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BankofSouth Sudan's Governance,Nature, Growth, and Impact ofBankingSector on the Economy

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Abstract: *This article studies Bank of South Sudan's governance structure, and its conformity to principles of independence, transparency, and accountability. It evaluates nature and growth of banking sector in South Sudan and impacts on the economy. This paper adopts a case study, evidentiary documentary evidence as corroborated by personal eye-witness accounts of the author, and uses cross-comparative analyses with Kenya and Uganda as baselines. This study finds that Bank of South Sudan's governance structure does not conform to required best governance practices of a central bank. The banking sector is extremely under-capitalized; the loan-deposit ratio is only about 15%, while only 3% South Sudanese access financial services as at the end of December 2013. The governance structure and banking sector contributed to the deterioration of South Sudan's macroeconomic fundamentals.*

This paper recommends that far-reaching reforms are required to enable Bank of South Sudan's governance structure conforms to the best practices. This requires a review of the Bank of South Sudan Act, 2011 and Banking Act, 2012. There is a need to recapitalize commercial banks to meet the international capitalization standards. Policies to enhance financial access should be instituted. War should be stopped. This will give room for efforts to stabilize South Sudan's macroeconomic fundamentals. A peer-to-peer review mechanism within the East African Countries' central banks can help speed-up regulatory convergence and practices to minimize possible banking sector exposures.

Keywords: *Independence, transparency, accountability, banking sector,central bank's governance and South Sudan*

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I. Introduction

South Sudan got its independence in July 2011. The two-decade war eroded all economic, political and social institutions. The government of South Sudan after independence began to establish its institutions and regulatory policies from scratch. South Sudan faced immense challenges, including making tough decisions at times: risky decisions. In 2012, South Sudan voluntarily shut-down oil production, a source of South Sudan over 90% of its revenues and in December 2013, a power struggle within the ruling party Sudan People's Liberation Movement (SPLM), became a full-blown civil war that continues to date.

At the center of an economy is a central bank, an institution charged with the responsibility to ensure macroeconomic stability and growth. Acentral bank plays a crucial role in explaining growth and development of a country. The nature of an institution can be inclusive or extractive (Acemoglu and Robinson 2013). An inclusive institution serves the interest of the majority while an extractive one serves the interests of few and their associates. Nature and governance architecture of a central bank plays an important role if a central bank is to achieve its objective(Pollard 1996). To create a central bank that serves the interest of the public for prosperity. Economists advocate for the creation of a central bank that is independence, transparent and accountable (Morris and Lybek 2004). South Sudan as a country got its independence in July 2011 and is the newest nation, there is a need to study whether South Sudan has established a central bank that respects these principles.

This article studies Bank of South Sudan's governance structure, and its conformity to principles of independence, accountability, and transparency; it proceeds to evaluate how the Bank of South Sudan's governance structure impacts the nature and growth of the banking sector; and finally, assesses the impact of the governance structure of the Bank of South Sudan, nature and growth of the banking sectoron the economy.As a young nation, South Sudan financial institutions are young and fragile. Such astudygoes a long way to identify

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institutional and policy gaps that should be filled to spur growth;suggests corrective policy actions; provides useful lessons for policy-makers; and,helps economic agents in forwarding-looking economic decisions.

This study adopts a case-study approach, evidentiary documentary evidence as corroborated by personal eye-witness accounts of the author; and uses cross-comparative analyseswith Kenya and Uganda as baselines for this study. Uganda and Kenya are chosen because they are interconnected to South Sudan through trade and financial services. Due to lack of data and deterioration of South Sudan's currency after 2013, the analysis is doneup-to 2013 for easy comparison. The remaining part of this paper is structured as follows: Part II provides brief literature review on Central Bank's governance architecture; Part III analyzes South Sudan's banking sector's governancestructure; Part IV looks at the nature and growth of banking sector in South Sudan; Part V provides evidence of an extractive behavior in South Sudan banking sector; Part VI looks at impacts of an extractive banking sector on South Sudan's economy while Part VII concludes.

II. Brief Literature Review on Central Bank's Governance Architecture

Central Bank's governance structure is based on three governance pillars: independence, accountability, and transparency(Amtenbrink 2004). Due to complexities and importance of a central bank role, there is a growing consensus that a central bank should be independent to run its affairs with little influence from the executive and other agencies of the government.

There are many justifications provided for an independent central bank. First, political interference forces a central bank not to prioritize its primary policy objectives. Second, fiscal policy dominance steers away central bank from its targets(Neil and Wallace 1981).Third, when an institution is not well regulated, it can be captured by interest groups to pursue a predatory interest (Stigler 1971), and fourthly, an independent central bank insulates monetary policy from improper manipulation or pursuit of a short-term benefit of elected political leaders. For these reasons, amongst others, provide justifications why both in theory and practice, many calls for a central bank governance structure underpinned by the above principles. This section, attempt to demonstrate whether Bank of South Sudan governance structure conforms to these principles.

Those opposed to central bank structured in accordance with these principles provide many counter-arguments. First, they argue that an independent central bank places the monetary policy in the hands of the few un-elected officials of a central bank. Second, that it is difficult to separate fiscal and monetary policies. Third, a central bank's independence causes the unbalanced working relationshipbetween fiscal and monetary policy; andfinally, it might cause institutional rigidities(Taylor 2002).

Despite these divergent views, prioritizing competing objectives of a central bank is very critical given that any wrong decision, might impact across regimes or generations. As much as there is an inherent weakness in an independent central bank, lack of it is not a substitute. Balancing independence and coordination between fiscal and monetary policy is more appropriate for a successful economic management.

Central bank independence takes varied forms. An independent central bank sets its policy goal. For instance, targeted inflation. It selects financial instruments to pursue its targeted monetary policy objective. Designs its operational processes; and, finally, have autonomy on its finances or operations (Central Bank of Nigeria 2012) with little influence from other agencies of the government. In the last 30 years, countries which adopted an independent central bank policy delivered macroeconomic stability and to some extent, out-performed non-independent central banks by achieving low inflation rate(Lastra 2010; Abor et al. 2010).

Transparency refers to openness in an environment in which central bank's objectives operate. Policy decisions, rationale, data and information that relate to amonetary policy and operational processes should be made available to the public in a comprehensive, accessible and timely manner. Transparency enables the public to understand, evaluate and pass judgment on a central bank's performance. Policy-makers operating in the light of a day cannot do some of the things they can do in the dark of secrecy (Fischer, 2001).

Accountability ensures that transparent oversight mechanismsarecreated to account for monetary policy formulation and its implementation. In Europe, the Maastricht Treaty made a central bank's independence a prerequisite to joining the European Monetary Union. Current integration process in the East Africa Community (EAC) should be cognizant of this fact and efforts should be made for governance and regulatory governance for the banking sector's regulation in the EAC(Adam, Data, and Haas 2016).

III. Bank of South Sudan: Governance's Experiences[2]

In practice and theory, most central bank's governance should conform to these three pillars of governance: independence, accountability, and transparency(CBN 2012). Whether or not South Sudan is an exception to this best practice is a theme of this section. Like many other central banks, the highest decision-making body of the Bank of South Sudan (BSS) is the board(South Sudan 2011). However, in South Sudan and

[2]Evidence from this section is obtained from review of central banks' acts in Kenya, South Sudan and Uganda (Kenya 2015; South Sudan 2011; Uganda 2000).

