SOMALIA
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Richard WALKER / r.walker@afdb.org
Salome KIMANI / s.kimani@afdb.org

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SOMALIA

- **The country's economic base continues to be narrow with the majority of people depending on livestock and fisheries.**
- **The small tax base and weak public financial management continue to cause serious constraints on the government budget, thus leaving the country almost totally dependent on foreign assistance and remittances.**
- **While the main obstacles to commerce, investment, and government revenue collection continue to be a lack of peace and security, the Somali National Army (SNA) has had success in recovering many areas that were under Al-Shabaab's control.**

Overview

Somalia's economy remains fragile, as recovery continues to be hampered by the challenging security environment, poor infrastructure and limited financial resources. The country's dependence on agriculture and livestock in particular (which is a vital export commodity) reflects its narrow economic base and vulnerability to adverse external and environmental shocks. This also constrains the Federal Government of Somalia's (FGS) capacity to generate sufficient revenue to support its economic reconstruction and development agenda and stabilise the macroeconomic environment.

The IMF estimated real GDP to be 2.7% in 2015, driven by growth in agriculture, financial services, construction and telecommunications. Assuming gradual progress on the security front and absence of droughts, medium-term annual real GDP growth is projected at about 5%. Nevertheless, growth will remain inadequate to address the widespread poverty in the country. Creating jobs for the youth, providing social services such as education and health, and building sustainable livelihoods continue to be Somalia's key development challenges.

In a bid to attract investment, the FGS is taking steps in a few strategic areas. These include: i) trying to ease the flow of imports and exports; ii) creating more financial stability and legitimacy in the country; iii) facilitating the continued flow of remittances; and iv) rebuilding and developing basic infrastructure.

In June 2015, the Ministry of Planning and International Co-operation initiated the process of developing a National Development Plan (NDP) that will be the post-2016 planning framework for Somalia. The NDP framework will define the country's development priorities over a five-year period. The plan will also outline internal and external financing needs and major sources of funding and will guide the allocation of resources and prioritisation of government actions and international development support. The NPD will also serve as the Interim Poverty Reduction Strategy Paper (IPRSP), until a full-fledged official one is developed, and will include a vision and direction for Somalia's socio-economic development and poverty reduction.

The FGS has also set up a unit within the Prime Minister's office to develop a framework for public sector capacity building. This process is ongoing and will slowly start to enhance the federal government capabilities and responsiveness. However, the current tight fiscal space, with extremely limited revenue raising capacity, combined with the challenging security situation, makes it difficult to attract skilled professionals into the public sector, thereby limiting the government's capacity to deliver services.

Recent developments and prospects

Somalia's economy remains fragile as recovery continues to be hampered by the challenging security environment, poor infrastructure, and limited financial resources. The country's dependence on agriculture and livestock in particular (which is a vital export commodity) reflects its narrow economic base and vulnerability to adverse external (e.g. low external demand) and environmental shocks. This also constrains the FGS's capacity to generate sufficient revenue to support its economic reconstruction and development agenda and stabilise the macroeconomic environment.

Although the FGS is making some progress in establishing a sound macroeconomic and fiscal policy framework (including working together with the IMF to build capacity in macroeconomic policy making and the compilation of key macroeconomic statistics), the considerable expenditure pressure, deficiencies in revenue mobilisation, unfulfilled donor pledges, ineffective implementation systems, and nascent political processes have resulted in poor fiscal discipline and unrealistic budget outcomes.

There is also very limited capacity and data for economic analysis to underpin forecasts of the resource envelope or expenditure estimates. However, the IMF estimated real GDP to have grown by 2.7% in 2015, driven largely by growth in the agriculture, financial services, construction and telecommunications sectors. Assuming gradual progress on the security front and an absence of drought, medium-term annual growth (2016/17) is projected at 5%. Nevertheless, growth will remain inadequate to address the country's widespread poverty levels.

Creating jobs for the youth, providing social services such as education and health, and building sustainable livelihoods continue to be Somalia's key development challenges. In collaboration with international partners, the FGS has recently made efforts to rebuild schools and hospitals, and some of these rebuilt schools have already reopened in Mogadishu.

