NATIONAL ECONOMIC COUNCIL
GOLAHA DHAQAALAHA QARANKA

STATE OF THE ECONOMY REPORT

An Annual Report to the President by the National Economic Council on Economic Issues Shaping Somalia's Future Prosperity

Accelerating Economic Reforms and Building Resilience in the Post-HIPC Era

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ABBREVIATIONS

ACLED	Armed Conflict Location & Event Data Project
ADF	African Development Fund
AGO	Office of the Auditor General
AGOA	African Growth and Opportunity Act
AML/CFT	Anti-money Laundering and Counter-terrorism Financing
CAS	Customs Automation System
CBS	Central Bank of Somalia
CBS	Central Bank of Somalia
CCKP	Climate Change Knowledge Portal
CLs	Contingent Liabilities
CP	Completion Point
CPIA	Country Policy and Institutional Assessment
CV2060	Centennial Vision 2060
DMU	Debt Management Unit
DRM	Domestic Revenue Mobilization
EAC	East African Community
EAMU	East African Monetary Union
ECF	Extended Credit Facility
EIIT	Extractive Industry Income Tax
EITI	Extractive Industries Transparency Initiative
FDI	Foreign Direct Investment
FGS	Federal Government of Somalia
FIL	Financial Laws
FIU	Financial Intelligence Unit
FMS	Federal Member States
FRC	Financial Reporting Centre
GAVI	Vaccine Alliance
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IBAN	International Bank Account Number
ICT	Information and Communications Technology
IDA	International Development Association

IFIs	International Financial Institutions
IMF	International Monetary Fund
KYC	Know-Your-Customer
MDA	Ministries, Departments, and Agencies
MENAFATF	Middle East and North Africa Financial Action Task Force
MMOs	Mobile Money Operator (MMO)
MoF	Ministry of Finance
MTBs	Money Transfer Businesses
MTDS	Medium-Term Debt management Strategy
NDP	National Development Plan
NEC	National Economic Council
NPS	National Payment System
NPV	Net Present Value
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
PBA	Performance-based Allocation
PDM	Public Debt Management
PFM	Public Financial Management
POS	Point of Sale
PPPs	Public-Private Partnerships
PV	Present Value
SDR	Special Drawing Rights
SNBS	Somalia National Bureau of Statistics
SOS	Somali Shilling
SPARC	Supporting Pastoralism and Agriculture in Recurrent and Protracted Crises
SWIFT	Society for Worldwide Interbank Financial Telecom
UCS	Use of Country Systems
UCS	Utilization of Country Systems
UN Comtrade	United Nations Commodity Trade Statistics Database
UNCAC	United Nations Convention Against Corruption
USR	Unified Social Registry
WAEMU	West African Economic and Monetary Union
WB	World Bank
WDI	World Development Indicators
WEO	World Economic Outlook
WTO	World Trade Organization

Foreword

Somalia is at a critical juncture. On the one hand, the country has seen a significant progress on the fight against terrorism with vast swathes of land liberated. This is underpinned by improved cooperation between FGS and FMS resulting in a number of agreements moving our state-building agenda forward. On the other hand, the country is on the verge of reaching the WB/IMF HIPC Completion Point by the end of 2023 following a long period of sustained and satisfactory economic reforms. In light of these monumental state-building and economic advances, I am delighted to introduce the inaugural State of the Economy Report. This report aims to provide an authoritative analysis and assessment on the key economic issues currently facing the country.

Our economy is emerging from several challenges. The lengthy election process has had a negative impact on private sector demand, while the prolonged droughts and other environmental shocks added to the complexities. Despite these difficulties, the economy remained relatively resilient mainly underpinned by remittances and support from development partners. Consequently, the GDP growth was recorded at 2.4 percent in 2022, slightly lower than the 2.9 percent growth in 2021.

The economy is expected to bounce back in 2023 with growth rate of 2.8 percent and further up to 3.7 percent in 2024 as the broad headwinds including potential inflationary pressures, export sector underperformance and environmental shocks ease. However, this rebound is contingent upon the effective implementation of planned policy reforms that address potential risks which could negatively impact future prospects. These crucial policy reforms include investments in critical sectors, strengthening of the resilience of the productive sector, enhanced revenue mobilization, public financial management, and building on recent integrity measures to increase public trust in institutions.

This report takes a holistic look at our economy identifying both opportunities and bottlenecks. It focuses on the low-hanging fruits pinpointing where catalytic policy changes could result in the greatest outcomes possible.

Lastly, I take this opportunity to sincerely thank the National Economic Advisors, management, and technical staff of the National Economic Council for their dedication and professionalism in preparing this inaugural report. I hope you will find the analyses and the policy recommendations in this report insightful in shedding light on our economic trajectory and growth opportunities, serving as a guide for informed decision-making.

Hassan Adam Hosow

Chief Economic Advisor to the President/Executive Director of the National Economic Council

Acknowledgments

This inaugural State of the Economy Report was produced by the members of the National Economic Council at the Office of the President under the overall guidance of Hassan Adam Hosow with the support of the technical team. The preparation of this edition was coordinated by Abdisalam Abdirahman Mohamed and benefited from the contribution and inputs of various individuals, stakeholders, institutions, and expert reviewers.

The core preparation team included Hassan Hosow, Abdilahi Ali, Abdisalam Mohamed, Adam Roble, Kamaludin Ahmed, Mahad Mohamed Sheikh and Mohamed Osman. The core team was supported by the technical contributions of Mustafe Abdi Mohamed, Mohamed Abdurrahman, Abdisalam Artan, Hussein Abdilahi, Mustafe Ishak and Mohamed Sharif. The report was reviewed by Maluka Abdulkadir, Nimo Mohamud, Aues Sciek and Abdul Aziz Iddrisu.

The National Economic Council is truly grateful to the Office of the Prime Minister, the Ministry of Finance, the National Bureau of Statistics, the Financial Reporting Centre and the Central Bank of Somalia for their data inputs, comments and validation. To all experts and stakeholders who participated in the validation workshops, we truly appreciate your valuable feedback and contributions.

Abdisalam Abdirahman Mohamed

National Economic Advisor, Member of the National Economic Council

Executive Summary

Overview of the Economy

The Somali economy is expected to improve, with an estimated real GDP growth rate of 2.8 percent in 2023, up from a sluggish growth of 2.4 percent in 2022. This modest increase in growth reflects, in part, a weak global growth, the impact of floods that followed prolonged drought, moderate remittance growth, and slow recovery of livestock exports.

However, a growth rebound of 3.7 percent is expected in the fiscal year of 2024, assuming an improvement in security conditions, recovery of livestock and crop production, an upward trend in foreign direct investment, and an increase in the inflows of remittances (as global inflation eases, thereby relieving pressure on the disposable income of the diaspora communities).

Somalia's economic growth is primarily driven by agriculture and services. However, the performance of the agricultural sector is hindered by low productivity, owing to lack of enabling environment, climatic shocks, poor infrastructure, lack of technology and low investment. On the other hand, the service industry, particularly telecommunications and financial services, show a strong performance and potential for diversified growth and development.

The economy relies heavily on remittances, contributing significantly to household consumption and investment. Aid and grants play a vital role in sustaining the budget. However, there is a dire need to reduce dependence on external resources.

Regional integration holds promise for Somalia's economic development as the country is admitted to join the East African Community as the 8th Partner State and making efforts to join other trading blocks such as the African Growth and Opportunity Act (AGOA) and the World Trade Centre. With integration into the regional and global trading blocks, Somalia's strategic location can transform it into a logistics hub.

The private sector continues to show resilience in the face of the absence of regulatory environment and the lack of formalization, with limited access to support services and markets.

Recommendations for Somalia's economic development include improving the overall enabling environment; maintaining economic reforms, accelerating efforts to access trade blocks, enhancing tax revenues by formalizing the informal sector and widening the tax base, climate-proof agriculture, promoting foreign direct investment to enable industrialization and modernization of the service sector. Improvement in these areas could help Somalia build its resilience and achieve sustained economic growth and development.

Fiscal and Monetary Policy

Somalia has made remarkable progress in the implementation of robust fiscal and monetary policy reforms to enhance its macroeconomic stability. The government's fiscal policy focuses on improving revenue generation, expenditure management, and intergovernmental budgetary collaborations. Key initiatives include boosting domestic revenue, modernizing customs administration, and strengthening public financial management.

While the country has made significant strides in building core state capabilities, challenges in the form of inadequate domestic revenues persist. The government has committed to increasing its tax-to-GDP ratio to a level that would allow it to cover its recurrent costs by 2027.

In recent years, domestic revenue has shown mixed trends, influenced by factors such as the COVID-19 pandemic and political impasse over the political transition of the country. Taxes on international trade are a significant source of revenue, emphasizing the importance of international trade for the country's income. Non-tax revenues have grown substantially, reflecting Somalia's ability to generate income from diverse sources.

The government must address its informal economy, weak tax instruments, low compliance, and fragile tax administration to strengthen domestic revenue mobilization. Widening the tax base, reforming the tax policies, laws and regulations, along with improved administration, digitalization, and public awareness programs are crucial for achieving macro-fiscal stability.

Donor support plays a major role in the budget, with external grants representing a substantial portion. The country aims to reduce reliance on donor funding by increasing domestic revenue to meet its needs for operational spending in the short-term and development spending in the long-term.

The financial sector has experienced remarkable growth, with the banking industry's assets expanding significantly. However, challenges such as the lack of a unified national identification system and limited correspondent banking relationships hinder financial integrity and cross-border transactions.

The government is taking steps to address these challenges, including progress towards a national ID system and exploring the introduction of a reliable Somali Shilling to enable the Central Bank to deploy monetary policy instruments, replace counterfeit notes, and to enhance financial inclusion. Over the years, the Central Bank has made significant strides in implementing reforms and building its institutional capacity.

The government must focus on regulatory improvements, risk mitigation, and efforts to promote growth to strengthen the financial sector. A conducive environment for financial sector development is vital to a country's economic stability and long-term economic growth.

Trade and Investment in Somalia

Somalia, strategically located at the intersection of the Red Sea and the Indian Ocean, offers significant potential for trade and investment. Despite past challenges, the country has made significant strides towards economic recovery and has recognized the private sector as a critical driver. However, Somalia faces a persistent trade deficit driven by the importation of essential goods. Imports surged to $5.08 billion in 2021, with foodstuffs, vegetable products, and machines being significant categories. The UAE, China, and India are the primary sources of imports.

In 2021, exports amounted to $482 million, with animal and vegetable products leading the way. There is untapped potential for expanding the export base in categories such as animal hides, mineral products, agricultural products, and fisheries. With the right and strategic investments in these sectors, export revenues could be boosted.

Foreign Direct Investment (FDI) has increased since 2012, with Turkey emerging as a significant partner. The healthcare and education sectors have attracted FDI, and the banking sector is expected to expand. Policy recommendations include diversifying exports, improving the legal and regulatory environment for FDI, enhancing the financial sector, upgrading infrastructure, addressing trade deficits through structural reforms and industrialization, and promoting economic competition.

Debt Relief - A Monumental Achievement for Somalia

The country made remarkable progress towards achieving the HIPC Completion Point (CP), a monumental milestone for debt relief and access to concessional financing. As of September 2023, Somalia had completed the sixth review of the Extended Credit Facility Arrangement and is expected to reach the HIPC Completion Point by mid-December, 2023.

While grant financing is expected to be discontinued, access to concessional funding post-CP may offer an opportunity to rebuild and advance the development efforts. Essential prerequisites include well-thought public investment strategies, improving government operations, strengthening public debt management capacity, establishing a national fiscal framework, and ensuring a country's ability to honor new debt liabilities. It is essential to allocate future loans to productive projects and programs that promote economic growth, job creation, and poverty alleviation.

Post-HIPC fiscal sustainability is a significant concern, given challenges like low domestic revenue mobilization, donor grant dependence, and high spending demands. The report places emphasis on maintaining a responsible budget deficit, enhancing domestic revenue collection, and promoting good governance to ensure fiscal sustainability. A medium-term fiscal framework is recommended to guide fiscal discipline and decision-making.

The debt sustainability analysis underscores the importance of managing the debt service-to-revenue ratio and avoiding excessive borrowing to prevent medium-term debt distress. To address the financing gap, the report recommends combining policy measures, including accessing concessional financing with a grant element, increasing domestic revenue mobilization, and directing borrowings into productive spending. Policy implications include establishing comprehensive legal and regulatory frameworks for financial integrity, prioritizing long-term fiscal sustainability, increasing short-term domestic revenues, responsible borrowing, cost-effective resource allocation, and creating a cooperative fiscal federalism framework.

Countering Terrorism Strategy

The country faces complex challenges driven by terrorism, climate-related shocks, and severe economic constraints. The presence of a destabilizing terrorist group, Al-Shabaab, has not only crippled the productive sector but also disrupted supply routes and the movement of people and goods. The ongoing military offensive against Al-Shabaab by Somali forces with both local and international support, emphasizes security, making the fight against Al-Shabaab a top national priority for the new administration. This shift indicates a deeper sense of local ownership and a more comprehensive approach, resulting in strategic gains in key regions. Following these successes, the government aims to implement a comprehensive stabilization program in liberated areas. This entails fostering peaceful relations between clans, ensuring access to humanitarian aid, and planning for reviving the rural productive sector and reconstruction of vital infrastructure.

Conflict incidents in Somalia from 2017 to 2023 reveal that battles, explosions, and violence against civilians are major challenges, with the latter two primarily orchestrated by terrorists. Mogadishu, the capital city, has faced a higher proportion of such incidents than the national average. However, recent trends suggest a decline in conflict incidents, particularly in Mogadishu, which is attributed to Al-Shabaab's weakened position.

On the financial front, efforts to counter terrorist financing and money laundering have intensified. The Financial Reporting Center (FRC) plays a central role in receiving and analyzing suspicious transactions, with financial institutions increasingly complying with AML/CFT regulations. Since the last quarter of the year 2022, the government has recorded a marked rise in the number of accounts it has frozen due to increased monitoring of suspicious transactions involving terrorist activities leading to a disruption in the financial inflow to terrorist groups.

The National Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Committee, with active participation from top leadership, has enhanced domestic coordination and increased the frequency of their meetings. This positioned the committee to regulate and enforce the AML/CFT regime, prepare for evaluations, and strengthen the nation's capacity to combat financial crimes.

Climate Change in Somalia

The country faces escalating climate shocks, compounding its insecurity and economic instability challenges. Climate change manifests through recurring droughts, locust infestations, and floods, severely disrupting agriculture, water resources, and livelihoods. These impacts led to food insecurity, poverty, and displacement, exacerbating national instability and economic woes.

Somalia's vulnerability to climate change is rooted in its arid and semi-arid climate with high temperatures, erratic rainfall patterns and lack of investment in climate mitigation, adaptation and and limited capacity in sound environmental management. The country has experienced 14 droughts in the last two decades, devastatingly affecting agriculture, which employs over 70% of the population. Locust swarms and recurrent flooding have further aggravated these challenges.

The economic toll of climate change is significant, with losses estimated to be up to 15% of Somalia's GDP. The country's agricultural sector, which employs a substantial portion of its workforce, has been severely affected, leading to declining crop yields and livestock production.

To address these pressing climate issues, the government must prioritize climate action in its national policies and create institutional frameworks to coordinate efforts effectively. Investments should focus on clean energy solutions to decrease the carbon footprint, the development of resilient infrastructure designed to cope with extreme climate events, and the promotion of climate-smart agriculture for sustainable food security. Enhanced water management systems are crucial to counteract both droughts and flooding. International cooperation and partnerships are crucial for providing financial resources, technical expertise, and knowledge sharing for climate adaptation.

Post HIPC policy priorities

This report outlines critical post-HIPC policy priorities for the Federal Government of Somalia (FGS) to seize opportunities while mitigating risks in an imminent post-HIPC environment. As Somalia approaches the HIPC CP point, it faces unique challenges and prospects. The following is a summary of robust policies for an effective post-HIPC agenda.

