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Master Thesis

Topic: **Functions and Objectives of the Monetary Policy of the South Sudan Central Bank (CBoSS)**

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0. Index of Abbreviations

AEO	African Economic Outlook
AU	African Union
CBOS	Central Bank of Sudan
CBoSS	South Sudan Central Bank
BoSShq	South Sudan Central Bank High Quarter
CESifo	Centre for Economic Studies/ Institute for Economic Research Read
CIA	Central Intelligence Agency
CL	Chile
CPSS	Committee on Payment and Settlement Systems
ECB	European Central Bank
EU	European Union
FED	Federal Reserve System
ff	Following Pages
FOREX	Foreign Exchange
FR	France
G20	(Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, México, Russia, Saudi Arabia, South Africa, Korea, Turkey, the United Kingdom, United States)
GDP	Gross Domestic Product
GoSS	Government of South Sudan
i.a.	(inter alia), Among Others
IBP	International Business Publications
i.e.	that is to say
IMF	International Monetary Fund
IOU	Investor Owned Utility
JP	Japan
KCB	Kenyan commercial bank
LoLR	Lender of Last Resort
M2	Measure of the Money Supply
MP	Monetary Policy
MX	Mexico
MY	Malaysia

PH	Philippines
PL	Poland
SAR	Syrian Arab Republic
SE	Sweden
SPLA/M	Sudan People's Liberation Army/Movement
SRR	Special Resolution Regime
SSP	South Sudan Pound
TH	Thailand
UK	United Kingdom
US	United States
USA	United States of America
USD	United States Dollar

1. Introduction

Two years ago, South Sudan rejoiced in independence celebration to celebrate its secession from Sudan. The Independence Day was a historic moment of which many South Sudanese may not have dared dream. The euphoria and expectations ran high. But building a state from scratch is an enormous task, and in present time, people's patience is being tested - as the country is fighting against the people who were regarded as part of the solution or against countries who were regarded as friends.

Upon the independence in 2011, the government of South Sudan set out on an unprecedented state building mission. Four years was an extremely short period of time to build a solid system and to catch up with the rest of the world on working towards the Millennium Development Goals.

With the establishment of the South Sudan Central Bank (CBoSS), in July 2011 and the recording of the execution of the individual monetary policy of South Sudan by the CBoSS on 9 July 2011, was the previously second attempt for establishment of a Southern Sudanese currency. The CBoSS functions and objectives are presented in this thesis, in order to measure the system progress.

This study examines the monetary policy framework in South Sudan, and assesses the effectiveness of monetary transmission mechanism since the independence of South Sudan in 2011. The econometric analysis concludes that reserve money, the exchange rate, and decline of oil revenues and large demand for dollars are the main determinants of inflation after the secession from Sudan. These findings reinforce the need for a comprehensive package of fiscal and monetary measures that strengthens the monetary policy framework and improves its effectiveness.

The primary purpose of this thesis is to outline how the central banks run their monetary policy, and on another hand, the monetary policy of the CBoSS is illustrated as well. Section 2 reviews the need for central banks, discusses the form of policies used followed with an example of no need for central banks. Section 3 discusses the objectives and functions of central banks in general as well as maintaining the stability to the orderly development of the economy; to promote and maintain a banking system; and to advise the governments on any matter of a financial or monetary nature.

Section 4 introduces the South Sudan monetary policy course before and after independence. Section 5 and 6 describes the CBoSS objectives as well as functions. Finally Section 7 looks at monetary policy objectives as a channel of loss that the central bank may be exposed to in its policy operations. The summary is completed by decisive opinion, which can be used as a research field. This thesis does not include the CBoSS structure, since it is not existent in CBoSS website.

2. Necessity of Central Banks

Central banks are the most important actors of economic process in modern economy; The policies that lead those institutions are important as well, both in relation to achieving different economic policy objectives (economic growth, unemployment rate, price stability, balance of payment equilibrium) and in relation to the policies followed by other actors on the macroeconomic level (government, employers, trade unions and international institutions).

As higher monetary authorities, central banks have objectives e.g. the implementation of the monetary policies, prudential supervision and supervision of commercial banks.[1] In the current decline of oil price and its effects on the global economy, and the issue that the central banks have to involve in (ensuring financial stability) has been challenged.

The financial stability issue proposes a logical analysis of theoretical and practical foundations which support the necessity of central bank involvement in order to ensure the financial stability, the reasons and limits of its actions.

Generally, the contemporary economists agreed that an important role in ensuring financial stability belongs to central banks.[2] However, because of the relative nature of the concept of financial stability, central bank's tasks in this field are quite controversial in economic doctrine, and the stipulation of these tasks in legal texts is also imprecise and sometimes different from one country to another.

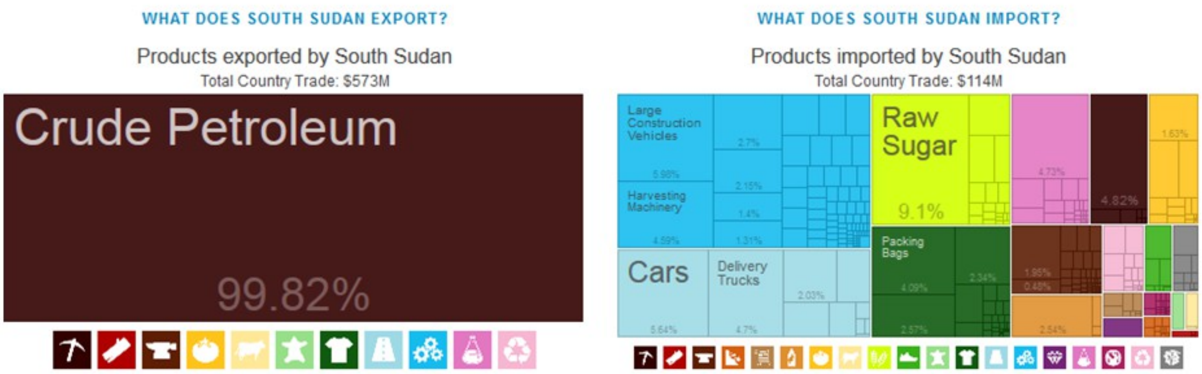
There are some functions and tasks of a central bank that can contribute to ensure and maintain financial stability. These functions are: banking regulation and supervision; management and oversight of payment systems; the function of lender of the last resort;

[1] Blejer (1999), P. 94
[2] Odekom (2015), P 686

guarantee of bank deposits. These are the conventional functions of central banks, which appear precisely for the gradual involvement of this institution in ensuring financial stability. Indeed, sometimes the inherent instability of commercial banking system imposed the control by the central banks, which had to perform a regulatory function and refinancing of those banks, which are in such a situation of not being able to face massive demands of deposits withdrawals. It wouldn't have been anyone to do this and customers would have suffered important losses from full non-recovery of their deposits, if the central bank had not assumed this role. In fact, even through the involvement of the central bank, in many cases, these losses couldn't have been avoided. It means, that the central bank's function as the lender of the last resort appeared as a mean of guarantee the system's liquidity and solvability.

One of the main key roles central banks must play is ensuring price stability; the monetary stability and the financial stability are closely related; one of the usual causes of decline of oil prices (oil crisis) is the excessive increase of the dollars demand in a country like South Sudan in which all needs are imported from abroad (Figure 1).

Figure 1



http://atlas.media.mit.edu/profile/country/ssd/

The decline of oil prices has proved the weakness of the whole monetary policy system of the South Sudan Central Bank.[3] South Sudan's monetary policy is determined by external factors; and so the question of the need for a central bank arises. I will go back to the history of the US Central Bank (Fed) as well as the English Central Bank to prove the traceability of the statement.

In US Continental Congress "current US Congress" had printed the first banknotes of the

[3] AEO, i.a. 2015, P 281

new nation in 1775 and established the first Bank of the United States in 1791. The bank was the largest corporation in the country and was not a classical central bank as we know today; it was dominated by big banking and money interests. The Federal Reserve System (FED) was established in 1913 as a decentralized central bank, which balanced the competing interests of private banks and populist sentiment.[4] The Bank of England was incorporated by act of Parliament in 1694 with the immediate purpose of raising funds to allow the English government to wage war.

It operates as a joint-stock bank with limited liability. This special status and its position gave the bank considerable competitive advantages. By that time it had become the largest and most prestigious financial institution in England, and its banknotes were widely circulated; it became banker to other banks. It began to print legal tender in 1833; it was privately owned until 1946, when it was nationalized.

Nevertheless sometimes people challenge the central bank task, the most popular arguments for and against bundling the duties of a central bank are as following:

"One of the pros is that the central banks are partner of the commercial banks in the framework of repurchasing agreements ('repos'). As a supervisory authority, it is well-placed to assess not only the collateral submitted (securities), but also the creditworthiness and the conduct of the submitting institutions, which certainly constitutes a major advantage given the information asymmetry between the players involved."[5]

One of the contra arguments is the so-called independence dilemma;[6] if the central banks were to be made entirely responsible for supervising the financial market, then it would also have to be given an authorization to intervene in banking business, to dismiss executives for example or to close-down banks. The ECB is the only central bank which can not be affected by independence dilemma.

[4] Vaish M C (2009), P 410

[5] CESifo Forum P. 40

[6] The independence dilemma stems from the enormous power central banks have to create money essentially out of thin air. Wielded judiciously, this power can foster economic prosperity and stability. However, it can also be misused as a short-term fix for governments to meet financing needs by printing money or to stimulate the economy before an election. Such misuse can undermine economic stability and fuel runaway inflation. The resulting longer-run damage may only be felt years or decades in the future, well outside usual political time frames.

3. Function and Objectives of Central Banks

Most important objectives of central banks are to maintain the external credit stability and balance of payments conditions conducive to the orderly development of the economy; to promote and maintain an adequate banking system and high standards of conduct and management therein; and to advise the governments on any matter of a financial or monetary nature.

3.1 Objectives of Central Banks

The central bank is responsible for providing its economy with funds when commercial banks cannot cover a supply shortage,[7] it is described as the lender of last resort. The central bank prevents the country's banking system from failing. However, the first objective of central banks is to provide their currencies with price stability by controlling inflation. Central bank has the regulatory authority of a country's monetary policy, and is the sole provider and printer of notes and coins in circulation. Lots of central banks proved their best function by remaining independent from government fiscal policy and therefore uninfluenced by the political concerns of any regime. The central bank should also be completely divested of any commercial banking interests.[8]

3.1.1 Monetary Policy Objectives

The central banks of most democratic countries with market economies share a similar objective. The objective of maintaining price stability, i.e. of fostering a stable environment for the development of entrepreneurial activity, reflects the central bank's responsibility for sustainable economic growth. A necessary condition for implementing monetary policy leading to price stability is central bank independence. The South Sudan Central Bank efforts to meet this objective within a monetary policy regime known as the price stability; but the policy of inflation targeting are not the issue; in the pursuit of its objective, it uses several monetary policy instruments. Most central banks focuse on stability of all prices

[7] IMF (1993), P 65
[8] Investopedia 2

including consumer prices; basically the price stability does not literally mean unchanging prices, it means moderate growth in prices. The high and volatile inflation has adverse implications for economic growth. This is confirmed by the long-term empirical experience from the world economy. High inflation erodes the value of incomes and savings and leads to high nominal interest rates. As a rule, it also means considerable inflation volatility, which essentially increases the cost of inflation and that is the reason of the price stability policy of most central banks to reduce costs of inflation. Central banks try to avoid the long term inflation so that the decision making of economic agent could not be influenced by inflation. The inflation causes several economic distortions that reduce the long-term growth potential of the economy; the commercial banks redistribute income from consumers to suppliers, create distortions in the saving system, and represent a hidden burden on savers, who are unable to safeguard the purchasing power of their incomes and savings.

