Monetary and Fiscal Policy of South Sudan

Analysis of a Newly Independent Oil-Exporting Country

Master of Arts in Law and Diplomacy Thesis

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Abstract

In May 2012, the Republic of Southern Sudan (South Sudan) is the newest country in the world. The economy of South Sudan was devastated by more than fifty years of the civil war with Sudan, but its economic level is as rich as neighboring East African countries, thanks to its abundant oil resources. Still, its actual economy is impoverished, with more than fifty percent of citizens living below the poverty line. The country suffers from high inflation, led by price increases in basic goods. Oil production in South Sudan is expected to start declining after production peaks around 2015. To achieve economic development, the Government of South Sudan (GoSS) allocates portions of its annual budget, ninety-eight percent of which comes from oil products, to the sectors necessary for economic growth. In monetary policy, the Bank of South Sudan (BoSS) currently applies the floating exchange rate regime with a band of SSP 2.9 to 3.3 to a U.S. Dollar. BoSS is also obliged to control the high inflation rate in order to stabilize the economy. With respect to fiscal policy, GoSS has effectively managed its fiscal balance since the CPA in 2005. Thanks to its abundant oil revenues, GoSS is able to allocate its financial resources to critical sectors. However, continuing conflict with Sudan forces GoSS to spend its budget for security as the first priority, while other areas such as infrastructure, health, and education are left behind. As non-oil private sector industries are still too primitive to contribute to the governmental revenues, GoSS is facing a serious budgeting problem due to its focus on expected oil revenues. To suggest possible solutions for the situation, this paper makes recommendations for the monetary and fiscal policy of South Sudan. In monetary policy, BoSS should shift its exchange rate regime to a currency basket that includes the major currencies of its oil export partners. The currencies included should be the Singapore Dollar and Chinese Renminbi as well as the U.S. Dollar, and the exchange rate for SSP should continue to be held within a band vis-à-vis the U.S. Dollar. As Kuwait has already discovered, the currency basket regime will enable South Sudan to effectively reflect the economic conditions of its export partners. In order not to lose the effect of inflation control, South Sudan should manage the currency basket portfolio by flexibly adjusting the portions of the U.S. Dollar and other currencies. In fiscal policy, South Sudan should enhance relations with international financial institutions (IFIs) and international community members that give aid as a form of development assistance. IFIs, including the World Bank, IMF, and African Development Bank, have been providing loans to South Sudan for the development of new oil wells and basic infrastructure. The international community, consisting of countries in advanced economies, will effectively complement the scarce investments made by GoSS in the fundamental sectors.

Contents

Introduction

The Republic of Southern Sudan (South Sudan) is the newest country in the world. It was established on July 9, 2011, as the 193rd country recognized by the United Nations. Following the long-lasting civil war that began in 1955, South Sudan had a six-year preparation period for its independence after the signing of the Comprehensive Peace Agreement (CPA) with Sudan in 2005. In 2011, South Sudan officially became an independent country as a result of the self-referendum, with over 98 percent of votes favoring secession from Sudan.[1]

South Sudan is located in the eastern-central part of the African continent, surrounded by Sudan (north), Ethiopia (east), Kenya (southeast), Uganda and Congo (south), and Central African Republic (west). The population is estimated to be 9.28 million people, 22 percent of whom reside in urban areas, with approximately 220,000 people living in the capital, Juba.[2] Being landlocked, the country's industry and infrastructure are severely underdeveloped, and poverty is widespread due to the civil war. About 50.6 percent of South Sudanese people live below the poverty line (determined as USD 1.25 per day by the World Bank).[3]

Industry and the economy of South Sudan are heavily dependent on oil production. Revenue from oil accounts for more than 98 percent of governmental revenue. Oil production of South Sudan started in the 1990s, and the country produces 490,000 barrels per day (as of December 2011). The volume is nearly three-fourths of the former Sudan's total oil production. Oil is exported through two pipelines that run to refineries and shipping facilities at Port Sudan on the Red Sea.[4] Other industries are severely underdeveloped due to the long-lasting civil war

1. Ibrahim Elbadawi, Gary Milante, and Costantino Pischedda, "Referendum, Response and Consequences for Sudan" (Washington DC: The World Bank 2008), 5.
2. "The World Factbook," Central Intelligence Agency, accessed December 27, 2011, https://www.cia.gov/library/publications/the-world-factbook/geos/od.html.
3. "A Poverty Profile of the Southern States of Sudan" (Washington DC: The World Bank), 2.
4. Jill Shankleman, "Oil and State Building in South Sudan" (Washington DC: United States Institute of Peace 2011), 3.

with Sudan. Agriculture provides a living for a vast majority of the population. However, the living standards of people in the agricultural sector are unstable because of disorganized markets and unsecured property rights. Infrastructure in South Sudan is very limited. Only 60 kilometers of paved roads exist, electricity is produced mostly by costly diesel generators, and running water is scarce. The Government of South Sudan (GoSS) spends a significant amount of money to maintain its large army, and its delays in salary payment cause riots with unruly soldiers.[5]

The financial system of South Sudan is governed by the Ministry of Finance and Economic Planning (MFEP) and the central bank, the Bank of South Sudan (BoSS). Budgetary planning and monetary and fiscal policy are mostly related to the oil industry, as almost 100 percent of the budget revenue of South Sudan comes from oil-related activities. In 2011, the national budget share from oil accounted for 5.66 billion South Sudanese pounds (SSP) out of the total budget of SSP 5.77 billion. The remaining budget allocation was distributed to other government sectors including security, economic functions, health, and education.[6] The budgetary plan of GoSS is to strengthen the other sectors with the revenue gained from oil production.

The financial management methods of MFEP and BoSS are both still primitive and unreliable despite six years of experience in the management of South Sudan's economic situation, since the signing of the CPA in 2005. For instance, the BoSS committed corruption by overseeing illegal transactions of several bank officials who sold SSP to the black market.[7] Commercial banks, which act as a mediator of capital in the country for parties with lower credit,

5. "The World Factbook-South Sudan," Central Intelligence Agency, accessed December 27, 2011, https://www.cia.gov/library/publications/the-world-factbook/geos/od.html.

6. Ministry of Finance and Economic Planning, "Approved Budget 2011" (Juba: Government of Southern Sudan 2011), 2–3.

7. "South Sudan's Central Bank to be Investigated over Black Market Forex Dealings," *Sudan Tribune*, October 22, 2011, accessed January 3, 2012, http://www.sudantribune.com/South-Sudan-s-Central-Bank-to-be.40505.

have a pile of nonperforming loans and require considerable financial support from the government. To enable efficient growth after independence, South Sudan needs to take more measures to stabilize the economy and its financial system. An immediate priority should be to reduce corruption among public officials. This is a necessary solution to improve the current economic and financial situation of South Sudan, but an insufficient one.

The purpose of this paper is to pave the way to stabilize the financial system of South Sudan to accomplish planned economic growth, especially in industrial growth, in response to the abundant funding from oil revenues. For monetary policy, this paper especially focuses on the current exchange rate regime of the BoSS. In comparison with the monetary policies of other oil-exporting countries, this paper suggests the most suitable exchange rate regime for South Sudan. For fiscal policy, this paper focuses in particular on MFEP budgetary policy, with the purpose of checking the balance between oil revenue and the effectiveness of investment utilizing financial resources. The first portion explains the current economic background of South Sudan, specifying characteristics which relate to the effective implementation of fiscal and monetary policy. The second part shows the current status of the monetary and fiscal policy of South Sudan. The third section compares the monetary and fiscal policies of resource-exporting countries with those of South Sudan to put together a possible policy to be implemented in South Sudan. The fourth part provides recommendations for both monetary and fiscal policy that could possibly be implemented in the next decade. These recommendations include an appropriate exchange rate regime, and a proposal for the GoSS's budgetary and investment policy after oil revenues start to decline.

1. Economic Background

The economy of South Sudan is typical for a newly established developing country sustained by abundant oil reserves in its territory. However, other economic resources are still scarce and make very little contribution to the economy—these account for only two percent of all governmental revenues in 2011. This chapter examines how the current South Sudanese economy is structured, its characteristics, and the problems it faces. This investigation has significance when considering the appropriate monetary and fiscal policy for the country.

1.2 Level of Economy

South Sudan is one of the poorest countries in the world, although its economic level is relatively higher than other countries in the same region. South Sudan is located in East Africa, a region which also includes six other countries: Burundi, Ethiopia, Kenya, Rwanda, Tanzania, Uganda and South Sudan. Its nominal GDP is the fifth of the seven with USD 13,227, and GDP per capita is the first among them with USD 1,546.[8] Globally, its GDP is ranked as 110th, and GDP per capita is 154th of 193 countries in the world.[9] In GDP per capita then, South Sudan seems to have better economic standards than other East African countries. However, these numbers mostly derive from its oil production. Most of the people in South Sudan live without direct access to the income from oil—82 percent of the population resides in rural areas, and 49.4 percent exist below the poverty line.[10] Scaled by the Gini index, South Sudan is ranked thirty-

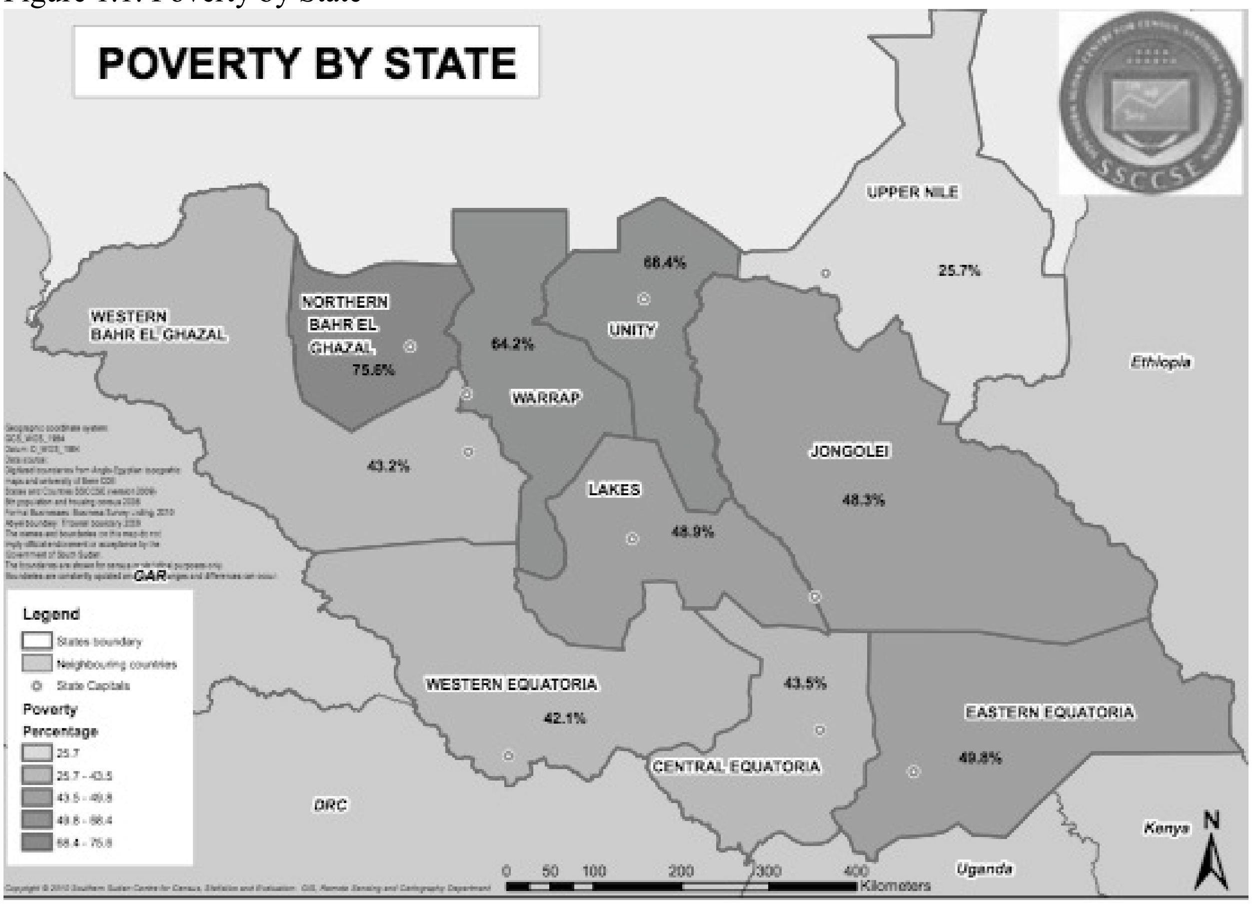
8. National Bureau of Statistics, "Release of First Gross Domestic Product (GDP) and Gross National Income (GNI) Figures for South Sudan by the NBS" (Juba: South Sudan National Bureau of Statistics 2011), 1–2.

9. "GDP in Current US$," The World Bank, accessed December 29, 2011, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD.

10. "Key Indicators for Southern Sudan" (Juba: Southern Sudan Center for Census, Statistics and Evaluation 2011), 1, 4.

fifth of all countries with a coefficient of 46, and is very close to Rwanda's ranking, which places thirty-third with a coefficient of 46.8.[11]

Figure 1.1: Poverty by State



Source: Southern Sudan Center for Census, Statistics and Evaluation (SSCCSE)

Figure 1.1 shows the poverty head counts by region. Regions in the northern part—Northern Bahr El Ghazal, Warrap, and Unity—have more than 60 percent of people below the poverty line, while the Upper Nile, where fertile soil is available for agriculture, has 24 percent of people below the poverty line. In comparison between urban and rural areas, rural areas have many more poor people than those in urban areas. Poverty head count of rural areas is 55 percent, while that of urban areas is 24 percent. Apart from oil production, the level of the economy in

11. "Distribution of Family Income—Gini Index," Central Intelligence Agency, accessed December 29, 2011, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2172rank.html.

South Sudan remains low, and the country has a specific problem given the living standards of the rural poor.

1.3 Industry

1.2.1 Oil Sector

The oil sector is *the* crucial industry in South Sudan. Since its discovery in the 1970s, oil has been a dominant factor in economics and politics for both the northern and southern areas of Sudan. Oil production started in the 1990s while South Sudan was still part of Sudan. Although currently Sudan has some resources, most of the oil fields are located in South Sudan. From an output of only two thousand barrels per day (bpd) in 1993 in the former Sudan, production reached 490,000 bpd by 2009. The dominant players of the South Sudanese oil production sector are China National Petroleum Corporation (CNPC), Petronas of Malaysia, and Oil and Natural Gas Corporation (ONGC) of India, which are wholly or partly state-owned oil companies. As is the case in neighboring Sudan, oil production of South Sudan is considered to have reached its peak at this time.[12] The World Bank expects that oil output from both Sudan and South Sudan will peak in 2012 at around 527,000 bpd and will start to decline sharply starting in 2015 unless new discoveries of oil wells are made.[13]

With 98 percent of its national revenue depending on oil, the GoSS will soon be required to transform its budgetary policy in preparation for the anticipated oil production decline. Since the CPA in 2005, GoSS has been creating its national budgets based on revenue sources from oil, personal income tax, customs, VAT, and other national income streams. However, non-oil revenues from these taxation policies are very limited in their contribution to the budget of the

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12. Jill Shankleman, "Oil and State Building in South Sudan" (Washington DC: United States Institute of Peace 2011), 2–3.
13. "Sudan," *The World Bank*, accessed December 29, 2011, http://data.worldbank.org/country/sudan.

country, and South Sudan will face severe challenges in securing its revenue base as its oil production starts to decline.

Figure 1.2: National Revenue of South Sudan

(Million SSP)

	2005	2006	2007	2008	2009	2010	*2011E*
Revenue	1,870	2,736	2,978	6,790	4,240	5,757	*5,767*
Oil Revenue	1,869	2,733	2,965	6,671	4,121	5,630	*5,656*
	100.0%	**99.9%**	**99.6%**	**98.3%**	**97.2%**	**97.8%**	***98.1%***
Non-Oil Revenue	1	3	13	119	118	127	*111*
	0.0%	**0.1%**	**0.4%**	**1.7%**	**2.8%**	**2.2%**	***1.9%***

Note: 1 USD = 2.9–3.3 SSP

Source: Ministry of Finance and Economic Planning, South Sudan

1.2.2 Non-oil Sectors

The second-largest industry of South Sudan next to oil is agriculture. As much as 78 percent of the population is involved in this sector, and the main products are crops and cattle. The country holds one of the richest agricultural areas in Africa. In the White Nile Valley, very fertile soils and abundant water are available. The region also supports 10 to 20 million head of cattle.[14] Of an area of 644,329 square kilometers, 37.7 percent is arable land, although only four percent of the total land is currently cultivated. Farmers are mostly located in rural areas, and their agricultural products are mainly produced for their own livelihood.[15] Access to local markets and trade is very limited, and this results in very limited income levels for rural farmers. However, there is large potential for growth in the agricultural sector of South Sudan, given its large and untapped arable land and expected investments from GoSS and international partners.

14. "The World Factbook—South Sudan," Central Intelligence Agency, accessed December 30, 2011, https://www.cia.gov/library/publications/the-world-factbook/geos/od.html.

15. "Agriculture and Rural Development—Sudan," The World Bank, accessed December 30, 2011, http://data.worldbank.org/topic/agriculture-and-rural-development.

Agriculture is the most promising sector for South Sudan to sustain its revenue base after the decline in the oil sector.[16]

The other sectors in South Sudan are still too primitive to significantly contribute to the revenue of the GoSS. Other than oil and agriculture, tourism holds the most potential. South Sudan contains large wildlife herds—these could be exploited in the future to attract ecotourists. GoSS plans to develop tourism utilizing its six national parks as major visiting spots for international tourists. GoSS has been continuing investments in these parks by constructing information centers.[17] Attraction to these national parks as spots for ecotourism has been enhanced recently. National Geographic Society, a nonprofit scientific and educational organization in Washington D.C., filmed and reported a huge number of white-eared kobs migrating across the national parks in its *Great Migrations* television program.[18] Since the establishment of South Sudan, the tourism sector has been proactively advertising its ecotourism opportunities, especially emphasizing the safety of the country. Though still primitive, tourism could become one of South Sudan's mainstream industries in the next 10 or 20 years.