A. Comprehensive National Development Strategies: Developing a stand-alone post-HIPC development strategy for the six years following the Completion Point is essential. This strategy must align with Somalia's long-term Centennial Vision 2060 (CV2060) and serve as a vehicle for medium-term priorities, cost-effective projects, and domestic solutions.

B. Fiscal Framework and Prudent Macroeconomic Policies: Establishing a robust fiscal framework, enhancing public financial management, and pursuing prudent macroeconomic policies are vital. This includes broadening the tax base, reducing tax exemptions, improving tax and legal capacity, minimizing informality, and enhancing transparency and accountability in public financial management.

C. Medium-Term Debt Sustainability Framework: FGS must avoid falling into a new post-HIPC debt trap. The essential steps include developing a medium-term debt management strategy, strengthening debt management capacity, establishing a public debt management legal framework, and preventing contingent liabilities.

D. Addressing the Structural Trade Deficit: Tackling structural trade deficit requires improving infrastructure, revising and integrating national strategies, focusing on small-scale industry development and export diversification, promoting private sector growth, and reducing corruption and barriers to formalization.

E. Public Integrity Measures: Cultivating a culture of public integrity is crucial, and that involves adopting a whole-society approach, purpose-driven leadership, merit-based recruitment, capacity-building, transparency, and openness. Addressing the specific risks related to public procurement, infrastructure projects, and policy capture is essential.

F. Reinforcing Central Bank Reforms: Sustaining the transformative reforms of the Central Bank of Somalia (CBS) is vital. Capitalizing on the CBS, safeguarding its governance, supporting currency exchange projects, fast-tracking the national identification system, and expanding CBS operations to Federal Member States (FMS) are critical to the CBS's continued success.

These priorities guide FGS in navigating the post-HIPC landscape, fostering sustainable development, and ensuring economic stability while avoiding the pitfalls of debt distress and corruption.

1 Background

Somalia's economy is currently experiencing growth after a period of conflict. However, this growth is starting from a low base and is slowly being achieved as peace and stability are established. During the conflict, critical infrastructure and assets were destroyed, and people were displaced, leading to a decline in economic production, especially in agriculture, livestock, and fisheries. Climate change worsened economic decline, such as multiple consecutive droughts and floods, which also reduced competitiveness. This has caused widespread displacement and increased poverty in rural and urban areas.

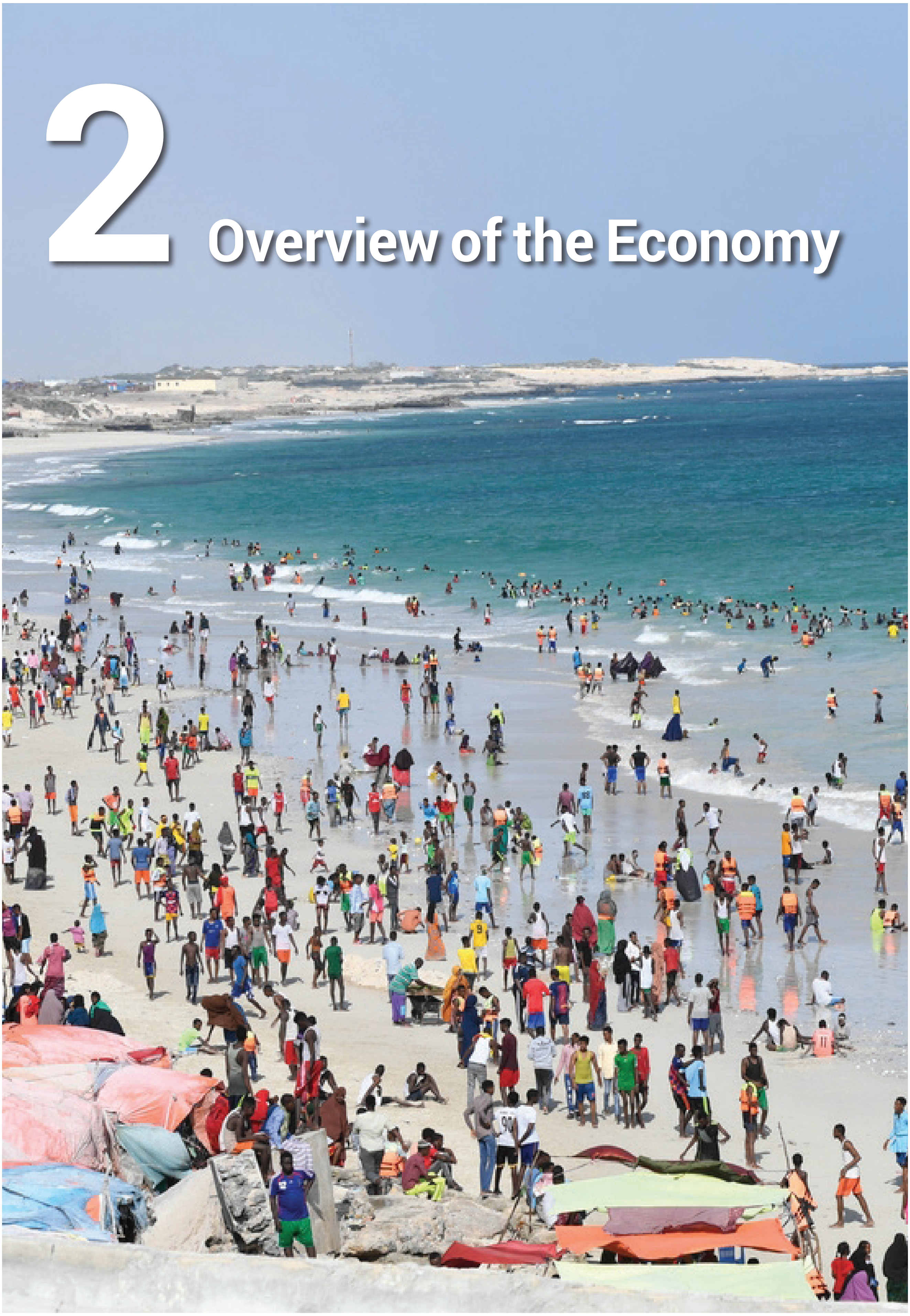
Since 2012, Somalia has been implementing an economic reform program. This program aims to build the capacity of the state, putting in place the foundations for economic policy and promoting private enterprise. The new economic policy relies heavily on private investment and market forces. Additionally, new policies have been introduced within a federal system of governance, further decentralizing the country's governance structure. The ongoing reforms also aim to help repair the extensive harm and economic decline, primarily affecting the agricultural industry, including livestock, crop production, and fisheries to spur economic development.

The country is also susceptible to environmental disasters such as droughts, floods, and locust invasions, highlighting the need for sustainable and proactive measures. However, weak public institutions, ongoing armed conflict, and the menace of terrorism and lawlessness have hampered development investment until recently. Consequently, the nation has relied on humanitarian aid to address its long-standing multitude of fragilities.

The State of the Economy Report 2023 is the inaugural issue of the annual report to the President on Somalia's economic policies drafted by the National Economic Council (NEC) of Somalia.

This report is the first of its kind to investigate Somalia's socio-political and economic landscape. It delves into the major development concerns and provides insights into the country's medium and long-term requirements, risks, and susceptibilities.

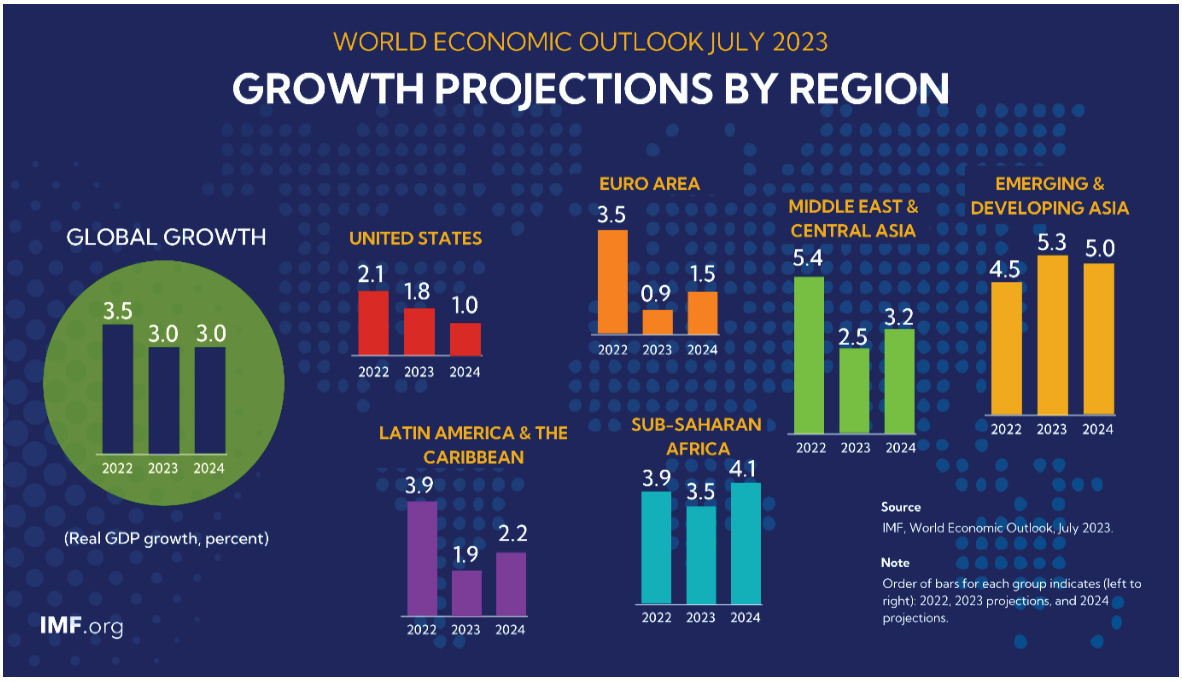
2 Overview of the Economy



2.1 Global Economy

The IMF's World Economic Outlook (WEO) Update in July 2023 predicts global economic growth to record 3 percent in 2023 and 2024, down from growth rate of 3.5 percent previously projected in 2022 as global monetary policy tightening meant to rein in inflation continues to subdue economic activities in many countries. The 3 percent growth forecast for 2023 represents an upward adjustment from 2.8 percent projected in the April 2023 WEO update, boosted largely by the service sector. Compared to the average growth rate of 3.8 percent between 2000 and 2019; however, the forecast of 3 percent for 2023 and 2024 is considered relatively low. The weak growth forecast for 2023, relative to 2022, is largely driven by the subdued growth in advanced economies where productivity in the manufacturing sector is struggling. The IMF assumes that, while growth at the global level may have bottomed out in the last quarter of 2022, growth in some major economies may not have bottomed out before the close of the first half of 2023.

Figure 1: World Economic Outlook July 2023



Growth in Sub-Saharan Africa is projected to be 3.5 percent in 2023, down from 3.9 percent in 2022, but expected to rebound to 4.1 percent in 2024. The decline in 2023 is on the back of significant projected decline in South Africa and a modest drop in Nigeria, the two economic powerhouses in the region. South Africa's energy challenges are expected to lead to a major decline in economic growth from 1.9 percent in 2022 to as low as 0.3 percent in 2023. Nigeria's modest decline in growth performance in 2023 to 3.2 percent, from 3.3 percent in the prior year, is fueled by the security challenges in the country's oil sector (as depicted in Figure 1).

2.2 The State of Somalia`s Economy

The domestic economy is expected to improve in 2023 and 2024. In particular, the country's real GDP growth rate is estimated to increase to 2.8 percent in 2023, up from 2.4 percent in 2022 (as shown in Figure 2). This represents a slight decrease from the previous projection of 3.1 percent for 2023 which was published in the December 2022 Economic Outlook update, as the impact of drought and lower remittances pose substantial risk. The slower growth in 2022 is also largely due to the drought conditions and reduced remittance inflows, but it is expected to pick up again in 2024, with a projected growth rate of 3.7 percent. The major threats to domestic growth come from the expected persistence of high import costs and slow global growth for the projected period. The conflict between Russia and Ukraine is expected to continue to have an adverse effect on the import bill, including gasoline and wheat, for which Somalia is a net importer. Other domestic risks include continued acute food insecurity, instability, and uncertainty about the effects of climate change going forward.[1]

Figure 2: Somalia GDP Growth rate

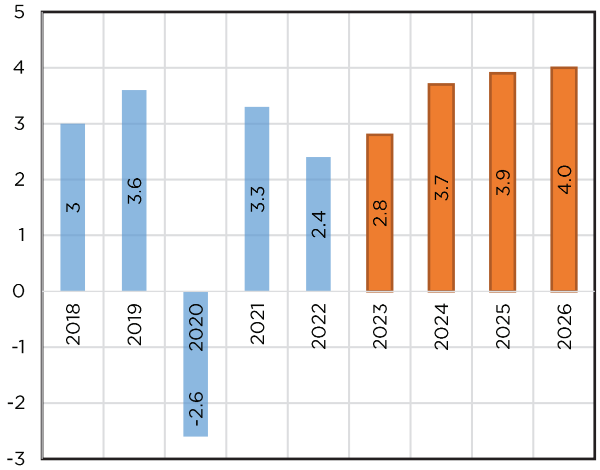
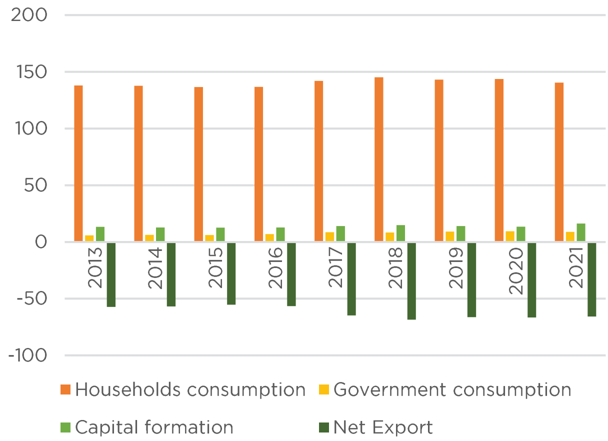


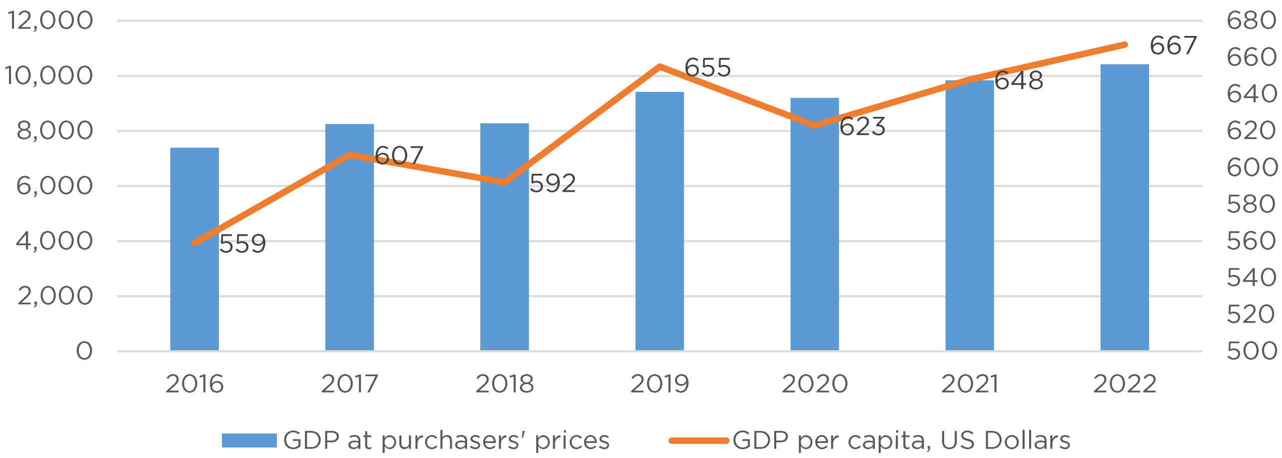
Figure 3: Annual Share of % GDP, Expenditure



Source: SNBS report June 2022 (year 2018 -2022) and IMF data 2023 (forecasted years)

Based on data from the National Bureau of Statistics, GDP components by expenditure as a share of GDP remained relatively stable in the last decade (Figure 3). During this period, household consumption expenditures remained, on average, 140 percent of GDP. This underlines the importance of remittances and ODA for household consumption. However, while the share of government consumption increased over the period, it remained at low levels within single digit range, averaging 7.74 percent of GDP. Gross capital formation accounted for a relatively minor share of GDP, averaging 14 percent annually, although it increased by more than 3 percent for the last year. The share of exports of goods and services averaged 19 percent of GDP, a reasonably low rate during the nine years that ended 2021, while imports of goods and services averaged 81 percent of GDP annually, resulting in large trade deficits of 62 percent per year.