In June 2015, the Ministry of Planning and International Cooperation initiated the process of developing a National Development Plan (NDP), as the post-2016 planning framework for Somalia. Building on the work of the New Deal COMPACT and following on from the Economic Recovery Plan (2014-15), the NDP framework will define the country's development priorities over a five-year period. The plan will also outline associated internal and external financing needs and major sources of funding and guide the allocation of resources and prioritisation of government actions and international support. It will be the primary strategic plan for the government and form the basis for the government's fiscal strategy and all sector plans. The NPD will also serve as the Interim Poverty Reduction Strategy Paper (IPRSP) and will include a vision and direction for Somalia's socio-economic development and poverty reduction efforts.

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Macroeconomic policy

Fiscal policy

In the absence of a central government and regulatory bodies for many years, there has been limited formal tax policy formulation and implementation, and domestic resource mobilisation has remained weak. As a result, high public expenditures and low revenues have contributed to Somalia's persistent fiscal deficits, which have been largely financed through printing money.

However, since 2014, the FGS has been trying to implement a Revenue Mobilisation Strategy to improve fiscal sustainability, including raising adequate resources for financing the government's recurrent budget. Currently, the main sources of government revenue are the Mogadishu port and airport, telecommunication and remittance firms, electrical companies and hotels.

Although the FGS is making some progress in establishing a sound macroeconomic and fiscal policy framework (including working together with the IMF to build capacity in macroeconomic policy making and the compilation of key macroeconomic statistics), the considerable expenditure pressures, deficiencies in revenue mobilisation, unfulfilled donor pledges, ineffective implementation systems, and nascent political processes have resulted in poor fiscal discipline and unrealistic budget outcomes. The continuous funding shortfalls have led the government to incur liabilities to local money transfer firms (MTFs), reduce assets, ration cash, and accrue arrears to the defence forces, civil servants and suppliers.

In December 2014, Parliament approved a 2015 budget of USD 239.9 million with a highly optimistic revenue forecast, thus setting the expenditure ceiling at 58.8% over the 2014 outcome of USD 151.1 million. Unfortunately, the expenditure envelope was not underpinned by prudent budgeting, and infrastructure investment and social spending have been crowded out by civil servants' wages.

The government recently prepared a new Income Tax Law, and a Revenue Mobilisation Strategy that aim to increase domestic revenue for fiscal sustainability (i.e. generate at least enough resources to support the recurrent budget). The Ministry of Finance has since reviewed the existing tax laws and tariffs and proposed new tax brackets and categories, which have been endorsed by Cabinet. However, these tax measures have yet to be implemented.

The National Development Plan (NDP), which is currently being prepared, will build on the initial planning and budgeting framework that has been set up under the Economic Recovery Plan (ERP) for 2014-15. Once finalised, the NDP will be central in the development of a fiscal policy that supports the reconstruction, development and growth of the country over the medium to long term. Furthermore, in order to improve budget outcomes going forward, there will be three key fiscal targets, namely: i) "reducing salaries as a proportion of total spending" to 35% by 2025; ii) increasing the "capital share of total spending" to 25% by 2025; and iii) increasing "domestic revenue as a share of total revenues" in order to cover operating expenditures by 2025. The 2016 and subsequent budgets will also ensure that there are no additional government debts, zero cash balances are maintained, is aided by expenditure ceilings limited to the 2015 revised budget, and allocates all windfall revenues to reducing expenditure arrears.

Monetary policy

For years Somalia was characterised by deficit financing through money printing, uncontrolled money supply and high inflation. In recent years, however, the Central Bank has not issued Somali shillings, deficit financing has stopped, dollarisation has increased, and inflation has largely been driven by increases in prices of imported goods.

