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Report No: PGD3926

INTERNATIONAL DEVELOPMENT ASSOCIATION

SUPPLEMENTAL FINANCING DOCUMENT FOR

A PROPOSED GRANT
IN THE AMOUNT OF SDR 40.1 MILLION
(US$55.0 MILLION EQUIVALENT)

TO THE

FEDERAL REPUBLIC OF SOMALIA

FOR THE

SOMALIA RE-ENGAGEMENT AND REFORMSUPPLEMENTAL DEVELOPMENT POLICY FINANCING

June 9, 2020

Public Disclosure Authorized

Macroeconomics, Trade and Investment Global Practice
Africa Region

**FEDERAL GOVERNMENT OF SOMALIA FISCAL YEAR**

January 1 – December 31

**CURRENCY EQUIVALENTS**

Exchange rates effective as of May 31, 2020

Currency Unit: Somali shilling (SOS)

US$1.00 = SOS 26,605

US$1.00 = SDR 0.72885235

**ABBREVIATIONS AND ACRONYMS**

| | |
|---|---|
| AfDB | African Development Bank |
| BRA | Benadir Regional Administration |
| CBS | Central Bank of Somalia |
| COVID-19 | Coronavirus Disease |
| CPI | Consumer Price Index |
| DPG | Development Policy Finance |
| DSA | Debt Sustainability Analysis |
| ECF | Extended Credit Facility |
| EU | European Union |
| FAO | Food and Agriculture Organization |
| FGS | Federal Government of Somalia |
| FMS | Federal Member State |
| GDP | Gross Domestic Product |
| GRS | Grievance Redress System |
| HIPC | Heavily Indebted Poor Country |
| IDA | International Development Association |
| IFC | International Finance Corporation |
| IFI | International financial institution |
| IMF | International Monetary Fund |
| IPF | Investment Policy Finance |
| LDP | Letter of Development Policy |
| MDA | Ministry, Department or Agency |
| MOF | Ministry of Finance |
| MSMEs | Micro, small and medium-sized enterprises |
| NCA | National Communications Authority |
| NDP | National Development Plan |
| PER | Public Expenditure Review |
| PFM | Public Financial Management |
| RCRF | Recurrent Cost and Reform Financing |
| SCALED-UP. | Somalia: Capacity Advancement, Livelihoods, and Entrepreneurship through Digital Uplift |
| SDR | Special Drawing Rights |
| UN | United Nations |
| UNICEF | United Nations Children's Fund |
| US$ | United States dollar |
| WBG | World Bank Group |

| | |
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**FEDERAL REPUBLIC OF SOMALIA**

**SOMALIA RE-ENGAGEMENT AND REFORM SUPPLEMENTAL DEVELOPMENT POLICY FINANCING**

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The Somalia Reengagement and Reform Supplemental Development Policy Financing was prepared by a team led by Philip Schuler, Gaël Raballand, and Natasha Sharma (co-Task Team Leaders), and that included Taneem Ahad, Asta Bareisaite, Geoff Handley, Wendy Karamba, Leonard Matheka, Julien Million, Ben Musuku, Jean Owino, Martin Serrano, Sitora Sultanova, Jiwanka Wickramasinghe, Fred Yankey, and Nobuo Yoshida. Kim Edwards and Appolenia Mbowe served as peer reviewers. Allison Holland, Issouf Samake, and Vinaya Swaroop also helpful technical input. Without logistical support provided by Eugenia Konya, Karima Ladjo, and Lydie Ahodehou, preparation of this operation would not have been possible.

## SUMMARY OF PROPOSED FINANCING AND PROGRAM

### BASIC INFORMATION

| Project ID | Parent Project |
|---|---|
| P174064 | P171570 |

**Proposed Development Objective(s)**

Facilitate Somalia's full reengagement with the World Bank Group and support Somalia’s economic recovery through policy reforms that strengthen fiscal management and promote inclusive private sector-led growth.

**Organizations**

| | |
|---|---|
| Borrower: | FEDERAL GOVERNMENT OF SOMALIA |
| Implementing Agency: | MINISTRY OF FINANCE |

### PROJECT FINANCING DATA (US$, Millions)

**SUMMARY**

| | |
|---|---|
| **Total Financing** | **55.00** |

**DETAILS**

| | |
|---|---|
| International Development Association (IDA) | 55.00 |
| IDA Grant | 55.00 |

### INSTITUTIONAL DATA

**Climate Change and Disaster Screening**

This operation has been screened for short and long-term climate change and disaster risks

**Overall Risk Rating**

High

## Results

| Indicator Name | Baseline | Target |
|---|---|---|
| Increased transparency of public debt information through publication of quarterly debt bulletins | None published (2018) | At least three quarterly bulletins published (end-2021) |
| Real growth of FGS inland tax revenue | US$38.6 million (FY2018) | 30 percent real increase above the 2018 value, deflated by the CPI (FY2021) |
| Increased national revenue allocated to FMSs | US$0.74 million allocated (FY2019) | Allocations to FMSs have doubled to US$1.5 million (FY2021) |
| Business creation process streamlined through launch and operationalization of an on-line registration system | No on-line business registration (2019) | 80 percent of new businesses registered are made through the on-line system (end-2021) |
| Increased number of telecommunications interconnection agreements completed | Zero (2018) | 80 percent of mobile network operators have at least one agreement (end-2021) |
| Increased transparency of mobile money transaction information through CBS publication of reports including mobile money deposits and other statistics | None published (2018) | At least three quarterly reports published (end-2021) |

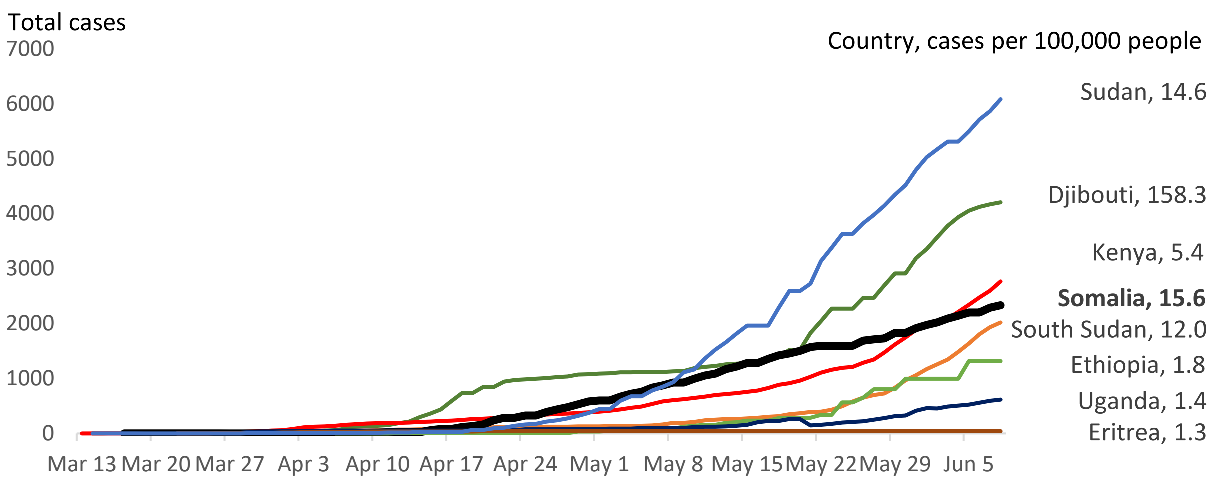
**IDA SUPPLEMENTAL FINANCING DOCUMENT FOR A PROPOSED GRANT TO THE FEDERAL REPUBLIC OF SOMALIA**

## 1. INTRODUCTION AND COUNTRY CONTEXT

1. This document proposes Supplemental Financing of SDR 40.1 million (US$55.0 million equivalent) to the Somalia Reengagement and Reform Development Policy Financing (DPF) (P171570), approved by the World Bank Board of Executive Directors on February 27, 2020. The objectives of the DPF are to facilitate full normalization of relations with the World Bank Group (WBG) and support Somalia's economic recovery through policy reforms that strengthen fiscal management and promote inclusive private sector-led growth. The proposed supplemental financing aims to mitigate the effects of the global coronavirus disease (COVID-19) crisis on the reform program supported by the DPF.[1] New swarms of locusts are now hatching and threaten agricultural production and rural livelihoods. These developments threaten to derail Somalia's reform program and its emergence from fragility.

2. **COVID-19 has spread rapidly in Somalia, which now has one of the highest infection rates in the region, with 15.6 cases per 100,000 people.** Somalia confirmed its first case on March 16 and had reported 2,334 cases and 83 deaths as of June 8. Internally displaced persons (IDPs) and the urban poor face risks from community spread of the disease. The economic spillovers from the pandemic are reducing household income and consumption. Coming on top of the 2019 floods and the locust infestation, COVID-19 is pushing more households into food insecurity and malnutrition.

**Figure 1. COVID-19 has spread rapidly in Somalia**




Sources: World Health Organization, World Development Indicators. COVID-19 data as of June 8.

3. **The health sector is unprepared to handle the COVID-19 pandemic.** Somalia ranks 194th out of 195 countries in the Johns Hopkins Global Health Security Index for 2019—scoring zero in several indicators including, emergency preparedness, emergency response, infection control practices, and healthcare

[1] COVID-19 is the disease caused by the severe acute respiratory syndrome coronavirus 2. The incidence of the disease has grown exponentially from the first reported case in China on December 31, 2019, to over 7.0 million confirmed cases and 402 thousand deaths by June 8, 2020, across 216 countries and territories (World Health Organization, Coronavirus Disease 19 Situation Report, June 8, 2020). See https://www.who.int/emergencies/diseases/novel-coronavirus-2019 for information on its origin, spread, and health effects.

access.[2] Decades of conflict and state fragmentation have left Somalia's public health system broken and unable to respond crises. The sector is underfunded, facilities are inadequate and dilapidated, and bed capacity range from few (in the main densely populated urban centers like Mogadishu) to none in the larger rural population. The healthcare system has few qualified health professionals—only two healthcare workers per 100,000 people, compared to the global standard of 25 per 100,000. Furthermore, there are no national laboratories to test and confirm cases of infection of the magnitude the country is facing. With these challenges, the country is constrained from mounting an adequate, timely, and effective response to manage the COVID-19 crisis.

4. **The pandemic adds to the challenges Somalia faces in emerging from conflict and fragility**. COVID-19 has slowed international partners' training of security personnel to address Al Shabaab's terrorist activities. However, even though the African Union Mission in Somalia has instituted social distancing and other preventive measures, these have not undermined operations to date. The May 17 attack on an oil tanker traveling in the Gulf of Aden (the first major act of piracy since 2017) has led some to worry that COVID-19, droughts, flooding, and locusts could create conditions conducive to the reemergence of piracy. The arrival of COVID-19 led parliament to postpone its reopening until June. This in turn has delayed parliamentary debate on amendments to the Electoral Law needed in advance of national elections scheduled for 2020 and 2021.[3] The Ministry of Constitutional Affairs continues to make progress with the constitutional reform process, although social distancing measures have complicated stakeholder consultations.

5. **The pandemic has disrupted economic activity—globally and in Somalia.** The government closed airports to international flights in March, and currently none of Somalia's 21 land border crossings are open.[4] COVID-19 containment measures and the global recession are expected to reduce remittance inflows and export revenue, wage earnings, and consequently spending on imports, household consumption, and investment. Closure of internal borders and panic buying of food and health items pushed up domestic prices sharply in March and April. Commercial banks report rising withdrawals and falling deposits, as many businesses close or limit their activity in response to social distancing requirements. The economy is now expected to contract by at least 2.5 percent—a dramatic downward revision to the forecast of 3.2 percent growth made in February 2020.

6. **Somalia now faces a large and unexpected financing need as a result.** Economic contraction and the closure of international borders are reducing revenue collection, which is constraining the capacities of federal and state governments to maintain limited public services and to respond to new expenditure needs generated by the crisis. The Federal Government of Somalia's (FGS's) revised 2020 budget projects a US$66.9 million (29 percent) reduction in domestic revenue below the in the pre-COVID approved budget, caused mainly by lower revenue derived from international trade and travel. Meanwhile, spending pressures have increased. The FGS plans to increase cash transfers to vulnerable households by US$34.9 million and proposes to increase grants to subnational governments, which face similar shortfalls, by US$122.6 million to support an integrated response to the crisis across Somaliland, the Federal

[2] Johns Hopkins Center for Health Security, https://www.ghsindex.org/.
[3] The amendments would resolve issues including designating constituencies, allocating Upper House seats, and guaranteeing 30 percent of the parliamentary seats for women. Parliamentary elections are currently expected to take place in November 2020 and the presidential election in 2021.
[4] UNOCHA, "COVID-19 responses in Somalia," https://covid19som-ochasom.hub.arcgis.com/, viewed June 2, 2020.

### Box 1. COVID-19 in Somalia: Major Economic Impacts and Policy Responses

**GDP:** The economy is projected to contract by 2.5 percent in 2020, a 5.7 percentage point downward revision from the pre-crisis baseline. Commercial activities, construction, transport, and travel industries are hit hardest by containment measures, while a second wave of locusts is likely to reduce crop and livestock production. Lower labor income, remittances, and export earnings are expected to reduce final consumption by 6 percent. Businesses are projected to cut investment spending by around 9 percent due to deteriorating economic conditions.

**Balance of payments:** The global recession is expected to depress Somalia's remittances inflows by 17 percent and export revenue by 40 percent in 2020 compared to the pre-crisis forecast. Grant inflows that are 6 percent higher than previously forecast limit the projected decline in imports to 12 percent. The resulting current account deficit widens to 12.7 percent of GDP from 12.3 percent in the pre-crisis forecast. FDI inflows are projected to fall by 9 percent as much is financed by the diaspora. As private and public sectors lack access to external credit, import spending must fall.

**Government revenue:** Disruption of international trade and domestic commercial activity began reducing federal and state revenue collection in March. The federal Ministry of Finance (MOF) projects 2020 domestic revenue to fall by 29 percent below targets set in the budget approved in January. Other governments also expect large losses, including an expected 55 percent decline in Puntland and a 15 percent decline in Somaliland.

**Spending:** The FGS has prepared a revised 2020 budget that proposes increasing 2020 spending by 35 percent, comprised mainly of an additional US$122.6 million in intergovernmental grants to support a national response to the crisis (73 percent of the total increase) and scaling up cash transfers by US$34.9 million (financed by IDA) to reach those affected by locusts (23 percent of the increase).