Uganda, the boards are chaired by governors (South Sudan 2011; Uganda 2000)while in Kenya by a chairman other than a governor(Kenya 2015).

This difference, though small but at the heart of financial sector regulation and functioning. A central bank management plays some fundamental roles such as policy formulation, oversight function, and execution of the bank's mandate. Governance structures might differ between central banks, but most features and roles mostly remain the same. The board in Kenya is in charge of policy formulation and oversight role over the executive management of the bank. In a nutshell, board and executive management of the bank are separated.

The practice in South Sudan and Uganda places the governor in-charge of the board and the executive management of the bank. But since the board is chaired by the governor, there is a little separation of oversight from executive management as the case in Kenya. Thegovernance structure like the one in Kenya creates a robust accountability mechanism within a centralbank. The board provides oversight and strategic direction to the executive management of the bank while executive does policy formulation and execution of a central bank's policies and mandates.

In a structure where the governor is in charge of the board, chairs Monetary Policy Committee, and runs the executive operation of a central bank as the practice in South Sudan and Uganda, accountability mechanism is weak. As fiscal policy managers regularly interact with the governor, an independent board is better placed to protect monetary policy from fiscal policy dominance. In this regard, a board chaired by an independent person from the governor might be more appropriate as the case in Kenya. Under the Central Bank of Kenya governance structure, the board is made up of independent, competent and representatives of various interest groups of the economy which inhibits political leaning interests to control the monetary policy. The board members are appointed by the President with Minister's for finance recommendation in accordance with interest groups like academic, private sector and women as defined by the Central Bank of Kenya Act. Appointing board's members after competitive process might add value in terms of competency to the diversity of interests in the Act.

The Presidents appoint governors in Uganda and South Sudan while the Minister in-charge of Finance appoints non-executive board members in Uganda; in South Sudan, they are appointed by the President on recommendation of Minister in-charge of Finance. This approach in Uganda and South Sudan have some limitations. First, the powers to recommend on theappointmentcan easily translate into a dominance of fiscal policy over monetary policy. Second, in the absence of a competitive recruitment process, it is natural to speculate about possible lack of competencies by those are recruited to the board. Hand-pick officers, well-connected to a political class, might not adequately represent critical sectors of the economy like the private sector, civil societies, academics, and think tanks views.

In essence, the governance structure of the bank and its recruitment process are vital to insulate monetary policy from fiscal policy's dominance and political interferences. Governance structure notwithstanding, recruitment, compensation, and termination procedures for central bank's employees and management influence their behavior, thus, these are crucial ingredients to consider for a well-managed central bank. Competitive recruitment process provides an opportunity for a country to get interests from her best talents, it reduces arbitrariness of an appointing authority and creates confidence in the governor and the bank.

In Kenya, Monetary Policy Committee (MPC) is responsible for monetary policy formulation. In South Sudan, policy formulation is amandate of a board chaired by the governor. In contrast, in Kenya, MPC is under the leadership of a governor who recruits independent experts to support monetary policy formulation. The board, chaired by an independent board memberprovides an oversight by approving policies formulated by the MPC.No institution can provide an oversight to itself. An independent board of practice in Kenya today might be appropriate for adoption in Uganda and South Sudan. This might insulate monetary policy from fiscal policy's dominance and political interferences; and, helps converge regulatory environment in these EAC countries.

To be transparent, a central bank must at all times provide information to the public to enable it critique. Central Banks' of Kenya and Uganda websites, profiles ofboard members, macroeconomic reports and data; and audited financial statements are made available. This enables public to critique and form macroeconomic expectation of the economic environment. For the Bank of South Sudan, it has nooperational website and difficult to get any information about its performance or data. This demonstrate reluctance on its part to be transparent and as Stiglitz noted many things can go wrong in the secrecy of darkness. Despite the demand by Bank of South Sudan Act 2011 for the management to provide information to the public, Bank of South Sudan has done little to meet this legal expectation and the best practice. Public economic policy discourse depends entirely on information made available to the public. Such discussions have potential to improve policies' formulation.

In accordance with theBank of South Sudan Act 2011, if a board member has a case determined by the governor as worth to removea board member, the governor writes a recommendation letter for a removal of a board member to the Minister in-charge of Finance. If a matter relates to a governor, a recommendation to remove a governor comes from the senior most deputy governor to the minister. After initiation of removal of an erred board member, the decision to remove the affected member rests with the President. Such provision, does not protect board members from office's politics. A plot to remove a board member, and it also gave a huge considerable arbitrary space which can be abuse by the President for a political correctness.

In Kenya, if a President considers a termination of a governor or a board member, the law provides that the President form a tribunal of three high court judges or the court of appeal judges to investigate the governor or a board member. The President can only remove the governor/board a member if a tribunal finds the governor with a cause worth his or remove. For Uganda, the Act provides that a governor can only be removed after conviction by a court of law, being an unsound mind, bankrupt or disqualified from a professional body. The Kenya and Uganda approaches are more transparent and accountable embedded in a judicial set up. South Sudan's law should incorporate these provisions.

Financial and operational independence are critical indicators of an independent central bank. However, it is far-fetched to assume that financial and operational autonomy can work alone. Such powers are derived from the type of a governance structure put in place. It is the structure put in place that controls resources, and operational processes of a central bank. It is the law that gives the management right powers to control its operations and resources. Bank of Uganda and Kenya publish the annual report every year, place reports on their websites. These reports contain all issues about the economy, finances, and governance issues. Providing this information helps the public evaluate the bank's management of its processes and resources.

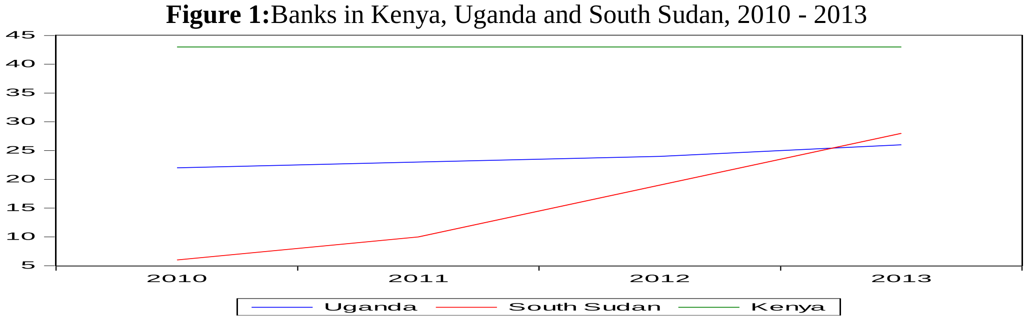
The Bank of South Sudan Act has similar reporting and accountability requirements. However, its website is not functioning. No public documents are available about the bank's performance which demonstrates a laxity of accountability and transparency from the side of the Bank of South Sudan. Despite a provision to restrict deficit financing to the government to 5% of audited government's revenues in the previous year or a 5% of a central bank's assets whichever is smaller, after December 2013, the bank provided a huge deficit financing to the government disregarding this legal provision. Though this financing might have been necessary, doing it without amending the law glorified financial impunity. This in part explains hyperinflation witness today and evidence fiscal policy dominance caused by an independent central bank governance.