It is an urgent matter for South Sudan to raise alternative industries that will contribute to governmental revenue after the decline of oil production. Agriculture and tourism have potential, but they are still somewhat immature to pay an adequate amount of tax revenue to GoSS. Revenues from these industries are very limited, and they also cannot play the role of acquiring foreign currencies from international partners. The fiscal and monetary policy of South Sudan

16. Jill Shankleman, "Oil and State Building in South Sudan" (Washington DC: United States Institute of Peace 2011), 13.

17. Ministry of Finance and Economic Planning, "Approved Budget 2011" (Juba: Government of Southern Sudan 2011), 3.

18. Wolfgang H. Thome, "National Geographic Boosts Southern Sudan tourism," *Global Travel Industry News*, accessed December 30, 2011, http://www.eturbonews.com/19921/national-geographic-boosts-southern-sudan-tourism.

will therefore be based on the activities of the oil sector for the foreseeable future, and possibly for several more decades.

1.4 Infrastructure Development

Although infrastructure development is key to economic growth, the infrastructure of South Sudan is limited. Due to the long-lasting civil war with Sudan, the country is devastated and underdeveloped. During the CPA-defined interim period from 2005 to 2010, South Sudan focused on reestablishing regional transport links, access to and facilities of seaports, and liberalization of the information communication and technology (ICT) sector. The country's annual infrastructure funding gap is USD 879 million per year. Considering that meeting the total needs of the country is beyond its reach in the medium term, South Sudan must adopt firm priorities for its infrastructure spending. With the expected decline of oil production, which accounts for 98 percent of the annual budget of South Sudan, it also must attract international and private sector investments with lower-cost technologies to fill in the funding gap.[19]

Road density in South Sudan is among the lowest in the African region. Connections of roads with neighbors are limited, especially in the north. Most traffic is between Juba, the capital of South Sudan located in the southern part of the country, and Uganda, which shares a border in the south of South Sudan. Elsewhere, road transportation does not work for commercial purposes due to nonexistence, or to poor conditions. The distant port of Mombasa, Kenya, provides connectivity to the sea. The country's power generation and transmission networks are still in a primitive state. An electricity network is available only in Juba with a very small distribution system. Power networks are not available in the remaining regions of the country. Water is naturally available in South Sudan, especially in the Nile areas, which provide ample irrigation

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19. Rupa Ranganathan and Cecilia M. Briceno-Garmendia, "South Sudan's Infrastructure" (Washington DC: The World Bank 2011), 1.

options to farmers. However, only four percent of the land is currently cultivated, even though 37.7 percent of the total land of South Sudan is considered arable.[20] The ICT sector is also underdeveloped. In 2005, landline subscriptions were 0.11 percent, and the number of active SIM cards was 12 percent, which is less than half of the other parts in Africa.[21]

Even though the budget of South Sudan seems to be abundant due to oil revenue, the budget for infrastructure is limited. GoSS is required to consider the cost efficiency of infrastructure development to cope with the expected budget constraints after the reduction of oil production starting around 2015. As Figure 1.3 shows, the current budget spent for infrastructure is less than 15 percent of the total GoSS budget. Despite the increasing size of the total budget, the allocation for infrastructure has not been increased in relation to the other budgets. GoSS needs to make more investments toward infrastructure development, with the purpose of both more efficient economic growth as well as cost reduction, in preparation for the reduced amount of revenue from the oil sector which will become a reality in only a few years. The largest obstacle is the budget for security, accounting for SSP 1,600 million and 27.8 percent of the total estimated budget of 2011. After ceasing the civil war with Sudan and gaining its independence, South Sudan needs to restructure its budget plan away from investments in security.[22]

20. Ibid, 7.
21. Ibid, 35.
22. Ministry of Finance and Economic Planning, “Approved Budget 2011” (Juba: Government of Southern Sudan 2011), 3.

Figure 1.3: Estimated Budget and Outturns of South Sudan in Infrastructure Development

(Million SDG)

	2009		2010		2011E	
Economic Functions (For Infra.)	78.3	2.0%	131.6	2.3%	159.6	2.8%
Electricity Corporation	42.3	1.1%	64.6	1.1%	89.1	1.5%
Information and Broadcasting	28.6	0.7%	48.7	0.9%	47.3	0.8%
Investment	1.5	0.0%	1.8	0.0%	9.9	0.2%
Telecom and Postal Services	5.9	0.1%	16.5	0.3%	13.4	0.2%
Infrastructure	600.3	15.0%	674.6	12.0%	618.8	10.7%
Housing and Physical Planning	61.1	1.5%	62.5	1.1%	61.8	1.1%
Transport and Roads	515.2	12.8%	541.8	9.6%	480.5	8.3%
Urban Water Corporation	7.9	0.2%	15.5	0.3%	18.7	0.3%
Water Resources and Irrigation	16.1	0.4%	54.8	1.0%	57.8	1.0%
Total GoSS Budget and Outturns	**4,012.0**		**5,629.5**		**5,757.1**	

Note: Only topics relevant to infrastructure development are shown in Economic Functions.
1 USD = 2.9–3.3 SSP

Source: Ministry of Finance and Economic Planning, South Sudan

1.5 Trade

Details of South Sudan's exports are hard to determine without appropriate data, but they are almost equivalent to the amount of oil produced, which is around USD 2 billion (SSP 6 billion) per year. For imports, South Sudan imports goods from neighboring East African countries such as Kenya and Uganda. In 2009, South Sudan imported goods from Kenya by USD 144.5 million and from Uganda by USD 184.6 million. South Sudan intends to join the East African Community trade block. Kenya Commercial Bank and SABMiller of South Africa operate in South Sudan now, and there is a potential for the country to accelerate its trade with these African countries. South Sudan also intends to open new oil pipeline routes from the country to Kenya and Uganda, though this could take many years. Trade and business relationships with these countries are becoming more and more important for the economic growth of South Sudan.[23] Though still limited, business cooperation with Sudan as trade partners also makes significant sense for South Sudan. Sharing resources and goods as it currently does with Kenya and Uganda is an inevitable part for the country to propel effective economic growth.

1.6 Foreign Direct Investment

Foreign direct investment (FDI) in South Sudan is limited because of its history of insecurity during and after the civil war. The country especially needs a large amount of infrastructure development with more cost efficiency, and is calling for international private participants. Right before independence, the vice president of South Sudan, Riek Machar, told the Ambassador of the United States that the country projects up to USD 500 billion worth of investment over the five years following 2011. He stated the intention of South Sudan to become the hub of Africa both geographically and economically, like Singapore or Dubai. He mentioned the plan of constructing an international airport in South Sudan, as well as other types of infrastructure development.

2. Monetary and Fiscal Status

The financial system of South Sudan has been malfunctioning. This is attributed to the corruption of central bankers, heavy dependence on oil revenues for its budget, and the high inflation rate of its currency SSP, which is currently linked to the U.S. dollar within a band. To structure a functional financial system, South Sudan needs to solve each of these problems, though this is a very difficult undertaking. This chapter shows in detail the monetary and fiscal policy that South Sudan currently follows and the problems it has. For monetary policy, current roles and associated problems of BoSS will specifically be shown. As for fiscal policy, those of

23. Jeremy Clerk, "South Sudan Balances North, African Trade after Split," *Reuters*, July 5, 2011, accessed January 2, 2012, http://www.reuters.com/article/2011/07/05/us-sudan-south-africa-idUSTRE7643E520110705.

MFEP will be described. Finally, the current status and problems of commercial banks in South Sudan will be explained to investigate the functions of the financial markets in South Sudan.

2.1 Monetary Policy

The BoSS acts as the central bank of South Sudan and manages the monetary policy of the country. It was established as a branch of the Bank of Sudan when the CPA was agreed on. Although actual independence was realized on July 9, 2011, the BoSS acted as a virtual central bank for the southern part of Sudan prior to that. Since its establishment, BoSS has been criticized for not functioning well. Only one month after independence, Elijah Malok, the governor of BoSS, was dismissed from his position by President Salva Kiir.[24] The main reason was considered to be the serious slide of SSP relative to the U.S. dollar. Though BoSS did not have any control over the exchange rate due to its absolute peg to the Sudanese pound (SDG), the governor had to take responsibility for the decline of the currency's value. BoSS sold a certain amount of U.S. dollars to stop the slide.[25] Under such unstable functions of BoSS, foreign exchange rates and inflation are not well managed in South Sudan. To stabilize the monetary policy of South Sudan, especially in foreign exchange rate and inflation, firm functions of BoSS are necessary.

2.1.1 Foreign Exchange Rate

Between July 18 and September 1, 2011, SSP was first circulated by converting approximately SDG 1.771 billion of the estimated SDG 2.1 billion in circulation in South Sudan to SSP at a one-to-one rate of exchange. BoSS had announced its intention to peg the SSP to the

24. "South Sudan's Salva Kiir Sacks Bank Chief Elijah Malok," *BBC*, August 17, 2011, accessed January 2, 2011, http://www.bbc.co.uk/news/world-africa-14559331.
25. "South Sudan C. Bank Governor Replaced by Deputy," *Reuters*, August 16, 2011, accessed January 3, 2012, http://af.reuters.com/article/investingNews/idAFJOE77F0AJ20110816.

U.S. dollar by December 2011.[26] However, to align with oil exports, which are the main industry of South Sudan, this policy is problematic in foreign exchange. Thus an exchange rate regime managed within a band has currently been used for SSP. Floating the exchange rate within a band was introduced in September 2011 to stop the weakening rate of SSP to foreign currencies, especially to the U.S. dollar. In the current policy, SSP is controlled as a band, between SSP 2.9 and 3.3, to one U.S. dollar. This policy is based on the lesson that a scarcity of U.S. dollars has caused the SSP to depreciate sharply, sliding to over four pounds against the U.S. dollar on the black market. To stabilize the exchange rate, BoSS has been supplying U.S. dollars using funds from oil revenues.[27]

BoSS has been making injections of U.S. dollars into the domestic financial market at the rate of USD 200 million weekly. This was increased from USD 100 million in October 2011, to cope with the increased demand for the U.S. dollar. Reasons for the increase are to ease the rise in prices and soaring inflation, and because of increasing speculation on foreign exchanges by market speculators who buy and hold U.S. dollars for a period and sell them in or out of the South Sudanese market when U.S. dollars become scarce. The updated policy of BoSS includes the increase of weekly foreign exchange allocated to the commercial banks for imports from USD 2 million to 4 million, weekly foreign exchange allocated to the Forex Bureaus from USD 200,000 to 400,000, and foreign exchange allocation for medical treatment, school fees, and outside of the country trips from USD 500,000 to 1 million. BoSS also increased its monitoring capacity and enforced penalties for noncompliance.[28]

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26. United Nations Security Council, "Report of the Secretary-General on South Sudan" (New York: United Nations 2011), 3.

27. "S. Sudan Sets Exchange Rate Target Band," *Reuters*, September 27, 2011, accessed January 3, 2012, http://af.reuters.com/article/investingNews/idAFJOE78Q0MG20110927?sp=true.

28. Mading Ngor, "Bank of South Sudan Doubles Foreign Exchange Quota for Financial Institutions to Meet Rising Demand," *The New Sudan Vision*, October 15, 2011, accessed January 3, 2012, http://www.newsudanvision.com/index.php?option=com_content&view=article&id=2464:bank-of-south-sudan-

The exchange rate regime of South Sudan is dependent on the amount of oil exports and the still-existing black market of foreign exchange. Domestic flows of U.S. dollars can be controlled by the central bank with capital injections into the market and this has been part of the current effort of BoSS. In the black market, U.S. dollars are traded with an exchange rate of SSP 4 for a U.S. dollar. Elimination of the black market should be prioritized to maintain the official exchange rate band of between SSP 2.9 and SSP 3.3 for a U.S. dollar.

2.1.2 Inflation

The inflation rate has been high since the establishment of South Sudan. The consumer price index (CPI) increased by 0.7 percent from November to December 2011, which equals a 65.6 percent increase since December 2010. The increase of CPI in South Sudan is driven by higher prices of alcoholic beverages and tobacco, which increased by 55.6 percent. Clothing and food prices increased by 28.2 percent compared with November 2011.[29] The black market in South Sudan for foreign exchanges between SSP and U.S. dollars is also considered to be a contributor to the high inflation of the country. It depreciated the value of SSP against U.S. dollars by exchanging SSP 4 to a U.S. dollar, while the official rates are settled between SSP 2.9 and 3.3 per U.S. dollar. The rise in food prices, one of the major contributors to the current high inflation of South Sudan is the trade with Sudan. After dividing the border with Sudan in July 2011, South Sudan imported most goods from Sudan. These used to be available without involving a cross-border transaction before independence in July 2011. Compared to the CPI of Sudan, the rates of South Sudan have been much higher since its independence.

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doubles-foreign-exchange-quota-for-banking-services-to-meet-rising-demand-&catid=1:sudan-news-stories&Itemid=6.

29. "Consumer Price Index for South Sudan," *The Republic of South Sudan National Bureau of Statistics*, accessed February 3, 2012, http://ssnbs.org/cpi/.

2.1.3 Corruption

South Sudan has many of cases of corruption, most of which have not been dealt with. To cope with the problem, President Kiir stressed the importance of anticorruption efforts in his national agenda, including this sentiment in several official statements since independence. The government has set legislative programs to combat corruption. The programs turned into five proposed acts related to public financial management and accountability, procurement, internal auditing, and petroleum and oil revenue management. The government has also launched the investigation and prosecution of corruption cases and the publication of investigation results, the enforcement of the declaration of public officials' income and assets, the review of land sales during the transaction period, and the facilitation of the anonymous return of illegally diverted funds.[30]

Despite such efforts, a serious case of corruption by BoSS bankers has since occurred. In October 2011, more than 20 central bankers were arrested for committing illegal foreign currency dealings. They seem to have bought U.S. dollars at the official rate of between SSP 2.9 and 3.3 and sold them on the black market, where a dollar rate goes beyond SSP 4. The incident was in the middle of a period of severe inflation in South Sudan, when it was experiencing inflation of 57.1 percent in August 2011 and 61.5 percent in September 2011. BoSS thus announced a weekly injection of USD 200 million to stabilize the foreign exchange rate of SSP.[31] BoSS has been forced to cope with not only serious inflation and depreciation of SSP against the U.S. dollar, but also the internal corruption of its bankers. The establishment of a

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30. United Nations Security Council, "Report of the Secretary-General on South Sudan" (New York: United Nations 2011), 3.

31. "South Sudan's Central Bank to be Investigated over Black Market Forex Dealings," *Sudan Tribune,* October 22, 2011, accessed January 3, 2012, http://www.sudantribune.com/South-Sudan-s-Central-Bank-to-be,40505.

rigid compliance system is urgently required for BoSS to prevent such corruption and to form a sound financial market in South Sudan.

2.2 Fiscal Policy

The core fiscal policy of GoSS is to distribute its oil revenue to the other sectors. These sectors include security (26 percent in the national budget for 2010), public administration, infrastructure (13 percent each), local states (12 percent), rule of law (11 percent), education (7 percent), natural resources (5 percent), health, economic functions, accountability (4 percent each), and social and human resources (2 percent). GoSS targets a gradual transition of revenue base from the oil sector to the taxes from other sectors by strengthening potential industries. However, tax revenue is currently very limited as a source of the GoSS budget. Of all the revenues of GoSS in 2010, 1.2 percent came from personal income tax; 0.4 percent from custom, VAT, and other revenue; 0.6 percent from other GoSS revenues; and 97.8 percent from oil revenues.[32] The most urgent and necessary challenge for GoSS on its fiscal policy is to establish a stable revenue base from tax sources.

2.2.1 Tax Policy

2.2.1.1 Personal Income Tax

According to the Personal Income Tax Act 2007 of South Sudan, the personal income tax rates are 0 percent for the people whose taxable income are up to SSP 300 (around USD 100 per year, assuming USD 1 = SSP 3), and 10 percent for the people whose taxable income are over SSP 300.[33] Having 51 percent of the population under the age of eighteen, the population of working age is less than half, and only 12 percent of those are paid employees. Furthermore,

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32. "Key indicators for southern Sudan," (Juba: Southern Sudan Centre for Census, Statistics and Evaluation 2010), 5.

33. Ministry of Legal Affairs and Constitutional Development, *Personal Income Tax Act 2007* (Juba: Government of Southern Sudan 2009), 9.

having 50.6 percent of the population under the poverty line of USD 1.25 per day, the number of those taxable in the population is very limited. Simply estimated, the taxable population is only around 550,000, or 6 percent of the total population.[34] It is difficult for GoSS to expect more personal income tax revenue from the people in both the number of the taxable population and level of income. Working-age people in unpaid jobs will continue working on them without cash transactions. Many of them will remain to live below the poverty line and incomes of under SSP 300 that are not taxable.

2.2.1.2 Corporate Income Tax

The corporate tax rates of South Sudan are specified according to the classification of companies. The rate is 10 percent for small businesses and enterprises, and 15 percent for medium-size businesses and enterprises.[35] Compared with the corporate tax rates in East Africa, most of which are 30 percent, the level of corporate income tax is much lower than the surrounding countries of South Sudan. Although several African countries have lower rates to encourage investors, including Egypt at 20 percent, South Africa at 28 percent, and Botswana, Ghana and Zimbabwe at 25 percent, rates in South Sudan are much lower.[36] The income tax rate of South Sudan is not high enough to make sufficient revenues from corporations. It seems effective to call for foreign investments from the international society in the country. Considering the current situation of South Sudan, which has just started its governance after the civil war, the existing corporate tax rates are rational at this stage. GoSS may, however, want to consider increasing the rates after the establishment of business foundations having enough corporations within its boundaries.

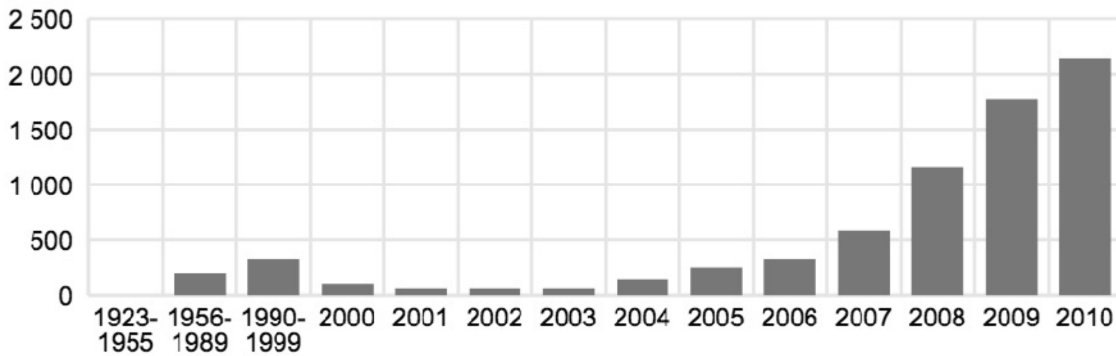
34. Entire population 9.28 million x rate of working age population (over 18) 0.49 x rate of paid employees 0.12 = 0.55 million.