**Fiscal financing gap:** The revised budget currently projects a financing gap of US$86.7 million (2.2 percent of GDP), after exhausting cash balances carried over from 2019 and including new external grants, including US$55 million from this proposed DPF and US$12 million expected in budget support from the African Development Bank (AfDB). The FGS will reevaluate revenue and spending outturns while seeking new grants and adjust discretionary spending to close the financing gap.

**Macroeconomic stabilization policies:** Somalia's de facto dollarization and limited central bank capacity rule out any independent monetary policy response to the crisis. The FGS cannot borrow to finance a countercyclical fiscal stimulus. The country is in debt distress and lacks access to foreign loans (including from the International Monetary Fund's (IMF's) Rapid Credit Facility), and domestic capital markets are underdeveloped.

**Health response:** The government introduced mobility restrictions in March and is working with United Nations (UN) agencies to undertake testing, tracing, and treatment. Newly approved financing from the IDA Crisis Response Window is supporting temporary field health facilities and provision of health and nutrition services.

**Measures to protect the vulnerable:** The FGS launched the national "Baxnaano" social safety net program in April 2020, which is delivering nutrition-linked cash transfers (financed by IDA). The FGS has temporarily waived import duties on several basic commodities to mitigate price increases caused by supply shocks.

**Support for jobs and enterprise:** The Central Bank of Somalia (CBS) released US$2.9 million from its microfinance fund to five commercial banks for on-lending to small businesses. The Gaargara facility (supported by IDA and the Multi-Partner Fund) is preparing to provide financing to small businesses affected by the crisis.

**Policies to support recovery and growth:** The government continues to undertake policy reforms aimed at promoting recovery from fragility. The FGS is preparing regulations under the newly enacted Company Law and developing the legal framework for the power sector, which will encourage investment and reduce Somalia's high electricity prices. The National Communications Authority unveiled an integrated licensing framework in February. Federal and state finance ministers agreed in May on measures to expand collaboration to respond the crisis and lay the foundation for new intergovernmental fiscal arrangements.

Member States (FMSs), and the Benadir Region.[5] After including all expected new financing (including this proposed DPF and newly approved IDA financing for crisis-response project), the revised budget would have a deficit of US$86.7 million (2.2 percent of gross domestic product (GDP)). The government is unable to borrow to finance budget deficits and therefore must reduce proposed discretionary spending to prevent a financing gap if it is unable to mobilize new funds. As Somalia exhausted its annual access to concessional resources from the IMF, the country is currently unable to access concessional financing through the Rapid Credit Facility, which other low-income countries are using to support their response to the COVID-19 crisis.

## 2. THE IMPACT OF CRISIS, ECONOMIC DEVELOPMENTS AND OUTLOOK

7. **The COVID-19 pandemic is taking a severe human toll, in a context of falling household income and a limited public sector capacity to respond**. Somalia has experienced one of the most rapid rises in COVID-19 caseloads in the region (Figure 1), which taxes the country's limited access to water and sanitation and provision public health services.[6] Meanwhile, food insecurity is rising due to the locust infestation, price increases, and market disruptions.[7] These multiple shocks risk increasing the number of Somalis living in poverty, currently estimated at close to 70 percent (at the US$1.90/day international poverty line).[8] The Food and Agriculture Organization (FAO) estimates that 6.4 million Somalis are facing acute food insecurity.[9] The urban poor, internally displaced people, and the elderly are bearing the brunt of COVID-19. Agriculturalists living in riverine areas and pastoralists face the greatest risks from flooding and locusts.

### Recent economic developments

8. **The crisis has interrupted a trend of moderate economic growth.** Prior to COVID-19's arrival, Somalia's economy was expected to grow by 3.2 percent in 2020, slightly above the estimated 2.9 percent growth in 2019, continuing the trajectory of recovery since the 2017 drought.[10] The country is now facing an economic contraction of 2.5 percent in 2020. Curfews, port closures, and other COVID-19 containment measures announced in March and April have broken domestic supply chains and reduced economic activity in services industries (especially trade, restaurants, transportation, and travel) and construction. The FAO estimates that agricultural output during the Gu season (May–June) will be 15–25 percent lower than average, despite favorable rains, due to the lasting effects of past flooding and the destruction from the growing locust infestation. Declining net export revenue and remittances (discussed below)

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[5] The 2012 Provision Constitution established the Federal Republic of Somalia and the FMSs, which include Galmudug, Hirshabelle, Puntland, Jubbaland, and South West States. The Benadir Regional Administration (BRA) is the municipal government of Mogadishu, the capital. In 1991, Somaliland declared its independence, which is not internationally recognized, and has been self-governed since that time.

[6] See Directorate of National Statistics, "The Somalia Demographic and Health Survey 2020," April 2020, for a description of health conditions in Somalia.

[7] Food Safety and Nutrition Analysis Unit-Somalia, Food and Agriculture Organization, "Quarterly Brief with a Focus on the 2020 Jiaal Impact and Gu Season Early Warning," May 9, 2020.

[8] WBG, "Somalia Poverty and Vulnerability Assessment," April 2019. Data were collected in December 2017.

[9] Food Safety and Nutrition Analysis Unit-Somalia, *ibid.*

[10] Growth estimates presented here are constructed using estimates of expenditure components. At this time, data limitations prevent constructing GDP from the supply side, i.e., based on estimates of value added in economic sectors, or by aggregating incomes. Furthermore, the available expenditure data tend to underestimate year-to-year variations in GDP growth rates. The growth slowdown during the 2017 drought therefore may have been more severe than suggested by the data, and the recovery in 2018 greater. The true level of nominal and real GDP across the series may be greater than estimated, as the estimate does not capture informal livestock exports to Ethiopia and Kenya. For more information on how GDP is estimated in Somalia, see World Bank, "Somalia Economic Update, Fourth Edition," August 2019.

compound the loss of household income caused by business closures. Nominal household final consumption spending is expected to be around 6 percent lower than in the pre-crisis baseline.

9. **Market disruptions have pushed up consumer prices.** Although de facto dollarization supports long-term price stability in Somalia, supply and demand shocks cause short-term volatility. Headline inflation measured by the FGS rose to 5.2 percent in March 2020 and 4.3 percent in April from 3.8 percent at the end of 2019. Food prices grew by 10.8 percent year-on-year (y/y) in March—equaling the food price inflation rate in July 2019 during the drought—before easing to 8.1 percent in April.[11] Prices of widely consumed imported goods such as sugar, rice and vegetable oil increased by an average of 8 percent in February and March 2020 compared with the same period in 2019.[12] Prices of domestically produced items also rose, due to disruptions in supply chains caused by closure of internal borders and damages to transport infrastructure during the Gu rain season. Reported speculative stockpiling by traders anticipating higher demand related to COVID-19 and Ramadan and panic buying also contributed to rising prices. In response, the FGS introduced temporary tax exemptions for important staples, and cautioned traders against speculative behaviors.[13]

10. **COVID-19 is putting pressure on Somalia's current account balance through reduced exports and inflows of remittances.** Somalia's structurally high trade deficit is expected to widen to 96 percent in 2020 from 89 percent in 2019 (Table 1). Somalia's goods exports fell by an estimated 43 percent year-on-year (y/y) in the first quarter. Saudi Arabia's cancellation of this year's Hajj, which accounts for most of Somalia's annual livestock exports, will cause an even larger decline in 2020 export earnings, although this is tempered by Saudi Arabia's temporary lifting of the ban on livestock imports outside the Hajj period. Exports of services, which have typically accounted for around half of Somalia's total exports and comprise mainly travel and hospitality services, are falling due to the closure of Somalia's airports and the global decline in international travel. CBS data show that, in contrast to exports, goods imports in the first quarter were 1.3 percent higher than in 2019. But food imports fell by 25 percent y/y in the first quarter, reportedly due mainly to shipping disruptions at Asian ports. Of significance for its contribution to government revenue, imports of khat ceased in April with the closure of airports. Remittances fell by around 13 percent y/y in April and are projected to drop by 12 percent during 2020 (y/y) as Somalia's diaspora suffers the effects of the global recession. An expected increase in external grants to 54 percent of GDP compensates for the increased trade deficit and reduced remittances, leaving the projected current account deficit at around 12.7 percent of GDP in 2020.

11. **There are early signs of liquidity constraints emerging from declining remittance flows.** Recession in remittance-sending countries reduces the Somali diaspora's financial capacity to provide remittances, and restrictions on air travel are aggravating pre-existing difficulties in moving these funds to Somalia. As Somali banks have few correspondent banking relationships with foreign banks, remittances sent to Somalis are either used by traders in Dubai or Turkey to purchase imports or are transported to Somalia in the form of cash. CBS reports that five of 10 money transfer bureaus have reported declining remittance flows. Reflecting tightening liquidity conditions, April showed a large reduction in deposits in Somali commercial banks (23 percent), but the sector remains liquid. CBS is also enhancing its monitoring of the sector to ensure liquidity conditions do not become critical.

[11] Directorate of National Statistics.
[12] Food and Agricultural Organization, Food Security Nutrition Analysis Unit Integrated Database System, data extracted on May 14, 2020.
[13] These trade measures are discussed below in Section 3.1.

12. **CBS is unable to use monetary policy to respond to the crisis.** De facto dollarization strips away the possibility of an independent monetary policy. CBS does not have the options of cutting interest rates, devaluing the nominal exchange rate, serving as a lender of last resort, or using other monetary policy tools that many countries are employing. CBS has taken steps to encourage banks to use their excess liquidity to increase lending. CBS is releasing US$2.9 million through a microfinance fund for five banks, to ease the loan burden to micro, small and medium-sized enterprises (MSMEs). Also, with support from international partners including the World Bank, CBS has made transitional arrangements for an inter-bank payment system as well as migration to digital platforms and banked money transfer bureaus, which should help households and firms respond better to the crisis.[14] As noted above, the CBS has moved to monthly financial sector reporting and more frequent liquidity monitoring to better assess sector stability.

**Table 1. Selected economic indicators (2018–2022)**

| | | | pre-COVID-19 | | with COVID-19 | | |
|---|---|---|---|---|---|---|---|
| | **2018** | **2019e** | **2020f** | **2021f** | **2020f** | **2021f** | **2022f** |
| GDP, nominal (millions of dollars) | 4,721 | 4,942 | 5,218 | 5,507 | 4,632 | 5,070 | 5,340 |
| real GDP growth | 2.8 | 2.9 | 3.2 | 3.5 | -2.5 | 2.9 | 3.2 |
| per capita GDP, nominal (dollars) | 332 | 338 | 347 | 357 | 331 | 335 | 344 |
| Poverty incidence (US$1.90/day PPP) | 69 | | | | | | |
| **Money and prices** | | | | | | | |
| CPI inflation rate (eop) | 3.2 | 3.1 | 3.0 | 2.5 | 3.0 | 2.5 | 2.2 |
| Private credit (growth, percentage) | 9.2 | 11.8 | 12.6 | 15.9 | 12.6 | 16.1 | 19.6 |
| Private credit (share of GDP) | 2.3 | 3.9 | 4.4 | 4.9 | 4.2 | 4.7 | 5.2 |
| **Fiscal (central government)** | | | *(share of GDP)* | | | | |
| Total revenue and grants | 5.7 | 6.8 | 9.5 | 10.8 | 12.0 | 11.0 | 12.5 |
| o/w external grants | 1.8 | 2.2 | 5.0 | 6.0 | 8.0 | 6.5 | 7.8 |
| Total expenditure | 5.7 | 6.3 | 9.1 | 9.5 | 12.4 | 10.7 | 12.1 |
| o/w Compensation of employees | 3.0 | 3.3 | 4.2 | 4.3 | 4.9 | 5.0 | 5.4 |
| o/w Intergovernmental grants | 0.6 | 0.9 | 0.8 | 0.8 | 2.1 | 1.3 | 1.6 |
| Overall balance, net | 0.0 | 0.0 | 0.0 | 1.0 | 0.0 | 0.0 | 0.0 |
| **External** | | | *(share of GDP)* | | | | |
| Current account balance | -10.3 | -13.7 | -12.3 | -12.5 | -12.7 | -11.6 | -10.9 |
| Trade balance | -84.8 | -88.7 | -88.9 | -89.3 | -96.4 | -90.7 | -85.8 |
| Exports of goods and services | 23.7 | 22.7 | 22.6 | 22.3 | 15.2 | 23.1 | 21.6 |
| Imports of goods and services | 108.5 | 111.3 | 111.5 | 111.6 | 111.6 | 113.8 | 107.5 |
| Remittances, private transfers | 31.4 | 31.9 | 32.4 | 32.7 | 30.3 | 31.2 | 29.4 |
| Official grants | 43.9 | 43.7 | 44.9 | 44.9 | 54.0 | 48.7 | 46.2 |
| FDI | 8.6 | 9.1 | 8.9 | 9.0 | 9.2 | 9.4 | 9.1 |
| External debt | 111.3 | 106.4 | 73.3 | 70.1 | 78.3 | 76.0 | 74.1 |
| Exchange rate (shilling/dollar) | 24,475 | 26,015 | | | | | |

Source: FGS, IMF and World Bank estimates, June 2020.
Notes: Central government refers to the FGS. Domestic revenue collection in 2020f and 2021f is associated with the baseline growth scenario.

13. **Unlike most national governments, the FGS also lacks the capacity for counter-cyclical fiscal policy.** Somalia is in debt distress and cannot borrow externally to finance a budget deficit. Under-developed capital markets and insufficient central bank capacity rule out domestic borrowing. And the

[14] IDA and the Multi-Partner Fund are financing the Somali Core Economic Institutions and Opportunities project (P152241), which is developing the relevant technology.

Somalia government has committed under terms of its IMF programs to accumulate no new arrears or to run a cash deficit. Domestic revenue collected by federal, state, and local governments is declining. All levels of government face new spending needs—to protect the most vulnerable, provide additional public health services, and support an economic recovery. The FGS seeks to support a national response to the crisis through increased intergovernmental grants to subnational jurisdictions.

