



The World Bank

Somalia Reengagement and Reform DPF (P171570)

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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED IDA ARREARS CLEARANCE SET-ASIDE GRANT
IN THE AMOUNT OF SDR 271.2 MILLION
(UP TO US\$375.0 MILLION EQUIVALENT)

AND A

PROPOSED IDA TURN-AROUND REGIME GRANT
IN THE AMOUNT OF SDR 32.6 MILLION
(US\$45.0 MILLION EQUIVALENT)

TO THE

FEDERAL REPUBLIC OF SOMALIA

FOR THE

REENGAGEMENT AND REFORM DEVELOPMENT POLICY FINANCING

January 29, 2020

Macroeconomics, Trade and Investment Global Practice
Africa Region

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FEDERAL GOVERNMENT OF SOMALIA FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

Exchange rate effective as of December 31, 2019

Currency Unit: Somali shilling (SOS)

US\$1.00 = SOS 25,878.87

US\$1.00 = SDR 0.72315469

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank	IOTC	Indian Ocean Tuna Commission
AML/CFT	Anti-money Laundering/Combatting the Financing of Terrorism	IPF	Investment Policy Finance
ASA	Advisory Services and Analytics	LDP	Letter of Development Policy
CBS	Central Bank of Somalia	LIC	Low-income Country
CPF	Country Partnership Framework	MDA	Ministry, Department or Agency
CPI	Consumer Price Index	MDRI	Multilateral Debt Relief Initiative
DPG	Development Policy Finance	MMO	Mobile Money Operators
DRA	Debt Relief Analysis	MOF	Ministry of Finance
DSA	Debt Sustainability Analysis	NCA	National Communications Authority
ECF	Extended Credit Facility	NDP	National Development Plan
EU	European Union	NPV	Net Present Value
FGS	Federal Government of Somalia	PER	Public Expenditure Review
FMS	Federal Member State	PFM	Public Financial Management
GDP	Gross Domestic Product	RCRF	Recurrent Cost and Reform Financing
GRS	Grievance Redress System	SCD	Systematic Country Diagnostic
HIPC	Heavily-Indebted Poor Country	SCOA	Standard Chart of Account
ICT	Information Communications and Technology	SDR	Special Drawing Rights
IDA	International Development Association	SFMIS	Somalia Financial Management Information System
IDP	Internally-displaced Person	SMP	Staff-Monitored Program
IEG	Independent Evaluation Group	SNA	Somalia National Army
IFC	International Finance Corporation	TSA	Treasury Single Account
IFI	International Financial Institution	UN	United Nations
IMF	International Monetary Fund	US\$	United States dollar
		WBG	World Bank Group

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The Somalia Reengagement and Reform Development Policy Financing was prepared by an World Bank Group team led by Philip Schuler, Gaël Raballand, and Natasha Sharma (co-Task Team Leaders), and that included Taneem Ahad, Lydie Ahodehou, Ivar Andersen, Virginia Cheng, Angelique DePlaa, Susan Evans, Geoff Handley, Tracy Hart, Wendy Karamba, Tim Kelly, Sher Shah Khan, Gregory Kisunko, Karima Laouali Ladjo, Leonard Matheka, Matthias Mayr, Julien Million, Ben Musuku, Jean Owino, John Randa, Axel Rifon Perez, Martin Serrano, Sitora Sultanova, Jiwanka Wickramasinghe, Fred Yankey, and Nobuo Yoshida. Kevin Carey (Practice Manager, EMNM2), Khwima Nthara (Country Manager, AFMLR), Sona Varma (Lead Economist, EMNM2) served as peer reviewers of the operation. Michael Goldberg, Allison Holland, Vinaya Swaroop, and Theo Thomas also offered helpful guidance. Without the security and logistical support for missions to Mogadishu provided by George Griffin, Hart Security, Eugenia Konya, and Doreen Wanjiku, preparation of this operation would not have been possible.



SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P171570	No

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	420.00
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DETAILS

International Development Association (IDA)	420.00
IDA Grant	420.00

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 PROGRAM DOCUMENT FOR A PROPOSED GRANT TO THE FEDERAL REPUBLIC OF SOMALIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This Program Document proposes a Reengagement and Reform Development Policy Financing (DPF) for the Federal Republic of Somalia in the amount of US\$420 million from International Development Association (IDA) grant resources.** The objectives of the proposed 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. Up to SDR 271.2 (up to US\$375 million equivalent) of the proposed grant would be disbursed to the bridge-loan creditor assisting with arrears clearance (“Portion A of the Financing”); and SDR 32.6 million (US\$45 million equivalent) would be disbursed to the Federal Government of Somalia (FGS) as budget support to meet cash flow needs after Somalia has cleared its arrears to IDA¹ (“Portion B of the Financing”).

2. **Strategically positioned in the Horn of Africa, Somalia has a land mass of 637,657 km² and boasts the longest coastline in Africa.** Traditional livelihoods are shaped by geographic and climatic conditions: while northern Somalia is mainly arid and semi-arid land, southern Somalia has higher agricultural potential, due to higher rainfall and water from two rivers: the Juba and the Shebelle. These rivers, rising in the Ethiopian highlands, underpin both crop and livestock production systems in southern Somalia – but irrigation and flood control infrastructure are in extremely poor condition following years of neglect and conflict. Livestock production systems are a core economic activity, requiring mobility to exploit seasonal pasture across vast areas of rangeland. Though still underutilized, the country’s long coastline is home to numerous valuable species of fish and other marine life that could support commercial offshore fishing as well as inshore fishing for local food security and trade.

3. **The country has suffered decades of protracted crisis and conflict.** Somalia experienced increasing macroeconomic instability during the 1980s associated with unsustainable fiscal policies, uncontrolled monetary expansion, and repeated devaluation. An elevated level of government spending in the face of exceptionally low domestic revenue—averaging 27 and 7 percent of gross domestic product (GDP), respectively, between 1981 and 1989—resulted in Somalia’s high dependence on foreign assistance and ultimately the accumulation of arrears to external creditors.² Civil conflict and state fragmentation followed the collapse of the Siad Barre regime in 1991. Combined with repeated droughts, these resulted in the destruction of the country’s manufacturing base and much of its crop production, large internal displacement of people, increasing urbanization, and acute vulnerability to external shocks. Somalia’s natural capital (its land, rivers, forests, minerals, and marine resources) has been heavily degraded and constantly stressed by overexploitation as political disagreements imperil the prospects for sustainable governance.

4. **The trust in government and its institutions that was lost over decades of violent contestation for power and resources must be rebuilt.** Asymmetric federal structures, limited government capacity, and a persistent war economy still challenge governance. Tax competition between jurisdictions within the

¹ The arrears clearance facilitated by the proposed operations follows the procedures set forth in IDA, “Further Elaboration of a Systematic Approach to Arrears Clearance,” June 2007. The proposed operation would disburse a grant of up to US\$375 million equivalent from the IDA arrears clearance set-aside and US\$45 million equivalent from the IDA18 Turnaround Regime.

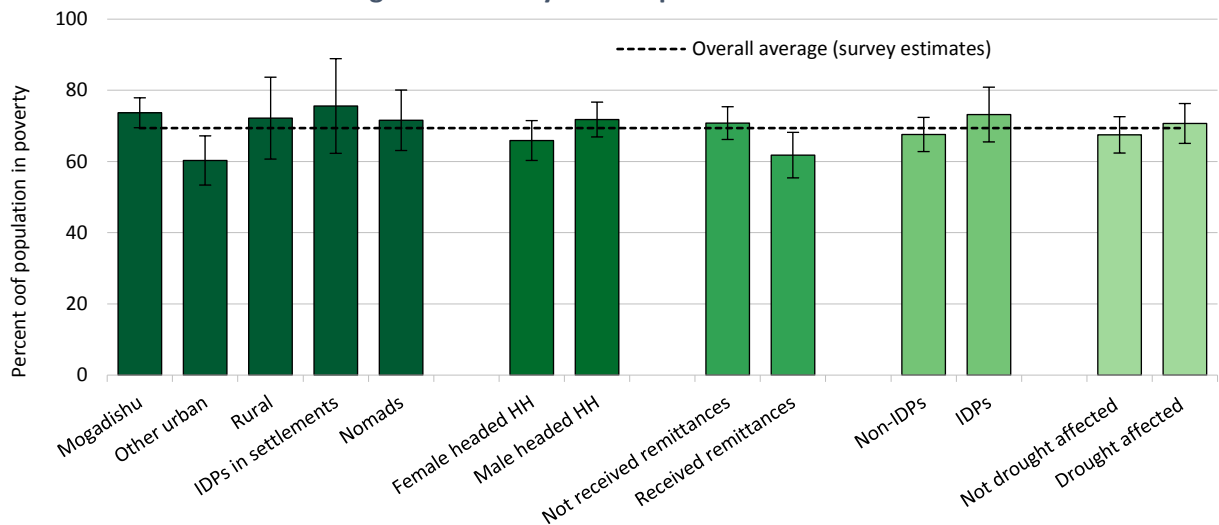
² World Bank, “Somalia: Crisis in Public Expenditure Management,” March 1991.



federal system reduce total revenue collected by all levels of government.³ Only when the Government begins to establish its value as a reliable provider of services and security, can trust between the people, governing institutions, and various stakeholder groups be rebuilt. Unless that happens, violent conflict will continue to plague Somalia and the Government will be unable to perform its core functions without large-scale external support.

5. **Sustained political and economic reforms since 2012 are supporting Somalia’s transition out of fragility.** The adoption of the Provisional Constitution in 2012 established a federal political system, which comprises the FGS and five Federal Member States (FMSs).⁴ Legal and institutional reforms implemented since 2012 are rebuilding core public sector functionalities. As will be elaborated in Section 2.1, improved fiscal management capacity has enabled the FGS to more than double its revenue collection, absorption of external grants, and total spending between 2013 and 2019. The Central Bank of Somalia (CBS) is building its financial supervision capacity, putting in place a stable and modern payments system, and (with the FGS) strengthening the country’s defenses against money laundering and terrorism financing. These reforms are building a strong and inclusive financial system.

Figure 1. Poverty is widespread in Somalia



Source: World Bank staff estimates, 2017 Somalia High Frequency Survey.

6. **Poverty remains pervasive, underscoring the need to build economic resilience.** Almost 70 percent of Somalis live on less than US\$1.90 a day in purchasing power parity terms (Figure 1), and economic growth is barely keeping up with population growth, estimated at 2.8 percent per year.⁵ Poverty is high throughout the country, with the highest incidence of poverty among internally displaced people living in settlements, people living in rural communities, and nomads. Almost nine of 10 Somali households are

³ Competition for customs revenue is documented in Thomas Cantens, “Somalia: Assessment of Customs Revenue Potential and Proposals for Reform,” World Bank, September 2018.

⁴ These are Galmudug, Hirshabelle, Puntland, Jubbaland, and South West States. In 1991, Somaliland declared its independence, which is not recognized internationally.

⁵ World Bank, “Somalia Poverty and Vulnerability Assessment: Findings from Wave 2 of the Somalia High-Frequency Survey,” April 2019. The population growth rate estimate is from Federal Republic of Somalia and UNFPA, “Population Estimation Survey 2014,” October 2014.



deprived in at least one dimension of poverty—monetary, electricity, education, or water and sanitation—and nearly seven of 10 households suffer in two or more dimensions. Access to services is especially limited for internally displaced people (IDPs) living in settlements, nomads, and those living in rural areas. Women across all population groups have lower literacy and educational attainment. Somalis are vulnerable to external shocks such as natural disasters and epidemics, as well as to household-level shocks such as injury, death, or unemployment. An estimated 74 percent of youth are unemployed, which contributes to the underlying drivers of fragility, as Al-Shabab and spoiler groups exploit constrained economic opportunities. This situation stresses the urgency of continued support to economic reforms that will promote inclusive growth and meaningful jobs for the youth.

7. Although Somalia has achieved much since 2012, it continues to face daunting challenges. At the most basic level, Somalia faces the challenges associated with reconstructing the state, such as fostering inclusive politics, ensuring security, and providing access to justice. Overcoming these requires building core economic governance capabilities appropriate for a federal political system and a market economy. To rebuild the social contract, the public sector must find ways to generate more revenue, share it across levels of government, and spend it efficiently, equitably, and effectively. It must also establish the legal and regulatory institutions that underpin a competitive market economy—many of which do not exist under the system of central planning pursued by the Siad Barre regime. Building the capacity for economic governance is also a prerequisite for addressing challenges of reducing poverty, generating inclusive economic growth, and increasing households' and the economy's resilience to shocks. The National Development Plan (NDP) identifies the need for significant public and private investments over the medium term that will not be forthcoming without improved economic governance.⁶

8. In addition, Somalia is vulnerable to extreme weather shocks, which are expected to become more frequent and severe as the climate changes. Somalia has historically suffered droughts or floods every several years. More recently, it was struck with severe drought in 2016/2017, drought in early 2019, flooding in late 2019, and in early 2020 a plague of locusts that has been the worst in 25 years. Weather and climatic shocks could lower agricultural output (both crops and livestock) damage structures, exacerbate water stress, and displace people.⁷ The government's capacity to reduce risks from natural hazards ex ante and manage effects of disasters ex post has been limited, and humanitarian agencies increasingly filled this gap after 1991. The government's 2018 Recovery and Resilience Framework marks a major step towards a more proactive management of disaster risks.⁸ It is developing sectoral strategies to guide development of climate change-resilient production (e.g., in livestock) and is planning to undertake reforms to clarify institutional mandates for aspects of disaster risk management.

9. The proposed DPF contributes to addressing Somalia's development challenges through support for policy reforms that strengthen fiscal management and promote inclusive private sector-led growth. Pillar 1 includes measures to improve debt transparency, revenue collection, expenditure containment, budget accountability, and intergovernmental fiscal arrangements. These lay the foundation for the Government to deliver critical social services needed to build human capital, reduce poverty, and increase

⁶ FGS, National Development Plan 2017–2019 (October 2016) and 2020–2024 (September 2019).

⁷ The 2016–2017 drought caused damages and losses estimated at US\$3.25 billion, displaced 926,000 people, and left more than half of the population in need of humanitarian assistance (FGS, "Drought Impact Needs Assessment," February 2018). The October–November 2019 floods have affected around 575,000 people, and preliminary estimates of damages and losses are in the vicinity of US\$275–300 million.

⁸ Federal Republic of Somalia, "Recovery and Resilience Framework," (June 2018).



resilience. Measures in Pillar 2 are aimed at building the business and investment climate and improving regulation of modern services industries. These are prerequisites for a private sector that creates good jobs at good wages. Measures selected for both pillars of the proposed DPF complement the WBG ongoing technical and financial assistance.

10. **The proposed DPF complements a rapidly expanding engagement to build human capital and strengthen resilience to climate change and other shocks.** In FY2020, the World Bank is currently delivering technical assistance to develop livestock insurance, a major Urbanization Review, and upstream analysis on health and education that are expected to inform new financing

11. **The proposed DPF also addresses the above challenges by enabling full reengagement with the WBG.** The DPF would facilitate Somalia's clearance of arrears to IDA, which is a requirement to qualify for international debt relief under the Heavily-Indebted Poor Countries (HIPC) Initiative.⁹ Full reengagement with the international community through the HIPC process is expected to enable Somalia to access the financial and technical support the country needs for sustained poverty reduction and inclusive economic growth. Normalization of Somalia's relationship with IDA would give the government's access to financing from IDA's Crisis Response Window, Regional Window, and Window for Host Communities and Refugees. Normalization is also a prerequisite for the International Finance Corporation (IFC) to make investments in Somalia's private sector.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

12. **The economy has been growing at a modest pace in recent years.** GDP is estimated to have grown by an average annual rate of 2.6 percent between 2013 and 2018 (Figure 2.A). The severe drought in 2016–2017 reduced growth to an estimated 1.4 percent in 2017, and preliminary estimates suggest the economy has recovered, with growth estimated at 2.8 percent in 2018 and projected at 2.9 percent in 2019, following modest improvements to weather conditions.¹⁰ Although national accounts data are limited, the available evidence suggests that the services sector—telecommunications, financial services, and trade in particular—and construction have enjoyed rapid growth, despite the difficulties the country has experienced.¹¹ Agriculture is a major source of livelihood, especially for poorer Somalis, and livestock

⁹ To reach the HIPC Decision Point, a country must face an unsustainable debt burden that cannot be addressed through traditional debt relief mechanism, establish a track record of policy reform (measured by at least six months of implementation of a suitable IMF program), adopt at least an interim poverty reduction strategy, and be eligible to borrow concessionally from international financial institutions (IFIs). Somalia is potentially eligible for HIPC Initiative debt relief as a “grandfathered country,” as discussed in IDA and IMF, “HIPC Initiative — List of Ring-Fenced Countries that Meet the Income and Indebtedness Criteria at end-2004,” April 11, 2006.