35. “International Tax-South Sudan Highlights 2012,” (London: Deloitte Global Services Limited 2012), 2.

36. Fred Omondi, “Tax Measure for Tough Economic Times,” *The Standard*, (Nairobi: Deloitte & Touche 2011), 1.

Though still limited, the number of companies in South Sudan has steadily been increasing. In 2010, there were a total of 7,333 formal businesses in the country. Of these businesses, 84 percent consists of shops or restaurants. Most of these business entities were established in the three years from 2008 to 2010, accounting for more than 2,000 business registrations in 2010.[37] GoSS may accelerate the establishment of businesses for more years by holding corporate income tax rates at the current level, until the necessary number of businesses are operating in South Sudan.

Figure 2.1: Number of Business Establishments by Year



Source: South Sudan Centre for Census, Statistics and Evaluation

2.2.1.3 Value-Added Tax (VAT)

The standard rate of VAT in South Sudan is 10 percent,[38] and the revenue does not contribute much to the budget of GoSS. Combined with customs and other national revenue, VAT contributed only 0.4 percent to the total national revenue in 2010. The main reason for scarce revenue from VAT is the people's habit of consumption. In South Sudan, 52.7 percent of the total population use cash in a week, and 53 percent of the people of working age are unpaid family workers.[39] This habit of consumption does not appropriately fit the VAT system to collect

37. "Key indicators for Southern Sudan" (Juba: Southern Sudan for Census, Statistics and Evaluation 2011), 11.
38. "International Tax-South Sudan Highlights 2012" (London: Deloitte Global Services Limited 2011), 2.
39. "Key indicators for southern Sudan," (Juba: Southern Sudan Centre for Census, Statistics and Evaluation 2011), 11.

revenue from citizens. To be able to collect significant VAT revenue, GoSS needs to create local and central markets where agricultural and other goods are sold and bought by cash. However, this will take a long-term effort to stabilize the cash-transaction-based market in the country, and VAT cannot be a major source of tax revenue for GoSS.

2.2.2 Financial Policy

The financial activities of South Sudan are mostly dependent on commercial banking. Both GoSS and BoSS recognize the importance of developing and enforcing an autonomous and stable domestic financial framework for job creation, infrastructure development, global financial integration, and economic growth. In pursuing these goals, BoSS expressly recognizes two major priorities to creating a sound finance sector in South Sudan: first, refocusing its objectives to better service the citizens of South Sudan; and second, evolving and catering to the policy and regulation shifts conducted by BoSS. However, there are many obstacles that remain unsolved, and threats to the stability and growth of the local economy are greater than those typically found in other emerging countries.[40]

2.2.2.1 Governance of Private Financial Institutions

There are ten commercial banks licensed by BoSS in South Sudan: Agricultural Bank of Sudan, Bank of Khartoum Juba, Buffalo Commercial Bank, Commercial Bank of Ethiopia, Equity Bank, Ivory Bank, Kenya Commercial Bank, Mountain Trade and Development Bank, Nile Commercial Bank, and Ramciel National Bank. Of the commercial banks active in South Sudan, Nile Commercial Bank, Kenya Commercial Bank and Buffalo Commercial Bank are especially active in the commercial banking sector.

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40. "Finance," *Relief Aid and Development in South Sudan*, accessed January 23, 2012, http://reliefaid.com/Strategies/Finance/.

Figure 2.2: Commercial Banks of South Sudan

Name	Headquarters	Total Asset (USD)
Agricultural Bank of Sudan	Khartoum, Sudan	-
Bank of Khartoum Juba	Khartoum, Sudan	-
Buffalo Commercial Bank	**Juba, South Sudan**	-
Commercial Bank of Ethiopia	Addis Abeba, Ethiopia	4.45 billion
Equity Bank (South Sudan)	Nairobi, Kenya	1.5 billion
Ivory Bank	Juba, South Sudan	-
Kenya Commercial Bank (South Sudan)	**Nairobi, Kenya**	**2.65 billion**
Mountain Trade and Development Bank	Juba, South Sudan	-
Nile Commercial Bank	**Juba, South Sudan**	**-**
Ramciel National Bank	Juba, South Sudan	-

Source: Bank of South Sudan

Nile Commercial Bank (NCB) was the first commercial bank licensed in South Sudan following the signing of the CPA in 2005. Originally established in 2003, it has 20 branches in South Sudan and offices in Sudan, Kenya, and Uganda. It has 1,700 South Sudanese shareholders, and is diversified among many people, without a major shareholder. The main business of NCB is to provide loans to individuals and SMEs and currency-exchange services of U.S. dollars, Kenyan shillings, Ugandan shillings, euros, and pounds sterling, and trade finance instruments, such as letters of credit. NCB has close relationships with the Kenyan and Ugandan branches of Stanbic Bank. Stanbic Bank is a part of the Standard Bank Group Ltd., which is the largest banking group in Africa with more than USD 138 billion, and 44 countries in operation.[41]

NCB has experienced the dangers of bankruptcy twice in the six years since its establishment. In 2008, the bank nearly collapsed, but survived with USD 10 million of capital injection by GoSS. In 2009, NCB became nearly bankrupt again because of hundreds of defaults by borrowers, most of whom were believed to be GoSS officials and were financed by millions of dollars in total. The bank received USD 44 million (SDG 102 million) of capital injection by

[41] "The Nile Commercial Bank—South Sudan," *Nile Commercial Bank*, accessed January 23, 2012, http://www.southern-sudan.com/nilebank.htm.

GoSS and BoSS to recover from this crisis of its financial management.[42] It was divided in half by MFEP and BoSS, who each injected USD 22 million (SDG 51 million). The authorities of GoSS blamed the weak and inexperienced management of NCB for causing consecutive crises with nonperforming loans. The governor of BoSS warned that he would publish the names of defaulters if they failed to repay the money. To make matters worse, a journalist from the *Sudan Tribune* was arrested three times, after he wrote that NCB had run out of cash for operations because of the actions of GoSS officials.[43] Although NCB is considered to have recovered from its severe condition, doubts about its financial stability still exist three years after this official capital injection.

Kenya Commercial Bank Sudan (KCB Sudan) is the first international commercial bank of South Sudan. It started operations in 2005. KCB Sudan has five branches in South Sudan, including two in Juba. Its financial services include private corporate loans, asset finance, currency exchange, and trade finance. Because of its solid branch base, GoSS appointed KCB Sudan as the sole tax collection agent for the government. GoSS further expects that the bank will encourage foreign investments.[44] In 2009, KCB Sudan signed a USD 452 million contract with GoSS to build housing units for the civil servants of the semiautonomous government, planning to finance 1,750 houses ranging from low- to high-income borrowers. The main reason for launching this program was that most parts of South Sudan were destroyed by decades of

[42] "Finance," *Relief Aid and Development in South Sudan*, accessed January 23, 2012, http://reliefaid.com/Strategies/Finance/.

[43] "South Sudan Rescues Nile Commercial Bank, Restructures Management," *Sudan Tribune*, accessed January 23, 2012, http://www.sudantribune.com/South-Sudan-rescues-Nile.32255.

44. "KCB Opens Mega Branch in Juba, Pledges 10 More Outlets," KCB Sudan, accessed January 23, http://www.kcbbankgroup.com/su/index.php?option=com_content&task=view&id=238&Itemid=1.

civil war. Due to the lack of proper housing, rental fees have become expensive in Juba, and civil servants suffer from high prices for accommodation in tented camps or dilapidated buildings.[45]

At the current stage, KCB Sudan has been functioning well without any financial problems, and it responds well to the GoSS's intention for the creation of financial flow through the bank, opening branches and taking part in governmental programs such as building houses and collecting taxes. KCB Sudan will also be requested by GoSS to invite foreign investments to South Sudan. With its international and domestic reach, finance options, and financial stability, KCB Sudan will continue to be regarded as a key commercial bank in South Sudan by GoSS.

Buffalo Commercial Bank (BCB) was established shortly after the signing of the CPA between South Sudan and Sudan in 2005. BCB started its operations in Juba by receiving an operating license by BoSS.[46] The bank has branches in all the ten states of South Sudan, as well as in Khartoum, the capital of Sudan. The bank offers personal and corporate finance, currency exchange and trade finance.[47] Given its geographic reach in South Sudan, BCB is considered a strong candidate for the integration of civil society and private institutions in the country. Focusing on recovery, reconstruction, and reintegration, BCB is expected by GoSS to provide extensive support for individuals and business entities in South Sudan.[48]

The above three commercial banks are essential to the financial and development plans of MFEP and BoSS. These two public bodies consider that financial institutions need to align themselves with the needs of the South Sudanese, have a broad reach within the country to overcome logistical gaps in the current infrastructure conditions, have an established credibility

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45. "Finance," *Relief Aid and Development in South Sudan*, accessed January 23, 2012, http://reliefaid.com/Strategies/Finance/.
46. "About Buffalo Commercial Bank," Buffalo Commercial Bank, accessed January 23, 2012, http://buffalocommercialbank.com/about.
47. "Products and Services," Buffalo Commercial Bank, accessed January 23, 2012, http://buffalocommercialbank.com/products_services.php.
48. "Finance," *Relief Aid and Development in South Sudan*, accessed January 23, 2012, http://reliefaid.com/Strategies/Finance/.

with domestic and international parties, focus on development as well as on commercial lending, and contribute to the maintenance and creation of an environment conducive to existing and potential international investments and capital inflows.[49] At the same time, however, GoSS needs to support financial restructuring of weaker commercial banks operating in South Sudan. For example, GoSS granted more than USD 7 million by 2009 to Ivory Bank, which was heavily indebted and needed a shift to become a profitable bank. GoSS granted its financial resource to Ivory Bank so that it can move its headquarters from Sudan to South Sudan, considering the importance of the bank for facilitating imports of agricultural products to South Sudan.[50]

Of the budget planned by MFEP in 2011, GoSS spent additional SSP 21 million (USD 8 million) in grants to Ivory Bank and NCB as general administration expenses. In the budget of 2011, MFEP explicitly shows its intent to support NCB whenever necessary.[51] GoSS strategy on governing the commercial banks active in South Sudan is to make every effort to sustain their existence in good financial condition, no matter how vulnerable their current statuses. GoSS puts priority on the stabilization of the private financial sector. While grants to Ivory Bank have been continuing, GoSS sees that the current main target of financial restructuring is Nile Commercial Bank, as Ivory Bank has been recovering from its heavy debts and shifting to a phase of profit making.

2.2.2.2 Debt Funding

South Sudan is basically a debt-free country. It was established without inheriting any outstanding debt of Sudan from IMF and the World Bank. An IMF statement confirmed that

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49. Ibid.

50. James Gatdet Dac and Isaac Vuni, "South Sudan Pays $11 mln to Ivory Bank," *Sudan Tribune*, April 28, 2009, accessed January 23, 2012, http://www.sudantribune.com/South-Sudan-pays-11-mln-to-Ivory,31012.

51. Ministry of Finance and Economic Planning, *Approved Budget 2011* (Juba: Government of Southern Sudan 2011), 59, 66.

"Sudan continues its membership in the IMF and retains all of its quota in the IMF, and all assets in, and liabilities to, the IMF."[52] After independence, South Sudan started planning to borrow its own debt from international financial institutions (IFIs), mainly for its infrastructure development.

Currently, South Sudan borrows USD 250 million from the IMF, African Development Bank (AfDB), and other international banks. In addition to the above loans, GoSS plans to borrow USD 679 million in the 2011-2012 fiscal years to invest in its road and rail networks. GoSS also plans to borrow additional USD 750 million in the 2012–2013 period. This is considered to be a strategy to cope with the difficulties of oil exports in the international markets. GoSS considers abundant capital necessary to avoid stalling the implementation of ongoing infrastructure projects due to scarcity of funds. The construction of oil refinery projects in Akon, Bentiu, Malakal, and Bor were suspended due to financial constraints. The loan from the World Bank and other public financial institutions is seven years in tenor with 5.2 percent of annual interest rate.[53]

Funding through government bonds is still difficult for South Sudan. Due to the continuing tension and frequent riots with Sudan along the border, South Sudan's political instability reduces its ability to acquire a satisfactory credit rating from credit rating agencies. At the same time, South Sudan has been experiencing high inflation that makes the stability of its currency weaker. Sudan, with abundant oil resources like South Sudan and as an Islamic country, raised EUR 100 million (USD 147 million) from the sale of Islamic bonds in 2008. Along with the turmoil in global credit markets triggered by the U.S. subprime home loan market, the

52. "South Sudan Born Free from IFI Debt," *Bretton Woods Project*, September 14, 2011, accessed January 23, 2012, http://www.brettonwoodsproject.org/art-568923.

53. "South Sudan Seeks over $600 Million from International Banks," *Sudan Tribune*, December 3, 2011, accessed January 23, 2012, http://www.sudantribune.com/South-Sudan-seeks-over-600-million,40888.

Islamic bond market was very active at that time to avoid the international capital markets.[54] Although Sudan does not have credit ratings from major credit rating agencies, such as Moody's and Standard and Poor's, the country has "C" rating with a stable outlook for local and foreign currency ratings received from Dagong Global Credit Rating, a Chinese credit rating agency.[55] As well as Sudan, South Sudan has potential to finance its fiscal budget with government bonds from international capital markets. However, not being an Islamic country, accessing Islamic financial markets as Sudan did is not possible for the country, and the higher credit ratings necessary to raise governmental bonds from international capital markets would not be available for South Sudan. Funding of South Sudan will continue to be through borrowing from IFIs such as IMF, the World Bank, and AfDB.

2.2.3 Government Expenditure

2.2.3.1 Budget Distribution

The main strategy of GoSS is to distribute its financial resources to security and growing sectors in the country. Current top priorities of the budget are (1) Security, (2) Roads, (3) Primary health care, (4) Basic education, (5) Water, and (6) Production.[56] Being right after its independence and still facing unstable security along the border with Sudan, GoSS allocates a large portion of its budget to security. Budget allocation for infrastructure, health care, and industry come after security in terms of priority. The amount of the security budget has been increasing, even after five years have passed since the conclusion of the CPA in 2005,

54. "Sudan Raises Funds in First Islamic Bond Sale," *Sudan Tribune*, January 9, 2008, accessed January 24, 2012, http://www.sudantribune.com/Sudan-raises-funds-in-first,25506.

55. "Dagong Maintains Sovereign Credit Rating of Austria, Sudan," ChinaDaily.com, January 19, 2012, accessed January 24, 2012, http://www.chinadaily.com.cn/bizchina/2012-01/19/content_14478271.htm.

56. Ministry of Finance and Economic Planning, "Approved Budget 2011" (Juba: Government of Southern Sudan 2011), 1.

accounting for SDG (or SSP) 1,627 million in 2011, and increasing by roughly SDG 400 million from SDG 1,205 million in 2006.

Figure 2.3: GoSS Budget Outturns and Estimates 2006–2011

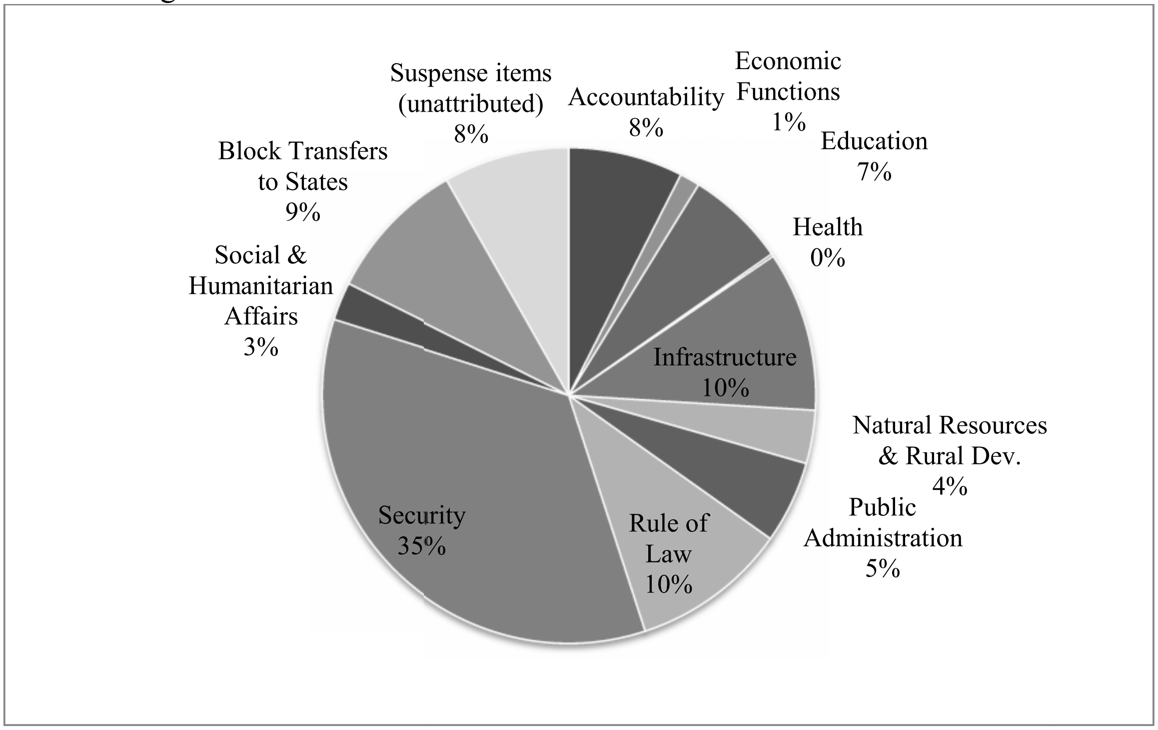
(Million SDG)

	2006	2007	2008	2009	2010	2011E
Accountability	259	71	656	333	533	197
Economic Functions	45	53	195	95	162	206
Education	225	233	290	5	279	429
Health	6	4	114	97	139	224
Infrastructure	**361**	**170**	**814**	**536**	**636**	**619**
Nat. Resources & Rural Dev.	120	109	196	179	185	266
Public Administration	186	235	513	348	845	771
Rule of Law	351	257	515	529	666	561
Security	**1,205**	**1,192**	**1,882**	**1,411**	**1,515**	**1,627**
Social & Humanitarian Affairs	85	38	84	39	73	129
Block Transfers to States	324	416	453	439	543	728
Suspense items (unattributed)	284	95	-	0	-	-
OVERALL TOTAL	3,451	2,874	5,713	4,012	5,576	5,757