14. **COVID-19 has reversed a trend of steady improvements in domestic revenue mobilization.** FGS tax revenue grew to 3.1 percent of GDP in 2019 from 1.8 percent in 2014, as the FGS increasingly strengthened its tax administration capacity. COVID-19 containment measures have resulted in a halt in khat imports and airline ticket sales, and have reduced hotel business—all significant sources of revenue. During the first two months of 2020, revenue collection was 29 percent higher than in the same period of 2019. In March and April, however, revenue fell by 10 percent y/y. The loss of revenue from the tax on khat is the largest factor in this decline. It generated US$1.8 million per month in January and February, fell to US$1.2 million in March and to zero in April with the closure of airports.[15]

15. **The FGS has limited capacity to reprioritize expenditures in the short run.** Ministries, departments, and agencies (MDAs) in the administration and security sectors accounted for 88 percent of non-donor project spending in the first quarter of 2020, and personnel costs consumed 66 percent of spending by economic classification.[16] This spending composition reflects Somalia's nascent state-building and the need to give priority to spending that fosters security and state capacity. The FGS has nevertheless been able to increase spending on investments in human and physical capital by mobilizing external project financing. The approved 2020 budget allocates 9 percent of spending to capital projects, up from 4 percent in 2019, and in April 2020 the FGS launched the "Baxnaano Program," which provides nutrition-linked cash transfers (see Box 2).[17]

**Box 2. The Baxnaano Program**

The Baxnaano Program was launched on April 19, 2020. This national program provides predictable cash transfers to around 200,000 rural poor and vulnerable households with children under age 5. It represents a significant accomplishment for Somali people as they will be receiving direct assistance from the government for the first time, targeting the most vulnerable communities in areas of fragility due to widespread poverty, acute drought and long-drawn-out conflicts and insecurity.

Beneficiary households receive a monthly support of US$20, delivered on a quarterly basis through mobile money, with women being the direct recipients of the transfers. The US$20/month accounts for 25–30 percent of the food minimum expenditure basket. Beneficiaries of cash transfers are also linked to existing preventive and curative nutrition services to prevent malnutrition. The program is implemented in 21 districts across all Somalia. The World Food Program and the United Nations Children's Fund (UNICEF) are implementing partners.

The program will be scaled up in anticipation of a larger locust infestation in 2020. Households already benefiting from the Baxnaano Program and residing in locust-affected areas will receive a temporary top-up of US$40 per household per month, in addition to their regular US$20 benefit. Households that are not regular Baxnaano beneficiaries will be paid US$60 per household per month. These benefits will be provided for six months.

Sources: Somalia National News Agency, World Bank staff

[15] Staff calculations using monthly budget utilization data published on the MOF website at http://mof.gov.so/fiscal/.
[16] Donor projects account for 27 percent of the 2020 approved budget. First quarter project spending data are not yet available.
[17] Cash transfers provided by the Baxnaano Program are financed by IDA through the Shock Responsive Safety Net for Human Capital (P171346) and the Shock Responsive Safety Net for Locust Response (P174065) projects.

16. **State and local governments are also suffering revenue shortfalls and have limited capacity to reprioritize expenditures.** Jurisdictions that have major ports and are dependent on revenues from taxes on international trade are experiencing large revenue shortfalls. Revenue losses are projected at 90 percent in Jubbaland, 68 percent in Puntland, and 18 percent in Somaliland, for example. The assessment of the economic impact is ongoing and as monitoring of trade patterns is expected to be enhanced, the quality of projections of revenue losses should also improve. As at the federal level, FMS government expenditures are dominated by recurrent costs, as part of efforts to establish a nascent state structure, particularly in the more recently formed states. As such, compensation of employees dominates public expenditures. Spending on personnel costs ranges from 47 percent of total operational spending in Puntland to 78 percent in Galmudug. Expenditures on public administration dominate overall, with relatively limited fiscal space for social sector MDAs, ranging between 4 percent in the FGS and 14 percent in Galmudug.[18] As resources from development partners are largely channeled through the FGS, spending on social development projects in FMSs may not be reflected in their budgets.[19] Galmudug and South West State have passed revised budgets to reflect the impact of the crisis. Jubbaland is currently finalizing its revised budget, which is expected to be appropriated at the end of June 2020.

17. **Intergovernmental dialogue is continuing to support a national response to the COVID-19 crisis.** As an early signal of enhanced intergovernmental cooperation, the prime minister authorized a transfer of US$1 million to each FMS on an exceptional basis in April, with half of the resources intended as budgetary support to make up for revenue shortfalls and the remainder to support the crisis response. The June revised budget proposes increasing intergovernmental grants to as much as US$153.4 million in 2020 to help subnational jurisdictions overcome domestic revenue shortfalls.[20] Discussions between the FGS and FMS continue to progress. Finance ministers met in April and May to develop the nation-wide fiscal response to the crisis, and they agreed on specific steps to enhance data transparency and intensify dialogue. Meanwhile, the Ministry of Constitutional Affairs and the Oversight Committee continued to lead intensive national consultations on the federal structure in the first half of 2020 as part of the ongoing constitutional reform process, with the support of the United Nations Development Program.

18. **Somalia reached the Decision Point of the Heavily Indebted Poor Countries (HIPC) initiative on March 25, 2020, restoring the country's access to regular concessional financing and launching the process toward debt relief.** Somalia cleared its arrears to the African Development Bank (AfDB), IMF and IDA. On March 31, 2020, it reached agreement with the Paris Club on terms of debt relief, and it is working with remaining creditors to reach similar agreements. Through clearance of arrears owed to the three international financial institutions (IFIs), Somalia's external debt was reduced to US$3.9 billion (78 percent of revised 2020 GDP) from US$5.3 billion. In March, Somalia also resumed servicing its outstanding debt to the AfDB and IDA. To receive irrevocable debt relief, Somalia must maintain sound macroeconomic policies, implement its poverty reduction strategy—the Ninth National Development Plan (NDP9)—for at

[18] Statistics are from the originally approved budgets.
[19] An exception is Puntland, where the 2020 budget had increased reporting of financing from development partners on the budget. The first quarter budget utilization report for 2020 states revenues received from development partners and whether these pass through the Treasury Single Account.
[20] As will be discussed, the revised budget projects the level of intergovernmental based on current estimates of domestic revenue shortfalls in the FMSs, Somaliland, and BRA. The final increase in grants made during 2020 depends on both the realized revenue amounts and on the FGS's receipt of new budget support grants beyond what is currently expected. The revised 2020 budget appropriates up to US$156.5 million in grants, of which US$3.1 million is for international organizations, the Somalia Chamber of Commerce, the Somalia Development Bank, and foreign governments.

least one year, and complete a set of policy measures known as Completion Point triggers that are aimed at promoting inclusive growth and poverty reduction.[21]

**Table 2. FGS fiscal operations (2019–2022) and 2020 budget revisions**

| | 2019e | 2020 budgets | | | 2020f[b] | 2021f | 2022f |
|---|---|---|---|---|---|---|---|
| | | Jan.[a] | June | adj. | baseline | | |
| **Revenue and grants** | **6.8** | **10.1** | **11.7** | **+1.5** | **12.0** | **10.8** | **12.5** |
| Revenue | 4.6 | 5.1 | 3.6 | -1.5 | 4.0 | 4.3 | 4.7 |
| Tax revenue | 3.1 | 3.4 | 2.3 | -1.1 | 2.5 | 2.7 | 2.9 |
| Tax on income and profits | 0.2 | 0.2 | 0.2 | -0.1 | 0.2 | 0.2 | 0.2 |
| Taxes on goods and services | 0.5 | 0.6 | 0.4 | -0.2 | 0.4 | 0.4 | 0.5 |
| Taxes on international trade | 2.2 | 2.3 | 1.6 | -0.7 | 1.8 | 1.9 | 2.1 |
| Other taxes | 0.2 | 0.2 | 0.1 | -0.1 | 0.2 | 0.2 | 0.2 |
| Non-tax revenue | 1.5 | 1.7 | 1.3 | -0.4 | 1.5 | 1.6 | 1.7 |
| Grants | 2.2 | 5.0 | 8.0 | +3.0 | 8.0 | 6.5 | 7.8 |
| Bilateral | 0.7 | 0.7 | 0.7 | 0.0 | 0.7 | 0.6 | 0.6 |
| Multilateral | 1.5 | 4.4 | 7.4 | +3.0 | 7.4 | 5.9 | 7.2 |
| o/w IDA DPFs[d] | | 0.0 | 2.2 | +2.2 | 2.2 | | |
| o/w AfDB budget support | | | 0.3 | +0.3 | 0.3 | | |
| o/w EU 2021 budget support | | | 0.2 | +0.2 | 0.2 | | |
| o/w new crisis project financing | | | 1.2 | +1.2 | 1.2 | | |
| **Total expenditure** | **6.3** | **10.3** | **13.9** | **+3.6** | **12.4** | **10.7** | **12.1** |
| Current | 6.1 | 9.4 | 13.0 | +3.6 | 11.5 | 9.9 | 10.9 |
| Compensation of employees | 3.3 | 4.8 | 4.9 | +0.1 | 4.9 | 4.9 | 5.3 |
| Use of goods and services | 1.9 | 2.9 | 3.0 | +0.1 | 3.0 | 2.9 | 3.2 |
| Interest and other charges | .. | 0.01 | 0.06 | 0.05 | 0.02 | 0.02 | 0.02 |
| Intergovernmental grants | 0.9 | 0.9 | 3.6 | +2.7 | 2.1 | 1.2 | 1.4 |
| Social benefits | 0.0 | 0.5 | 1.4 | +0.8 | 1.4 | 0.6 | 0.7 |
| Contingency and other expenses | 0.0 | 0.3 | 0.1 | -0.2 | 0.1 | 0.3 | 0.3 |
| Purchase of non-financial assets | 0.3 | 0.9 | 1.0 | +0.1 | 1.0 | 0.7 | 1.3 |
| Memo: Grant-financed crisis projects | | | 1.2 | +1.2 | 1.2 | | |
| **Overall fiscal balance** | **0.5** | **-0.2** | **-2.3** | **-2.1** | **-0.4** | **0.1** | **0.4** |
| **Financing sources** | **-0.5** | **0.2** | **2.3** | **+2.1** | **0.4** | **-0.1** | **-0.4** |
| Net use of cash balances | -0.5 | 0.2 | 0.6 | +0.4 | 0.7 | 0.2 | 0.0 |
| Net change in arrears (- = reduction) | 0.0 | 0.0 | -0.1 | -0.1 | 0.0 | 0.0 | -0.1 |
| Net new debt (- = payment) | 0.0 | 0.0 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| **Overall fiscal balance, net** | **0.0** | **0.0** | **-2.0** | **-2.0** | **0.0** | **0.0** | **0.0** |

Source: Ministry of Finance (MOF), IMF, and World Bank estimates, June 2020.
Notes: [a] Nominal values in the January 2020 budget are scaled by the revised projection for 2020 GDP.
[b] Spending projections in column 2020f incorporate World Bank estimates of the likely revenue shortfall and adjustments in discretionary spending (predominately grants) that the FGS would make to avoid a financing gap.
[c] As some donor disbursement projections were revised downward in the June budget, the net increase in total multilateral grants is smaller than three additional items listed above.
[d] The January budget did not include budget support from the Somalia Reengagement and Reform DPF in its revenue projection.

[21] See IDA and IMF, "Somalia-Enhanced Heavily Indebted Poor Countries Debt Initiative: Decision Point Document," March 12, 2020. There is no pre-determined timetable for reaching the HIPC Completion Point. Most countries have reached it three–four years after the Decision Point.

### Macroeconomic outlook

19. **The economy is projected to contract by 2.5 percent in the 2020 and rebound with modest GDP growth averaging 3.0 percent in 2021–22** (Table 1). This represents a large downward revision from the pre-COVID-19 outlook, which projected economic growth of 3.2 percent in 2020, accelerating to 3.7 percent in 2022. Real GDP recovers to its 2019 level by 2021, but as annual population growth is estimated at around 2.9 percent, per capita income may not recover until 2023 or later. The baseline assumes large contractions in global GDP and trade in 2020 with a rebound in 2021. It is based on the expectation that countries, including Somalia, are able to lift major mitigation measures during the third quarter of 2020. In this baseline scenario, Somali consumption declines from its 2019 level due to a fall in labor income and remittances. The new generation of locusts attacks crops and pastures, reducing agricultural output. Gross fixed investment falls in an environment of reduced business activity, and this is only partially offset by increased government consumption spending. The global recession and COVID-19 containment measures (at home and abroad) substantially reduce both goods and services exports. The resulting import compression is mitigated to a degree by increased inflow of external grants into the economy. The decline in FGS domestic revenue associated with international and domestic market disruptions is projected at US$49.9 million. While Somalia and other countries may be able to reopen their economies quickly enough so that that financial market dislocations are not long-lasting (in contrast to the Great Recession), it is reasonable to expect persistent effects that could dampen potential output, e.g., through reduced human capital, lower firm profitability, or greater desire to hold precautionary savings.

20. **A downside growth scenario is considered, due to the considerable uncertainty about the progression of the pandemic and its economic spillovers.** In this scenario, an additional three months are required to lift restrictions, and there is a risk of a further wave of COVID-19. GDP would contract by at least 3.0 percent in 2020 (the FGS project a 5.3 percent [Annex III]), followed by a slower recovery in 2021, with growth at around 1.0 percent. If global job losses continue to mount, remittances to Somalia would decline by an estimated 20 percent. Combined with lower labor income, this would further depress household consumption and increase the risk of food poverty. Trade volumes fall. Demand for imports (particularly food items) declines to potentially 105 percent of GDP, with associated reductions in taxation from international trade. FGS domestic revenue could fall by as much as US$67 million (as projected in the June revised budget), and if additional resources are not secured, this would be a contributing factor to the lower growth estimate. The fall in remittances is associated with shortages of liquidity, which may spur instability in the financial system. Declining business confidence is likely to halt investment plans, including by the diaspora and domestic firms as risks are elevated.

21. **Despite the upward pressure in food prices, inflation is expected to remain modest in 2020.** Market shocks are expected to subside by the end of 2020. Over the medium-term, inflation is projected to stay within the range 2–3 percent, provided that moderate growth of the agriculture sector prevails. De facto dollarization should continue to provide price stability. Lower oil prices are already being passed through to consumers and should contribute to downward pressure on prices. Price hikes for imported goods may lead consumers to substitute locally produced items for imports (e.g., millet for rice).

