

Islamic Banking Versus Conventional Banking System The Case of Sudan During Peace Interim Period

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1- Introduction:

Framework Agreement on Wealth Sharing that has been signed in Lake Naivasha, Kenya on 7th January, 2004, by the Government of the Sudan and the Sudan People's Liberation Movement / Army has clearly explained in simple terms that a dual banking system is to be established in Sudan during the interim period, to be in consistent with the Mashakos Protocol of 20th, July 2002. An Islamic Banking system shall operate in the Northern Sudan and conventional banking system shall operate in the Southern Sudan. It is believed that the implementation of a final comprehensive peace agreement in Sudan will affect the banking industry in terms of the monetary and fiscal policies that are essentially to be formulated in a macro framework consistent with other macroeconomic policies. And from now onwards the Central Bank of Sudan shall generate programmes aiming at restructuring the banking sector in order to meet the requirements of the peace agreement. Not only that it is responsible for a comprehensive banking policy, but also to apply its liability in the peace agreement requirements, regarding monetary policies under a new dual banking system, which are calculated to focus on price stability, maintaining stable exchange rate, sound banking system and issuance of one single currency for the whole country. The purpose of this humble study is to take a brief look at the banking and monetary policy framework in the protocol of wealth sharing, so we can then become familiar with the most characteristics and general ideas on these policies, as well, in trying to examine the scope of prior assumed – arrangements by the Central Bank of Sudan in designing the consistent monetary policies for the dual banking system.

2- Historical Roots of Sudanese Banks:

The banking activities have been introduced into Sudan before World War 1 when the British Colonial Authorities at that time allowed the foreign banks branches to open their offices in Khartoum City for handling the functions of foreign exchange facilities at home, to act as correspondent for the parent banks, serve domestic clients abroad and facilitate the extension of trade locally. The expansion of the foreign banks in the country as far back as 1900s had had taken place actually as a product of the Colonial Administration's desire to dominate the country's finance for servicing their own objectives and financing the foreigners' business in the first place. Evenly, dramatic observation that had seen is the growth of foreign trade finance that was granted by

these foreign banks branches while did stay away from financing the local productive activities and development projects. The names of some foreign banks in the Sudanese Banking History are (1) National Bank of Egypt, (2) Barclays Bank of Britain (3) Ethiopian Commercial Bank. and (4) Arab Bank.

In the period of first four to six years after independence in 1956, Sudan Government established three development banks namely (1) The Agricultural Bank of Sudan in 1959 (2) the Industrial Bank of Sudan in 1962, and (3) the Sudanese Estate Bank in 1967. Each of these banks was intentionally planned to promote development in its own specialized area. In addition, the banking sector observed the formation of the first Sudanese commercial bank, the Commercial Bank of Sudan, as well as a joint foreign local bank, El Neilain Bank. The Central Bank of Sudan, however, was opened in 1960 to replace the Sudanese Currency Commission - SCC in order to exercise the most important responsibilities for control of the Sudanese Banking System, namely, issuance of currency, serving the Country's development and to undertake the general monetary policy.

At the present time, there are 26 banks operating in Sudan under the Central Bank of Sudan regulations, they are classified into four groups (1) Four are public - owned banks, (2) Eighteen are incorporated joint – venture banks, (3) Three are foreign banks branches and (4) one investment bank. The branches of operating banks are totaling to 547 branches by the end of the year 2003, mainly scattered into seven regions, with concentration in the Capital and Central regions, that is to say (1) Khartoum state with 184 branches - (33%), and the Central States with 110 branches - (20%)(3) Eastern States 76 branches – (14%) (4) the Northern States 61 branches - (11%), (5) Kordofan States 54 branches - (10%), (6) Dar Fur States 43 branches - (9%), and (7) the Southern States 19 branches - (3%). This is evidenced of defensive nature by the patterns of the operating banks in Sudan, if a certain bank branches are more in a specific area his domestic competitors will follow his lead in order to preserve the ability of market share on the rule of “ follow – the – leader “ investment. After the peace, the probability of rush entry from foreign banks' branches into the Southern Sudan is highly expected, even though, all banks in the southern Sudan shall operate and offer their services according to the conventional system instruments as agreed in the wealth sharing protocol. The less obvious “follow – the – leader” effects would not be seen among existing banks because of the prohibition of interest rate tools against their banking operations at this instant, or they mayl close their branches in the Southern Sudan. The fear that will be developed, as only a few conventional banks would dominate the banking market in the Southern Sudan, shall be solved through growing a desire to encourage legitimate authorities later on to permit Islamic Banks to branch in the South or to build special ties with the local banks over there for Islamic banking facilities according to the regulations at the national monetary policies level.