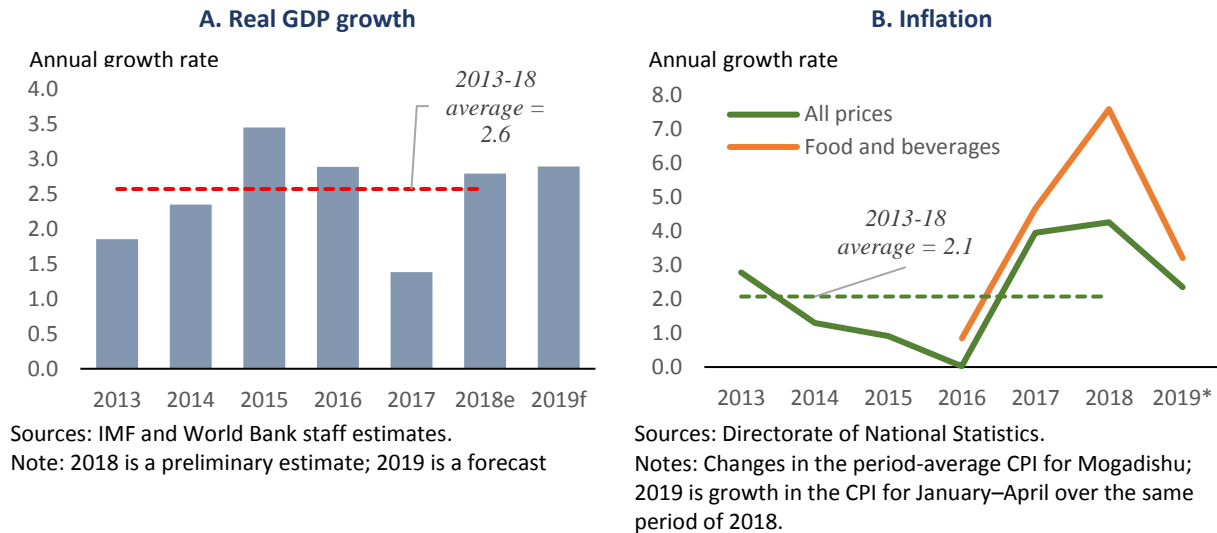
¹⁰ Somalia experienced a rainfall deficit in April 2019 that reduced cereal output and livestock supply. From May to August 2019, there was an increase in rainfall, which improved vegetation but did not improve crop production. October and November 2019 have witnessed flash flooding in 50 percent of agricultural lands (Food Security and Nutrition Analysis Unit, Food and Agricultural Organization, December 2019).

¹¹ 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



accounts for virtually all recorded merchandise exports. Destruction of physical infrastructure (e.g., irrigation systems and farm-to-market roads), displacement of the rural population, and vulnerability to extreme weather have prevented the sector from serving as a source of dynamism.¹²

Figure 2. Somalia has enjoyed moderate growth and inflation since 2013



13. **Prices have been relatively stable during the past decade in Somalia.** The consumer price index (CPI) grew by an average annual rate of 2.1 percent between 2013 and 2018 (Figure 2.B).¹³ This stands in sharp contrast to the high and accelerating inflation suffered in the last decade of the Siad Barre regime, when annual inflation was estimated to have exceeded 100 percent in 1989–1990.¹⁴ Fiscal discipline (reinforced through successive International Monetary Fund (IMF) programs), de facto dollarization, and a commitment to avoid the monetary policies of the 1980s have contributed to price stability. Shocks to agricultural production, which are largely weather-related, are the primary contributor to price volatility. Droughts, floods, and delayed rains can reduce agricultural output and place upward pressure on prices. Inflation in 2018 eased to 3.2 percent from 6.1 percent in 2017, as the effects of a prolonged drought subsided. Price data in 2019 indicate that inflation has crept up again to 4 percent, as weather conditions affected cereal and livestock production, highlighting the need to invest in climate-resilient agricultural production.

14. **Somalia’s chronically high structural trade deficit is a legacy of conflict, which destroyed much of the country’s manufacturing and crop production capacity.** Virtually all commodity exports take the form of shipments of livestock to Gulf Cooperation Council countries. Exports of goods and services in 2019 are

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.

¹² The sector’s performance and investment needs are analyzed in World Bank and Food and Agriculture Organization, “Rebuilding Resilient and Sustainable Agriculture in Somalia,” 2018.

¹³ Even when evaluated using monthly data, the year-on-year growth in prices has not exceeded 6.5 percent since 2015 (World Bank staff estimates using CPI data from the Directorate of National Statistics).

¹⁴ World Bank, “From Resilience Toward Recovery and Development: A Country Economic Memorandum for Somalia,” January 2006.



estimated at 23 percent of GDP, broadly maintaining the same trends as in 2017 and 2018, as the effects of the prolonged drought conditions, as well as import restrictions imposed by Saudi Arabia and the United Arab Emirates at the end of 2016 continue to prevail. The country typically imports more than four times as much as it exports, with import spending estimated at 110 percent of GDP in 2018 (Table 1). Key imports include most foodstuffs and petroleum. The trade deficit is financed by stable external flows, including remittances, grants, and foreign direct investment, including for investments related to the port. Remittances from Somalia's large diaspora and official grants, estimated at 32 and 44 percent of GDP, respectively, in 2019. Remittance inflows are high despite the absence of international correspondent banking relationships.

15. Although the official currency is the Somali shilling, the country is de facto highly dollarized. The last legitimate shilling notes were printed in 1990, and virtually all notes in circulation are counterfeit. CBS estimates that these notes account for a small share of the money supply.¹⁵ Most Somalis use the U.S. dollar for all but low-value transactions, either in the form of currency or as mobile money, which is used by the vast majority of Somalis.¹⁶ CBS does not conduct currency transactions. The shilling/dollar exchange rate is fully market determined and has stayed relatively stable, averaging around 23,000 since January 2015.

16. The authorities are strengthening their supervision of the financial sector. The collapse of the state in the 1990s opened the door for privately-owned banks to emerge.¹⁷ Since the approval of the Central Bank Act and the Financial Institutions Act in 2012, CBS has been expanding its regulatory capacity to ensure stable growth of the sector. CBS began issuing licenses to money transfer bureaus and commercial banks in 2014. It issued regulations for mobile money operators in July 2019, which brought this important sector under central bank supervision. In October 2019, CBS established a payments system unit as part of its functional reorganization and is also working with the private sector to establish a national payments system.¹⁸ In addition, Somalia has been working to strengthen financial integrity. The anti-money laundering/combating the financing of terrorism (AML/CFT) Act was passed in 2016, establishing the Financial Reporting Center, and more reforms to strengthen the AML/CFT framework and support the reestablishment of correspondent banking relationships are underway.¹⁹

¹⁵ A CBS survey of market participants estimated that around 1 billion Somali shilling notes (essentially all counterfeit) were in circulation (CBS, "Somali Shilling Currency Reform Project Plan," July 2018). Based on this survey, CBS officials informally estimated in September 2020 that shilling notes represented 10 percent of total currency in circulation. The IMF reported an estimate that U.S. dollar banknotes accounted for around 95 percent of currency in circulation in Somalia, excluding Somaliland (IMF, "Somalia: Staff Report for the 2015 Article IV Consultation," July 2015).

¹⁶ In 2017, a World Bank-commissioned survey estimated that 73 percent of Somalis over the age 16 use mobile money services: 83 percent in urban areas, 72 percent in IDP camps and 55 percent in rural areas (Altai Consulting, "Mobile Money Ecosystem in Somalia," April 2017). The PVA estimates that 69 percent of urban households on average, ranging from 55 percent in central Somalia to 85 percent in northwestern Somalia), and that 46 percent of domestic remittances and 12 percent of international remittances go through mobile money.

¹⁷ The sole commercial bank operating in 1990 was state-owned. The World Bank's 2006 CEM argued that the uncontrolled credit this bank extended to other public enterprises was a leading contributor to the acceleration of inflation in the late-1980s. See World Bank, "Somalia: From Resilience toward Recovery and Development," January 2006.

¹⁸ The establishment of a national payments system is supported by a World Bank Investment Project Financings (IPF).

¹⁹ The authorities have developed an AML/CFT Action Plan, where key items include covering financial entities other than Money Transfer Bureaus, issuance of targeted financial sanction regulations once the bill is passed, capacity building at the Financial Reporting Center, strengthening reporting compliance and enforcement; and improving interagency communication and coordination. These reforms are being supported with World Bank and IMF technical assistance.

**Table 1. Selected Economic Indicators (2017-2023)***(percent of GDP unless otherwise indicated)*

	2017	2018e	2019p	2020f	2021f	2022f	2023
GDP, nominal (millions of dollars)	4,509	4,721	4,958	5,218	5,507	5,827	6,179
real GDP growth	1.4	2.8	2.9	3.2	3.5	3.7	3.9
per capita GDP, nominal (dollars)	327	332	339	347	357	369	381
Poverty incidence (US\$1.90/day PPP)	69						
Money and prices							
CPI inflation (eop)	6.1	3.2	4.0	3.0	2.5	2.2	2.2
Private credit growth (eop)	75.2	9.2	12.4	12.8	..		
share of GDP	2.3	3.9	4.1	4.3	4.6	5.0	5.3
Fiscal (central government)							
Total revenue and grants	6.0	5.7	6.9	8.8	10.0	11.4	12.5
o/w external grants	2.8	1.8	3.0	4.3	5.2	6.2	6.7
Total expenditure	6.6	5.7	6.9	9.1	9.3	10.2	11.6
o/w Compensation of employees	2.8	3.0	3.2	4.0	4.1	4.5	4.8
o/w Transfers to subnational	0.5	0.6	0.7	0.9	0.9	1.1	1.4
Overall balance, net	0.1	0.2	0.1	-0.3	0.7	1.2	0.9
External							
Current account balance	-9.8	-10.3	-11.8	-12.0	-12.2	-12.2	-13.0
Trade balance	-86.7	-84.8	-87.1	-88.1	-88.4	-89.1	-88.4
Exports of goods and services	22.6	23.7	23.0	22.8	22.5	22.6	22.6
o/w Live animals	11.8						
Imports of goods and services	109.2	108.5	110.1	110.9	110.9	111.7	110.9
Remittances, private transfers	31.5	31.3	31.9	32.4	32.7	32.9	32.1
Official grants	46.1	43.9	44.1	44.4	44.2	44.8	44.1
FDI	8.2	8.6	9.0	8.9	9.0	9.1	9.3
External debt	115.1	111.5	106.2	77.0	73.5	70.1	10.3
Exchange rate (shilling/dollar)	23,605	24,475	25,879		

Source: IMF and World Bank estimates.

Notes: Central government refers to the FGS. Systems for producing consolidated general government statistics are still under development. Fiscal and debt statistics assume clearance of International Financial Institutions (IFI) arrears in early 2020 and full delivery of HIPC and Multilateral Debt Relief Initiative (MDRI) debt relief in 2023. Data as of December 2019.

17. **These steady improvements to the financial sector are starting to bear fruit, albeit from a low base.** Increased confidence in the banking sector is supporting a rise in deposits at banks, which in turn is facilitating growth in credit to the private sector, increasing to 4 percent of GDP from 1 over the period 2015 to 2018. These developments mirror the estimated expansion of the tertiary sector, in areas such as construction, including investments financed by the returning diaspora. Total loans to deposits have risen to 55 percent in 2018 from 39 percent in 2016, indicating robust liquidity ratios.



Table 2. FGS Fiscal Operations (2017-2023)

(percent of GDP)

	2017	2018e	2019e	2020f	2021f	2022f	2023f
Revenue and grants	6.0	5.7	6.9	8.8	10.0	11.4	12.5
<i>Revenue</i>	3.2	3.9	4.0	4.5	4.8	5.2	5.8
Tax revenue	2.5	2.9	2.8	3.0	3.2	3.5	3.7
Tax on income, profit, and capital gains	0.1	0.2	0.2	0.2	0.2	0.3	0.3
Taxes on goods and services	0.2	0.5	0.5	0.5	0.6	0.6	0.6
Taxes on international trade and transactions	2.1	2.1	2.0	2.0	2.2	2.4	2.5
Other taxes	0.2	0.2	0.1	0.2	0.2	0.2	0.3
Non-tax revenue	0.7	0.9	1.2	1.5	1.6	1.8	2.1
<i>Grants</i>	2.8	1.8	3.0	4.3	5.2	6.2	6.7
Bilateral	1.8	0.5	0.6	0.6	0.6	0.5	0.5
Multilateral	1.0	1.3	2.4	3.7	4.6	5.7	6.1
Total expenditure	6.6	5.7	6.9	8.7	9.3	10.2	11.5
<i>Current</i>	5.3	5.5	6.4	8.1	8.3	9.1	10.1
Compensation of employees	2.8	3.0	3.2	4.0	4.1	4.5	4.8
Use of goods and services	1.8	1.7	2.4	2.4	2.5	2.7	2.9
Interest and other charges	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Transfers to subnational governments	0.5	0.6	0.7	0.9	0.9	1.1	1.4
Contingency	0.1	0.1	0.0	0.0	0.0	0.1	0.1
Repayment of arrears and advances	0.2	0.0	0.1	0.0	0.0	0.0	0.0
<i>Capital (net acquisition of non-financial assets)</i>	0.1	0.2	0.3	0.6	0.9	1.1	1.4
Transfer to government deposits	1.1	0.0	0.2	0.0	0.0	0.0	0.0
Draw down of government deposits	0.7	0.1	0.1	0.2	0.0	0.0	0.0
Amortization of external debt				0.3	0.3	0.3	0.3
Overall fiscal balance, net	0.1	0.3	0.1	0.2	0.5	1.0	0.7

Source: FGS Ministry of Finance (MoF), IMF, and World Bank estimates. Data as of December 2019.

18. **The FGS has succeeded in placing public finances on a more stable footing since 2013.** It has maintained fiscal discipline despite the many pressures the Government faces, supported by fiscal targets under IMF programs. Apart from a small deficit in 2016, the FGS has maintained a balanced budget, avoided the accumulation of expenditure arrears, and met its fiscal commitments under successive IMF programs. It should be noted that the Government effectively has no access to instruments to finance budget deficits: the central bank has no capacity to provide financing; the domestic capital market is not sufficiently developed to support Government issuance of securities or other borrowing; and Somalia is excluded from external sources due to its arrears on past debt. FGS domestic revenue collection is estimated to have expanded to 3.9 percent of GDP in 2019 from 1.7 percent in 2013. Meanwhile, the FGS has increased its capacity to absorb external grants, which to date have been channeled through non-governmental organizations. The steady increase in revenue has enabled the Government to gradually expand total spending estimated at 6.9 percent of GDP in 2019. Although this is a striking increase from 3.0 percent of GDP in 2013, it remains among the smallest in the world, and pales in comparison to the country's vast spending needs to deliver the types of services and infrastructure required to stimulate growth and reduce poverty.

19. **Improvements in tax policy and administration have supported the modest rise in revenue collection.** Key policy reforms include extending the income and sales tax to more industries, including telecommunications, ports, and hotels. In addition, improved capacity in areas of air traffic control and fisheries management have enabled the FGS to collect additional non-tax revenue. Improvements in tax



administration are complementing these efforts, which includes the operationalization of a new large and medium tax payer's office and creating modern customs processes. As shown in Table 2, these reforms are helping to reduce the heavy dependence on customs duties and other international trade taxes, which in 2019 accounted for half of the revenue that the FGS collects (down from 90 percent in 2013).

20. The wage bill and other recurrent spending dominate the budget. Reflecting the demands posed by security conditions and the need to rebuild state institutions, the Government devotes essentially all available financial resources to wages, procurement of goods and services, and transfers, with only a small share allocated to investments in physical or human capital. Table 2 shows that personnel costs have overtaken procurement of goods and services as the largest component of spending; a trend which is projected to increase over the medium to long term as the authorities assume increasing responsibility for security-related personnel costs. Around 94 percent of all Federal Government personnel (including disciplined forces) in 2018 were employed by security or administrative ministries, departments, and agencies.²⁰ Similarly, the security sector has a large weight in procurement, where food rations for security forces represent the largest non-wage recurrent spending item in the FGS budget.

21. Although these spending priorities are understandable under prevailing conditions, spending will need to be rebalanced over time towards programs and investments that build resilience, reduce poverty, and generate economic growth. The FGS is taking steps to contain expenditure growth, including through the first-ever audit of the security sector, biometric registration of all federal and military personnel, and improved procurement of rations.²¹ These measures have resulted in stronger payroll controls and greater procurement efficiencies.