Against the backdrop of these challenging conditions, the new Central Bank of Somalia (CBS) – based on legislation enacted in 2011 – is not yet in a position to operate as a modern central bank. The CBS Board of Directors was established and started operations in April 2014. As of end-2015, the Board had met numerous times and had approved and implemented a first set of relevant by-laws. The CBS also prepared financial statements for 2014, and the preliminary balance sheet shows assets of USD 57.3 million, primarily gold, foreign exchange assets, property and equipment.

The CBS has also started to implement a Memorandum of Understanding that clarifies the roles and obligations of the CBS as the fiscal and financial agent of the state. However, the institutional, human, and material resources of the CBS are very limited. The CBS and Ministry of Finance are currently in the process of establishing a new organisational structure and setting up human resources best practices.

Monetary policy instruments do not exist, the exchange rate of the Somali shilling (SOS) is freely floating, and the *de facto* exchange regime is free of restrictions or multiple currency practices. The economy is predominantly dollarised in a generally unregulated financial environment. The exchange rate is set daily on an *ad hoc* basis by large currency traders operating in Mogadishu, based on their assessment of the current availability of USD.

Cash currency, particularly in lower denominations, is scarce, and Somali banknotes issued by the CBS are not readily available, which creates problems for the poorest. This severely limits economic transactions, especially of poor people who rely mostly on cash transactions using the national currency. With a general lack of technical, human, and financial resources, the CBS needs considerable assistance to change the status quo. In addition, political pressure has been mounting for a full currency reform. The IMF (among others) has been advising against it, and instead suggesting a phased approach.

Economic co-operation, regional integration and trade

Unlike many neighbouring countries, Somalia is not a member of the WTO or any of the various regional economic communities (RECs) in Africa. Somalia is in principle a member of the Common Market for Eastern and Southern Africa (COMESA), but needs to reactivate its membership. However, the country did submit an application to become a member of the East African Community (EAC), but the application was deferred. Somalia is a member of the Intergovernmental Authority on Development (IGAD). IGAD has already supported Somalia on dialogue in areas including peace building, livelihoods and drought resilience, and infrastructure development (transport and communication).

Somalia does, nonetheless, have independent free trade agreements with several nations, including China, Kenya and Indonesia. The country is also a member of the Council of Arab Economic Unity, which includes several Middle Eastern and African nations. This enables Somalia to benefit from certain policies on trade with Member States of the Council, including Egypt, Sudan and Yemen. Somalia is not eligible for benefits under the US African Growth and Opportunity Act (AGOA).

The Somali economy operates officially on the principals of a free trade regime, with the US dollar as the main international currency. Given the limited regulations, the lack of a formal institutional structure with necessary capacity, and the largely informal nature of the Somali trade regime, it is difficult to assess the height of tariff barriers and the extent to which non-tariff barriers are used. There is, however, a general feeling that trade barriers are low, as formal and unregulated tax collectors compete to attract traders through the channels they control. Also, the lack of formal structures means that Somalia is open to informal cross-border trade, which, although playing an important role in the economy, goes unregulated and undocumented.

Debt policy

Somalia's external public debt burden is very high, and is likely to be assessed as being unsustainable under the Heavily Indebted Poor Countries (HIPC) Initiative (for which the country is eligible). There has not been a HIPC-debt sustainability analysis (DSA) in recent years, but the ratio of NPV-debt to exports is likely to be far above the HIPC threshold of 150%. Similarly, no Low Income Country Debt Sustainability Analysis (LIC-DSA) has been done for Somalia under the IMF/World Bank Debt Sustainability Framework. However, the debt ratios relative to GDP, exports, and revenue are likely to be well above the thresholds of 30%, 100%, and 200%, respectively, for a weak policy performance country.

In late 2013, with support from the African Development Bank, a Debt Management Unit (DMU) was established in the Ministry of Finance and work is on-going to develop a debt database and management system and also prepare a debt management policy. A first step has been to reconcile Somalia's external debt. Given that debt recording has been inadequate for many years and that debt data and corresponding contracts were destroyed this has been a very slow process. To date, about 70% of external loans have been reconciled and recorded in an external debt database. For example, all multilateral loans have been inserted into the database, as well as about 70% of the Paris Club (PC) debt. With the exception of one creditor, all PC creditors have provided their loan-by-loan data. Only 30% of non-Paris Club creditors have provided loan data, but responses to data requests are being pursued with the remaining creditors through various channels. Although data on domestic debt instruments or arrears to suppliers is incomplete, any amount owed by government (and its entities) is likely to be very small.