IV. Nature and Growth of Banking Sector

South Sudan fought a protracted war with Sudan since independence from Britain in 1956. These wars inhibited the growth of social, political and economic institutions. In 2005, the North and South Sudan signed a Comprehensive Peace Agreement (CPA) Kenya after over two decades of protracted war(South Sudan, 2005). Referendum enshrined in this agreement led to a separation between North Sudan and South Sudan in July 2011 and a consequent birth of South Sudan as the newest state.

As at the beginning of 2005, there were only four banks in operation in South Sudan(Bank of South Sudan 2014: 4). Immediately after the peace was signed, the number of banks grew at a high pace. As at the end of 2013, there were 28 banks (Bank of South Sudan 2014: 6). These banks provided access to 3% of South Sudan population compared to 42% in Kenya and 20% in Uganda (Conference 2013: 6). Figure 1 shows the evolution of banks in Kenya, Uganda and South Sudan. It is clear that the growth in the number of banks in South Sudan has been phenomenal. In addition to 28 banks, there were 70 applications for bank's licenses as at the end of November 2013 (Conference 2013:4).

Figure 1: Banks in Kenya, Uganda and South Sudan, 2010 - 2013

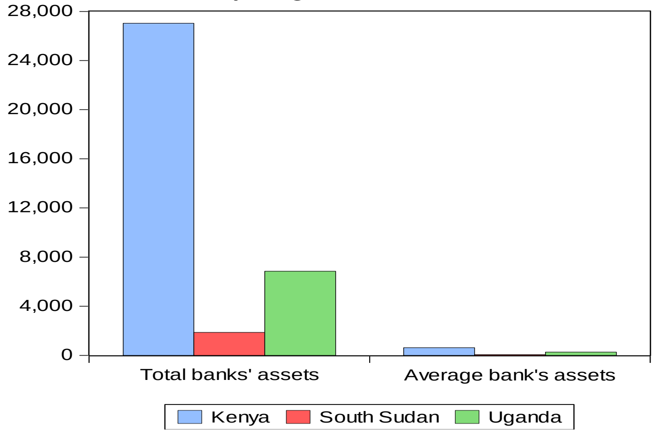


Source: Conference 2013; Bank of South Sudan 2014; Central Bank of Kenya 2011; Central Bank of Kenya 2013; Bank of Uganda 2011, 2013.

Banks exist to provide financial services to individuals, governments, and corporate entities. Firms, banks included are assume to be rational(Smith 1976). That is, they work for their self-interest to maximize profits. Banks in particular have three sources of revenues.Interest on loans advanced to investors; fees charged on transactional services, and incomes on foreign currency trading. It isrevenues from these sources that drives growth of banks.

As already indicated early, as at 2005, there were only four banks in operation in South Sudan. Since South Sudan's independence, the number banks increased to twenty-eight. The products that the banks in South Sudan provided are basic deposit accounts, foreign exchange, transfers, and remittance services (Conference 2013: 4). Figure 2 shows the total assets value for banks: $27 trillion for Kenya's banks; $6 trillion for Uganda's banks and $1.9 trillion for South Sudan's banks. These values are from total banking sector balance sheets converted into dollars, estimated at exchange rates in December, 2013. On average, assets value for a bank in Kenya is worth $629 million dollars; $263 million for bank in Uganda; and $67 million for a bank in South Sudan. South Sudan banks' assets value deteriorated further after liberalization of the pound in December 2015.

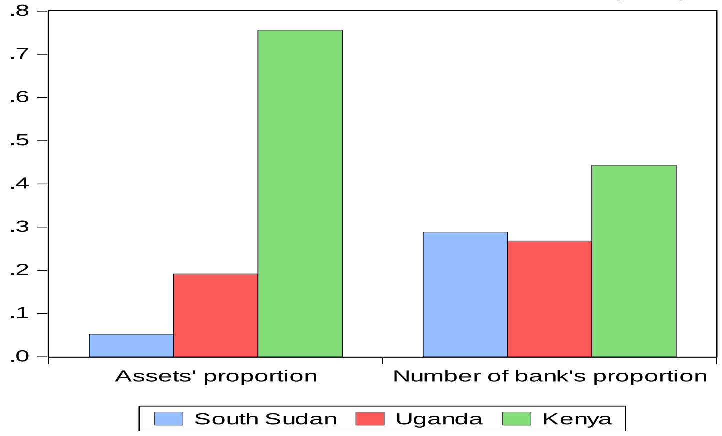
Figure 2: Assets for banks in Kenya, Uganda, and South Sudan as at December 2013.



Source: Conference 2013; Bank of South Sudan 2014; Central Bank of Kenya 2011; Central Bank of Kenya 2013; Bank of Uganda 2011, 2013

The number of banks in South Sudan increased at a pace that does not match the trend in the region as shown with Kenya and Uganda comparisons. Of course, as a new country, the demand for banks' products would be assumed to have driven the growth of banks. The growth of the banks was not matched by a strong assets base as shown in figure 2. Figure 3 shows the assets and number of banks for each country as a proportion of the total assets, and banks in the three countries. It is clear from this figure that South Sudan has the lowest assets proportion.

Figure 3: Banks' Aseets and Number of Banks as at December 2013 for Kenya, Uganda and South Sudan.



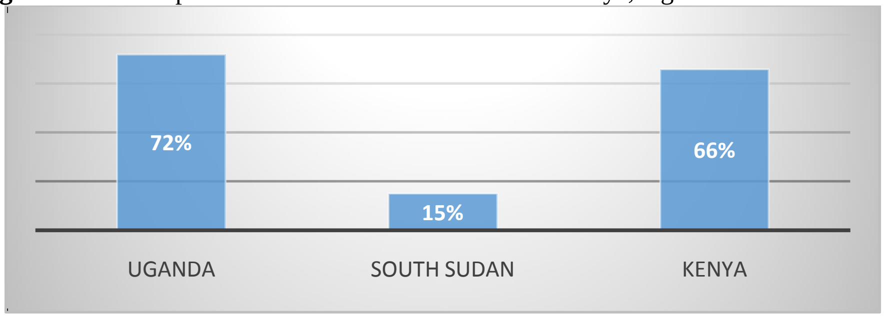
Source: Bank of South Sudan 2014; Central Bank of Kenya 2013; Bank of Uganda 2013

The above analyses, outlines some key useful characteristics of South Sudan's banking sector. First, the growth of the banks increased significantly since South Sudan's independence. As at the end of 2013, there were 70 applicants for bank's licenses as already alluded to and 28 licensed banks. Due to lack of data, it hasn't been possible to validate the current number of banks. Second,value of the assets for the banks in South Sudan has been very minimal compared to the banks in Uganda and Kenya. Thirdly, access to financial products as at the end of 2013 was only 3% in South Sudan compared to Kenya at 42%; and 20% for Uganda. This increase in the number of banks didn't improve financial access to South Sudan's populace.

The logical question is what driven the growth in the number of banks in South Sudan? Figure 4 shows loan-deposit ratio in these three countries. While that of Uganda wasat about 72%; Kenya at about 66%; and

South Sudan's loan-deposit ratio was only 15% as at the end of October 2013. What this tells us is that loan as a source of revenue for the banks in South Sudan was not one of the reasons that drive the growth of banking sector in South Sudan.