Source: GoSS Budget 2011, Ministry of Finance and Economic Planning, GoSS

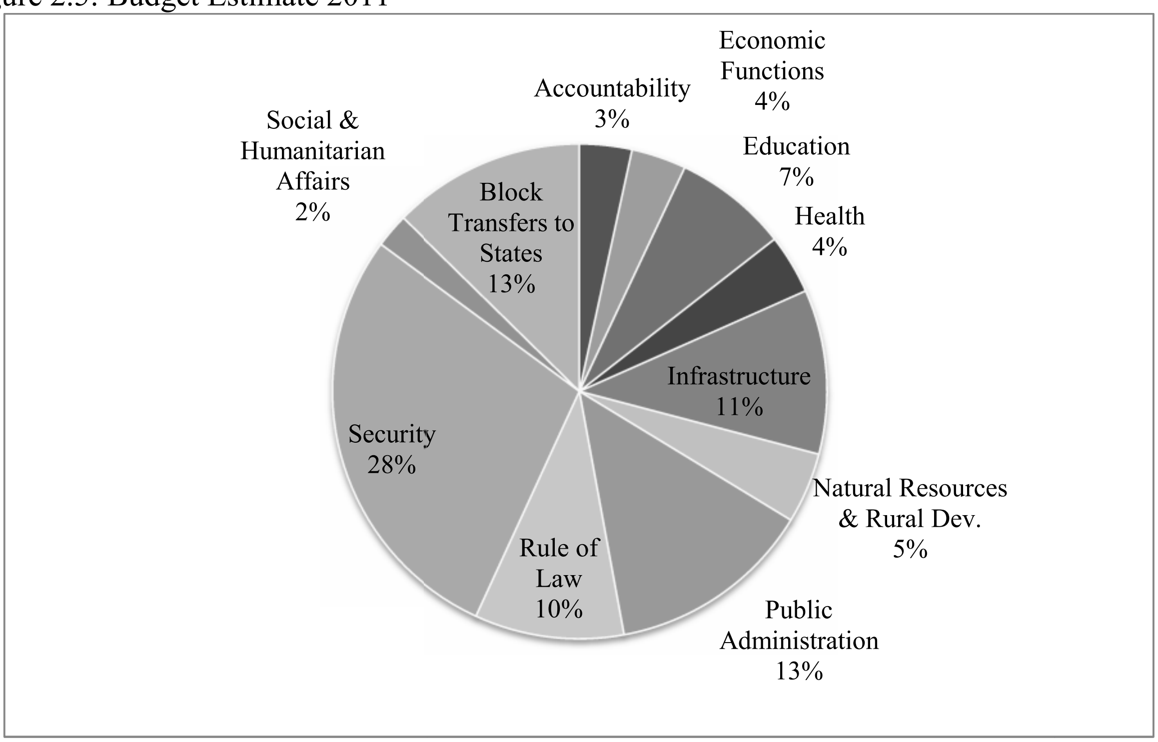
In accordance with the revenue increase from oil production, the share of security in the total budget has decreased by 7 percent, from 35 percent in 2006 to 28 percent in 2011. However, the amount still accounts for around 30 percent of the national budget of GoSS, and the other major prioritized areas in budgeting, such as health care, infrastructure, and education, are not sufficiently budgeted. Of the budget for 2011, 11 percent was allocated to infrastructure, 7 percent for education, and 4 percent for health care, only accounting for 22 percent of the total amount of the budget. The numbers are not much different with the outturn of 2006, where 10 percent of the expenditure was for infrastructure, 11 percent for education, and 0 percent for health care—thus, accounting for 21 percent of the total. Drastic expansion of governmental expenditures in top budget priorities other than security is critical for South Sudan, to ensure its further economic development and growth.

Figure 2.4: Budget Outturn 2006



Source: GoSS Budget 2006, Ministry of Finance and Economic Planning, GoSS

Figure 2.5: Budget Estimate 2011



Source: GoSS Budget 2011, Ministry of Finance and Economic Planning, GoSS

2.2.3.2 Balance of Payments

The revenues and expenditures of GoSS are well balanced in South Sudan. Outturns of expenditures are mostly within the revenues each year except for 2006. The main problem in budgeting and expenditure in the future is to manage the annual budgets when the decline in oil revenues starts around 2015. As GoSS intends in its budgetary priorities, development in infrastructure, health care, and education are important factors for future economic development of the country after oil production declines. To do so, the development of security in the country, especially with Sudan, is significant. South Sudan needs to reduce expenditures on security within three to four years, setting the deadline for 2015, when oil revenue decline will start.

Figure 2.6: GoSS Revenues and Expenditures: 2005–2011

(Million SDG)

	2005	2006	2007	2008	2009	2010	2010E
Revenue	**1,870**	**2,736**	**2,978**	**6,790**	**4,240**	**5,757**	**5,767**
Oil Revenue	1,869	2,733	2,965	6,671	4,121	5,630	5,656
Non-Oil Revenue	1	3	13	119	118	127	111
Expenditure	**452**	**3,582**	**2,936**	**5,713**	**4,235**	**5,576**	**5,767**
Salaries	35	1,186	1,480	1,873	1,977	2,206	2,433
Operating	402	1,438	1,058	2,227	1,255	2,280	2,076
Capital	15	958	398	1,612	1,002	1,091	1,258
Balance	**1,417**	**-845**	**41**	**1,077**	**5**	**181**	**0**
GoNU Direct Expenditures	191	81	89	24	-	-	-
Residual/Exchange Loss	16	5	-	65	-	167	-
Reserves/Deficit	**1,211**	**-932**	**-47**	**988**	**5**	**14**	**0**

Source: GoSS Budget 2011, Ministry of Finance and Economic Planning, GoSS

3. Comparative Policy Analysis with Oil-Exporting Countries

South Sudan has been trying to accomplish its economic development through its currently abundant oil revenues. However, the level of oil production is predicted to decline after its peak in 2015. GoSS is urged to satisfy the financial needs of domestic sectors for development, including infrastructure, agriculture, and tourism. This chapter examines possible means of economic development utilizing oil resources by referring to the experiences of other oil-exporting countries. These countries are chosen by three criteria: (1) the budget of the country is heavily dependent on oil revenues, (2) the size of the economy is relatively smaller than major oil-exporting countries, and (3) policies are different among each other within the entire basket of countries.

3.1 Monetary Policy

BoSS governs the monetary policy of South Sudan as the central bank. Its major role is to manage exchange rates to stabilize the revenue from oil exports. Management of the inflation level is also a significant problem for BoSS to tackle as the inflation rate of South Sudan in December 2011 was recorded to be as high as 65.6 percent. Although it eased from 78.8 percent in November 2011, the rate remains high, and it is again expected to rise in 2012.[57] Policies on exchange rates and inflation are especially significant for South Sudan compared with other countries, considering its heavy dependence on oil exports and its underdeveloped economy. Also, its limited experience in managing monetary policy requires BoSS to make valuable references in order to make successful decisions in its future monetary policy. To obtain meaningful suggestions for the monetary policy of BoSS and GoSS, this section compares the monetary policies of relevant economies with South Sudanese policies on exchange and inflation rates.

3.1.1 Exchange Rate Regime

BoSS takes a floating exchange rate regime with a band for its currency SSP to the U.S. dollar. The range of the float is between SSP 2.9 and 3.3 to a U.S. dollar, and the government

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57. "South Sudan Inflation Eases to 65.6 pct in December," *Thomson Reuters*, January 6, 2012, accessed January 26, 2012, http://af.reuters.com/article/investingNews/idAFJOE80505G20120106.

tries to exclude black market transactions, where the currencies are traded in SSP 4 to a U.S. dollar. After independence in July 2011, SSP was pegged to SDG of Sudan for two months until September 2011, and it shifted to the current policy of floating with a band. Between the CPA in 2005 and its independence in 2011, South Sudan used Sudanese SDG as its official currency, and it started SSP at the time of independence with equal value to SDG, where one SSP equals to one SDG. This part examines the validity of the current exchange rate regime of floating linked to the U.S. dollar within a band in comparison with other oil-exporting countries with relatively small economic scale as shown in Figure 3.1.

Figure 3.1: Exchange Rate Regimes of Selected Oil-Exporting Countries

	Currency	Regime	Anchored Currency	Exchange Rate
Algeria	Algerian Dinar	Managed Float	U.S. Dollar	1 USD = 75.84 DZD
Brunei	Brunei Dollar	Currency Board	Singapore Dollar	1 SGD = 1 BD
Equatorial Guinea	CFA Franc	No separate legal tender	Euro	1 Euro = 655.957 CFAF
Kuwait	Kuwaiti Dinar	Pegged to a basket	U.S. Dollar (75–80%)	1 USD = 3.33745 KWD
Trinidad and Tobago	TT Dollar	Fixed peg	U.S. Dollar	1 USD = 6.25050 TTD
Sudan	Sudanese Pound	Float with a Band	U.S. Dollar	1 USD = SDG 2.67
South Sudan	*S. Sudanese Pound*	*Float with a Band*	*U.S. Dollar*	*1 USD = 2.9–3.3 SSP*

Source: International Monetary Fund

3.1.1.1 Choice of Anchor Currency

The U.S. dollar is used as external anchor of SSP in the floating exchange rate regime with a narrow band in South Sudan. It basically gives two benefits for oil-exporting countries. First, oil is invoiced in the U.S. dollar and the peg or float within a band stabilizes revenues in domestic currency terms as long as the oil price is stable. Second, the status of the U.S. dollar as an international currency allows oil producers to invest oil revenue in deep and liquid financial markets denominated in U.S. dollars, minimizing the currency risk and offering superior riskadjusted returns.[58] The major benefit for South Sudan is the first part, where it may stabilize the oil revenue avoiding currency risks.

Pegging to a currency with low inflation allows a small open economy to anchor domestic inflation expectations and import monetary stability. Member countries of the Gulf Cooperation Council (GCC) have enjoyed low inflation for a long time because of their long-standing U.S. dollar peg. However, more recently, the appeal of the U.S. dollar has been fading because of the loose monetary policies of the United States and the depreciation of the U.S. dollar since around 2010.[59] In comparing among the U.S. dollar, euro, and Singapore dollar, it seems that the stability against inflation and depreciation of value in the U.S. dollar does not function better than the other currencies.

Currencies used by trade partners of a country are important to stabilize the transaction prices of oil. The countries picked up in this section anchor their own currencies to the U.S. dollar, euro, and Singapore dollar. These countries seem to be making rational choices of their anchored currencies as each currency is used by the major importers of their oil products. Of the chosen countries, the United States acts as a major importer of Equatorial Guinea and Trinidad and Tobago. Trinidad and Tobago pegs its Trinidad and Tobago dollar (TTD) to the U.S. dollar. On the other hand, Equatorial Guinea pegs its CFA Franc to euro, while the United States is the largest importer of its oil products. It is because Equatorial Guinea imports their goods from Eurozone countries, where exchange rates for the euro have significance for its price stabilization of imported goods. Brunei pegs its Brunei dollar (BD) to the Singapore dollar, following the trade volume of both imports and exports of oil products which are heavily weighted on the Asia Pacific region. Of 58.8 percent of import directions from the Asia Pacific region, Singapore

58. Mauzirio M. Habib and Jan Strasky, *Oil Exporters in Search of an External Anchor* (London: European Central Bank 2008), 7.

59. Ibid, 7.

accounts for 33.5 percent. Brunei chooses its anchor currency mainly to stabilize the prices of its imported goods. For these oil-exporting countries, currencies with large trade volumes are prioritized over the stability and efficiency of the U.S. dollar for oil exports and inflation control.

Figure 3.2: Directions of Oil Exports

	U.S.	UK	Euro-zone	Japan	China	Asia Pacific	Others
Algeria	3%	-	72%	-	-	-	25%
Brunei	6%	-	-	14%	7%	28%	46%
Equatorial Guinea	31%	-	22%	-	12%	0%	35%
Kuwait	12%	-	6%	N.A.	N.A.	83%	0%
Trinidad and Tobago	100%	-	0%	-	-	-	0%
Sudan	-	-	-	11%	67%	19%	3%
South Sudan	-	-	-	-	*43%*	*48%*	*9%*

Note: Numbers are acquired from available data sets of the latest year.
1. Exports of Kuwait to Asia & Pacific include Japan and China, as specific data for these countries were not available.
2. Data of South Sudan were estimated by the shares of operating plants held by international explorers

Source: UN Comtrade and U.S. Energy Information Administration (EIA)

Figure 3.3: Directions of Exports in 2010 (All goods)

	U.S.	UK	Euro-zone	Japan	China	Asia Pacific	Others
Algeria	25%	N.A.	38%	N.A.	N.A.	N.A.	37%
Brunei	N.A.	N.A.	N.A.	46%	7%	35%	13%
Equatorial Guinea	24%	N.A.	27%	N.A.	6%	8%	35%
Kuwait	8%	N.A.	N.A.	16%	10%	29%	37%
Trinidad and Tobago	44%	N.A.	6%	N.A.	N.A.	N.A.	50%
Sudan	N.A.	N.A.	N.A.	13%	68%	6%	13%
South Sudan	*N.A.*	*N.A.*	*N.A.*	*N.A.*	*43%*	*48%*	*9%*

Note: Numbers only consist of top six import partners of the countries.
1. Numbers of South Sudan are estimated based on assumption that they almost equal to directions of oil exports, as 98 percent of the exported goods are oil products.

Source: CIA World Factbook

Figure 3.4: Directions of Imports in 2010 (All goods)

	U.S.	UK	Euro-zone	Japan	China	Asia Pacific	Others
Algeria	N.A.	N.A.	39%	N.A.	11%	N.A.	50%
Brunei	4%	7%	N.A.	5%	13%	58%	12%
Equatorial Guinea	N.A.	6%	30%	N.A.	21%	N.A.	42%
Kuwait	14%	N.A.	11%	7%	10%	N.A.	58%
Trinidad and Tobago	28%	N.A.	N.A.	N.A.	4%	N.A.	68%
Sudan	N.A.	N.A.	N.A.	N.A.	22%	N.A.	78%
South Sudan	*N.A.*	*N.A.*	*N.A.*	*N.A.*	*N.A.*	*N.A.*	-

Note: Numbers only consist of top six import partners of the countries.

Source: CIA World Factbook

Considering the exchange rate regimes of the selected oil-exporting countries, South Sudan may choose its anchor currency based on the currencies of its major trade partners. Major trade partners of South Sudan are China (43 percent), Malaysia (38 percent), and India (10 percent). Products exported to these countries are mostly oil products, accounting for 98 percent of total exports. Of the three countries, China is the major importer of the oil products of South Sudan. Data of importing goods are not currently available, but the key exchange rate strategy of South Sudan should be based on its oil exports, as the amount of imported goods are currently very limited. For South Sudan, anchoring SSP to a currency used in trades with China seems a rational choice. Although transactions of oil are mainly paid in U.S. dollars in the world market, Chinese Renminbi (RMB) could be a choice to which SSP could be anchored. However, South Sudan does not have to peg SSP to RMB as a single currency. It could choose a currency basket, as Kuwait currently applies.

Kuwait is the only GCC member country that pegs to a currency basket. Kuwait exports its oil products to the United States (8 percent), Japan (16 percent), China (10 percent), and the other countries in the Asia Pacific region. Kuwait had long kept the single currency peg to the U.S. dollar. However, it dropped the peg to the U.S. dollar in favor of a currency basket to overcome its soaring inflation in 2007. Witnessing the U.S. dollar depreciation against major currencies for a consecutive fifteen months in 2009, the other GCC countries—Saudi Arabia, United Arab Emirates (UAE), Qatar, Bahrain, and Oman—also considered introducing a currency basket in accordance with the suggestion of Kuwait.[60] Currently, Kuwait puts 75 to 80 percent of the weight on the U.S. dollar and pegs the rest of weight to the other currencies in its currency basket.

Under weak conditions of the U.S. dollar against major currencies, anchoring SSP to the currency bears revenue fluctuation risks of oil exports and inflation risk of imported goods for South Sudan. The current situation of the U.S. dollar is very similar to the conditions in which Kuwait decided to shift to a currency basket fearing inflation due to the depreciated U.S. dollar in 2007. Considering that the United States is not a major trade partner for South Sudan, the weight of the U.S. dollar could be even lower than that of Kuwait, whose exports and imports with the United States account for 8 percent and 14 percent, respectively. The portions of the currencies in the currency basket may be changed with respect to the status of the U.S. dollar and the trade portfolio of South Sudan.

3.1.1.2 Choice of Exchange Rate Regime

South Sudan applies a floating exchange rate regime with a band against the U.S. dollar for the exchange rate of SSP. The current official exchange rate is between SSP 2.9 to 3.3 for a U.S. dollar effective from September 2011, after setting a hard peg to SDG of Sudan for two months since the independence of South Sudan in July 2011. BoSS's main reasons for introducing the "floating within a band" regime were to cope with price fluctuations of oil prices, which is a significant revenue source of the country, and to exclude currency black markets in

[60] Rania El Gamal and Rania Oteify, "Gulf to Mull Single Currency Peg to Basket: Kuwait," *Reuters*, November 17, 2009, Accessed January 28, 2012, http://www.reuters.com/article/2009/11/17/businesspro-us-kuwait-union-idUSTRE5AG3BL20091117.

which SSP was traded by SSP 4 to a U.S. dollar. Although this policy has been managed for several months and up until now, it would be prudent to reconsider whether the policy is truly effective, taking into account the status of oil exports and the other issues.

3.1.1.2.1 Hard Peg

The theory of optimum currency area explains that countries with small and open trade with diversified export structures and flexible labor markets may take full advantage from an exchange rate peg or a currency union.[61] In this definition, South Sudan seems to satisfy the criteria of small and open trade with somewhat diversified export structures, having China, Malaysia, India, and Sudan as oil-export partners. However, imports are not very diversified compared to the exports. Also, the labor market is not so flexible considering an economy of many rural farmers isolated from choice of jobs and cash transactions in their daily life. One of the major benefits of pegging is that it fixes the inflation rate for internationally traded goods and thus directly contributes to keeping inflation under control. Another benefit of a currency peg is that if the exchange rate is credible, it is reasonable to anchor inflation expectations of the pegging country to that of the pegged country.[62] As long as the U.S. dollar is credible for its low inflation, pegging to the U.S. dollar is effective for South Sudan.