Almost all the external debt is in arrears, with a large part (between one-third and one-half) being penalty interest on accumulated principal and interest in arrears. Somalia has not been paying any debt service for years and the stock of arrears has been increasing at a rate of about 3% a year. No information is available on arrears to commercial creditors.

Economic and political governance

Private sector

Although there is a strong political commitment to promote private sector development in Somalia evidenced by the significant growth of the construction, financial services, telecommunications and ICT sectors, the business community still faces considerable constraints. There is also very little information available on the sector as well as government regulation of the sector. However, in a bid to attract investment and better "oversee" the private sector, the FGS is taking steps in a few strategic areas. These include: i) trying to ease the flow of imports and exports (e.g. by standardising and regulating customs and fees charged on the import and export of goods, including livestock which is the country's major export); ii) creating some semblance of financial stability and legitimacy in the country (e.g. the CBS recently issued provisional licenses to six commercial Banks and nine MTOs); iii) facilitating the continued flow of remittances (e.g. the CBS and the World Bank have agreed to appoint a "Trusted Agent" to supervise MTOs and help build capacity in their licensing and supervision); and iv) rehabilitating and developing basic infrastructure.

Financial sector

In June 2015, the formal Somali financial sector consisted of the Central Bank, six banks with provisional licenses, nine provisionally licensed Money Transfer Operators (MTOs), and thirteen MTOs with pending applications for banking licenses. The sector is, thus, small and nascent while there is reportedly a large informal sector. Balance sheets and financial statements for banks and MTOs are not available.

The MTOs mostly facilitate the transfer of funds from the diaspora community to their families within Somalia. At an estimated USD 1 to 1.5 billion per year, remittances are the single largest contributor to national capital inflows and wealth. They also enable investments by allowing business communities to solicit funds from abroad and in some instances they help facilitate the flow of donor/NGO resources into the country. International concerns about the use of remittances to finance terrorism, and the resultant potential and actual closure of international banking services for MTOs, threaten these services.

With support from the IMF, the FGS is drafting Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) legislation and aiming to ratify related UN conventions. The World Bank, in partnership with FGS, is developing an initial Action Plan to build AML systems and capacity for better financial/remittance supervision. The Action Plan targets the CBS, international Banks, and local and international Financial Institutions and MTOs. The UK's Department for International Development (DFID), in collaboration with the Financial Sector Deepening Trust (FSDT) for Africa, is assessing how to reduce and manage risk in the "last mile" of the UK-Somali remittance corridor. This initiative will complement a wider set of activities along the "first mile", the "second mile" and the "last mile" which together form the UK-Somalia "Safer Corridor Pilot" project.

The provisional licenses that have been extended by the CBS to MTOs are supposed to be renewed under more stringent rules in 2016. The IMF has, however, strongly recommended that the practice of awarding provisional licenses should cease, as they have no legal basis in the CBS Act or the Financial Institutions Law. Elaboration of a proper financial sector roadmap will be a critical first step to build credibility in licensing and supervising MTOs.

Public sector management, institutions and reforms

Due to the breakdown of the state and the general absence of a functioning government, policy co-ordination and responsiveness has been largely non-existent. The FGS has been slowly trying to rectify this through the development of documents such as the Economic Recovery Plan (2014-15) and PFM Reform Action Plan (2013), as well as production of annual budgets since 2011.

Efforts at state rebuilding have so far been more successful in the self-governing regions of Somaliland and Puntland, where basic processes and structures of public administration are in place. Mechanisms for policy co-ordination seem to generally function effectively in these regions.