Figure 4: Loan-deposit ratio as at December 2013 for Kenya, Uganda and South Sudan



Source: Bank of South Sudan 2014; Central Bank of Kenya 2013; Bank of Uganda 2013

With this evidence of dismay performance of loan as a traditional source of revenues to the bank, why did banks' owners found it necessary to establish banks that were not adequately capitalized as by comparisonwith their counterparts in Kenya and Uganda? Why did the regulator, the Bank of South Sudan for that matter, allowed the establishment of these shallow banks? Answers to these questions, provide useful insights about what driven the growth of banks and the uniqueness of South Sudan's banking sector.

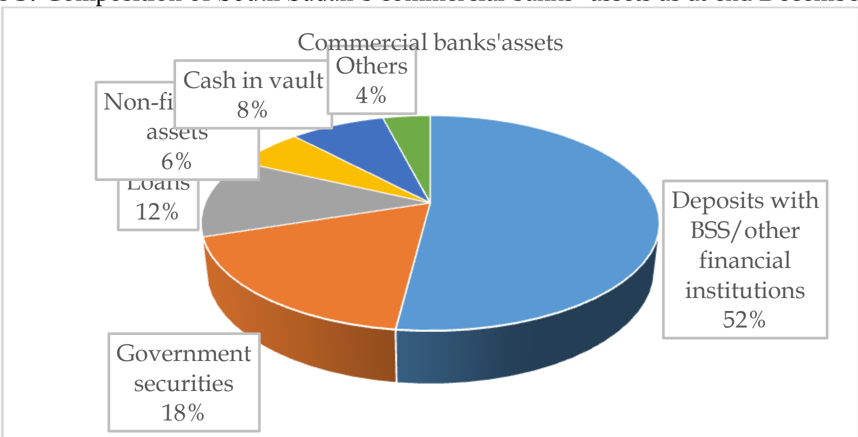
"Why do banks exist?" Banks exist to provide financial services demanded by the financial market. In essence, for them, there is an opportunity to be exploited for a profit from loan's interest income; foreign currency trading fees; and transactional services. So, owners who are the investors put their money to establish a bank for a profit. The theory of competitive market, states "firms enter a market with abnormal profit till abnormal profit is normalized."With this logic, was there an abnormal profit in South Sudan's banking sector that drive the increase in the number of banks?

As the theory of competitive marketstates, let's assume there was an abnormal profit and that is why more banks were created from four banks in 2005 to 28 banks in October 2013. From figure 4, the loan-deposit ratio is low. The demand for loans was not one of the main drivers of banks' growth. This paper hypothesizes that the growth of banks in South Sudan was caused by an arbitrage opportunity created by fixedexchange rate regime that was in practice. This issue will be explored in details insection V.

Few issues are very clear with regards to the growth of the banking sector in South Sudan. First, the banks established were extremely under-capitalized; second, loans to the economy were very minimum, so to speak, banks contributed very little in terms of investment creating; third, banking services access was only at 3% in South Sudan in October 2013. The banks in South Sudan provided little access to the populace compared to banks in Kenya and Uganda taking into consideration relative proportions.

As at the end of December 2013, 52% of banks' deposits were with the Bank of South Sudan and other financial institutions. Furthermore, 18% was in the form of government's securities. Put together; this made 70% of banks' assets in South Sudan was under control of the Bank of South Sudan(Bank of South Sudan 2014) and by extension, the government.The impact of the bank's growth, banks that provide no loans was a huge holding of cash that is reflected in a high liquidity in the banking sector as shown in figure 5.

Figure 5: Composition of South Sudan's commercial banks' assets as at end December 2013



Source: The Bank of South Sudan, Annual Banking Supervision report, 2013.

Current liquidity crisis experienced in the banking sector in South Sudan could be attributed to the fact that the Bank of South Sudan has not made the available part or the whole 70% of the banks' assets that was under government's control as at the end of the December 2013.The banks in South Sudan departed significantly from the practice in other countries such as Kenya and Uganda were much of the deposits were given out as a loan as shown in figure 4. The loan is a medium through which a banking sector contributes to economic growth.

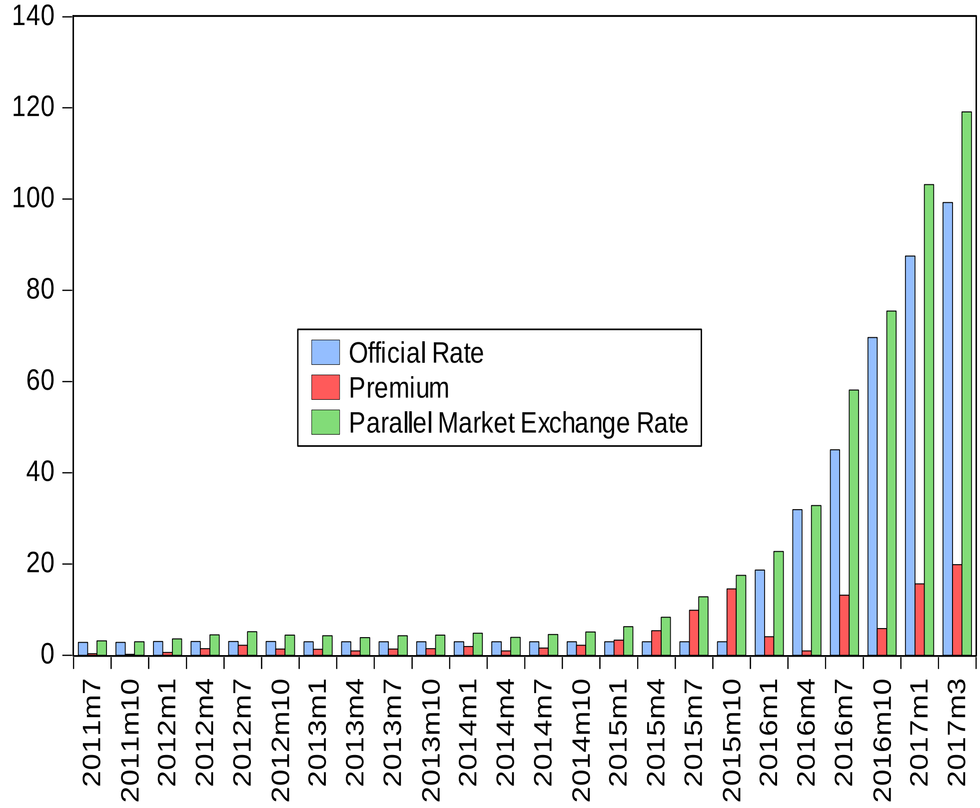
V. An ExtractiveBanking Sector

The growth in the number of banks in South Sudan is significant compared to Kenya and Uganda during the periods under review. Section IV shows unique characteristics that in a normal banking sector sense, the growth in the number of banks wouldn't be significant in South Sudan. These banks have shallow capital base when compared with banks in Kenya and Uganda; loan, a medium through which the banking sector boost growth of an economy was extremely low; and financial services access has not improved to South Sudan's populace despite enormous growth in the number of banks in South Sudan from 4 in 2005 to 28 in October 2013 with 70 applications for bank's licenses in October 2013 (Bank of South Sudan 2014).