Figure 4: GDP at purchasers' prices (Million US dollars) and GDP per capita (US Dollars) Somalia



Source: SNBS 2023

The past decade has not seen considerable economic growth to contribute to reduction in poverty. According to recent estimates, GDP has only grown by less than 2 percent on average, while the population has grown at a rate of 3 percent. This has resulted in a contraction of about 1 percent per year in per capita GDP. The growth rate has remained too low to create enough job opportunities, especially for young people and women who are part of the rapidly expanding labor force. Poverty has increased and worsened, as per recent estimates. Severe droughts, flooding, and locust infestations have had a significant impact on declining income, particularly for rural households, and have led to a large number of internally displaced people in the country. The drought and fragile security situation have negatively affected the livelihoods of many poor people living in rural and nomadic areas, as well as those in IDP camps.

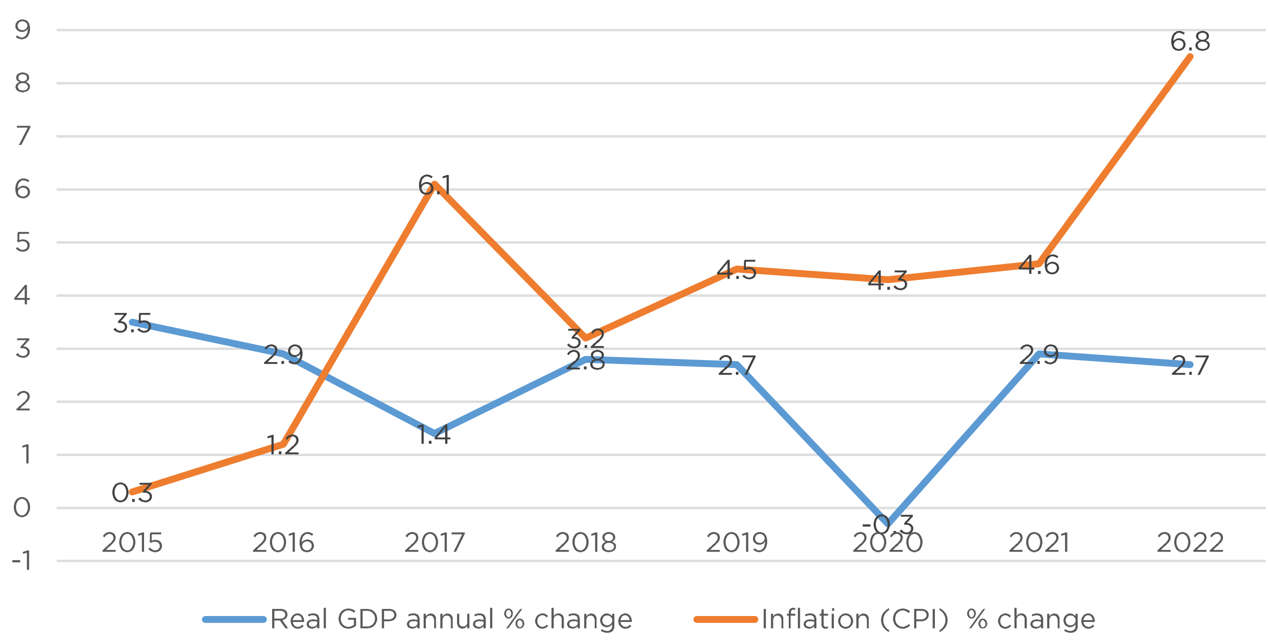
2.2.1 Somalia Economic Growth

Somalia's economic growth is mostly driven by the agriculture and services sectors. Agriculture accounted for over 60 percent of GDP over the last decade (2011 – 2022), making it the largest contributor to the country's growth. Livestock is the largest subsector within the agricultural sector, accounting for about 40 percent of GDP. The strong growth in agriculture was primarily driven by increased crops and livestock production due to favorable precipitation and relatively improved security in the farming areas. The agricultural sector, given the natural endowment and the reform momentum, would continue to be a major contributor to Somalia's GDP.

he slowdown in growth has been triggered by three main headwinds: drought combined with flooding; presidential election during the second quarter of 2021, which induced wait and see attitude by investors and donors; and fragile security. With the easing of headwinds, GDP is projected to grow by 2.8 percent and 3.7 percent. In 2023 and 2024 respectively.

Based on a breakdown of growth, the slowdown was mainly caused by a decline in the agricultural sector, while the nonagricultural sector remained relatively stable. The agricultural sector suffered from poor rains, drought, and insecurity, reducing livestock output. Since the agricultural sector depends on rainfall, the drought severely impacted its productivity. As a result, the contribution of agriculture to GDP declined in 2020 and 2021, with the sector accounting for more than half of GDP. This decline had a significant negative impact on GDP growth, which in turn affected livestock and food production.

Figure 5: Real GDP growth and Inflation



Source: SNBS 2022

The growth of the agricultural sector slowed down, but this was balanced by the impressive performance of other services subsectors such as ICT, transportation (including air services), and construction. Public investment in urban infrastructure and private sector projects, financed by donors, also contributed to this growth. The increasing demand for ICT services, coupled with the financial sector's efforts to adopt new technologies and the expansion of mobile banking operations, have maintained high growth rates in information communication since early 2010. Currently, financial services and telecommunications are the main services experiencing growth, with significant potential for future growth. There remain significant downside risks that could dent the rebound in economic activities. Lingering political uncertainty and the unsettled relationship between the FMS and the Federal Government could undermine business confidence and curtail a robust recovery.

2.3 GDP Composition

The Somali GDP[2] is dominated by private consumption, followed by imports. Figure 6 below indicates that household consumption, which is generally driven by remittances, was equivalent to over 140 percent of the GDP in 2022. This implies that the economy is primarily driven by consumption and external financial flows which has been unpredictable and volatile and is expected to continue to be so in the medium terms (near future). In 2020, private consumption was estimated at 10 billion USD, exceeding the country's gross domestic product (GDP) by 1.4-fold. Due to low domestic productive capacity, Somalia's largely dollarized economy relies on imports for essential commodities. Official exports are dominated by livestock to Gulf Cooperation Council countries. As demand fell during the COVID-19 pandemic, the trade deficit has widened from 83 percent of GDP in 2019 to 91 percent in 2020. These trends highlight the dependence of the economy on imported goods. The contribution of net exports continues to be negative, as drought continues to induce contraction of livestock exports, thereby causing widening current account deficits.

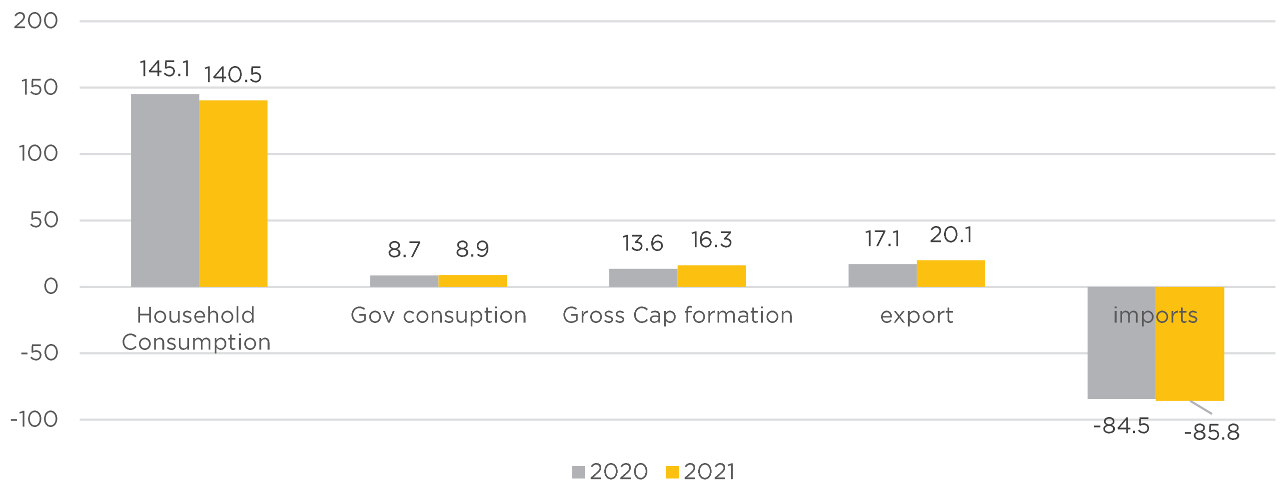
While export was estimated to be around 17 percent of GDP, livestock exports have stagnated and, in some cases, even declined due to droughts, flooding, and the Covid-19 pandemic.

The Somali economy remains dependent on imports[3] and the country continues to import more merchandise for both consumption and investment. The growth in imports is driven not only by consumption but also by some capital goods, including imports for transport equipment, machinery and electrical equipment among others.

In 2021, government final consumption accounted for approximately 9 percent of GDP. This figure reflects the significant support provided by development partners in response to the triple crises and security expenses. Over the years, government consumption has been on the rise, mainly due to the FGS's expansion of administration and services throughout the country. In 2021, government consumption was estimated to be only 9 percent of GDP.

Capital formation has been growing gradually in recent times. Investment remains low, contributing only 16 percent of GDP in 2021. Gross investment is picking up, mostly driven by the construction sector and urban infrastructure. Fragile security, difficult business environment, and political uncertainty continue to hinder investment in the country.

Figure 6: GDP by Expenditure Current Price in Percentage



Source: SNBS 2022: Somalia Gross Domestic Product

2.4 Inflation

Though relatively stable, the Somali macroeconomic environment faced serious challenges during 2020 - 2022, with inflation reaching 6.8 percent in 2022 from its low level of 4.6 percent in 2021. The increase in prices was primarily due to the decline in agricultural production, driven by drought, flooding, fragile security conditions, and political turmoil due to the delayed parliamentary and presidential elections. The limited availability of cereals and other agricultural products in the local market contributes to inflation (Figure 5). In addition, the supply chain has also been disrupted following the Russia-Ukraine war, thereby exacerbating prices of commodities imported into Somalia.

In recent months, there has been a noticeable decline in economic activity due to global economic slowdown and the country's drought conditions. Additionally, the escalation of food and fuel prices and security concerns may lead to an increase in inflation in 2023 and beyond. Inflation spiked during the year 2022, mainly due to cost-push factors rather than a reflection of underlying demand pressures. First, poor rains during short and long rains by end of 2021 and throughout 2022 and delays in importation to make up for the domestic shortfall due to the war in Ukraine led to a sharp rise in food prices. Second, a slight increase in energy inflation reflected the pick-up in global oil prices, and through increases in transportation costs, and depreciation of the dollar (indirectly SoS), drove up inflation.

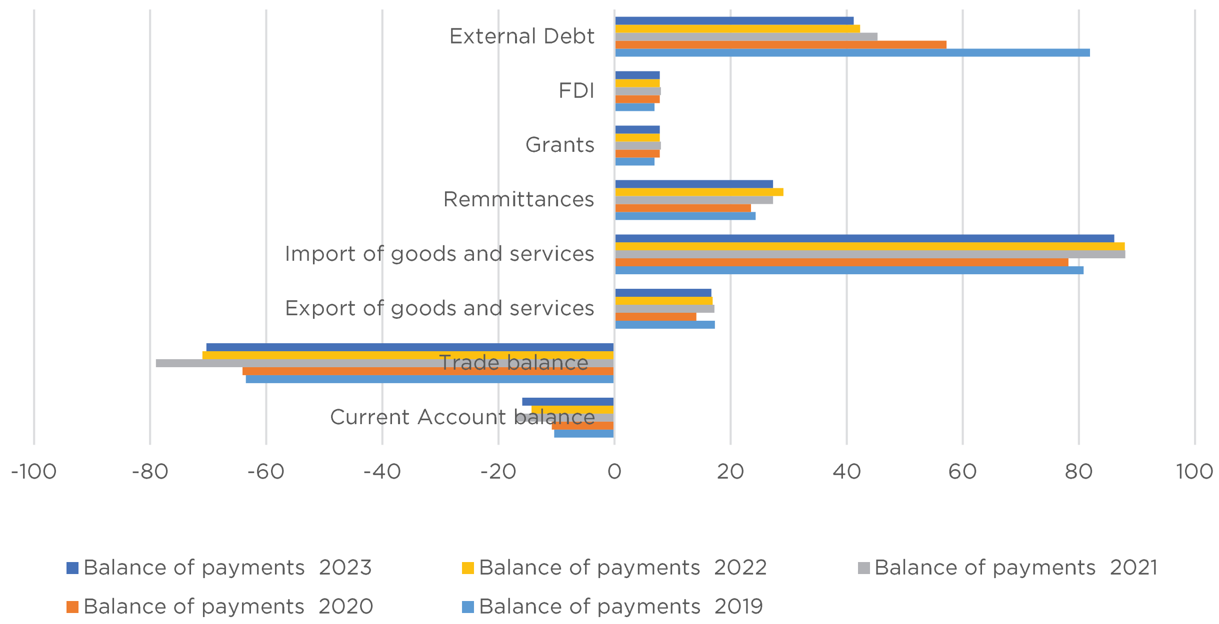
The rise of food and energy prices, slowing global economic activities, and tightening global financial conditions are expected to affect Somalia to varying degrees. The key transmission channel operated through trade with a substantial impact on domestic inflation because most (if not all during the drought, flooding, etc.) of food products and energy are imported. Inflation is exacerbated by rising transportation costs for both goods and services.

2.5 Trade and Current Account

In 2020, Somalia's trade balance was 64.1 percent of its GDP, but it rose to 70.3 percent in 2022. Unfortunately, there has been a decrease in exports due to drought and insecurity caused by frequent attacks from Al Shabaab and the war in Ukraine. As a result, the country has seen an increase in merchandise imports, particularly food items, machinery, and transport equipment, due to ongoing private and public construction projects.

Somalia's trade structure is clustered around a few trading partners. The key export markets are Oman, United Arab Emirates, Saudi Arabia, and Yemen. Together, these four countries account for about 85 percent of Somalia's export each year (World Bank). In terms of the structure of export products, the trade structure remained highly concentrated, with export basket consisting of a few products, all of which are either agricultural products or agricultural-related products (particularly livestock). With the narrow export products and a limited international market, Somali exports remain fragile and vulnerable to any market disruption that can create chaos[4] and disrupt the socioeconomic development of the country.

Figure 7: Balance of Payment 2019 – 2023



Source: Ministry of Finance, 2023

Somalia's key export products include live animals that account for approximately 80 percent of the total export earnings. Wood charcoal account for about 7 percent, even despite being illegal. Oil seeds take up about 4 percent, while some grain, seeds, fruits and dried limes among others make up the rest.

The economy is overwhelmingly dependent on imports. The country's main imports are food, comprising basic consumer goods, such as vegetables, wheat flour, raw sugar cane, rice and many more including imports of capital goods essential for expanding and diversifying the economy. Imports also include construction materials and equipment. Worth reporting is the considerable unrecorded trade which occurs across the borders of Somalia. These include arm import and charcoal exports. Most of the imports originate from Ethiopia, Kenya, China, Oman and Brazil.