Natural resource management and environment

Despite Somalia having ratified a number of international and regional environmental regulations and treaties, the environmental regulatory and institutional framework for most of the country was largely absent over the last two decades. As a result, there has been tremendous destruction of natural resources. Major concerns relate to soil erosion, uncontrolled exploitation of marine resources, deforestation, water pollution, non-existent waste management, and very limited disaster preparedness and management. The UN Security Council has also determined that the illegal trade of charcoal is a huge factor in funding terrorism and is a major cause of deforestation.

As a first step to addressing this dire situation, the transitional Constitution, Article 18, notes that "the State shall give a special priority to the protection and safeguarding of the environment". However, while the transitional Constitution allows for the creation of Autonomous States, it indicates little about how the revenues from natural resources, available in one area, should be shared with the rest of the country.

A Ministry of National Resources (MNR) was created in 2012 and a National Resources Strategic Plan (2013-16) was developed. It was being implemented up until the end of 2013, including work to amend major environmental, fishery, gas and mineral laws. However, the MNR was split in January 2014, by the then newly appointed Prime Minister, into five separate ministries (e.g. Energy and Water, Agriculture etc.). Due to limited and differing capacity constraints in these new ministries, it is not clear whether the Strategic Plan is still being implemented.

Political context

Nicolas Kay, the outgoing representative for the United Nations Secretary General in Somalia, said that the country is "no longer a failed state but a recovering, fragile country", citing improvements in a number of areas including the political domain. The cabinet of Prime Minister Omar Abdirashid Ali Sharmake, appointed in February 2015, has injected fresh momentum into the governance of the country. The FGS has also been actively building a federal state through the establishment of a number of Regional Administrations (e.g. Interim Jubba Administration, Interim South West Administration, and Interim Galmudug Administration), addressing outstanding disputes with Puntland, and trying to improve relations with Somaliland. Based on the government's Vision 2016: Framework for Action, the FGS is also currently in the process of revising the Provisional Constitution, preparing for 2016 elections and establishing relevant commissions (e.g. the Borders and Federation Commission).

Although gains have been made in promoting political stability, the political context still remains fragile. For example, at different times over the last three years, the parliament has called for the president to resign given reports over mismanagement of public resources and ineffectiveness in combating Al-Shabaab. Such incidents have resulted in cabinet reshuffles and/or the appointment of a new Prime Minister, which have often paralysed the functioning of state institutions and undermined the state and peace building processes. Such political instability and contestations are likely to continue. Going forward, it is important that steps are put in place to monitor the 2016 elections and ensure an acceptable and successful outcome.

Social context and human development

Building human resources

With an estimated adult literacy rate of 24%, Somalia now ranks among those countries with the lowest levels of adult literacy worldwide. In addition, the net primary school enrolment in Somalia is estimated at only 13% for boys and 7% for girls.

Currently there are two approaches to rectifying this situation. Firstly, local administrations and communities continue to co-operate with external donors, including the Somali diaspora, in rehabilitating primary and secondary schools and they have also initiated campaigns to improve women's education. Secondly, the FGS has recognised education as a priority in rebuilding peace in Somalia. This led to the establishment of the USD 117 million Go-2-School: Educating for Resilience Initiative (2013-16) to get 1 million Somali children and youth into school. This initiative has already led to tens of thousands of children getting enrolled in education for the first time, with an estimated growth in enrolment of more than 90 000 children in formal primary education and approximately 9 000 new students enrolled in alternative basic education.

Given that institutions charged with political and economic governance in Somalia lack or have inadequate processes, structures and human resources to be effective and functional, these two approaches should help improve the situation.

Life expectancy in Somalia is about 49.7 years, and only 29% of the population has access to improved water sources and 23% to improved sanitation facilities. The under-five mortality rate in 2015 was estimated at 61 deaths per 1 000 live births (which is an improvement over the 200/1 000 live births recorded in 2010). The main causes of death are diarrheal diseases, respiratory infections and malaria (an estimated 87% of Somalis live in malaria endemic areas). In fact, malaria remains the most common cause of illness and death among under-five children and pregnant women in Somalia. The nomadic lifestyle of Somalia's rural population makes regular immunisation programmes difficult to implement. Measles and cholera are serious threats against which few have been vaccinated.

