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Policy brief

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STABILIZING THE SOUTH SUDAN POUND TO ENABLE PRODUCTIVE DEVELOPMENT

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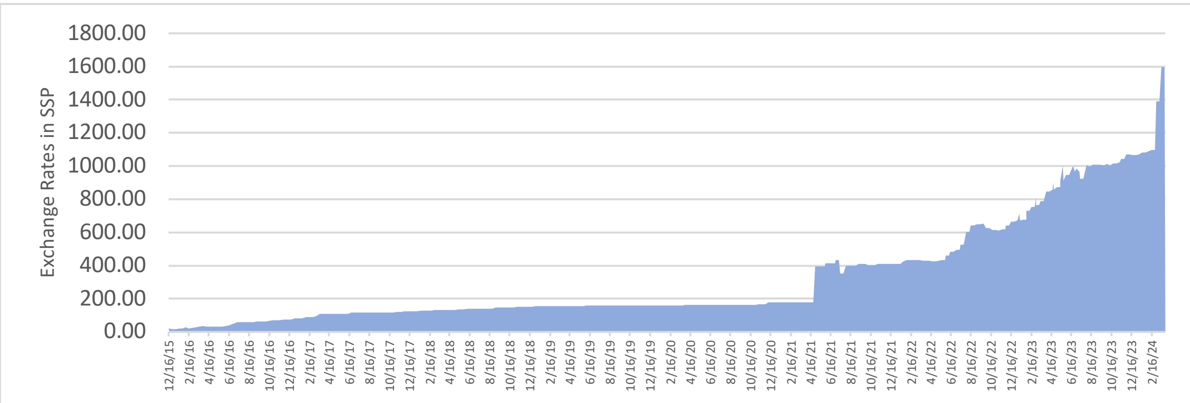
1. Introduction

This Brief explores the causes of South Sudan's spiraling inflation and depreciating currency, as well as the policy interventions needed to stabilize the currency and by extension, the economy.

The acute stage of the crisis started in February 2021, when the exchange rate jumped from SSP 177 to SSP 400 (Figure 1). Five decrees and five Governors of Bank of South Sudan later, the US$ commercial exchange rate has reached SSP 1,596.76. On the parallel market, the exchange rate reached SSP2,250/$1 in March 2024. A litre of petrol is sold for SSP 2,999, up from SSP 1500 on 4th March 2024. Rising transportation costs mean added hardship for informal traders and reduced purchasing power for poverty-stricken citizenry.[1]

The immediate cause of the crisis is clear: pipeline disruptions due to the ongoing conflict across the border in Sudan have brought a sudden halt to South Sudan's main —and, for all intents and purposes, only— source of hard currency, oil. But the proximate cause should not be allowed to hide the structural, long-run reasons for South Sudan's fragility. Our country remains a commodity mono-exporter with little to fall back on when oil revenues are disrupted.

Figure 1. USD to SSP Exchange (Commercial Rates)



Source: CLiMIS

Successive decrees have failed to address the currency crisis, which has its roots in excessive government spending in non-productive sectors. Again and again, deficit spending has been

[1] EyeRadio https://www.eyeradio.org/juba-residents-forced-to-walk-as-motorists-increase-fares/#google_vignette

financed through monetary expansion. The results, for everyday people, have been acute shortages of essential goods and services amid an inflationary spiral that has wiped out the value of SSP savings.

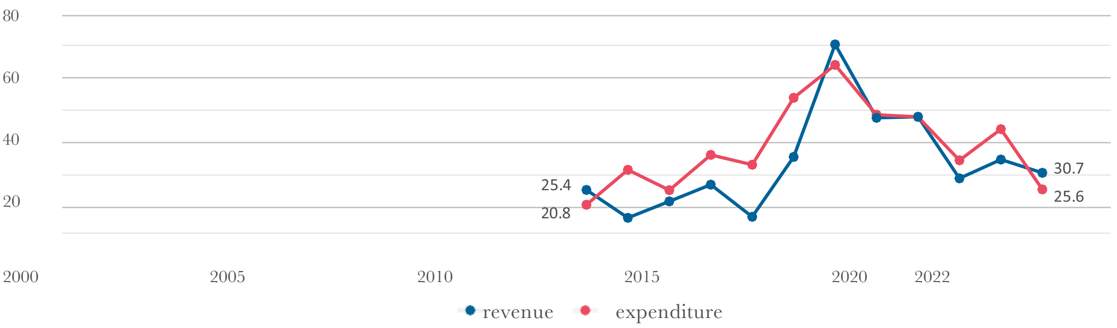
The causes of runaway inflation and currency collapses are no mystery, they have been studied in detail by economists for many years. Excessive government spending, financed by printing money, has led to currency collapse wherever it has been tried: Germany (1922-23), Hungary (1945-46), China (1948-1949), Peru (1985-1987), Russia (1992-1994), Zambia (1996-1999), Turkey (1999-2002), Zimbabwe (2014-2017), Venezuela (2017-2020) and many others.