3- The Peace Agreement and Restructure of the Banking System:

The Banking System also was in the heart of the wealth sharing Agreement, for its imperative function and its key role in supporting the political stability and economic development. Subsequently; the two parties - GOS and SPLM/A - agree that

conventional banking facilities are urgently needed in Southern Sudan. Therefore, they agree to establish, during pre – interim period, the Bank of Southern Sudan (BOSS). Again, The parties agree to restructure during the interim period, the Central Bank of Sudan so as to reflect the duality of the banking system in Sudan. The Central Bank of Sudan shall therefore, use and develop two sets of banking instruments, one is Islamic and the other is Conventional, to regulate and supervise the implementation of a single monetary policy through: (1) an Islamic financing window in the Northern Sudan under a deputy Governor of the Central Bank of Sudan using Islamic financing instruments to implement the national monetary policy in the Northern Sudan, and (2) the Bank of Southern Sudan (BOSS) headed by a deputy governor of the Central Bank of Sudan to manage the conventional window using conventional instruments in implementing the national monetary policy in Southern Sudan.

In order to enlighten the increasingly heavy load of the wealth sharing agreement on the Central Bank of Sudan, H.E. the governor of the CBOS has formed various Steering Committees from related departments of the bank (CBOS) on the new banking systems that are so proposed by the peace agreement, for studying means of simplifying and standardizing the regulations of the dual banking system that will be established upon signing the comprehensive peace agreement on 9th, January, 2005 at Nyayo Stadium in Nairobi. The Central Bank of Sudan System will concern chiefly with controlling monetary conditions with assuring the unification of banking policy under the dual system, and general appropriateness of the application in the light of the broad public objectives, the relevant banking and financial status where are intended to serve:

- Ensuring an equality of the cost of finance through the operating banks under the two sets instruments, as they will be applied in tolerable part for establishment of a certain system in the country.
- Providing fairness of banking finance procedures and regulations for each of these two systems throughout the country.
- Confirming equal opportunities for broad monetary policy in both systems in the whole country.
- Backing neutrality of mechanisms for developing each of these two systems both in the North and the Southern Sudan.
- Securing the Central Bank capacity for assuring the solvency of the operating banks in the two systems, under its role as lender of last resort of the borrowing.
- Developing a safe and sound banking control system in the Central Bank of Sudan for both systems in the whole Sudan.
- Preparing for adopting a program to issue a new currency during the interim period.

4- Two Banking Systems and One Monetary Policy:

There is evidence in the wealth sharing agreement that the major changes will happen and the monetary authorities by any standards have to restructure the banking system at its linking as a turning point in Sudan's monetary history in the time of peace. The Central Bank of Sudan shall formulate a new regime based on the duality of banking

operators in the country, is an Islamic banking system in Northern Sudan and a conventional banking system in Southern Sudan. The new monetary policy framework will combine effective overall control with much greater flexibility and freedom for individual banks and financial institutions, a system which will give full scope for competition, innovation and technological systems and market - based instruments. The bank of Sudan has an experience since Feb. 1992, the time, when the Sudanese Banking Sector has broken away from the old regime that relied on rigid quantitative controls over foreign exchange operations, lending and banking policies.

The main impact of the new dual system on the overall monetary policies will be the sudden stream of interest rate in the local banks and certified foreign bank branches throughout the Southern Sudan while the main features of the banking operations in the Northern Sudan will continue as in the current situation where all the banks operate without a specific interest rate mechanism, due to religious dictates of Sharia Law. In addition, the Sudanese Banking system has a great experience in dual banking practices, for Islamic Banking system in the country has been introduced to function gradually alongside an existing conventional banks and it is recognizable in the period of 1977 - 1989 with effective operations on its credits instruments. And the famous Islamic Banking System Instruments are Mudarabah, Murabaha, Masharaka and Ijara. Moreover, due to conflicting views of Sudanese Political Parties and the Civil Associations on the issue has resulted in a partial implementation, at the same time, has led to slow - down and freezing the full application of Islamic Banking System and in some cases up to 1990s.

Despite the implementation of Islamic Shari'a in Sept. 1983, the conventional banks in Sudan were allowed to deal in compensatory rates, and of determining the compensation rates for credits balances, debit balances, saving accounts and loans. There are many cases in Muslem Countries now in which it is allowed to any bank to operate either on conventional banking or on Islamic banking.