Sometimes, the currency stability is equivalent to price stability;[9] the potential conflict has been removed by many central banks, but the conflict is still relevant for South Sudan. For example, where stability in the value of the currency is stated in the law as the singular objective, but it is unclear whether the value of the currency is intended to refer to the domestic purchasing power, or the external exchange value of the national currency, or both. There are various ways in which potential conflicts are resolved.

3.1.2 Financial Stability Objectives

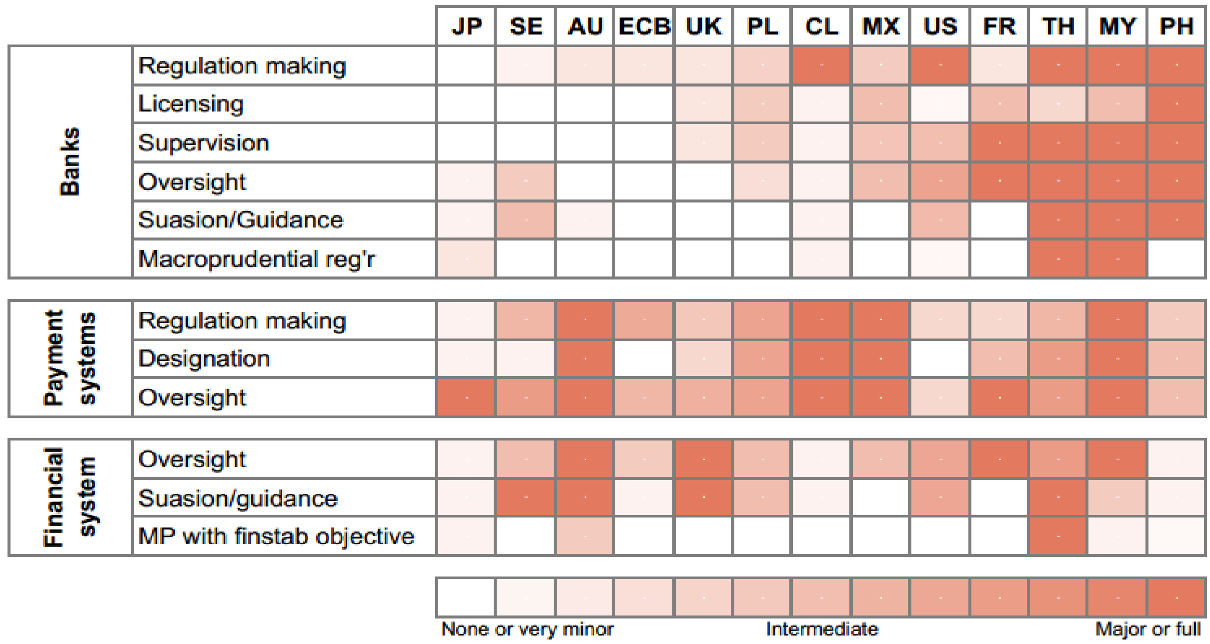
The survey that was conducted amongst study group of central banks for this report captured arrangements for financial stability policies as they stood before the financial crisis. The results of this survey is to provide a useful point of rethinking about new arrangements in the financial stability matters.

Before the financial crisis, the financial stability mandates of surveyed central banks differed widely, both for normal times (Table 1.1), and for crisis times (Table 1.2). The only mandate held by almost all central banks in the group was the oversight of payment systems.

[9] Oatley (2014), P 26

Table 1.1 **Financial stability related mandates of central banks in 2009**

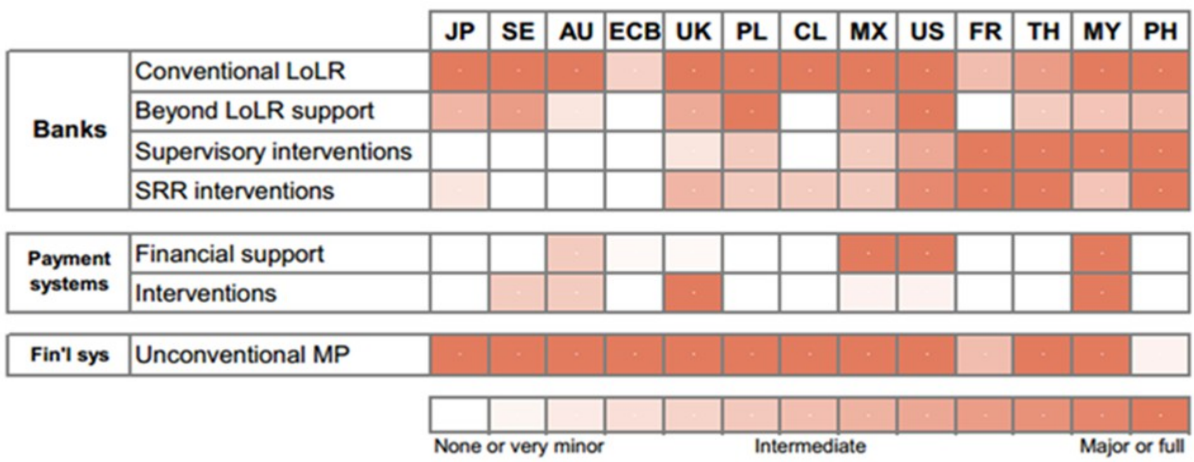
(The darker the shading the bigger the mandate)



Source: BIS survey of participating central banks, conducted in 2009

Table 1.2 **Financial stability related mandates of central banks in 2009**

(The darker the shading, the bigger the mandate)



Source: BIS survey of participating central banks, conducted in 2009

Both Tables draw on the survey that was conducted amongst Study group of central banks, which captured arrangements for financial stability policy emergency actions as they stood before the financial crisis.

Sometimes the central banks confront a problem of asymmetric information and that make the utility of these function questionable. Indeed, the central banks have a lack of necessary information in order to determine whether a commercial bank is insolvent or has only temporary liquidity problems, and therefore, has no option either to help all commercial banks or not help any of them. However, it is clear that the banking financial stability must be ensured above all.

From here comes the idea of creating separate supervisory institutions from central banks,[10] which impose commercial banks rigorous prudential rules, as currently, the most known prudential rules at European level are defined by Basel II and more recently by Basel III. In this classical evolution of central bank's functions, some recent phenomena are added, such as deregulation, globalization and the increase of financial innovation process as well as foreign exchange liberalization, which strengthen the links between banking sector and other important sectors of financial system (insurance, financial market). This splitting of capital markets create new challenges for central banks, inducing it to assume new tasks and functions. Among these new responsibilities that involve the central banks in ensuring financial stability, we mention the monitoring of financial assets prices and supervision of financial conglomerates; some economists state that the central banks should primarily deal with elaboration and implementation of monetary policies.

"The main cause for this special interest of modern Central Banks in ensuring financial stability is the fact that monetary policy can't be fully effective, unless it is based on predictable transmission mechanisms that requires a quite stable environment. Mutually, price stability – the final objective of monetary policy – is a necessary condition, although not sufficient to ensure financial stability".[11]

[10] Kellermann, i.a (2013), P 194

[11] Ovidius (2011), P.2014

3.1.3 Payment System Objectives

An objective relating to the payment system oversight function is found frequently in central bank's laws,[12] especially when these laws were written in the last decade.

A common feature of all economies is the different ways in which payments are made and the forms of money used. There is also a wide range of advanced economic agents whose liabilities function as money. The central banks are most familiar issuers of money, which provide central bank money in the form of both banknotes and deposit liabilities, and commercial banks, which generally issue private money (commercial bank money) in the form of deposit liabilities.[13] Basically the economic activity can take place without the coexistence of central and commercial bank money. Indeed, both solutions the central bank money as well as commercial bank money has existed in the past, refers to Section 3. But neither has proved sufficiently stable or efficient to survive, the both types of money play an important part in facilitating economic activity. Committee on Payment and Settlement Systems (CPSS) central banks believe on competition among commercial banks as the most effective and efficient financial system, in which central bank money is used where its particular features are most important. An important feature of this coexistence is in a given currency, central and commercial banks monies are convertible into each other at par. Conversion at par removes high transaction costs that could arise for users of a currency if there were multiple issuers whose monies were exchanged at different values. Conversion between commercial and central banks monies takes place in a tangible way when a commercial bank depositor withdraws banknotes from an account. Conversion between different commercial bank monies takes place through payment systems when a customer of one bank makes a payment to a customer of another bank, using central bank money as the bridge in most cases.

[12] IMF, (2005)P 634
[13] World Bank (2005), P 253

3.2 Function of Central Bank

The central bank has a unique monopoly of note issue in almost every country. Printing and issuing the currency notes. The central bank becomes unlimited legal tender throughout the country. According to De Kock statement, "*The privilege of note-issue was almost everywhere associated with the origin and development of central banks*."[14]

However, the monopoly of central banks to issue the currency notes may be partial in certain countries.[15] For example, in some countries the coins are issued by the Ministry of Finance and all other notes are issued by the Reserve Bank.

The advantages of giving the monopoly right of note issue to the central bank are as follow: Usage of central banks to issue currency brings uniformity in the monetary system of note issue and note circulation. An institution (central bank) can exercise better control over the money supply in the country and it increases public confidence in the monetary system of the country. The monetary system management of currency becomes easier. Being the supreme bank of the country, the central bank has full information about the monetary requirements of the economy, and therefore the central bank can change the quantity of currency accordingly; it can exercise control over the creation of credit through commercial banks. Through monopoly right the central banks avoid the political interference in the matter of note issue.

The central banks keep their position as a banker to government*;* it performs same functions for the government as a commercial bank performs for its customers.[16] It maintains the accounts of the central as well as state government and some times the whole government institution accounts. Moreover, the central bank receives deposits from the government, and makes short-term advances to the government; it collects cheques and drafts deposited in the government account; it provides foreign exchange resources to the government for repaying external debt or purchasing foreign goods or making other payments.

[14] Vaish; P.412
[15] Vaish M C (2009), P 411
[16] Vaish MC (2009), P 410

The central banks as agent of the government they collect taxes and other payments on behalf of the governments. They raise loans from the public and thus manage public debt. They also represent governments in the international financial institutions and conferences and give advice to the governments on economic, monetary, financial and fiscal matters such as deficit financing, devaluation, trade policy, foreign exchange policies.