At the same time, however, a country which chooses to peg needs to abandon its independent monetary policy, and it thus becomes susceptible to speculative attacks and the potential to weaken the accountability of policy makers to pursue anti-inflationary policies.[63] If South Sudan pegs its SSP to the U.S. dollar or the other major currencies, BoSS would need to abandon its monetary policy and become vulnerable, if the country of the pegged currency

61. Mauzirio M. Habib and Jan Strasky, *Oil Exporters in Search of an External Anchor* (London: European Central Bank 2008), 10.
62. Frederic S. Mishkin, “The Dangers of Exchange-Rate Pegging in Emerging Market Countries,” in *Monetary Policy Strategy*, ed. Frederic S. Mishkin (Cambridge: MIT Press 2009), 445–447.
63. Ibid, 447.

experiences depreciation or high inflation. Currently, the inflation rate of the United States is not problematic compared with other countries that have major currencies. Given similarly low inflation rates in these countries, South Sudan would not have to avoid the U.S. dollar due to the sole reason of inflation. The major problem to be considered is whether to abandon its monetary policy by entirely pegging SSP to a major currency.

Figure 3.5: Annual Inflation Rate of Countries with Major Currencies

	2007	2008	2009	2010	2011P
U.S.	2.5	2.9	-0.3	1.4	3.0
Eurozone	2.1	3.3	0.3	1.6	2.7
Japan	0.1	1.4	-1.4	-0.7	-0.2
China	4.8	5.9	-0.7	5.0	1.7
Singapore	2.1	6.5	0.6	2.8	1.8
Sudan	*8.0*	*16.0*	*11.2*	*11.8*	*15.8*

Note: Inflation rates of Sudan are shown, as those of South Sudan are not available.
Numbers are based on CPI.
Numbers of 2011 are projections of several economic research institutes.

Source: Eurostat and CIA World Factbook

3.1.1.2.2 Currency Board under Hard Peg

A possible solution to maintain the monetary policy while pegging to a currency is to operate a currency board. A currency board requires that the note-issuing authority, whether the central bank or the government, announce a fixed exchange rate against a particular foreign currency and then stand ready to exchange domestic currency for the foreign currency at that rate whenever the public requests it. Unlike the typical pegged exchange regime, which allows monetary authorities to conduct interest rate adjustment or open market operations, a currency board does not allow them to conduct monetary policy, and it typically has foreign reserves backing more than 100 percent of the domestic currency. The currency board has stronger commitment by the central bank to the fixed exchange rate and is effective in bringing down inflation quickly and may decrease the likelihood of a successful speculative attack against the currency. Argentina had succeeded in its application of a currency board to reduce inflation in

1991, when the country was suffering from over 1,000 percent of inflation in 1989 and 1990. However, in the aftermath of the Mexican peso crisis, deposits of Argentine banks fell by 18 percent, and the money was exchanged from Argentine pesos to U.S. dollars. This caused a contraction of the Argentine money supply. The monetary board of Argentina could not cope with the incident, which occurred outside the relation between Argentine peso and the U.S. dollar.[64] In this sense, a currency board does not effectively work if economic activities outside the pegged country have strong effects on the economy of the pegging country.

Of the selected countries, Brunei sets a currency board for its exchange rate regime of pegging the Brunei dollar to the Singapore dollar. Brunei Currency and Monetary Board (BCMB) acts as a currency board of Brunei on behalf of a central bank. Based on the trade volume and its closeness in politics to Singapore, application of BCMB seems rational for the country, as Singapore is the largest exporter for Brunei with 33.5 percent of the total imported amount of Brunei in 2010. In contrast, South Sudan does not have much relation with the United States for trade, and the reason for pegging to the U.S. dollar is because of oil exports. South Sudan would be able to prevent speculative attacks and the potential to weaken the accountability of policy makers by introducing a currency board. However, South Sudan would be very vulnerable to the movement of the other currencies, such as RMB, Malaysian Ringgit (MYR), and Indian Rupee, which are the currencies of major trade partners for South Sudan. Considering that major trade partners are China, Malaysia, and India, and not the United States, the benefit of setting a currency board for the U.S. dollar peg is much less than that of Brunei.

64. Ibid, 454.

3.1.1.2.3 Floating within a Band

Floating exchange rate within a band is the exchange rate regime that South Sudan now applies for its foreign exchange. Under the current policy, SSP is anchored to the U.S. dollar with a band between 2.9 and 3.3. Siklos (2005) defines three types of controlled floating regimes: (1) an exchange rate regime with an explicit exchange rate target that may or may not be fixed over time, (2) a float with a band that operates with an interest rate objective that may serve as an indicator of the sustainability to enter into a monetary union, and (3) an exchange rate regime with no explicit exchange rate objective, but one that is managed for the express purpose of achieving an inflation objective.[65] Under this definition, the current exchange rate regime of South Sudan can be classified as (2) an exchange rate regime with an explicit exchange rate target. The purpose of choosing this type of float for BoSS is to stabilize its oil revenue by setting the exchange rate depending on the price of oil and the value of regional currencies.[66] It seems appropriate for BoSS to put a priority on stabilizing oil revenues by applying an explicit exchange rate target, as 98 percent of the government revenue comes from the sales of oil products.

At the same time, however, there is the fact that South Sudan has been suffering from high inflation under the current floating exchange rate regime linked to the U.S. dollar within a band. The current regime does not work for lowering the inflation level, although SSP is tightly anchored to the U.S. dollar, whose inflation rate is currently controlled as low as between 1 and 3 percent. To manage the inflation of South Sudan, which experienced 65.6 percent rise in CPI from December 2011 to December 2012, anchoring to a foreign currency with a low inflation

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65. Pierre L. Siklos, *The Impact of Managed Floats as Devices to Achieve Selected Macroeconomic Objectives* (Waterloo: Wilfrid Laurier University, 2005), 5–6.

66. Matt Richmond, “South Sudan Plans ‘Managed Float’ of New Currency,” *Bloomberg*, July 11, 2012, accessed December 31, 2012, http://www.bloomberg.com/news/2011-07-12/south-sudan-plans-managed-float-of-new-currency-correct-.html.

rate is necessary. Controlling the oil revenue with floating exchange rate linked to the U.S. dollar within a band is a rational choice for BoSS in that it enables South Sudan to reserve its own policy making to cope with oil price fluctuations. However, it would be more worthwhile if a further choice of floating exchange rate regime with a band enables the country to lower its severe inflation.

3.1.1.2.4 Floating

The major advantage of a floating exchange rate is that it gives monetary policy some direction and flexibility to cope with shocks to the domestic economy. Due to the benefit of flexibility in monetary policy, many developed countries apply floating to their exchange rate regimes. On the other hand, the floating exchange rate has a weakness in that it allows too much discretion to monetary policy and so may not provide a sufficient nominal anchor. This aspect of a floating exchange rate usually makes it difficult for emerging countries to apply this regime. Of course, many emerging countries have been able to keep inflation under control with flexible exchange rate regimes, but a central bank can only work to reduce inflation if supported by the public and the political process. In some countries, giving the central bank an explicit focus on inflation targeting can help focus the public debate so that it supports a monetary policy focus on long-run goals such as price stability.[67]

With the requirement of a large contribution to monetary policy, no oil-producing countries in emerging markets apply the floating exchange rate regime. Even in richer emerging market countries with oil resources, such as GCC members and other countries located in the Middle East and North Africa (MENA), central banks control the exchange rates with floating within a band or hard peg regimes. These countries are in between the hard peg to single

67. Guillermo A. Calvo and Frederic S. Mishkin, "The Mirage of Exchange-Rate Regimes for Emerging Market," in *Monetary Policy Strategy*, ed. Frederic S. Mishkin, (Cambridge: MIT Press 2009), 472–474.

currency regimes on the one hand, and the entire float of their currencies on the other.[68] It is because they realize that hard peg does not really reflect their trade directions, and they also do not have enough capacity to manage floating exchange rates within their monetary policy—a necessary factor to be able to cope with large shocks, interest rates, and reserve movement. For these reasons, they entirely avoid the floating exchange rate regime for their exchange rate policy.

Large emerging countries, such as Mexico, Chile, and Brazil, utilize floating exchange rates and announce domestic monetary policy aiming at targeting inflation. Although they choose the floating rate which allows them to avoid the foreign reserves required in fixed exchange rates, they indeed hold foreign reserves in excess of monetary base. The main reason for having the large reserves is that policy makers in emerging economies need to be concerned about devaluation of their currencies against foreign currencies as it would lead to inflation. Emerging countries are still required to keep large foreign reserves in applying floating exchange rates.[69] If an emerging market country intends to apply a floating exchange rate, it would need to abandon the benefit of not having a large foreign reserve.

South Sudan has a much smaller economy compared to GCC and other oil-producing MENA countries. South Sudan is more vulnerable to external shocks, which can lead to high inflation. To avoid the large shocks, South Sudan would need to have a foreign reserve as large as emerging countries such as Mexico, Chile, and Brazil. Under the current economic condition of South Sudan, it would be rational to exclude the option of a floating exchange rate, even for the purposes of avoiding large external shocks, because of the accompanying requirement of a large foreign reserve. Anchoring SSP to a single or multiple currencies with a hard peg, setting a

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68. Elias El-Achkar and Wassim Shahin, "Exchange Rate Arrangements and Price Stability in MENA Countries" (Urbana Champaign: University of Illinois-Urbana Champaign, 2006), 19–21.

69. Guillermo A. Calvo and Frederic S. Mishkin, "The Mirage of Exchange-Rate Regimes for Emerging Market," in *Monetary Policy Strategy*, ed. Frederic S. Mishkin (Cambridge: MIT Press 2009), 477.

currency board, or keeping the floating exchange rate policy within a band would be the more appropriate exchange rate regimes for South Sudan.

3.1.1.3 Overall Assessment of Exchange Rate Regime

As a result of analyzing possible anchor currencies and exchange rate regimes, application of a currency basket in a floating exchange rate, with an effectively narrow band in inflation objectives would be the most appropriate policy. The U.S. dollar is not suitable for South Sudan to anchor its currency to, because South Sudan's major trade partners are China, Malaysia, and India, which are not closely related to the U.S. economy and the U.S. dollar. If the trade volume with the United States were as large as Trinidad and Tobago's volume with the U.S., it would be rational to anchor the currency to the U.S. dollar, but South Sudan does not have a trade partnership with the United States in both exports and imports. If South Sudan has a close relationship with a country having a major currency, then the possibility exists to choose it as an anchor. Brunei is an example, in that it anchors BD to Singapore dollar; the country imports 33.5 percent of its goods from Singapore. However, the currencies of major trade partners of South Sudan, such as RMB and MYR, are not appropriate to be anchored since RMB remains anchored to the U.S. dollar and MYR is anchored to SGD since the Asian Financial Crisis. Still, these currencies are surely important for South Sudan, especially because of its oil exports. Considering the significance of these currencies in trade, the country should include them in its exchange rate regime. The most effective way to reflect the status of trade is that BoSS would manage a currency basket consisting of the U.S. dollar, RMB, SGD, and other possible currencies, using the Kuwaiti model as a feasible sample.

With regard to exchange rate regimes, South Sudan should use a floating exchange rate regime within a band in order to achieve inflation objectives. In choosing an exchange rate regime, a hard peg should be avoided as it requires BoSS to abandon its monetary policy. The current exchange rate regime in South Sudan was introduced to effectively respond to the fluctuation of oil prices. A hard peg would eliminate the benefit that BoSS currently intends to obtain. Floating does not fit to South Sudan as it requires a lot of policy control for keeping the exchange rate. The economy of South Sudan is too small and vulnerable to cope with large external shocks. Also, it requires large foreign reserves for emerging countries. Just like larger emerging countries, such as Mexico, Chile, and Brazil, have large foreign reserves, South Sudan would also be required to have the reserves to prevent large external shocks. Considering the level of its economy and the necessity of lowering inflation, a float with a band in inflation objectives is the most suitable exchange rate regime for South Sudan.

3.1.2 Inflation

3.1.2.1 Current Conditions

South Sudan has been suffering from high inflation. Its CPIs have been high since its independence in July 2011, especially compared with the preceding year. In January 2012, the CPI of South Sudan was higher than that of January 2011 by 47.8 percent. Main factors of the recent inflation are high prices of health, furnishing, and housing equipment. However, the factors differ from month to month. In the seven months since its independence, factors of monthly inflation were food and nonalcoholic beverages (July, August, and October 2011), furnishing and housing equipment (September and November 2011), alcoholic beverages, and tobacco (December 2011).[70] It would be difficult to target a single factor to cope with the current inflation.

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70. "Consumer Price Index for South Sudan," *The Republic of South Sudan National Bureau of Statistics*, accessed February 3, 2012, http://ssnbs.org/cpi/.

Figure 3.6: Monthly CPIs of South Sudan in 2011

	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.
CPI (from previous month)	5.8%	9.0%	0.8%	7.4%	2.7%	0.7%	0.1%
CPI (from the same month in last year)	46.2%	57.1%	61.5%	71.7%	78.8%	65.6%	47.8%

Note: Numbers from July to December are of 2011. That of January is of 2012.

Source: National Bureau of Statistics, South Sudan

Although the inflation level remains high compared with that of the last year, CPI increases have abated in the recent two months, with a 0.7 percent monthly rise in December 2011 and a 0.1 percent increase in January 2012. This result is due to the decrease in food and nonalcoholic beverages, which pushed up the CPIs in July (5.8 percent), August (9.0 percent), and October (7.4 percent) 2011. For January 2012, food and nonalcoholic beverages decreased by 0.3 percent from December 2011. This is a good symptom for South Sudan as the food price inflation in East Africa does not seem to affect the inflation of the country anymore. In actuality, the inflation rates of East African countries have gone down. Food price inflation of Uganda decreased to 34.7 percent in December 2011 from 40.3 percent from previous month.[71] In Kenya, CPI increased by 0.56 percent in December 2011 from the previous month, and increase in food and nonalcoholic beverages was 0.58 percent, calming down from 1.71 in July 2011, 1.78 in August 2011, and 0.98 in September 2011.[72] The decrease of the food prices is considered to be a result of the heavy rainfall in the fall 2011which increased production of crops in the East African region.[73]

71. Elisas Biryabarema, "Food Prices Push Down Ugandan Inflation Rate," *Reuters*, December 30, 2011, accessed February 3, 2012, http://af.reuters.com/article/investingNews/idAFJOE7BT01N20111230.

72. "CPI and Inflation Rates for the Month of July (August, September) 2011," *Kenya National Bureau of Statistics*, Accessed February 3, 2012, www.knbs.or.ke/cpi.

73. George Omondi, "Food Prices Set to Go Down as Rainfall Boosts Production," *allAfrica.com*, September 9, 2011, accessed February 3, 2012, http://allafrica.com/stories/201109081509.html.

3.1.2.2 Inflation Targeting

Although the high inflation led by the increasing food prices has calmed down, South Sudan needs to continuously cope with high inflation rates triggered by the various types of goods, including health care, housing equipment, alcoholic beverages, and tobacco, as well as food and nonalcoholic beverages. Aligned with the exchange rate policy, GoSS and BoSS are required to stabilize the inflation rate to sustain the livelihoods of South Sudanese citizens and to call for foreign investment in the domestic sectors.

A possible solution for maintaining the inflation rate at a lower level is the application of inflation targeting. Inflation targeting is mainly used by industrialized countries, but several emerging countries also apply it as their monetary policy strategy.[74] It is an attractive policy for commodity-exporting countries once a country builds up money and financial markets and develops the technical ability to run the policy. The announcement of a quantitative inflation target gives a clear and transparent nominal anchor to the economy.[75] Chile and South Africa are commodity-exporting countries that apply inflation targeting among emerging market countries. Chile succeeded in applying inflation targeting in 1990, when its inflation rate was in excess of 20 percent. The central bank of Chile targeted a gradual decrease of the inflation rate from 20 percent in 1991 to 3.5 percent by the end of the 1990s, and successfully achieved it. However, the success of inflation targeting in Chile was achieved thanks to elements supportive of the central bank, such as the absence of large fiscal deficits, well-supervised financial markets and policy instruments to run an independent monetary policy.[76] To successfully manage inflation

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74. Frederic S. Mishkin, "Inflation Targeting in Emerging Market Countries," in *Monetary Policy Strategy*, ed. Frederic S. Mishkin (Cambridge: MIT Press 2009), 271.

75. Maurizio Michael Habib and Jan Strásky, *Oil Exporters: In Search of an External Anchor* (London: European Central Bank, 2008), 8.

76. Frederic S. Mishkin, "Inflation Targeting in Emerging Market Countries," in *Monetary Policy Strategy*, ed. Frederic S. Mishkin (Cambridge: MIT Press 2009), 275.

targeting in an emerging country, these conditions are necessary. Many oil-exporting countries, especially GCC and the other MENA countries, are currently considered to lack these elements required to conduct inflation targeting.[77]

As for South Sudan, it does not have large fiscal deficits, as it did not have to take over deficits from Sudan at the time of independence, and it successfully balanced the budget and expenses for the six years since the CPA in 2005. However, in terms of other policy elements, such as well-regulated and supervised financial markets and policy instruments to run an independent monetary policy, it cannot be considered that South Sudan is more sophisticated in its policy conditions than GCC and other African countries. Under the current situation, in which South Sudan has just been established and is still primitive in its policy operations, the country should avoid inflation targeting as a tool of controlling inflation. Considering that even GCC countries are pointed out in their insufficiency of policy environment, inflation targeting would not be a suitable monetary policy strategy for South Sudan, at least for the first several years after independence.

3.2 Fiscal Policy

Fiscal policy of South Sudan currently functions well in terms of balance of payments. With an abundant revenue base from oil production, GoSS managed its annual expenses within budget for six years since the CPA in 2005. However, there are various hurdles to accomplish economic development, especially with 50.6 percent of the population under the poverty line. On the revenue side, South Sudan needs to consider alternative sources of funding after the expected peak of oil production around 2015. Market creation for exporting goods is also an urgent issue for GoSS, as the current amount is almost identical to produced oil. As the other sectors are very

77. Maurizio Michael Habib and Jan Strásky, *Oil Exporters: In Search of an External Anchor* (London: European Central Bank, 2008), 9.

primitive, expansion of a revenue portfolio consisting of different sectors is urgent. On the expense side, there is a problem that much of the budget is used for security issues while there are a lot of funding needs from the other sectors, such as infrastructure development, public health, education, and business development. Within the 2011 budget, the projected expense for the security sector amounts to as much as 28 percent of the total budget. To obtain valuable suggestions for these problems, this section examines the fiscal policy of South Sudan in comparison with oil-exporting countries of similar economic conditions.

3.2.1 GDP Growth

Real GDP growth of oil-exporting countries has recently been greater than advanced economies, although the fluctuations are larger. MENA countries, many of which rely on oil exports for their revenues, also show better results in their GDP growth than advanced economies. Their relatively higher GDP growth rates are sustained by elevated oil prices, even though they have political unrest and uncertainties. On the other hand, oil-exporting countries with smaller economies, such as Brunei, Equatorial Guinea, and Trinidad and Tobago have shown negative GDP growth in the last three years. This is mainly because they tend to be affected by external economic conditions, such as the economic ups and downs of their main trade partners in advanced economies.

