Sudan Banking Sector Reform

By: Hafiz Ismail Mohamed *Banker(Follow of the Chartered Institute of Bankers)*

hafiz@justiceafrica.net

The banking system plays a fundamental role in the economy by implementing the state's monetary policies and providing liquidity to boost productive activities such as agriculture, manufacture, and services. At the same time, it can play a negative role in cases of excessive financing.

The banking system in Sudan has undergone many developments over the past seven decades. One major shift was the Islamization of financing in 1984. The first bank operating under Islamic principles was established in 1978 (Faisal Islamic Bank of Sudan). After that, banks in Sudan shifted from being deposit holders and financiers to investors engaging in speculative trade in goods and services. Islamic banks, controlled by the Muslim Brotherhood, engaged in speculation in essential commodities, which drove up prices. This period saw the rise of parasitic capitalism, which imposed its dominance on trade and weakened traditional capitalism in Sudan.

Following the March/April 1985 uprising, and under pressure from the Bankers Officials Trade Union , investigative committees were formed to look into banking violations. These committees uncovered breaches of credit policies and foreign exchange regulations by some Islamic banks. However, their work stopped after the 1986 elections, when the Islamic Front joined the coalition government in 1987.

After the Islamic Front's coup on June 30, 1989, the committees were dissolved, and all incriminating documents were destroyed. These documents implicated prominent Brotherhood leaders in manipulating export foreign currency revenues and violating credit policies.

From June 1989 onwards, the banking system was completely taken over through control of the Central Bank and all bank administrations. Banks were used to implement empowerment policies, allowing the Islamic Front to dominate Sudan's economy and systematically loot national resources.

The banking system became the mechanism through which empowerment policies were executed and the country's wealth plundered. Without a comprehensive investigation into all banking practices since 1989, it is impossible to uncover the full truth or determine the scale of corruption during the thirty years of Islamic Front rule.

The Need for Structural Reforms in the Banking System

Since the Islamic Front took control of the banking system, appointments were made based on loyalty rather than merit, competence, or qualifications. This weakened banks' financial positions according to international standards of capital adequacy and liquidity, leaving most Sudanese banks unable to meet those standards.

Financial positions were further undermined by poor lending practices and insufficient guarantees, which increased the proportion of bad debts and weakened banks' capital and reserves. Weak oversight and auditing also meant that published financial statements often did not reflect reality (window dressing).

The regime privatized public-sector banks and seized their assets, valuing them far below their true worth. These banks and assets were handed over to regime loyalists in a systematic theft of public funds. Rising inflation further eroded bank capital, weakening their financial positions and leaving them unable to provide the liquidity needed for productive activities.

International sanctions isolated Sudan's banking system from global financial institutions, cutting ties with correspondent banks in Europe and North America. As a result, Sudanese banks lost many advantages.

For the banking system to play its proper role in the post-regime era, all negative effects of the past thirty years must be removed, and the sector rehabilitated. The transitional government must implement structural reforms, including:

First: The Central Bank of Sudan

The Central Bank plays a key role in achieving economic stability. According to the Bank for International Settlements, it must be able to determine the size of the money supply using available tools, including credit policy and interest rates. One of its main goals is to help the government achieve its targeted inflation rate as part of macroeconomic policy. The Central Bank is also crucial in adjusting liquidity levels in the economy and works in tandem with fiscal policy to control inflation.

Since Sudan adopted Islamic financing, the Central Bank lost one of its most important monetary policy tools: the interest rate. Islamic financing operates on profit margins rather than interest, and in the absence of proper regulation, borrowing costs were set outside the Central Bank's control (base rate).

Reforms to the laws and regulations governing the Central Bank are essential to restore its effectiveness in economic reform. These should include:

1. Ensuring monetary stability and proper use of government resources.
2. Achieving financial stability and price stability (inflation control).
3. Directing bank credit toward investment and development goals.

4. Stabilizing the currency and restoring fiscal balance.
5. Controlling the money supply through monetary policy tools.

Central Bank Autonomy

The size, structure, and qualifications of the Central Bank’s leadership play a vital role in its ability to operate independently. Autonomy—freedom from political and partisan interference—is the accepted standard worldwide. Board appointments should be based on merit and competence.