22. Somalia is also taking steps to develop the intergovernmental fiscal arrangements that are needed for a well-functioning fiscal system. Budgetary transfers from the FGS to subnational governments (including to the Banadir Region Administration) have grown to an estimated 0.7 percent of GDP in 2019 from 0.2 percent in 2013. Discussions around fiscal federalism continue to progress with a revival in recent months of the Intergovernmental Fiscal Forum, as well as plans to reinvigorate debates around the Provisional Constitutional and power-sharing agreements. Federal and state governments have reached agreement to share natural resource revenues in two sectors: fisheries and petroleum.²² The March 2019 fisheries agreement (discussed in detail in Section 4.2) is the first to allocate national revenue, as opposed to Federal Government revenue, and it thus set an important precedent. However, in parallel, further efforts are needed to harmonize the customs regimes of the FGS and the FMS of Puntland and Jubbaland to avoid the current challenges of tariff competition, as part of ongoing efforts to improve intergovernmental fiscal relations.

23. FGS external debt is estimated to be US\$5.3 billion as of the end of 2018 in nominal terms, of which US\$5.0 billion are in arrears.²³ Paris Club creditors hold most of Somalia's external debt. The United

²⁰ This is discussed further in World Bank, "Somalia PER: Overview Module," July 2019.

²¹ As discussed below, rations are the largest non-payroll recurrent spending item in the budget.

²² As no oil exploration licenses have yet been issued, the revenue-sharing agreement has not taken effect.

²³ Figures are from the IMF-World Bank debt relief analysis, based on a loan-by-loan debt reconciliation, reported in IDA and IMF, "Somalia: HIPC Preliminary Document," January 24, 2020. Debt records provided by the authorities and reconciled with creditor statements include loans that were contracted from 1965 to 2002. These loans include loans that financed projects in pre-civil war subnational jurisdictions (including, for example, Somaliland). For all loans, the recognized debtor is the Ministry of Finance of the FGS or a line ministry of the FGS.



States is Somalia's largest creditor, with 20 percent of debt as of end-2018, followed by Russia (13 percent) and Italy (11.7 percent).²⁴ Multilateral creditors account for 29 percent, over half of this which is owed to IDA, the IMF and the African Development Bank (AfDB).²⁵ The remainder (13 percent) is owed to non-Paris Club official creditors. There is no known publicly guaranteed or commercial external debt. Furthermore, the loan-by-loan reconciliation uncovered no debt owed by subnational jurisdictions.

24. **The FGS has limited debt management capacity.** MoF established a Debt Management Unit in December 2015. AfDB has financed installation of a debt recording system (CS-DRMS) and provided training to staff in the unit. Staff have focused on reconstructing the government's loan records in preparation for the HIPC debt relief process. The unit has begun issuing annual external debt reports (covering 2013–2016, 2017, and 2018).

Table 3. External Financing Requirements (2017-2023)

(millions of U.S. dollars)

	2017	2018e	2019p	2020f	2021f	2022f	2023f
Current account deficit	440	486	587	628	671	708	804
Amortization	0	0	0	16	16	16	16
Total Financing Needs	440	486	587	644	686	725	820
FDI (net)	369	408	447	464	495	528	574
Project loans	0	0	0	0	0	0	0
Other external financing	102	105	140	182	194	198	220
Total Financing Sources	470	513	587	646	689	726	794
<i>Memorandum</i>							
Change in reserves (- = increase)	-30	-27	0	-18	-18	-18	...

Source: CBS, IMF, and World Bank estimates. Data as of December 2019.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

25. **The medium-term economic growth outlook is positive, subject to the reform momentum continuing at both the FGS and FMS levels and assuming support from the international community through the HIPC Initiative.** Real GDP is expected to strengthen from a projected 3.2 percent in 2020 to 3.5 percent over the medium-term.²⁶ Consolidation of peace and security, rising domestic demand (due mainly to the growing population), remittances, and official donor inflows are expected to drive growth in 2019–21. Growth of the services sector is projected to continue, where reforms such as interconnection arrangements among mobile network operators, which is supported by this DPF, are expected to promote growth of the digital economy. Strengthening of CBS's regulatory capacity is building trust in financial system, which should increase financial services' contribution to the economy. Construction and trade are

²⁴ The United States, Russia, and Italy are Somalia's three largest creditors overall, as well as the three largest Paris Club bilateral creditors.

²⁵ As of end-2018, Somalia's nominal debt to IDA was US\$501.0 million, of which US\$341.2 million was in arrears.

²⁶ A pickup in growth following the HIPC Decision Point is consistent with the experience of other HIPCs. Specifically, the positive impact on growth in Somalia of reaching the HIPC Decision Point is expected to be marginally stronger than the median of a sample of fragile HIPC countries, given its strong record of reform implementation under successive IMF SMPs, but weaker than the median of a wider sample of all 36 HIPC countries, given Somalia will continue to be fragile and vulnerable to shocks. Growth could accelerate further over the long run to around 4.8 percent. Achieving this rate would imply about a two-percentage point pickup in growth relative to the historical average, supported by reform implementation and resumed access to external financing.



also expected to enjoy continued robust activity. This outlook depends critically on political stability and continued improvement in constructing a federal political system that serves the needs of poor Somalis throughout the country. Vulnerability to climate-related shocks, which can affect agricultural production and security incidences that impede business confidence, are large downside risks that affect the outlook.

26. The current account deficit is forecast at 12.0 percent of GDP in 2020 and is projected to steadily widen over the medium term. It is expected that Somalia will remain heavily import-dependent over the medium-term, as it will take time to rebuild the economy's productive capacity.²⁷ Official grants and private remittances will continue to finance most of the trade deficit.

27. Inflation is expected to remain modest. Over the medium-term, inflation is projected to stay within the range of 3.0 to 2.2 percent, based on the assumption that moderate growth of the agriculture sector prevails. De facto dollarization should continue to provide relative price stability, particularly given the dependence on imports. Geopolitical uncertainty in major oil-producing countries may lead to increases in domestic fuel prices.

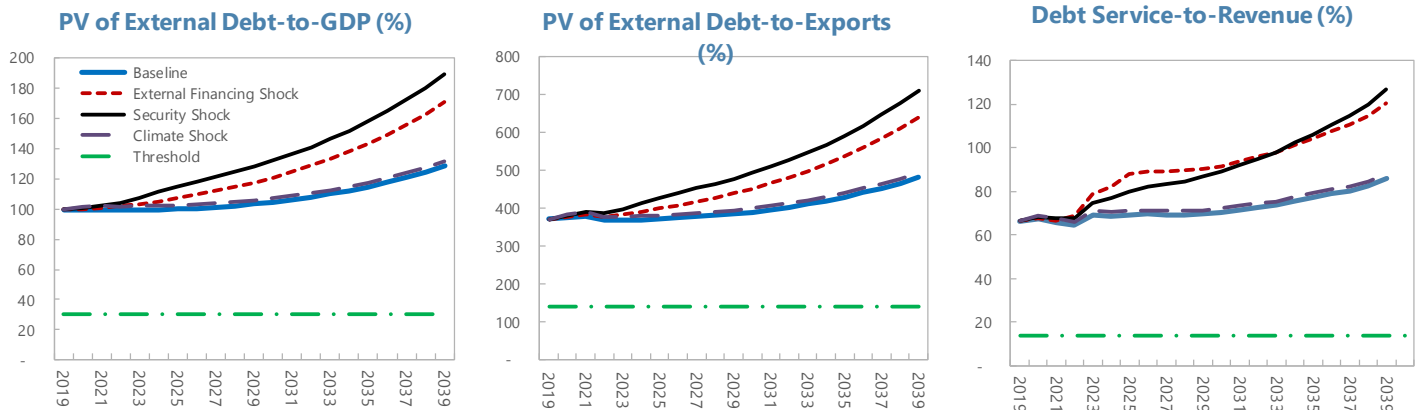
28. Expected improvement in revenue collection should allow commensurate modest increases in spending. The 2019 Revenue Administration Law strengthens the legal foundation for FGS revenue collection and modernizes tax administration (as discussed in Section 4.2). These expand the tax base and should improve revenue mobilization efficiency. Revenues and grants are projected to increase to 8.8 percent of GDP in the 2020 budget (where grants comprise nearly half). FGS tax revenues are projected to modestly increase over the medium-term from 2.8 percent in 2019 of GDP to an average of 3.2 percent of GDP over the period 2020–2022. This progress assumes that reforms to increase tax revenues will continue. Spending on compensation of employees is expected to increase from 3.2 percent of GDP in 2019 to an average of 4.2 percent of GDP over the medium-term, as the FGS takes on increasing responsibility for the delivery of services, including security. Resources spent on the use of goods and services are expected to remain relatively constant over the medium-term at around 2.5 percent of GDP. The outlook assumes continued FGS commitment to avoiding deficits. Over time, further efforts are needed to reprioritize expenditures towards social priority sectors, in support of poverty reduction objectives.

29. The latest (June 2019) IMF-World Bank Low-Income Country Debt Sustainability Analysis (LIC-DSA) confirms that Somalia is in debt distress, based on both external and public debt indicators, in the absence of debt relief. Key solvency and liquidity indicators are well above LIC-DSA thresholds (Figure 3). So long as Somalia lacks access to external financing, its debt stock and debt servicing levels will continue to grow through the accumulation of late interest on debt in arrears, even under relatively benign economic conditions assumed in the baseline outlook. As shown in Figure 3, these would grow even more rapidly in the event of adverse security or climate shocks.

²⁷ For example, Somalia's high power costs are a binding constraint on the development of an internationally competitive food processing industry. Significant investment in electricity generation and transmission is unlikely to be forthcoming until Somalia puts in place critical legal, policy, and regulatory institutions. Easing this constraint will therefore take several years.



Figure 3. Somalia will remain in debt distress in the absence of debt relief



Source: IMF-World Bank LIC-DSA, June 2019.

30. **Preliminary findings from simulations using various debt relief scenarios indicate that conventional debt relief would significantly reduce debt but would be insufficient to reduce debt to a manageable level.**²⁸ In a scenario where Somalia receives full delivery of traditional debt relief, debt falls gradually relative to both GDP and exports, but remains above HIPC Initiative threshold of 150 percent of exports (in net present value [NPV] terms) throughout the 20-year horizon used in the LIC-DSA. Only in an alternative scenario where Somalia receives HIPC Initiative, MDRI, and beyond HIPC debt relief at the HIPC Completion Point would debt fall to a sustainable level. Both scenarios use the long-run macroeconomic framework that underpins this proposed DPF.

31. **The IDA-IMF HIPC debt relief analysis (DRA) estimates that US\$1.9 billion (in end-2018 NPV terms) of debt relief would be required to reduce debt to the HIPC threshold of 150 percent of exports.**²⁹ After full application of traditional debt relief mechanisms, Somalia’s NPV of debt is estimated at US\$3.5 billion at end-2018, equivalent to 328.9 percent of exports and services. For debt-to-exports to be at the minimum sustainable level under HIPC, an estimated US\$1.9 billion is needed in debt relief. Based on proportional burden sharing, multilateral creditors’ assistance would amount to US\$0.8 billion, and bilateral assistance to US\$1.1 billion (in NPV terms).

32. **A multi-pronged financing strategy is being prepared to support Somalia’s debt relief efforts.** International financial institutions have either set aside resources for arrears clearance (IDA and the AfDB) or are putting in place exceptional financing measures to finance debt relief (IMF). These resources will enable Somalia to clear arrears, fully normalize relations with the IFIs, and access new sources of financing. Other multilateral creditors are assumed to provide debt relief through cancellation or concessional rescheduling of arrears, to commence at the Completion Point. Following the example of other countries that have gone through the HIPC process, Paris Club creditors are likely to provide HIPC debt relief at 90 percent NPV reduction once Somalia reaches Decision Point, and the remaining debt relief delivered at Completion Point. Rescheduling agreements have commenced with other non-Paris Club creditors.

33. **Between the HIPC Decision Point and Completion Point, Somalia will need to resume its debt servicing obligations to multilateral agencies.** These include servicing of outstanding debt that are not in

²⁸ IMF and World Bank, “Somalia: Preliminary Debt Sustainability Assessment,” December 2014.

²⁹ IDA and IMF, “Federal Republic of Somalia: Enhanced HIPC Initiative Preliminary Document,” January 24, 2020.



arrears (virtually all to IDA and AfDB), as well as repayment of new IMF loan financing. Somalia's annual debt service during the interim period to IDA, IFAD, AfDB is estimated to average US\$17.6 million (or 7.4 percent of projected fiscal revenues), of which IDA's portion is US\$14.1 million.³⁰

34. **Risks to the economic outlook are high.** Over the medium term, economic activity is likely to continue to be exposed to significant risks related to insecurity in Mogadishu and southern Somalia. Exogenous shocks—related to both weather and commodity prices—compound these risks to the outlook. Weather and climatic shocks could lower agricultural output (both crops and livestock) damage structures, exacerbate water stress, and displace people. A slowdown in domestic revenue collection or lower-than-pledged grants from donors would put pressure on fiscal performance. The failure of a mobile money operator would undermine the stability of the domestic payments system and deplete household savings. Weak institutions and lack of access to financing hamper the authorities in responding to risks as they materialize.

35. **The policy reform program can mitigate some of these risks.** The government's commitment to maintaining fiscal discipline, rebuilding macroeconomic policy-making institutions, and establishing the track record of reform required to qualify for HIPC debt relief strengthen its ability to manage shocks. Somalia's progress in achieving reforms has been steady, as demonstrated by successive reviews of IMF Staff-Monitored Programs (SMPs), the achievement of disbursement linked indicators in the World Bank's Recurrent Cost and Reform Financing project, and the realization of reforms in European Union (EU) budget support. These reforms demonstrate that while fiscal space continues to remain constrained, a government committed to reforms has prioritized fiscal discipline, and is establishing institutional measures to maintain commitment controls. The government's implementation of the 2018 Recovery and Resilience Framework through NDP9 should also strengthen its ability to manage external shocks. Finally, the Urban Resilience Project (P170922) (financed jointly by the Multi-Partner Fund and IDA), the Shock Responsive Safety Nets for Human Capital Development Project (P171346) (financed by IDA), and other support from international partners are also expected to increase Somalia's resilience to shocks.

36. **But this reform program also faces substantial risks that, if they materialize, would put additional pressure on the macroeconomic outlook.**³¹ A deterioration in the security environment would make it difficult to implement economic policy reforms and delay the ultimate rebalancing of government budgets towards spending on economic growth and poverty reduction. Upcoming elections could politicize technical reforms and hamper their implementation. Increased tensions between federal, state, and local political leaders would delay progress in establishing the intergovernmental fiscal arrangements that are critical for governments at all levels to be effective. Of particular importance to this proposed DPF, a deterioration of FGS-FMS relations would likely increase interjurisdictional tax competition. This undermines domestic revenue mobilization and hinders progress in developing revenue-sharing arrangements. The reforms in this proposed DPF aim to help strengthen the government's capacity to mitigate these key risks. Improved growth prospects associated with access to better jobs (particularly for Somalia's youth) is important for reducing insecurity. Reforms to support increased intergovernmental

³⁰ Data from the HIPC DRA. Averages are taken over full calendar years. Data provided by WFA show that Somalia would need to service US\$12.6 million of IDA principal and interest during April through December 2020 (estimated using end-October 2019 exchange rates for SDR-denominated credits).

³¹ Risks to achieving outcomes from policy reforms supported by this operation are detailed in Section 6.



fiscal relations and resource revenue sharing also demonstrate progress in achieving reforms towards greater state unification in politically sensitive areas.

37. **The macroeconomic policy framework is assessed to be adequate for the proposed DPF.** This assessment rests critically on the role the operation plays in enabling Somalia to reach the HIPC Decision Point and to fully normalize relations with the AfDB, IMF, and World Bank. Full support from the IFIs is essential for Somalia to continue maintaining fiscal discipline, to rebalance spending, and undertake the structural reforms needed to place the country on a sustained trajectory towards poverty reduction and economic growth.

2.3. IMF RELATIONS

38. **The IMF began to reengage Somalia in 2013 and has steadily expanded its technical support to the country.** In 2015 it completed the first Article IV consultation in over 25 years. In 2016 it began to support the authorities through a series of SMPs with conditionality that has grown steadily more demanding as country capacity increased. The SMPs have focused on (1) economic and financial data development; (2) the building up and enhancement of fiscal and monetary institutions; (3) public financial management (PFM) reform; (4) domestic revenue mobilization; (5) strengthening the banking system; (6) AML/CFT framework; and (7) currency (exchange) reform. Indicative targets have included the non-accumulation of arrears and floors on the fiscal balance (zero cash balance), domestic revenue, and central bank net foreign assets.³²

39. **In July 2019, the IMF Board endorsed the fourth consecutive SMP as meeting the policy standards associated with upper credit tranche (UCT) arrangements.** SMP4 runs from May 2019 through July 2020. IMF executive directors stated “that satisfactory implementation of the SMP will help establish a track record and pave the way toward arrears clearance and eventual debt relief under the HIPC initiative.”³³ IMF staff completed its first review mission in September and reached a staff-level agreement that Somalia had completed all structural benchmarks and fiscal indicative targets covered by the review (see Annex 2). The second review mission was completed successfully on January 8, 2020. The IMF Board is expected to discuss the staff report summarizing the second review on February 12, 2020.

