



Sudan's Exchange Rate How to Sustain Progress and Preempt Risks

By Suliman Baldo

On February 21, Sudan's civilian-led transitional government implemented a managed float of the Sudanese pound, aligning the official rate of exchange, previously at 55 Sudanese pounds (SDG) to \$1, with the parallel market's rate of 375 SDG to \$1.¹ The elimination of the defective exchange rate system opens the door for a potential windfall of benefits for the economy by leveling the playing field for the private sector, encouraging foreign investments, and eliminating venues for corruption.

This long overdue reform represented a 580% devaluation of the national currency and fueled concerns over Sudan's rate of inflation, which stood at 304% in January—one of the highest rates of inflation in the world.^{2,3} Many Sudanese economists cautiously welcomed the move while warning that it will need to be complemented by broader economic and governance reforms in order for stabilization of the economy to take root and become sustainable.

Momentum for Positive Change

The realignment of the exchange rate is only the latest development in a series of domestic and international improvements to the standing of Sudan's dismal economy. These have included the removal of Sudan from the United States' State Sponsors of Terrorism list,⁴ the partial restitution of Sudan's sovereign immunity by the US,⁵ and the US extension of a \$1 billion bridge loan to the World Bank, which will clear Sudan's arrears and remove an obstacle to its consideration for debt relief under the International Monetary Fund's Heavily Indebted Poor Countries (HIPC) initiative.⁶ Through the HIPC initiative, Sudan may begin the process of seeking forgiveness of its crippling \$60 billion debt. The bridge loan, together with the US Export-Import Bank's commitment of another \$1 billion of financing support for US exports to Sudan, represents a dramatic departure from nearly three decades of costly US comprehensive trade and financial sanctions on Sudan.⁷

Coming after the restructuring of subsidies on fuel and electricity,^{8,9} the elimination of multiple rates of exchange helps to cut off a system that caused serious harm to Sudan's economy for decades. In the past, when allocating the Central Bank of Sudan's dollar reserves amid a chronic situation of extreme dollar scarcity, the government had given priority to trading enterprises and companies owned by the state or by regime insiders. These companies and their domestic and international business partners were able to take advantage of the disparity between the official and black-market exchange rates to enrich themselves and channel illicit funds out of the country, for instance by taking advantage of letters



of credit programs.^{10, 11} This, in turn, crippled the ability of the private sector to compete in the market and encouraged smuggling of imported goods.¹²

The decision to float the currency will likely yield a significant political dividend to the transitional government. One recent study in *The Journal of Politics*, published by the University of Chicago, concluded that the harm caused by the black market for dollars reduces popular support for incumbent governments,¹³ and initial reactions on the ground in Sudan lend some credence to this argument. In a spontaneous show of support for the change, the public and Sudanese migrant workers exchanged remittances and dollar holdings at the bank in unanticipated numbers.¹⁴ If this trend persists, Sudan could—for the first time—count on what the UN estimates to be \$2.9 billion in annual remittances to boost its foreign reserves.¹⁵ In addition, the donor community delivered on pledges of financial assistance, helping to stabilize the new rate of exchange.

Remaining Hurdles

Black market currency arbitrage operations were just one of numerous corrupt schemes that lined the pockets of regime insiders while crippling Sudan's economy writ large. Reestablishing civilian control over the finances of the military and security services remains an existential challenge. Despite the rapidly changing landscape, the existence of hundreds of state-owned enterprises (SOE) that continue to keep their revenues off the books while benefiting from the lion's share of public expenditures—a distortion inherited from the kleptocratic regime of deposed President Omar al-Bashir—poses a real threat to the economic recovery the Sudanese people have long waited for.^{16, 17} In particular, the military and security services oversee businesses earning significant international profits. The former government had empowered security companies to retain the proceeds of their foreign and domestic trading activities in order to reinforce their financial autonomy and secure their loyalty.

This diversion of proceeds deprives the civilian government of resources that could be used to deliver public services, while also limiting the administration's capacity to oversee the military and security services. Prime Minister Abdalla Hamdok hinted at the crippling impact of this legacy, which has left his government in control of only 18% of the nation's public funds.¹⁸ Former Finance Minister Ibrahim al-Badawi, as well, publicly admitted that his ministry had no access to the proceeds of meat exported by an army holding company and no oversight of the foreign currency collected by the Civil Aviation Authority, managed by the Ministry of Defense, from servicing international air traffic over Sudan and in its airports.¹⁹

As long as the government's own enterprises continue to withhold from the treasury proceeds that should be overseen and controlled by the Finance Ministry and the Central Bank of Sudan, Sudan's economy will continue to suffer. In addition to its crippling impact on the economy, the financial autonomy of SOEs creates real risk for money laundering and terrorist financing by providing avenues for illicit financial flows. It also fuels inequality between public sector workers and their peers in government agencies and units that have the privilege of shielding their finances from public service norms and standards.

The convergence of intense pressures from the government and the international community, including the International Monetary Fund in its Staff-Monitored Program agreements with the government, appears to be having an impact. The army's Defense Industries System recently agreed to transfer its civilian operations to the finance ministry, with the goal of converting them into public shareholding companies.²⁰ This is a welcome development, as long as it is followed by

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immediate steps to conduct the transfer transparently and on the basis of an independent valuation of assets and production capacities conducted by a reputable national or international audit firm.

Next Steps

While the exchange rate policy is an essential and welcome reform, a lot remains to be done as Sudan moves to stabilize its economy.

Concerns that the reactions of the parallel market to the exchange rate alignment could lead to an overshoot of the dollar price have not yet materialized. However, that could change rapidly if the government fails to strategically coordinate other economic policies. The government must rationalize Sudan's imports, eliminate tax exemptions for all parties, including state-owned enterprises, and strictly enforce a Treasury Single Account (TSA). A fully enforced TSA would bring all government agency receipts and payments within the purview of the Ministry of Finance and eliminate untold numbers of ghost workers. Sudan has the technology for a rapid and full deployment of the TSA, including unique national ID numbers issued to the vast majority of the population, smart ID cards, and a partially deployed electronic government receipt. The government should also completely stop printing money, which it refers to as borrowing from the Central Bank of Sudan, and find creative ways to increase revenues, including by enforcing the independence of the central bank, reforming the taxation system, and cutting expenditure on its own bloated bureaucracy.

Additionally, the Sudanese government must fight the pervasive economic corruption that prevents it from delivering development outcomes and social services by improving the efficacy of its legal and regulatory regime for countering money laundering, terrorist financing, and illicit financial flows. Sudan's international partners have already committed to aiding the civilian-led transitional government in this endeavor by extending financial support and technical and diplomatic assistance. In particular, donors, foreign investors, and banks should ascertain the beneficial ownership of potential clients and commercial and service partners, confirming their full compliance with Sudanese laws. Banks and financial institutions especially should heighten due diligence for transactions involving Sudan, particularly those that involve oil or gold exports, helping curb illicit financial flows from the country.

The US, in particular, has identified the empowerment of a civilian-led democratic transition as a pillar of US policy in Sudan. The Sudan Democratic Transition, Accountability, and Fiscal Transparency Act of 2020, enacted last December, directs the Treasury Secretary to periodically report to Congress on demonstrable progress by the government in improving the fiscal transparency of security sector agencies and their corporate holdings and in controlling their finances and assets, the intention being to strengthen such efforts.²¹ The US could further support this goal by identifying SOEs in Sudan that deny the treasury access to their books and proceeds as money-laundering risks. Such heightened scrutiny would contribute to closing the loophole that enables foreign currency to be diverted from contributing to the financing of development in Sudan.



Endnotes

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