The brief review of the survey, which was made by Banking Studies Institute of Kuwait in 2001, on the duality of banking system in The Gulf Countries alone, was concluded in some important evaluation results and summarized as follows:

- The Islamic Banking provides both an alternative and supplement to the existing conventional banking practice.
- The Islamic Banking Market itself is characterized by fairly degree of concentration where Al - Rajhi and Investment Company accounted for about 50% of the total assets of Islamic Banks.
- Over the period 1995 - 1998 the total assets of Islamic Banks recorded in the Gulf Countries, an annual rate of increase of 7%. They are sharing in the banking market in the Gulf Countries.
- The market for Islamic banking and finance is without doubt a growing one.
- Evidence of their importance in the banking industry can be gleaned from the fact that some of them have already been rated within the top of Arab banks according to overall areas of finance.

It is, of course, likely to say that the Sudanese Banking Sector - as a matter of fact - has to identify their contribution by choosing a particular area for operating the

banking business either by specializing in the Islamic Banking in the north or pursuing the conventional banking in Southern Sudan, in order to support the peace process by more active mobilizing for deposits and aggressive financing the local productive projects, each of these banks must operate in its own specialized field and in a permitted geographical area in the country according to the wealth sharing agreement. But, one thing is certain: this country is visibly ordained to assume again the leading role in rebuilding the banking structure a unique one in the form of the two systems, and even more than before the civil war, Sudan shall have to function as the chief Conventional and Islamic Banking Systems in the region.

5- Banking Policies and Economic Objectives in the time of peace:

One important aim of wealth sharing agreement as mentioned in its paragraph 1.4 is that the sharing and allocation of the Sudanese wealth originating from the resources of the country shall ensure that the equality of life, dignity and living conditions of all the citizens are promoted without discrimination. The sharing and allocation of this wealth shall be based on the premise that all parts of Sudan are entitled to development. The new redistribution approach of the wealth has made several suitable points:

- (1) The Southern Sudan, Nuba Mountains / Southern Blue Nile, Abyei and other war affected areas face serious needs to (a) be able to perform basic government functions (b) build - up the civil administration and (c) rehabilitate and reconstruct / construct the social and physical infrastructure in a post – war Sudan.
- (2) The Southern Sudan and other war affected areas in need of construction / reconstruction, shall be brought up to the same average level of soci – economic and public service standards as the Northern states.
- (3) In the coming peace - time many Sudanese people aim to become better quickly and well off economically as well as politically stable after a long time of suffering and distressing. The Sudanese people now believe that their country apparent abundant natural resources, agricultural prosperity and growing oil production would lead Sudan to a model of economic development or the model that has too benevolent a perception of the benefits of economic development during the peace interim period.

In reality, the mechanisms of economic and political stability cannot be separated, as simply as some people would seem to imply. There is justifiable reason for many people to be more optimistic in the peace process and its possibility of tackling the problems of Sudanese economic and mass poverty of large areas in the south, far north, west and east of the country. And, as the writers of the 1990 UNDP Human Development report define the economic development as promotion of the individual well – being, closing the eyes to the old meaning of the development in the 1950s and 1960s that was concentrated on “the meaning” a rapid economic growth only as measured in terms of GNP. For most lay Sudanese people with a less technical conception of “ development “ would see the restoration of the peace into the country as an implication of the change for the better and the ordering of society, social and economic process in such a way to lead to achieve the following objectives:

- 1- Eradicating the rampant poverty, ill health and ill literacy in the country.
- 2- Rising standards of living and increasing material comforts for all Sudanese people.
- 3- Developing Sudanese people capacity and enlarging their economic and social choices.
- 4- Enabling the Sudanese people to take part in reaching a consensus about the process of new changes.
- 5- Enhancing the capacity of all the Sudanese citizens to realize their full potential of creativity and spirituality.

The framework agreement on wealth sharing paragraph 14.0 in particular include a call for the Central Bank of Sudan to create the conditions that will ease application of conventional banking and financial system in Southern Sudan. The current situation gives the ten southern states only 3% of the local banks branches that are 547 branches by the end of 2003 in the whole country. The weak growth of the banking units in the area can interpret the difficulty of a logical assessment for monetary policies effects throughout the south in terms of financing the local productive projects, serving domestic clients and facilitating the extension of local trade. Banking has been an industry for almost more than a century in Sudan, but for the Southern Sudan until recently a bank never means really a business.