40. **IMF staff anticipate that Somalia will clear its arrears in March 2020.** The IMF Board approved a financing package for debt relief in December 2019. The IMF reached a staff-level agreement on a multi-year program under the Extended Credit Facility (ECF) in January 2020, with financing front-loaded to facilitate arrears clearance. Approval is expected in late-March 2020 upon Somalia reaching the HIPC Decision Point.

3. GOVERNMENT PROGRAM

41. **Somalia’s NDP provides the foundation for the government’s reform program.** On September 26, 2019, the Cabinet approved a new NDP covering 2020–2024. NDP9 is a nationally-owned strategy for poverty reduction and inclusive growth. It builds on the progress made and lessons learned from 2017–2019 NDP, Somalia’s eight development plan, and is the first to be crafted by the central government

³² See Annex I (“Strategy and Progression of SMPs Since May 2016”) of IMF, “Somalia: Second and Final Review under the Staff-Monitored Program and Request for a New Staff-Monitored Program,” IMF Country Report No. 18/212, July 2018.

³³ “IMF Executive Board Concludes 2019 Article IV Consultation with Somalia,” Press release number 19/309, August 1, 2019.

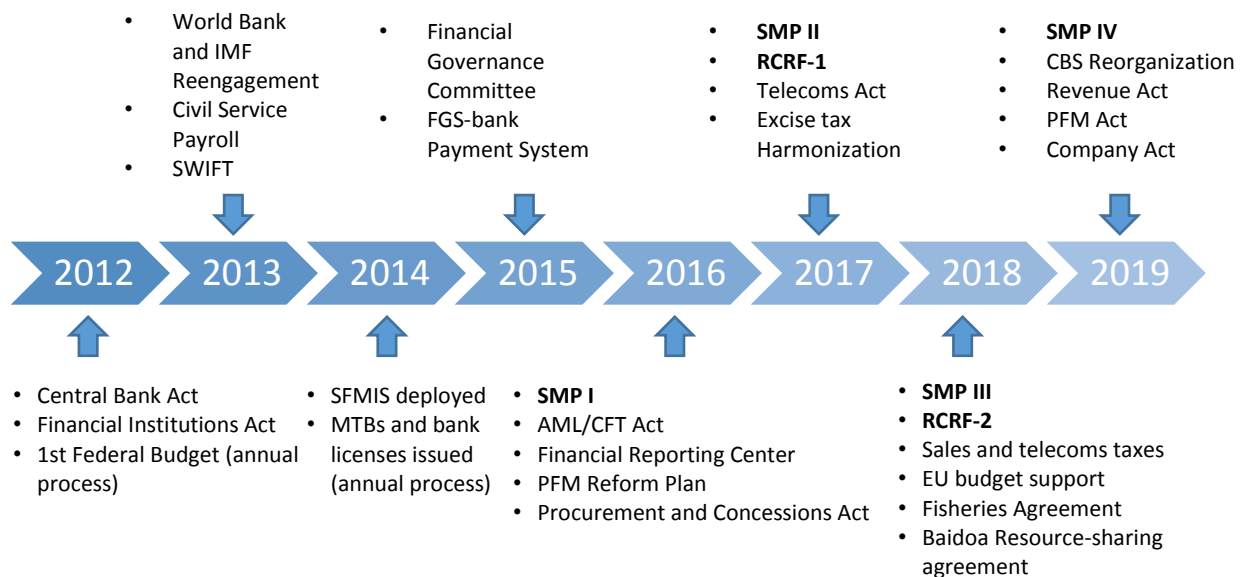


since 1986. The strategy is informed by a careful analysis of the drivers of poverty, which include political fragility, conflict, insecurity and lawlessness, and climatic shocks. It implements the action plan developed in the 2018 Recovery and Resilience Framework. It was developed through extensive consultations with civil society, private sector representatives, FGS and FMS line ministries, national and state parliamentarians, members of the judiciary, and development partners.

42. **NDP9 presents a comprehensive strategy for development that emphasizes inclusive growth and poverty reduction.** There are four pillars. Pillar 1 is *Inclusive Politics* which focuses on deepening the federal system, ratifying the constitution, building trust, and the delivery of fair and credible elections. Pillar 2 is *Improved Security and the Rule of Law*, which aims to establish a unified, capable, accountable, and rights-based Somali federal security institutions, as well as securing and improving access to justice. Pillar 3 is *Economic Development*, which aims to create an enabling environment for economic growth through regulatory changes, strengthening economic infrastructure, diversifying the private sector, and sustainably developing natural resources. Pillar 4 is *Social and Human Development*, which seeks to improve health and education outcomes to strengthen resilience and reduce poverty.

43. **Economic policy reform has been a central focus of the government’s program since 2012** (Figure 4). From a narrow starting point, its fiscal management reform agenda has gradually expanded to cover the spectrum of concerns—including revenue mobilization, budgeting, procurement, auditing, cash management, as well as accountability over public finances of the security sector. There has been equally strong attention to building core monetary and financial sector governance institutions, establishing the basic legal foundations for a market economy, and introducing reforms in strategic sectors (e.g., telecommunications, banking, and energy.) Complementing the series of IMF SMPs described above, the WBG has supported economic policy reforms through performance-based financing (e.g., Recurrent Cost and Reform Financing (RCRF) Project (P176224)), IFC advisory services support for the public-private dialogue, and Advisory Services and Analytics (ASA). World Bank investment financing (using resources from the Multi-Partner Fund and IDA pre-arrears clearance grants) support implementation of critical fiscal and financial sector reforms.

Figure 4. Economic policy reform has intensified since 2012



Source: IMF and World Bank.



4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

44. **The proposed DPF supports major elements of NDP9 by strengthening fiscal management and promoting inclusive private sector-led growth.** The program development objective on ‘strengthening fiscal management’ supports various dimensions of the government’s program. For example, harmonization of revenue raising and sharing fishing revenues between the federal and state government is supportive of inclusive politics, while measures to improve PFM support NDP9 Pillar 2’s objectives, as well as contribute to building greater fiscal space, which in turn is a prerequisite for delivering the social services planned in NDP9’s Pillar 4. Going further, measures to strengthen the transparency and accountability of debt management supports an enabling environment for economic growth and furthers progress towards HIPC Completion Point, which is supportive of NDP9’s Pillar 3. The proposed reforms under the ‘strengthening inclusive private sector led growth’ program development objective directly support Pillar 3 on economic development. For example, the enactment of the Company Law and the issuance of mobile money regulations strengthen the regulatory basis for doing business in Somalia, with supportive measures to strengthen institutions.

45. **This DPF builds on lessons emerging from DPFs prepared in fragile environments, especially as part of a reengagement process.** An Independent Evaluation Group (IEG) report on engaging with fragile states highlights the need to focus on politically feasible reforms that can build momentum for future changes, with an emphasis on restoring and strengthening basic state functions.³⁴ Such operations should strike an appropriate balance between policy changes and institutional reforms. Hence, the proposed reforms seek to both support the development of policies as well as ensure that the institutional architecture is in place. The design and implementation of reforms are supported by World Bank investment projects (financed by the Multi-Partner Fund and IDA pre-arrears clearance grants), which means that policy dialogue and technical support needs have already been established with counterparts who are committed to the reengagement process. Finally, given capacity constraints, the preparation of this DPF has benefitted from close collaboration with development partners to ensure coordinated and complementary reforms are being supported.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1. Strengthen fiscal management

46. This pillar selects critical reforms in the areas of debt management, revenue mobilization, and intergovernmental fiscal arrangements from the government’s broader reform program. Reconstituting core fiscal management capacities for raising, sharing, and spending public resources has been at the core of the government’s reform program since 2012. The 2015 Systematic Country Diagnostic (SCD) argued that, to break out of the trap of political strife, fragility, and violence in Somalia, the Government must build its legitimacy by delivering of public goods and services. This means that all levels of government must be able to collect and then redistribute resources in the form of services and investments.³⁵

³⁴ Independent Evaluation Group, “World Bank Group Assistance to Low-Income Fragile and Conflict-Affected States: An IEG Evaluation,” 2013.

³⁵ World Bank Group, “Somalia Systematic Country Diagnostic,” Report number 123807-SO, May 2018.



47. Measures selected for this pillar complement important reforms that contain expenditure growth and that will support the rebalancing of spending toward poverty reduction and inclusive growth. Personnel costs, administration, and the security sector dominate government spending at this time, given the continued security threats and the pressing need to rebuild public institutions. The FGS is working to tighten controls on these recurrent expenditures so that, as conditions in the country improve and revenue mobilization increases, there will be fiscal space for the Government to devote funds to poverty reduction and inclusive growth.

48. Informed by a human resources audit conducted in 2018, the Government has taken major steps towards reducing leakage in the wage bill, which currently consumes an estimated 46 percent of total federal spending and 80 percent of domestic revenue. The Ministry of Labor completed a full headcount and biometric registration and verification of civilian FGS personnel in February 2019. The MoF led the biometric registration of Somali National Army (SNA) and Somali Police Force personnel, completed in March 2019. Payments of salaries to all personnel have transitioned from cash distribution to direct electronic transfers to bank accounts—reducing both leakage and exposure to corruption risks.

49. Achieving efficiencies in procurement is also important. Food rations for the security sector—beans, sugar, pasta, cooking oil, rice and wheat flour—are the largest non-personnel spending item in the FGS budget, accounting for approximately 20 percent of FGS goods and services procurement.³⁶ The World Bank's 2017 Security and Justice Public Expenditure Review (PER) underscores that weak PFM systems in the security sector have contributed to corruption and spending inefficiencies.³⁷ Historically, rations were procured entirely through one single-source contract. In February 2019, the Cabinet issued a decree that tightened controls on rations spending by requiring that all existing security goods and services contracts to be re-tendered through competitive bidding. This reform has achieved savings estimated at US\$7.6 million to date in reduced procurement costs through lower unit prices resulting from greater competition.³⁸ Furthermore, amendments to the 2016 Procurement and Concessions Act are expected to be approved by Parliament in 2020 and should result in additional efficiencies.

Policy area: Debt management

Prior Action 1. To increase transparency and accountability of debt management, the Recipient has enacted the Public Financial Management Law.

50. **Rationale.** Public debt levels rose to unsustainable levels in the 1980s in the absence of adequate legal and institutional mechanisms to guide borrowing and ensure accountability, and public debt management in Somalia collapsed after 1991 during the civil war, along with other institutions. After the creation of the FGS and as the country began to reengage the international community with an eye towards receiving debt relief, strengthening debt management became a priority. In December 2015, MoF established a Debt Management Unit, which to date has focused its attention on reconstructing the public debt database and monitoring the accumulation of domestic and external arrears. Since then, the

³⁶ World Bank, "Somalia Programmatic PER: Overview Module," July 2019.

³⁷ World Bank, "Somalia Security and Justice PER," September 2017.

³⁸ Twenty-one different firms submitted bids for the four contracts that were tendered earlier this year, with the two largest contracts attracting 13 and 14 bids respectively.



Government has worked to establish a legal framework for public sector borrowing and debt management. Enactment of the PFM Law in December 2019 marks a crucial step forward.

51. **Substance of the action.** The PFM Law gives the finance minister sole power to borrow on behalf of the Government. It requires the minister, as a part of the annual budget submission, to present details on government indebtedness to the parliament, to explain the government's debt policy, and to present an analysis of the sustainability of public debt. The law also subjects government borrowing to annual ceilings set by parliament (set forth in an Appropriation Act), and it makes the general terms and conditions of government loans and guarantees be subject to parliamentary approval. Finally, the PFM Law requires that all loan agreements must be recorded by the Auditor General. The FGS may guarantee a loan entered into by an FMS, but the law prevents FMSs from borrowing externally.

52. **Expected outcome.** The debt management provisions of the PFM Law will support prudent fiscal policy and transparent debt management. After Somalia has received debt relief and regains access to external sources of financing for development priorities, these provisions will provide strong controls on borrowing that should reduce the risk that public debt will once again grow unsustainably. Until then, the PFM Law is expected to contribute to increased debt transparency. This will become important once Somalia reaches the HIPC Decision Point, when it will clear arrears with IFIs, restructure its debt with other major creditors, and resume paying debt service. Full transparency about the changing state of public indebtedness will enable citizens to hold policy makers accountable. Increased transparency will be measured by publication of quarterly debt bulletins. Ongoing AfDB technical assistance that supports rebuilding the capacity of the Debt Management Unit will contribute to the realization of this outcome, as will World Bank and IMF advisory work through the Debt Management Facility.

Policy area: Revenue mobilization

53. Somalia's chronically low level of revenue mobilization critically limits the government's ability to provide the public goods (security, first and foremost), invest in human and physical capital, and deliver public services that the country needs to reestablish the social contract and move towards a trajectory of inclusive growth and poverty reduction. Establishing a legal and institutional framework that will promote increased revenue mobilization is at the top of the government's reform agenda.

Prior Action 2. To increase revenue mobilization potential, the Recipient has enacted the Revenue Administration Law.

54. **Rationale.** Somalia's tax system has been characterized by outdated legislation, poor enforcement, and weak tax administration.³⁹ Its legal framework is based on conditions and practices that prevailed in the country before 1990, including some features that date from the 1960s. One chief difference is that Somalia no longer has a unitary state. In the absence of laws defining the assignment of revenue-raising powers to different levels of government, jurisdictions have competed with one another for tax revenue. This has contributed to what might be called a race to the bottom in customs duties.⁴⁰ There is thus a clear need to modernize the legal framework for revenue administration.

³⁹ A detailed analysis of Somalia's tax system and its evolution can be found in World Bank, "Somalia Economic Update: Mobilizing Domestic Revenue to Rebuild Somalia," July 2017.

⁴⁰ This form of tax competition is documented in Thomas Cantens, "Somalia: Assessment of Customs Revenue Potential and Proposals for Reform," World Bank, September 2018.



55. **Substance of the action.** The Revenue Administration Law was enacted in October 2019. The law defines (for the first time) which revenue instruments are to be regulated at the federal level. Although the law does not dictate which level of government will collect any given tax (e.g., customs duties), it nonetheless provides a legal basis for the FGS to work with the FMSs to harmonize tax rates across the country. In addition, the law establishes modern procedures for administration of inland revenue that the FGS collects. It sets forth basic procedures for tax payments and refunds—including requiring a unique tax identification number—as well as rules for compliance, enforcement, and dispute resolution.

56. **Expected outcome.** Enactment of the law is expected to boost revenue collection substantially. The law strengthens the government’s legal authority to enforce payment of taxes, particularly the authority of the newly established large and medium taxpayer’s office, as it seeks to collect revenue from large private sector actors. Providing clarity over revenue-raising power is critical for harmonization of tax policies and administration and thereby for reducing incentives for tax competition. The expected outcome is increased inland tax revenue mobilization. This will be measured as a 30 percent real increase in FGS tax revenue collection between 2018 and 2021. Financial and technical support from the World Bank and IMF Fiscal Affairs Division will help support achievement of this outcome.⁴¹

Policy area: Intergovernmental fiscal arrangements

57. Arguably no dimension of fiscal management reform is as politically challenging as establishing intergovernmental fiscal arrangements for a federal political system. The framers of Somalia’s 2012 Provisional Constitution were unable to reach agreement on a framework that defines how different levels of government collect, spend, and share revenue. The 2019 PFM Law contains provisions that establish accounting and reporting procedures for natural resource revenue (including from fisheries) that federal and state governments decide to share. As the country works through the lengthy constitutional reform process to construct a comprehensive framework for fiscal federalism, political leaders are working to develop incremental arrangements in focused areas.

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.

58. **Rationale.** The March 2019 agreement on the distribution of fishing license revenue is the first, albeit incremental, agreement on sharing national revenue across jurisdictions. With the longest coast in continental Africa and a productive marine ecosystem, the Somali fishing industry has the potential to develop into an important source of jobs, income, and economic activity.⁴² In the absence of a revenue-sharing arrangement, competition between state and federal jurisdictions for fisheries revenue would not only risk reducing total revenue collected by all jurisdictions, but it could also result in overfishing and increased tensions between jurisdictions. A successful revenue-sharing arrangement for fishing license

⁴¹ Two World Bank IPFs directly support improvements in revenue generation: The Domestic Revenue Mobilization and Public Financial Management Capacity Strengthening Project (P166206) and the Recurrent Cost and Reform Financing Project—Additional Financing (P167224), both approved in FY19. The domestic revenue module of the Programmatic PER (P160458), to be delivered in FY20, will provide analysis to inform additional improvements in revenue collection.

