms that support well being, exacerbates these poor health circumstances for majority of the South Sudanese, situating them on a very precarious path of human development.

3.4. Poverty, Crimes, and Political Conflicts

Poverty amplifies potential for involvement in crimes, especially the economic ones. The currency floating policy compounds this problem. In particular, economic crimes have been on a rise in South Sudan immediately following the discontinuation of oil production in 2012. Since then, there have been numerous reports of robberies and even murders in the nation, as citizens become poorer and poorer. As the economic stress hits a new level, these criminal activities are now beginning to involve some elements of the organized forces whose current income is too low to make the ends meet. Our interviews with some members of these forces confirm this undertaking, with nearly all of the respondents suggesting that robbery may become the way to subsist since public service employment does not provide even for the barest minimum of one's needs anymore. Married individuals with children are particularly more distressed.

Moreover, being poor is a cause for engagement in political violence or conflicts. Hungry, redundant youth, as is ubiquitously the case in South Sudan, are likely to be co-opted by militant groups and violent oppositions. The more South Sudanese youth become economically disgruntled, the more likely they are to fan violence, political or otherwise. All of this isn't good news for an infant nation that is trying to end a devastating civil war.

4. Conclusions

As South Sudan attempts to escape political fragility through the Agreement on the Resolution of Conflict in South Sudan (ARCISS), guaranteeing decent economic access to all its citizens demands primacy. To achieve this, reforms in the exchange rate regime, monetary and fiscal policies must be in the center of the policy agenda of the upcoming Government of National Unity (TGONU).

From an economic theory perspective as well as in practice, there is no such a thing as a single exchange rate regime choice that is all encompassing and good for all or any country. The old fixed exchange rate regime adopted at independence overvalued the South Sudan Pound, leading to excess demand for and rationing of dollars and a growing parallel exchange rate system, with high inflation on general goods and services in the country.

With reduced foreign exchange inflows from oil brought about by forces outside South Sudan's control, the fixed exchange rate was just another economic time bomb waiting to explode. The new managed float, though promising in the macroeconomic sense, has been adopted at a time of severe economic and policy challenges and it will face monumental implementation hurdles. Its drastic effects on poverty elevate the implementation challenge. To be more effective and to benefit the citizenry, the current foreign exchange auctions to defend the new rates ought to be designed better. Specifically, an advanced monitoring and reporting system in the banking sector to include the utility of the foreign exchange ought to be instituted by the Central Bank of South Sudan.

In sum, to stand a chance of success, the new exchange rate regime should be executed in concert with corresponding monetary and fiscal restraints, as well as proper streamlining and enabling of core supporting institutional and regulatory arrangements.

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About Sudd Institute

The Sudd Institute is an independent research organization that conducts and facilitates policy relevant research and training to inform public policy and practice, to create opportunities for discussion and debate, and to improve analytical capacity in South Sudan. The Sudd Institute's intention is to significantly improve the quality, impact, and accountability of local, national, and international policy- and decision-making in South Sudan in order to promote a more peaceful, just and prosperous society.

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