22. **The current account deficit is forecast to narrow slightly in 2020 and 2021.** Increased grant inflows are expected to compensate for a larger trade deficit in 2020, reducing the current account deficit to 12.8 percent of GDP in 2020, compared to 13.7 percent in 2019, and declining further to 11.5 percent in 2021. A quadrupling of multilateral grants between 2019 and 2020, primarily associated with Somalia's reengagement with IFIs and entry into the HIPC debt relief process, accounts for almost all the increase

in official assistance inflows, which are expected to reach projected 54 percent of GDP in 2020. As Somalia's livestock exports have historically been overwhelmingly concentrated during the time of the Hajj, Saudi Arabia's cancellation of this year's pilgrimage, is expected to contribute to a 50 percent reduction in Somalia's goods exports.[22] Meanwhile, services export revenue (which has slightly exceeded goods exports in recent years) is expected to fall by 25 percent y/y due to the closure of Somalia's airports and the global decline in international travel. Lower oil prices, export revenue, and remittance inflows will reduce Somalia's import spending by an estimated 6 percent (mostly due to lower services imports). The trade deficit narrows in nominal terms. All trade flows are expected to recover to above their 2019 levels in 2021. Remittances from Somalia's diaspora are expected to fall by 12 percent in 2020 y/y—a smaller drop than the 20 percent decline that the World Bank forecasts for global remittance inflows into low- and middle-income countries.[23]

**Table 3. External financing needs and sources (2018–2022)**

| | | | pre-COVID-19 | | with COVID-19 | | |
|---|---|---|---|---|---|---|---|
| | **2018** | **2019p** | **2020f** | **2021f** | **2020f** | **2021f** | **2022f** |
| **Total Financing Needs** | **4,032** | **4,382** | **6,467** | **4,954** | **6,271** | **4,635** | **4,966** |
| Trade deficit | 4,005 | 4,381 | 4,639 | 4,918 | 4,443 | 4,599 | 4,930 |
| Amortization | 33 | 1 | 12 | 14 | 12 | 14 | 15 |
| Interest on external debt | 24 | 4 | 2 | 2 | 2 | 2 | 2 |
| Reduction of arrears (- = accumulation) | -57 | -5 | 1,795 | 0 | 1,795 | 0 | 0 |
| Reserve accumulation (+ = increase) | 27 | 0 | 19 | 19 | 18 | 18 | 19 |
| | | | | | | | |
| **Available Financing** | **4,032** | **4,382** | **4,316** | **4,935** | **4,120** | **4,616** | **4,948** |
| Current transfers (net) | 3,555 | 3,738 | 4,035 | 4,272 | 3,885 | 4,050 | 4,343 |
| o/w IDA budget support | | | 45 | tbd | 100 | tbd | tbd |
| o/w AfDB budget support | | | 0 | | 12 | | |
| o/w EU 2021 disbursement moved to 2020 | | | | | | | |
| o/w new crisis project financing | | | 0 | | 56 | | |
| FDI (net) | 408 | 447 | 464 | 495 | 422 | 478 | 523 |
| Official borrowing | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other flows (net) | 70 | 196 | -183 | 168 | -187 | 87 | 82 |
| | | | | | | | |
| **Exceptional Financing and Debt Relief** | **0** | **0** | **2,151** | **18** | **2,151** | **18** | **18** |
| Net use of IMF resources | 0 | 0 | 355 | 17 | 355 | 17 | 17 |
| HIPC debt relief | | | 1,796 | 1.3 | 1,796 | 1.3 | 1.3 |
| o/w IDA | | | 360 | | 360 | | |
| | | | | | | | |
| **Financing Gap** | **0** | **0** | **0** | **0** | **0** | **0** | **0** |

Source: CBS, MOF, IMF and World Bank estimates, June 2020.
Note: External debt was not serviced prior to 2020. Values shown for amortization and interest in 2018 and 2019 are added to the stock of arrears and do not affect total financing needs. Amounts of World Bank budget support in 2021 and 2022 are under discussion as part of the Performance and Learning Review.

23. **The FGS prepared a revised 2020 budget in June to respond to the crisis**. The revised budget proposes increasing total expenditures by US$168.1 million to 13.9 percent of GDP from 10.3 percent of

[22] Saudi import data show that 80–94 percent of total imports from Somalia occurred during Hajj months in 2017–19 (General Authority for Statistics, Kingdom of Saudi Arabia, https://www.stats.gov.sa/en/325).
[23] WBG, "The COVID-19 Crisis through a Global Lens," April 2020. The authorities cite anecdotal evidence to suggest that the Somalia diaspora has maintained relatively high levels of remittances during past global downturns.

GDP envisioned in the 2020 budget approved in January. As will be discussed below, the increased spending is allocated almost entirely to providing additional grants to subnational governments to support their response to the crisis and to scaling up the new Baxnaano cash transfer program (financed by IDA). The revised budget projects total revenue and grants rising by US$71.1 million to 11.7 percent of GDP, including US$55 million from this proposed operation and an expected US$12 million in AfDB budget support (1.2 and 0.3 percent of GDP, respectively). The revised budget also includes US$56 million in projected disbursements from crisis-response project grants.[24]

24. **Although the revised budget shows a deficit of US$104.7 million, it will be executed as a balanced budget.** The Appropriation Act prohibits the FGS from making spending commitments if financing is not available.[25] MOF will evaluate projected federal, state, and local government revenue shortfalls as new data become available and reassess spending needs (including the size of grants needed to cover subnational governments' needs). MOF is likely to use cash reserves carried over from 2019 as needed to cover some expenses. In the coming months it will seek additional donor funding to prevent a financing gap if revenue shortfalls persist. If these funds are not forthcoming, however, the FGS will defer or reduce the proposed increases discretionary spending, including the increased intergovernmental grants.[26]

25. **Domestic revenue is expected to fall sharply in 2020**. MOF's revised 2020 budget estimates that that its domestic revenue collection will fall short of its original revenue target by US$66.9 million (by 29 percent of the approved budget).[27] The main contributors to MOF's projected decline in revenue are taxes, fees, and other revenue collected on transactions associated with international trade and travel and taxes and fees paid by businesses, as shown in Table 4 below.

26. **Across the FMSs, Benadir Region, and Somaliland, estimates of revenue losses vary in accordance with dependence on trade-related taxes.** Subnational territories that have major ports and are dependent on revenues from taxes on international trade are likely to be the most affected by revenue shortfalls, as overall trade volumes decline. Notably, these losses are projected at US$45.9 million in Puntland, US$15.7 million in Jubbaland, US$26.6 million in Benadir, and US$36.7 million in Somaliland. As airports have closed, revenues from the import of khat have declined, and social distancing related measures are expected to reduce economic activity and affect the capacity to collect tax. As the compensation of employees dominates public spending in the BRA, FMSs, and Somaliland, these governments would need to retrench workers and curtail essential services without additional revenue.

[24] These include an additional US$9.1 million from the Shock-Responsive Safety Net for Human Capital Project (P171346) above what was projected in the original 2020 budget and US$46.4 million from the newly approved Somalia Crisis Recovery Project (P173315) and the proposed Shock Responsive Safety Net for Locust Response Project (P174065).

[25] Furthermore, the Government committed in the ECF program to incur no new arrears—a target that will be evaluated continuously. See IMF, "Second Review under the Staff-Monitored Program and Request for Three-Year Arrangements under the Extended Credit and the Extended Fund Facility," March 2020.

[26] In the event that cash balances are insufficient to meet expenditure commitments, the Appropriation Act's sequestration clause requires MOF to pay commitments in the following order: (1) compensation and rations for security personnel; (2) finance costs; (3) civilian compensation; (4) allowances for political appointees; (5) non-discretionary goods, services, and intergovernmental grants; (6) wages and allowances included in discretionary expenditure from last year's budget; and (7) discretionary expenditure, arrears and advances.

[27] This revenue decline is consistent with the downside growth scenario presented above. The baseline scenario assumes that domestic revenue collection will begin to recover sooner than in the downside scenario, but the distribution of revenue losses across instruments is roughly the same.

**Table 4. Main contributors to the projected decline in FGS domestic revenue**

| Revenue instruments | Amount (US$ million) | Share of total |
|---|---|---|
| **Related to international trade and travel** | **- 52.3** | **78%** |
| Customs and sales taxes on imports | - 36.3 | 54% |
| o/w import tax on khat | 9.0 | 13% |
| Harbor and overflight fees, stamp duty on customs | 4.8 | 7% |
| Sales taxes on airline tickets and hotels | - 2.3 | 3% |
| **Taxes and fees paid by businesses** | **-6.1** | **9%** |
| Corporate profit tax | 1.5 | 2% |
| Stamp duties (excl. customs), road taxes | 4.6 | 7% |

Source: Staff estimates using 2020 revised budget projections, June 2020.

27. **Over the medium-term, however, improvements in revenue administration should boost revenue collection.** Building on recent policy reforms such as the 2019 Revenue Administration Law (a prior action in the parent operation), which strengthens the legal foundation for FGS revenue collection, efforts are underway to improve tax collection and administration. The FGS and FMSs are progressing with plans to harmonize customs duty rates across Somalia and ultimately adopt and apply a single national tariff schedule (a HIPC Completion Point trigger). Tariff harmonization would reduce port competition, which has been an important contributor to low revenue mobilization in Somalia.[28] Over the medium-term, FGS domestic revenue is projected to increase from 4.0 percent of GDP in the baseline 2020 scenario to 4.3 percent in 2021 and thereafter to 4.7 percent in 2022.

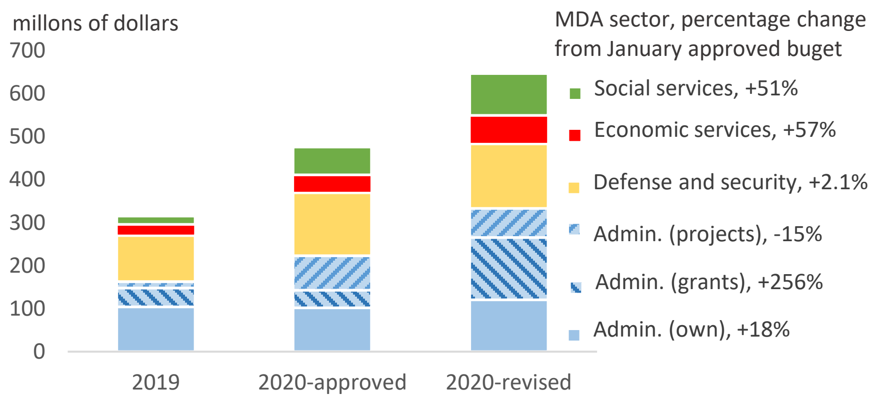
28. **To address the crisis, the revised 2020 budget includes substantial increases in spending on social programs and intergovernmental grants in 2020** (Figure 2). The additional spending on grants to subnational jurisdictions (including Somaliland and the BRA) and to households (through scaled-up cash transfers made through Baxnaano Program, financed by IDA) accounts for 96 percent of this increase, bringing spending on these two items to 22 percent of the FGS budget (5.0 percent of GDP). Spending by social services MDAs (including cash transfers) is projected to rise by 51 percent above the original budget. Spending on donor-funded projects in the revised 2020 budget is projected to increase by 32 percent.[29] New and additional spending by crisis-related projects is projected to reach 1.2 percent of GDP. The revised budget also includes, for the first time, interest payments on external debt, which in 2020 are projected at 0.06 percent of GDP.

29. **The composition of spending over the medium-term is expected to remain focused on state development.** Spending will remain concentrated on administration and security, and the wage bill is expected to continue growing in 2021–22 at annual rates similar to the past.[30] Capital spending (largely donor-financed) is projected to rise to 1.3 percent of GDP, bringing it to 10 percent of total FGS spending. Consequently, the wage bill's share of spending falls to 45 percent of total spending in 2021–22 from 53 percent in 2017–19. Over time, further efforts are required to increase expenditures on the social sectors

[28] World Bank, "Programmatic Public Expenditure Review (PER): Domestic Revenue Mobilization in Somalia," April 2020.
[29] This includes multi-sectoral projects, which are included in administration sector MDAs and projects managed by MDAs in economic and social services sectors. The Recurrent Cost and Reform Financing (RCRF) IPF projects (P154875, P167224, and P173731) finance a portion of civil service wages and salaries. This spending is distributed across MDAs.
[30] Since post-crisis nominal GDP is expected to grow along a lower trajectory than before the crisis, the wage bill will be higher as a share of GDP.

to support poverty reduction, and a stronger health system, in line with improvements in capacity to deliver.

**Figure 2. Sectoral composition of spending, 2019–2020**




Source: Staff estimates from revised budget, June 2020.
Notes: Intergovernmental grants are presented as spending by the finance and, to a lesser extent, planning and interior ministries, which are classified under the administration sector. Multi-sectoral donor-funded projects are presented in the FGS budget as spending by MOF.

30. **Somalia remains in arrears to most of its creditors, and the March 2020 IMF-World Bank Debt Sustainability Analysis (DSA) accordingly confirms that Somalia is in debt distress.** Furthermore, although clearing arrears to IFIs has reduced the present value of Somalia's external debt to 41 percent of GDP, this remains well above the 30 percent threshold for countries with weak capacity to manage debt. The DSA finds that the stock of outstanding debt will remain unsustainably high until Somalia reaches the HIPC Completion Point. At the Completion Point, the present value of any remaining debt is projected to fall to around 8 percent of GDP and 35 percent of exports, under the assumption that Somalia receives expanded relief under the Multilateral Debt Relief Initiative (from AfDB and IDA) and Beyond HIPC relief from other creditors at that time.

31. **Somalia will remain without access to new credit until after it has reached the HIPC Completion Point.** The authorities have committed under the Extended Credit Facility (ECF) program to refrain from undertaking any new borrowing, as will be discussed below.

32. **Debt service is expected to remain low and manageable in the medium term.** The DSA projects debt service to average only 1.4 percent of exports and 6.6 percent of revenue in 2020–22. These fall below the DSA thresholds for assessing the risk of debt distress.[31] Somalia currently services only its debt to IDA and the AfDB while it negotiates a rescheduling of its debt to Paris Club and other creditors.

33. **Risks to the economic outlook remain high.** There is great uncertainty about the course the pandemic is likely to take. It remains to be seen whether countries will be to permanently loosen containment measures in the absence of a vaccine. At this time, the risks are tilted more the downside scenario presented above than to the upside. In addition, the country continues to face many risks related to security and violence, climatic shocks, and commodity price volatility that were identified prior to the pandemic. Tensions between political stakeholders across Somalia could escalate as national elections

[31] This projection assumes that Somalia continues to receive assistance under the HIPC Initiative.

approach, which could risk derailing the reform momentum. On the other hand, fruitful dialogue between the FGS and FMSs on a coordinated crisis response could lead to a reduction in political tensions.