⁴² For information on the potential of Somalia’s fishing industry, see World Bank and Food and Agriculture Organization, “Somalia Country Economic Memorandum, Volume 1: Building Resilient and Sustainable Agriculture in Somalia,” 2018.



revenue, on the other hand, could foster greater intergovernmental fiscal cooperation and contribute to improved fisheries management.

59. **Substance of the action.** On March 22, 2019, the Ministry of Fisheries and Marine Resources of the FGS signed an agreement with counterpart ministries the Puntland, Jubbaland, Southwest, Galmudug, and Hirshabelle States. The agreement states that revenue that the FGS collects from tuna fishing licenses shall be distributed as follows: 29 percent of total revenue to the FGS, 18 percent to Puntland State, 14 percent to Hirshabelle State, and 13 percent each to Galmudug, Jubbaland and Southwest States. The parties also agreed to earmark 40 percent of their budgets “for the development, management and storage of the fisheries and marine resources as well as for covering the needs of the local/Somali fishermen.”⁴³ The federal fisheries ministry received US\$1.04 million in 2019 from tuna fishing licenses, which the FGS has distributed according to the formula.

60. **Expected outcome.** The 2019 fisheries revenue-sharing agreement is expected to increase future fisheries revenue and to set a positive precedent for intergovernmental revenue-sharing arrangements in Somalia, especially revenue from natural resources. Because of the uncertainty about the government revenue potential of the fisheries industry and the limited experience with revenue-sharing agreements, the agreement is effective initially for 18 months (i.e., until September 2020), but it states that there shall be a final agreement that will also be binding (Article 6.1). The authorities have confirmed that the terms will remain valid beyond September 2020 while they conduct the review and develop a permanent revenue-sharing arrangement (see Letter of Development Policy (LDP) in Annex 3). Revenue raised during the current licensing round, which is expected to conclude shortly, will therefore be governed by the March 2019 agreement. The World Bank is providing technical assistance to support this licensing round as well as redrafting of the Fisheries Law, which is expected to incorporate the provisions of the March 2019 agreement. Furthermore, the World Bank is also assisting Somalia to develop broader intergovernmental arrangements through support for the Finance Ministers Fiscal Forum, analysis on fiscal federalism, and channeling funds from IPF to work at the subnational level.

61. The success of the March 2019 fisheries agreement has helped to build trust between the federal and state government, as evidenced by the agreement reached in September 2019 by the federal and state finance ministers to share proceeds from EU budget support grants. As part of the constitutional review process, finance ministers are discussing whether to share revenue exclusively through sector- or revenue source-specific arrangements (the practice to date) or mainly through some overarching arrangement that applies to all revenue. Regardless of their modality, these arrangements would increase the flow of shared revenue to FMSs over time. In FY2018—i.e., prior to the 2019 fisheries agreement—no national revenue was allocated to FMSs. In FY2019, US\$738,000 was allocated (71 percent of the US\$1.04 million collected from the 2018 licensing round). Annual national revenue allocated to the FMSs is expected to double by FY2021, reaching US\$1.5 million, through a combination of increased fee revenue from fishing licenses (expected to grow by 80 percent) and the extension of allocation to other sources of national revenue.

⁴³ FGS, Ministry of Fisheries and Marine Resources, “Agreement: Management and Revenue Sharing,” REF: WKKHB/XW/19, March 22, 2019.



Pillar 2. Promote inclusive private sector-led growth

62. Somalia's private sector has transformed itself during the decades of conflict and state fragmentation. New private enterprises emerged to fill voids left by the collapse of central planning (e.g., electricity generation). Others responded to new market demands (e.g., to transfer remittances from the diaspora) or technological innovation (e.g., mobile telecommunications). The mobile money sector flourished—a testament to the creativity and resilience of Somalia businesspeople.

63. To harness this energy, promote inclusive private sector-led growth, generate jobs, and facilitate economic transformation, the Government has been working to put in place a legal, policy and institutional framework that supports a competitive market economy. The post-2013 reform program described in preceding sections includes basic laws governing private sector activity that did not exist during the period of central planning (e.g., the Company Law and the draft Insurance Law). It includes laws and regulations to reestablish the central bank and its supervision over the financial sector. CBS created a new payments system unit in October 2019 and is drafting a Payments System Law. The authorities are preparing a Targeted Financial Sanctions Law, which will strengthen AML/CFT enforcement. The Government is also working to ensure a level playing field in the economy through laws and regulations aimed at eliminating conditions that can lead to anti-competitive and rent-seeking behavior. Pillar 2 of the proposed DPF supports selected measures from this ongoing reform program.

Policy area: Business and investment climate

Prior Action 4. To strengthen the environment for private sector competition and market entry and exit, the Recipient has enacted the Company Law.

64. **Rationale.** Somalia's private sector has grown despite years of insecurity, state fragmentation, and other substantial challenges. However, the business regulatory environment suffers from weak (or absent) rules and inadequate enforcement, which heighten the risks of elite capture and reduce trust. Furthermore, lengthy and opaque procedures (that were developed in the absence a clear legal framework) make it costly to start new firms or for small firms to grow, thus reducing market contestability and the potential for job creation and economic transformation.

65. **Substance of the action.** The Company Law was passed by the parliament in November 2019 and enacted by the president in December 2019. It creates the Office of the Company Registrar and provides for streamlined rules for starting a company. The law also establishes the basic requirements for financial and operational reporting by companies, shareholder rights, responsibilities of directors, and dissolution of firms that provide the foundation for a competitive market economy. This is a new law that will replace pre-1991 legislation.

66. **Expected outcome.** The reform will make it easier for new firms to form, enter markets, and transact with one another. This in turn will contribute to growth of dynamic and competitive markets that can generate the jobs and incomes needed for inclusive economic growth. Expansion of the formal economy will also broaden the tax base. WBG investment and advisory projects are providing support to the Ministry of Commerce and Industry to develop and make operational the on-line business registration system and to prepare implementing regulations that will, inter alia, protect minority shareholders rights, introduced standardized corporate documentation, and make operational the Office of the Company



Registrar.⁴⁴ Results will be measured by the intermediate outcome of the use of an on-line system to register new businesses. Currently all registration is manual and paper-based. In 2021, it is expected that an on-line system will be operational, and that 80 percent of new company registrations will take place through this system. Over time all the current manual, paper-based system will be fully phased out. Over time the reform's impact will also be reflected in Doing Business indicators measuring the time and cost to start a new business and the strength of minority shareholder rights.

Policy area: Sectoral and financial policies

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.

67. **Rationale.** The information communications and technology (ICT) sector, especially mobile communications, flourished in the political and regulatory vacuum that followed the collapse of the Siad Barre regime in 1991. This has in turn enabled the emergence of the mobile money industry. The ICT sector has become concentrated, however, as the sector is dominated by a single operator, a second player with strength in certain regions, and a few smaller players. Furthermore, few operators in Somalia are interconnected with each other, thus stifling market competition and reducing the quality of telecommunications and mobile money services provided to consumers. The 2017 Communications Act established the National Communications Authority (NCA) and began to lay the basis for a regulatory framework that encourages competition.

68. **Substance of the action.** The NCA approved and issued the Interconnection Regulation in October 2019, after several rounds of stakeholder consultations. The regulation establishes procedural and substantive requirements for interconnection negotiations and agreements. It requires an operator to begin negotiation of an interconnection agreement upon request of another operator. And it requires that technical and commercial terms in interconnection agreements be nondiscriminatory and transparent. For example, an operator must provide an equivalent quality of service to interconnection operators that it provides to its own customers.

69. **Expected outcome.** The regulation will facilitate interconnections between mobile network operators, thus improving competition and the quality of ICT services provided to households and firms in Somalia, as well as enabling other services (e.g., mobile money and digital government services) that rely on ICT services. This result will be measured by the share of mobile network operators that have signed interconnection agreements. Prior to this regulation, no operators had signed an interconnection agreement. The target for this result indicator is that 80 percent of mobile network operators will have entered into an interconnection arrangement by the end of 2021. The regulation will also help to limit an important channel for anti-competitive behavior in the telecommunications industry. Financial and technical assistance provided to the National Communications Authority through the World Bank IPFs and the IFC SUSIP Project will support realization of expected outcomes.⁴⁵

⁴⁴ Projects include the SCALED-UP IPF (P168115) and the IFC Investment Climate Reform Project advisory services (IFC 603600).

⁴⁵ These include the Additional Financing: ICT Sector Support in Somalia (Phase 2) IPF (P164441), approved FY18, and IFC Somalia Unlocking Sectoral Investment Program (SUSIP) advisory services (IFC 603088).



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).

70. **Rationale.** Building on the expansion of mobile communications discussed above, the use of mobile money has also increased rapidly in Somalia, largely superseding the use of cash.⁴⁶ As noted in Section 2.1, a majority of Somalis use mobile money—to make purchases, receive salary, pay bills, or to send or receive remittances. Usage is high in rural as well as urban areas, and by women as well as men. An estimated 155 million transactions take place each month on average. Despite mobile money's ubiquity, the system is vulnerable to technical disruptions, anti-competitive behavior, or other abuse. This poses risks to individual users and to the stability of the economy's payments system. The industry grew rapidly in a regulatory vacuum, and consequently provides little or no protection for consumers. Historically there have been no systematic know-your-customer requirements, thus making AML/CFT efforts difficult. Neither has there been a requirement that money held in mobile money wallets be matched by funds in a financial institution. Because of the pervasive use of mobile money in Somalia, the failure of a mobile money operator would undermine the domestic payments system and erode household savings. The World Bank and IMF have been providing the financing and technical support to help Somalia construct a regulatory framework to address these risks while extending the benefits of mobile money to more Somalis.

71. **Substance of the action.** CBS issued the Mobile Money Regulations (CBS/NBS/REG/06) in July 2019. Developed through extensive stakeholder consultations, the regulations extend central bank supervision to the mobile money sector by creating a framework for the licensing, regulation, and supervision of mobile money services; providing a consumer protection framework for consumers of mobile money services; and establishing a framework to prevent mobile money services from being abused for money laundering and terrorism financing. The regulation gave existing mobile money operators (MMOs) six months to apply for a license. To protect customers and ensure overall financial stability in the sector, the regulations require MMOs to continuously maintain funds in its bank account equal to the amount of mobile money issued to consumers. Operators must establish the data and information security protocols needed to ensure operational stability. The Mobile Money Regulations impose specific “know your customer” provisions on MMOs and require them to comply with AML/CFT laws and regulations.

72. **Expected outcome.** The regulation is expected to strengthen stability of the mobile money industry and thereby the financial sector, build trust, increase transparency, and protect consumers. The initiation of regular publication of financial stability and related statistics of the mobile money industry will serve as an indicator. A World Bank ASA is supporting CBS's implementation of the regulations and outreach to MMOs on regulatory compliance.⁴⁷ Continued World Bank financial and technical assistance to CBS under the SCALED-UP IPF (P168115) will also support realization of these expected outcomes.⁴⁸

⁴⁶ For background on the rise of mobile money in Somalia and its implications, see World Bank, “Somalia Economic Update: Rapid Growth in Mobile Money—Stability or Vulnerability?” August 2018.

⁴⁷ Implementation Support: Regulatory Framework for Mobile Money in Somalia (P171387).

⁴⁸ Somalia Capacity Advancement, Livelihoods and Entrepreneurship, through Digital Uplift Project (SCALED-UP) (P168115) approved FY19.



Table 4. DPF Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Operation 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.	An advisory note prepared by the Financial Governance Committee suggests that the PFM Bill should be strengthened to include provisions on debt management. Specifically, it was suggested that the Minister of Finance should have the sole authority to borrow on behalf of the FGS and issue guarantees, and that Parliamentary approval is required. These recommendations have been incorporated in the revised PFM Law.
Prior Action 2. To increase revenue mobilization potential, the Recipient has enacted the Revenue Administration Law.	<i>The Somalia Economic Update 4</i> , World Bank, 2017 and <i>An Assessment of Somalia’s Revenue Potential: A Way forward for Customs Reforms</i> , Cantens, 2018 explain how the legal framework for taxation in Somalia is underdeveloped where different customs authorities have various tax regimes, which undermines efficiency. <i>Somalia Economic Update 2</i> , World Bank 2017, provides a detailed analysis of Somalia’s tax system and its evolution.
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.	To support the transparent and equitable management of natural resources, the <i>Financial Governance Report</i> , May 2018, produced by the Financial Governance Committee (supported jointly by the IMF, World Bank, and the EU), underscored the need to agree a framework for sharing federal offshore fishing revenues with FMSs.
Operation 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.	<i>The Somalia Economic Update 3—Rapid Growth in Mobile Money? Stability or Vulnerability</i> , World Bank 2018, discusses how firms currently operate in a regulatory void, which hinders the business environment. Developing the legal framework to strengthen the environment for competition in the private sector is a specific recommendation in the report.
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.	<i>The Somalia SCD</i> , World Bank 2018 discusses how the lack of interconnection across services requires users to buy multiple SIM cards which has reduced competition by squeezing small players to the detriment of the growth of the digital economy.
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).	<i>The Somalia Economic Update 3—Rapid Growth in Mobile Money? Stability or Vulnerability</i> , World Bank 2018, highlights how the legal framework for telecommunications needs to be improved to promote financial stability of mobile money and guarantee consumer protection.



4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

73. **The proposed DPF achieves the interim goal of Focus Area 1 in the FY19–FY22 Somalia Country Partnership Framework (CPF): “to secure normalization of Somalia’s relations through the HIPC process.”**⁴⁹ In addition, the reform program supported by the proposed DPF complements the IPFs, ASA, and IFC Advisory Services identified in the CPF in achieving several of its major objectives.⁵⁰

74. **DPF Pillar 1:** Prior actions on debt transparency, expenditure containment, and budget accountability are aligned with CPF objective 1.1 (“Improve public finance management and institutional effectiveness”). Prior actions on revenue mobilization and intergovernmental revenue sharing are aimed at CPF objective 1.2 (“Enhance domestic revenue mobilization and resource sharing”). The World Bank currently provides financing that supports these prior actions through the RCRF (P167224), and the Domestic Revenue Mobilization and Public Financial Management Capacity Strengthening (P166206), and Capacity Injection (P149971) projects.⁵¹ A programmatic PER is delivering modules in FY2020 on revenue mobilization, PFM, the wage bill, and fiscal federalism that will inform implementation of Pillar 1 reforms. World Bank advisory support to the Financial Governance Committee provides critical oversight over these and related reforms.

75. **DPF Pillar 2:** Prior actions on the business environment and regulation of the telecommunications industry are aligned with CPF objective 2.1 (“Improve the business environment and lowering barriers to entry”). Prior actions on the financial sector are aligned with CPF objective 2.2 (“Access to finance to increase inclusion and digital development opportunities”). The World Bank currently provides financing that supports these prior actions through the Somali Core Economic Institutions and Opportunities (P152241), ICT Sector Support in Somalia Additional Financing (P164441), and SCALED-UP (P168115) projects and technical assistance on implementation of the mobile money regulation. The IFC currently provides advisory services through the Somali Unlocking Sectoral Investments (IFC 603088) and Somali Investment Climate Reform (IFC 603600) projects that support implementation of the Company Law and Interconnection Regulation.

76. **A Performance and Learning Review will guide the adjustment of the CPF program and guide the use of resources that will be available after arrears clearance.** An application for a country allocation under IDA18 and IDA19 turnaround facilities is under preparation. Somalia will also be eligible for other IDA facilities and for IFC investments upon normalization of relations.⁵²

77. **The proposed DPF is an essential step towards realizing the WBG strategy.** Normalization of relations with the IFIs is an eligibility requirement for HIPC debt relief and can help Somalia unlock additional and more predictable support from the international community. Somalia critically needs this support to implement its poverty reduction strategy (NDP9), increase the country’s resilience to climatic shocks, and foster inclusive economic growth.

⁴⁹ The Board of Executive Directors discussed the Joint IDA/IFC/MIGA CPF for Somalia for the Period FY19-FY22 (IDA/R2018-0291, IFC/R2018-0280, MIGA/R2018-0128) on September 25, 2018.

⁵⁰ Until FY2019, the Multi-Partner Fund and other trust funds financed all IPFs. In FY2019 and FY2020, IDA allocated approximately US\$140 million per year on an exceptional basis for pre-arrears clearance grants.

⁵¹ These three IPFs are commonly referred to as the “Troika.”

⁵² Major facilities include IDA’s Crisis Response Window, Regional Window, and Window for Host Communities and Refugees.



4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

78. **The proposed reforms in this DPF support NDP9, which was prepared in a consultative manner.** The NDP9 benefitted from two rounds of consultations, which support the principles behind Pillar 1 concerning inclusive politics. The first round of consultations focused on poverty analysis and drew upon the participation of stakeholders from civil society, the private sector, FGS or FMS line ministries, and representatives of the National Parliament of FMS Assemblies. The poverty analysis considered the drivers of poverty, coping mechanisms and actions to reduce poverty. A second round of consultations was launched in May 2019 with substantial inputs sought from the National Development Council and the high-level officials in the FGS and FMS, as well as the private sector. The second round of consultations stressed the importance of narrowing and deepening the scope of NDP as well as prioritizing interventions. The outcome of the consultations is reflected in the preparation of NDP9 which also describes the consultative process.