Recent appointments to the Central Bank of Sudan’s board did not follow these standards. This will negatively affect its ability to stabilize prices, control inflation, and stimulate economic growth through sound monetary policy.

Several Studies on Central Bank Independence

Several studies in both industrialized and developing countries have shown that nations with highly independent central banks achieve price stability by controlling inflation. Accountability and transparency also play a fundamental role in restoring confidence in the banking system.

Degree of Central Bank Independence

The performance of a central bank depends primarily on its degree of independence and its insulation from political and partisan influence. Central bank autonomy and accountability in fulfilling its mandate are guided by International Monetary Fund (IMF) principles.

- The state’s primary goal is to achieve welfare and prosperity, which must be realized by satisfying the people without excluding any group. This is pursued through policies set by politicians.
- Price stability and financial system stability are essential requirements for sustainable economic growth, since high inflation negatively affects overall economic performance.
- Inflation control is the responsibility of the central bank. Even when the state intervenes by fixing certain prices, supply and demand factors still influence inflation.
- Credible monetary policy, with strong implementation and monitoring capacity, helps reduce inflation. Inflation directly impacts fiscal policy and economic planning, making it easy to derail such policies.
- Politicians often intervene in monetary policy to serve their own medium- to long-term interests, seeking short-term gains.

- False or contradictory information requires flexibility in handling, which is only possible if the central bank enjoys independence. This enhances credibility and strengthens its ability to manage the economy.
- Standards and safeguards must be established to prevent misuse of independence. For example, the Central Bank of Sudan enjoyed some independence under Dr. Saber Mohamed Hassan, but this was largely because he was a senior figure in the ruling National Congress Party and head of its economic sector.
- The central bank must provide accurate and transparent information to the public in a timely manner. This reassures markets and includes data on government debt, foreign currency reserves, liquidity positions, and associated risks.
- Independence and transparency are especially important in countries with weak political institutions. Central bank laws must enshrine a degree of autonomy to support economic stability.
- **Independence of expenditure:** This gives the central bank greater freedom. One of the most important features of independence is its responsibility for setting monetary policy and exchange rate systems (as in the U.S. Federal Reserve).
- **Policy independence:** This includes setting monetary policies and controlling exchange rates when the national currency is floating and subject to market forces (as in the European Central Bank).
- **Instrument independence:** In this case, the government sets monetary policy in agreement with the central bank, which then implements it using its tools, with full authority.

Factors Affecting Central Bank Structures

- Economic development defines the central bank's objectives and management bodies, including price stability and overall financial stability. Political interference affects its governance structures.
- Independence is reduced when board members are appointed for political reasons and subject to dismissal if their policies displease the government. In Sudan, the government often exceeded borrowing limits from the banking system, turning the Central Bank into a money-printing machine.

Central Bank and Currency Stability

Several factors determine the exchange rate system of the national currency. The central bank's role is to use available tools to influence exchange rates according to economic conditions.

In a globalized economy, capital flight strongly affects exchange rates, often beyond the central bank's control. This has been evident in Sudan over the past nine months, where the sharp depreciation of the Sudanese pound was not only due to trade flows but also to capital flight, including money laundering by elements of the former regime seeking to evade sanctions.

Central bank independence must prevent conflicts of interest with the government and ensure that partisan or political agendas do not undermine monetary policy objectives. Strict criteria for appointing board members are essential to prevent political manipulation.

Accountability and Responsibility

The central bank must be held accountable for its commitment and ability to implement policies effectively and manage resources in ways that serve the economy.

Role of the Central Bank Board

a. Responsibilities: The board's role varies depending on the degree of independence. It may oversee monetary policy and supervise the banking system. In some countries, a Monetary Policy Committee operates under or independently of the central bank. In others, separate supervisory authorities oversee banks to avoid conflicts of interest. In some systems, the board simply implements state-set monetary policy.

b. Conflict of interest: Board members must act independently under the law and not receive directives from any external body. Independence requires that the governor, deputy, or board members not hold shares in supervised institutions or exercise supervisory roles over them.

c. Appointment and dismissal: Procedures for appointing and dismissing board members must be clear and well-defined to safeguard independence and prevent external pressures.

d. Qualifications: Board members must have expertise in banking, finance, economics, law, and in some cases accounting, auditing, or international trade. Some countries also require professional experience in these fields alongside academic qualifications.