The central banks acts as the bankers' bank in term of custodian of the cash preserves of the commercial banks and as the lender of the last resort as well as clearing agent. As the commercial banks cash reserves custodian central banks maintain the cash reserves of the commercial banks. Every commercial bank has to keep a certain percentage of its cash balances as deposits with the central banks.[17] These cash reserves can be utilised by the commercial banks in times of emergency. Centralization of cash reserves in the central banks inspire confidence of the public in the banking system of the country and the centralised cash reserves provide the basis of a larger and more elastic credit structure than if these amounts were scattered among the individual banks; the reserves can be used to the fullest possible extent and in the most effective manner during the periods of seasonal strains and financial emergencies. Centralised reserves make it possible for central banks to provide financial accommodation to the commercial banks which are in temporary difficulties. Actually the central banks function as the lender of the last resort on the foundation of the centralised cash reserves. The centralised system of cash reserves enables the central banks to influence the creation of credit by the commercial banks by increasing or decreasing the cash reserves through the technique of variable cash-reserve ratio. The national welfare can be promoted through central bank cash reserves.
As the keeper of the cash reserves of the commercial banks, the central banks act as the clearing house for these banks. Since all commercial banks have their accounts with the central banks, the central banks can just settle the claims of various banks against each other with least use of cash. The clearing house function of the central banks has advantages. First, it economies the use of cash by banks while settling their claims and counter-claims; and it enables the commercial banks to create credit on a large scale through reducing the withdrawals of cash.[18]

[17] Baliño, i.a (1997), P 1962
[18] Fernando (2011); P 560

The clearing house function keeps the central banks fully informed about the liquidity position of the commercial banks.

3.2.1 Financial Stability

Without prevention the authorities will have limited tools to deal with a crisis once it has broken out, the authorities including the central banks can attempt to limit the damage to the rest of the economy. This makes prevention important as well as treatment. Central banks have traditionally focused on treating financial crisis, but they also have an important role in helping to prevent the crisis.

The distortions in the financial system can not be solved by monetary policy rate.[19] But there is a growing consensus around the use and design of macro prudential tools, which are more flexible and can be targeted at certain areas of the financial system, where they create distortions. Particularly, central banks could use cycle adjusted capital requirement ratios, lending-to-asset-value ratios and loan loss provision ratios to discourage speculation in markets where a potential bubble is forming.[20]

The improvements in the payment and security settlements systems as well as providing incentives for certain derivatives transactions to be settled in central counterparty institutions could reduce a systemic risk.

One of the ways in which central banks can help prevent financial crisis is by designing procedures of dealing with the systemically collapse of important institutions. The allocated manner in which this issue was dealt with during this crisis intensified uncertainty and damage to the system. As desired, central banks could establish resolution procedures analogous to those of corporation so that systemically important institutions cease being too big to fail.

The probability of a crisis could be reduced by central banks by designing intervention procedures to avoid large misalignments in the real exchange rate whose reversal could be more costly and affect the financial system stability. Ultimately, central banks should work hand and hand with financial institutions so that they issue contingent capital certificates.

[19] Claessens, (2014), P. 9

[20] Kobrak, i.a, (2013), P. 44

These are debt securities that would be converted into capital once a threshold is reached and so provide automatic recapitalization in the event of a crisis.
The central banks offer extensive liquidity support against good collateral at a penalty rate as the first measure offer. This is a traditional role as a lender of last resort. However, the offer of this support has been limited to commercial banks. When non-bank intermediaries are important, as it is the case in some countries, in the US for example, the FED should also lend to these non-bank intermediaries under the same conditions.
The monetary policy rate can be considered as a second toll. Authorities should reduce the policy rate aggressively in response to the projected decrease in aggregate demand so as to move the neutral level of the observed real policy rate closer to its new equilibrium value.
The flexibility can be used as an additional tool by central banks. With central banks request to commercial banks, they may relax their collateral requirements and lend against a wider variety of instruments. But the flexibility of the commercial banks can increase pressure on central banks. The best example is the US boom in mortgage lending and housing prices that came before the current crisis.
The central banks can cooperate with fiscal authorities when a crisis calls for additional support in the form of government insurance or capital infusions.

3.2.2 Financial Stability and Regulatory Functions

In addition to the monetary stability mandate of central banks they are seeking for a financial stability mandate. Indeed, most of the central banks indicated that they are responsible for maintaining overall financial stability.[21] There are several reasons why central banks have a natural role in ensuring financial stability.[22] The means of payment and immediate liquidity are offered by the central banks, it is their role to ensure the smooth functioning of the national payment system. Individual problems of one bank may cascade through the payment system and can lead to bottlenecks in payments and the possibility of a widespread effect. Moreover, the banking system is the key in the transmission mechanism through which monetary policy affects the economy. It will be more difficult for

[21] Brearle, i.a. (2001), P. 81
[22] Schinasi (2003), P. 3

central bankers to do whatever they think necessary to achieve their monetary objectives, if the banking system is experiencing distress. Central banks therefore have an interest in solid financial institutions as well as stable financial markets. Nevertheless, there is a connection between monetary stability and financial stability. Trust and confidence breaks down, when financial instability occurs; and there is usually a rush (bank run) to obtain liquidity; the bank credit and the money supply begin to decline. There will be the potential for a sharp contraction in monetary aggregates that would ultimately lead to a decline in economic activity, if the bank run process is allowed to continue. Table 1.3; the following countries summarizes the position of the central bank with respect to financial stability and banking supervision.

Table 1.3

Tasks of the central bank

Country	Central bank responsible for maintaining financial stability?	Banking supervisor
Australia	Yes	Australian Prudential Regulation Authority (APRA)
Austria	Yes	Financial Market Authority (FMA)
Belgium	Yes	Banking and Finance Commission (BFC)
Canada	Yes	Office of the Superintendent of Financial Institutions (OSFI)
Czech Republic	Yes	Czech National Bank
Denmark	Yes	Danish Financial Supervisory Authority
Finland	Yes	Financial Supervisory Authority
France	Yes	Banque de France/Commission Banqaire
Germany	Yes	Bundesanstalt fur Finanzdienstleistungsaufsicht (FinDAG)
Greece	Yes	Bank of Greece
Hungary	Yes	Hungarian Financial Supervisory Authority (HFSA)
Ireland	Yes	Central Bank of Ireland
Italy	Yes	Banca d'Italia
Japan	Yes	Financial Services Agency (FSA)
Luxembourg	Yes	Commission de Surveillance du Secteur Finance (CSSF)
Mexico	Yes	National Banking and Securities Commission (CNBV)
The Netherlands	Yes	De Nederlandsche Bank (DNB)
Norway	Yes	Federal Kredittilsynet (The Banking, Insurance and Securities Commission of Norway)
New Zealand	Yes	Reserve Bank of New Zealand
Poland	Yes	Commission for Banking Supervision (CBS)
Portugal	Yes	Banco de Portugal
Slovakia	Yes	Slovak National Bank
Spain	Yes	Banco de España
Sweden	Yes	Financial Supervisory Authority (FSA)
Switzerland	Yes	Federal Banking Commission (FBC)
Turkey	Yes	Banking Regulation and Supervision Agency (BRSA)
United Kingdom	Yes	Financial Services Authority (FSA)
United States	Yes	Federal Reserve Bank, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), as well as the commercial bank supervisors from individual states

Source: Update and extension of Goodhart and Schoenmaker (1995).

Since there is no agreement on what financial stability exactly means, the textbooks do not provide an official definition of financial stability and/or systemic risk. The Bank of Canada could provide a definition of systemic risk. But, this definition is limited to clearing and settlement systems.

Some central banks view financial stability as the smooth functioning of the financial system as a whole both in stress periods as well as in normal conditions. The financial system can be seen as stable in normal condition, provided that it does not encompass any type of imbalances. Financial instability depends on the ability of financial markets in stress periods. There are two dimensions in the financial stability approach: (*ex ante, i.e. preventing the building up of imbalances on financial markets, and ex post, i.e. ensuring the ability of financial markets to accommodate the correction of these imbalances.)*[23] Other central banks define the financial stability as when a financial system is capable of efficiently allocating resources and absorbing shocks, preventing these from.

3.2.3 Provision of Infrastructure for the Financial System

The central banks functions or objectives are to promote the good of the people of the country by maintaining monetary and financial stability.

Financial market infrastructures sit at the heart of global financial markets. Financial stability as well as monetary stability depend on the appropriate design, orderly operation and continuity of service of financial market infrastructures.

Financial market infrastructures are assuming even greater systemic importance as the international regulatory community encourages more financial activity to take place via centralised infrastructures.[24] In 2009, G20 Leaders committed that standardised over-the-counter derivatives should be cleared through central counterparties.[25] Furthermore, many of the financial market infrastructures supervised by the bank are used by market participants all over the world.

As part of the central banks supervisory approach, each supervised financial market infrastructures is assessed against international standards, as set out in the Principles for

[23] Masciandaro (2005), P. 34
[24] IMF (1996), P. 29
[25] Quaglia (2014), P. 94

financial market infrastructures published by the Bank for International Settlements' Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions in April 2012. Many central banks expects supervised financial market infrastructures to perform a self-assessment against these standards as an input into the bank's own assessment. Since both European Market Infrastructure Regulation and the Central Securities Depositories Regulation draw on the Principles for financial market infrastructures for much of their content, there is an overlap between these international standards and the EU regulations for central counterparties and Central Securities Depositories. For internationally recognised payment systems, the majority of the central banks have adopted the Principles for financial market infrastructures without amendment as the principles to which operators of recognised payment systems must have regarded when operating their systems.[26]

3.2.4 Services of the Government

The central banks have been given the mandate in many countries to preserve price stability as their single or primary objective,[27] and been authorized from government to make sure that short term political considerations do not interfere with achieving this objective. Accountability to the public as well as the legislature at large balances the central bank autonomy. Transparency is extremely important for holding the central bank to account, and for making monetary policy efficient by shaping inflation expectations. Basically, there is a distinct division of responsibilities and accountabilities between the central banks on the one hand, and the governments or the Minister of Finance on the other hand. Even so, symmetric information sharing as well as the cooperation and coordination between the central bank and the government are important in a number of respects. The major part of this note focuses on practical aspects of the cooperation between the central banks and the governments, and is mostly based on a survey of central banks. This is followed by an aspect of the financial relationship between the central bank and government. A brief discussion of the underlying issues may be useful, before turning to the survey information.

[26] World Bank (2013), P. 159
[27] Baliño, i.a. (1994); P. 330

The central banks coordinate the government's monetary and fiscal policy.[28] If the fiscal authorities know the central bank's policy reaction function and its analytical model, they can expect the monetary policy response to a given fiscal action and adjust the action accordingly. Basically, coordination between both policies (monetary and fiscal policy) can be achieved without negotiations between the fiscal and the monetary authorities, and the central bank can take advantage of being the first mover which is important to avoid ignoring its price stability objective. It will still be useful if the central banks and the governments can establish a culture of no surprises, so this concept became implementable to assist each other in staying the course in spite of a myriad of daily challenges.

The coordination between a central bank and the government in some areas than monetary policy may need to be quite close. This is the case for fiscal agent functions of the central bank for example. Moreover, the central banks financial sector regulatory functions or advisory responsibilities allow it to foster the development of the sector, which will require close coordination with the government, for instance on legal reform.

The development role is one of the most important contribution central banks can make[29] – in industrialised as well as in developing economies alike –, is to provide an environment of monetary stability, which in turn is conducive to economic growth and development. At the margins of this principle, central banks in some industrialised countries are making an effort to focus their activities ever more on this core responsibility. By contrast, in emerging market economies central banks are often a centre of resources and expertise that is requested to take on a number of development functions. It is remarkable that historically, many central banks have played a major role in developing the financial sector's capability – for example, the Bank of England has been seen as a financial centre. But it is also worth noting the dangers in an institution shouldering too many tasks at once, and losing clarity of incentives in the process, for itself as well as for other economic agents. Therefore, the central banks in developing countries prefer to limit their development functions to the financial sector, where they are best placed to contribute to infrastructure building and human capital formation.