Figure 3.7: Real GDP Growth of Selected Oil Producing Countries (%)

	2003	2004	2005	2006	2007	2008	2009	2010	*2011*
Algeria	6.9	5.2	5.1	2.0	3.0	2.4	2.4	3.3	*2.9*
Brunei	2.9	0.5	0.4	4.4	0.2	-1.9	-1.8	2.6	*2.8*
Equatorial Guinea	14.0	38.0	9.7	1.3	21.4	10.7	5.7	-0.8	*7.1*
Kuwait	17.4	11.2	10.4	5.3	4.5	5.0	-5.2	3.4	*5.7*
Trinidad and Tobago	14.1	7.9	6.2	13.2	4.8	2.4	-3.5	-0.6	*1.1*
Sudan	7.4	3.6	7.9	9.4	10.2	3.7	4.6	6.5	*-0.2*
South Sudan							**-12.5**	**22.2**	
Advanced Economies	*2.1*	*2.9*	*2.8*	*2.7*	*2.3*	*-0.1*	*-2.9*	*1.8*	*1.3*
MENA	*7.3*	*5.9*	*5.4*	*6.0*	*6.7*	*4.6*	*2.6*	*4.4*	*4.0*
Sub-Saharan Africa	*4.9*	*7.1*	*6.2*	*6.4*	*7.1*	*5.6*	*2.8*	*5.4*	*5.2*

Source: World Economic Outlook 2011, IMF, National Bureau of Statistics, South Sudan

Although South Sudan announced its GDP growth rates of 2009 and 2010, it is not enough to judge that its economy as the numbers have fluctuated. However, at least it is clear that the economy is largely affected by the economic conditions of its major trade partners such as China, Malaysia, and India. Comparing its GDP growth rates with the growth rates of small oil-exporting countries like Brunei, Equatorial Guinea, and Trinidad and Tobago, it shows similar movements with the GDP growth rates of their major trade partners. Although Sudan does not show such high growth rates as China and India, its GDP growth rate was relatively higher than that of Sub-Saharan African countries. Expected GDP growth of Sudan is negative for 2011 and 2012, but this is mainly due to the exclusion of South Sudan from the Sudanese economy.[78]

78. "World Economic Outlook" (Washington DC: International Monetary Fund 2011), ix.

Figure 3.8: GDP Growth Comparison of Small Oil-Exporting Countries and Trade Partners

	Weight of Exports	2003	2004	2005	2006	2007	2008	2009	2010	*2011*	*2012*
		GDP Growth Rate									
Brunei		**2.9**	**0.5**	**0.4**	**4.4**	**0.2**	**-1.9**	**-1.8**	**2.6**	***2.8***	***2.2***
Japan	45.6%	1.4	2.7	1.9	2.0	2.4	-1.2	-6.3	4.0	*-0.5*	*2.3*
South Korea	12.0%	2.8	4.6	4.0	5.2	5.1	2.3	0.3	6.2	*3.9*	*4.4*
Australia	11.9%	3.3	3.8	3.1	2.6	4.6	2.6	1.4	2.7	*1.8*	*3.3*
Indonesia	7.4%	4.8	5.0	5.7	5.5	6.3	6.0	4.6	6.1	*6.4*	*6.3*
China	7.1%	10.0	10.1	11.3	12.7	14.2	9.6	9.2	10.3	*9.5*	*9.0*
India	5.8%	6.9	7.6	9.0	9.5	10.0	6.2	6.8	10.1	*7.8*	*7.5*
New Zealand	5.1%	4.2	4.5	3.3	1.0	2.8	-0.1	-2.0	1.7	*2.0*	*3.8*
Developing Asia	5.1%	8.1	8.5	9.5	10.3	11.5	7.7	7.2	9.5	*8.2*	*8.0*
Weighted Average		**3.5**	**4.4**	**4.1**	**4.3**	**5.0**	**1.9**	**-1.0**	**5.2**	***2.6***	***4.1***
Equatorial Guinea		**14.0**	**38.0**	**9.7**	**1.3**	**21.4**	**10.7**	**5.7**	**-0.8**	***7.1***	***4.0***
U.S.	24.3%	2.5	3.5	3.1	2.7	1.9	-0.3	-3.5	3.0	*1.5*	*1.8*
Italy	10.3%	0.0	1.5	0.7	2.0	1.5	-1.3	-5.2	1.3	*0.6*	*0.3*
Spain	10.1%	3.1	3.3	3.6	4.0	3.6	0.9	-3.7	-0.1	*0.8*	*1.1*
Canada	8.3%	1.9	3.1	3.0	2.8	2.2	0.7	-2.8	3.2	*2.1*	*1.9*
France	7.6%	0.9	2.3	1.9	2.7	2.2	-0.1	-2.6	1.4	*1.7*	*1.4*
Netherlands	6.3%	0.3	2.0	2.2	3.5	3.9	1.8	-3.5	1.6	*1.6*	*1.3*
Brazil	6.1%	1.1	5.7	3.2	4.0	6.1	5.2	-0.6	7.5	*3.8*	*3.6*
Sub-Saharan Africa	27.0%	4.9	7.1	6.2	6.4	7.1	5.6	2.8	5.4	*5.2*	*5.8*
Weighted Average		**1.2**	**2.2**	**1.9**	**2.1**	**1.9**	**0.4**	**-2.4**	**1.8**	***1.2***	***1.2***
Trinidad and Tobago		**14.4**	**7.9**	**6.2**	**13.2**	**4.8**	**2.4**	**-3.5**	**-0.6**	***1.1***	***2.6***
U.S.	44.2%	2.5	3.5	3.1	2.7	1.9	-0.3	-3.5	3.0	*1.5*	*1.8*
Spain	6.1%	3.1	3.3	3.6	4.0	3.6	0.9	-3.7	-0.1	*0.8*	*1.1*
Jamaica	5.1%	3.5	1.4	1.1	3	1.4	-0.9	-3	-1.2	*1.5*	*1.7*
L. America and Caribbean	44.6%	2.1	6	4.6	5.6	5.8	4.3	-1.7	6.1	*4.5*	*4*
Weighted Average		**2.4**	**4.5**	**3.7**	**4.1**	**3.7**	**1.8**	**-2.7**	**4.0**	***2.8***	***2.7***
Sudan		**7.4**	**3.6**	**7.9**	**9.4**	**10.2**	**3.7**	**4.6**	**6.5**	***-0.2***	***-0.4***
China	68.3%	10.0	10.1	11.3	12.7	14.2	9.6	9.2	10.3	*9.5*	*9.0*
Japan	12.6%	1.4	2.7	1.9	2.0	2.4	-1.2	-6.3	4.0	*-0.5*	*2.3*
India	5.8%	6.9	7.6	9.0	9.5	10.0	6.2	6.8	10.1	*7.8*	*7.5*
Sub-Saharan Africa	13.3%	4.9	7.1	6.2	6.4	7.1	5.6	2.8	5.4	*5.2*	*5.8*
Weighted Average		**8.1**	**8.6**	**9.3**	**10.3**	**11.5**	**7.5**	**6.3**	**8.8**	***7.6***	***7.6***

Note: Numbers of 2011 and 2012 are projections of IMF.

Source: World Economic Outlook 2011, IMF

Sustained a bit by the slowing, but still strong, demands of oil importers, the country will be able to achieve further economic growth as long as the volume of oil production does not significantly decrease. The central challenge for South Sudan will be the development of the oil sector, in which some plant construction has stopped due to budgetary issues. As the demand of major oil importers is expected to be strong, at least in the short to medium term, meeting the supply level of oil to their demand is critical for the country. In the long run, however, South Sudan will face the shortage of oil reserves, which currently accounts for 98 percent of the total national revenue after the expected peak around 2015. To maintain the GDP growth rate currently delivered primarily by oil revenues, South Sudan needs to strengthen the other industries in the medium to long term.

Figure 3.9: GDP Growth Comparison of South Sudan and Oil Importers

	Weight of Export	GDP Growth			
		2009	2010	*2011E*	*2012E*
South Sudan		**-12.5**	**22.2**		
China	42.6%	9.2	10.3	*9.5*	*9.0*
Malaysia	37.6%	-1.6	7.2	*5.2*	*5.1*
India	9.9%	6.8	10.1	*7.8*	*7.5*
Sudan	8.1%	4.6	6.5	*-0.2*	*-0.4*
Sub-Saharan Africa	2.0%	2.8	5.4	*5.2*	*5.8*
Weighted Average		**4.4**	**8.7**	***6.9***	***6.6***

Note: Numbers of 2011 and 2012 are projections of IMF.

Source: World Economic Outlook 2011, IMF, National Bureau of Statistics, South Sudan

However, there are problems that resource-rich countries have faced in their economic development phase. After the first oil shock in the 1970s, economists researched oil-exporting countries and showed that resource-abundant countries tend to grow slower than countries without natural resources, naming it as the resource curse. There are four major explanations for the resource curse, which are: (1) Dutch disease, where appreciation of the real exchange rate caused by a booming resource sector tends to draw capital and labor away from manufacturing and agricultural sectors, raising their production costs; (2) jeopardized economic development caused by reduced incentives to accumulate skills, invest in human resources and accumulate private capital, and delayed difficult decisions on economic reforms; (3) poor performance of the economic policy caused by volatility of resource revenues, which leads to unstable public expenditures on economic growth; and (4) political economy effects caused by resource abundance, such as conflicts, political instability, corruption, weak institutions, and inequitable distribution of wealth and societies.[79]

For South Sudan, (2) jeopardized economic development caused by lack of necessary incentives would be the most likely risk to its future economic development. With currently abundant revenues from oil production, South Sudan has enjoyed balanced revenues and expenditures for six straight years since 2005. However, this could lead to excessive dependence of its revenue base on oil, especially in the long term after the oil reserve becomes scarce.

Another curse South Sudan might encounter is (1) Dutch disease. Currently FDI to South Sudan is almost entirely targeted toward oil exploration and facility development. Although there is an increasing number of small and medium enterprises in the country, the interests of foreign companies and governments are exclusively in oil resources. Labor in South Sudan is not very mobile, as many in the population are rural farmers isolated from economic activities involving cash transactions. The other problems specific for resource rich countries are also applicable for South Sudan. It has volatility in governmental revenue dependent on international oil prices, as shown in (3) poor performance of economic policy caused by volatility of resource revenues. However, the revenue of South Sudan is stable so far, and the budget and expense have been well matched for these six years. Compared to the other oil-exporting countries, the performance

79. Michael Sturm, François Gurtner, and Juan Gonzalez Alegre, *Fiscal Policy Challenges in Oil-Exporting Countries* (London: European Central Bank 2009), 11.

of economic policy seems to be more stable. The problem of (4) political economy effects is something that South Sudan has already experienced since the CPA in 2005. Political instability caused by its oil resource continued in South Sudan, but the political stability became better after independence, especially in the relationship with Sudan. Although a problem of security expense still remains, it could be manageable in the budgetary reform for the next several years.

For the GDP growth rate, the most concerned issue for South Sudan is how it will structure its economy after exhausting its oil reserves. Although the expectation of GDP growth during the oil-rich period is backed by the growing economy of importers such as China and India, South Sudan could be very vulnerable in its revenue base once the production amount of oil peaks out. The other oil-exporting countries with small economies, Brunei, Equatorial Guinea, and Trinidad and Tobago, face fluctuations in growth, including negative growth, more often than those of larger countries. To sustain the growth of the country in the long term, South Sudan should create a sector portfolio which is sustainable after the oil-dependent phase.

3.2.2 Trade Balance

The structure of trade in South Sudan is simply to export its oil products and import necessary goods from neighboring countries. Backed by abundant oil revenues, the exports of South Sudan were almost twice than that of imports for the three years from 2008 to 2010. Though the exact number is not available, the trade balance in 2011 will likely result in almost the same ratio. This structure of the trade balance will continue as long as South Sudan's oil reserves exist. Its main import partners are Uganda, Sudan, and Kenya. For Uganda, bilateral exports from Uganda to South Sudan are highly asymmetric, with the volume of exports from Uganda being disproportionately larger than the volume of exports from South Sudan. While South Sudan lacks local production capacity, the oil revenue transfer from Khartoum has financed those imports from Uganda as well as from elsewhere in the region and the world. Also, imports from Uganda largely come through informal channels. However, this rapid growth in cross-border trade stalled after 2008. Formal trade declined in 2009 as a result of import controls imposed by the Central Bank of Sudan due to concerns over foreign exchange reserves. A substantial drop of informal trade by 55 percent occurred in 2010 following violence against Ugandan traders in South Sudan, and because of fears of insecurity during the general election in April 2010 and run-up to the referendum in February 2011.[80]

Figure 3.10: GDP Breakdown of South Sudan

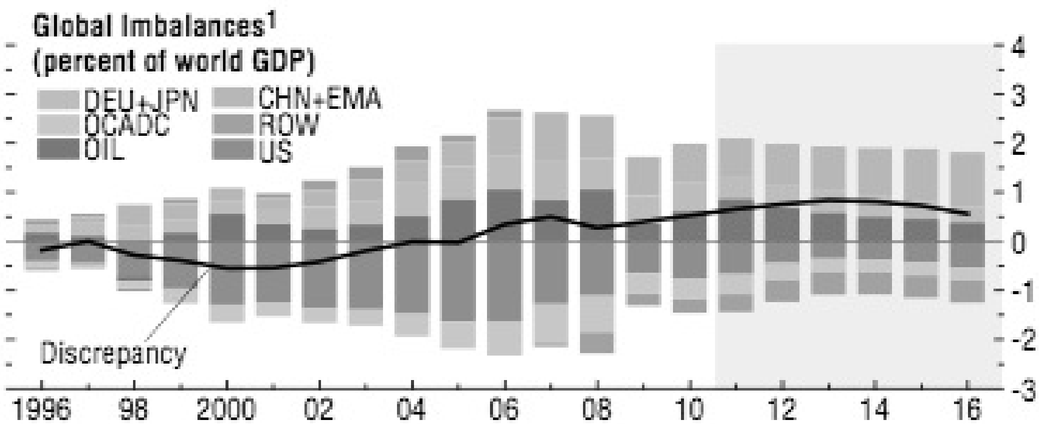
GDP at Current Prices (SDG Million)	**2008**	**2009**	**2010**
Final Consumption Expenditure	14,263	14,472	16,820
Private	9,619	10,493	11,145
Households	9,231	9,864	10,156
NPISHs	388	629	989
Public	4,644	3,978	5,674
GoSS	3,488	2,164	3,302
GoSS off budget	315	710	1,116
States	841	1,105	1,256
Investment Expenditure	4,816	3,921	4,005
Private	2,873	2,545	2,418
Oil	2,270	1,849	1,643
Non-oil	603	696	775
Public	1,943	1,377	1,587
GoSS	1,610	981	1,055
GoSS off budget	175	188	296
States	158	207	236
Exports of Goods and Services	21,325	16,837	21,973
Goods (FOB)	21,135	16,618	21,729
Services	190	219	244
Imports of Goods and Services	11,898	10,284	12,310
Goods (FOB)	8,914	7,245	8,719
Services	2,985	3,039	3,591
Net Exports (Balance of Trade)	9,426	6,553	9,663
GDP at Current Prices (SDG Million)	**28,505**	**24,946**	**30,488**
GDP at Current Prices (USD Million)	**13,630**	**10,800**	**13,227**
GDP per capita (SDG)	**3,451**	**2,967**	**3,564**
GDP per capita (USD)	**1,650**	**1,285**	**1,546**

Source: South Sudan National Bureau of Statistics

1 80. Gozde Isik, “Addressing South Sudan’s Impediments to Regional Trade,” Growth and Crisis Blog, *The World Bank*, July 15, 2011, accessed February 20, 2012, http://blogs.worldbank.org/growth/addressing-south-sudan-s-impediments-regional-trade.

Looking at other oil-exporting countries, this characteristic of excess export amounts led by oil revenue is outstanding. Flow of the world current accounts shows that oil-exporting countries maintain their current account surplus together with China and the other emerging economies over fifteen years, while the United States and the other advanced economies keep deficits in the same period. According to the IMF, this status is expected to continue for five more years, although the amount of the surplus in oil-exporting countries will decrease.

Figure 3.11: Global Imbalances in Current Account



Source: World Economic Outlook 2011, IMF

Of the selected countries, most of them excluding Equatorial Guinea continue to gain a current account surplus since 2003 on average, while advanced economies continue to maintain deficits. Furthermore, most of their surplus accounts are in double digits, which make them available to spend a large amount of revenues on public investment and foreign reserves annually. With excess exports over imports by a large margin, South Sudan is also able to make public expenditures for its economic growth, as is the case in the other oil-exporting countries.

Figure 3.12: Current Account Balance of Selected Oil-Exporting Countries (%)

	2003	2004	2005	2006	2007	2008	2009	2010	*2011*	*2012*	*2013*
Algeria	13.0	13.0	20.5	24.7	22.8	20.2	0.3	7.9	*13.7*	*10.9*	*8.0*
Brunei	50.6	48.3	52.7	56.4	51.1	54.3	40.2	45.0	*48.5*	*46.9*	*50.2*
Equatorial Guinea	-33.3	-21.6	-6.2	7.7	4.3	9.1	-17.1	-24.2	*-9.6*	*-10.5*	*-6.7*
Kuwait	19.7	26.2	37.2	44.6	36.8	40.5	23.6	27.8	*33.5*	*30.4*	*28.7*
Libya	8.4	21.1	38.3	51.0	43.2	38.9	15.9	14.4			
Trinidad and Tobago	8.7	12.4	22.5	39.6	24.8	31.3	8.2	18.8	*20.3*	*20.3*	*15.6*
World	*-0.2*	*0*	*0*	*0.4*	*0.5*	*0.3*	*0.4*	*0.5*	*0.7*	*0.8*	*0.6*
Adv. Economies	*-0.7*	*-0.7*	*-1.2*	*-1.2*	*-0.9*	*-1.2*	*-0.2*	*-0.2*	*-0.3*	*0.1*	*-0.2*

Source: World Economic Outlook 2011, IMF

These large amounts of revenues from oil exports allow South Sudan to spend them for internal economic growth and to accumulate foreign reserves to manage its exchange rate regime. Over recent years, oil-exporting countries have enjoyed buoyant real GDP growth accompanied by high current account and fiscal surpluses. Real GDP growth has been driven by domestic consumption and investments as public investment is playing a major addition to private consumption. This fact has been bolstered by high consumer confidence as a result of high oil prices. Considering the heavy weight of public investments, expansionary fiscal policy is a key driver of the economic expansion of recent years. Indeed, fiscal expansion is the key mechanism in most oil-exporting countries for injecting oil revenues into the economy. As upstream activities in the oil sector are controlled by state oil companies in most major oil-exporting countries, oil revenues accrue directly and completely to the government. Thus, the use of oil revenues is a fiscal policy decision, and it is through public expenditure that oil revenues impact the domestic economy, including inflation. Fiscal policy has been expansionary over past years as evidenced in public expenditure growth and the development of non-oil deficits. The fiscal expansion has been masked by high and rising surpluses as increasing expenditure has not kept pace with revenue growth. For instance, of the selected countries, Algeria launched a USD 55 billion public investment program, later augmented to USD 155 billion, focusing on infrastructures of social housing and transportation.[81]

3.2.3 Public Investment

GoSS has been making investments in the existing sectors of South Sudan, putting priorities on (1) security, (2) roads, (3) primary health care, (4) basic education, (5) water, and (6) production.[82] South Sudan's investment focus is on primary issues for the livelihood of the people and infrastructure, as 50.6 percent of the population lives under the poverty line without satisfying their basic needs, and the infrastructure remains devastated by the civil war against Sudan. Considering the amount of revenue available from oil production, the amount of public investment budgeted by GoSS seems satisfactory. However, a large amount of the budget is spent for the sector of its first priority, (1) security. In 2011, as much as 28 percent of the governmental budget was allocated on security. Infrastructure (11 percent), education (7 percent), natural resources and rural development (5 percent), health (4 percent), and the other sectors are not well budgeted compared with the security sector (Figure 2.5).