34. **The FGS continues to work closely with partners to build Somalia's capacity to mitigate and manage risks.** Addressing challenges related to security will require ongoing dialogue between the FGS, FMSs, and Somaliland, as well as other actors. The UN is supporting dialogue at the political level as part of the constitutional review process, while other partners are engaged in technical reforms that encourage intergovernmental dialogue. The government's implementation of the 2018 Recovery and Resilience Framework through NDP9 should also strengthen its ability to manage external shocks. The Somalia Urban Resilience Projects (P163587 and P170922) (financed jointly by the Multi-Partner Fund and IDA), the Somalia Crisis Recovery Project (P173315), the Shock Responsive Safety Nets for Human Capital Development Project (P171346) (both financed by IDA), and other support from international partners are also expected to increase Somalia's resilience to shocks. The exceptional circumstances around the COVID-19 pandemic requires additional support from the international community during the crisis.

35. **The macroeconomic policy framework is adequate for the proposed operation.** This assessment rests critically on the successful reengagement that Somalia achieved by reaching the HIPC Decision Point: this restored Somalia's access to concessional financing and placed it on a clear path towards debt relief. More importantly, it established a framework for collaboration on medium-term policy reforms through the HIPC Completion Point triggers and the related reform-based financing provided by IFIs and the European Union (EU). These reforms are helping the authorities develop the fiscal and monetary policy tools they need to manage economic shocks, as well as improving the foundations for resilient economic growth. This assessment also rests on the preparation of the revised 2020 budget, which commits to scaling up cash transfers to those most affected by the crisis and to increasing grants to subnational jurisdictions. These spending adjustments are essential for the FGS to lead a national response to the COVID-19 pandemic and to seek additional financing from partners. Finally, the assessment rests on the steps taken to strengthen intergovernmental collaboration, including the FGS's decision to increase the level of intergovernmental grants, the decision by federal and state finance minister to hold monthly consultative meetings during the crisis, and their agreement to expand sharing of fiscal information.

### IMF Relations

36. **Somalia entered into a three-year financing program with the IMF in March 2020 when it reached the HIPC Decision Point.** On March 25, 2020, the Executive Board of the IMF approved arrangements under the ECF and the Extended Fund Facility for Somalia in the amount of SDR 292.4 million—about US$395.5 million or around 179 percent of quota (Annex 2). The new program built on the track record of reform Somalia had established through a series of four Staff-Monitored Programs.

37. **The three-year financing package supports the implementation of the NDP and anchors reforms needed to reach the HIPC Completion Point.** These reforms will focus on a continued strengthening of public finances to meet Somalia's development needs in a sustainable manner, a deepening of central bank capacity, improvement of the business environment and governance, and enhancing statistics. The program sets ceilings on FGS spending on public compensation, procurement of goods and services, and contingencies, and a floor on the fiscal balance. The authorities also agreed to refrain from new domestic and non-concessional external borrowing. The first review is planned for September 2020.

38. **Somalia is not able to take advantage of the IMF's Rapid Credit Facility to address its financing needs.** As Somalia exhausted its annual access to the Poverty Reduction and Growth Trust in March 2020, it does not have access to concessional financing that would otherwise be available through the Rapid Credit Facility. Any additional financing would be through non-concessional borrowing from the General Resource Account, which would be both undesirable and potentially infeasible while the country is in debt distress.

## 3. RESPONSE TO THE CRISIS

39. **Somalia has responded rapidly to the crisis within the severe institutional constraints imposed by the country's legacy of state fragmentation, conflict, and fragility.** Since the onset of the pandemic, the FGS has worked with international partners, state and local governments, and non-state actors to develop an integrated national response.

- In March the FGS introduced mobility restrictions and distancing requirements, including closing airports and land border crossings, closing schools, prohibiting large gatherings, and closing non-essential businesses.
- FGS and FMS health institutions—assisted by World Health Organization—are undertaking testing, contact tracing, treatment, and quarantine activities. UNICEF and United Nations Population Fund are frontloading support to these institutions for health preparedness and response.
- In April 2020 the FGS launched the Baxnaano Program, which is providing nutrition-linked cash transfers to address food insecurity and loss of income. The program builds on World Food Program and UNICEF delivery systems and is financed by IDA.
- In April, the FGS introduced temporary tax and customs duty relief: 100 percent relief on rice and dates, and 50 percent relief on cooking oil and flour. These will be in effect through mid-July.
- To offset revenue losses from these measures, the FGS introduced permanent tax and customs duty increases on tobacco, beauty products, and plastic bags.
- The Gargaara finance facility is being repurposed to protect livelihoods and support struggling but viable MSMEs during the COVID-19 crisis. It is allocating US$15 million towards this end.[32]
- CBS released US$2.9 million in microfinance funds to five commercial banks for on-lending to MSMEs.

40. **The FGS has prepared a revised 2020 budget to address the crisis.** The cabinet approved it on May 28. The Budget and Finance Committee began its review when Parliament reconvened on June 6, and the authorities expect approval of the revised budget by June 20 (Annex III). In addition to adjusting projections for 2020 revenue and spending to respond to the crisis (as described above), the revised budget reflects Somalia's entry into the HIPC debt relief process: debt service (interest and principal) to AfDB and IDA starting in March; budget support disbursed in March through the Reengagement and Reform DPF. The revised budget also incorporates updated forecasts of 2020 grant disbursements and associated project spending. The budget includes US$55 million from this proposed operation and US$12 million from the AfDB, which is expected to be approved in June.[33] Table 5 below presents these adjustments.

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[32] The Gargaara Company Limited is an apex development finance institution founded in 2019 with a mandate to invest in financial institutions to expand their lending to MSMEs. Its COVID-19 investments are financed by IDA and the Multi-Partner Fund through the Somalia Capacity Advancement, Livelihoods and Entrepreneurship, Through Digital Uplift Project (SCALED-UP) IPF (P168115).
[33] There is the possibility that the amount disbursed by the AfDB could exceed the initial planned US$12 million, if access to a regional window of resources is approved.

**Table 5. Revised budget adjustments and financing**

| Revenue and grants | US$ m |
|---|---|
| **Approved 2020 budget** | **466.2** |
| Net additional revenue | 73.5 |
| Reduced domestic revenue | -66.9 |
| Additional budget support (net)[a] | 99.5 |
| *o/w Supplemental DPF* | *55.0* |
| *o/w AfDB* | *12.0* |
| *o/w EU originally planned for 2021* | *8.0* |
| Additional project financing (net)[b] | 40.9 |
| *o/w crisis project financing* | *55.5* |
| **Revised 2020 budget** | **537.3** |

| Expenditure | US$ m |
|---|---|
| **Approved 2020 budget** | **473.7** |
| Net additional spending | 170.7 |
| Additional intergovernmental grants | 122.6 |
| Additional social benefits | 34.9 |
| Additional capital spending | 6.8 |
| Additional interest spending | 2.3 |
| Other spending adjustments | 4.1 |
| **Revised 2020 budget** | **644.0** |

| Financing needs and sources | US$ m |
|---|---|
| **Overall balance** | **-104.3** |
| Available financing | 16.1 |
| Use of cash reserves[c] | 30.4 |
| Accumulation of arrears (- = repayment)[d] | -2.5 |
| Net borrowing (- = amortization) | -11.8 |
| **Financing gap** | **-86.7** |

Source: MOF, IMF and World Bank staff estimates, June 2020.
Notes: [a] Budget support includes non-project RCRF disbursements that finance salaries and other recurrent costs. Budget support provided through Reengagement and Reform DPF was not included in the original 2020 budget and is therefore included in the revised budget as additional.
[b] New crisis-related project financing exceeds the net increase in total project financing as MOF revised downwards its projection of 2020 spending by some donor-financed projects.
[c] The use of cash reserves shown is a staff projection based on cash balances as of December 31, 2019 of US$43.9 million. It assumes that MOF continuously maintains a liquidity buffer of US$13.5 million but otherwise uses cash carried over from 2019.
[d] The revised budget shows repayment of arrears as an above-the-line expenditure.

41. **As part of broader efforts to have a national response to the COVID-19 crisis, the revised FGS budget significantly increases grants to the BRA, FMSs and Somaliland to compensate for revenue losses and support their response to the crisis.** The amount required for each FMS and Somaliland has been determined through a phased and consultative process. As a first step, the subnational jurisdictions reviewed each revenue line to assess the sensitivity to COVID-19 effects.[34] Secondly, these estimations were discussed between the FGS and FMS through a series of intergovernmental ministerial meetings. If the revenue losses materialize, and additional resources are not forthcoming, the transfer amounts will be reduced on a pro rata basis across the jurisdictions in line with the resources that are available.

42. **The revised budget currently projects a deficit of US$104.3 million and a financing gap of around US$86.7 million after available cash reserves are used.** The FGS is not able at any time to spend in excess of available cash, and the revised budget clearly states that the budget, as executed, will be balanced. The FGS will adjust spending as needed and plans to seek additional grants from partners (including the World

[34] Puntland and Somaliland have published their impact assessments: Puntland State of Somalia, Ministry of Finance and Ministry of Planning, Economic Development, and International Cooperation, "Assessment Report of the Economic Impact of the Global COVID-19 Outbreak on Puntland," April 2020. Ministry of Finance Development, Republic of Somaliland, "Fiscal and Economic Implications of COVID-19," April 2020.

Bank) to prevent the financing gap that is projected in the budget from materializing in practice.[35] In the case where no additional grants are secured, MOF would defer some capital investments, and spending on intergovernmental grant would likely increase to only US$98.2 million in 2020 (from US$42.7 in the budget approved in January).[36] It is expected that MOF will reevaluate the fiscal situation in August, once the second quarter economic and FGS and FMS fiscal data are available, and recalibrate its spending projections.

43. **The WBG's response to the crisis includes other financial and technical assistance that complement the proposed Supplemental DPF.** Newly approved IDA financing will help protect the poorest and most vulnerable. The US$137.5 million Somalia Crisis Recovery Project (P173355) includes US$7.5 million from the WBG COVID-19 facility and US$75 million from the IDA Crisis Response Window to finance immediate basic services and livelihood support for those affected by flooding, locusts, and COVID-19. This will also finance medium-term flood recovery and the development of disaster risk management institutions. The proposed Shock Responsive Safety Net for Locust Response Project (P174065) will provide US$40 million from the IDA Regional Window, of which US$26 million will finance nutrition-linked cash transfers delivered in 2020 through the recently launched Baxnaano program.[37] Other World Bank activities support job creation and entrepreneurial activity. Through the SCALED-UP IPF (P168115), the World Bank is financing the Gargaara facility, which is providing loans to small businesses through participating financial institutions. SCALED-UP and technical assistance from the World Bank and International Finance Corporation (IFC) support institution building and regulations that aim to make the financial system more resilient and facilitate restoration of correspondent banking relationships. IFC technical assistance is supporting preparation of new electricity legislation, which is a precondition for attracting private investment to rebuild Somalia's power sector.

44. **Other development partners are also providing budget support financing to Somalia to address the crisis.** The AfDB is expected to provide US$12 million through a new policy-based financing operation. The EU has reallocated around US$7 million previously programmed for 2021 to support the FGS in 2020. Its adjusted 2020 budget support is currently projected at US$25.3 million. The World Bank's Third RCRF IPF (P173731) is projected to disburse US$3.2 million in calendar year 2020, bringing total expected 2020 financing of civil service salaries, intergovernmental grants, and other non-project recurrent costs under the RCRF IPFs to US$36.4 million.[38] Turkey is providing a grant of US$30 million in 2020.[39] International humanitarian organizations and other partners are also helping Somalia to address the crisis through off-budget activities.

## 4. THE REFORM PROGRAM SUPPORTED THROUGH ORIGINAL OPERATION: AN UPDATE

45. **Somalia continues to make progress on the reform program supported by the parent operation.** The authorities are making investments and pursuing reforms aimed at realizing the expected results

[35] MOF revises the annual budget no more than once per year, generally in September. Because the crisis has escalated so sharply, MOF has prepared the 2020 revision much earlier than usual. It assumed a somewhat pessimistic outlook for revenue losses at federal, state, and local levels as a precaution.

[36] This assumes that repayment of past years' arrears is postponed and that domestic revenue declines by a more modest 21 percent from its original target.

[37] This is one of several national IDA projects in the US$500 million regional Emergency Locust Response Program (P173702), which uses the Multiphase Programmatic Approach.

[38] Portions of RCRF financing and EU budget support are contingent on FGS and FMS reform measures.

[39] The grant from Turkey was in the original 2020 budget and is therefore not a direct response to the crisis, although Turkey has provided in-kind assistance to Somalia to support the health response.

identified in the Reengagement and Reform DPF. For example, the government is preparing regulations under the Public Financial Management and Companies Laws, which were supported by the DPF. And CBS and the National Communications Authority (NCA) are working with the institutions that are now subject to the new regulations that the DPF supported. These and other developments are listed in Table 6.

46. **Furthermore, the authorities have intensified their commitment to policy reform since approval of the parent operation.** As discussed in Section 2, Somalia entered into a new multi-year financing program with the IMF in March 2020 (Annex 2), which entails challenging conditionality on fiscal outcomes and reforms in areas of revenue mobilization, financial management, anti-corruption, financial integrity, and banking sector supervision. Somalia made commitments in March to implement reforms on a broader set of issues through the HIPC Completion Point triggers. These include not only reforms of economic management in the DPF and IMF program, which are helping Somalia to develop its macroeconomic policy making capabilities, but also policies that support assignment of social spending functions across federal and state governments and structural reforms to promote economic growth. Finally, it is worth noting that Somalia submitted its Memorandum of the Foreign Trade Regime to the World Trade Organization on May 4, 2020. This initiates an exhaustive process of reforming laws, policies, and institutions related to international trade and investment, in addition to making binding commitments on the terms of WTO members' access to Somalia's domestic market.