Somalia's critical priority is to develop viable export industries by diversifying export products to generate more resources from the export earnings. Somalia's prime export is livestock, estimated to generate more than 50 percent of its export earnings. Improvement in the export of the livestock sector is hindered by the lack of disease control, which leads to poor competition on the international stage. Somalia has no national quality control procedures and, therefore, importing countries impose their own quality control measures to the detriment of Somali goods. Expanding the trade routes would be of great importance in reducing the vulnerability of the export sector.

The current account deficit widened as imports rebounded strongly (see Figure 8). Despite the substantial increase in remittances, a strong increase in imports (primarily construction and medical equipment) and a decline in budget grants widened the current account deficit to 15 percent of GDP in 2021 (from 10.8 percent of GDP in 2020). The financial account increased, reflecting the 2021 General SDR Allocations.

2.6 Remittances

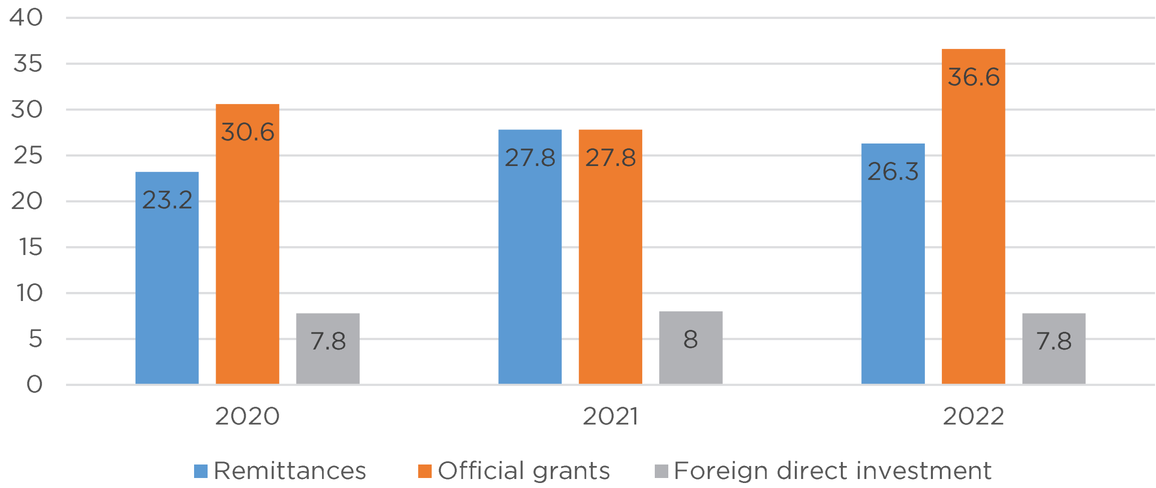
Remittances continue to play a critical role in the economy. A large part of the Somali population relies on remittances from relatives and friends abroad. Recent estimates by CBS indicate that Somalis in the Diasporas have been sending remittances worth over 2 billion USD annually. This accounts for over 26 percent of GDP (2022).

The amount includes support given to individual families, relatives and friends, contributing to aid and development, as well as investment in small and medium enterprises. Remittances have been playing a crucial role in social and economic development. First, it has been directly contributing to households' consumption (education, health and other related consumption), and investment, particularly in the construction sector, allowing the Somali society to sustain higher consumption rates and to finance a large trade deficit. Somali continues to live at the subsistence level, and most of them are engaged in small-scale businesses as petty traders, livestock and small-scale agricultural producers. Diaspora remittances provide many individuals and families with additional sources of income. Joint projects financed and sometimes implemented by diaspora actors contribute to improving infrastructure, economic conditions and social services in a neighborhood or town. But diaspora support network can also contribute to rendering access unequal as not every household has someone oversees.

2.7 Grants

Somalia remains highly dependent on aid and remittances. The official grants to Somalia exhibited a fluctuating trend, with average value of more than 30% of GDP over the last three years. On the other hand, foreign direct investment (FDI) in Somalia remained relatively stable, with an average of 7.8. Somalia is heavily reliant on external grants, which are expected to decline significantly after the HIPC Completion Point (HIPC CP). External grants finance roughly half of the budget, with the World Bank providing around 82 percent of total grants in 2022. However, while debt relief at the HIPC CP will facilitate Somalia's access to new sources of financing, it will also entail a change in IDA financing terms as applicable to countries at a moderate risk of debt distress, from all grants to only concessional lending.

Figure 8: Financial flow as % of GDP



Source: World Bank, 2023, Somali Economic Update

2.8 Trade - Regional Integration[5]

Somalia's geographically strategic location in the Horn of Africa region, straddling the Gulf of Aden, Red Sea, and Indian Ocean, where 80% of the international maritime trade moves through, provides strategic importance for the region. The region is estimated to have a population of about 136 million of which over 60% are under the age of 30 years. While this disproportionally young population (often referred to as the youth bulge) presents a broad array of challenges, nevertheless, the region can be transformed into a great economic power with its population growth-purchasing power, mineral and other natural resources.

Due to the consequence of more than three decades of civil conflict and fragile security conditions, Somalia was unable to fully participate in regional trade and economic integration.

Nonetheless, the FGS hopes that Regional Integration can assist the country in achieving its goals of ensuring sustainable, pro-poor economic growth, poverty reduction, and stability. Active participation in regional integration will enable Somalia to benefit from its opportunity of having the longest coastline in mainland Africa. In particular, its strategic geographical location as the bridge and/or corridor between the Horn of Africa region and the Middle East, Asia and Europe, has the potential to transform Somalia into a logistics hub and free trade area for exports to and imports from the region (specifically Kenya, Ethiopia and South Sudan). In this context, the potential benefits of regional integration include, among others, increased physical access to markets, an enhanced trade environment, and improved business competitiveness. Currently, Somalia's main regional trading partners include Ethiopia and Kenya, which, respectively, account for about 34% and 9% of its imports. However, the country's exports to the region are very low. Thus, the need to develop potential trade corridors and improve customs and border management to facilitate trade and increase revenues[6], is becoming increasingly important and urgent. To this end, Somalia's accession to the East African Community as the 8th Partner States and the ongoing efforts to secure membership of key trading blocks such as the African Growth and Opportunity Act (AGOA), the World Trade Organization (WTO) are commendable. Also underway are significant efforts to accelerate the country's membership of the WTO spearheaded by the newly appointed Chief Trade Negotiator. The AGOA file has also made headway with the submission of the membership request to the US government following bilateral engagements between the two countries on the side-lines of the US Africa Summit of December 2022.

2.9 Private Sector

Somalia's Private sector has been operating in a regulation-free environment and has flourished since the central government's collapse in 1991. During this period (conflict period), private sector economy, particularly in the financial, telecommunication, transport, and related services, expanded significantly. The main drivers of the Somali economy are remittances, trade, and services. The scale and importance of the diaspora in all aspects (political and economic) cannot be overstated.

Recommendations and the Way Forward

Years of conflict and instability have hurt Somalia's economy, resulting in low-income levels and few job opportunities. Economic growth has been slow, failing to keep up with population growth. Employment rates are low, particularly for women and youth. The economy is also vulnerable to natural disasters and external economic shocks. Floods and droughts are hurting Somalia's agriculture and causing food insecurity and displacement. The country relies on aid and remittances to finance consumption and trade deficit but needs to build resilience for sustained growth. The lack of jobs and monetary/fiscal tools make investment in human and physical capital difficult. Private sector growth and the successful conclusion of the debt relief initiative can help Somalia's development.

2.10 Policies Needed – The Fiscal Side

The rather low domestic revenues, with root causes from the collapse of the country's tax system during the decades of civil war and substantial informality, continues to hinder government's ability to deliver developmental projects and offer services to the citizens. The country's tax revenue from income (including profit and capital gains) is estimated to be 0.2 percent of GDP in 2022 and 2023, whiles taxes on goods and services is also estimated to be 0.3 percent of GDP in 2022 and 2023. Meanwhile, taxes on international trade, which is the largest source of domestic income, is only 1.4 percent of GDP in 2022 and 2023. Indeed, the overall tax revenue in Somalia is estimated to be 2.1 percent of GDP in 2022 and 2023. Such is the low levels of domestic revenues which cannot cover even compensation of workers estimated to be 3.1 percent and 3 percent of GDP in 2022 and 2023 respectively (IMF, 2023). Improving domestic tax revenue is an imperative that should begin with strengthening of the tax policies and framework, as well as diversification of sources of tax revenues. Although progress has been made in recent past through reforms on tax administration and policies such as spectrum fees, customs modernization, turnover tax, and roll out of point-of-sale machines at the premises of large tax-paying institutions (especially in tourism and telecom sectors), more needs to be done to improve domestic tax revenues. The large informality in Somalia, reflected by the taxes on income (including profits and capital gains) of 0.2 percent of GDP, would have to receive the most attention. Government would have to work on registration of businesses and citizens. Easing registration processes, providing tax identification numbers to businesses and citizens, and making registration for tax identification numbers by citizens and businesses a requirement for accessing public services (including passport acquisition, land registration, sim card registration etc.) are important steps towards formalizing the informal sector. In addition to broadening the tax base by formalizing the informal sector, government would have to work at containing expenditure levels, especially as the country approaches HIPC Completion Point where grants (on which the country depends heavily) may not be readily available.

2.11 The Productive Sector (Crop, Livestock and Fisheries) is a Key to the Somali Economy

Somalia with its population of 16 million people occupies an important geopolitical position between Eastern Africa and the countries of Arabia and southwestern Asia. The topography of Somalia is mostly made up of plateaus, plains and highlands, with 8 million hectares of arable land available for cultivation and the longest coastline in Africa (3,333 km). The livestock population (mostly goats and sheep) is estimated at 56 million heads, with 68 percent of land territory considered to be rangeland. The country is also endowed with two major rivers (Juba and Shabelle) supporting the production of irrigated crops (maize, rice, sesame, fruits, and vegetables) on about 250 to 300 hectares in southern Somalia. The majority of the territory is classified as arid or semi-arid with minimum amount rainfall in the central and northern part of the country and sufficient rainfall that supports crop and livestock in the southern parts of the country. The current pollical condition, climatic change, lack of agriculture support services have clearly impacted the country's productive (crops, livestock and fisheries) sector in recent decades.

Despite prevalent security challenges, notably within the agricultural production domain, coupled with erratic weather patterns, diminished productivity, and inadequate infrastructure, Somalia has demonstrated commendable advancements across various facets of its productive sector. In recent years, there has been a notable surge in diaspora and local-driven investments within the private sector, thereby creating a substantial potential for economic expansion. A significant portion of these investments is directed towards climate-resilient agriculture practices, exemplified by the implementation of greenhouses for vegetable cultivation in urban areas, as well as the augmentation of fodder production in rural hinterlands. Concurrently, the productive sector's value chain has witnessed the establishment of a spectrum of processing industries, encompassing grain mills with sophisticated machineries, seed processing and packaging using out-grower's model, modernized slaughterhouses, and fish processing industries.

This revitalized focus on both livestock and crop segments is a manifest in their heightened contribution to the GDP, which now stands at an impressive 75%. Particularly noteworthy is the rise of livestock exports, predominantly live animals, constituting a substantial 93% of the nation's total export revenue[7]. Moreover, government institutions engaged in the productive sector are eagerly involved in formulating crucial policies and regulatory frameworks, aimed at fortifying the enabling environment and smoothing the path for heightened private sector involvement and investments.

In addition to the crop and livestock sectors, the productivity of the fisheries sector is poorly developed. This is attributed by the lack of know-how (fishing technology), inefficient means of production (appropriate boats, engines and fishing gear), lack of cold storage facilities, and restricted market access (both local and international). Despite having the longest coastline in Africa and oceanic waters with diverse fish species, very little is known about the state of fish stocks due to a lack of effective government oversight. Moreover, studies conducted by the Frontier of Marine Science show that Illegal, Unreported, and Unregulated (IUU) fishing in Somali waters has been problematic for decade. Foreign fishing has increased more than twenty-fold since 1981, as against a very small increase in local fishing. From 2019 to 2022 it was estimated that IUU fish caught each year in Somali waters had a value of between USD 50 to 200 million[8]. To discourage this practice, the national Fisheries Sustainable Development Act of 2023 prohibits all types of trawling and illegal fishing in Somalia waters.

Somalia's exports totaled $482 million USD in 2021. The productive sector, livestock and crop sectors in particular, are the major contributors to the export market, accounting for 56% and 15% revenue generation. The revenue for the livestock and crop sectors in 2021 was valued at $275 million and $72 million, respectively[9]. Oman was the top destination for the export of the livestock and crop products, followed by UAE and Saudi Arabia. Investing in these sectors will significantly contribute to employment opportunity for the growing youth population, food security while generating revenue from new market opportunities.

1. Characterization of the dominant actors in the Somalia's productive sector

The livelihood systems consist of pastoralists, agro-pastoralists, fishing and coastal communities, urban population, and internally displaces people. According to FAO studies, almost 46 percent of employed people work in agriculture, 25 percent in crop cultivation, 9 percent in herding, 4 percent in fishing, and 7 percent in related activities[10] (such as forestry and agro-processing). In recent years, because of conflict and recurrent droughts and floods, there has been mass migration of rural communities, particularly those involved in the crop sector, to urban and per-urban areas thus increasing the production cost due to labor shortages. A summary of the major actors engaged in the productive sector is listed below[11]:

- **Small-scale and subsistence farmers** that form about 90% of the crop sub-sector with an average of 2 to 5 hectares. The small-scale farmers are heavily engaged in the production of cereal crops such as maize and sorghum; legumes such as cowpea, mung beans and groundnut as well as vegetable production.
- **Commercial farmers** that constitute about 10 of the crop sub-sector with an average of 20 to 100 ha of land. The commercial farmers are heavily engaged in the production of fruit crops such as banana, lemon, grapefruits, papaya and mangoes.
- **Nomadic pastoralism and agro-pastoralism (settled mixed crop and livestock farming).** Pastoralists rely on seasonal migration in search of pasture and water. Agro-pastoralists often use crop residues as feed in dry seasons if they have access to sufficient water.
- **Peri-urban dairy farming system,** which mainly relies on purchased supplements and grain and crop by-products as feed, alongside the open pasture systems in rainy seasons. These commercial medium-sized livestock-rearing operations with dairy animals (mostly camels) have been on the rise in peri-urban settings, supplying nearby urban markets with fresh raw milk only, as there are only a few processing facilities in the country.
- **Agri-Vet dealers** that supplies seed, inputs and veterinary services to both crop and livestock sectors
- Domestic food import markets that are characterized by a myriad of small and medium size traders typically relying on a small number of large importers operating across the country or at least in several regions.
- **Agri-processing** investing in the state-of-the-art technologies in the in seed, grain, meat and fishery processing, packaging and marketing. Sesame industry plays a major role in both local and international markets.
- **Women farm workers and traders** that play a major role the agriculture activities and market trade

of agriculture products. Almost 90% of the milk traders and market traders are women. Also, the retaile and food service sectors are dominated by informal, mostly family-owned microbusinesses, with women playing an important role in trade.

- **Small-scale and artisanal fishermen** that for form over 90% of the fishery sector. Outside the main urban centres and coastal villages and towns, fish consumption is not an integral part of the diet, which is dominated by meat and dairy as main sources of protein, especially for the nomadic population.
- **The diaspora community** who provide remittances to relatives living in the country. In recent years, the Somalia diaspora is directly investing in the productive sectors while also providing technical support services to government institutions.
- **The humanitarian and development agencies** that play a role in supporting the productive sector through distribution of seed, inputs, fishing gears and rehabilitation of crop, livestock and fishery infrastructure to help communities affected by drought and flooding.
- **Government institutions** that play a leading role in designing and implementing policies, laws and regulations related to the Somali food systems. The role played by the government is to protect the interest of both the producers and the consumers while attracting investments and facilitating export of the local products to international markets.