In low-income countries the dependence on selected commodity exports can make them

[28] IMF (1998), P. 19
[29] House of Commons i.a (2012); P 32

highly susceptible to terms-of-trade shocks;[30] the predominant role of the primary sector can lead to large fluctuations in output, demand and government revenues, and the volatility of aid flows can be a further huge challenge in trying to stabilise output.[31] The monetary policy can have permanent effects on real variables through market imperfection, and the central banks may be subject to more political pressure than in advanced emerging market economies or industrialised countries.

An important aspect of policy coordination in a number of developing countries concerns the management of oil and other raw resource revenues. Tow approaches may be used for oil-exporting countries. One is to budget at a normal oil price. These decrease the danger of large budget deficits if prices decline suddenly, and it has been implemented by some countries like Nigeria. The second is to establish a resource fund to set aside some or all of the resource revenues net of costs, and is has been done by Norway and Canada, and it has been implemented by Gabon as well and now Chad for oil revenues and Botswana for diamond mining revenues. Such arrangements for resource funds are essential but they can be difficult to devise and implement.

3.2.5 Other Public Good Functions

One of many causes of the financial crisis was the failure of the governments to properly rein in some of the volatile and unstable aspects of market forces, which were fast becoming global in nature. The monetary policy making was almost exclusively concentrated at the level of the state, hence leaving unmanaged the rapid emerging reality of global finance. The increase in global financial activities required a corresponding increase in the provision of basic services or facilities including prudent regulation and supervision from a global perspective. Nevertheless, the supply of such facilities or services was deficient or lacking because the governments inherently could not provide for them. Therefore, the financial stability is a global public good transcending national objectives and interests. A public good is a good that is both non-rivalrous and non-excludable:[32] The use of a public good, it does not reduce the availability to others and one cannot effectively prevent the use by

[30] Science Direct
[31] Flood, i.a. (2003), P.65
[32] Arnold (2007), P. 306

others. Non-rivalry in consumption means that the central banks marginal cost of providing services to an additional consumer is zero.[33] Non-excludability in currency supply e.g. means that no one would be willing voluntarily to pay for using or supplying the South Sudan Pound (SSP). Consequently, there are two important features of considering the central bank's functions as a public goods: First that they can not be provided if left solely to the market, and they tend to be consumed excessively, if they are ever provided. All central banks would like to preserve the financial stability because there are both private and public costs associated with bank failures, market dysfunctions and systemic financial problems. However, no institution except a central bank can do much to prevent problems from arising before engaging in prudent portfolio and risk management. Moreover, because the private cost of doing something about systemic risk is too high, and the private rewards too low, on balance everyone has the incentive to let someone else worry about it.[34] Maintaining financial stability provides benefits to all financial systems, the fact that one from financial system incurs these benefits does not prevent others from doing so. Therefore, the principles of non-excludability and non-rivalry apply to financial stability just as they do to other public goods such as national defence and the maintenance of law and order.

Turning to Europe as an example, in order to understand better why the financial stability should be viewed as an European public good as well as financial intermediation and integration in the EU; by focusing on the banking sector.

Financial intermediation increased considerably in the EU as well as all over world in the years leading up to the financial crisis. This is an evidence for the growth in the (relative) size of the banking sector during the mentioned period.

The costs of financial instability and banking crises go beyond the costs of an ordinary public good or implicit fiscal support and central banks liquidity provision. While not all of the adverse economic consequences since the outbreak of the crisis can be attributed to failures in the banking sector, the system had an important role to play; therefore, the costs of bailing out the banks can be regarded as a public good as well as the costs related to the misallocation of resources and boom-bust cycles.

The financial crisis triggered a recession and significant job losses, thus, the cost of banks

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[33] For example: implementation of a chosen monetary policy; and determining Interest rates; controlling the money supply as well as managing the foreign exchange and gold reserves and the Government's stock register

[34] Schinasi (2003), P33

bailing out (public good) can be lower than recession cost. The recession cost has been a significant increase in public debt levels, which will imply higher debt servicing costs for future generations and which can at least partly be attributed to the direct and indirect costs of bailing out the banks.

4. South Sudan Monetary Policy Course

Shortly after independence, the government of South Sudan (GoSS) introduced its own currency (South Sudanese pound) and adopted a managed floating exchange rate policy. However, despite the government controls, the difference between the official rate and that in the illegal but thriving black market has increased in recent months. It is currently estimated that the black market value of the South Sudanese pound (SSP) in Juba is around 400% higher than the official rate.

4.1 Before Independence of South Sudan

Sudan government declared Sudan as an Islamic state in 1983, including the non-Islamic majority in the southern region. The Southern Sudan Autonomous Region was abolished on 5 June 1983, ending the Addis Ababa Agreement.[35] Sudan People's Liberation Army/Movement (SPLA/M) was formed as response against islamisation, and the Second Sudanese civil war erupted.

The South Sudan revolutionary war was the last successful colonial war of independence in Africa against our own people of the former Northern Sudan. South Sudan gained independence from Sudan in July 2011 as the outcome of 2005 peace deal that ended Africa's longest-running civil war.[36] Under the 2005 accord, South Sudan received 50% of the former united Sudan's oil revenue, which provide the vast bulk of the country's budget. But that arrangement was set to expire with independence. South Sudan has started to build the administration as well as the economic and financial system before its independence und developed an ideology of "International Banking System" early at 2005. The banks were just

[35] Pachodo.org
[36] Arnold, LeRiche P. 1

one part of the South Sudan financial institutions, standing alongside investment banks, insurance companies, and other companies that profit from the creation and flow of money. However, monetary policy was homogeneous throughout the country; South Sudan couldn't establish its own monetary policy, since it was still a province of Sudan. And some tax revenue that could be taken by South Sudan, were prohibited by (Sharia) Islamic legal system.

The Comprehensive Peace Agreement between Southern Sudan and Sudan provided for a dual banking system in Sudan during the interim period (2005- 2011).[37] The Bank of Southern Sudan was established as a unit of the Central Bank of Sudan. The Central Bank of Sudan continued to operate under an Islamic financial system and the South established a conventional banking system. The Bank of Southern Sudan was managed as a conventional door of a dual banking system. Both Sudan and South Sudan maintained one monetary policy directed by the Sudan Central Bank during this period and the Bank of Southern Sudan was responsible for chartering and supervising financial institutions in the South.

4.2 After Independence of South Sudan

South Sudan faces difficult challenges in the conduct of its monetary policy following fifteen months suspension of oil production in January 2012 and had a devastating impact on GDP, which declined by 48% in 2012.[38] However, the outbreak of conflict on December 15, 2013 combined with a further reduction of oil exports and decline of oil prices on International markets, which means that GDP growth forecasts for 2014 are being revised downwards again, and poverty and food insecurity as well.[39]

South Sudan's economic conditions deteriorate rapidly after this permanent shock. The fiscal deficit widened owing to fifteen months loss of oil revenues in year 2012 and the outbreak of a conflict. The decline of oil revenues and large demand for dollars led to devaluation of SSP in the end of 2014 and beginning of 2015 which reached to 79, 5% annual inflation in May 2012 but declined rapidly thereafter, to an average of 1.7% in 2013 (Fig. 2).

[37] Azikiwe (2009) P 285
[38] IBP (2013), P 12
[39] CIA Factbook

Figure 2

https://www.quandl.com

Understanding of the effects of monetary policy on macroeconomic variables (such as output, employment and prices) and the channels by which these effects are transmitted is critical for effective policy formulation and timely implementation and for ensuring macro-financial stability.

After South Sudan independence in 2011, the Bank of Southern Sudan began to operate as the central bank for South Sudan with an authorization to monitor policy and price stability, and ensure a stable exchange rate system. However, South Sudan still has to rely on its neighbours such as Kenya and Uganda for its external financial transactions such as money transfers. The current situation for the banking sector is quite limited with minimum coverage for banks and a weak regulatory framework and limited management capacity and expertise. Many foreign banks have got licensed in South Sudan for covering a lack of commercial banking sector; Kenya Commercial Bank the so called KCB is among those banks.[40]

The services provided by the foreign banks are limited to foreign exchange transactions for remittances and bank transfers. The provision of loan, finance, and savings transactions are limited. Complaints by customers in banking industry are rampant regarding the quality of service and high transaction charges. The sentiments in the country regarding the Kenya, Ethiopia and Uganda owned banks are very negative with charges of exploitation levelled at the banks.

As the structure of the banking system in South Sudan and the degree of domestic financial development have a significant bearing on the effectiveness of monetary transmission, the analysis should cast against the background of the main institutional features of the South Sudan banking system. The commercial banks in many countries have major part in the creation of the new currency; *how does it work?* The UK monetary system for example is created by commercial banks when they extend or create credit, either through making loans or buying existing assets. In creating credit, banks simultaneously create deposits in our bank accounts, which, to all intents and purposes, is money.

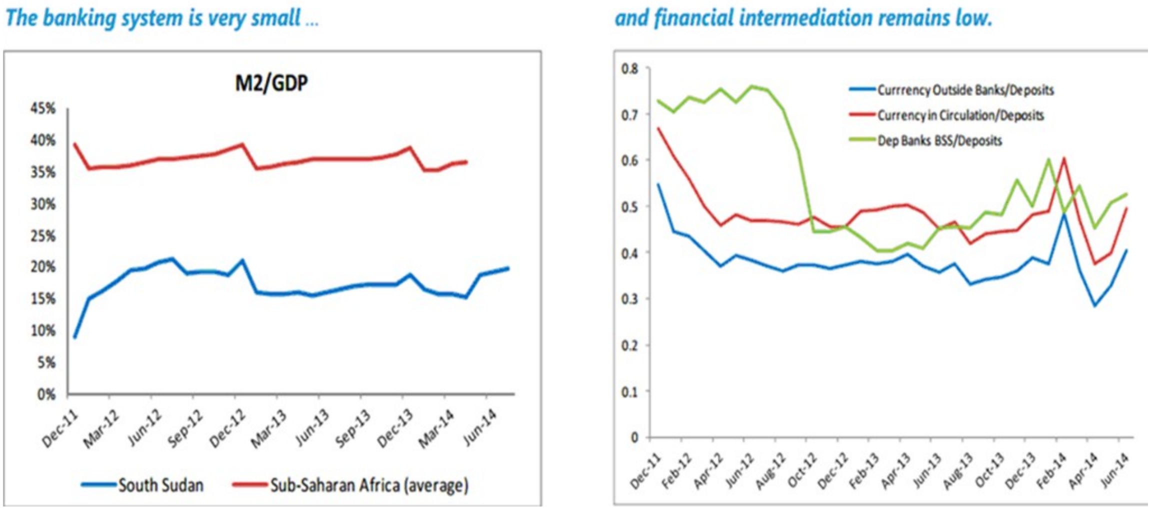
The economy of South Sudan is cash-based, with limited use of demand deposits and almost no term deposits. The ratio of M2 to GDP is approximately 15 percent, well below the sub-Saharan Africa average of 36 percent. Banking sector assets are equivalent to just 18.4 percent of GDP.[41] Figure 2.1 illustrates the banking system in southern Sudan compared with the Africa Sub-Saharan countries.