So, in the peacetime when the Central Bank of Sudan leads the way into the region by establishing the bank full-fledged - branch “ the bank of Southern Sudan (BOSS), will develop the conventional window using conventional financing instruments in implementing the same national monetary policy and allowing conventional banks to operate in Southern Sudan, the banking business will be capable to meet the urgent needs of the economic and social development for the people in the area.

6- Banking Policies’ Consistency is needed for Macro - economic Stability:

Concerns for the establishment of the conventional banking system in the Southern Sudan during the peace interim period will not bring about significant changes on the Central Bank of Sudan banking and financial policies over the banking sector, but it will give an additional role for the bank (CBOS) to implement monetary policies, directives, circulars and actions for controlling the financial institutions working under the new financial system at the side of the functioning financial and monetary policies. Current reform programme for the commercial banks will resume to provoke economic activities in a peaceful environment.

All in all, the wealth sharing agreement has deep-rooted the principle of unity and consistence of the national macro - economic policies, as in the paragraph 14.16. For this instance, is quoting that “**foreign borrowing by all sub –**

national governments shall be done in a manner that does not undermine national macro - economic policies and shall be consistent with the objective of maintaining external financial viability. All sub – national governments’ foreign borrowing transactions shall conform to the Central Bank of Sudan”.

The form and nature of monetary and fiscal policies in Sudan are formulated in a macro - framework compatible with other economic policies. For example, during the period 1992 to 2002, the central government determined to apply a programme for the ten years, namely, Comprehensive National Strategy, this plan was intended to increase the productivity and economic growth, while at the same time employing all available economic resources for the benefit of the country. The programme was involving all public sectors of the Sudanese Community. The Central Bank of Sudan as an agent and principal for the government for pursuing its monetary and fiscal policies has started to carry out a general reform programme, to accompany the ten years strategy by restructuring the banking system. This banking reform policy was scheduled to achieve some objectives summarized as follows:

- Sustaining flexibility of cost of finance
- Promoting the role of the market forces in allocation the finance
- Deepening the money markets and capital markets
- Strengthening the self-sufficiency for commercial banks

The success – or otherwise- of the policies that would dominate the rehabilitation, reconstruction and development in Sudan during the interim period will depend heavily on their consistence throughout the country. The Central Bank of Sudan monetary policies are to be emphasized over the banking system both in the North or in the South, in case, either to increase the role of commercial banks in allocating economic resources to important sectors or to encourage the banks to cope with international new banking issues or hamper their entrepreneurial performance. In addition to that and in the monetary policy side, under the dual banking system with market - based instruments in the implementation of monetary policy, and to keep the Sudanese banking jingle and to attain effective prudential supervision for both windows, consistent with the broad banking policies packages, the Central Bank of Sudan should play a great role to go ahead with formulating prudent monetary and financial programmes that serve the economic strategies in the following fields.

- 1- Improving the monetary policy framework
- 2- Deregulating the financial sector
- 3- Promoting competition in the banking sector
- 4- Strengthening the prudential regulations and the supervision framework.
- 5- Encouraging the banking sector to cope with international financial liberalization and standards.

7- Conclusion:

The future of progress of the banking industry in Sudan during the interim period will depend largely on the ability of the Central Bank of Sudan to manage the two sets of

banking instruments of Islamic Window on one hand and conventional banking window on the other hand.

In addition, the ability of the bank (CBOS) to create an environment for individual banks to become competitive depends on internationally recognized regulatory and prudential standards for Islamic and Conventional finance, as they will be set, although, each banking system representing a somewhat different view of the way a country banking system and monetary policy would relate to the international banking system. And to encourage the banks to initiate to be so innovative in an information age and fast technological advances rather than arguing over the whole effects in terms of monetary return and comparative performance analysis of these two banking systems in the country.

The Central Bank of Sudan monetary policies for the coming period have to be concerned with internal policies that would support the agriculture production, industry, service institutions, infrastructure projects and to promote the role of external business and foreign – trade, export and import. The policies, which are to be taken the two forms one is, import substitution, thus, saving the foreign exchange through production for the domestic market of many manufactured products previously imported and other policies packages are for export promotion that means earning the foreign exchange through efforts of the production of local products for external markets. In this century, every country's welfare would increase, particularly, if every country opens its doors to the recognized international economic systems, and when some consistent processes are achieved at home, in turn peace will prevail.

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