2. The productive sector is a key to the Somali economy

The pillars of the Somali economy lie in its livestock, crops, and fisheries. In the late 1980s, the nation achieved near self-sufficiency in cereal production, particularly in maize and sorghum, and even emerged as a key exporter of bananas to Italy and Middle Eastern nations. However, this trend took a downturn in the 1990s, following the onset of civil strife, which significantly curtailed crop cultivation and resulted in a persistent deficit in food crop production. Moreover, the sector grapples with challenges stemming from inadequate agricultural inputs, lack of improved seed varieties, constrained market accessibility, and substantial postharvest and storage losses.

It is noteworthy that there was a consistent increase in animal production from 1961 to 1989. The advent of the civil war in 1990 has temporarily slowed down the production; however, livestock production has since rebounded and found stability post-1995[12]. Nevertheless, the pace of livestock production has not kept abreast with the burgeoning human population. Over time, there has been a shift in the relative prominence of the livestock subsector, which ascended from 75 percent of sectoral production in the late 1980s to 83 percent in the mid-2010s. During this same interval, the crop subsector's contribution dwindled from 25 percent to 17 percent of sector output[13].

In spite of formidable challenges faced over the past three decades, and in anticipation of those on the horizon with the escalating impacts of climate change, the livestock and crop subsectors persist as the primary sources of economic endeavor, employment, and exports for Somalia. It merits mention that due to recurrent droughts and environmental degradation resulting from overgrazing, the population of livestock in Somalia may have reached a plateau. Elevating livestock productivity will necessitate the adoption of enhanced livestock production practices.

Regarding cereals, maize and sorghum hold paramount importance as staple food crops in Somalia. The primary production regions are in the South West and Hir-shabelle States. Notably, cereal production attained its peak in the mid to late 1980s, followed by a sharp decline in 1990. Over the past half-decade, annual production has averaged a mere 200,000 tons, a stark contrast to the 650,000 tons recorded in 1988[14]. Production is characterized by notably low yields, particularly for small-scale farmers, ranging from 1 to 1.50 tons per hectare for maize and 0.3 to 0.6 tons per hectare for sorghum. The potential yield for maize and sorghum is reported as 10 to 15 MT/ha for maize and 5 to 10MT for sorghum[15]. The low yields of both crops primarily stem from a lack of high-quality seeds, the prevalence of endemic pests and diseases, and suboptimal crop management and production practices.

In light of the production declines in recent decades, it is not surprising that domestic food production in Somalia now fulfills only a modest fraction of the local demand. The 2023 Gu season cereal production in southern of Somalia is estimated at 85 400 tons. The above production estimate is 34% below the long-term average. This is mainly attributed to moisture stress and long dry spells, low river levels that affected irrigation in riverine areas, floods in some riverine areas, high cost of farm inputs and civil insecurity that disrupted crop cultivation[16]. The food production deficient and the domestic requirement is covered through food imports and food aid. Food imports reached a peak in 2012 due to a declared famine in 2011 and accounted for almost 75 percent of the food consumed in Somalia that year[17]

The main imported food products include cereals (primarily rice, wheat, and maize), sugar and honey, roots and tubers, and dairy products. The value of food imports rose by a factor of 18, reaching almost USD 5.08 billion in 2021[18], up from an annual average of about USD 0.082 billion in the late 1980s. Import of food products in 2021 accounts for $2.38 billion. Increased domestic demand for food, changing dietary habits and the collapse of domestic staple crop production are key factors behind this massive food import increase[19].

Livestock stands as the primary export commodity, with goats and sheep forming the predominant share. These are primarily destined for Saudi Arabia, where a heightened demand is witnessed, especially during the annual Hajj pilgrimage. Since 2003, annual exports of goats and sheep have witnessed a steady rise, culminating in a peak of approximately 250,000 goats and 150,000 sheep in 2015 – three to fourfold increase compared to pre-civil war figures[20]. This notable surge is primarily attributed to robust growth in livestock exports. In contrast, crop exports have dwindled significantly compared to their pre-civil war levels, chiefly due to the collapse of banana export. Consequently, the livestock subsector's contribution to total export earnings escalated from 53 percent in the late 1980s to an impressive 84 percent by the mid-2010s[21]. The estimated average annual worth of live animal exports for food surged from roughly USD 56 million in the late 1980s to USD 378 million during the period of 2011–14, peaking at USD 494 million in 2019[22]. However, it is crucial to acknowledge that the subsector's output can experience notable declines in years marked by drought or in the wake of export market disruptions, such as the import ban imposed by Saudi Arabia.

The fastest growing export market for the fishery sector is Ethiopia and United Arab Emirates. However, the import of processed fish far exceeds the export. An estimate of $17.5 million/year of canned fish is imported into Somalia[23]. The annual fish production is estimated at 85 MT year with 90% of the catch consumed locally. The potential yearly fish production is about 300,000 MT[24]. Estimates from the Ministry of Fishery suggests 7% increase in local fish consumption, though the consumption is confined mainly to urban areas. The sector employs 100,000 to 120,000 people both directly and indirectly and generates government income ranging between $4 to $17 million/year from issuing licenses to foreign vessels[25].

3. Proposed entry points-strategic Interventions

Based on the analysis discussed above, the productive sector requires a major reform to address the food insecurity and trade deficits. The following strategic interventions are recommended:

1. **Institutional capacity building capable of undertaking adaptive research and extension services, developing agriculture policy and regulations and promoting linkages in the crop, livestock and fishery value chains.**

In the midst of three decades of civil unrest, the capacity of government institutions to provide essential research and technical support services has regrettably waned. This has led to a shortfall in policies and regulations, exacerbating challenges within the productive sector's value chains. The persisting skill gaps in crucial areas like crop cultivation, livestock management, and fisheries have further compounded the issue, exacerbated by limited resources. Academic institutions, too, are struggling to produce skilled professionals to meet the demands of emerging industries. As a result, existing and new private ventures are grappling to access the latest technologies to keep the industries functional.

Now, more than ever, there is a pressing need to invest in institutional and personnel capacity. This encompasses policy development, in-depth research, adaptation trials, and widespread extension services. Recognizing the urgent reality of climate change, we must invest towards climate-smart technologies. This includes adaptation trials, conservation agriculture, and the cultivation of drought-resistant food and fodder crops, finely tuned to local conditions, thereby fortifying value chains for crops, livestock, and fisheries. These dynamic interventions are poised to revolutionize the productive sector, sparking a wave of innovation and growth. A crucial step forward is the establishment of technical and vocational education and training (TVET) schools, accompanied by robust capacity-building programs tailored specifically for the productive sector. By aligning skill development with market demands, we not only create new job opportunities but also propel economic prosperity. This integrated approach is the cornerstone for sustainable progress and inclusive growth.

2. **Crop diversification and production of nutrient rich food for both human consumption and livestock feeding through better rangeland management.**

Crop diversification is crucial for Somalia's food system, as the majority of consumed food is carb-heavy and lacks essential nutrients. Introducing protein and vitamin-rich crops can significantly boost farmers' economic returns, with legumes fetching notably higher prices in the market. The integration of diverse and micronutrient-rich crops such as fruits and vegetables is key to combating malnutrition and reducing child stunting.

Enhancing rangelands through strategic closures constitutes a key strategy for elevating livestock quality and productivity, encompassing both meat and milk production. By temporarily limiting access to specific areas, overgrazing is mitigated, allowing for vegetation to recover and flourish. This practice, when implemented judiciously, strengthens the overall health of the rangeland ecosystem, providing ample forage for livestock.

The introduction of high-quality fodder crops further amplifies the benefits. These crops, carefully selected for their nutritional content and suitability to local conditions, augment the dietary options available to livestock. This translates into improved livestock health, leading to increased meat production. Moreover, nutrient-rich forage directly impacts milk production, enhancing both quantity and quality. By integrating these measures, livestock keepers can optimize their operations, ensuring a sustainable and thriving livestock sector. This not only fortifies food security but also underpins the economic livelihoods of communities reliant on livestock for their sustenance and income. Additionally, it contributes to the broader goal of sustainable land management, fostering a more resilient and balanced agricultural landscape. Advancements in these domains, coupled with endeavors to encourage fish consumption, are poised to yield a host of positive outcomes. These include amplified food production, diminished dependence on imports, elevated employment rates for both youth and women, stimulated rural development, and a decrease in urban migration for employment. Furthermore, these efforts promise to enhance overall nutrition standards.

3. Support the strengthening of productive sector value chains and creating a larger market through improved quality standards.

Strengthening the production sector value chain, spanning from production to consumption is very crucial. This brings a comprehensive transformation to give rise to robust industries focused on value addition, resulting in a surge of employment opportunities and the creation of high-caliber products, all underpinned by elevated quality standards. Elevating these standards serves as a gateway to unlocking new potential markets, propelling the export of food products onto the international stage. To fortify these value chains, a multifaceted approach is imperative. This encompasses the bolstering of security measures, the judicious and effective enforcement of government policies and regulations, the cultivation of enhanced knowledge and skills among stakeholders, the facilitation of access to financial resources, and the establishment of robust research and extension institutions.

In this dynamic landscape, the private sector plays an important role in driving innovation and research, particularly in sectors characterized by strong commercial incentives, such as export markets for commodities like sesame, livestock, and fisheries.

3 Fiscal and Monetary Policy

3.1 Fiscal Policy

The Federal Government of Somalia has committed to boosting revenue, enhancing expenditure management, refining the intergovernmental fiscal framework, and improving collaborations with external development partners. The Ministry of Finance has successfully devised a comprehensive plan to bolster public financial management (PFM) practices from 2021 to 2024. The plan incorporates crucial reforms to establish a robust foundation for PFM. Collaborating closely with relevant departments and development partners, the Ministry has developed a strategy that will pave the way for more effective PFM practices.

The Government developed a thorough plan that focuses on addressing key issues in a prioritized manner. The plan will be overseen by the Ministry of Finance, but we also aim to establish stronger relationships with the Federal Member States to lay the groundwork for full fiscal federalism in the future. By successfully implementing this plan, the fiscal authorities will be able to achieve fiscal discipline, strategically allocate financial resources, and improve service delivery for all citizens. These outcomes are crucial for the well-being of our community.

Somalia has made remarkable strides in establishing core federal state capabilities through political, economic, and institutional reforms, despite the challenges posed by a prolonged civil conflict and ongoing violent conflicts with Al-Shabab terrorists. However, the government continues to struggle with inadequate domestic revenues, rendering it unable to cover its expenses. In pursuit of fiscal sustainability over the medium term, Somalia has set its sights on attaining a 15 percent tax-to-GDP ratio through a robust fiscal reform agenda that prioritizes domestic revenue mobilization, expenditure controls, and transparency and accountability in public resource management.

The Ministry of Finance is responsible for developing and implementing economic and fiscal policies. These policies include economic strategy, budgeting, and managing debt, collecting resources, managing cash, and overseeing taxes. In the upcoming fiscal policy sections, we will examine the details of domestic revenue and external grants, expenses, and recent government initiatives to improve domestic revenue through expanding the tax base, modernizing customs administration, and introducing new tax tools. These efforts give us hope that Somalia will achieve financial stability over the next few years with increased domestic revenue.

3.1.1 Fiscal Policy Consolidation

Fiscal discipline is of severe concern and needs to be sustained as the country is in debt distress. Somalia's budgetary discipline continues to yield positive results in reducing the debt-to-GDP ratio. The present value of total debt is around 40 percent of GDP as of 2022. This is significantly higher than the recommended level of 30 percent given the structure and debt servicing capacity of the country. Debt indicators are forecasted to improve gradually over the medium term, although the country is in debt distress.

A key outcome of a well-performing PFM system is fiscal discipline: Government spends only what it affords. Fiscal discipline requires that governments maintain fiscal positions consistent with macroeconomic stability and sustained and inclusive economic growth. To this end, the country cannot borrow as the IMF program prevents arrear accumulation. At the same time, the policy must be reasonable in pursuing resource allocation and distributional objectives and smoothing output fluctuations. Moreover, it is prudent to create budgetary cushions to allow for the possibility of a response to both adverse shocks and to deal with predictable fiscal pressures, such as those arising from security needs, pandemics, natural disasters, IDPs, and other issues. Failing to keep public expenditure within reasonable limits has dire consequences. Risks are significant in post-conflict and fragile environments, such as the case of Somalia.

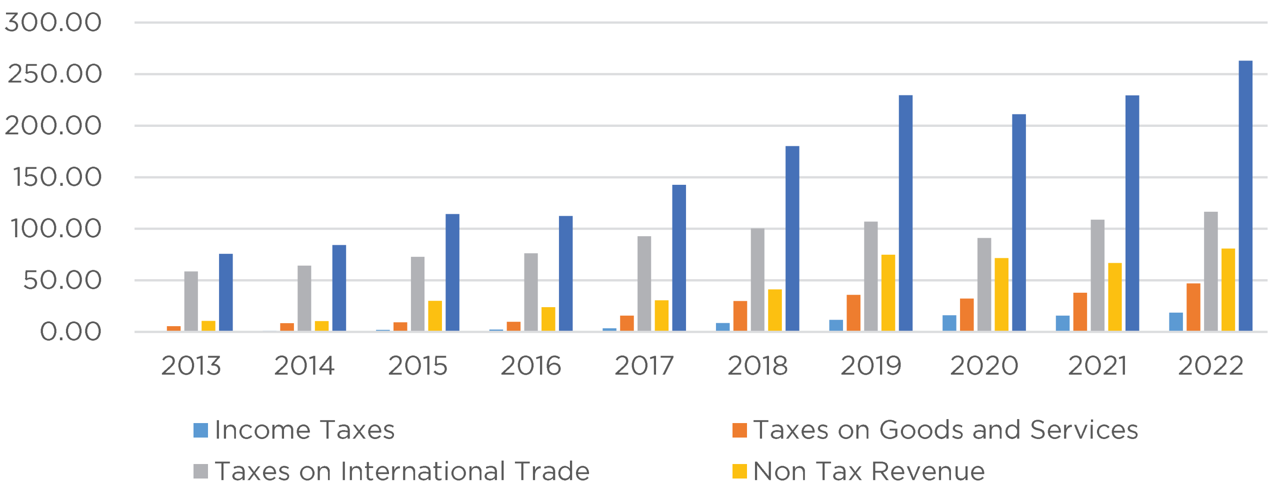
The fiscal policy in Somalia is being driven by a combination of higher (recurrent) expenditure and weak revenue performance supported by a high reliance on external grants. Thus, the country has limited capacity to provide services for the population. It is characterized by limited ability to mitigate social, economic, political, security, and environmental risks. Due to being a vulnerable economy, Somalia has followed a slower recovery after the pandemic hit it in 2019/20. GDP contracted by 0.4 percent in 2020, and inflationary pressures mounted as prices increased by 4.7 percent compared to pre-pandemic projections. Together, these challenges and others underscore how Somalia risk falling further behind the rest of the neighboring countries and the world if concrete actions are not taken to improve revenue mobilization.

3.1.2 Domestic Revenue

The domestic revenue of Somalia has exhibited a mixed trend over the years. Between 2013 and 2019, the revenue showed a steady growth trajectory, with a notable spike in 2018. However, a dip was observed in 2020, attributable to the impact of the COVID-19 pandemic, resulting in a recorded revenue of 211 million. Notwithstanding the challenges of the previous year (2021 and early 2022), largely attributable to election disputes, a marked upturn was achieved in 2022, with a figure of 263 million, indicating a growth of over 15 percent compared to the preceding year. This upswing can be attributed to the recent change in administration and the post-election stabilization of the economy, which led to a resurgence in economic activity and revenue generation.

Taxes on international trade emerged as the largest revenue source, which contributed 58.73 million USD in 2013 and almost doubled in 2022. This source accounted for 44% of Somalia's total domestic revenue of 263.08 million USD in 2022, highlighting the importance of international trade as a significant source of revenue. In Figure 9, the bar chart illustrates the breakdown of Somalia's domestic revenue from 2013 to 2022, classified into four categories: taxes on international trade, non-tax revenue, taxes on goods and services, and income taxes.