[40] Lovell-Hoare; P. 123

[41] IMF- Country Report 2014

Figure 2.1 South Sudan Banking System vs. Sub-Saharan Africa

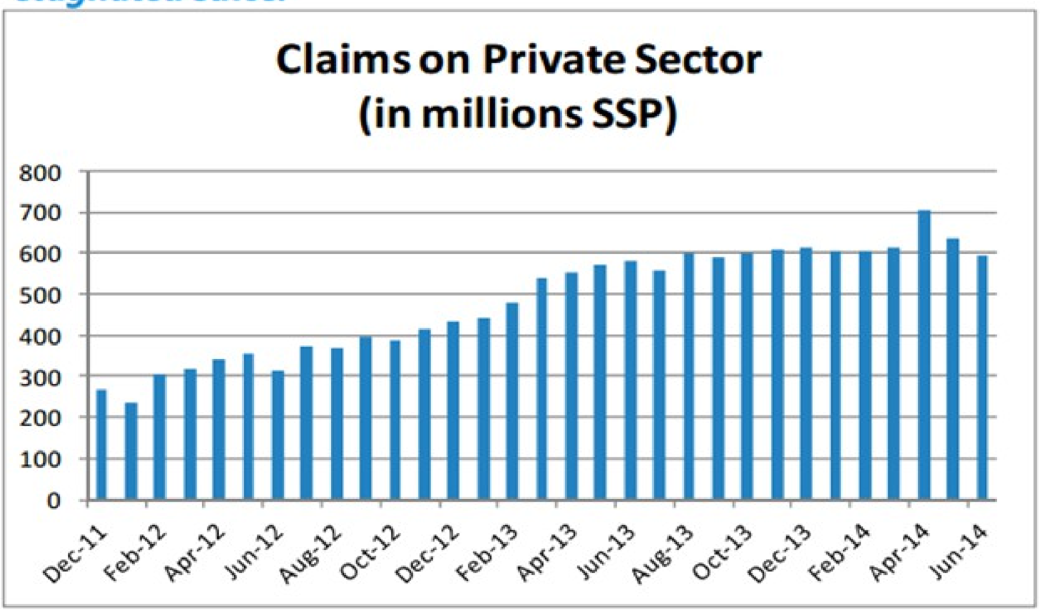
The Banking sector is shallow and growth has stagnated.



Bank assets and deposits grew at about 16 percent per year until 2014, but there has been less growth this year. At the same time, claims on the private sector expanded from a meagre base since 2011, but has stagnated this year (Figure 2.2).

Figure 2.2

Claims on the private sector grew until mid-2013 and has stagnated since.



IMF[42]

Banks remain highly liquid because of their reluctance to lend. The main sources of bank

[42] IMF- Country Report 2014; P. 33

revenue are trade financing, foreign exchange transactions, and interest from a limited stock of government securities, however South Sudan commercial banks don't contribute in the creation of the new currency,[43] on the one hand the South Sudan commercial banks did not give credits to the private sector and on the other hand they are engaged in foreign currency exchange, which brings more money than loan interest. More than 97% of all the money in the economies exists as bank deposits; banks create these deposits simply by making loans.[44]

Theoretically the demand of a currency is determined by the foreign demand for domestic products. For example, when the USA imports cars from Germany it must pay in euro (€), and to buy euro from the European Central Bank it must supply (sell) dollars ($). The more it imports the greater the supply of dollars into the foreign exchange market.

South Sudan runs its biggest trade with China, both have common interests (everyone owns goods which other trading partners need). However, South Sudan requires payment in dollars and China wants to free itself from foreign exchange reserves, mainly of US dollar; since the People Bank of China is afraid of rapidly growing U.S budget deficits which could lead to breakdown of the US economy. Such pressure on People Bank of China leads to the famous idea of the governor of the People's Bank of China, which stated for creation of a new international reserve currency to replace the dollar.[45]

The unchallenged status of the US dollar in South Sudan as the only international currency, which is used for oil trade since independence 2011, will remain for some time (as long as other players of international trade did not decide against US dollar). However, the trade with US dollar could fall slightly if the South Sudan government introduces the SSP as the oil trade currency. Thus, trading and pricing with local currency can have many advantages in a commercially area of east Africa. The choices of currency invoicing will have an impact on the way in which macroeconomic shocks are transmitted, with traders able to price and invoice in our own currency being less exposed to exchange rates shifts. However, the number of African currencies for which a real potential exist is limited because of the high number of pegging to other currencies, these countries impose restrictions on the use of

[43] Banks create money, in the form of bank deposits, by making new loans. When a bank makes a loan, for example to someone taking out a mortgage to buy a house, it does not typically do so by giving them thousands of pounds worth of banknotes. Instead, it credits their bank account with a bank deposit of the size of the mortgage. **At that moment, new money is created.**

[44] Positive Money

[45] Global Financial Contagion P.323

their currencies, for example by implementing tight foreign exchange controls.[46]

Money creation in southern Sudan should follow the modern economy system of lending creates deposits (broad money).[47] So that the South Sudan commercial banks can create money, in the form of bank deposits, by making new loans. For example of countries taking out a loan to buy South Sudan's oil, it would not be typically done by giving them thousands of SSP worth of banknotes; instead, they would credit their bank account with a bank deposit of the size of the loan. At that moment, South Sudan would create new money.

5. Objectives of the South Sudan Central Bank

While new functions were acquired as central banks evolved into public policy agencies,[48] the accompanying change in underlying objectives was rarely explicitly stated. Given the context, one could infer that the objective underlying all functions was for the economic interests of the nation, consistent with government economic policy. Indeed, that is the type of general statement found in each of the central banks and stated its objective.

Compared with the situation in which objectives straddle both commercial and public policy dimensions, such a statement substantially increases the clarity of the guidance provided to central bankers. A sense of purpose of the Central Bank of South Sudan has been identified. Its role is to discharge its functions in a manner consistent with the public interest, taking into account functions of other state agencies and coordinating with them if necessary. To the extent that the public interest could be served by adding functions not formally assigned, all to the good. But it shall not be the beginning of neglecting the responsibility of the financial sector; oversight of the payment system (beyond those parts that the central bank itself operated); and oversight of the operation of money, foreign exchange, debt and capital markets. From an observer perspective, such a general public interest objective is open to wide interpretation and offers little guidance as to what to do when functions, or views as to what is in the interest of the nation, conflict.

A trend towards specifying objectives, rather than only assigning functions, may have begun

[46] Knoop (2013), P 176

[47] Broad money is made up of bank deposits, which are essentially IOUs From commercial banks to the rest of the economic agents.

[48] Singleton (2011), P 2

to emerge, but South Sudan Central Bank functions are still not guided by legally stated objectives. The policy of South Sudan Central Bank shows that objectives related to monetary policy are far more frequent in the policy of reconstruction of the country.

5.1 Monetary Policy Objectives of CBoSS

The South Sudan Central Bank's focus and functions were set at the beginning of its foundation for response to the changing economic environment. In keeping with trends in central banking, the objectives of the Central Bank were streamlined by adopting the Bank of South Sudan Act in 2011. The monetary policy objective is set in Article 182 of the constitution of the Republic of South Sudan and in article 6 of the Bank of South Sudan Act to enable it to pursue its core objectives and to avoid the multiple objectives.

In particular, the South Sudan Central Bank is required to maintain price stability. Without prejudice to its primary objective, it shall support the general economic policies of the government leading to sustainable economic growth.

For monetary policy objectives, the increase in clarity has generally taken the form of a narrowing towards a single or dominant objective – most commonly, price stability – in clear priority over others. Monetary policy objectives of the South Sudan Central Bank extracted from the legislation and categorised by the focus of the objective and the level of the law in which the objectives statement is found. Extra-statutory statements of monetary policy objectives are also listed if they have a status sufficient to be recognised as the basis for the policy framework.

Price stability is the dominant monetary policy objective specified in legislation.[49] Price stability – or its equivalent, stability in the domestic purchasing power of the currency – appears as the dominant or one of the dominant legal objectives in the Bank of South Sudan Act. It is a superior objective to other macroeconomic objectives specified in the law (as is made clear; for example, in mandates such as those requiring central bank supports for the government's general economic policy without prejudice to the central banks' primary price stability objective).[50]

However the stability in the domestic purchasing power of the currency is very difficult for a

[49] Pinstrup-Andersen (2015), P 209

[50] Bank of South Sudan Act

country like South Sudan since most goods are from neighboring countries; a shortage in neighboring countries for example, can lead to catastrophic consequences in domestic market.

The stability policy of the exchange rate system of a currency cannot be operated because of pegging to the other currency; the best example of the risk of pegging to the other currency is the Bretton Woods System.[51]

And despite this fixed exchange rate stabilization policy had brought neither the currency nor the good to stability, it has led the whole system to the shortage of dollar, which had caused the parallel exchange market (black market). The shortage of foreign exchange and the resulted exchange rationing have driven virtually big part of private sector transactions to the parallel exchange market. The gap between the official rate and parallel market exchange rates reached a peak of almost 400 % in August 2015 and the consequence was the rise in prices of all imported Good.

In contrast, as banking system support is not legally specified as one of the prime objectives of monetary policies of the South Sudan Central Bank; the prime objectives tend to become more general. Since there is only one legally dominant (prime) objective and no lower targets (supreme), the dominant objective could be neglected, because it competes against itself.

However, among countries that do follow this broad pattern are China, SAR, Russia and South Africa; they all operate under a legally dominant objective. The South Sudan Central Bank objectives may be ranked as following.

[51] The Bretton Woods Agreement was developed at the United Nations Monetary and Financial Conference held in Bretton Woods as a landmark system for monetary and exchange rate management. It major outcomes included the formation of the International Monetary Fund and the International Bank for Reconstruction and Development and, **most importantly, the proposed introduction of an adjustable pegged foreign exchange rate system**. Currencies were pegged to gold and the IMF was given the authority to intervene when an imbalance of payments arose. Although gold initially served as the base reserve currency, the U.S dollar gained momentum as an international reserve currency that was linked to the price of gold. The system dissolved U.S. announced the "temporary" suspension of the dollar's convertibility into gold. While the dollar had struggled throughout most of the 1960s within the parity established at Bretton Woods, this crisis marked the breakdown of the system.

5.1.1 Exchange Rate/ Currency Regulator

The central bank is known as the bank of issue, it has the monopoly of note issue.[52] Notes issued by it circulate as legal tender money. The currency issue department is one of its departments which issues notes[53] to commercial banks. Central banks have been following different methods of note issue in different countries. The South Sudan central bank is required to keep a certain amount of dollar securities against the issue of notes. Minimum fixed amount of foreign currencies is required to be kept against note issue by the South Sudan central bank. The monopoly of issuing notes helps in facilitating exchange and it brings stability in the monetary system and creates confidence among the public. The central bank can restrict or expand the supply of cash according to the requirements of the economy; but the consequences of the restriction or expanding of cash are more significantly on the black market, another result is the inflation or deflation.