Evidence outlined in section IV dismiss traditional banking sector's growth justifications. In this section, an attempt is made to show that the growth in the number of banks in South Sudan was due to arbitrage's opportunities created by fixed exchange rate regime established by the Bank of South Sudan since independence in July 2011. In November 2013, the Bank of South Sudan attempted to devalue South Sudanese Pound (SSP) from 3.16 SSP to 4.5 SSP. Parliament rejected this decision. The Bank of South Sudan was forced to revert back to a fixed rate regime.

In December 2015, the bank of South Sudan finally liberalized SSP to 18.5 from a fixed rate of about 3.16 SSP. This liberalization, caused the pound to lose about four-times its value compare to the devaluation that was proposed and rejected by parliament in December 2013. Figure 6 shows an evolution of exchange rates: fixed rate, and parallel rate; and exchange rate premium. The way a fixed regime worked was a bank buys dollars at about 2.95 SSP from the Bank of South Sudan. These dollars bought at a fixed rate of 2.95 SSP were sold to the public at the rate of 3.16 SSP. The difference is a profit to a bank. But due to insufficient supply of dollars to the financial market at the official rate, the parallel exchange market rate developed. This caused the rates in the two markets to diverge. This created a significant arbitrage's opportunities for the banks that got allocations from the Bank of South Sudan at a fixed rate.

Figure 6: OfficialRate, parallel exchange rate and exchange rate premium



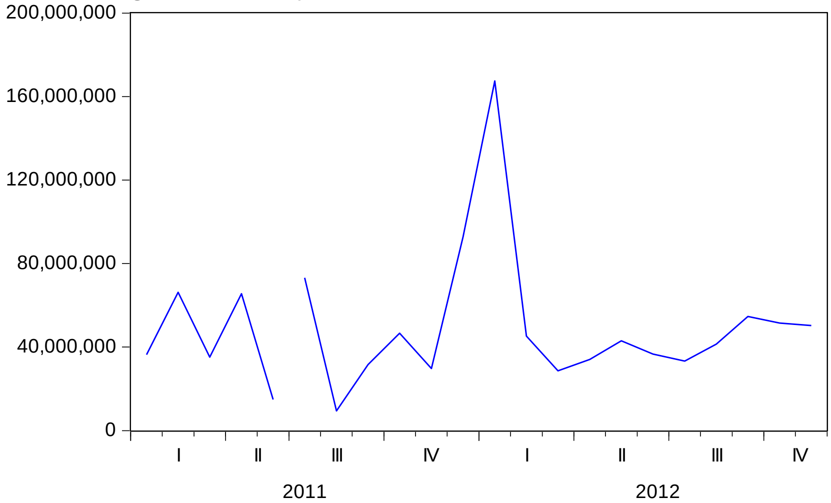
Source: Bank of South Sudan, Financial Market Department

Divergence in exchange rates in the parallel market and the official markets created an arbitrage opportunity that was exploited by well-connected persons to obtain a vast profit allocations to banks, bureaus, and individuals. The profit is a difference between black market exchange rate and official exchange rate, a price from which a bank buys dollars from the Bank of South Sudan. This is shown as a premium in figure 6. Rational investors and regulators should have curtailed the growth of banks with such unusual characteristics. The profit from exchange rate premium was the main motivation for the expansion of banks. With 28 licensed banks and 70 applications for bank's licenses as at end of 2013 (South Sudan Investment Conference, 2013), it difficult to provide any conventional justification for this phenomenal growth.

According to the theory of demand and supply, to achieve an equilibrium price, the supply and demand of a commodity must be equalized. If a price at which a dollar is sold is fixed, say at the rate of 3.16 SSP as was the case, the Bank of South Sudan needs to know the number of dollars demanded by the foreign exchange market. This demanded amount of dollars was to be matched with sufficient amount of dollars supplied to the market by the Bank of South Sudan if the exchange rate was to stabilize at a fixed rate.

Contrary to the above theoretical postulation, the Bank of South Sudan supplied dollars to the foreign exchange market in an inconsistent manner. The supply increase or reduce in unpredictable pattern as shown in figure 7. It seems, the Bank of South Sudan had no consistent policy on how to determine the number of dollars to be supplied to foreign exchange market to meet the demand. Amount of dollars supplied to the foreign exchange market seems to be based on the availability of dollars. This unsystematic management of foreign currency and fixed rate regime were not going to be sustainable. The deterioration in pound's confirmed this malaise.

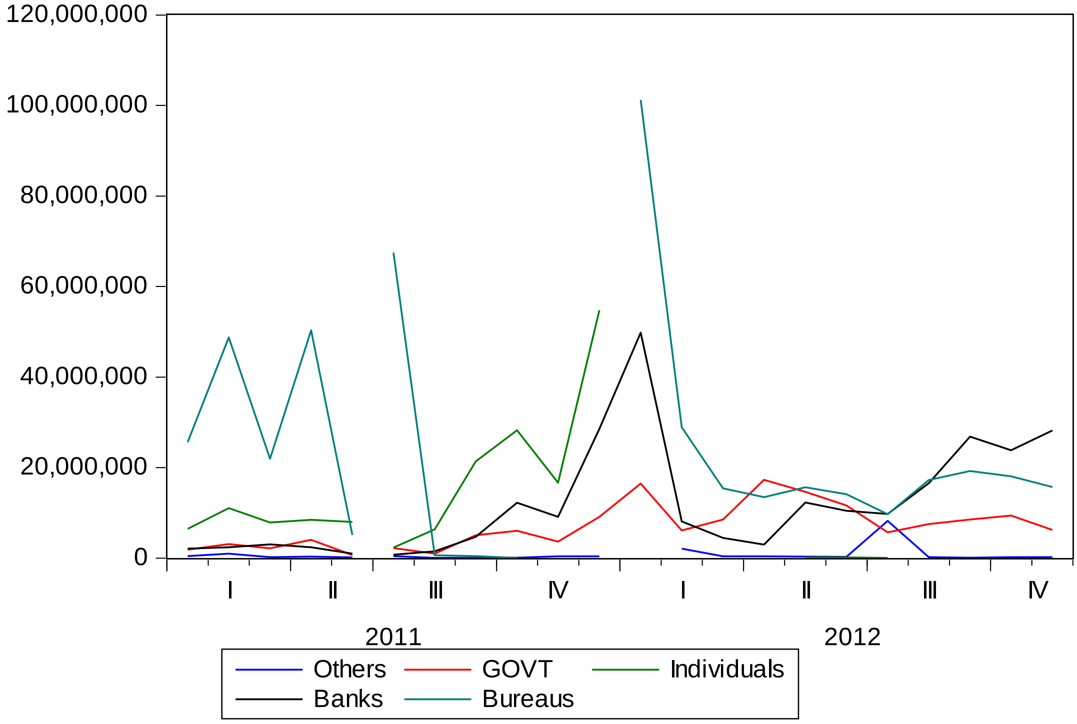
Figure 7: Monthly USD allocations to the financial sector



Source: Atem, 2013

Erratic supply of dollars to the financial sector as shown in figure 7 is traced to a massive quantity of dollars allocated to individuals and bureaus as shown in figure 8. The number of dollars to the government, banks, and others followed some consistent pattern. However, the number of dollars allocated to individuals and bureaus were vast and inconsistent. How could such huge amount of dollars be allocated to individuals? Though not much data is available, restrictions on allocation to individuals might have spurred licensing and application for 70 banks' license in by October 2013. Bureau's owners and individuals that benefited were possibly well-connected people to the management of the Bank of South Sudan or their agents. Though without sufficient evidence, it is difficult to prove this claim. The allocations to individuals and bureaus might have been conduits to transfer money from public coffers to individuals' pockets through the arbitrage opportunity.