Figure 9: Trends on domestic revenue 2013-2022



Source: Ministry of Finance, 2022

In Somalia, non-tax revenue is the second-largest contributor to domestic revenue, accounting for 31% of the total revenue in 2022 and amounting to 81 million USD. This revenue has increased rapidly from 10.72 million USD in 2013, demonstrating the country's growing ability to generate income from sources other than taxes. The third-largest source of domestic revenue is taxes on goods and services, which generated 47 million USD or 18% of the total revenue in 2022.

It is worth noting that income taxes have consistently remained low, contributing only 7.1% of domestic revenue or 18.66 million USD in 2022. Despite this, there has been a gradual increase in value over the years, albeit slower compared to other revenue segments. It is interesting to note that income taxes have never contributed more than 7% of the total domestic revenue. However, there is hope for an increase in the future as a new income tax bill is expected to be ratified soon.

3.1.3 Strengthening Revenue Mobilization in Somalia

The FGS is facing major obstacles in increasing its tax revenue due to a lack of an effective domestic tax system, a weak formal economy, and fragile revenue-generating institutions. The economy is mostly informal, with weak regulations, and relies on industries such as livestock, crop production, fisheries, communications, construction, and energy.

Somalia relies heavily on imported goods and services, which are funded by remittances and aid. Although accurate data is scarce, most estimates place Somalia's GDP per capita in the bottom five countries worldwide. Additionally, the country's domestic revenue as a percentage of GDP is extremely low. This is primarily due to a poorly functioning tax administration system, which leads to inconsistent tax compliance from both citizens and corporations. Another obstacle to increasing tax revenue is the public's lack of confidence that paying taxes to the government will result in adequate public services. This is partly due to budget limitations, as the majority of the Federal Government of Somalia's budget is allocated to civil servants and security staff salaries, with only a small portion left for public services. As a result, state legitimacy and public trust are crucial in ensuring progress in development efforts. With the relative absence of a functioning state for an extended period, building social contracts in Somalia is challenging and has primarily come second or third to more pressing issues, such as security and fragility. As the FGS continues to establish itself, it is trying to support its state legitimacy by establishing national safety net programs.

Somalia has a huge unused potential for mobilizing domestic revenues. Key factors hindering Somalia from reaching its potential for domestic revenue mobilization include a large informal sector, weak tax instruments, low tax compliance, and inadequate tax-customs administration performances weakened by a fragile security condition. Tapping into its full potential will require: (i) expanding tax base; (ii) a revised tax policy aligned with those of best performers in the region; (iii) a strengthened tax administration with the capacity to recover tax arrears and fight against tax evasion; (iv) digitalized tax and customs administration procedures to promote transparency and reduce tax misreporting; and (v) Government commitments underpinned by a transformative leadership that places peace and stability at the center of sustainable development are also critical ingredients to leveraging domestic resources.

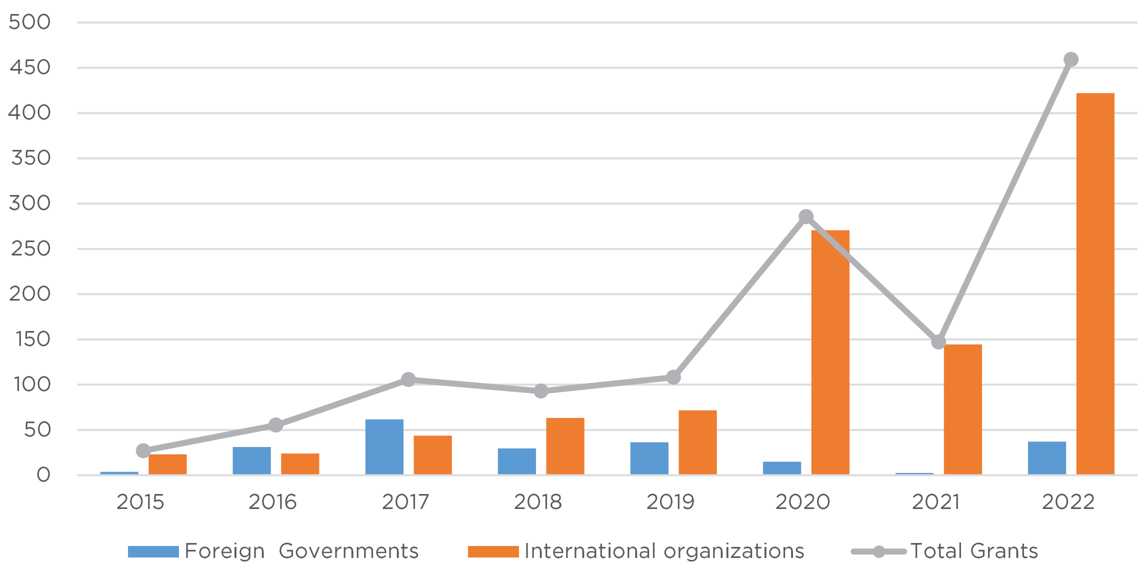
There is a substantial divergence of revenue collection and potential[26] between the FGS and Federal Member States (FMS) due to the reliance on trade taxes, which leaves the FGS, and some member states (Puntland and Jubaland), who operate major ports in a strong position compared to the other FMS. This leads to relatively limited revenue potential in the short term but a much higher potential in the mid-term as other sectors play a bigger role.

3.1.4 Donor Financing

The Somali Budget has almost doubled to 918.7 million USD in 2022 namely due to a surge in donor funding, particularly in project support, accounting for two-thirds of the budget. Domestic revenues remain low at 3 per cent of GDP and 27 per cent of total revenues as informality and poverty make it difficult to impose and enforce new taxes. More than half of the budget is allocated to recurrent operational spending, whereas capital and social spending remain relatively low compared to peers. It is vital for Somalia to improve domestic revenues and limit wasteful spending against structural difficulties in widening the tax-base to expand fiscal space for financing socio-economic development.

Seventy percent of the budget is funded by donor revenues. Grants are predicted to amount to 159 million USD in 2023, while project support is expected to reach 505.4 million USD. The majority of donor revenue comes from World Bank programs, which make up approximately 88.6 percent of total spending, equalling 587.5 million USD. The remaining sources are as follows: Turkey (4.5 percent), African Development Bank (3.8 percent), UN agencies (1.6 percent), and the EU (1.5 percent).

Figure 10: FGS external grants 2015-2022



Source: Ministry of Finance, 2022

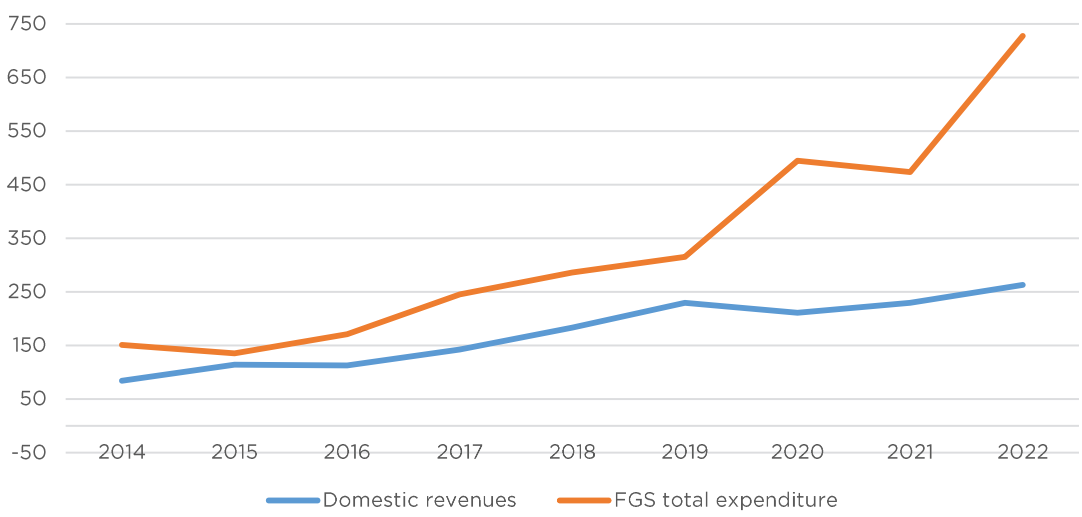
Here is a breakdown of the external grants that Somalia received between 2015 and 2022, as shown in Figure 10. In 2015, the country received 27 million USD in external grants. This amount gradually increased to 55 million USD in 2016, and then spiked to 106 million USD in 2017. However, in 2018 and 2019, the amount of external grants slightly decreased, returning to 2017 levels. In 2020, external grants increased substantially to 286 million USD, mainly due to international partners providing support to combat the impact of the COVID-19 pandemic, flooding, and locust infestation. Unfortunately, external grants decreased in 2021 to 147 million USD due to the stalled election and disputes over the extension of the previous government's term.

3.1.5 Expenditure

Somalia has an unusual fiscal structure reflecting its historical legacy (e.g., traditionally low domestic revenue mobilization), the long period of conflict (civil service wage greatly eroded by inflation and severely compressed by fixed allowance), and current reconstruction activities (very high spending) and priorities (e.g., massive expenditure on security).

The fiscal structure and trends outlined above shows that there is a great and urgent need to mobilize more domestic revenue. As shown in Figure 11, only an intensive effort to improve tax – collection – with sound policy measures and administrative improvements leading to higher compliance will result in sustained rapid revenue growth and sustainable fiscal balance over the medium term. Robust revenue growth will also give development partners greater confidence to continue providing external support to finance the operating budget.

Figure 11: Revenue & Spending (in Million dollars)



Source: Ministry of Finance, 2022

When making spending decisions, it is important to consider their long-term implications. While external assistance may cover significant operating costs in the short run, these expenses will eventually become a burden on the government's own resources.

3.1.6 Fiscal Sustainability

Relying too much on external grants can put the country's macroeconomic stability at risk, especially if there are any shocks in the flow of grants, such as the one which happened in 2021 over the election impasse. To address this challenge, it is crucial for the Somali government to focus on increasing its internal revenue by introducing policy reforms and coming up with innovative ways to generate revenue.

It is important for Somalia to expand its sources of income and reduce its dependence on external grants in order to achieve financial stability and meet the country's developmental needs.

3.1.7 Summary and Recommendations

To attain fiscal stability, the government implemented various measures, including the modernization of customs operations. This involved implementing the planned an ad-valorem tariff schedule and issuing customs regulations on valuations and declarations.

The government is currently testing out the Customs Automation System (CAS) at Mogadishu's port and airport. This system will help make revenue collection more efficient and transparent. Once implemented across all FMS ports, the CAS will allow for a common valuation table and make customs operations smoother.

In September 2022, the government approved a spectrum fee schedule for telecom operators. This measure is expected to bring in 6 million USD annually for the next 10 years and will help enhance revenue collection. Although there were initial delays, this plan is now in effect. In the near future, the government plans to put POS machines in place at large taxpayers in the telecom and tourism sectors. This will be an important step towards contributing to revenues in 2023 though the actual revenue yield is currently uncertain.

Key measures to be undertaken by the Government include:

- Finalizing arrangements on fiscal federalism and adopt mechanisms on revenue sharing arrangements between the FGS and FMS's.
- Passing legislation to establish the Somalia Revenue Authority.
- Clarify existing legislation and pass new ones to reform the excise system.
- Eliminate the majority of goods from the list of items that are subject to excise and switch all excise rates from ad valorem to unit (specific) basis.
- Implement public financial management reforms to cut back on wasteful expenditure and budget escalation.
- Given the lack of a tax culture in the nation, a strong program for tax education, awareness, and sensitization should be put in place.

3.2 Financial and monetary sector developments

The financial sector in Somalia is still in its early stages and faces various obstacles. Among these hurdles are barriers related to financial infrastructure, such as the lack of credit market infrastructure, movable asset registry, and credit information systems, which result in high collateral requirements. One of the major challenges for the financial industry is the lack of a consistent national identification system, which makes it difficult to conduct proper know-your-customer (KYC) procedures and ensure financial integrity.

The financial sector in Somalia is made up of the Central Bank of Somalia, as well as 13 commercial banks, money transfer businesses, mobile money services, and microfinance institutions.

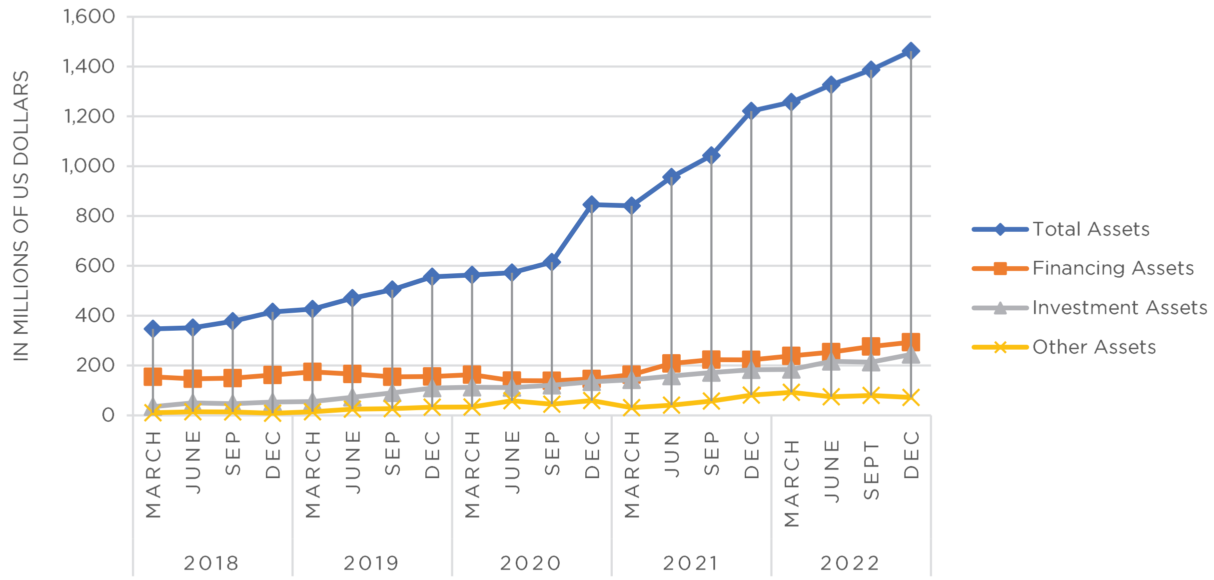
3.2.1 Banking sector structure and performance

Although the banking industry is still relatively new, it has demonstrated impressive expansion and durability. The overall assets of the banking sector have risen from 414.9 million USD in December of 2018 to over 1,462 million USD by December of 2022. It is impressive to note that there has been an expansion of over 3.5 times or more than 250 percent. Looking at recent trends, the banking industry's total assets increased by 20 percent from December 2021 to December 2022, from 1,221.2 million USD to 1,462.5 million USD. Financing assets and investment assets are the two largest categories of total assets.

3.2.2 Assets

Over the last four years, financing assets and credit provided to the private sector have grown significantly, increasing by over 86 percent from 161.4 million USD in December 2018 to almost 300 million USD in December 2022. Additionally, financing assets have expanded by 32 percent year-on-year from Q4 2021 to Q4 2022. Investment assets have also experienced substantial growth, increasing four-fold from 53.5 million USD in December 2018 to 244.8 million USD by December 2022, which represents an increase of more than 350 percent. In Q4 2022, investment assets increased by 34 percent compared to the same period in 2021, rising from 182.8 million USD to 244.4 million USD, which is equivalent to 17 percent of total assets (see figure 12).