The mechanism through which the Pound weakens is well understood. Fortunately, so are the remedies. Reducing the fiscal deficit, improving public spending efficiency, developing the private sector, improving tax collection and diversifying the economy away from reliance on a single or few commodities to sustain growing revenue. However, essential conditions are necessary for such measures to succeed. These measures are effective in lower-middle-income countries, typically those supported by a diversified economy that includes agriculture, manufacturing, and services, where the economy is growing at an average annual rate of more than 3%. In addition to these technical solutions, the political measures are even more important to address governance deficits and state capture as argued by the World Bank in its Country Systematic Diagnosis Report (World Bank, 2015).

The government has consistently spent more than it takes in (Figure 2), with spending concentrated in non-productive sectors. It pursued an expansionary fiscal policy between 2012 and 2020. The fiscal deficit averaged 8.6% of GDP, a large gap by international standards.

Figure 2. General government revenue and expenditure

% of GDP



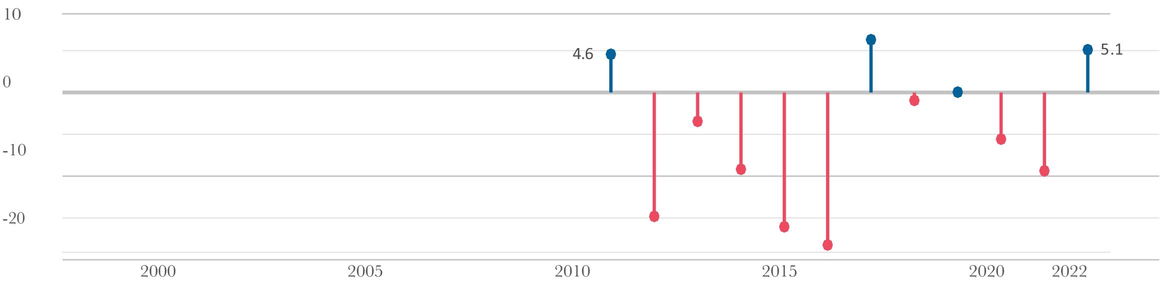
Source: IMF-WEO

The government must strive to adopt policies to create an environment that enables private sector development, growth, and investment and to improve infrastructure and human capital development. Monetary policies should be set to encourage savings and maintain monetary and domestic price stability. Overall, the government must reduce spending to curb inflationary pressures, and implement fiscal reforms to improve the efficiency of public expenditures, accountability and transparency.

However, South Sudan has mostly been buried in deficits (Figure 3).

Figure 3. General government net lending/borrowing

% of GDP

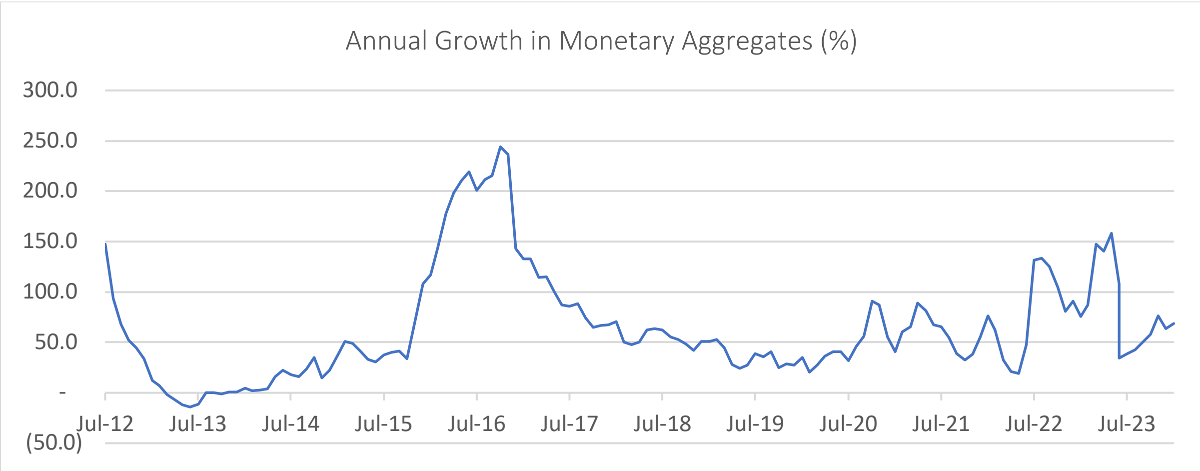


surplus deficit

Source: IMF-WEO (Destatis - Statistisches Bundesamt)

To finance these deficits, the government has continued borrowing from the Central Bank. To produce these loans, the Central Bank effectively prints new money, expanding the money supply. The money supply has been steadily increasing over the past decade. In November 2016, the annual growth rate stood at 236.2%, up from its lowest point of 11% in 2013. It dropped to 20.6% in 2020 but rose to 158% in 2023. Figure 4 shows the trend of annual growth of monetary aggregates.