Figure 8: Monthly USallocations to financial sector

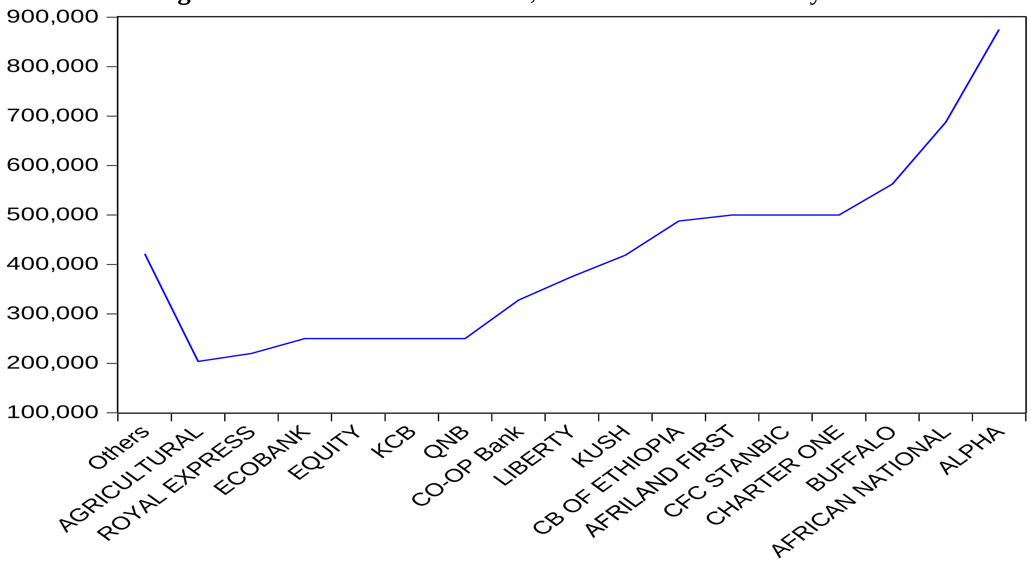


Source: Atem, 2013

After liberalization of exchange rate regime in December 2015, When the Bank of South Sudan auctioned its first dollars' allocation in December 2015, the Bank sold dollars at a fixed rate despite the liberalization. This action can be inferred as a fight within the Bank of South Sudan to continue to retain the arbitrage opportunity for the banks. In fact, as shown in figure 9, a massive allocation of dollars after the liberalization went to national banks with small customers' base. Only CfC- Stanbic bank which is a big bank with a huge customer's base that got some substantial allocation.

Big regional banks like Kenya Commercial Bank, equity bank, and Coop bank that controlled significant market share in South Sudan's financial market didn't benefit significantly from these allocations. In fact, the allocations in figure 9 could be inferred as an extractive lobbying power of the banks. The big banks in South Sudan by customers' base are Kenya Commercial Bank, Equity Bank, CfC-Stanbic bank and Cooperative bank in that order. Though there is no data to support this claim, this classification is from author's understanding of the banking sector in South Sudan.

Figure 9:USD allocations to banks, December 2015 – January 2016

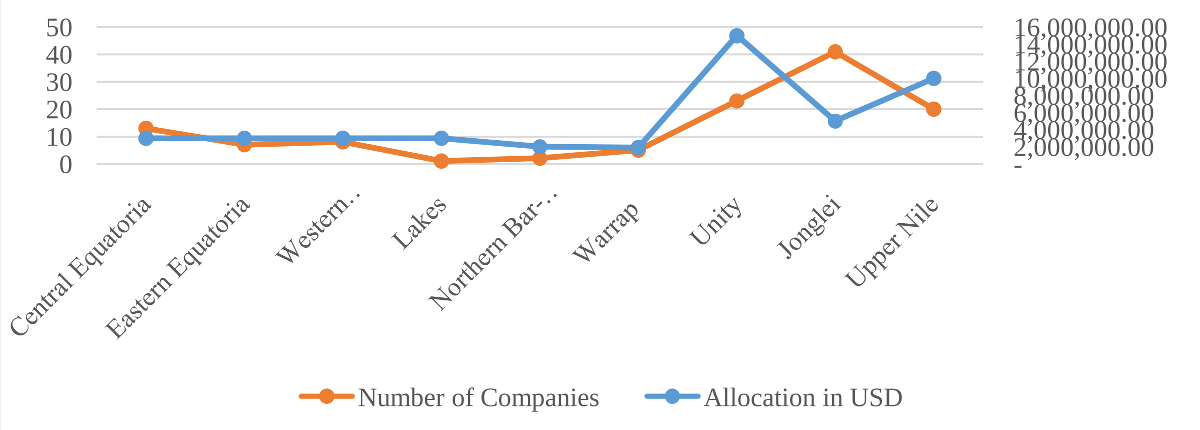


Source: Computed by author fromReng and Mayai, 2016

In 2012, the Bank of South Sudan conceived an idea to make dollars available to importers to ensure essential goods and services were accessible to the public at affordable prices. A concept referred to as "letter of credit" in South Sudan's banking sector. The way this letter of credit was designed, was that a credit facility was set-up by the Bank of South Sudan with Qatar National Bank and later with CfC-Stanbic bank. Specific amounts of dollars were allocated to agencies of the government to allocate to firms that intend to import essential goods to the country. Figure 10 and 11 show amounts awarded to states and government's agencies, and the number of firms that benefitted from these allocations. The total amount allocated was $725 million (Assembly, 2015). From the national assembly investigation's report, it was difficult to establish the total amount of dollars disbursed from the letter of credit's allocations.

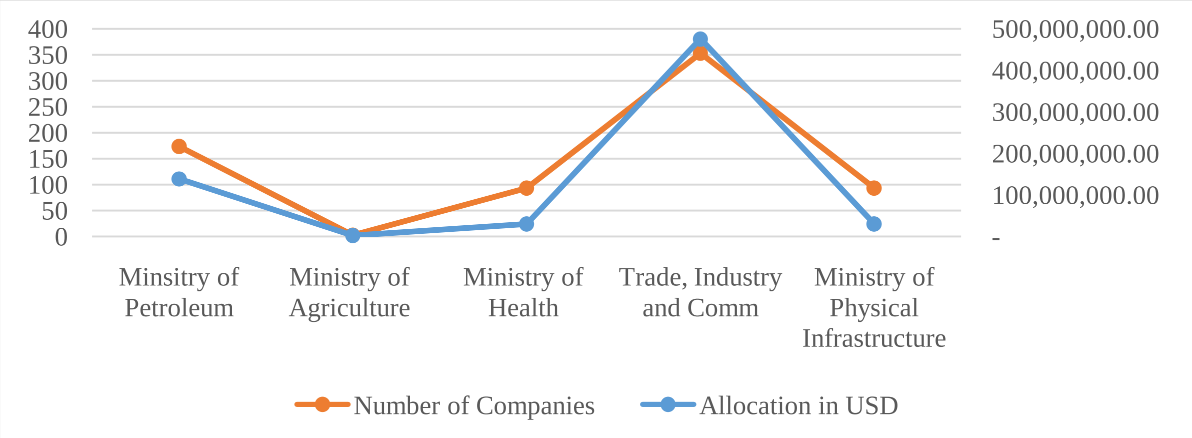
The details in national assembly investigation report were extracted from information provided by various agencies to the committee of parliament. Some of the agencies didn't keep records of the allocations alluded to in the report (Assembly 2015). The comprehensiveness of the details in this report is in doubt. In another independent work by Simona Foltyn, an investigative journalist, she put the amount allocated through the letter of credit to about $993 million between 2012 and 2015 (Simona Foltyn, 2017).