In addition to professional experience and expertise, a person must also possess integrity, a good reputation, and proper conduct.

c. Nomination and Appointment: To ensure proper standards and criteria for managing the central bank, one body should be responsible for nominations based on agreed-upon standards, while another body should handle appointments after thorough review and scrutiny.

h. Dismissal and Termination of Service of Central Bank Board Members: Members of the central bank's board must be protected against arbitrary dismissal. This guarantees the bank's independence and its ability to set policies and make decisions without undue influence. Dismissal should only occur according to law, in cases of misconduct or negligence. In some cases, dismissal may be carried out by the legislative authority, which limits the executive branch's influence over central bank policies and management.

Good governance of central banks means they perform their role effectively and with high efficiency. There is broad recognition and consensus on the importance of central bank independence, as it directly impacts their ability to carry out their duties properly and reflects positively on overall economic performance.

Proposed Reforms

To restore the banking system's effectiveness, the following reforms are necessary:

1. **Establish an Investigative Committee on Banking Corruption:** The former regime used banks as tools to implement economic empowerment policies. By disregarding proper banking principles, this led to the accumulation of bad debts, weakening banks' financial positions. These debts were settled without recovering most of the loan assets. Therefore, all borrowing operations over the past thirty years must be reviewed, and stolen funds must be returned at their real value (real value/indexation).
2. **Review the Valuation and Sale of Banks and Their Assets:** Most banks were sold to regime loyalists through manipulated valuations. All such transactions must be reviewed, with assets restored to their true value.
3. **Restructure Sudanese Banks and Their Management:**
    - Reconstitute bank management based on competence.
    - State-owned banks must be recapitalized to strengthen their financial positions and meet international capital adequacy and liquidity standards (Basel Accord).
    - Private banks must also be restructured and supported to meet capital and liquidity requirements.
    - Strengthen oversight by empowering boards of directors and separating regulatory bodies from ownership.
    - Establish an independent regulatory authority. The Central Bank of Sudan must not own or hold shares in banks while also acting as regulator, as this creates a conflict of interest.
4. **Introduce a Dual System of Islamic and Conventional Banking:** Since Islamic financing alone makes it difficult for Sudanese banks to integrate with

international financial institutions, a dual system should be introduced, allowing clients to choose between Islamic and conventional loans. No country in the world operates solely under Islamic financing because it is:

- Inflexible.
- Costly for borrowers.
- Discourages savings.

5. **Encourage Savings and Personal Sector Investment:** Islamic savings instruments are inflexible and yield poor returns, discouraging personal savings. This deprives banks of resources to invest in productive sectors. As of September 2019, deposits in banks accounted for only about 3% of total money in circulation, severely undermining monetary and fiscal policy and facilitating tax evasion.

6. **Develop a Secondary Market:** Encourage interbank lending and trading of financial instruments, creating highly liquid quasi-money assets.

7. **Revitalize Personal Sector Financing:** Since the late 1970s, central bank credit policies excluded personal loans, depriving many of investment opportunities. Although car and housing loans were briefly allowed in the early 2000s, they were discontinued. This deprived banks of a major income source and middle-income groups of access to credit. Banks should be allowed to finance the personal sector and introduce credit cards.

8. **Allow Banks to Invest in Pensions and Post-Service Benefits:** Pensions have long been monopolized by government agencies, limiting competition and returns. Banks should be allowed to enter the pension market, providing resources for long-term investments.

9. **Invest in Technology:** Banks must modernize infrastructure to keep pace with global technological developments and prepare for the post-sanctions era.

Administrative and Structural Reforms

1. Reconstitute bank boards of directors based on competence and expertise.

2. Eliminate all forms of political empowerment in the banking system, including appointments made under the former regime without regard for qualifications.

3. Review all employment conditions and post-service benefits that were unlawfully abolished, violating basic human and socio-economic rights, and compensate those harmed by such unjust decisions.