In Somalia, the average HIV prevalence rate is estimated at 0.5% of the population aged 15 to 49, and the adult prevalence rate is 0.7%. While these figures appear relatively low, various surveys suggest that HIV/AIDS awareness and prevention mechanisms remain low across Somalia, thereby increasing the risks of further infections.

Poverty reduction, social protection and labour

Somalia's economic and social conditions remain grim. Vast areas remain highly insecure making agriculture, trade and livelihood activities extremely difficult. Access to basic services such as water and sanitation, health services and education remain elusive. Combined with a high level of internal displacement, these factors have led to widespread poverty and deprivation. High levels of youth unemployment coupled with the limited possibilities for constructive engagement in the economy drive youth into illegal activities that promise better rewards including recruitment into groups such as Al- Shabaab.

State-run social protection mechanisms collapsed in Somalia following the decades of instability and civil war. However, with the recent progress in the political landscape, a return of government support to protect and cushion the poorest and most vulnerable will be considered when public resources are available. Already, various development partners, including NGOs, have tried to implement social protection programmes on a limited scale in the country and the lessons from these could inform greater government and donor engagement in the sector going forward. For example, cash transfers have played a key role in Somalia to cushion the extensive vulnerability that has been caused by drought and famine. Often this has been the only form of assistance that aid agencies could provide to enhance access to food and other basic products quickly.

Somalia has ratified conventions in two of the four core areas of Labour Standards. These include the conventions on forced labour and discrimination. The country has also adopted 11 other international labour conventions with support from the ILO Decent Work Programme for Somaliland, Puntland and Southern Somalia: 2012-15. The country's insecurity challenges have, however, affected the implementation of these conventions. According to the ILO, the conflict in Somalia has also disrupted and destroyed delivery of social services and the ability for all, particularly women and youth, to access decent work. For example, discrimination against women remains high and this has affected their participation in the labour force – i.e. 74% of working age woman are estimated to be unemployed compared to 61% for men.

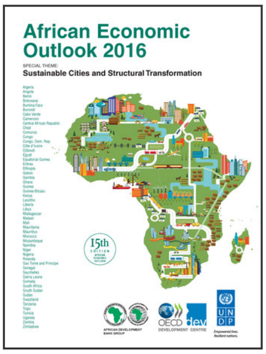
Overall, the linkage between employment and social protection, two critical avenues towards achieving pro-poor economic growth and mitigating conflict, have not received enough attention in policy making by both the international community and Somali administrations. Going forward, it would be important for the FGS and development partners to try and develop long-term social protection schemes and basic services (particularly economic infrastructure) that are tightly linked to active labour-market policies.

Gender equality

The 2013 UN Human Development Report noted that Somalia's Gender Inequality Index was one of the worst in the world. Women and girls are excluded and discriminated against in various spheres including health, education, employment and political life. At primary education level, only 42% of Somali children of primary school age are in school and only 36% of these are girls. The country also has a very high Maternal Mortality Ratio (MMR) of 1 000 per 100 000 births, almost double the average for sub-Saharan Africa (640). Only 33% of deliveries are actually supervised by skilled health personnel and only 9% of births happen in health facilities.

With the gradual return to stability, the fight for equality and protection of women's rights under the law is progressing. The FGS together with the Minister of Women and Human Rights is in the process of preparing an action plan to promote gender ideals and human rights. The road map will ensure that the FGS: i) establishes an independent human rights commission; ii) strengthens the institutional capacity for implementing agencies and ministries; and iii) mainstreams gender equality and human rights into the five Peace and State Building Goals (PSGs) – the priorities of the New Deal COMPACT that represent agreement on what is required to move towards peace and recovery within Somalia.

The PSGs aim to foster the resilience of Somali people and institutions, restoring the Somali people's trust in the state and its ability to protect and serve their basic needs for inclusive politics, security, justice, economic foundations and revenue and services, in full respect of human rights. To ensure effective implementation, continuous follow-up and resource needs will need to be addressed.



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