Figure 10: Ua Allocation to states and administrative areas, and number of firms that benefited from the allocations



Source: Computed by author from Assembly 2015

Figure 11:US allocation to government's ministries and number of firms that benefited from the allocations



Source: Computed by author fromAssembly 2015

So what was wrong with this letter of credit? In theory, a letter of credit is used to hedge an importer who might pay for a good for fear an exporter might fail to deliver goods paid for, or, it hedges exporter who delivers products that an importer, might fail to pay. Letter of credit removes this risk from both sides by involving banks' for importer and exporter. Banks 'role is to guarantee payment to the exporter once he delivers. The purpose of the bank is therefore to follow-up payment or pay once one party to the arrangement meet its obligation.

In the letter of credit designed by the Bank of South Sudan, there was no proper documentation of the process, no adequate oversight mechanism put in place, and there was no validation process on delivered goods purchased with the letter of credit's allocations. In fact, all government agencies concerned with the letter of credit management acknowledged that the letter of credit never achieved its intended objectives (Assembly 2015). Possible criteria that should have been used as a basis to award a letter of credit such as the amount of corporate tax paid in the previous periods; number of employees a firm has; personal income taxes paid in prior periods; and performance in the previous allocations were ignored in the design.

The poor design of letter of credit's managementshow high level of ignorance by policy-makers. It seems the design was meant to extract financial benefits to those who got letter of credit's awards. Without a control in place, it was made easy to sell the dollars awarded on the letter of credit in the parallel market as this was a profitable venture than really importation itself. At times, it seems, extractive behavior was a collusive decision across agencies of the government for individuals to enrich themselves through rent-seeking behavior.

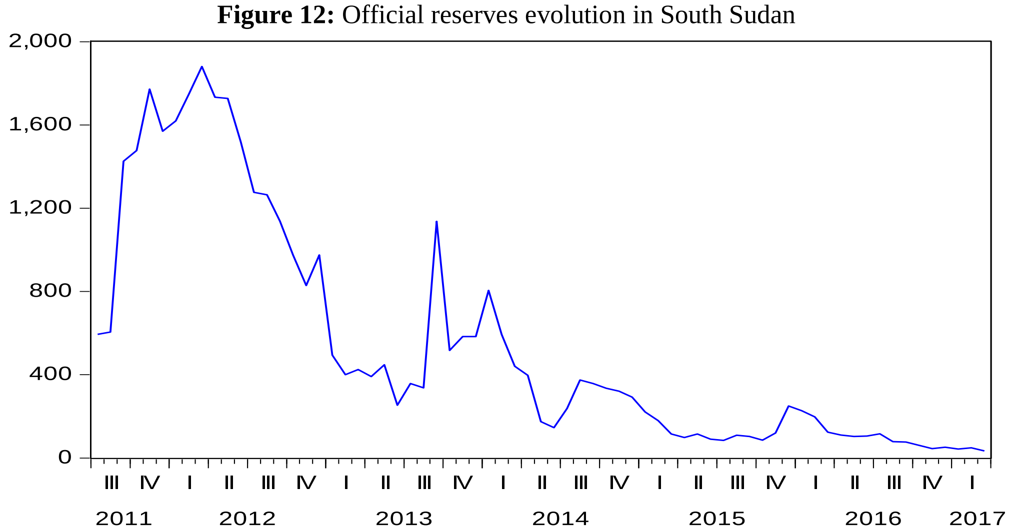
VI. Impacts ofan Extractive Banking Sector

One of the central bank's role is to ensure macroeconomic stability, or in other countries as it is in the United States of America, a dual function for macroeconomic stability and economic growth. To achieve these objectives, there are fundamental economic indicators that show the health of an economy. An interest rate is a crucial tool that is used by a central bank to control the money supply. Figure 4 shows that loan to South Sudan's economy has been extremely minimal. When the credit from the banking sector is minimal, interest rate as a crucial tool to control money supply becomes ineffective as market's fundamentals become less responsive to it. In such an environment, it becomes difficult if not impossible for a central bank to contribute to economic development.

South Sudan in June 2012 voluntarily shut down oil production due to a dispute over transition's fees with Sudan. In December 2013, a power struggled within the SPLM, turned into a full scale civil that led to a loss of oil production in Tharjath and Unity that accounts for approximately 40% of national oil output. The reduction of oil's price in the global market confounded economic problems that South Sudan faces. The impact of oil shutdown in June 2012, the war that started in December 2013 and reduction in a price of oil the world market negatively impact the ability of South Sudan's ability to accumulate reserves. Figure 12 shows how official reserves evolved since independent in July 2011.

In essence, the maintenance of the fixed exchange rate by the Bank of South Sudan was at the expense of diminishing reserves. It was only lifted in December 2015 when foreign reserves were completed depleted. The reason for maintaining this unsuitable fixed rate regime might be in part to ensure foreign currency arbitrage's benefit continue to flow to the extractive banks that have been established. It was too difficult to starve the banks of their income by the Bank of South Sudan. In such a setting, issues of conflict of interests by some of the people in the Bank of South Sudan couldn't be ruled out.

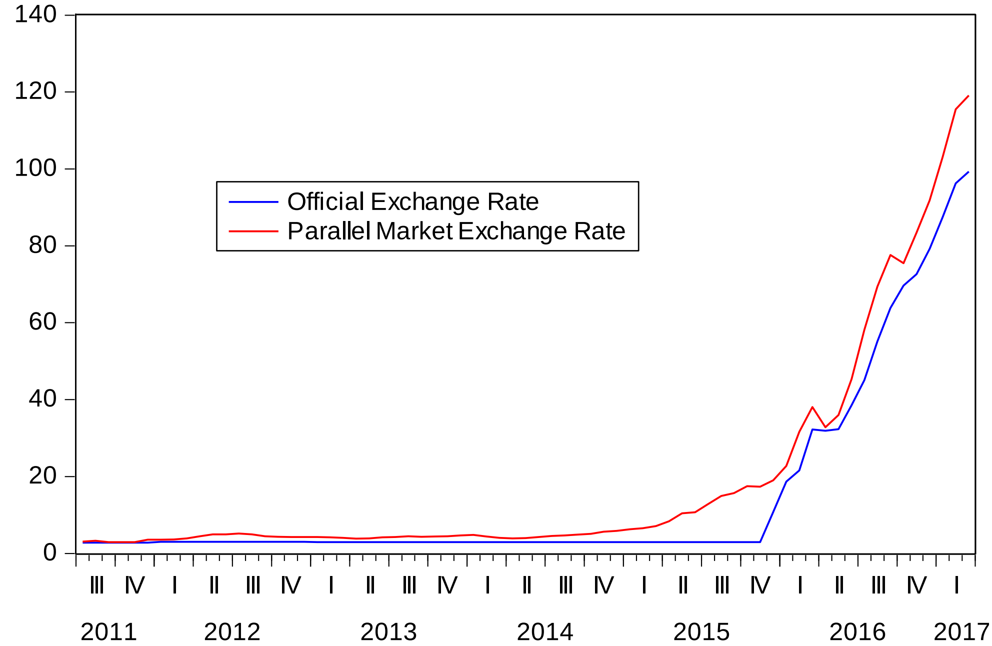
Figure 12: Official reserves evolution in South Sudan



Source: Research and Statistics Department, Bank of South Sudan.