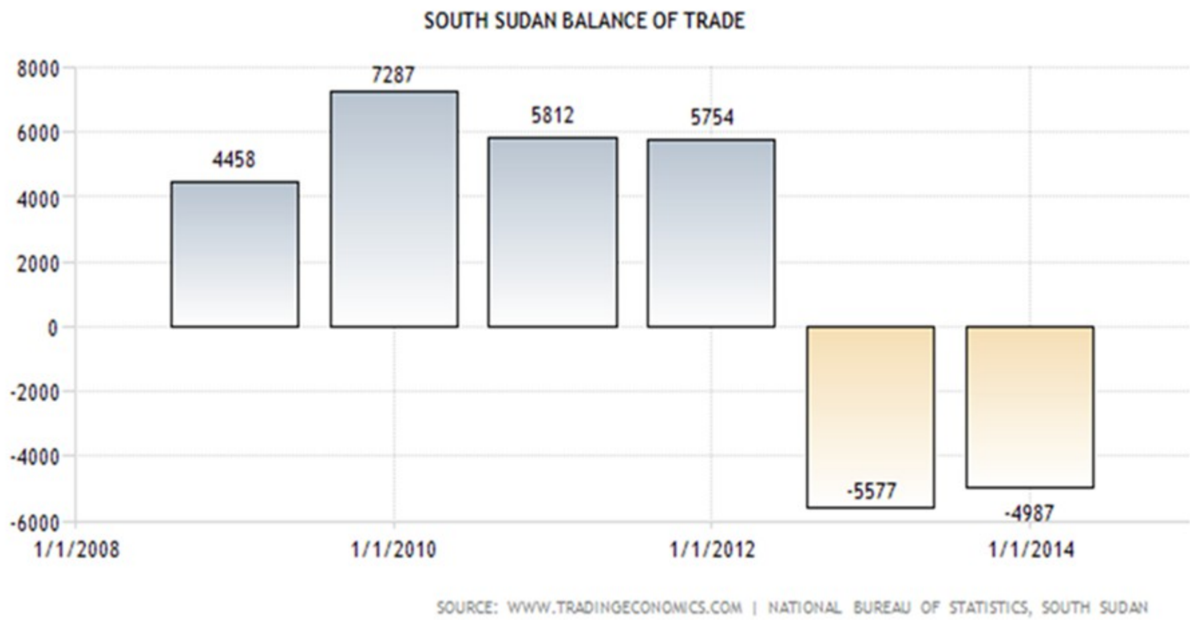
In order to maintain a fixed exchange rate the South Sudan Central Bank will always need to intervene in the private foreign exchange market (FOREX), by buying or selling domestic currency in exchange for the foreign reserve currency. The problems arise as the South Sudan currency reserves began to run out, as a result of the fall of oil prices. On the other hand, the deficit or surplus of the South Sudan Central Bank arises from the following circumstances.[54]

Unfortunately South Sudan runs a trade deficit, because its demand for imports exceeds foreign demand for their exports.[55] This implies that domestic demand for foreign currency (to buy imports) exceeds foreign demand for domestic currency (to buy our exports). Assuming no additional foreign demands for domestic currency on the financial account, in order to keep the exchange rate fixed, the central bank would need to intervene by selling foreign currency in exchange for domestic currency. This would lead to a reduction of

[52] Vaish (2009), P 120
[53] The coins will be issued in the form of 1, 5, 10, 25 and 50 piaster's
[54] When the central bank buys domestic currency and sells the foreign reserve currency in the private FOREX the transaction indicates a balance of payments deficit. Alternatively, when the central bank sells domestic currency and buys foreign currency in the FOREX the transaction indicates a balance of payments surplus.
[55] IBP (2013), P 12

foreign reserves and hence a balance of payments deficit. In the absence of transactions on the financial account, to have a trade deficit and a fixed exchange rate implies a balance of payments deficit as well; as it shown in Figure 3.

Figure 3



More generally, a balance of payments surplus (deficit) arises whenever there is excess demand or supply of foreign currency on the private FOREX at the official fixed exchange rate. To satisfy the excess demand (supply) the central bank will typically automatically intervene on the FOREX and sell or buy foreign reserves. Thus, by tracking sales or buy of foreign reserves in the official reserve account we can determine if the country has a balance of payments deficit or surplus.

Because the rationale justifying a currency peg differs from case to case, the benefits and shortcomings of pegged currencies will be different in different scenarios.[56] But the obvious features that are present in the South Sudan Central Bank case: Such as loss of independence by the pegging, and the stability and credibility granted to the currency by the adoption of the new regime.

[56] Forexfraud

The advantages of the peg lie in its predictability and clarity as well. On the other hand its disadvantage is the lack of flexibility in adapting to economic.

5.1.2 Reserve Requirements

Reserve requirements have played a part in the South Sudan financial system from the earliest days; long before the creation of a national currency or a central bank.

The first commercial bank in Southern Sudan was not required to keep reserves either against deposits, which were little used at the time, or against their own, more ubiquitous, banknotes. In the absence of a national currency, Sudan's currency was commonly used as a medium of exchange, since South Sudan was still a part of Sudan.

The first governor of the South Sudan Central Bank “Elijah Malok Aleng”[57] introduced the South Sudan first controversial currency, the so called New Sudan Pound; even though South Sudan was still part of Sudan; though high transaction costs of redeeming the notes and limited information about the underlying solvency of the issuer generally confined the use of any individual bank’s notes to a small geographic area “Lakes State[58]”.[59]

Under current regulations all commercial banks are required to maintain reserves against transaction deposits, which include demand deposits, negotiable order of withdrawal accounts, and other highly liquid funds.[60] Reserves against these deposits can be taken in South Sudan currency (SSP) and balances at the South Sudan Central Bank. The Central Bank required reserve may vary the percentage of transaction deposits that must be kept in reserve. The commercial bank may take any corrective action authorized by the Bank of South Sudan Act 2011, if it fails to fulfil its required reserves.

[57] He was a Deputy Governor of the Central Bank of Sudan (CBOS) in 2005 and President of the Bank of Southern Sudan (BOSS)

[58] Is one of the ten states of South Sudan and the only state that was entirely liberated during Liberation War

[59] According to the statements by the General Daniel Awet Akot, the deputy Speaker of the National Legislative Assembly of South Sudan.

[60] BoSShq

5.1.3 Lender of Last Resort

As one of the highest institution of the country and the bankers' bank, the South Sudan Central Bank acts as the lender of the last resort.[61] In other words, in case the commercial banks are not able to meet their financial requirements from other sources, they can, as a last resort, approach the central bank for financial accommodation. According to the South Sudan Central Bank Act, the bank provides financial accommodation to the commercial banks by rediscounting their eligible securities and exchange bills.

The m advantages of the central bank's functioning as the lender of the last resort are as follow. The consideration of a central bank as the lender of last resort increases the elasticity and liquidity of the whole credit structure of the economy; and it enables the commercial banks to carry on their activities even with their limited cash reserves. Und provides financial assistance to the commercial banks in times of emergency. Providing the commercial banks with financial assistance enables the central bank to exercise its control over the banking system of the country.

5.1.4 Controller of Credit

One of the most important functions of the South Sudan Central Bank is to control the credit creation power of commercial banks in order to control whole economy. The South Sudan Central Bank adopts quantitative methods and qualitative methods for this purpose. Quantitative methods aim at controlling the quantity of credit; and the qualitative methods control the use and direction of credit.

Besides the above noted functions, the central bank in South Sudan has been entrusted with the responsibility of developing a strong banking system to meet the expanding requirements of agriculture, industry, trade and commerce.

Accordingly, the South Sudan Central Bank possesses some additional powers of supervision and control over the commercial banks. It is the issuing of licences; the regulation of branch expansion; to see that every bank maintains the minimum paid up

[61] CBoSS Acts 2011 § 71

capital and reserves as provided by law; controlling (inspecting/ auditing) the accounts of banks; to approve the appointment of chairmen and directors of such banks in accordance with the rules and qualifications; to publish periodical reports relating to different aspects of monetary and economic policies for the benefit of banks and the public; and to engage in research and train banking personnel.

5.2 Financial Stability Objectives of CBoSS

The focus of the CBoSS since 2011 is to enhance the safety and soundness of the financial system through appropriate banking reforms and achieve improved access to financing institutional capacity building, and entrenchment of good corporate governance practices, thereby stimulating economic development.

One of the core functions of the CBoSS, as provided for in section 6 of the CBoSS Act of 2011, is promoting financial stability. The importance of this function became more apparent during the recent decrease of oil prices and its effect on South Sudan's economy. The global crisis affected the South Sudan economy in two significant ways: The exit of portfolio investors from the South Sudan market; and a significant reduction in government revenues.

The impact was compounded by a sharp decline in capital inflows, which put considerable pressure on foreign reserves. The resultant liquidity shock necessitated the intervention of the CBoSS to restore financial stability

Since independence 2011 the CBoSS encouragement programme significantly transformed the South Sudan banking system. The number of commercial banks increased from about 6 to 26. The commercial banks exercise led to considerable growth in capital as well as to the expansion in internal and external operations. Banks embarked on an aggressive expansion of their branch networks in all southern Sudan. Credit expansion has yet not been established. Consequently, banks are not under pressure to report high returns on their expanded activities.

Regulatory concerns about poor corporate governance practices, and distress borrowing from the inter-bank market by some banks, a special examination of the banking system should be created by the CBoSS.

Another consideration is the decline of oil prices, which heighten the awareness of financial stability and the need for a macro prudential dimension to financial surveillance and regulation in South Sudan. The observer analyzes notice that macroeconomic policies did not take into account building systemic risks" and that "a key failure during the high oil prices was the inability to spot the big picture threat of a growing oil price. It is widely believed the CBoSS underestimated the buildup of financial imbalances coming from shutting down of oil production up to high oil prices.[62] The CBoSS appears to have assumed that, even if the oil prices collapsed the impacts on the financial system and the economy could be mitigated by other revenue or complementary measures. Some observers pointed out a fallacy of aggregation, that is, the fact that "mis-educated" supervisors and examiners were focused on individual institutions, without regard to how the system can create new revenue.

It is difficult to find a generally agreed definition of financial stability, because financial systems are complex with multiple dimensions, institutions, products, and markets. Indeed, it is perhaps easier to describe financial instability in South Sudan than stability.

The aim of macro prudential supervision and regulation is to reduce systemic risk and preserve systemic financial stability by identifying vulnerabilities in financial systems [63] and implementing policy actions to address those vulnerabilities in a timely manner to prevent a crisis.

The South Sudan Central Bank is well qualified to play a key role in monitoring and regulating financial stability from the point of view of its surveillance capacity and the policy tools at its disposal. This reflects it's monitoring the macroeconomic developments and financial system conditions and its responsibility for overseeing payments and settlement systems (Section 6.3).

As described in more detail in Section 8.1, CBoSS have a policy tool that can affect financial stability, for example exchange rate management. This tool can be used both to prevent crises and to mitigate crises when they occur.

[62] It was one of CBoSS tasks to consult the government about the consequences of shutting down the oil production as well as market prospects in terms of price formation

[63] Ferran, i.a (2005), P 367

5.3 Payment System Objectives of CBoSS

South Sudanese various forms of money required more or less complex arrangements to enable them to be used to make payments. The most common forms of money used to make payments in South Sudan as well as abroad are banknotes and commercial bank deposit money. Many of the businessmen and households even the government officials in South Sudan prefer the banknotes, which always set banks under stress. Banknotes are bearer instruments and thus the payments process is simple - the notes are simply transferred from payer to payee.