79. **In addition, the Government has undertaken in-depth consultations with stakeholders relevant to measures in its economic policy reform program that are supported by the proposed DPF.** In some cases, these consultations were facilitated by WBG activities. For example, IFC Advisory Services projects are supporting a public-private dialogue mechanism that has provided an important avenue for the Government to engage the private sector on the Company Law and its forthcoming implementing regulations, as well as other measures to improve the business enabling environment. World Bank and IFC projects also supported CBS's stakeholder consultations on the Mobile Money Regulation and NCA's consultations on the Interconnection Regulation. Similarly, the federal MoF consulted extensively with the FMSs on the PFM and Revenue Administration Laws.

80. **As part of the process of securing HIPC debt relief and Somalia's reengagement with the international community, the proposed DPF is being developed in close collaboration with development partners.** Throughout the HIPC process, the World Bank has closely collaborated with other IFIs. Specifically, the World Bank has worked closely with the IMF in reforms concerning fiscal management and financial sector regulation. There has been close collaboration with the AfDB to coordinate progress on seeking resources to support arrears clearance. The EU has also been a close partner for budget support-related activities, coordinating reforms to complement the World Bank's Recurrent Cost Reform Financing project. There have been regular outreach activities on the HIPC process with the broader development community, including bilateral partners and United Nations (UN) agencies. The regular outreach activities have contributed to broad support for the HIPC process and have bolstered an understanding of the benefits of Somalia's reengagement with the international community.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

81. **Prior actions under the DPF are expected to have positive poverty and distributional effects in the medium to long term.** Data limitations constrain short-term quantitative analyses of the poverty and social impact of the prior actions. The analysis below describes the channels through which the actions contribute to poverty reduction.

82. **Prior actions under Pillar 1 are expected to have direct and indirect positive effects on poverty alleviation and increasing resilience of the Somali population.** The positive effects are expected as



actions create fiscal space that can be directed to improving public service delivery, robust safety nets and ultimately contribute to poverty reduction. Overall, the prior actions under Pillar I support the government's efforts to strengthen fiscal management by establishing a framework that creates transparency and accountability in spending and improves the potential for revenue mobilization. In addition, greater transparency and accountability provides a critical foundation for protecting the poor and vulnerable from abuses and unfair treatments. Specific effects are as follows:

- Enactment of the PFM law will improve debt management and contribute to macroeconomic stability and long-term debt sustainability. This action has medium-term positive effects on poverty reduction by enabling economic growth that foster job creation and better government revenue generation.
- Enactment of the Revenue Administration Law will increase the government's capacity to raise revenue, thus relaxing the primary constraint on the government's capacity to provide services and make investments to reduce poverty. Increased revenue has positive effects in the medium- to long-term through its use in pro-poor spending, as envisioned in NDP9.
- Increased revenue sharing has potential long-term positive effects through FMSs' use the funds for anti-poverty and vulnerability programs.

83. Prior actions under Pillar 2 are expected to have a positive impact on poverty by expanding financial inclusion and digital economy over the medium term. The Somali private sector is dominated by micro, small and medium-sized enterprises, many of which are informal and unregistered. Low-income individuals in Somalia tend to be self-employed or own a small business and have little access to the formal banking systems. Mobile money usage is remarkably high in Somalia, even among the poor, and is an important channel for means of exchange and domestic remittance flows. The regulation of the mobile money market effected through Prior Action 6 will reduce system vulnerabilities and help to safeguard consumer funds, which the poor cannot afford to lose. Regulation of mobile money can contribute to financial inclusion, equity, and resilience, especially within a context where access to banking services are limited. Expected effects of other prior actions are as follows:

- The Company Law has potential medium-term positive effects as streamlined business registration procedures encourage establishment of new businesses that in turn generate employment. However, as this mainly affects the formal sector while most of the poor are engaged in micro, small and medium enterprises, the benefits of this action will take time to reach the poor and vulnerable.
- Requiring mobile services providers to enter into interconnection agreements contributes to poverty reduction in the medium- to long-term by reducing transactions costs in making mobile money transactions (since interconnection is a prerequisite for cross-network payments) and by constraining anti-competitive pricing behavior by telecommunications operators. The reform can also have long-term effects to the extent that a broader digital economy creates opportunities to enable a digital workforce and expand reach and usage of digital financial services.

5.2. ENVIRONMENTAL ASPECTS

84. Environmental laws, policies, and institutions are still evolving in Somalia. Article 25 of the 2012 Provisional Constitution establishes that all Somali's have the right "... to an environment that is not harmful to their health and well-being, and to be protected from pollution and harmful materials" and "... to have a share of the natural resources of the country, whilst being protected from excessive and damaging exploitation of these natural resources." The Provisional Constitution calls on the FGS (in consultation with the FMSs) to adopt general environmental policies. To start this process, the FGS has



established the Directorate of Environment within the Office of the Prime Minister. The directorate is mandated to draft national environmental policies and legislation, including inter alia those that will government environmental quality standards, sectoral environmental assessments, environment impact assessments, and environmental audits.

85. The agreement on intergovernmental revenue allocation in Prior Action 3 may indirectly make a positive contribution to improved fisheries management. The allocation of fishing license revenue across jurisdictions itself does not directly harm or benefit the environment, forests, and other natural resources. But the 2019 fisheries agreement requires parties to devote 40 percent of the revenue they receive from the sector to the “development, management, and storage of the fisheries and marine resources as well as for covering the needs of the local/Somali fisherman” (Article 3.1). In addition, the revenue-sharing agreement is associated with issuing licenses to catch tuna in Somalia’s exclusive economic zone that may contribute to improved management of Indian Ocean tuna. Somalia is a member of the Indian Ocean Tuna Commission (IOTC), which has the mandate to manage tuna and tuna-like resources in the Indian Ocean. IOTC currently imposes a fishing limit on fleets for a particular species (e.g., Yellowfin tuna). Although Somalia’s fishing licensing regime is not a tool for preventing overfishing, the information that Somalia collects may help IOTC validate some of the data it receives from fishing fleets and thereby strengthen IOTC’s management of tuna resources in the Indian Ocean. This effect may be small, however, as fishing activity along Somalia’s coast is small relative to total fishing in the Indian Ocean.⁵³ The World Bank has been providing technical and analytical support to the Ministry of Fisheries and Marine Resources since 2017. It is currently developing technical assistance (TA) to support revisions to fisheries legislation that would strengthen sustainable fisheries management.

86. Other prior actions in Pillar 1 are unlikely to directly affect Somalia’s environment, forests, or other natural resources, but they contribute to a macroeconomic and fiscal environment that is more conducive to effective environmental management. Policies that improve debt management, increase domestic revenue mobilization, contain wage bill growth, and strengthen controls on spending contain no provisions on environmental management.⁵⁴ They create fiscal space, strengthen institutions for fiscal management, and contribute to macroeconomic stability. These in turn create preconditions for the authorities to more effectively manage the country’s natural resources.

87. Actions in Pillar 2 are unlikely to directly affect Somalia’s environment, forests, or other natural resources. The prior actions aim to establish a business and investment climate and sectoral regulations that favor formalization, investment, competition, and reduced transactions costs. None contains measures related to Somalia’s natural resources. The prior actions are expected to contribute to employment and income creation in the long term. For example, by providing more alternatives to environmentally harmful economic activities (e.g., charcoal production), these measures may indirectly have long-term beneficial effects.

88. The World Bank is currently preparing a country environmental assessment. This will review the most critical environmental issues facing Somalia and assess the country’s policies and institutions that

⁵³ The total longline catch in 2017 in the Indian Ocean is 193,417 tons, while the current estimated catch of the long-liners operating in Somalia is around 7,500 tons.

⁵⁴ The Revenue Administration Law (Prior Action 2) states that royalties, license fees, profit shares and other revenues imposed with respect to natural resources are to be regulated at the national level by the FGS. However, the law does not create any new revenue instruments or set rates of existing instruments (e.g., tuna fishing fees).



can address these issues. The analysis is expected to be completed in FY20. In parallel, a climate risk assessment is being prepared to screen potential development interventions for long-term sustainability.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

89. **This DPF entails two Management-granted exceptions to the World Bank’s DPF Policy and Directive.** The first exception is to the Directive for DPF, which does not permit the signing of legal agreements for DPF if there are payments of IDA credits that are overdue by 30 days or more unless, in exceptional circumstances, Management approves the signing. The second exception is to the Directive for DPF (Bank Policy (BP) 8.60), which provides that, in the case that there are payments under any IDA credit to the member country that are overdue by 30 days no new operation be submitted to the Executive Directors unless an exception is granted by Management. These exceptions are necessary to facilitate the complex transactions involved in the clearance of Somalia’s arrears. Management granted both exceptions on January 23, 2020.

90. **The FGS has been progressively rebuilding its core PFM systems in the context of the PFM Action Plan 2016–2020.** The FGS is building a modern legal framework, enacting the Procurement and Concessions Law in 2017 and, in 2019, replacing a PFM framework dating to 1961 with enactment of the new PFM Law. The annual budget is passed on time and the budget documentation covers the basic elements to meet minimum levels of transparency (see paragraph 92). The implementation of the Somalia Financial Management Information system (SFMS) has enabled the Government to produce financial reports covering all expenses in the budget, produce quarterly fiscal reports and annual financial statements via the system. The Government has taken a significant step towards strengthening cash management, operationalizing a treasury single account (TSA) in 2017, consolidating all bank balances of ministry, department, or agency (MDAs) via the SFMS and significantly reducing cash advances to MDAs for non-salary expenses, and implementing a cash-forecasting system to inform allotments which are issued prior to commitment. Biometric verification of FGS personnel (both civilian and security), replacing cash payments with direct deposit, and integration of payroll into the SFMS have strengthened payroll controls.⁵⁵ The Government has undertaken a complete stocktaking and recording in the SFMS of all payroll, goods, services obligations that are in arrears. Since 2016 it has refrained from accumulating new domestic expenditure arrears (a commitment under successive IMF SMPs). The Financial Governance Committee, established in 2014 by agreement between the FGS and international partners, has increased scrutiny over new and existing contracts. The Auditor General is moving to adopt International Standards for Supreme Audit Institutions. There is timely completion of audits and capacity is being strengthened to carry out security sector audits.

91. **Notwithstanding these achievements, there are several areas that still need improvement.** Although the new PFM Law has been passed, its implementing regulations must be drafted and issued. The Audit Bill and the amendments to the Procurement and Concessions Law remain to be enacted. Apart from a few basic fiscal rules mentioned in the Appropriation Act, there is no comprehensive fiscal strategy that drives the budgeting process and there is no practice of forecasting the impact of fiscal policy proposals. As a result, the credibility of the annual budget is questionable. Budget classification is guided

⁵⁵ In addition to saving money for the Government (by narrowing the scope for corruption and reducing leakage in the wage bill), these controls have ensured that people receive their pay on time. The average delay from the statutory payment date (28th of month) for the FGS civil service has declined from 86 days in 2015 to 1 day in 2018.



by the Government Financial Statistics Manual, however there is further room for improvement to obtain greater transparency. A functional classification is not used. Rules and processes of fiscal federalism are at a nascent stage including the arrangements for reporting. Additionally, the Government does not report on contingent liabilities or maintain consolidated data on financial assets. The overall cash management and commitment control processes require improvements. (Increased enforcement of commitment controls and tightening of procurement procedures are structural benchmarks under SMP4.)

92. **Budget transparency.** The FGS publishes the annual appropriation act and supporting documents on the MoF website. Quarterly financial statements produced by the Accountant General are also published on the MoF website. MoF also releases periodic analytical reports of the in-year revenue and expenditure outturn and supporting datasets with detailed, high-frequency data. The FGS Office of the Auditor General publishes on its website the audit of the annual financial statements of the FGS.

93. **Central bank capacity and safeguards assessment.** The IMF is currently (January 27–31, 2020) conducting a safeguards assessment of CBS. CBS financial statements for FY2016 were prepared based on International Financial Reporting Standards. The financial statements were audited based on International Standards on Auditing by an international audit firm, which issued a qualified audit opinion with emphasis on the matter. The audit report cited challenges in obtaining historical transaction data to ascertain the accuracy of the opening balances, assets, and liabilities. The audit report affirm CBS management has embarked on a process of reconciling the opening balances including reconfirming completeness and accuracy of the bank's assets and liabilities in the previous years. This process had not been fully concluded by the time the auditors concluded the audit. The auditors were therefore unable to determine whether any misstatement in the unaudited opening balances could have a material impact on the opening reserves of the bank, profit or loss and other comprehensive income for the prior years. The audit for the financial statements 2017 and 2018 is expected to be completed and reports published in the coming months.

94. **Grant amount.** The Recipient is the Federal Republic of Somalia, represented by the MoF. The total amount of the proposed IDA grant is for US\$420 million equivalent. Over and above the usual conditions for effectiveness (receipt of a legal opinion satisfactory to IDA, the macroeconomic program being satisfactory, and the reform program on track), Board approval is being sought subject to an additional effectiveness condition that is reflected in the Financing Agreement, which requires Somalia's arrears to the World Bank to be cleared before both portions the grant can be disbursed. The grant will be disbursed in one tranche following notification by IDA of effectiveness of the Financing Agreement.

95. **Disbursement mechanism and flow of funds.** The proposed DPF will follow the World Bank's disbursement procedures for DPF. Upon effectiveness, IDA will disburse the proceeds of the grant (i) for direct reimbursement to the institution extending the bridge-loan of up to US\$375 million for arrears clearance; and (ii) the remaining US\$45 million into a foreign currency account of CBS dedicated to the DPF for FGS budget support. The DPF account will be mapped and aggregated as part of the government-wide TSA. Upon receipt, CBS will notify the FGS of receipt of the funds into its account, with copy of the notice to the World Bank. In addition, the FGS will provide IDA with confirmation within 30 days after disbursement that an equivalent amount of the proceeds received into the dedicated account has been accounted for in the FGS Somalia Financial Management Information System as revenues (using the Standard Chart of Accountant (SCOA) full coding segment, SCOA bank account ledger code). CBS will take steps to transfer the funds into the FGS treasury single account through a Designated Bank Account to support the financing of the budget. Disbursements of these proceeds will not be linked to any specific



purchases and no procurement requirements must be satisfied, except that FGS is required to comply with the standard negative list of excluded items that may not be financed with World Bank credit proceeds, as shall be in the Financing Agreement. If any portion of the grant is used to finance ineligible expenditures as defined in the Financing Agreement, the World Bank has the right to require the government to promptly, upon notice from the World Bank, refund the amount equal to such payment to IDA. Amounts refunded to IDA will be cancelled from the grant.

96. **Reporting and accounting.** The FGS will provide an irrevocable instruction to IDA for direct disbursement to the institution that will extend the bridge loan. As a due diligence measure, IDA will obtain written confirmation from the bridge lender that funds have been received. 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 will not require specific tracking of the end use of the DPF funds, except as required by government PFM procedures and budgetary controls.

97. **Auditing arrangements.** 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 TSA through the designated account. The audit will be essential more so, if in the opinion of the World Bank, the control environment ceases to be effective at any time during implementation. In such a case, the federal MoF, on request from the World Bank, shall provide full details of the off-shore bank accounts to which the DPF funds are disbursed (whether in U.S. dollar or any other alternative currency) and related transactions, audited based on audit terms of reference acceptable to the World Bank. The audit report shall be submitted to the World Bank within a period of four months after the World Bank's request for the audit. The audit will be conducted by the Federal Republic of Somalia Office of the Auditor General with support of technical assistance firm, if required.

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

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

99. The MoF has the lead responsibility for the coordination, monitoring, and ensuring ultimate completion of the prior actions. Monitoring of results from the proposed DPF will build on mechanisms that the ministry has developed for managing the SMPs, which it intends to broaden for monitoring implementation of HIPC Completion Point commitments. Recognizing the government's capacity constraints, prior actions for the proposed DPF were selected to complement the ongoing support provided under World Bank and EU projects. This is expected to minimize the additional workload associated with DPF monitoring.

100. **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.

6. SUMMARY OF RISKS AND MITIGATION

101. **Overall risks to this DPF are high.** The enduring legacies of conflict and state collapse pose risks to policy reform in general. The principal risks to the proposed DPF are political and governance (high), macroeconomic (high), fiduciary (substantial), and institutional and capacity (substantial). These are elaborated below.