Security problems in South Sudan have been serious even after its independence in July 2011. For instance, more than 10,000 people have been waiting to return to their homes after fleeing the fighting in Abyei region near the border of Sudan and South Sudan that occurred in May 2011. Insecurity in the area still prevents these people from returning, as there is still the presence of armed forces and landmines. The area is claimed by South Sudan but currently controlled by Sudan. Along the border with Sudan, South Sudan still has such conflicts, and

81. Michael Sturm, Francois Gurtner, and Juan Gonzalez Alegre, "Fiscal Policy Challenges in Oil-Exporting Countries" (London: European Central Bank 2009), 26–27.
82. Ministry of Finance and Economic Planning, "Approved Budget 2011" (Juba: Government of Southern Sudan 2011), 1.

budgetary accounts need to be shared for security issues.[83] Although the UN Peacekeeping Operation supports the operations of the South Sudanese military for peace building, it will take some time before the conflicts along the borderline are resolved.

3.2.3.1 Funding from International Financial Institutions

Taking into account that security spending will remain significant in the near future, GoSS needs to allocate the budget after deducting security costs. The current progress of development does not seem sufficient. With limited financial resources from governmental revenues, GoSS has been requesting public funding from international financial institutions (IFIs), such as the World Bank and AfDB. In September 2011, South Sudan signed a general cooperation agreement with AfDB to receive financial and technical support, pending its full membership in the bank.[84] In December 2011, the parliament of South Sudan approved to join the World Bank and the IMF to receive their financial support.[85] Now South Sudan has been negotiating with these institutions as well as AfDB to borrow funds for the development of infrastructure and basic services.

Figure 3.13: Scheduled Funding from International Financial Institutions

Financial Institution	Amount	Purpose	Fiscal Year
IMF, AfDB, etc.	USD 250 million	Governmental Funding	2011
World Bank	USD 679 million	Infrastructure Development	2011–12
World Bank	USD 750 million	Infrastructure Development	2012–13
World Bank	USD 75 million	Basic Services	2012

Source: Sudan Tribune

83. "South Sudan/Sudan: UN Must Step Up Security Efforts to Allow Civilians Displaced from Abyei to Return," *Amnesty International*, December 20, 2011, accessed February 23, 2012, http://www.amnesty.org/en/news/south-sudansudan-un-must-step-security-efforts-allow-civilians-displaced-abyei-return-2011-12—0.

84. "AfDB, South Sudan Sign General Cooperation Agreement," *African Development Bank Group*, September 24, 2011, accessed February 23, 2012, http://www.afdb.org/en/news-and-events/article/afdb-south-sudan-sign-general-cooperation-agreement-8383/.

85. Mary Ajith, "South Sudan: Parliament Approves South Sudan Membership in World Bank," *allAfrica.com*, December 14, 2011, accessed February 23, 2012, http://allafrica.com/stories/201112140576.html.

3.2.3.2 Funding through Foreign Aid

South Sudan is a major recipient of official development assistance (ODA) from developed countries. Since the CPA in 2005, it received considerable financial resources in the form of ODA as part of Sudan and will continue to be the central locus of global foreign aid.[86] The total amount of the appealed foreign aid from advanced economies accounts for USD 210.8 million or 10.6 percent of the annual budget of GoSS for 2011.[87]

Figure 3.14: Donors to South Sudan in Consolidated Appeal Process for 2011

Donor	Funding (USD M)	% of total
U.S.	80.1	38.0%
Japan	19.5	9.3%
EC	11.9	5.6%
Demark	3.9	1.9%
Sweden	2.1	1.0%
Italy	1.7	0.8%
Germany	1.3	0.6%
France	1.2	0.6%
Canada	1.0	0.5%
New Zealand	0.8	0.4%
Korea	0.6	0.3%
Spain	0.4	0.2%
Switzerland	0.3	0.1%
Norway	0.1	0.0%
Estonia	0.1	0.0%
Private	0.0	0.0%
Other income	49.2	23.3%
Carry-over	22.0	10.4%
Various	14.4	6.8%
Total	210.8	100.0%

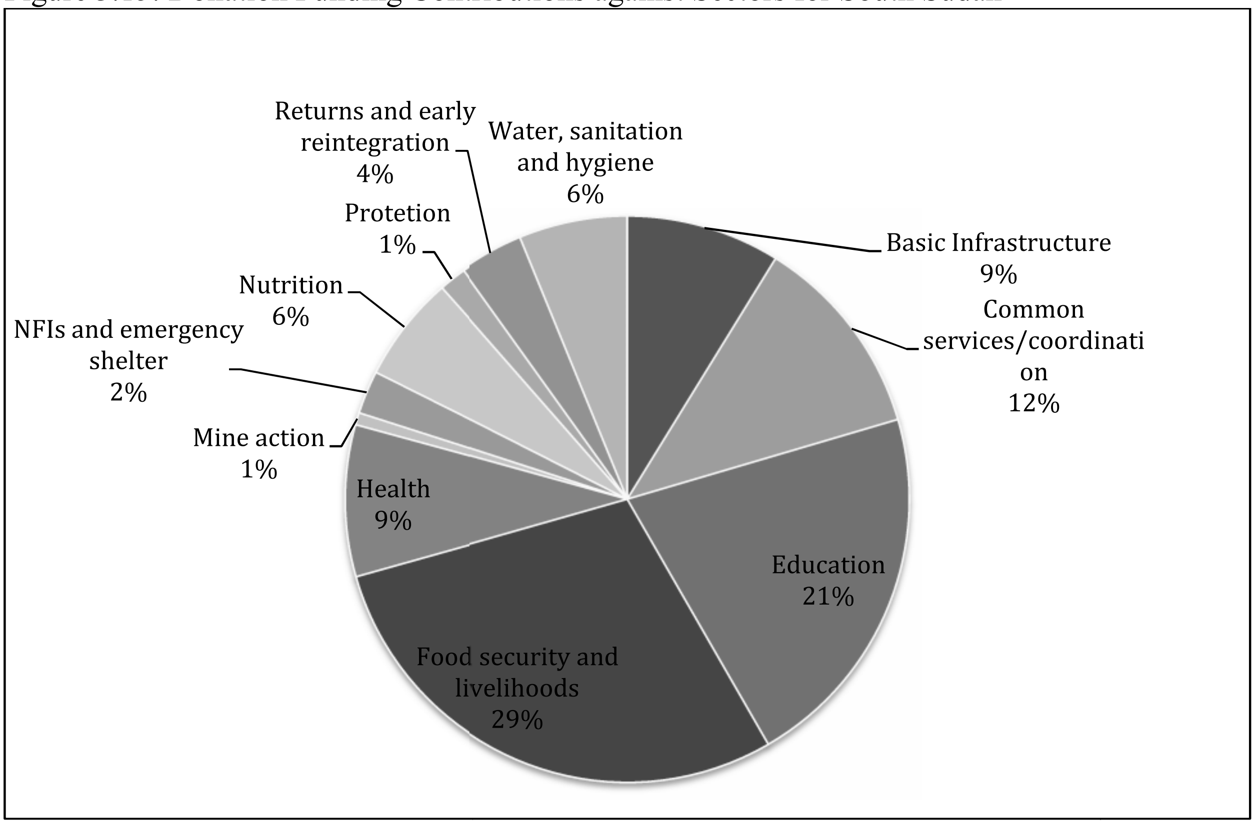
Source: Global Humanitarian Assistance

This financial assistance is distributed to satisfy the needs of development for each sector other than security in South Sudan. The 2011 UN Work Plan for Sudan records donor funding contributions against sectors for South Sudan. According to the record, aid received is

86. Global Humanitarian Assistance, *"Resource Flow to Sudan—Aid to South Sudan"* (London 2011), 1.
87. Budget of GoSS is calculated on the U.S. dollar basis with an expected exchange rate of SSP 2.9 = USD 1.

concentrated on food security (29 percent), education (21 percent), common services and coordination (12 percent), and health and infrastructure (9 percent). Many of these are prioritized in the budget plan of South Sudan. Being required to make large expenditures for security issues, South Sudan relies on international financial aid to fund expenditures on other primary public investments necessary for its economic growth.

Figure 3.15: Donation Funding Contributions against Sectors for South Sudan



Source: Author's Calculation from the Data of Global Human Assistance

The net amount of ODA that South Sudan received is larger than those of the selected oil-exporting countries in the African region, Algeria, Libya, and Equatorial Guinea. Considering that the cumulative ODA of South Sudan is only from the fiscal year 2010, the amount of ODA will grow further as time passes after its independence. Considering that poorer oil-exporting countries may receive ODA alongside their oil revenues, South Sudan can take advantage of being a newly independent country after the long-lasting civil war with Sudan to receive substantial financial support from advanced economies to fund its economic growth. As well as the current oil revenues, foreign aid is a key funding source for South Sudan. The other oil-exporting countries are not eligible for this support.

Figure 3.16: Net ODA from All Donors (African Countries)

Rank	Country	Value (USD M)	% of Africa
1	Africa	40,571	100.0%
2	Sub-Saharan Africa	37,975	93.6%
3	Sub-Saharan Africa excluding South Africa	37,257	91.8%
4	Sub-Saharan Africa excluding South Africa and Nigeria	25,823	63.6%
7	Sudan	2,058	5.1%
32	**South Sudan**	**354**	**0.9%**
37	Algeria	209	0.5%
51	Libya	37	0.1%
55	Equatorial Guinea	27	0.1%

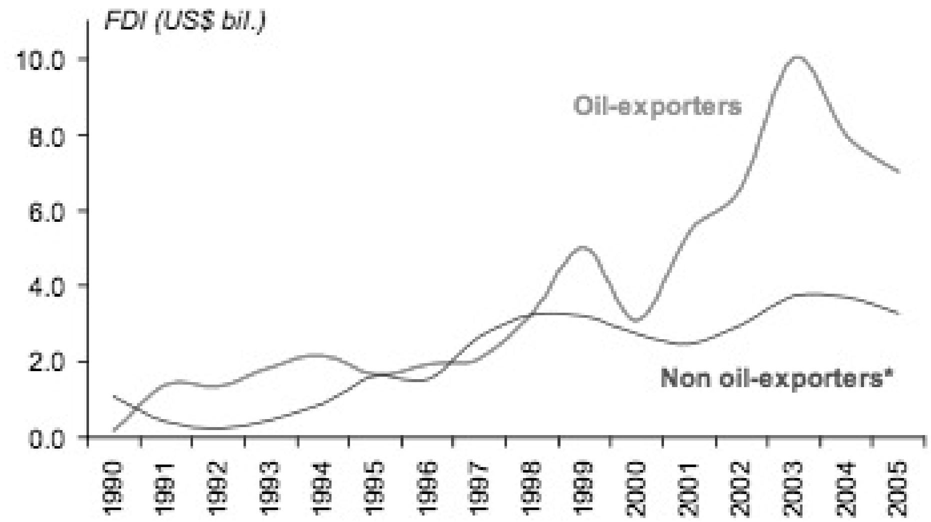
Note: Value of South Sudan is only of fiscal year of 2010, retrieved from Global Human Assistance. Cumulative foreign aid will grow further as the time after independence passes.

Source: African Development Indicators and Global Human Assistance

3.2.4 Foreign Direct Investment

FDI to the African region, especially for Sub-Saharan African countries, has become the second-largest source of external financing. Low-income African countries have received almost all medium- and long-term private capital flows in the form of FDI. As an oil-exporting country, FDI is far more important for South Sudan, as it is required to call for long-term private funding for its oil exploration and production. South Sudan's FDI flows are concentrated in enclave sectors such as oil and natural resources. FDI flows to oil and commodities exporting countries have been larger than in other countries in the African region since 1990. In Sub-Saharan Africa, oil-exporting countries received nearly 70 percent of all the FDIs to the region in 2005. Net FDI inflows to four major oil producing countries in Sub-Saharan Africa--Angola, Equatorial Guinea, Nigeria, and Sudan--are estimated to have been USD 10 billion in 2006, half of all the FDI to low-income African countries in 2006. Other countries excluding South Africa recorded rising but substantially lower inflows of FDI.[88]

Figure 3.17: FDI Flows in Sub-Saharan African Region



Source: The World Bank

In terms of selected oil-exporting countries in the African region, Equatorial Guinea (ranked first), Libya (ranked fourteenth), and Sudan (ranked nineteenth) receive higher values of FDI among the fifty-seven African countries. These countries enjoy more inflow of FDIs than non-resource intensive countries. However, it should be noted that these FDIs are directed toward natural resource production and FDIs to the other sectors are as limited as non-resource intensive countries in Sub-Saharan Africa.

Figure 3.18: Foreign Direct Investment in Percentage of GDP

Rank	Country	Value (% of GDP)
1	Equatorial Guinea	145.2
14	Libya	6.72
19	Sudan	5.25

Source: African Development Indicators

88. Dilip Ratha, Sanket Mohapatra, and Sonia Plaza, *Beyond Aid: New Sources and Innovative Mechanisms for Financing Development in Sub-Saharan Africa* (Washington DC: The World Bank 2008), 8–9.

4 Policy Recommendation

The previous chapter showed that South Sudan has advantages and challenges in choosing its monetary and fiscal policy, in comparison with other oil-exporting countries of a similar economic scale. In monetary policy, there is room to consider an effective exchange rate regime to stabilize revenues of oil products and high inflation. In fiscal policy, there is a challenge in funding abundant financial resources for its economic growth, which is currently prohibited by the insecure situation with Sudan and the large amount of expense related to security. This chapter makes recommendations for policy choices of South Sudan on its monetary and fiscal policy, referring to the international comparison made in the previous chapter.

4.1 Monetary Policy Recommendation

As suggested in the previous chapter, this paper recommends that South Sudan should take a currency basket regime under a floating exchange rate regime with a band. As an oil-exporting country, the U.S. dollar has been a key currency to stabilize the revenue of exported oil products. However, the recent weakness of the U.S. dollar against the other major currencies makes pegged local currencies unstable. As a matter of fact, Kuwait has shifted its currency from the U.S. dollar peg to a currency basket to overcome its soaring inflation in 2007. Furthermore, witnessing the U.S. dollar depreciation against major currencies, the other GCC countries started to consider shifting to a currency basket following the suggestion of Kuwait. Current conditions of the U.S. dollar suggest that South Sudan should shift to a currency basket taking the currencies of major trade partners into account. This section analyzes how the currency basket is applicable to the exchange rate regime of South Sudan.

4.1.1 Currency Basket

In the last five years, the U.S. dollar has depreciated against major Asian currencies like the Japanese yen (JPY) and the Singaporean dollar (SGD), while it has been appreciating against the euro (EUR) and pound sterling (GBP). With the weakening U.S. dollar and no exports of oil products to the United States, benefits of pegging SSP to the U.S. dollar have been decreasing. Although South Sudan can continue to be anchored to receive benefits of a stabilizing inflation rate, it may consider including the other currencies if they are more suitable for stabilizing oil revenue and fixing inflation rate.

Figure 4.1: Relative Value of U.S. Dollar against Major Currencies

	USD/GBP	USD/EUR	USD/JPY	USD/SGD	USD/INR	USD/MYR
Current Price	0.63	0.75	80.57	1.26	49.02	3.01
Price of five years ago	0.51	0.63	107.04	1.36	42.89	3.24
% of Depreciation (5Y)	-25.2%	-18.1%	24.7%	7.6%	-14.3%	7.1%
Volatility (1Y)	8.24%	11.72%	10.01%	5.91%	7.79%	7.33%

Note: The exchange rates retrieved from Bloomberg are as of February 24, 2012.

Source: Bloomberg

As a possible portfolio for its currency basket, this paper suggests that South Sudan should include RMB and SGD as well as the U.S. dollar. Considering that oil export revenues come from China, Malaysia, and India, this basket will better reflect the economies of trade partners. South Sudan's major export partners are China (43 percent), Malaysia (38 percent), India (10 percent), and Sudan (8 percent)--and most of them apply currency basket regimes without entirely anchoring to the U.S. dollar. If these countries choose to peg to the U.S. dollar, South Sudan would naturally be able to choose anchoring to the U.S. dollar, assuming that the movement of their local currencies almost entirely follows the U.S. dollar. However, their exchange rate regime reflects the movement of other major currencies, under a currency basket regime. South Sudan will better manage the oil revenue by facing these currencies rather than the U.S. dollar.

Figure 4.2: Shares of Oil Exports and Exchange Rate Regimes of Relevant Countries

Country	% of Exports	Exchange Rate Regime	Anchored Currency
China	43%	Currency Basket	11 Currencies (USD, JPY, EUR, KRW, SGD, GBP, MYR, RUB, AUD, THB, CAD)
Malaysia	38%	Currency Basket	USD and other currencies
India	10%	Currency Basket	USD and other currencies
Sudan	8%	Peg	USD
Others	2%	-	-

Source: Oil and State Building in South Sudan, United States Institute of Peace

Furthermore, China and India have been decreasing the proportion of the U.S. dollar in their currency baskets, seeing the continuing current deficits and depreciation of the U.S. dollar. This fact will effectively separate the influence of the U.S. dollar on other currencies and the direct possession of the U.S. dollar in the currency basket of South Sudan. Another effect of applying the currencies of these trade partners is that South Sudan may relate its SSP to the exchange rates, which are decided by their own currency baskets. Although the export partners are classified as emerging economies, South Sudan may avoid taking the entire risk of volatility and inflation of these countries, as their controlled exchange rates backed by currency baskets.