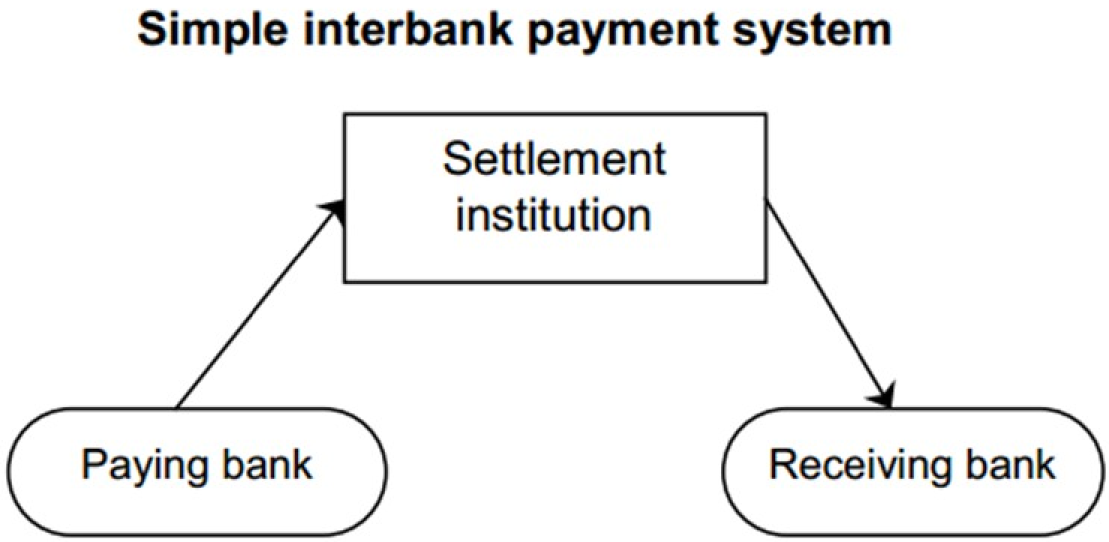
However, where commercial bank deposit money is used, transfers generally take place within organised payment systems in which central and commercial bank money[64] often complements each other in more complex chains of payments. Although the payment system can be used broadly to refer to the entire web of payments within an economic system in the country as well as abroad, it is often applied in a more limited sense to refer to an interbank payment system, incorporating a particular set of payment instruments, technical standards for the transmission of payment messages and an agreed means of settling claims among system members, including the use of a nominated settlement institution.

The interbank payment system has one intermediary, generally (although not always) the central bank, which acts as the settlement institution.[65] The paying and receiving banks are both direct participants in the interbank payment system and hold accounts at the settlement institution, and settlement is affected by a debit from the account of the paying bank and a credit to the account of the receiving bank. The payment may either be financed with credit provided by the settlement institution, or with funds already on the account of the paying bank. The receiving bank may leave the funds it receives on account at the settlement institution or it may decide to pay them away. Figure 4 illustrates interbank payment system.

[64] The role of commercial bank money is very poor in South Sudan, due to the low credit system

[65] Benink (1995), P 137

Figure 4



Settlement takes place in the settlement institution's liabilities "known as Central Bank in South Sudan", and both paying and receiving banks need accounts with that institution respectively CBoSS.

6. Functions of South Sudan Central Bank

The obtaining of political independence[66] in South Sudan in 2011 provided a strong impetus in favour of the establishment of the Central Bank as the National Monetary authority, which would use a variety of monetary controls in order to ensure efficiency of operations of the monetary system. The legislation that established the Bank of South Sudan Act received presidential assent, when the first South Sudan currency (SSP) went into circulation.

[66] South Sudan depends largely on imports of goods, services, and capital. Oil is exported through two pipelines that run to refineries and shipping facilities at Port Sudan on the Red Sea. The economy of South Sudan remains linked to the neighbouring countries.

6.1 Monetary Stability

Monetary stability and economic stability are considered as two sides of the monetary system. Times of protracted economic instability tend also to be periods of monetary instability, and vice-versa. Although the one of the main objectives of South Sudan Central Bank is monetary stability, in particular in the form of sustainable prices, South Sudan policy makers attach great importance to monetary stability, insofar as it is instrumental to achieving economic stability.

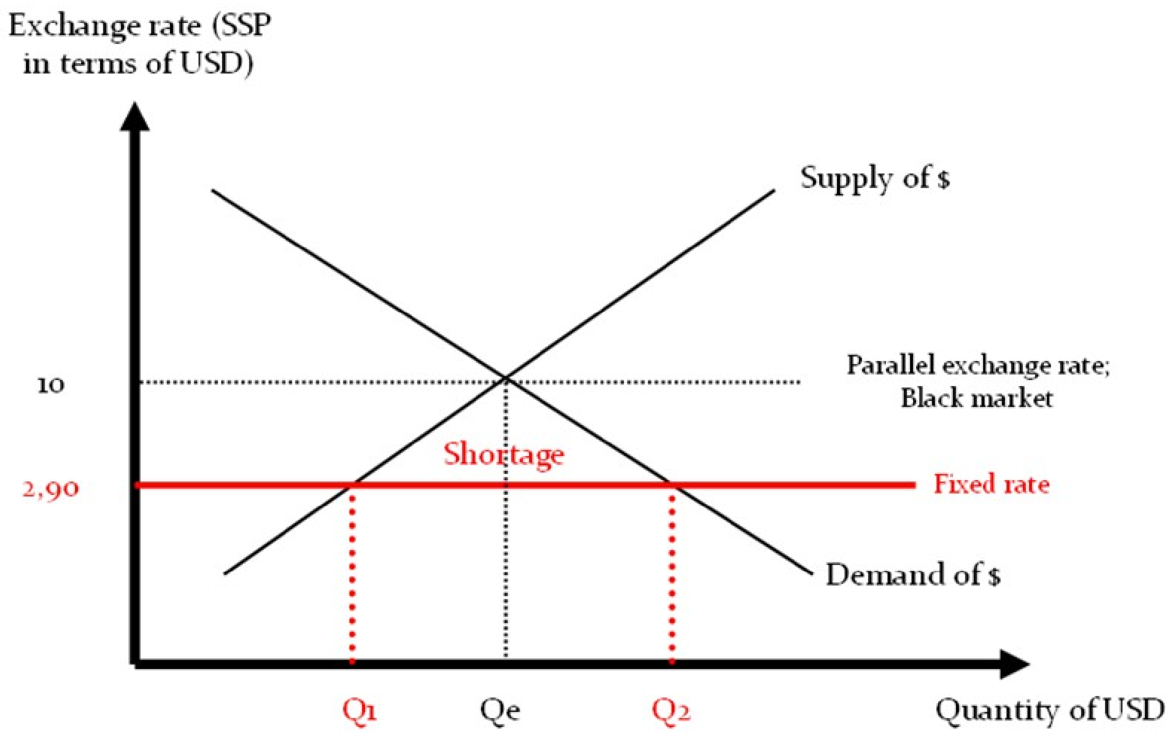
South Sudan monetary stability policies can be defined in terms of the stability of the value of money, which can be measured in terms of its domestic purchasing power. But the SSP domestic purchasing power can not be used as the absolute measurement of monetary stability; because a lot of businessmen purchase the US dollar on the black market and that makes the imported goods more expensive.

It is now widely agreed among academics as well as policy makers that monetary stability is an important condition for sustainable growth. Another condition for sustainable growth is that economic agents are confident of the continuance of monetary stability. This requires that the purchasing power of currency will be maintained and that money continues to perform its main functions through time.

Besides, South Sudan monetary policy is consistent with a fixed exchange rate system.[67] With full capital control, this implies different monetary conditions and a credible commitment to maintain the fixed exchange rates. Figure 5 is showing the possible effects of a fixed rate is shown below. The market equilibrium wage for this particular exchange rate is at Qe (where demand = supply). If the fixed rate is set at 2,90 SSP, there will be an excess demand of USD equal to Q1 – Q2 because the demand of USD will expand (more people/ businessmen will be willing and able to purchase more USD), but the existing risk is that the demand for USD from the Central Bank will contract because the fixed rate is below equilibrium price.

[67] IBP (2013), P 77

Figure 5



In Figure 4 the official exchange rate has been fixed at a level of SSP 2, 90 = USD 1 which is under the market rate of SSP 10≈USD 1. For the exchange rate to be fixed at a level lower than the market rate requires official intervention by the South Sudan Central Bank or parallel exchange rate, the so-called black market. At this level the CBoSS would have to sale the USD equivalent to Q1Q2. To buy the surplus of SSP the government would need to sell its reserves of foreign currency.

South Sudan monetary policy is not highly integrated in the region and not subject to major asymmetric shocks likely to affect relative prices. There is no alternative adjustment mechanism able to replace the exchange rate. An overall framework is required that will ensure the political acceptability of monetary policies and of the adjustment mechanism in the region.[68]

The first step in the South Sudan monetary policy is made through the irrevocable fixity of exchange rates and the creation of the South Sudan Central Bank, which is in charge of the monetary policy system. The condition of fixed exchange rates will be hard to satisfy in view of the difficulty of managing a fixed but adjustable exchange rate system with a restrict capital mobility and autonomous monetary policies. The history has shown that even the currencies of countries with strong economic fundamentals can be subject to speculative attacks. Under these circumstances, the defence of exchange rate stability

[68] Majority of South Sudanese government officials sent their children for school in Uganda. These government officials needs monetary policies and of the adjustment mechanism in the region for their support.

means that monetary policy of CBoSS has to become more restrictive in terms of monetary stability.

It should be noted that the economy of South Sudan is relatively heterogeneous, so that real shocks can not affect the demand or supply of certain types of goods; since South Sudan a landlocked country with very poor infrastructure, all goods transportation get through southern border, which led to differences of prices between the goods. Asymmetric shocks tend to be caused more by different national macroeconomic policies. However, such differences are likely since there is major difference between goods. The existence of a single monetary policy will also limit the scope for differentiated developments in wages and costs, but the price differences between goods can be a disadvantage to other consumers. This does not exclude the possibility of real shocks, as they should be done at the regional level, but they are likely to be less important, as long as wages are still identical in South Sudan.

6.2 Financial Stability and Regulatory Functions of CBoSS

The financial crisis has added impetus to policies to strengthen financial stability in most developing countries as well as in African countries.[69] Thanks to their strong governance and credibility, central banks have often been tasked with this work: how should the South Sudan Central Bank fulfil this role? The South Sudan Central Bank is still at an early stage of integrating micro-prudential and macro-prudential regulation with monetary policy. Coordinating these new financial stability activities raises some institutional challenges. This section summarises recent work on this important question. One issue is the differences between the analytical frameworks for traditional central bank activities (such as monetary policy or payments systems) and those needed for financial stability work. Such differences are further accentuated by the different types of talent that these two fields attract. However, it will be imperative to harmonise these cultures and build an interface between macroeconomics and financial stability experts: a more efficient exchange of information before the financial crisis could have allowed the growing financial strains to be identified much earlier.

Many central banks have started to create financial stability committees that involve all

[69] Prasad Eswar i.a (2003), P 1985ff

major stakeholders.[70] These committees seem to be useful for avoiding the problem of asymmetry information and in assessing the decentralised information necessary for financial stability work. In addition, most participants found the participation of the finance ministry to be key of financial stability-related committees, given the potential fiscal costs of any resolution mechanism. Several issues can not be raised by involvement of finance ministry. Some subscribers warned that the involvement of politicians in financial stability work can give rise to "inactivity bias": politicians might fail to get agreement on pre-emptive measures to be taken before a crisis but they could in principle respond forcefully to an actual crisis. Countercyclical policies might be run better by central banks. As the lesson from financial crisis, the central banks should to take a more prominent role before the crisis.

Several central banks have also started to issue financial stability reports.[71] Organising this work and acquiring the necessary human capital and confidential data, while embedding these activities within the central bank structure, took some time and effort for most African central banks as well as SSoCB.

Financial stability goals are harder to define and performance against them is more difficult to track. The increased responsibilities of central banks are not without risks._The improvement and credibility with the public reflects the additional financial stability remit of central banks, and can improve their monetary policy.