102. **Political and governance risks are high.** Election disputes, increased tensions between federal and state governments, or increased insurgent attacks on political leaders could undermine the commitment to economic reforms that are needed to achieve the DPF's objectives. Measures aimed at revenue mobilization and allocation require support from FMS political leaders, for example, which can politicize the process and making reforms challenging to implement. The Finance Ministers Fiscal Forum has provided one important channel for the authorities to depoliticize these reforms and mitigate political and governance risks. IFI normalization and the HIPC Initiative provide a broader framework for risk mitigation by providing incentives for political leaders to collaborate around breaking the vicious circle of weak state capacity, conflict, and persistent vulnerability.

103. **Macroeconomic risks are high.** The Somali economy is vulnerable to shocks—including from adverse weather, disruptions in international trade or external payments, or unexpectedly low government revenue mobilization—that could result in macroeconomic instability that might overwhelm the reform momentum. The government is working to mitigate these risks through improvements in its macroeconomic management capacity. Many interventions planned under NDP9 are aimed at reducing the economy's vulnerability to shocks.

104. **Institutional and capacity risks are high.** Somalia's policy agenda is crowded and competing demands from domestic and external stakeholders could overwhelm the authorities' limited capacity to implement the reforms needed to achieve the DPF's expected results. Risks are mitigated by extensive financial and technical support from international partners, including the WBG. Indeed, the measures in the government's program that are proposed as prior actions in this DPF were selected in part to take advantage of ongoing support provided by World Bank IPFs and ASAs, and IFC Advisory Services.

105. **Fiduciary risks are substantial.** The government's legal framework, procedures, and operational systems are new and remain incomplete, posing significant challenges to the government overall reform program. Some risks to this operation are contained by disbursing much of the grant into an account outside the government system.⁵⁶ However, despite recent reforms, financial controls remain weak and there is an important fiduciary risk to the operation from failure to make effective and efficient use of the fiscal space made available by arrears clearance and budget support. Strengthening fiduciary systems remains an ongoing government priority. The new PFM Law (supported by this operation) will contribute

⁵⁶ As indicated in Section 5.3 above, while the Recipient of this grant is the FGS, an irrevocable instruction will be issued to disburse most of grant directly into an account belonging to the institution that will extend the bridge loan to the Government.



to reduction of fiduciary risk, as will continued support from World Bank IPFs and ASA and from IMF programs.

Table 5. 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	● Moderate
8. Stakeholders	● Moderate
9. Other	
Overall	● High



ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions	Results		
Prior Actions	Indicator Name	Baseline	Target
<i>Pillar 1—Strengthen fiscal management.</i>			
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		
<i>Pillar 2—Promote inclusive private sector-led growth</i>			
<p>Prior Action 4. To strengthen the environment for private sector competition and market entry and exit, the Recipient has enacted the Company Law.</p>	<p>Results Indicator #4: Business creation process streamlined through launch and operationalization of an on-line registration system</p>	<p>No on-line business registration (2019)</p>	<p>80 percent of new businesses registered are made through the on-line system (end-2021)</p>
<p>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.</p>	<p>Results Indicator #5: Increased number of telecommunications interconnection agreements completed</p>	<p>Zero (2018)</p>	<p>80 percent mobile network operators have at least one agreement (end-2021)</p>
<p>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).</p>	<p>Results Indicator #6: Increased transparency of mobile money transaction information through CBS publication of reports including mobile money deposits and other statistics</p>	<p>None published (2018)</p>	<p>At least three quarterly reports published (end-2021)</p>



ANNEX 2: IMF RELATIONS ANNEX



INTERNATIONAL MONETARY FUND



Press Release No. 19/420
FOR IMMEDIATE RELEASE
November 18, 2019

International Monetary Fund
Washington, D.C. 20431 USA

IMF Management Complete the First Review Under the Staff-Monitored Program with Somalia

On September 23, 2019, the Management of the IMF completed the first review under the fourth Staff-Monitored Program¹ (SMP IV) with Somalia, which covers the period May 2019–July 2020. Reforms in SMP IV focus on further efforts to mobilize revenues, including across the Federal Member States, strengthen public financial management, enhance financial sector stability, and strengthen compliance with the framework for anti-money laundering/ combating the financing of terrorism.

The authorities' strong commitment and program implementation has strengthened capacity despite a challenging environment. Sustaining the stated commitment of the Finance Ministers of all the Federal Member States (FMS) to the goals of the program will be critical to mitigating program implementation risks.

Underlying economic growth remains stable, supported by donor support and the ambitious and broad reform agenda. However, insecurity and recurring drought represent key risks to the outlook, and, despite progress, growth is insufficient to substantially reduce poverty.

The fiscal policy framework continues to strengthen, with domestic revenue mobilization reaching \$126 million in the year to July 2019 exceeding the indicative target of \$111 committed to in the program. Continued progress on public financial management, including to strengthen expenditure controls and pass the updated Public Financial Management Law, will be key to continuing to improve governance and donor confidence.

Financial stability reforms are deepening. New mobile money regulations are welcome, and implementation will be key for supporting financial stability. Continued efforts to expand the operational and organizational capacity of the Central Bank of Somalia will underpin further development of the financial sector more broadly.

¹ An SMP is an agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic program. SMPs do not entail endorsement by the IMF Executive Board. The SMP is supported by quantitative performance measures, indicative targets and structural measures.



Reducing Somalia's debt to sustainable levels under the Heavily Indebted Poor Countries (HIPC) Initiative and normalizing relations with international financial institutions will unlock access to additional financial resources to address Somalia's development needs. Achieving this goal in a timely manner will require a concerted effort on the part of both the authorities and the international community. To reach the HIPC Decision Point, the authorities are developing the necessary track-record in the context of the SMP IV, and work on the authorities' ninth National Development Plan, which will form Somalia's interim poverty reduction strategy, is complete. Securing sufficient financing commitments for arrears clearance and debt relief is also required. The IMF fully supports this goal and is working with its membership to secure the necessary financial resources to cover the IMF costs of debt relief.



ANNEX 3: 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/14/20
January 23rd 2020

Mr. David Malpass
President
World Bank
1818 H Street, NW Washington, D.C. 20433
Washington DC

RE: Somalia Letter of Development Policy.

Mr. President,

I. Introduction

Somalia's devastating civil war, which started in 1988, led to the collapse of the central government in 1991 and a period of lawlessness that lasted almost 22 years. The result was the destruction of the nation's social, economic and political institutions, widespread human suffering, including large-scale internal displacement and emigration, and the erosion of the country's human capital.

Since 2012, when the first internationally recognized government from the state collapse was formed, Somalia has made significant progress in rebuilding its economy after the end of two-decades of devastating civil war. The Federal Government of Somalia (FGS) has successfully implemented wide-ranging reforms and capacity-building initiatives. This has had a positive impact on the reform process and journey towards debt cancellation and possible future access to grant resources from the International Financial Institutions (IFIs) and other bilateral and multilateral partners. These challenging but fruitful reforms, which have strengthened our economic fundamentals, were made possible by the unwavering resolve and iron-cast commitment of the FGS and the financial and technical assistance of the IFIs, including the World Bank since our re-engagement in 2013, which has facilitated access to pre-arrears clearance grants.

The Federal Government of Somalia made debt cancellation its utmost priority as it is recognized that all other developmental issues truly depend on it. The Government was clear in its realization, vision and mission, that alleviating Somalia's debt burden would open doors for concessionary/grant resources to enable the rebuilding of the country. Since 2012, the FGS has dedicated considerable effort and resources to ensuring the successful implementation of economic reforms during a challenging period. These successes, as they stand today, are irreversible.

These reform efforts have been effectively guided and further intensified by the International Monetary Fund's (IMF) Staff Monitored Program (SMP) in implementing three successive SMPs

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from May 2016. Today, we are on the 4th SMP and we have performed strongly throughout in achieving agreed benchmarks, all aimed at strengthening our economic fundamentals and good governance. Successful implementation of SMP4 will culminate in the attainment of Decision-Point in February 2020. This is consistent with the agreement the FGS has with the international community and based on the outcome of the Somalia Roundtable meeting during the 2019 World Bank and IMF Annual Meetings.

In addition, the recent budget support from the European Union (EU) of 100 Million Euros bolstered the reform agenda of the FGS. This budget support, in itself, was a recognition on the part of the EU of the successful economic reforms that the FGS was undertaking, including improvement in transparency in managing the resources of the country. The EU budget support was conditional on additional level of reform initiatives agreed with the EU complimenting the SMP4 benchmarks. These will collectively lead to the FGS building a strong and credible track record of reforms and delivery on its journey to debt cancellation through the Highly Indebted Poor Countries Initiative (HIPC). Despite the successful economic reforms noted above, some challenges still remain, and the reform programs will need to be further strengthened to continue to show strong performance in all sectors of the economy and governance.

This Letter of Development Policy, therefore, outlines the progress achieved thus far in the following areas of reform and remaining challenges in the implementation of the reform agenda. It also presents clear programs that the FGS is committed to undertake in the coming years.

II. Economic situational analysis and outlook

Somalia is now on its way to recovery, and since the promulgation of the Provisional Constitution in 2011 and the establishment of the Federal Government of Somalia in 2012, significant progress has been made in promoting economic growth and a stable macroeconomic environment. However, these achievements continue to face some remaining challenges, and issues related to Climate Change. For example, the 2016/17 droughts diverted resources and government energy away from recovery and development and towards addressing the country's humanitarian crisis and reduced economic growth from around 3.5 percent in 2015 to a mere 1.3 percent in 2017. It is therefore a testament to Somalia's underlying resilience that, despite such difficult conditions, the Somali economy was able to recover to an estimated growth rate of 2.5 percent in 2017 and 2.8 percent in 2018. However, economic growth is not keeping pace with population growth (estimated at 2.9 percent), which means that per capita income during the same time period actually fell.

The economic outlook for 2019 is stable. There are, however, risks reflecting the difficult security situation and vulnerability to climatic conditions affecting the agriculture sector. In particular, drought conditions in early 2019 threaten this year's agricultural season. Over the medium term, growth is projected to remain at around 3.5 percent. This outlook is based on continued political stability and strong external financial flows to support investment and consumption, and steady growth in agricultural production (the largest sector), telecommunications, transport, and construction.

The fiscal position is projected to continue improving on the back of stronger revenue mobilization and Public Financial Management efforts, with the help of the recently enacted Revenue Administration Law, domestic revenues projected to reach 4.9 percent of GDP by 2022, and grants

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remaining broadly steady. This is expected to facilitate a gradual increase in expenditures in social sectors but will still remain well below investment and social needs.

The expenditure side of Somalia's GDP is dominated by private consumption and imports, which account for more than 67 percent of GDP, creating a large trade deficit, financed mainly by remittances and international aid. The diaspora remittances, which in 2018 amounted to some US\$1.4 billion or over 20 percent of Somalia's GDP, provide a lifeline for large segments of the population, augmenting household income and creating a buffer against shocks, exceeding both international aid flows and Foreign Direct Investment (FDI). While some are invested (largely in residential construction), most are spent on consumption (often on private education and health services).

Somalia received almost US\$ 2 billion in Official Development Assistance (ODA) annually in 2017 and 2018, nearly doubling previous levels. However, outstanding external debt of about \$5 billion meant that Somalia has been unable to access assistance from IFIs. The country's development has been significantly inhibited as a result.

On the supply side, the major contributors to, and drivers of, the economy are agriculture, livestock, financial and telecommunications services, transport and construction. All these areas are run by the private sector and are now subject to newly approved laws and regulations including the Telecommunications Bill, Company Law, Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) and Anti-Corruption Law. Many more are in the legislative pipeline and are likely to be cleared and enacted shortly into law.

Insufficient data in Somalia makes it difficult to estimate the exact contribution of the productive sectors to the economy¹. However, it is generally agreed that agriculture and livestock form the largest share of GDP, having risen significantly from their pre-war levels of about 62 percent to possibly 75 percent. Within this wider sector, crop production and goods processing, which remains crucial for national food security, has declined by almost 60 percent from its 1989 peak. Livestock remains Somalia's largest agricultural export, having increased by a factor of almost 10-fold between the late 1980s and the mid-2010s.

While fishing has significant economic potential, some weaknesses still remain and continue to pose some challenges which led to illegal fishing, while efforts to re-establish manufacturing and other private sector businesses are hampered by insufficient regulation, legislation and affordable energy.

International trade has grown steadily over the past six years, and the trade deficit has been declining since 2018, confirming faster increase of exports relative to imports. The current account balance has hovered around 8 percent of GDP after 2017 and is financed by grants and remittances. Export growth and investment will act as the main development accelerators in the medium term, and so maintaining these, while fostering an enabling business environment, can be identified as one of Somalia's most urgent challenges.

¹ As outlined in the NDP-9, the Government plans to invest in institutional strengthening towards reducing data gaps, both within the DNS and line ministries. There is also a clear and present priority for the Government to (i) unconditionally have access to all data collected in the country, (ii) set definitions of variables and methodologies on a national level as a pre-requisite for Government endorsement and (iii) set nationally adhered quality control measures on data collection.

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Somalia's repeated and increasing exposure to periods of drought is eroding traditional pastoral and agro-pastoral livelihood systems. This, combined with security challenges, drives impoverishment, displacement and migration of the rural poor, mainly to the country's urban centers. The result is one of the highest rates of urbanization in the world, accompanied by very high levels of unemployment, particularly, among the youth, Somalia's largest demographic. Increasing labor force participation of young people must, therefore, be treated as one of the country's highest priorities.

a) Financial sector

A stable financial sector that provides intermediation and inclusive access to financial services is critical to economic growth and poverty reduction. Financial sector reform is a key element in moving the economy of Somalia forward.

Somalia's financial sector is still young, and intermediation is limited. Total sector assets are equivalent to about 9% of GDP; credit to the private sector is about 3% of GDP, although growth has been rapid over the past two years. Banks provide a mix of Islamic and conventional financial products. Demand for credit is primarily generated to pay for imports, followed by real estate and from households. Widespread use of mobile money (MM) (73% penetration rate) and remittance inflows (over 20% of GDP) represent opportunities to increase the inclusivity and broaden access to financial services.

The financial sector faces numerous constraints to greater financial stability and intermediation. There is a considerable trust and information deficit. Financial institutions, including the Central Bank of Somalia (CBS), require additional capacity and improved governance, and the financial infrastructure (credit information, judicial system, legal framework) is under-developed or non-existent. Individuals and businesses report that the main obstacles to accessing credit are unfavorable terms and conditions, and insufficient collateral. The payments system is under-developed: Mobile Money (MM) penetration is high, but lacks inter-operability among the service providers; settlement and clearance of inter-bank transactions at the CBS lacks scalability; and international payments are largely transacted through Money Transfer Businesses (MTBs) and to lesser extent through MasterCard services offered at local banks, which continue to face challenges on correspondent banking relationships. These gaps inhibit more efficient financial intermediation and more robust economic growth.

The CBS has made progress on reforms under three consecutive SMP programs, the fundamentals of banking supervision and regulation have been introduced. The World Bank has also supported the CBS on MTB's compliance with Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) regulation. CBS has also made significant improvement on functions relating to banking operations, accounting and ICT. On supervision of commercial banks, the CBS has issued nine sets of regulations including annual re-licensing, periodic financial reporting, and defining minimum prudential ratios. In addition, all banks are subject to on- and off-site inspections. Further improvements in financial supervision has been made, on July 25, 2019 the Board of Directors of CBS has issued Mobile Money Regulation for the mobile money sector. To further improve supervision, the CBS is preparing guidelines on operational risk and accounting standards for Islamic Banking.

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While considerable progress has been made in a short space of time, the CBS organizational structure and governance requires further modernization. The decision-making and oversight structures, the internal organization, technologies, and transparency mechanisms require uplift. At the same time, accountability and information flow and communications need to be strengthened. The restructuring of the CBS is, therefore, an urgent priority. In October 2019, the CBS Board of Directors endorsed an appropriate Strategic Plan for 2020-2024 and costed Transition Plan, which aims to operationalize restructuring of the CBS organization. CBS is seeking the support of the World Bank to implement the Transition Plan. The CBS is taking crucial steps to modernize national payment systems. The ongoing projects including: Automated Transfer System (ATS), Information Technology Infrastructure (ITI) and National Switch is supported by the World Bank and will complement each other. The national payment system will facilitate interoperability of retail payment systems in Somalia and open doors to manage international payments in single platform. The payment unit is established under the new CBS organizational structure which is endorsed by the CBS Board on October 28, 2019.

Furthermore, the government established the Financial Reporting Center (FRC) that has been operational since the second half of 2018, with Suspicious and Large Transaction Reporting now reported to FRC regularly. The Targeted Financial Sanctions (TFS) Bill was also approved by the Cabinet and submitted to the legislative houses for consideration. In June 2018, Somalia joined the Middle East and North Africa Financial Action Task Force (MENAFATF) and committed to contribute to the bi-annual plenaries and fulfil all MENAFATF requirements. Somalia is required to carry out a Mutual Risk Evaluation Assessment. The outcome of the ongoing National Risk Assessment (NRA) supported by the World Bank will, not only help the FGS to understand systematically the nature and scale of money laundering and terrorist financing problems in the country but also assist with making appropriate preparations for the Mutual Evaluation Assessment required by the MENAFATF.

a. Currency: Anti-Counterfeiting and New Banknotes

Somalia's economy is highly dollarized leaving the CBS with limited monetary instruments to regulate the national currency. Official Somali shilling banknotes have not been issued by the CBS since 1991, and the stock of Somali currency in circulation at present, mostly being used by the poor and vulnerable, consists of a mix of old and torn official banknotes and counterfeit notes accumulated over the years.