Considering the percentages of oil exports to the trade partners, this paper recommends that South Sudan should include RMB and SGD into its basket while keeping the USD as a major portion. Although MYR and INR are the currencies of major trade partners of South Sudan, these should be excluded from the basket. MYR is a relatively stable currency in Southeast Asian countries, but a smaller exchange volume and relatively higher volatility against SGD make it unsuitable for including in a basket. INR has been depreciating against USD for the last five years and has a higher inflation rate than the United States. Considering these conditions, INR also does not seem to be suitable as an alternative of the U.S. dollar. To reflect the economic conditions of Malaysia, which imports 38 percent of the oil products of South Sudan, SGD may be the best alternative due to the exchange volume, lower inflation rate of Singapore, and large trade volume of the country with Malaysia.

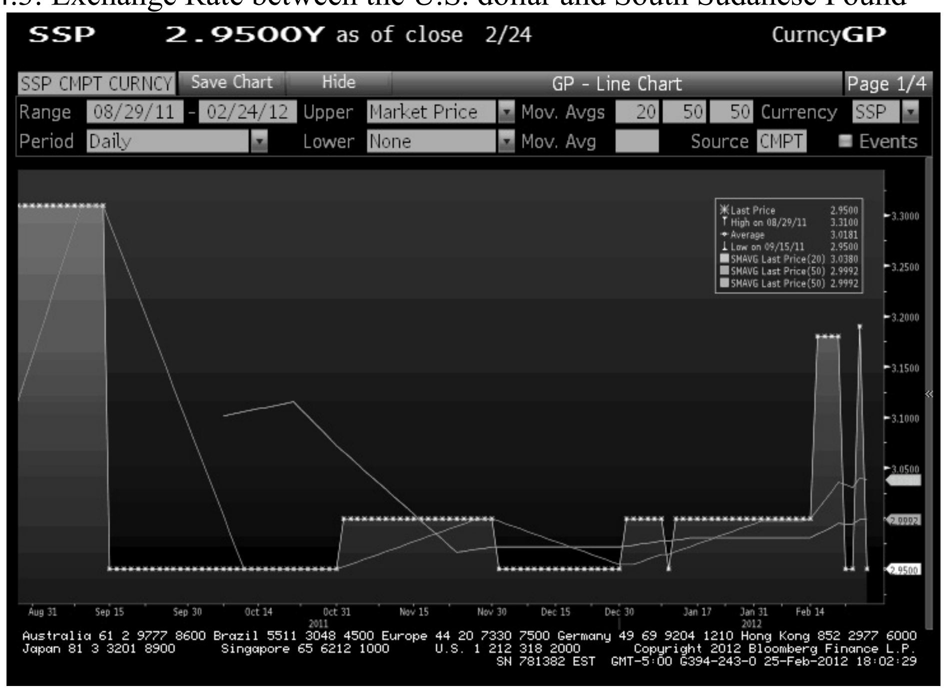
Although imports of South Sudanese products are mostly from neighboring East African countries, the proposed currency basket is more effective to reflect the capital inflow by means of FDI, which oil importers of South Sudan proactively do towards the country. Putting forward the revenues from oil exports and FDI than the imports from the neighboring countries, the introduction of a currency basket system will be a suitable exchange rate regime for the South Sudanese economy.

The benchmark of the currency basket portfolio can be comparable to that of Kuwait. Considering that the Kuwait's currency basket consists of 75 percent of the U.S. dollar and 25 percent of the rest of currencies, the U.S. dollar still dominates the exchange rate regime of oil-exporting countries which have abandoned the U.S. dollar peg. The U.S. dollar still has more significance for South Sudan than Kuwait in that all the loans borrowed from IFIs are the U.S. dollar denominated. Even though South Sudan should apply the currency basket, the portion of the U.S. dollar should be kept large. The recommended portion of the U.S. dollar could be larger than 80 percent. RMB and SGD would fill in the remaining 20 percent.

4.1.2 Fixed, Float within a Band, or Float

South Sudan has been applying the floating exchange rate regime within a band since September 2011. The exchange rate of SSP is within a band between SSP 2.9 and 3.3 vis-à-vis a U.S. dollar. Considering the differentials in inflation rates between South Sudan and the United States, SSP can be regarded as highly overvalued against the U.S. dollar. Although it is difficult to say that the SSP has been receiving a benefit to lower the inflation rate by anchoring the exchange rate with the U.S. dollar, at least South Sudan enjoys the benefit of anchoring the SSP to stabilize the oil revenue under the overvalued exchange rate. Under the condition of a high inflation rate, a floating regime will be too dangerous for South Sudan to maintain the exchange rate. On the other hand, the fixed exchange rate will make the oil revenue in SSP base inflexible. South Sudan has shifted its fixed exchange rate regime to a floating exchange rate regime with a band to cope with possible fluctuations of oil prices. This paper recommends that South Sudan should keep the floating exchange rate regime with a band, which was established two months after its independence. The level of bundling the rate 6.7 percent above or below 3.0 SSP per USD would effectively be narrow in the current high inflation of South Sudan. Further flexibility of a band seems very difficult in the upcoming several years due to the inflation rate, but South Sudan may widen the range of a band once the economic conditions of the country become better.

Figure4.3: Exchange Rate between the U.S. dollar and South Sudanese Pound



Source: Bloomberg

4.2 Fiscal Policy Recommendation

As a result of the analysis on the fiscal policy of South Sudan done in the previous chapter, this paper recommends that South Sudan should combine oil revenues and international aid as funding sources. Oil revenues will be abundant at least until 2015, but will gradually decrease as oil production decreases. South Sudan may compensate the decline of the governmental revenue with financial aid available from the international community. For government expenditures, South Sudan should invest in private sector development other than the oil industry, which makes the country able to attract FDI from foreign enterprises. If the industries in non-oil sectors are not effectively strengthened before the decline of revenue in the oil sector starts, South Sudan will return to a low-income country with limited economic growth--as represented by Dutch disease. If South Sudan is trapped to the conditions of Dutch disease, it will become slower in the economic development of non-resource sectors because of the attractive incomes of the resource sectors and little investment in non-resource sectors. The following section analyzes how funding and investment will work for the economic development of South Sudan in the most effective way under the expectation of declining oil revenues.

4.2.1 Funding: Active Funding from the International Community

As an oil-rich and newly independent country, South Sudan currently enjoys abundant revenues without large external liabilities. Its successful independence by inheriting the revenue base of Sudan made the country debt-free at the time of independence. Utilizing this advantageous condition, South Sudan may borrow a certain amount of external liabilities from IFIs for its economic development. South Sudan has been taking loans from the World Bank, IMF, and AfDB for developing infrastructures and basic services by USD 1,754 million in total.

As long as the revenue stream backed by oil revenues continues to be stable, South Sudan may expand the borrowings from these IFIs.

Unlike other resource-rich countries, South Sudan has been receiving funding as a form of foreign aid from the international community. This assistance is distributed to the non-oil sectors which GoSS does not cover well due to its large expenditures for security issues. Ceasing the conflicts between Sudan along the border should be the first priority for South Sudan to enable more expenditure on economic development. However, assuming that the conflict will continue under the current conflict situations, it would be rational for the country to depend on international aid to distribute funds to the prioritized sectors for development such as health care, education, food and water supply, and basic infrastructure.

Considering the ability of South Sudan to repay the loans from IFIs and the capacity of the international community to provide international aid with the country, a possible scenario of the funding follows. With the expected peak of oil revenue around 2015 and very low expectations of non-oil revenue increases, international funding as forms of international aid and borrowings from IFIs will be significant funding sources for South Sudan. Assuming that oil revenue will decrease by 5 percent annually starting in 2015 and non-oil revenue will increase only by 5 percent, the national revenue base of GoSS will decrease by 16 percent in ten years from SSP 5,767 million in 2011 to SSP 4,819 million in 2021. To compensate the declined revenue from oil production, GoSS will have to request financial aid from developed countries with 10 percent of annual increase. Also, GoSS needs to obtain funding from IFIs for the development of its infrastructure, especially for new oil production facilities, with approximately SSP 500 million annually. To continue governmental spending for necessary industrial sectors, an increased amount of international funding is necessary for GoSS for the next ten years.

Figure 4.4: Budget Projections of South Sudan

(million SSP)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Budget	**7,419**	**6,999**	**6,659**	**7,095**	**7,186**	**6,931**	**6,914**	**6,907**	**6,912**	**6,930**	**6,961**
National Revenue	5,767	5,513	5,519	5,525	5,531	5,412	5,292	5,173	5,055	4,937	4,819
Oil Revenue	5,656	5,396	5,396	5,396	5,396	5,270	5,144	5,017	4,891	4,765	4,638
Non-Oil Revenue	111	117	122	128	135	142	149	156	164	172	181
International Funding	1,652	1,486	1,141	1,570	1,655	1,519	1,621	1,734	1,857	1,993	2,142
International Aid	633	696	766	843	927	1,019	1,121	1,234	1,357	1,493	1,642
Loans from IFIs	1,019	790	375	728	728	500	500	500	500	500	500

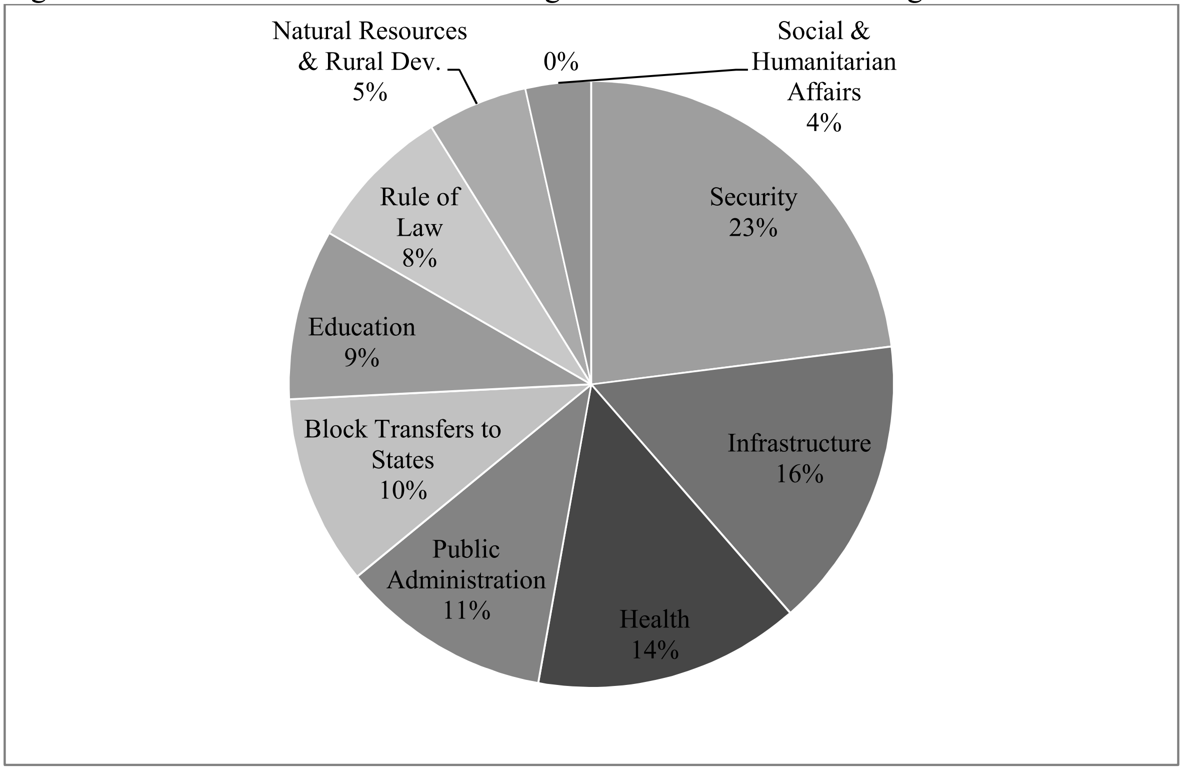
Note: 1. Oil revenue is assumed to decline with its peak in 2015. 2. Non-oil revenue is assumed to increase by 5 percent each year. 3. International aid is assumed to increase 10 by 10 percent each year. 4. Loans from IFIs are assumed to be borrowed by average of the first three years for two years and USD five dollars for the rest of years annually.

Source: Author's Calculation from Information of GoSS and Global Humanitarian Assistance

4.2.2 Investment: Development of Non-security Sectors

As long as the budgeting of GoSS is kept at the level of SSP 7,000 million for the next ten years, GoSS will be able to keep its governmental spending at the current level. As the national revenue has to be spent for security issues until the conflict with Sudan ceases, GoSS will need to rely on international aid and funding from IFIs for developing primary sectors such as health care, education, infrastructure development, and agriculture. If the GoSS budget is combined with international aid and IFI loans, shares of governmental spending will approximate the following numbers. Although spending on security takes the largest portion of spending among all the categories with 23 percent, primary spending such as infrastructure and education are better covered in the budget compared with those of the GoSS budget, where only 4 percent is allocated to health, 11 percent to infrastructure, and 7 percent to education.

Figure 4.5: Combined Share of GoSS Budget and International Funding



Source: Author's Calculation from the Data of GoSS and Global Humanitarian Assistance

Without a doubt, the development of non-oil sectors is the most urgent task in order for South Sudan to become economically viable after the peak out of oil production. However, this will take a long time due to limited market integration of the agricultural market and to high country risk to raise private companies within its boundaries. As the private sector will grow at a very slow pace, the priority of governmental expenditures should be to respond to the basic needs of its citizens, focusing on areas such as health, education, and infrastructure. GoSS should concentrate on satisfying the fundamental needs of its citizens for the first ten years to make possible further economic development driven by industrial sectors, which will fully emerge in the longer term, such as twenty to thirty years.

Conclusion

The main tasks of South Sudan after independence in July 2011 are to secure its revenue base without dependency on oil products and to accomplish economic development as soon as possible through adequate investments in the livelihood of its citizens and industrial sectors. To secure the revenue base, revenues from oil exports must be stable in terms of both the exchange rate and production volume. However, the production volume will start to decline around 2015 if no further oil wells are found and exploited. Furthermore, other sectors are still very primitive, and tax revenue from resident companies will not be expected to amount to much, at least in the short to medium term.

In the monetary policy, South Sudan needs to effectively control the foreign exchange rate with them so that SSP will not appreciate too much against their currencies. South Sudan should shift its floating exchange rate regime in which SSP is within a band between SSP 2.9 and 3.3 against a U.S. dollar to a currency basket regime that reflects the currency rates of the trading partners, such as China, Malaysia, and India. Taking into account that the U.S. dollar has become weaker against other multinational currencies, Kuwait shifted its exchange rate regime from a hard peg to the US Dollar to a currency basket regime to effectively reflect the currencies of its oil trade partners. Without having much trade volume with the United States, a floating exchange rate regime with a band against the U.S. dollar does not make significant sense for South Sudan. Although the floating rate with a band could help South Sudan control its high inflation rate, little trade volume with the United States makes the exchange rate less meaningful for inflation control of South Sudan. Rather, South Sudan exports oil products to non-U.S. countries and imports goods from neighboring East African countries. South Sudan should be careful not to be affected by the inflation rates of the countries whose currencies are included in the basket, but the inclusion of the currencies of its major trade partners, such as the Chinese RMB and the Singaporean SGD, in the basket would be more effective to stabilize its oil revenues in SSP terms.

In the procurement side of the fiscal policy, international funding through foreign aid and borrowings from IFIs is indispensable for South Sudan. Although oil production may increase if new oil wells are explored in a timely manner, the revenue base of South Sudan will start to decrease as soon as four years from now. Without expectations of an increase in tax revenues from non-oil private sectors, GoSS should raise its funding outside the government to keep the amount of its budgetary sources for its security and economic development. Fortunately, South Sudan does not have any debt inherited from Sudan at the time of independence, and it receives abundant foreign assistance to satisfy the fundamental needs of its citizens and for economic development. As a large portion of GoSS revenue is spent for security issues, the government should compensate the amount by requesting the international community to provide financial aid for development. In 2011, South Sudan received USD 201 million from the countries in advanced economy. GoSS may request further funding from these countries until non-oil sectors grow to sufficiently sustain the revenue base of South Sudan. GoSS also may continue to appeal to IFIs for funding basic infrastructure and oil wells development. Without any debt burden and fiscal deficits, South Sudan has more room for procuring debt financing than other developing countries. It has already started to borrow money from the IMF, the World Bank, and AfDB, which is scheduled to receive between 2011 and 2013. As long as its repayment capability is sufficient, GoSS will be able to seek further loans from these IFIs. Most of the other resource-exporting countries have more limited capability in both abundant foreign aid and large debt finance. South Sudan may take advantage of these capabilities until the private sector fully grows to sustain the tax revenue of GoSS.

In the expenditure side of the fiscal policy, governmental spending is not fully allocated to meet the fundamental needs of its citizens and the requirement of economic development. Needing to make large expenditures for security issues, 28 percent of GoSS revenue is directed to those expenses. Governmental spending for fundamental requirements and economic development may be compensated by international aid. Currently, South Sudan receives 16 percent of its total budget from the international community, and this assistance is allocated for fulfilling the financial needs of its fundamental requirements such as health, water, education, and basic infrastructure. GoSS has been funding the budget for exploration of oil wells and social services with loans provided by IFIs. Although ceasing the conflict to reduce security expenditures is the first priority of GoSS, it is still able to allocate enough of the budget for fundamental requirements and economic development through international aid and loans from IFIs.

Overall, heavy dependency on oil revenues is the most significant problem South Sudan needs to solve for achieving its effective economic development. Its primitive industries will not be able to replace the position of the oil sector in the short term. Assuming that the dependency on oil revenues will continue for at least ten years in South Sudan, GoSS should prioritize stabilizing oil revenues with an adequate exchange rate regime, and should fund enough of the budget from external sources so that it may allocate an amount of the budget adequate to satisfy the livelihood of citizens and to propel the economic development of the country. Taking advantage of an abundant source of international aid, and having room for debt financing that other resource-exporting countries do not have, South Sudan should balance the current security issues and its urgent need for economic development. The economic development phase will start only when the border conflict with Sudan ceases and non-oil sectors grow enough to sustain the budget of GoSS with their tax payments.

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