Figure 12: Consolidate Bank Assets



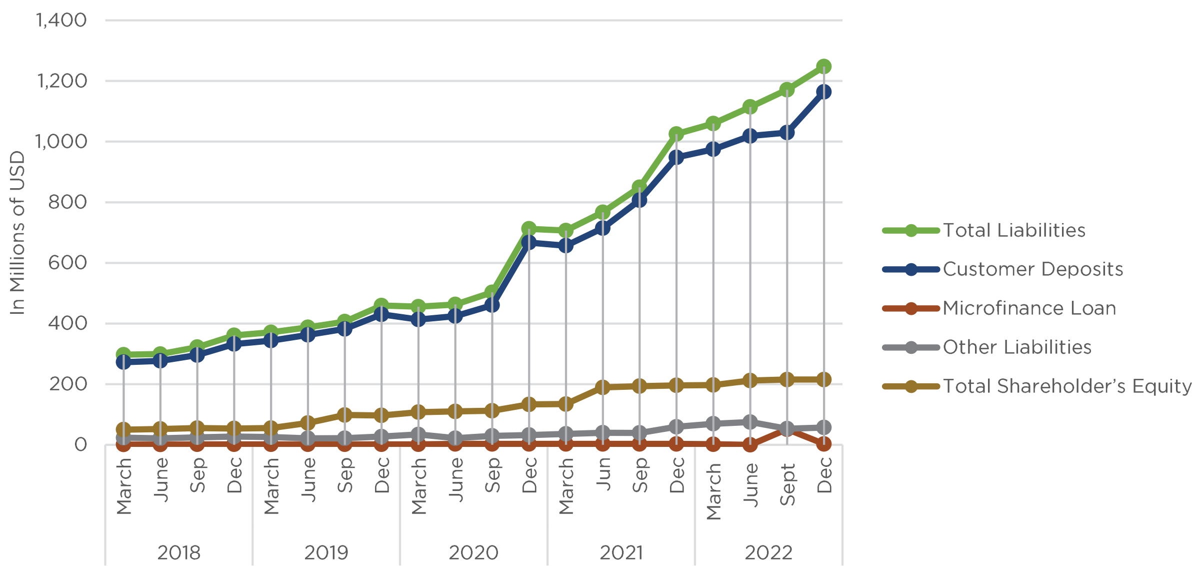
Source: CBS, 2022.

3.2.3 Liabilities

In the past decade, commercial banks in Somalia have experienced a consistent increase in their total liabilities and shareholders' equity. These liabilities consist of deposits from customers, interbank deposits, and microfinance loans. At the end of the fourth quarter in 2022, the total liabilities and shareholder equity reached 1,462.5 million USD, which is a 20 percent increase compared to the same period in 2021 when it was 1,221.2 million USD (see figure 13).

Liabilities in the banking industry grew by 22 percent to 1,247.4 million USD in Q4 2022 compared to the same quarter in 2021. Customer deposits increased by 29 percent in 2019, 57 percent in 2020, 44 percent in 2021, and 23 percent in 2022, reaching 1,164.3 million USD in 2022Q4.

Figure 13: Consolidated Commercial Banks Liabilities

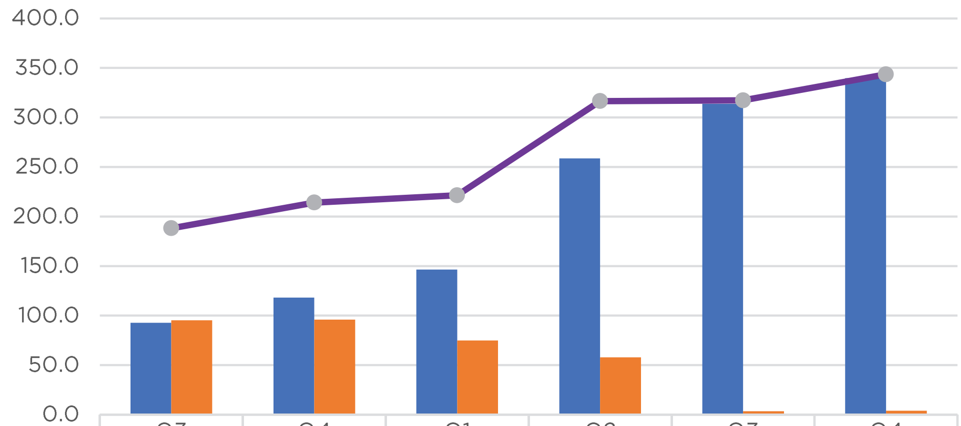


Source: CBS, 2022.

3.3 National Payment System

The Central Bank of Somalia established a National Payment System (NPS), enabling commercial banks to electronically transact with each other. The NPS is an interoperable system, which allows all 13 commercial banks to securely transact with each other electronically through a clearing and settlement system hosted and managed by CBS. The NPS increases the efficiency of the financial system and reduces risks for bank customers. In 2022, the total value of the performed transactions through the NPS reached 1,198.7 million USD. As shown in figure 14, as of March 2023, Somalia's NPS became ISO 20022 compliant, meaning it has the latest standards for exchanging electronic messages for domestic and cross border payments. Also, all commercial banks in Somalia successfully adopted the International Bank Account Number (IBAN) system for all transactions and payments. These milestones have made cross border payments more secure and modernized domestic payment infrastructure. In order to mitigate potential risks and strengthen AML/CFT protocols for domestic and cross border payments, the CBS has implemented SWIFT financial crime compliance services such as payment control service and transaction screening. Currently, the CBS is in the final stages of setting up a National Switch, which will support retail payments. As part of this initiative, CBS has drafted a national QR Code standard, which is expected to be fully functional in 2024. This will facilitate interoperability of the payment platforms including banks, MTBs and MMOs.

Figure 14: National Payment Report 2022 (Million USD)



	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
RTGS	92.8	118.1	146.5	258.7	313.8	339.7
ACR	95.3	96.0	74.9	57.8	3.5	3.9
Total Value is Million US$	188.1	214.1	221.4	316.5	317.2	343.6

Source: CBS, 2022.

3.4 Challenges, Opportunities and Outlook

Despite Somalia's impressive financial sector performance, critical issues need immediate attention. The lack of a unified national identification system is the most significant challenge, as it adversely affects the integrity of the entire financial system. The situation is made worse as international banks have adopted de-risking strategies to mitigate their exposure to AML/CFT risks. As a result, Somali financial institutions face multiple obstacles in cross-border payments and transactions due to limited correspondent banking relationships. Without a robust national ID system, it is difficult for financial institutions to maintain a robust financial integrity. Taken together, the challenges mentioned above have resulted in Somalia's credit to the private sector being below 4 percent of GDP, which is one of lowest in the world. Moreover, the absence of credit market infrastructure poses a related challenge that undermines robust financial intermediation.

Investment and exports in Somalia have remained low due to existing problems. However, the country has taken steps to address these issues, such as conducting a national risk assessment and preparing for a MENAFATF mutual evaluation in 2024. The Central Bank of Somalia (CBS) is also exploring a risk-based approach and considering an e-KYC system to enhance the reliability of the banking and payment systems. On the unified national identification system, significant progress has so far been achieved. For instance, the legal framework has been finalized, the agency responsible for national ID has been established, and most of the logistical and diagnostic work has been completed. These measures will increase financial access, promote development, and foster inclusion. It is important to note, however, that the Somalia economy is heavily reliant on the US dollar, limiting CBS's ability to conduct macroeconomic and monetary policies.

To overcome this issue, CBS is working with the World Bank to introduce new, reliable and secure Somali Shilling (SOS), which will enable the Somali population to use it as both store of value and medium of exchange. SOS is particularly critical for those segments of the population who do not have access to the dollar through wages or remittances. The objective of the 'currency exchange project' (known as 'Kalkaal') is to reclaim the money supply and to support SOS-denominated payment instruments for greater access to finance for the poorest people.

Although the Central Bank faces various challenges in setting future monetary and exchange rate policies, such as high public debt to GDP ratio, low foreign exchange reserves, underdeveloped financial and capital markets, high dollarization, and mobile money domination in payment instruments, there is a positive outlook. The CBS has made progress by identifying a suitable exchange rate policy and potential monetary policy regimes.

3.5 Recommendations

To strengthen the financial sector and expand financial deepening, the following policies are necessary:

- Policies to create an enabling environment for financial sector growth:
    - Strengthen the legal and regulatory framework with specific focus on risk-based approach and compliance to mitigate both idiosyncratic and systemic risks.
    - Widen the regulatory reach of the Central Bank, particularly in relation to overseeing the non-bank financial institutions such as mobile money, insurance, and microfinance.
    - Keep building and improving the underlying financial market infrastructure including credit information, collateral registry, national ID etc. to improve financial intermediation and private sector credit growth.
    - The Central Bank should update its financial sector development roadmap to sharpen its medium-term priorities given the post-HIPC environment.
    - Financial inclusion and financial sector integrity should be included into the new updated financial sector development roadmap to galvanize the role the financial sector plays in the overall economy.
    - The ongoing process of establishing Central Bank regional branches should be accelerated so that the Central Bank can perform its core mandates more effectively.
    - The Currency Exchange Project should also be accelerated to enable the country to have a viable local currency payment system. This is particularly important for the poorest segments of the society who are currently excluded from the dollarized economy.
    - Finally, the Central Bank should maintain its moratorium on new banking licenses to allow the sector to consolidate and grow properly. If this is not maintained, there will be a real risk of market saturation to the detriment of the integrity of the whole banking system.

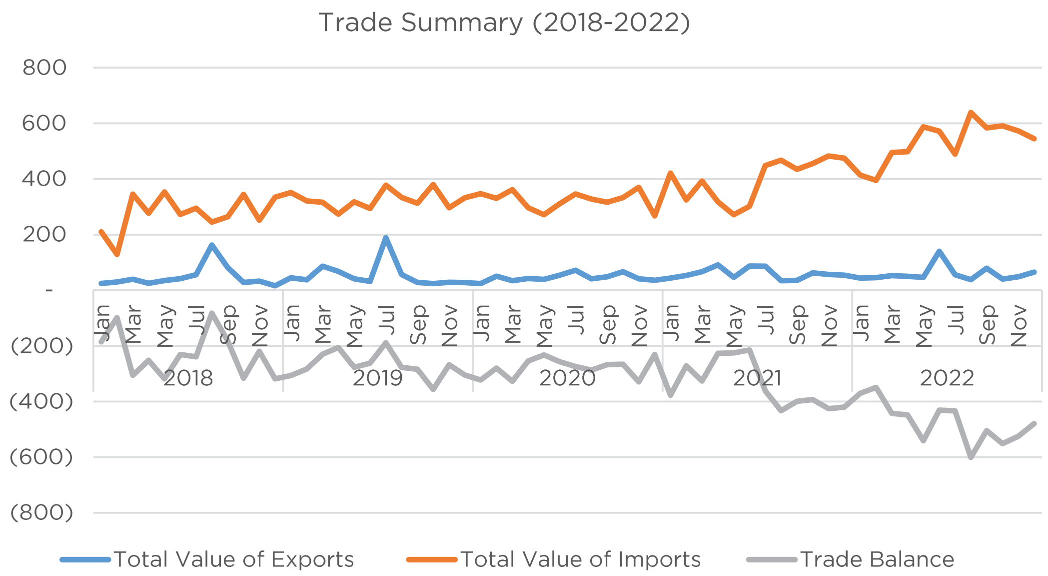
4 Trade and Investment in Somalia

Situated at the intersection of the Red Sea and the Indian Ocean, Somalia offers investors an opportunity to tap into a growing market in the region. This makes it an ideal hub for trade and commerce and a gateway to some of the world's most rapidly expanding economies[27]. Over the past decade, the country has made significant strides in recovering from the devastation of civil war and unrest, which has resulted in creating a robust and thriving market. The current government recognizes the private sector as the primary driver of the economic recovery.

4.1 Somalia's International Trade

Somalia has a diverse range of goods and activities involved in trade. Historically, the country has been actively engaged in trade along the Red Sea and the Indian Ocean. Key products traded include livestock, agricultural produce, and marine resources. The Somali diaspora's remittances also play a vital role in the country's economic growth. However, Somalia has encountered political instability and conflicts that have negatively impacted its trade.

Figure 15 Trend of Exports, Imports, and Trade Account Balance



Source: CBS, 2023

Trade plays a vital role in achieving growth, employment, and welfare. In Somalia, it is a critical component of GDP. Figure 15 illustrates the exports, imports, and balance of payments of the Somali Federal Republic from 2018 until 2022. Based on the CBS data, Somalia's exports amounted to 704 million USD in 2022, while imports were valued at 6.379 billion USD, resulting in a negative trade balance of 5.675 billion USD.

4.1.1 Analysis of Exports

The export trends in Somalia from 2018 to 2022 reveal significant changes in various categories of exported goods, reflecting both challenges and opportunities in the country's economy. Overall, total exports in Somalia experienced fluctuations during this period, with a notable increase from $549.28 million in 2020 to $717.10 million in 2021, followed by a slight decrease to $704.04 million in 2022.

Livestock: Livestock exports have consistently grown over the years, significantly increasing from $388.62 million in 2018 to $558.38 million in 2022. Somalia's livestock sector remains a vital contributor to its economy, and the consistent growth suggests its resilience and demand in international markets.

Table 1: Trends of Exports in Somalia 2018-2022(Figures in Millions)

#	Category	2018	2019	2020	2021	2022
1	Livestock	388.62	406.20	402.18	523.35	558.38
2	Livestock Product (Meat)	-	-	-	24.06	16.10
3	Fishery Export	-	-	-	34.80	51.33
4	Animal Skins	17.05	44.69	29.84	8.24	7.04
5	Crops & Vegetable Oil	95.53	96.00	88.08	79.79	46.02
6	Forest Products	60.97	110.43	12.73	10.17	12.15
7	Other	9.24	4.92	16.45	36.70	13.02
	Total	571.42	662.24	549.28	717.10	704.04

Source: CBS, 2023

Meat & Animal Skins: While not recorded in 2018-2019, the export of livestock products, particularly meat, experienced a noteworthy resurgence, reaching $24.06 million in 2021. This signifies Somalia's need to increase its capacity to process and export value-added livestock products. On the other hand, the export of animal skins, which was relatively stable until 2019, experienced a sharp decline to $8.24 million in 2021 and decreased to $7.04 million in 2022.

Fishery Export: Fishery exports started in 2021, amounting to $34.80 million and surging to $51.33 million in 2022. This sector holds untapped potential, and the upward trend indicates growing interest and investment in Somalia's fisheries.

Crops & Vegetable Oil: Crops and vegetable oil exports declined gradually from $95.53 million in 2018 to $46.02 million in 2022. Factors such as climate-related challenges and competition may have influenced this.

Somalia's export trends demonstrate a diverse range of goods, with livestock and fishery products gaining prominence recently. While specific sectors like livestock and fishery show consistent growth, others, like animal skins and forest products, display volatility. These trends highlight the importance of diversifying export sectors, improving agricultural practices, and exploring opportunities for sustainable economic growth in Somalia.

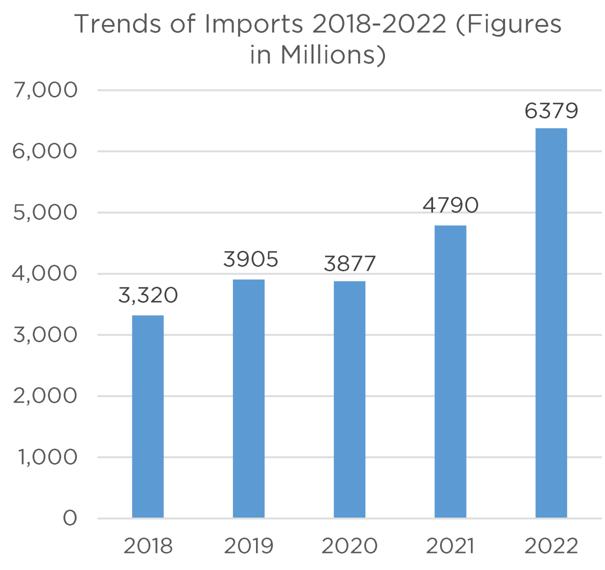
4.1.2 Analysis of Imports

Somalia has been experiencing a perennial trade deficit, with imports significantly exceeding exports at all times. This is due mainly to the country's heavy reliance on imported goods such as food, oil, construction materials, and manufactured products. The productivity in the country is low, and the economy is predominantly driven by household consumption.