Figure 4. Key Monetary Indicators (Million SSP)



Source: Bank of South Sudan 2024

As a result, too much money is chasing too few goods and services. This has damaged the Central Bank's credibility, as market participants can see its independence is a fiction. The only way to end this dynamic is to stop monetary financing of fiscal deficits.

A lower-middle-income status, which South Sudan must strive to become, would provide the minimum economic conditions necessary to reduce inflation and address challenges such as high poverty levels, unemployment, corruption, and inequality.

2. Strengthening the Financial Sector

South Sudan needs to do much more than stopping the immediate crisis; it needs to build a financial sector that supports its productive development. Today the financial sector is small and underdeveloped, with low levels of intermediation and high lending interest rates.[2] To strengthen the finance sector, the recent National Economic Conference (NEC) recommended a set of interventions[3], including:

- Call on the government to immediately establish a Treasury Single Account (TSA) to ensure government revenues are pooled and administered in a single account.
- Urge the government to streamline the tax system to prevent leakages and improve revenue collection, including implementing tax digitalization.
- Urge the government to establish a fund that targets and supports microfinance institutions and SMEs countywide to boost economic activity.
- To expand tax base, call on the government to review tax laws governing subcontractors operating under SOFA/EPSAs.
- Urge the government to have the oil revenues remitted to BoSS to build foreign reserves and to facilitate International Payment System through the BIS and

[2] AfDB Interim Country Strategy Paper (I-CSP) 2022- 2024 https://www.afdb.org/sites/default/files/documents/projects-and-operations/south_sudan_-_interim_country_strategy_paper_2022-2024_0.pdf

[3]

corresponding banks supporting South Sudanese Commercial Banks and other suppliers.

- Call on the government and commercial banks operating within South Sudan to design and facilitate access to business loans to people/entities with promising business plans.
- Urge the government to conduct a study on inflation dynamics in South Sudan, to help inform policy community and all economic actors operating/those with interest to invest in South Sudan.
- Call on the government to uphold BoSS's independence as envisaged in the Bank's Act, 2011.
- Call for the strengthening of National Development Planning functions within the MoFP to advance a renewed social contract between the South Sudanese citizenry and their State by restoring investment programs in the people through more inclusive economic development.
- Call on the government to implement measures to improve transparency on debt and procurement processes (i.e., loans and state contracts).
- Urge the government to strengthen a Debt Management Committee (now established and headed by Deputy Minister of Finance and Planning) to guide and advise the government.
- Call on the government to restore the Petroleum Revenues Gazette, which issues public reports annually regarding production and sales of oil to ensure transparency and accountability in the petroleum sector.
- Call on the government to implement the Sovereign Wealth Fund according to the Petroleum Act, 2012.
- Urge the government to invest in an alternative pipeline and to construct a refinery for local and regional markets.
- Call for the privatization of oil sector holdings and business activities to maximize value for local businesses and engender economic growth.

The Bank of South Sudan (BoSS) cannot adequately supervise branches of commercial banks. As of April 2022, the banking market comprises 30 licensed commercial banks.[4] Twelve are national banks, seven are foreign-owned banks, and eleven are Joint Venture (JV) banks. Besides bringing many benefits to the country, financial institutions and commercial banks face new challenges beyond monitoring and managing risks.

Concerns include poor risk management practices in financial institutions and weak Central Bank capacity to oversee the commercial banking sector.[5] Reforms would imply moving away from an all-encompassing Bank Governor to a team of highly skilled professionals with backgrounds in economics, finance, law, and public policy, as well as extensive experience in both monetary and fiscal policies and negotiation skills to run a hybrid Central Bank and individuals with exceptional managerial skills to manage the bank's operations.

Prof. Bromley goes further, characterizing the economy as an "autarky," a situation where "every household, every village, is on its own. There is virtually no movement of goods within the country since no localized abundance can satisfy localized scarcities elsewhere. There is no internal trade; hence, there is nothing much to trade with neighbors—either near or far."

[4]Licensed commercial banks are obligated to operate according to the law and guidelines of the regulator for the proper delivery of banking products and services to customers.
[5] IMF Country Report No. 23/108, March 2023

Whatever semblance of trade occurs reacts but little to Central Bank interventions such as foreign exchange market intervention, interest rate intervention or capital controls.[6]

South Sudan must concentrate on the most urgently needed reforms. First, the government must relinquish its control over monetary policy and adhere to the provisions of the South Sudan Act, 2011. This is a political decision—a political commitment to ensure the Central Bank's independence. Such a commitment will ensure that monetary policy decisions are grounded in economic fundamentals, rather than narrow political considerations.