**Table 6. Status of supported by the DPF**

| **Prior action** | **Policy implementation** | **Progress towards achieving results** |
|---|---|---|
| 1. To increase transparency and accountability of debt management, the Recipient has enacted the Public Financial Management Law. | MOF has drafted regulations to implement the PFM Law, supported by World Bank and IMF technical assistance. (Note: Issuance of these regulations is a HIPC Completion Point trigger.) | The World Bank and IMF are preparing technical assistance to build the capacity of the Debt Management Unit, including the capacity to compile and publish statistical reports. |
| 2. To increase revenue mobilization potential, the Recipient has enacted the Revenue Administration Law. | MOF is developing an action plan to implement provisions of the Revenue Administration Law. MOF is preparing a tax audit strategy (to be completed by June), which will be important for successful implementation of the law. | Prior to COVID-19, revenue mobilization was on an upward path, with January–February 2020 inland tax revenue 14 percent higher than the same period of 2019. Due to COVID-19, inland tax revenue for 2020 is now projected at 29 percent below the January approved budget. |

| Prior action | Policy implementation | Progress towards achieving results |
|---|---|---|
| 3. The Recipient's Ministry of Fisheries and Marine Resources has signed an agreement with the fisheries ministries of the five Federal Member States that defines how fishing license revenue will be allocated between federal and state governments. | The 2019–20 tuna licensing round was completed in February 2020. The Ministry of Fisheries and Marine Resources licensed 31 long-line vessels, generating US$1.65 million in revenue. FMS governments will receive their shares according to the March 2019 agreement. Activities to strengthen intergovernmental relations include the following:<br>• In February, FGS ministries held consultations on fiscal federalism as part of the constitutional reform process. Meetings with FMSs and civil society are expected in the coming months.<br>• In May, FGS and FMS finance ministers agreed to meet monthly and to increase the scope, granularity, and frequency of fiscal data sharing. | The FGS is on track to increase volumes of transfers of national revenue to the FMSs. The 2019–20 licensing round generated US$1.65 million in license revenue, a 62 percent increase over the 2018–19 round. |
| 4. To strengthen the environment for private sector competition and market entry and exit, the Recipient has enacted the Company Law. | The Ministry of Commerce and Industry (MoCI) begun drafting regulations to implement the Company Law 2019, supported by IFC technical assistance. (Note: Issuance of these regulations is a HIPC Completion Point trigger.) | The SCALED UP IPF is financing investments that will add functionalities to MoCI's business registration system, which is expected to become operational later in the year. |
| 5. To strengthen the mobile money payments system and support growth of the digital economy, the Recipient's National Communications Authority has issued the Interconnection Regulations providing for interconnection among telecommunications operators. | (NCA continues to strengthen telecommunications regulations. In February 2020, it issued Somalia's first uniform licensing framework, which encourages market entry and the growth of new telecommunications services and applications. | One active interconnection negotiation underway and additional are expected after NCA completes licensing of operators under the new framework. IFC technical assistance is supporting the negotiation process. |
| 6. To strengthen oversight over the mobile money payments system, the Recipient's Central Bank of Somalia has issued Mobile Money Regulations (CBS/NBS/REG/06). | The CBS Board of Directors approved mobile money licenses for the two largest operators in April. CBS will issue these once NCA has approved their communications licenses. | CBS has developed the template for licensed operators to report mobile money activity (supported by World Bank and IMF technical assistance) and is beginning to collect data. |

## 5. RATIONALE FOR PROPOSED SUPPLEMENTAL FINANCING

47. **The COVID-19 global pandemic has created an unanticipated financing gap that jeopardizes Somalia's reform program, which otherwise is proceeding on schedule and in accordance with the agreed policy matrix.** The global economic downturn and the Somali government's health measures to contain the rapid spread of the disease are pushing Somalia into a recession that threatens to derail Somalia's progress towards recovery from conflict and fragility. The resulting disruptions in livelihoods, business activities, and government operations have created an unanticipated financing need of US$86.7 million in 2020, after exhausting cash balances carried over from 2019 and taking into account this proposed DPF and US$12 million expected from the AfDB. The government has been making progress in undertaking reforms to strengthen fiscal management systems and put in place a regulatory environment that promotes inclusive private sector growth, as described in Section 4. Without supplemental financing from the World Bank and other partners, the FGS would need to reduce spending to match falling

revenues—both spending on its own limited programs as well as spending on grants to subnational governments that finance their delivery of services.

48. **Somalia is implementing its program in compliance with the provisions of the legal agreement (including the Letter of Development Policy (LDP) and the authorities remain committed to the program and capable of carrying this out.** The FGS continues to implement the six policy reforms that were prior actions for the parent operation (see Table 6), as well as other measures outlined in its January 23, 2020, LDP. In March 2020, the FGS strengthened its dedication to policy reform through new commitments made under the new IMF financing program and the HIPC Completion Point triggers (see supplemental LDP in Annex III). To ensure that the FGS adheres to its reform commitments, the Office of the Prime Minister has expanded the government's oversight framework developed to monitor the IMF's Staff-Monitored Programs to encompass the broader scope of policy reforms under the DPF, ECF, and HIPC Completion Point.

49. **Somalia is unable to obtain sufficient funds from other lenders or guarantors on reasonable terms or in a reasonable time without the proposed Supplemental DPF.** Somalia is in debt distress and lacks access to external credit. This includes access to the IMF's Rapid Credit Facility, as Somalia has exhausted its access to annual concessional financing. Furthermore, the domestic capital market has not yet developed the capacity to lend to the government. Finally, the global scope of the crisis limits the availability of new grant financing to Somalia. The FGS has succeeded in mobilizing new project financing and reorienting some existing externally financed projects to respond directly to the crisis (including newly approved and proposed IDA financing discussed above in paragraph 43). MOF projects that these projects will spend an additional US$55.5 million in 2020 to responds to the crisis, of which US$34.9 million is for transfer payments to households. However, project financing cannot help a government address a revenue shortfall because these funds are necessarily tied to specific spending.

50. **The urgent need for financing, combined with Somalia's weak institutional capacity, precluded a free-standing crisis DPF.** Government capacity to rapidly develop a new policy reform program so soon after the approval of the parent DPF is constrained by the stage of Somalia's transition out of fragility and conflict. In March, Somalia entered into new and far-reaching reform commitments through the ECF program and HIPC Completion Point Triggers, which further limits the scope for preparing a credible crisis DPF program. One should note that Somalia is currently taking important steps to develop policies and institutions to support fiscal federalism, resilience to shocks, human capital development, and inclusive economic growth. Some of these steps may lead to reforms that could be supported by a programmatic DPF series later in 2020. Meanwhile, the FGS faces immediate financing needs as COVID-19 spreads rapidly through the country. Unlike governments of most countries, the FGS lacks access to even short-term financing to maintain spending while the World Bank prepares a new DPF—including financing from the central bank, which lacks resources to provide even liquidity to the government (or to the market).

## 6. OTHER DESIGN AND APPRAISAL ISSUES

### Poverty and social impact

51. Prior actions in the parent operation contribute to poverty reduction by creating fiscal space, improving fiscal management systems needed for effective spending on social programs (including systems for intergovernmental transfers), establishing a legal framework for new firm creation, and introducing regulations to promote a stable and competitive mobile payments system. The crisis is

reversing progress the government had achieved in mobilizing revenue and encouraging new firm entry, while it pushes more Somalis into food insecurity, joblessness, and poverty. The urban poor, displaced people, and elderly are bearing the brunt of COVID-19. Both agriculturalists and pastoralists face loss of income from the locust infestation.

52. Somalia is taking steps to address these challenges. The FGS has temporarily reduced taxes on many basic food items to mitigate pricing pressures. The FGS and FMSs are strengthening intergovernmental fiscal systems to support an integrated national response to the crisis and channel for funds to state and local governments, which have the primary responsibility for providing public health and education. The government launched the Baxnaano Program in April and is developing a national social registry (a HIPC Completion Point trigger), which will enable it to more efficiently deliver cash transfers to the neediest. Finally, the proposed operation supports the government in meeting unanticipated financing needs arising from the crisis, which if left unchecked would disproportionately hurt the poor and vulnerable.

### Environment aspects

53. Prior actions in the parent operation are not likely to directly affect Somalia's environment, forests, or natural resources. These reforms are expected to create a conducive macroeconomic and fiscal context for sound environmental management. Conditions are now arguably less supportive of environmental protection, but the revised FGS budget preserves or increases funding for MDAs with mandates that are important for sound use of natural resources (e.g., it increased the allocation to the Ministry of Fisheries and Marine Resources by 17 percent).

54. The government is taking steps to improve its resilience to environmental shocks. The FGS is setting up a National Emergency Operations Center and FMSs are establishing disaster mitigation and management systems to operationalize the 2018 Recovery and Resilience Framework. Through the IDA-financed Somalia Crisis Recovery Project (P173315), the country is rehabilitating water resources, afforesting riverbanks, and rehabilitating irrigation systems.

### Public financial management, disbursement, and auditing aspects

55. **PFM systems.** Somalia's PFM systems have not changed significantly since the approval of the parent operation on February 27, 2020. Consequently, the fiduciary rating remains at "Substantial."

56. The FGS continues to build its core PFM systems, notwithstanding the COVID-19 pandemic. The PFM Act of 2019 (supported by the parent DPF) established a modern legal framework. MOF is currently preparing regulations covering budget preparation and execution, payment processing, cash advances, and cash management and banking. MOF has been tightening commitment control compliance and is commissioning a quality assurance review of the financial management information system in 2020. The parliament has approved amendments to the Public Procurement and Concessions Act, which empowers the Public Procurement Authority and strengthens MOF's oversight over procurement by MDAs. The Financial Governance Committee (consisting of FGS officials and representatives from international partners, including the World Bank and IMF) continues to review all high-value contracts and concessions undertaken by the FGS.

57. Supported by conditionality in EU budget support and the RCRF IPFs, federal and state PFM systems associated with intergovernmental grants have been strengthened significantly since 2018. FMSs must report to the FGS on their use of grants received from the FGS. The newly formed FMSs carry out monthly

bank reconciliations, which are completed within a week after the end of the month. This practice enhances the integrity of financial reports. By 2019, all five FMSs had begun publishing quarterly budget fiscal outturn reports. Publishing of annual unaudited fiscal/budget reports varies across FMSs, as does publication by auditors general of the audited annual financial statements.[40]

58. Despite these achievements, several areas still need improvement. The Audit Bill remains in parliament. Development of a coherent set of financial regulations to support the implementation of the PFM Act must be completed. The PFM module of the World Bank's Programmatic PER (P160458) notes that continued use of parallel manual systems undermine commitment controls and that weak cash forecasting and expenditure management in MDAs constrain MOF from releasing budget appropriations at greater than monthly frequencies. It also highlights the need to update the PFM-related business process review to further strengthen processes, while at the same time identifying redundant and inefficient ones. It is also noted the importance to conduct an independent quality assurance review of the FGS's financial management information system and develop and adopt a comprehensive governance policy and sustainability plan for the system.[41] Finally, the need for a coordinated FGS-FMS response to the COVID-19 crisis has shone new light on the importance of fiscal data consolidation, which would be facilitated by a common FGS-FMS chart of accounts. The World Bank, EU, IMF, United Kingdom, and other partners are providing financial and technical support to improve Somalia's PFM systems.

59. **Budget transparency.** The FGS continues to publish the annual budget, quarterly financial statements, and monthly execution reports. Although DPF funds are disbursed to the FGS and not to FMSs, it is worth noting that all five FMSs now publish quarterly revenue realization and budget execution reports.

60. **Central bank systems.** CBS financial statements for 2016 were prepared based on International Financial Reporting Standards and have been audited based on International Standards on Auditing by an international audit firm. The audit of the financial statements for 2017, 2018 and 2019 is expected to be completed and reports published in the coming months. This year the IMF completed its first safeguards assessment of CBS. The March 2020 IMF staff report commended CBS for developing some safeguards, including the legal framework and internal audit. The internal auditor produces relevant reports and follows them up on them.[42] However, the staff report also noted that CBS's limited access to international correspondent banks introduces credit risks in the area of foreign exchange accounts. It also recommends stronger oversight of the external audit committee and improved transparency of financial reporting. CBS does not conduct foreign exchange operations. Somalia's economy is de facto dollarized, and the bulk of Somali shilling notes in circulation are counterfeit.[43]

[40] Galmudug and South West have published unaudited annual reports for 2017, 2018 and 2019; Jubbaland for 2017 and 2019; HirShabelle for 2018 and 2019; and Puntland for 2019. Galmudug, Jubbaland, South West States submitted audits of their 2018 financial statements to their respective state parliaments in March 2020. In 2019 they published audits of their 2017 financial statements on their finance ministry websites: http://galmudugmof.so/wp-content/uploads/2019/05/GSS-2017-annual-report-in-English.pdf; https://www.jubbalandmof.so/consolidated-financial-statements-of-jss-fy-2017/; and https://southwestmof.so/2017-complete-annual-report/. HirShabelle completed financial statements for 2018 and has submitted them for audit.

[41] World Bank, "Somalia: Public Financial Management Assessment," June 2020. The EU and United Kingdom have been providing technical assistance to these four FMSs to support their audit processes and broader PFM systems.

[42] IMF, "Second Review Under the Staff-Monitored Program and Request for Three-Year Arrangements under the Extended Credit and the Extended Fund Facility," March 2020.

[43] Somalia has issued no legal banknotes since 1990.

61. **Disbursement, flow of funds, reporting, and audit.** Disbursement will follow the "General Conditions for IDA Financing, DPF," dated December 14, 2018. Upon effectiveness, IDA will disburse the proceeds of the grant of US$55 million into a foreign currency account determined by the FGS and acceptable to IDA that forms a part of the Somalia's foreign exchange reserves at CBS. Upon receipt, CBS will notify the FGS of receipt of the funds into its account, with copy of the notice to the World Bank. The FGS will provide IDA with confirmation within 30 days after disbursement that an equivalent amount of the proceeds has been accounted for in the FGS Somalia Financial Management Information System as revenues. The FGS will reflect the proceeds of the grant in its budget and report these as part of government-wide fiscal summary reports and annual financial statements submitted to the Office of the Auditor General for audit. The World Bank reserves the right to have a specific audit conducted to confirm the funds flow and movement of funds from the World Bank to the treasury single account.

### Other issues

62. **Closing date:** The expected closing date of this grant is July 15, 2021.

63. **Monitoring and evaluation arrangements.** The authorities have enhanced their arrangements for monitoring economic policy reforms as part of reaching the HIPC Decision Point. The Office of the Prime Minister now leads the process, whose scope has expanded to include HIPC Completion Point triggers, as well as reforms supported by IMF and World Bank programs. Because of the close alignment between the LDP and NDP9, which serves as Somalia's poverty reduction strategy, the status of the reform program will be included in the annual progress reports on implementation of the poverty reduction strategy that Somalia submits to the IMF and World Bank. In addition, FGS and FMS finance ministers agreed in May to enhance the reporting and sharing of fiscal data.

64. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and World Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

## 7. SUMMARY OF RISKS AND MITIGATION

65. **Overall risks are high, although the reform program remains on track.** Ratings for macroeconomic and institutional capacity risks remain unchanged at high, but the pandemic accentuates these risks. External trade and financial shocks and the reduction in domestic business activity are hindering efforts to increase domestic revenue mobilization (Prior Action 2 of the parent DPF) and slowing the pace of new company formation (Prior Action 4).