For a country like South Sudan that depends almost entirely on imported products, there is a close positive correlation between exchange rate and inflation rate. As expected, when official reserves get depleted, the ability of a central bank to defend a fixed rate diminishes. Theoretically, it is anticipated that as reserves get depleted, parallel market's exchange rate diverges from the official exchange rate as shown in figure 13 below.

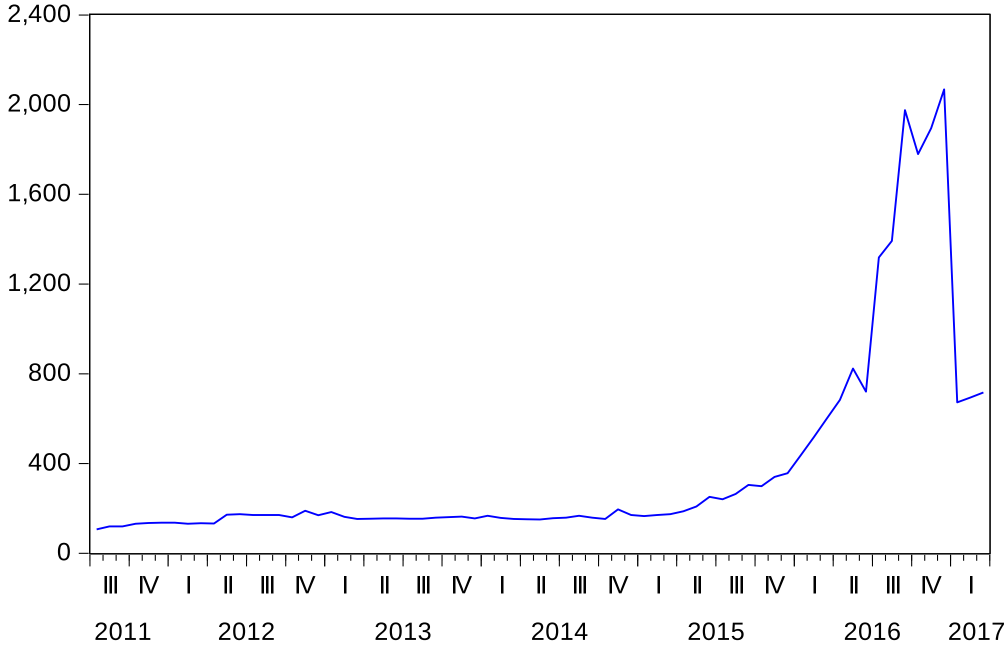
Figure 13: Evolution of official exchange and parallel market rates in South Sudan.



Source: Research and Statistics Department, Bank of South Sudan.

With the supply of dollars to the market is reduced, businesses owners, find it difficult to obtain dollars at the official exchange rate. As a result, business people are forced to purchase dollars at the parallel market's rate. The cost of dollars, enter through imports and this cause an inflation. As shown in figure 14, the Consumer Price Index (CPI) for South Sudan since independence in July 2011 - March 2017 has been increasing reflecting relations to reserves and exchange rates. The war in July 2016 between forces loyal to the then First Vice-President Dr. Riek, and the Government of South Sudan forces under H.E President Kiir Mayardit caused the higher CPI in July 2016 to jump. This could be because this war disrupted transport routes, business activities, and negatively affected people's expectation.

Figure 14: Evolution of CPI in South Sudan from Jan 2011 – Jan 2017



Source: Research and Statistics Department, Bank of South Sudan.

As the preceding section shows, South Sudan's economy meets conditions of a currency crisis. Unexpected harmful disruption to the economy by December 2017 war; plummeted oil prices in the global market that affected over 40% of oil production, and a deficit financing of public expenditures. The result was a rapid depreciation of South Sudan pound. Depreciation of pound eroded firms and households savings, distorted macroeconomic fundamentals which caused economic stagnation, and economic misery to the people of South Sudan (Ariic and Mayai, 2016).

For managed or fixed exchange rate to work correctly, a central bank has to supply all foreign currency demanded by the foreign exchange market. Non-market rules that determine which transactions occur at the official rate, and which market’s participants are entitled to trade at the official rate causes inequity and rent-seeking(Adam and Crawfurd 2012). The banking sector growth in South Sudan was in a response to arbitrage opportunities created by a fixed exchange regime. Banks were conduits to extract public resources. Government's agencies that were involved in foreign currency management did little to mitigate reserves misuse; no punishments were done to individuals or institutions that abuse, or, never kept records as the case with the letter of credit. The inability to design right policies deprived the public a lot of money. The lack of accountability encourages and accelerates the rate at which public resources were looted. It seems institutions and regulators were captured (Stigler 1971).

VII. Recommendations and Conclusions

Bank of South Sudan’s governance structure does not conform to required principles of independence, transparency, and accountability. The board should not be chaired by a governor but by an independent board member. This will separate policy formulation and oversight functions. Transparent recruitment should be instituted for the board and MPC members. More accountable and transparent methods to be created for the Bank of South Sudan’s management. Macroeconomic data, audited financial management, and policy briefs to be made available to the public. This will enable the public to hold the bank accountable.

The banking sector requires an overhaul. There is a need to recapitalize the banks to meet the international capitalization requirements. Those banks that will not live-to capitalization’s standards to consolidate or liquidate. Policies for financial access, deepening and loan’s provision to the economy should be prioritized, enhanced and this should include a review of the banking act 2012 to make it sufficient to address new issues in the banking in South Sudan. This will enable banks to contribute economic growth and macroeconomic stability.

Though a fixed exchange rate is broadly useful in a macroeconomic sense for stability, it is plagued by severe problems of corruption and rent-seeking if not well-managed. A managed float with an efficient inter-bank market and robust national payment system will help streamlines operation of the foreign exchange market. But if the Bank of South Sudan is to serve its purpose, the ongoing war should be stopped. This will allows the bank to build reserves to help in the stabilization of macroeconomic fundamentals.

This article demonstrates that there is a considerable disparity in terms of regulation between Kenya, Uganda, and South Sudan despite the fact that these countries are closely linked through trade, financial services, and are members of the EAC. A peer-to-peer review mechanism within the East African Countries’ central banks can help speed-up regulatory convergence and practices to minimize monetary policies’ exposures in the community.

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