Secondly, strengthening the regulatory framework governing South Sudan's financial institutions is critical to ensuring their safety, sound operation and contribution to local business development. For example, adopting an inflation-targeting regime that sets clear targets for inflation should guide the Banks' decisions.

As an import-dependent country, collaboration with neighboring countries is necessary to coordinate regional monetary policy and prevent imbalances in the bilateral and regional economies. Total revenues have increased by prioritizing on-oil tax revenue, mainly from trade in border towns. While a good thing, an increase in the money supply without a corresponding increase in productivity and the supply of goods and services leads to inflation.

Some observers say the economy collapsed about a decade ago. The informal sector has been keeping households afloat. These small-scale producers and traders, most of them women and self-employed individuals, adapt to changing market conditions to provide affordable goods and services to the public. Many might not survive the recent hike in petrol prices, which stood at SSP 3100 March, up from SSP 1300 in January 2024. Fit-for-purpose support should target and nurture these groups.

South Sudan has a significant humanitarian sector which brings in over US$ 1.5 billion annually. That is substantial money flowing into the country. But being an "open economy", most of the humanitarian and oil income quickly escapes abroad, including salaries paid abroad, hotel bills from foreign-owned hotels, imported food, luxury vehicles and high-priced security protection. Little earnings are retained in South Sudan to invest in productive capacities. The announcement in 2023 by WFP to drastically cut its operations and staff demonstrates the unsustainable impacts of foot-loose humanitarian sectors on the economy.

3. Emerging Challenges

The effects of climate change on the financial system and the economy are increasingly being felt. Adaptation to climate change requires investments. Climate change reduces crop yields, disrupts the food supply chains, and increase food prices which has a significant impact on efforts to finance food systems transformation. Also, the transition to a low-carbon economy requires significant investments in renewable energy and innovative industries. At the same time, the physical effects of climate change leads to property damage and supply chain disruptions, which can directly impact the financial and insurance systems.

Today, climate considerations are at the center of operations of prudential, economic stability, and monetary policy objectives. South Sudan's underdeveloped banking system means the domestic market's capacity to absorb new challenges is limited. Therefore, the BoSS must be equipped to act as a market-maker and a catalyst to mobilize resources needed to achieve a sustainable and carbon-neutral economy as the goals of the Paris Agreement.

4. Conclusions

The focus of the Bank of South Sudan (BoSS) must reconnect with its reason for being, a bulwark to protect the stability of the South Sudan Pound and an aid to financing the

[6] The currency exchange rate is an essential metric for informing economic policy, but traditional sources are often produced with delay during crises and only at an aggregate level. This may poorly reflect the actual rate trends in rural or poverty-stricken areas, where large populations reside in fragile situations.

development of the nation. As the legal and regulatory framework will undoubtedly evolve, the BoSS must reflect on the changing domestic and international dynamics to identify opportunities. To stabilize the currency of South Sudan's small open economy, the government should take the following steps urgently:

i. Commit to respecting the BoSS's functional independence as provided for in its 2011 Act.
ii. Strengthen the bank's research department to conduct studies and analyses on economic indicators, trends, and policies. To help comprehend the economic climate and make informed decisions regarding monetary policy to promote financial stability.
iii. Establish structural fiscal surplus rule with parliamentary oversight that sterilizes spending levels against crude oil fluctuations to ensure macroeconomic stability, save revenues and invest in critical growth expenditures.
iv. Strengthen the regulatory framework governing financial institutions.
v. Consider empowering the BoSS to act as a hybrid Central Bank by establishing a monetary policy advisory council, a multidisciplinary group of experts to advise the Governor to inter-alia:
    - target capital critical for financing and being mindful of its spending.
    - ensure it has sufficient revenue to fund its expenditures and assure fiscal stability and discipline.
    - effectively supervise the commercial banking sector.
vi. Implement digital payment systems to manage the money supply.
vii. Coordinate regional monetary policy to help balance the regional economy and stabilize the currency.
viii. Establish a monetary policy advisory committee, a multidisciplinary group of experts to advise the Governor.

About The 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 to promote a more peaceful, just, and prosperous society.

Authors' Biography

Constantine O. Bartel is an economist with backgrounds in agriculture trade and development. A long-time lead consultant and author of UN flagship reports, co-Author of the 2020 UNCTAD Least Developed Countries on productive capacities, the 2019 Economic Development in Africa Report (EDA), author of the AfCFTA national implementation strategies for Cameroon, Togo, South Sudan and Chad, and co-author of the brief on WTO reforms to negotiate multilateral modalities to enhance micro, small and medium enterprises (MSMEs).