66. **The crisis also accentuates political and governance risks, which remain rated as high.** National parliamentary elections are planned for late-2020 and presidential elections in early 2021 with support of the United Nations; any delay could undermine public trust in the process and resulting political fault lines could be taken advantage of to create instability. The pandemic could widen political divisions, particularly between the FGS and FMSs, and thereby slow the pace of reform. The constitutional reform process, which receives technical support from the United Nations Development Program, mitigates some of this risk. One emerging source of tension could be a perceived inequitable distribution of funds or equipment to support the COVID-19 response. This risk is partially mitigated by efforts by finance ministers to use the crisis as an opportunity to strengthen federalism by working towards a coordinated national response to COVID-19. The FGS has taken the initiative to increase the level of intergovernmental transfers to assist sub-national government in responding to the crisis. The World Bank continues to support the efforts of the Somali authorities to strengthen intergovernmental fiscal cooperation (e.g., through the Finance Ministers Fiscal Forum) with a strong focus on intensified data collection and dialogue, while working towards a longer-term resource-sharing arrangement. Although there are signs of renewed dialogue between Somalia and Somaliland following the historic meeting of their two presidents in February 2020, risks remain that political sensitivities might prevent Somaliland from accepting the FGS transfer, as set out in the revised FGS 2020 budget. Given the importance of rebuilding relations between Somaliland and the federal government, and the role that equitable resource sharing plays in that process, diplomatic efforts by key international actors including the United Nations political mission are underway. These aim to increase the chances that public resources are distributed fairly and in fact reach Somalis in Somaliland, thereby building confidence between the two parties as wider political dialogue is prepared.

67. **The crisis elevates social and environmental risks to the operation, which are now rated as substantial.** The rapid spread of the disease and the disruption of households' livelihoods threaten the realization of the reform program's objectives of inclusive growth and poverty reduction. The Government is taking steps to address these risks. In April 2020, the FGS launched Baxnaano Program, to help protect poor and vulnerable families faced by shocks, including public health and other natural hazards. In addition to introducing testing, tracing, and other short-term responses to the pandemic, the authorities are redoubling their efforts to strengthen national health systems to address future shocks. The World Bank is providing financing to support these efforts through the Shock-responsive Safety Net for Human Capital (P171346), Somalia Crisis Recovery (P173315), and Shock Responsive Safety Net for Locust Response (P174065) Projects.

68. **Fiduciary risks remain rated as substantial.** National emergencies often provide temptations for governments to loosen public procurement and financial management controls and thereby undermine the reform program's measures to create fiscal space. This risk is partially mitigated in Somalia by the continued development of PFM systems (supported by World Bank financial and technical assistance), conditionality in the ECF financing program, and oversight by the Financial Governance Committee. Increasing the volume of intergovernmental grants that the FGS provides to subnational jurisdictions is a critical for efficient, effective, and equitable taxation and public service delivery in a well-functioning federal system, but this also exposes the reform program to fiduciary risks. To mitigate these risks, FGS and FMS finance ministers signed a memorandum of understanding in June to increase the frequency and coverage of their fiscal data sharing. Conditionality on FMS fiscal reporting and their use of intergovernmental grants tend to mitigate these risks, as does technical assistance on PFM systems provided to the FMSs by development partners (on payroll, use of Treasury Single Account, the legislative framework or the management of fiduciary risks more broadly).

**Table 7. Summary risk ratings**

| Risk Categories | Rating |
|---|---|
| 1. Political and Governance | High |
| 2. Macroeconomic | High |
| 3. Sector Strategies and Policies | Moderate |
| 4. Technical Design of Project or Program | Moderate |
| 5. Institutional Capacity for Implementation and Sustainability | High |
| 6. Fiduciary | Substantial |
| 7. Environment and Social | Substantial |
| 8. Stakeholders | Moderate |
| 9. Other | |
| **Overall** | High |

## ANNEX 1: PARENT PROJECT POLICY AND RESULTS MATRIX

| Prior actions | Results | | |
|---|---|---|---|
| **Prior Actions** | **Indicator Name** | **Baseline** | **Target** |
| ***Pillar 1—Strengthen fiscal management.*** | | | |
| Prior Action 1. To increase transparency and accountability of debt management, the Recipient has enacted the Public Financial Management Law. | Results Indicator #1: Increased transparency of public debt information through publication of quarterly debt bulletins | None published (2018) | At least three quarterly bulletins published (end-2021) |
| Prior Action 2. To increase revenue mobilization potential, the Recipient has enacted the Revenue Administration Law. | Results Indicator #2: Real growth of FGS inland tax revenue | US$38.6 million (FY2018) | 30 percent real increase above the 2018 value, deflated by the CPI (FY2021) |
| Prior Action 3. The Recipient’s Ministry of Fisheries and Marine Resources has signed an agreement with the fisheries ministries of the five Federal Member States that defines how fishing license revenue will be allocated between federal and state governments. | Results Indicator #3: Increased national revenue allocated to FMSs | US$0.74 million allocated (FY2019) | Allocations to FMSs have doubled to US$1.5 million (FY2021) |

| Prior actions | Results | | |
|---|---|---|---|
| ***Pillar 2—Promote inclusive private sector-led growth*** | | | |
| Prior Action 4. To strengthen the environment for private sector competition and market entry and exit, the Recipient has enacted the Company Law. | Results Indicator #4: Business creation process streamlined through launch and operationalization of an on-line registration system | No on-line business registration (2019) | 80 percent of new businesses registered are made through the on-line system (end-2021) |
| Prior Action 5. To strengthen the mobile money payments system and support growth of the digital economy, the Recipient's National Communications Authority has issued the Interconnection Regulations providing for interconnection among telecommunications operators. | Results Indicator #5: Increased number of telecommunications interconnection agreements completed | Zero (2018) | 80 percent mobile network operators have at least one agreement (end-2021) |
| Prior Action 6. To strengthen oversight over the mobile money payments system, the Recipient's Central Bank of Somalia has issued Mobile Money Regulations (CBS/NBS/REG/06). | Results Indicator #6: Increased transparency of mobile money transaction information through CBS publication of reports including mobile money deposits and other statistics | None published (2018) | At least three quarterly reports published (end-2021) |

## ANNEX 2: IMF RELATIONS ANNEX

PRESS RELEASE

PR20/105

### IMF Executive Board Approves 3-Year ECF and EFF Arrangements for Somalia

FOR IMMEDIATE RELEASE

- IMF Board approves SDR 292.4 million (about US$395.5 million) ECF and EFF arrangements for Somalia.
- The three-year financing package will support the implementation of the authorities' National Development Plan and anchor reforms between the HIPC Decision and Completion Points.
- Reforms will focus on a continued strengthening of public finances to meet Somalia's development needs in a sustainable manner; a deepening of central bank capacity; improvement of the business environment and governance; and enhancing statistics.

**WASHINGTON, DC – March 25, 2020** the Executive Board of the International Monetary Fund (IMF) approved three-year arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) for Somalia in the amount of SDR 292.4 million (about US$395.5 million or around 179 percent of quota). The program will support the authorities' implementation of their ambitious reform agenda and catalyze concessional donor financing. This will help the country implement its National Development Plan to build greater economic resilience, promote higher and more inclusive growth, and reduce poverty.

At the conclusion of the Executive Board's discussion, Ms. Kristalina Georgieva, Managing Director and Acting Chair, stated:

"Somalia has reached the HIPC Decision Point given the authorities' sustained commitment to reform in a challenging political, security and climate environment. The second review of the staff-monitored program, which has been endorsed as meeting the standards of upper credit tranche conditionality, has been completed. The authorities' strong policy commitment has helped strengthen public financial management and the financial sector, improve governance, and enhance macroeconomic stability.

"The authorities' new three-year economic program is an ambitious and appropriate response to Somalia's macroeconomic challenges. Continued reform commitment, together with the necessary technical assistance, will be critical to achieve the program's objectives, as well as to secure higher and more inclusive growth. The authorities need to continue strengthening the cooperation between the Federal Government of Somalia and Federal Member States.

"The medium-term fiscal framework under the program appropriately balances the need to contain recurrent spending while channeling new resources toward Somalia's development plan. Continued efforts to strengthen fiscal federalism, enhance revenue mobilization and build social protection mechanisms will be important as Somalia moves forward. Swift implementation of Somalia's comprehensive public financial management law is needed, together with efforts to strengthen debt management and ensure a conservative approach to any future borrowing to minimize the risk of falling back into debt distress.

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Washington, DC 20431
USA

IMF.org

"The central bank's efforts to strengthen its organizational capacity and enhance regulation and supervision will be critical for the robust and sustainable development of the financial sector. Continued capacity building is needed to improve AML/CFT compliance and the national risk assessment should be completed as quickly as possible. Advancing reforms to promote good governance are also important.

"Improving macroeconomic statistics is important, particularly GDP and balance of payments data. In this regard, the authorities should support the creation of the independent national statistics office and implement the macroeconomic statistics action plan.

"The consultative process that accompanied the drafting of the Ninth National Development Plan (NDP9) is commendable. It is important that the authorities update the underlying macroeconomic policy framework and complete the costing exercise. Financial and technical support from the international community is important to support the authorities' reforms and the implementation of the NDP9.

"Somalia's request for interim assistance under the HIPC Initiative on the debt service falling due to the Fund over the next 12 months has been approved. The progress made in securing commitments from other creditors to provide debt relief in the context of the HIPC Initiative is welcome, as there is a need for equitable burden-sharing across all creditors. The coverage and content of the HIPC floating Completion Point triggers, which focus on growth, public financial management, debt management, governance, domestic revenue mobilization, and statistics, is appropriate.

"The global COVID-19 pandemic and regional desert locust swarm pose new risks to the outlook and program. In this regard, strong support from the international community remains critical."

**Annex**

**Recent Economic Developments**

Despite a challenging security, political, and climate environment, Somalia has remained steadfast in implementing economic reforms. This has brought them to the Decision Point for debt relief under the Heavily Indebted Poor Country (HIPC) Initiative. Economic growth and inflation have been relatively stable, but growth has been too low to significantly tackle widespread poverty. In 2019, real gross domestic product (GDP) is estimated to have grown by 2.9 percent. However, the impact of the recent desert locust swarm and the global coronavirus pandemic makes the near-term outlook less certain. Fiscal data reflects continued strong performance in 2019, with domestic revenues outturns outpacing the indicative targets set in Somalia's Staff Monitored Program (SMP). As a result, there was a small fiscal surplus at the end of the year. The current account deficit, which is primarily financed by grants, remained close to 12 percent of GDP.

**Program Summary**

The new three-year IMF financing arrangements aim to anchor medium-term policies during the period between the HIPC Decision and Completion Points. These policies build on the 2019 Article IV recommendations and reforms underpinning Somalia's fourth SMP. Reforms will focus on a continued strengthening of public finances to meet Somalia's development needs while balancing fiscal sustainability considerations; a continued deepening of central bank capacity; efforts to improve the business environment and governance; and enhancing statistics.

The program will:

• **Guide fiscal policy via a robust medium-term fiscal framework (MTFF)** and balance Somalia's development priorities and fiscal sustainability. In the context of HIPC and NDP9 implementation, staff envisages a substantial increase in expenditures. The program will also further mobilize domestic revenue to support self-sufficiency, provision of public services, and social stability. Nevertheless, fiscal space will remain constrained. To ensure sufficient resources are available for critical development expenditure a ceiling on expenditures on compensation and the use of goods and services has been put in place. Expenditures will continue to be capped by the overall size of the revenue envelope, with a zero limit on new debt accumulation. Additionally, the program places critical importance on sustaining and deepening inter-governmental fiscal relations.

• **Deepen and broaden on-going public financing management (PFM) reforms** which hinge on implementing aspects of the new PFM Act. In particular, strengthening budget preparation and execution, enhancing oversight, institutionalizing recent improvements in budget processes, and enhancing the quality of general government fiscal reporting.

• **Improve the capacity of the central bank**. The program will support the implementation of the central bank's new organizational structure and develop a medium-term vision to guide future policy priorities.

• **Reinforce the supervisory framework and improve AML-CFT compliance**. Further progress in strengthening regulatory and supervisory standards will contribute to continued financial stability. These efforts will include the expansion of supervision to the whole financial sector, especially the mobile money sector. The program will support improvements in AML/CFT capacity, including the deepening of capacity of the Financial Reporting Center, and enhancing inter-agency cooperation through the National Anti-Money Laundering Committee.

• **Support efforts to improve governance**. The program will support the completion of the authorities' National Anti-Corruption Strategy and the related workplan to implement the strategy.

• **Support long-term growth and poverty reduction**. The program will support these goals through fiscal conditionality and reforms, and the complementary floating Completion Point triggers, along with other conditionality in World Bank operations, which are expected to address growth, water management, poverty, gender, and improving the ease of doing business. Additionally, the program will continue to support improvements in the production and dissemination of macroeconomic statistics. Along with other technical assistance providers, staff will monitor and provide capacity development support to the authorities' macroeconomic statistics action plan.