6.3 Policy Operations

The monetary operations of CBoSS are decisive to the achievement of both monetary policy and financial stability goals. Monetary policy operations require the CBoSS to lend money to private financial institutions to satisfy a system-wide shortage of liquidity. From such lending the CBoSS ensures that the supply of central bank money to the financial system is in line with the requirements put in place by the central bank choice of operational framework.

According to accounting regulations, central banks are set up in a similar fashion to other

[70] House of Commons i.a (2012) P 29 ff
[71] Cihák (2006), P 21

commercial banks.[72] Thus they are exposed to the potential losses through the standard risk channels. Therefore, every time the commercial banks got money from central bank it exposed to potential losses if the commercial banks are unable to repay the loan. Just like commercial banks, CBoSS can absorb losses through its capital buffers; unlike commercial banks, who raise capital through retained earnings or the issuance of fresh securities, the South Sudan Central Bank capital levels is tied to wider fiscal choices of the government. If commercial banks undergo such losses, they can damage the reputation of the central bank and lead to questions regarding its operational independence should the government be forced to recapitalize it.

To understand the policy operation of CBoSS or why a central bank will regularly intervene in transactions whereby its provide reserves to commercial banks; it is important to explain the role of such reserves in the policy operation. The most important place to start would be with the CBoSS balance sheet, but unfortunately CBoSS has no available balance sheet online. However, nearly the CBoSS balance sheets can be generalised to the form presented in Table 2.

Table 2

Stylised central bank balance sheet

Assets	Liabilities
Foreign assets (net)	Notes (and sometime coins)
Lending to government (net)	Required bank reserves
Market lending (net)	Free bank reserves[(a)]
Other items (net)	Capital

(a) Free bank reserves are defined as reserves held by commercial banks at the central bank that are held in excess of those required to satisfy contractual reserves. They may be held voluntarily as insurance against unforeseen payment shocks or involuntarily.

The main liabilities of the South Sudan Central Bank including (notes, required bank reserves and free bank reserves) are known as the monetary base. The monetary base, and especially bank reserves, both, free and required, are the ultimate means of settlement for

[72] Sundararajan, i.a (1997), P 140

transactions in an economy. South Sudan Commercial Banks settle transactions between themselves rarely but on behalf of customers across the books of the central bank in the form of reserves. These constellations of transactional role of the central bank feeds broader intermediation between the commercial banks and the wider economy encouraging commercial banks to play their traditional role of maturity transformation to assist growth in retail and commercial deposits.

CBoSS started to exploit its monopoly control over the supply of the monetary base, setting the terms on which its permit access to it, to achieve its policy goals. CBoSS monetary policy goal is to achieve price stability and thereby encourage economic growth; as described in Section 3. But these targets tend to be outside of CBoSS direct control and there is a lag between CBoSS action and its impact on the ultimate goal._Therefore central banks often have in addition an operational target. Operational targets of CBoSS are an economic variable which can directly control and a crucial determinant of the ultimate goal. In recent times there has been a consensus among CBoSS that short-term exchange rate is the optimal operational target. Generally central banks influence market interest rates by adjusting the terms on which they are willing to supply or absorb reserves from the market; but it does not work in the same way in South Sudan, since the country has to import a lot of its needs; this increases the demand for dollars. CBoSS aims to make the optimal quantity of reserves available to commercial banks so that it can fulfil reserve requirements, make interbank payments and draw down on such reserve balances to meet economic agents' demand for banknotes. Basically, if the central bank provides too little or too much reserves to the market and there are penalties for deficiencies and excesses then it is likely that the market interest rate will deviate away from the desired target; the results of such actions are only reflected in the black market. The financial stability goals of CBoSS are usually less tightly defined than monetary policy goals; however, CBoSS has an incentive to reduce the possibility of economy-wide problems stemming from the banking sector. As known in all monetary systems, commercial banks play a vital role in an economy by providing maturity transformation, turning short-term deposits into long-term lending; but the role of South Sudan Commercial Banks are too low, because they are concerned with exchange rate; this makes the liquidity shocks ineffective .

6.4 Provision of Infrastructure for the Financial System

There are growing ambitions in eastern Africa and both Sudan countries (South Sudan, Sudan) the post war 2005 development agenda, in the context of attractiveness of unity development targets, at the time of increasing pressure on South Sudan official development assistance given prevailing economic unwillingness in Sudan. At the same time[73], there were interests for South Sudan to move away from economic dependence, feeling the need for market-based solutions to meet increasing financing requirements. Given the importance to financial system infrastructure could contribute to the development of the whole region (South Sudan), and it could be a key for peace, security and rebuilding of infrastructure in southern Sudan. As it has been empirically proven that projects which help build efficient and reliable financial infrastructure can enhance investment climate.

The financial sector in South Sudan is in the first stage of development, over-populated by financial investments, and largely cash-based.[74] By 2013 there were 26 commercial banks, 79 exchange bureaus, 12 multilateral financial institutions and 10 insurance companies in South Sudan. Big parts of private financial institutions are owned by foreigners. Adherence to the Basel core principles is limited and the quality of risk management in financial institutions is very weak. Moreover, with regard to banks supervision, the CBoSS capacity to oversee the existing banks is very weak, implying that the sustainability of the financial system is ascertained with confidence. The central bank has to take the following measures to improve the situation: to enforce the implementation of the authorization procedures available and their ability to undertake on-site and off-site supervision in order to improve compliance to strengthen.

[73] The time, in which conflict between Sudan and South Sudan ended with the six years Comprehensive Peace Agreement, followed by a referendum on independence.

[74] House of Commons, P 26 ff

6.5 Services of the Government

The relation between the CBoSS and the South Sudan Government has been defined in central bank laws passed since the establishment of CBoSS in 2011.
An important aspect of policy coordination between the South Sudan government and CBoSS concerns the management of oil and other resource revenues; since the oil revenues constitute more than 98% of the budget of South Sudan's government.[75]
The coordination between CBoSS and the government may need to be quite close. For example, this would be the case for fiscal agent functions of the central bank. In addition, the CBoSS advisory responsibilities allow it to foster the development of the sector, which will require close coordination with the government, for example on legal reform.

7. Summary and Conclusion

Central banks are the most important actors of economic process; ensuring financial stability belongs to one of their important roles. As higher monetary authorities, central banks have objectives the implementation of the monetary policies, prudential supervision and supervision of commercial banks. The following functions can contribute to ensure and maintain financial stability: banking regulation and supervision; management and oversight of payment systems; the function of lender of the last resort; guarantee of bank deposits. In fact, the central bank involvement can not avoid the losses. It means that the central bank’s function as the lender of the last resort appeared as a mean of guarantees the system’s liquidity and solvability; and so the question of the need for the central bank arises. Since the United States and England had founded their central banks too late.

The Central banks are responsible for providing the economy with funds when commercial banks cannot cover a supply shortage, they are described as the lender of last resort and they prevent the country's banking system from failing. However, the first objective of central banks is to provide their currencies with price stability by controlling inflation, fostering a stable environment for the development of entrepreneurial activity, responsibility for sustainable economic growth. Central banks have the regulatory authority

[75] IBP (2013), P 27

of a country's monetary policy, and are the sole provider and printer of notes and coins in circulation. Central banks in democratic system prove their best function by remaining independent from government fiscal policy and therefore uninfluenced by the political concerns of any regime, and they have a unique function of monopoly of note issue. The advantages of giving the monopoly right of note issue to the central banks are as follow: It brings uniformity in the monetary system; exercising better control over the money supply in the country and it increases public confidence in the monetary system; monetary system management of currency becomes easier. Central banks can change the quantity of currency because they have full information; they can exercise control over the creation of credit by the commercial banks. Central banks keep their position as a banker to government; they perform same functions for the government as a commercial bank performs for its customers. Moreover, the central banks receive deposits from government, they provide foreign exchange resources to the governments for repaying external debt or purchasing foreign goods or making other payments. They also represent the governments in the international financial institutions and conferences and give advice to the government.

Under the 2005 accord, South Sudan received 50% of the former united Sudan's oil revenue, which provides the vast bulk of the country's budget. The Central Bank of Sudan continued to operate under an islamic financial system and the South established a conventional banking system.

South Sudan faces difficult challenges after independence in 2011 in the conduct of its monetary policy following the suspension of oil production in January 2012 and the outbreak of a conflict on December 15, 2013 combined with a further reduction of oil prices on international markets. The current situation for the banking sector is quite limited with minimum coverage for banks and a weak regulatory framework and limited management capacity and expertise. The provision of loan, finance, and savings transactions are limited, which led to cash-based economy. The banks remain highly liquid because of their reluctance to lend.

Objectives of CBoSS are to discharge its functions in a manner consistent with the public interest, taking into account functions of other state agencies and coordinating with them if necessary; and the financial sector shall not be neglecting as well. In particular, the objective of the South Sudan Central Bank is required to maintain price stability as a dominant objective; it supports the general economic policies of the government leading to sustainable economic growth. However the stability in the domestic purchasing power of the currency is very difficult for South Sudan since most goods are imported from neighboring countries; a shortage in neighboring countries can lead to shortages in domestic market. And the stability policy of the exchange rate system of a currency cannot be operated because of pegging to US Dollar. In contrast, as banking system support is not legally specified as one of the prime objectives of monetary policies of the South Sudan Central Bank. The major advantages of the central bank's functioning as the lender of the last resort are as follow. The consideration of a central bank as the lender of last resort increases the elasticity and liquidity of the whole credit structure of the economy; and it enables the commercial banks to carry on their activities even with their limited cash reserves and provides financial assistance to the commercial banks in times of emergency. Providing the commercial banks with financial assistance enables the central bank to exercise its control over the banking system of the country. With regard to function of South Sudan central bank is required to maintain monetary stability; financial stability and regulatory functions; policy operation; provision of infrastructure for the financial system and the services to government, CBoSS shall support the general economic policies of the government leading to sustainable economic growth.

According to my observation, as well as many more experts, the monetary policy in South Sudan is not yet well developed; underdevelopment of the monetary policy system came about as a result of the following challenges: First the challenge within the central bank as well as the level of development of the financial sector. Another challenge is the lack of expertise, since South Sudan is a young nation and all the experts of the country have not come into contact with monetary policy before. But, the expertise of the central bank employees shall not be only reached through experience however through exchange and trainee program with other central banks. The full currency substitution could be regarded as a temporary solution until the elimination of know-how issue. Thus, political corruption has become a weak point for the world's youngest state, since the structure of public administration has been strongly influenced by political elite.

The foreign exchange rate rationing is the most available effective monetary instrument of

CBoSS, while insufficient infrastructure and a clear direction from CBoSS authorities, the financial sector in South Sudan is severely lacking and what exists is highly fragmented. Unfortunately the lack of directive operations of the central bank led to greatest challenges and the acceleration of underdevelopment of a full suite of thebanking system. The reason of the deficit of electronic payments and banking guidance has been the shortage of expertise.

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9. Affidavit

I hereby confirm that my thesis entitled Functions and Objectives of the Monetary Policy of the South Sudan Central Bank (CBoSS) is the result of my own work, I did not receive any help or support from commercial consultants. All sources and/ or materials applied are listed and specified in the thesis.

Furthermore, I confirm that this thesis has not yet been submitted as past of another examination process neither in identical nor in similar form.

Place, Date

Signature