The poorest segment of the Somali society lacks access to US dollars and other sources of hard currency including remittances and mobile money services. The lack of acceptance of Somali Shillings by providers of mobile money, remittances and banking services due to the prevalence of counterfeits, acts as a significant constraint on broad-based financial inclusion.

There is a significant market demand for Somali shillings and lack of response from the CBS is not helpful to discourage the supply of counterfeit local currency, which is a major obstacle to financial inclusion, transparency and poverty reduction. It is in this context that the FGS has placed a high priority on currency reform. To facilitate the replacement of old and counterfeit notes in circulation, the FGS is working with the World Bank on a currency exchange project to issue new banknotes.

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b) Intergovernmental coordination and fiscal federalism

With regards to reforms undertaken on intergovernmental coordination and fiscal federalism, the government institutionalized intergovernmental coordination platforms to promote intergovernmental dialogue and coordination on issues that matter among levels of federal and state governments. The platform is composed of a two-layer coordination mechanism, (technical and ministerial) that produced, over a period of four years, several notable achievements. These include agreement on harmonizing some tax tariffs, agreement on regular fiscal transfers, timely disbursement and reporting conditions on funds utilization from Federal Member States (FMSs) to FGS on a quarterly basis and agreements on modernizing the country's customs operation through establishment of consolidated management unit and the sharing of data.

FGS and FMSs made further agreement on a cooperation framework on education between two levels of governments to facilitate effective assignment of functions, roles and responsibilities, as well as the establishment of teaching proficiency and performance to determine the standard of teaching qualities across the country.

The FGS has also recently made progress in agreeing to revenue sharing arrangements for petroleum and fishery resources with the FMSs. In March 2019, FGS reached an interim eighteen-month agreement to share revenue from the 2018 tuna license with the FMSs, enabling distribution of the revenues earned from the 2018 tuna-licensing round. Although the funds yielded to date from tuna licensing are modest, the achievement is significant, as it signals that Somalia's fishery sector is starting to be managed in accordance with the law after decades of illegal fishing. FGS and FMS agreement on fisheries revenue sharing also represents a milestone in intergovernmental fiscal relations. The revenue sharing formula embedded in interim March 2019 agreement between FGS and FMSs/BRA on revenue sharing from issuance of fishing licenses is implemented by allocating revenues from 2019 and will remain valid beyond its expiry date until parties come together to discuss review of the agreement. The Ministry of Fishery and Marine Resources is in the process of collecting sufficient data on fishing now to inform the review of the agreement which was also a conditional clause for the review of the agreement. A similar arrangement on the petroleum sector was also concluded in June 2018 with FMSs.

In a recent Intergovernmental fiscal federalism meeting that was concluded in Kismayo on 22nd December 2019, FGS and FMSs finance ministers agreed that the financial chapters of the constitution be reviewed with the consideration of key provisions that is missing from the current draft constitution, drawing upon experiences in other countries and adapting this to the Somali context.

Fiscal transfers from FGS to FMS and Banadir Regional Administration (BRA) have increased significantly, growing from 1.64% of total FGS expenditure in 2015 to 10% in 2018. This increased to 40% allocation in 2020 Appropriation Act. This demonstrates that transfers have increased at a faster rate than the growth of the overall FGS expenditure.

The impact of the efforts undertaken, thus far, under the intergovernmental coordination approach has shown an effective gradual increase in the legitimacy and capacity of the Somali Federal Government with respect to its engagement with FMSs and its institutions. This has further advanced the federal project and created conditions for growth.

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Building on the aforementioned achievements will require further advancement of policy and legal framework on sharing national financial resources between the FGS and FMS. The FGS will further solidify efforts already taken by developing a Policy Paper that includes: (i) principles to guide FGS transfers and allocations to FMSs/BRA; (ii) comparative analysis that reflects regional context; and (iii) long-term views, that will be tabled and discussed at Finance Ministers Forums. The document will be based on the provisional constitution and support the development of a draft federal law on Fiscal Federalism that will sanction the policy and procedures for sharing financial resources.

In a meeting of Finance Ministers' Forum on the 14th September 2019, the overall approach to allocation of EU budget support to Somalia was agreed between the FGS and FMS to the effect that 40% is allocated for FMS and 60% is retained for FGS expenditures. Of the 40% earmarked for the FMS, two thirds (2/3) must be spent on social and security related expenditures while one third (1/3) is discretionary.

c) Institutional development

The government has made tangible progress over the last two years on a number of issues that are important for improving public institutions, including civil service reforms, security sector registration, domestic revenue mobilization, contract renegotiations, tuna licensing and the development of core components of the Public Financial Management framework. All Civil Servant Staffs, Somali National Army, Somali Police Force, NISA, and Custodian Corps have been biometrically registered into SFMIS and salaries are paid directly to the recipients' accounts at the private banks. This exercise improves expenditure control, transparency and accountability in public resource management. Many of these reforms have helped improve governance and reduce the risks of corruption in the public sector including the Anti-Corruption Act and Revenue Administration Law which were both recently assented to law by President Mohamed Abdullahi Farmaajo, effectively establishing the Anti-Corruption Commission. The Government enacted Public Financial Management (PFM) and Company law in January 2020.

The Statistic Law, Audit Law, Amendment of Procurement Law and Amendment of Customs Law are awaiting the assent of the President. With these legislative reforms and others in the pipeline, Somalia is endeavoring to improve its standing in global indices on peace, democracy, transparency, economic growth and governance.

d) Human capital development strategy

The government is aware that investing in human capital is essential for the country to escape the trap of poverty and put it back on the path to prosperity. Somalia has a low median age of 16 years, indicative of a young population with high fertility, mortality, and population growth rate. This further indicates that about three-quarters of Somalis are below 30 years of age, and around 46 percent of the population is below the age of 15. A focus on this crucial demographic characteristic, means that the young population will have the opportunity to acquire the knowledge, skills and health to contribute productively to the national economy. The World Bank estimates that 10 to 30 percent of differences in per capita GDP is attributable to differences in national human capital.

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Government is committed to both increasing the quality of education as well as access to education with specific focus on gender equity. The government further recognizes the impact of population dynamics, reproductive health and gender on poverty, and considers women's empowerment not only as a means of eradicating poverty, but also a prerequisite for achieving the aspirations of NDP9 and the Global Sustainable Development Goals (SDGs). In light of this, the government supports the demands made by the Somali women and girls in the Women's Charter. In line with the Charter, the government acknowledges and commits itself to paying attention to the education of young boys and girls and achieving gender parity at all levels of education. The FGS sees girls' education as a means of reducing child marriage, GBV, FGM, advancing women's health and empowerment across the country. FGS is also committed to reducing the overall maternal mortality rate across the country by no less than 25% by 2030 through training and employment of 1,000 midwives by 2030. The substantial increased budget allocation to support Human Capital and health in the Appropriation Act of 2020 demonstrates the commitment of the government to support social services.

III. Government's vision

The Government's vision for Somalia is articulated by the country's new *National Development Plan (NDP-9)*, which sets out 3 overarching development priorities: political stability, improved security, and economic growth which are all geared to empower the government to provide public services including social services.

NDP-9 Participatory Consultations: The Government of Somalia is committed to ensure to the extent possible that citizens engage in the preparation of NDP-9 through an iterative process of consultation. Such consultations are an essential part of the planning process and inform the Government's understanding of both the effects and root causes of poverty, and the formulation of the plan's poverty reduction strategy.

Consultations for NDP-9 took place across three rounds. The first round (C1), conducted in January and February 2019, focused exclusively on obtaining input from Somali stakeholders on the causes of poverty and appropriate responses to these. Its output is summarized in this chapter, with the full results available in Annex 1. The second round (C2) was conducted in May and June 2019 and was an opportunity for Somali stakeholders to respond to the first draft of NDP-9, and for the development partners to engage with the plan preparation process and to influence the plan content. The output of C2 has further shaped the content of the second draft of NDP-9. The NDP9 was completed and approved by the Cabinet in September 2019 and formally launched by the President in December 2019.

The analysis upon which the NDP-9 is based argues that poverty in Somalia is driven by political fragility, insecurity and weak rule of law, exacerbated by climate emergencies. Political stability, security and the rule of law must improve to create the conditions in which efforts to support a climate proof economic growth can succeed. Social development is needed to fuel and sustain economic growth, through human capital development, social protection and disaster risk management. *The poverty strategy for NDP-9 is therefore organized in four Pillars:* Inclusive and Accountable Politics; Improved Security and the Rule of Law; Inclusive Economic Growth

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(including increased employment) and Improved Social and Human Development. By focusing interventions in these four pillars, Somalia will be addressing the most significant root causes of poverty.

The Inclusive and Accountable Politics pillar envisions substantial progress towards a stable and peaceful federal Somalia with an effectively decentralized, functional democratic system based on inclusive political processes. Strategies will include: the deepening of federalization; further stabilization and the establishment of local governance; completion of the constitutional reform process; implementation of fair and credible national elections in 2020/2021 and 2024 and implementation of the national reconciliation framework.

The Improved Security and the Rule of Law pillar foresees a security sector that serves the expectations of its citizens and the purpose of ensuring security and stability, equitable access to affordable justice and increasing public trust and confidence in the judiciary. The pillar calls for the continuation of the ongoing reform and strengthening of the security sector, including the armed forces and the police, the corrections system, and the judiciary and judicial system. In doing so, human rights will be embedded in all security and rule of law systems and efforts will be made to address corruption in the sector.

At the heart of the Inclusive Economic Growth pillar is the transformation of the economy by improving the resilience of traditional livestock and crop production industries to better meet the growing challenges from climate change, and enabling the private sector to broaden and sustain the growth while availing greater employment opportunities. In realizing this aim, the Government will take steps to improve the functioning of the market by developing a more enabling business environment and introducing stronger regulation coupled with enforcement. Recent adoption of regulations on interconnections of mobile networks and mobile money further demonstrate the Government's commitment to regulatory reforms. These regulations were intended to remove barriers to competition and enable efficient functioning of markets.

The Company Law, which was recently enacted, conforms to international corporate governance best practice and is expected to encourage new investment, particularly foreign and institutional investment. The government is also engaged in several initiatives supported by IFC aimed at promoting and unlocking investment as well as creating a more enabling business environment through addressing regulatory gaps in priority sectors, including energy and ICT. In addition, investments will be made to promote sustainable production, employment and food security, and the development of key utilities (infrastructure, affordable energy, comprehensive water strategy). Finally, reforms and investments will be made to diversify the economy through support to a number of promising sectors, including financial services, telecommunications, construction, fisheries and petroleum, as well as the expansion of international trade.

The Social and Human Development pillar is central to building the resilience of Somali citizens to economic, conflict and environmental shocks, and is framed by two important principles. These are, (1) a focus on regulating the private sector while looking to engage with development partners to ensure support to the vulnerable; and (2) human capital development focused on investments in education, training and cultural values. Strategies that will be pursued include improving health access and outcomes; education and training; social protection; disaster risk management; and public service delivery.

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The government will also partner with development agencies to scale-up responses to climate shocks and drought to ensure the most vulnerable received enough quantity and quality food. The government has also published a National Disaster Policy and will look to strengthen the Ministry of Humanitarian Affairs and Disaster Management. Establishment of early warning systems, integrating with existing systems, is an early priority. Together with its Partners, the government has initiated several projects that are meant to increase resilience of the (traditional) productive sectors to climatic shocks as part of its recovery and resilience strategy. Most notable among these initiatives is the Biyoole project, the objective of which is to develop water and agricultural services among agro-pastoralist communities in dry-land areas of Somalia. A USD 65 million shock-responsive social safety net project which is meant to support a gradual shift from the purely humanitarian approach to crisis response to instituting government capacity and systems for sustainable social protection, with the aim of building household, community and institutional resilience, is currently underway.

The NDP-9 is underpinned by a Macro-Economic and Fiscal Framework that aims to promote economic growth in an environment of low inflation, sustainable fiscal position, favorable current account and healthy foreign exchange reserves. Monetary and fiscal reforms lay the foundation for economic recovery and growth by promoting a sustainable medium-term macroeconomic environment. This, in turn, promotes infrastructure development, increased investments and exports; and improves efficiency in labor markets will promote increased employment opportunities. The macro-economic and fiscal framework sets out the Government's investment plan and short-term investment strategy, with the latter containing three priorities: (1) creating an enabling environment for the private sector; (2) building government's capacity to increasingly play its role; and (3) ensuring through collaboration between the government and its development partners, that the excluded and vulnerable are empowered participants.

a) Risk analysis in implementation process

The Government remains committed to the ambitious developmental reform program laid out in the NDP-9. However, gaps in security, implementation capacity and expertise, missing or unclear legislative and regulatory frameworks and limited geographic reach of the government, are considered to be significant risks towards delivering on national priorities. To compound these challenges, the unclear distribution of roles and responsibility and weak level of coordination between the federal and regional institutions continue to affect the overall efficacy and efficiency of public policy in Somalia.

IV. Conclusion

The government has realized notable achievements in different sectors in economic development and has laid significant foundations for core government functions that have strengthened capacity of government institutions in delivering services to its citizens. This has been achieved in a relatively short period of time and has already resulted significant impact.

Under the IMF's baseline assumptions, external debt to Somalia will increase to about 128 percent of GDP in the absence of debt relief by the end of the 2023 Therefore, further work is needed in order to achieve debt relief under the Enhanced Highly Indebted Poor Countries (HIPC) Initiative. In this regard, the debt management unit capacity has been strengthening its debt sustainability

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analysis which is in line with PFM law. FGS will continue to secure the necessary financing assurances for HIPC relief and arrears clearance with creditors.

We are, therefore, confident that the outlined reforms will help Somalia realize its potential as it re-engages with the international community and seeks to improve the living standards of its people. Building on our current reform trajectory, coupled with support from the World Bank through the Development Policy Operation, this government is committed to ensuring sustainability of the reform agenda.

In conclusion, I would like to reiterate the Federal Government of Somalia's appreciations to the World Bank's continued support and, we look forward to the Bank's full re-engagement with Somalia as we work towards the development of our country.

Yours Sincerely,



Dr. Abdirahman D. Beileh
The Minister



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ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Strengthen fiscal management		
<p>Prior Action 1. To increase transparency and accountability of debt management, the Recipient has enacted the Public Financial Management Law.</p>	No	<p>No significant positive or negative impact in the short-term, but possible positive impact in the medium, long term.</p> <p>Potential medium-term positive effects if improved debt management contributes to macroeconomic stability and growth that foster job creation and reduces poverty. In addition, improved debt management, paired with debt relief, may improve the balance between poverty reduction spending and fiscal stability.</p>
<p>Prior Action 2. To increase revenue mobilization potential, the Recipient has enacted the Revenue Administration Law.</p>	No	<p>No significant positive or negative impact in the short-term.</p> <p>Potential medium-term positive effects if (i) increased revenue mobilization leads to an increase in public spending on poverty reduction and social spending; and (ii) revenue-raising instruments do not have a disproportionate effect on the poor.</p>
<p>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.</p>	<p>No direct effects. Possible indirect, long-term contribution to improved Indian Ocean tuna fishing management.</p>	<p>No significant positive or negative impact in the short-term, but possible positive impact in the medium, long term.</p> <p>Improving the intergovernmental resource allocation can improve the productivity of the fishing industry, which can provide an important source of income among the poor.</p>



Operation Pillar 2: Promote inclusive private sector-led growth

<p>Prior Action 4. To strengthen the environment for private sector competition and market entry and exit, the Recipient has enacted the Company Law.</p>	<p>No</p>	<p>No significant positive or negative impact in the short-term, but possible positive impact in the medium, long term.</p> <p>Introducing more competition and reducing the bottlenecks in the market will have a positive impact on the private sector growth. But such benefits will take time to reach the poor and the vulnerable because they are concentrated in informal small and medium enterprises.</p>
<p>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.</p>	<p>No</p>	<p>A possible positive impact on poverty reduction in medium-term.</p> <p>In medium-term, a broader digital economy creates opportunities to enable a digital workforce and expand reach and usage of digital financial services even among the poor since the mobile coverage of the poor in Somalia is high.</p>
<p>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).</p>	<p>No</p>	<p>A possible positive impact on poverty reduction in medium-term.</p> <p>In the medium-term, strengthened oversight of Mobile Money Regulations will safeguard consumer funds and promote further financial inclusion.</p>