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## Table 3. Somalia: Selected Economic and Financial Indicators, 2016-2025

(Population: 14 million, 2018 estimate)

| | Est. | | | | Proj. | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
| **National income and prices** | | | | | | | | | | |
| Nominal GDP in millions of U.S. dollars | 4,198 | 4,509 | 4,721 | 4,958 | 5,218 | 5,507 | 5,827 | 6,179 | 6,570 | 7,012 |
| Real GDP in millions of U.S. dollars | 4,241 | 4,300 | 4,420 | 4,548 | 4,694 | 4,858 | 5,038 | 5,235 | 5,454 | 5,705 |
| Real GDP, annual percentage change | 2.9 | 1.4 | 2.8 | 2.9 | 3.2 | 3.5 | 3.7 | 3.9 | 4.2 | 4.6 |
| Real GDP per capita in U.S. dollars | 316 | 311 | 311 | 311 | 312 | 315 | 319 | 323 | 328 | 335 |
| Consumer prices (e.o.p., percent change) | 1.2 | 6.1 | 3.2 | 3.1 | 3.0 | 2.5 | 2.2 | 2.2 | 2.2 | 2.2 |
| | | | | | (Percent of GDP) | | | | | |
| **Central government finances 1/** | | | | | | | | | | |
| Revenue and grants | 4.1 | 6.0 | 5.7 | 6.8 | 9.5 | 10.8 | 12.4 | 13.6 | 10.8 | 11.5 |
| *of which:* | | | | | | | | | | |
| Grants | 1.4 | 2.8 | 1.8 | 2.2 | 5.0 | 6.0 | 7.2 | 7.7 | 4.2 | 4.1 |
| Expenditure (FGS) | 3.3 | 5.3 | 5.7 | 6.3 | 9.1 | 9.5 | 10.4 | 11.7 | 13.1 | 13.7 |
| Compensation of employees 2/ | 1.3 | 2.8 | 3.0 | 3.3 | 4.2 | 4.3 | 4.7 | 5.0 | 5.3 | 5.6 |
| Purchase of non-financial assets | 0.3 | 0.1 | 0.2 | 0.3 | 0.8 | 0.9 | 1.1 | 1.4 | 1.8 | 1.9 |
| Overall balance | 0.8 | 0.7 | 0.1 | 0.5 | 0.4 | 1.4 | 2.0 | 1.8 | -2.3 | -2.2 |
| Overall balance, net | 0.0 | 0.0 | 0.0 | 0.6 | 0.0 | 1.0 | 1.7 | 1.7 | -2.3 | -2.2 |
| Stock of domestic arrears | 1.8 | 1.5 | 1.5 | 1.4 | 1.3 | 1.2 | 1.1 | 1.0 | 0.9 | 0.8 |
| Public debt 3/ | 122.9 | 116.6 | 112.8 | 107.4 | 74.6 | 71.3 | 67.9 | 10.3 | 12.2 | 13.9 |
| | | | | | (Millions of U.S. Dollars) | | | | | |
| **Monetary Sector** | | | | | | | | | | |
| Net Foreign Assets | -324 | -318 | -258 | -212 | -183 | -174 | -162 | 191 | 174 | 179 |
| Central Bank claims on non-res 4/ | 58 | 89 | 122 | 148 | 193 | 219 | 248 | 263 | 243 | 244 |
| Net Dometic Assets | 539 | 611 | 697 | 735 | 758 | 806 | 865 | 593 | 711 | 854 |
| Credit to the private Sector | 70 | 105 | 184 | 206 | 232 | 269 | 321 | 395 | 500 | 651 |
| Broad Money 5/ | 178 | 270 | 334 | 432 | 471 | 517 | 580 | 664 | 777 | 928 |
| | | | | | (Percent of GDP) | | | | | |
| **Balance of payments** | | | | | | | | | | |
| Current account balance | -9.4 | -9.8 | -10.3 | -11.9 | -12.3 | -12.5 | -12.5 | -12.7 | -14.5 | -14.8 |
| Trade balance | -74.4 | -86.7 | -84.8 | -86.6 | -88.9 | -89.3 | -90.2 | -86.6 | -81.5 | -78.1 |
| Exports of goods and services | 25.2 | 22.6 | 23.7 | 22.8 | 22.6 | 22.3 | 22.4 | 22.4 | 22.3 | 22.1 |
| Imports of goods and services | 99.6 | 109.2 | 108.5 | 109.4 | 111.5 | 111.6 | 112.6 | 109.0 | 103.7 | 100.2 |
| Remittances | 32.5 | 31.5 | 31.3 | 31.9 | 32.4 | 32.7 | 32.9 | 32.1 | 31.3 | 30.4 |
| Grants | 33.3 | 46.1 | 43.9 | 43.5 | 44.9 | 44.9 | 45.6 | 42.4 | 36.1 | 33.4 |
| Foreign Direct Investment | 7.9 | 8.2 | 8.6 | 9.0 | 8.9 | 9.0 | 9.1 | 9.3 | 9.6 | 9.8 |
| External debt 3/ | 121.1 | 115.1 | 111.3 | 106.0 | 73.3 | 70.1 | 66.8 | 9.4 | 11.4 | 13.2 |
| **Market exchange rate** (SOS/USD, e.o.p.) | 24,005 | 23,605 | 24,475 | 26,015 | … | … | … | … | … | … |

Sources: Somali authorities; and Fund staff estimates and projections.

1/ Budget data for the Federal Government of Somalia. Fiscal operations are recorded on a cash basis. GDP data cover the entire territory of Somalia.

2/ Increase in compensation of employees in 2017 reflects bringing onto budget military spending related to the loss of an off-budget grant. The increase in 2020 reflects a reallocation of allowances from G&S to compensation in the context of Somali National Army reform.

3/ Assumes application of HIPC debt relief and interim HIPC assistance from the Decision Point, and MDRI and "beyond-HIPC" relief at Completion Point.

4/ Includes FGS grants held abroad.

5/ Primarily desposits at commercial banks. Data does not yet include balances held with MNOs.

## ANNEX 3: SUPLEMENTAL LETTER OF DEVELOPMENT POLICY

Federal Republic of Somalia
Ministry of Finance
Office of the Minister

جمهورية الصومال الفيدرالية
وزارة المالية
مكتب الوزير

Jamhuuriyadda Federaalka
Soomaaliya
Wasaaradda Maaliyadda
Xafiiska Wasiirka

**MOF/OM/976/20** **June 9th 2020**

**Mr. David Malpass**
**President**
**The World Bank Group**
**Washington, D.C.**

**Re: Letter of Development Policy for the Somalia Reengagement and Reform Supplemental Development Policy Financing**

### I. Introduction

Since the Letter of Development Policy (MOF/OM/14/20) was issued on 23rd January 2020, the Government made substantive and clear progress against the Government's Reform Programme priorities and maintained macroeconomic stability. This is reflected in our continued fiscal reports that are regularly shared with our partners and the actions taken under the IMF Staff Monitored Program (SMP) and committed under the Extended Credit Facility (ECF)/Extended Fund Facility (EFF) program. Finally, it is also reflected in Somalia's re-engagement with the international community upon reaching Decision Point under the Heavily Indebted Poor Countries (HIPC) Initiative in March 2020. The Government's commitment was realized after sustained reform initiatives were undertaken and successfully implemented by the government institutions. We are committed to further strengthening the gains achieved despite the remaining security and political challenges and regular climate shocks. This supplemental Letter of Development Policy, therefore, outlines the progress achieved since January 2020 LDP in the following areas of reform and in the implementation of the reform agenda. It categorically shows clear progress has been achieved despite the Covid-19 pandemic.

### II. The Covid-19 crisis

On 17th March the Ministry of Health confirmed the first case of Covid-19 in Somalia. As of 5th June, 2204, people have contracted the disease and 79 have died. The Covid-19 outbreak is a severe public health emergency due to the very weak health infrastructure and prevention systems in the country.

In addition to its significant social impacts and human dimension, the pandemic is creating a major economic shock to the Somali people, especially, the poor which calls for a decisive coordinated economic response. The economic outlook for the first quarter of the year 2020 where the government was expecting Deyr rain fall and harvesting in February, likely resulting in lower price for food and beverage, high export of livestock and crops did not

Ministry of Finance-Shangani District
Mogadishu, Somalia

fully materialize. However, in the wake of Covid-19 impact, it is expected GDP will decline by 5.3% in 2020, with 95% probability that falls between -11% to 0.55%. Factors contributing to the negative economic growth include:

- 35% decrease in exports, (mainly affected livestock exports to the upcoming Hajj);
- 20% decrease in import value, (due to supply route closure and low demand);
- 40% decline of sales tax on imported goods, (high value for sales tax items not coming any more);
- 100% loss of Khat due to the closure of flights;
- Hospitality and aviation sector decline, (both were growing exponentially and contributed 25% of actual revenues collected in 2019);
- Hight rate of unemployment, (drawing sectors that impacted the closure and construction);
- Lower demand of goods and services with high prices due to the supply routines closure;
- Reduced government spending as result of lower revenues
-

During March 2020, the following Categories increased monthly:

- Food 3.64%
- Health 4.49%
- Communication 3.37%
- Miscellaneous Goods & Services 1.15%

In response to this situation, the government developed a Socio-Economic Impact and Response plan that includes all Federal Member States (FMS) and Somaliland.[1] The plan was developed with the input of the FMS authorities, particularly Ministries of Finance and Health. The impact and response cover the fiscal, health and overall economic affect and required response. The FGS and FMS have established committee to address the COVID-19 response. Since April 9th, the Prime Minister of Somalia has been virtually (by video-tele conference) chairing the National COVID-19 Committee on a daily basis with the participation of respective FMS heads of committees.

The government has also prepared a supplemental budget for 2020. The crisis has created new spending demands while reducing revenue collection, including, in the Federal Member States (FMS), Somaliland and Banadir region. The estimated 2020 domestic revenue was $234 million before the effects of COVID revenue impacts were factored in. The Government now estimates a $67 million reduction in domestic revenue, or a shortfall of 29% when compared to the 2020 budget estimate. As a precaution, the supplemental budget proposes expenditures that would be required in a worst-case scenario. These expenditures incorporate a similarly conservative assessment on the potential revenue losses that the Federal Member States, Somaliland and the Banadir region could face, which has been incorporated into the potential transfers that might be needed to ensure they can continue their critical operations. The FGS operating expenditures are forecast to increase by $129.9 million and donor funded special projects expenditures will increase by $38.4 million in 2020

[1] Federal Government of Somalia, "Socio-economic Impact and Required Response for COVID-19," 27 March 2020.

over the budget provision. The majority of the increase being for grants to sub-national governments. FGS has already sent $1m to each of the FMSs in response to the crises. The Cabinet approved the supplemental budget on 28th May and it was subsequently submitted to the House of the People for approval and the anticipation date for this is 20th of June, 2020.

### III. Status of Somalia's PFM reform program

We are committed to increasing the pace of the reforms and to sustain the momentum which is critical for progress.

The Ministry of Finance continues to implement its approved Public Finance Reform Strategy Action Plan 2018–2021 which addresses fundamental PFM reform challenges identified in coordination with donors and international financial institutions (IFIs) for: enhancing domestic revenue mobilisation; improving public expenditure management; establishing effective federal fiscal and expenditure frameworks; and engaging with external partners to harness sources of financial support.

Pursuant to the new PFM Law, during March 2020, the Ministry of Finance Budget Director convened a team chaired the Deputy Director of Budget, and comprising the World Bank's Advisor to the Accountant General Office, the AfDB Advisor to the Budget Department, EU BSP TL and representatives from the AGO's office and other Budget officials, to further develop and finalise the draft regulations already developed by the IMF.

The Comprehensive Operating Procedures Manual (COPM) issued in late 2018 continues operationalisation through Quarter 1 of 2020 but will require updating to reflect the approved financial regulations developed pursuant to the new PFM Law. This issue was flagged in the government's public financial management assessment report whose draft was supported by the World Bank on March 26th.

With regard to cash management, under the new IMF ECF/EFF program, the government has committed to strengthen expenditure controls, cash management and accounting and reporting as part of medium-term priorities during the HIPC interim period and to support implementation of NDP-9. The government will maintain a budget in line with the agreed program targets with any unanticipated revenue surplus to be used to replenish the fiscal buffer or other cash balances, as needed, or pay down domestic arrears.

Supporting domestic revenue generation and modern customs operations is a key priority of the reform program and the key objective is to implement harmonized HS codes and prepare ad valorem tariff schedule at the key ports of Bossaso, Kismayo, and Mogadishu by the end September 2020. The government also continues to implement, after a successful 2019 fishing season, the issuance of fishing licenses by the Ministry of Fisheries and Marine Resources. This raised $1,685,500 in revenue for the country in March that has been deposited in an escrow account at CBS. These revenues will be shared according to the Revenue Sharing Agreement (March 2019 Addis Agreement).

The broader legislative PFM and governance reform agenda has continued to advance. The Public Financial Management (PFM) and Companies Laws have been enacted, the Senate has passed the Audit Bill, and the Lower House has passed the amendment to the Customs Law. The amendment to the Statistics Law has also been enacted, and staff have provided comments to a preliminary draft of the authorities' action plan for producing and disseminating macroeconomic statistics

With regard to the amendments of the Procurement Law, amendments to the Public Procurement Act has received the President's signature and draft implementation regulations are ready to be issued. The MoF Procurement Directorate is now planning to conduct training on the Procurement Law and the Regulation to civil society, the private sector and the government officials involved in financial management.

The Ministry of Finance will undertake community engagement event through the 2020 fiscal year for the preparation of the 2021 budget that aims to gather important feedback from the stakeholders, and to make the budget process more participatory, transparent and in line with international best practice.

The preparation and submission of the 2019 annual financial statements, a cash-basis IPSAS compliance of the FGS for the financial year of 2019, was submitted to the Office of the Auditor General on 30th April 2020.

## IV. Increased inter-governmental grants and fiscal cooperation in Somalia

Despite Covid-19 challenges, the FGS is strongly committed to, and is, advancing the intergovernmental coordination framework by continuing discussions on intergovernmental fiscal matters and further increasing level of intergovernmental fiscal transfer to the FMSs to help them cover the fiscal gap which emerged out of Covid-19. Two Ministerial level meetings and one technical level meeting was successfully concluded since the January Letter of Development Policy was shared with the Bank. Now, measures are underway to improve fiscal data sharing. A signed MoU with FMSs formalizes an updated frequency of data sharing from quarterly to monthly basis which provides a mechanism to assess the budgetary performance of the states and their use of the federal grants. All FMSs are obliged to submit full utilization report before the next tranche is released which allows for FGS to confirm whether funds were utilized for the intended purpose. To this effect, all FMSs submitted April fiscal data within the new timeframe to the FGSs for on-ward submission to the World Bank and IMF.

With the supplementary budget recently approved by the Cabinet, an increased spending on fiscal transfer budget was further allocated for all FMSs and Somaliland in an effort to further enhance the fiscal transfer mechanism within the level of governments. Almost 40% of the originally anticipated fiscal transfer under 2020 Appropriation Bill had been executed at the end of April 2020. This demonstrates the government's strong willingness to maintain continued and increased fiscal transfer mechanism to further enhance the intergovernmental coordination platform.

Within our dialogue with the EU on budget support targets and RCRF disbursement-linked indicators, and in support of fiscal federalism, we have further agreed that the execution rate for transfers to FMS/BRA to be equal to or greater than the outturn rate for domestic revenues in 2020.

In a further demonstration of our commitment to advancing fiscal federalism during 2020, we proposed to the World Bank to assist the framework for intergovernmental transfer formula, (in response to a joint benchmark) and develop a Policy paper including: (i) principles to guide FGS transfer allocations to FMS/Benadir Region Administration; (ii) comparative analysis, reflecting regional context, and; (iii) long-term views that should be tabled and adopted at Finance Ministers Fiscal Forum (FMFF). The document will support the development of a draft of federal law on fiscal federalism that will sanction the policy and procedures for sharing financial resources.

**Yours Sincerely,**

**Dr. Abdirahman D. Beileh**
**The Minister**