Somalia spent USD 6.3 billion on imported goods in 2022, which is twice the amount spent in 2018 at USD 3.3 billion. The primary import categories include food, construction materials, oil, clothing and footwear, cars & spare parts, and medical products.

In 2022, Somalia imported food items worth USD 2.1 billion, accounting for 33.9% of total imports. Additionally, imports of construction materials, oil, and clothes & footwear amounted to USD 1.17 billion, USD 624 million, and USD 570 million, respectively. These imports represented 18.3%, 8.9%, and 9.7% of total imports.

Figure 16: Trends of Imports 2018-2022



Source: CBS, 2023

Somalia's largest imports originate from the United Arab Emirates, which contributes 30% of the total imports. These imports comprise a range of commodities such as Jewelry, broadcasting equipment, and milk. The second-largest country that Somalia imports from is China accounting for 20% of the total imports. The imported goods from China include textiles, footwear, electronics, and furniture.

The third-largest import partner is India, which accounts for 14% of the total imports. These imported items include raw sugar, rice, cars and spare parts, medicines, rubber footwear, ceramics, wheat flour, and more.

Upon analyzing Somalia's trade with its neighboring countries, Ethiopia and Kenya, it is apparent that Somalia has a higher import than export rate. Ethiopia supplies Somalia with vegetables, cassava, potatoes, lettuce, bananas, and tomatoes. Meanwhile, Somalia imports goods such as tobacco, medicine, soap, tea, and medical instruments from Kenya.

4.1.3 Factors influencing the perennial trade deficit

Somalia has been facing a persistent trade deficit, where the total value of its imports is higher than that of its exports. Several factors have contributed to this systematic trade deficit; these include:

First, Somalia's exports are concentrated in just a few sectors, such as livestock, agriculture, and fishing. The lack of export diversification limits the country's ability to generate income from a broader range of products. Second, political instability in the country has disrupted trade routes and made it difficult to develop and maintain infrastructure critical to trade. Third, Somalia has faced infrastructure challenges, including inadequate transportation and logistics facilities, which can hinder the flow of goods and increase the cost of trade. Fourth, Somalia has become heavily dependent on imports for essential goods like food, fuel, and machinery, which also contributes to the trade deficit. Lastly, limited access to finance and banking services can hinder trade financing and investment in productive sectors, constraining export growth.

4.2 Foreign Direct Investment

Foreign Direct Investment, or FDI, plays a crucial role in driving economic growth for both developed and developing nations. FDI brings with it employment opportunities, knowledge, skills, and technology, all of which enhance economic development (Alenezi, A., 2020, Brimble, P., & Sherman, J., 1999). As a result, many developing countries are actively seeking ways to attract foreign investors (Finance and Vulnerability, 2005).

To attract FDI, a stable legal system that upholds the rule of law and an independent body to settle investment disputes are necessary (Almahmood, A., 2011). It is essential to note that FDI can be categorized into three types: Natural resource-seeking, market-seeking, and efficiency-seeking. Natural resource-seeking FDI aims to access and exploit natural resources while market-seeking FDI is motivated by the size, growth of domestic markets, cost of labor, infrastructure quality, and macro-economic policies of the host government. Efficiency-seeking FDI is motivated by production costs, skilled and professional labor, and knowledge & innovation development (Botrić, V., & Škuflić, L., 2006).

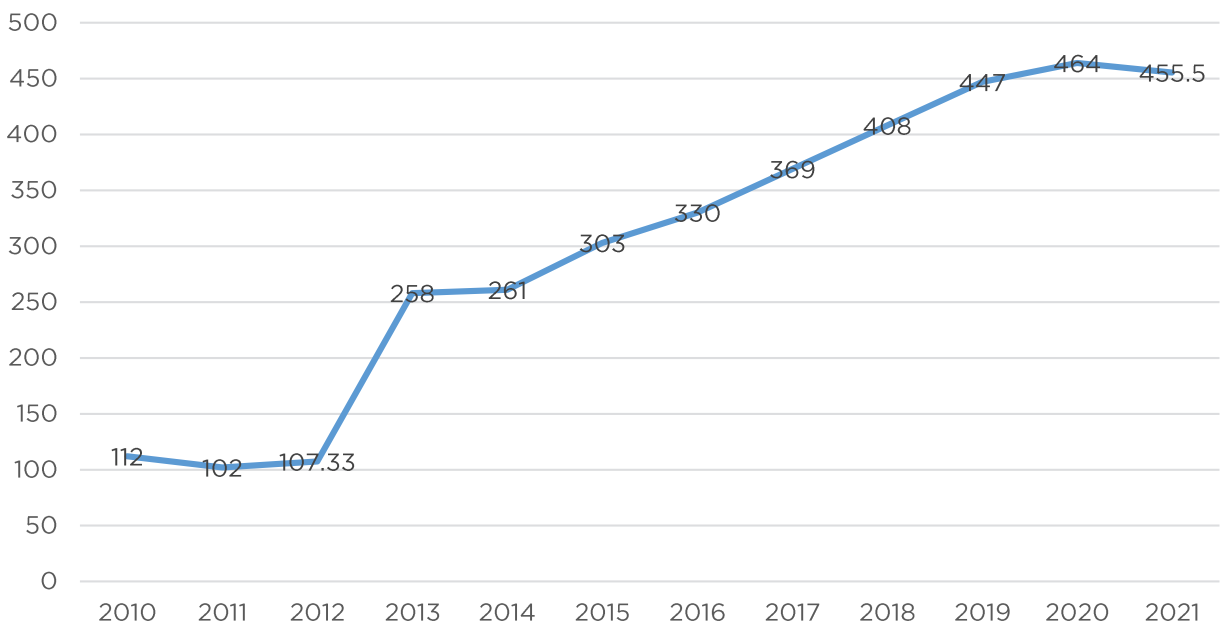
Foreign direct investment (FDI) in Somalia has been relatively low due to ongoing conflicts, political instability, and security concerns. However, recent efforts have been made to attract foreign investment and promote economic development in the country. The Somali government has implemented reforms to create a more business-friendly environment and initiated infrastructure projects to improve connectivity within the country. Some sectors that have attracted FDI in Somalia include telecommunications, banking, energy, and construction. Companies from countries such as Turkey, the United Arab Emirates and EU have made investments in various sectors. Additionally, Turkish companies have also been involved in construction projects in the country.

The Somali diaspora has played a crucial role in investment inflows, with many Somalis living abroad investing in sectors such as real estate, hospitality, and retail. Furthermore, remittances from the diaspora contribute significantly to Somalia's economy. It is important to highlight that despite facing different challenges such as inadequate infrastructure, corruption, legal uncertainties, and ongoing security issues, Somalia has made some progress in attracting foreign direct investment. The Somali government and its international partners are working tirelessly to address these obstacles and create a more favorable environment for foreign investment in the future.

Somalia is rich in natural resources such as arable land, a strong livestock industry, and a long coastline that offers access to an untapped "blue economy" (AGRA, 2019). Additionally, the country has a wealth of minerals such as gold, iron, and precious stones. With the right investment environment, these resources can lead to sustainable economic growth and provide a source of income for future generations. Somalia's natural resources and strategic location have traditionally made it an attractive location for FDI. However, in today's globalized world, these features alone are not enough to attract FDI as more countries compete for investment.

The chart presented displays the foreign direct investment inward flows to Somalia from 2010 to 2021. Notably, since 2012, there has been a significant increase in FDI inflows, indicating a marked improvement in the country's attractiveness to FDI. This is due to the end of the civil war, the end of the transitional government, and the formation of a new official federal government. Somalia has made some progress since then and has gained support from the IMF, the World Bank, and other international organizations. Unfortunately, due to political instability, Somalia's FDI performance has lagged behind many countries in the region over the last three decades.

Figure 17: Foreign Direct Investment, Inward Flows (Current Prices in Millions USD)



Source: WDI, World Bank, 2023

In 2021, Somalia received a total of 455.8 million USD in FDI, a decrease of 8.5 million USD from the previous year's inflows. This decline may be attributed to the post-pandemic economic crises affecting the world. The Ministry of Planning estimates that the FDI to GDP ratio is around 9 percent.

Since 2012, Somalia's security and state building has improved significantly, which encouraged FDI to increase in the country. Turkey has become one of Somalia's important partners, providing humanitarian assistance, military training, development aid, and private investment. Turkish companies' involvement in Somalia's private sector has increased significantly, with approximately 100 million USD invested in 2015.

Most of the FDI in Somalia is mainly concentrated in the healthcare and education sectors. More recently, two international banks from Egypt and Turkey have been licensed by the CBS and are expected to start their operations soon.

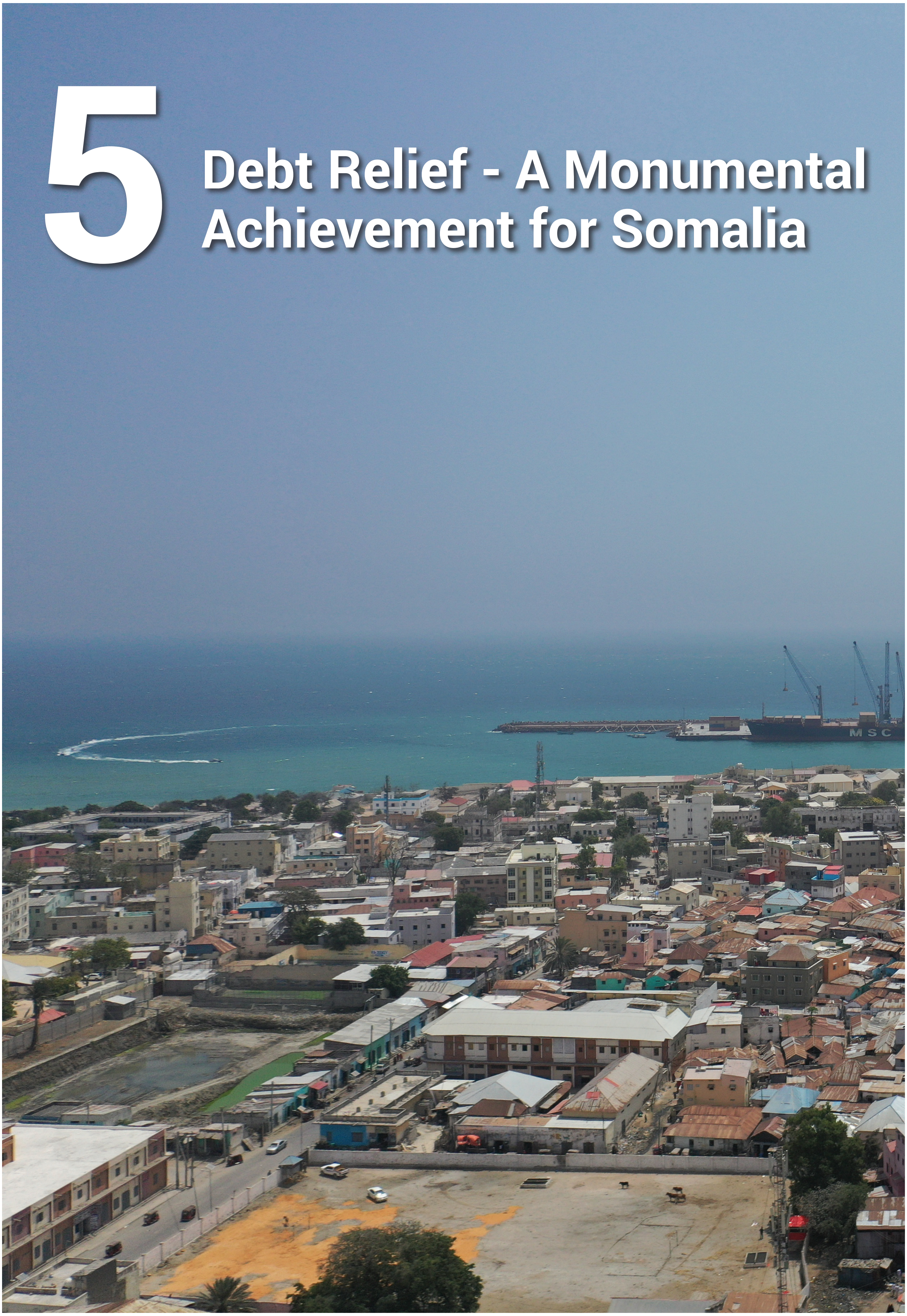
4.3 Policy Implications

The analysis of Somalia's international trade and FDI reveals that the country has been facing a consistent trade deficit for several years, which has worsened significantly since 2012. This persistent trade deficit is primarily attributed to Somalia's reliance on imports of food, fuel, construction materials, and manufactured goods. On the positive side, it seems that FDI has been increasing over the past decade, which has even a bigger potential to grow given the needs and opportunities available in the country.

Based on the overall analysis, the following policy recommendations are important:

- To improve the country's trade structure, it is important to diversify away from primary commodities such as live animals into more value-added products. At the same, the reliance on few concentrated markets is extremely risky, so improving access to global markets through trade agreements is pivotal.

- To attract and promote FDI, the legal and regulatory environment should be modernized and aligned with international best practices. This will subsequently support the domestic private sector of Somalia. Foreign investors demand a stable legal regime that upholds the rule of law and an independent body that can easily settle investment disputes.
- The financial sector should be improved to enable both domestic and foreign investors the means to get access to credit.
- Infrastructure (broadly defined) should be improved, and particularly access to road networks and reliable energy is important to support market corridors.
- The ongoing trade deficit can be addressed by instituting appropriate structural reforms and small-scale industrialization. This will aid both import substitution and export promotion.
- To promote economic competition and minimize monopolistic practices, competition and antitrust legislations and institutions are needed.



5 Debt Relief - A Monumental Achievement for Somalia

5.1 Introduction

The immediate priorities of the present FGS administration are: (a) to attain HIPC Completion Point (CP), (b) to combat Al Shabaab's terror, and (c) to deal with climate change-related issues.

In March 2020, Somalia reached Decision Point for the IMF debt relief program through the Heavily Indebted Poor Countries (HIPC) Initiative. As a result, it cleared the existing arrears and normalized its relationship with International Financial Institutions (IFIs). This process would pave the way for significant reduction in Somalia's debt stock and eventually would give the country the ability to address various economic challenges that have been affecting its growth and development.

In order to qualify for full debt relief under the HIPC initiative, countries must demonstrate satisfactory performance and meet certain conditions. This includes having a successful track record under an IMF program and implementing a poverty reduction strategy for at least one year prior to reaching the completion point.

At the heart of Somalia's debt relief process are a set of policy conditionalities and structural reforms that are meant to strengthen public institutions and ensure the effective and equitable use of public resources for the benefit of all Somali citizens.

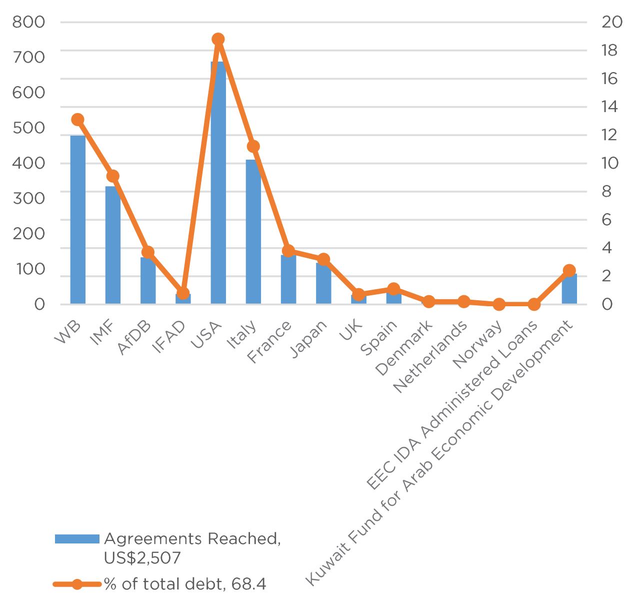
At the time of writing this report, the Somali authorities have so far successfully completed the sixth and final review of the Extended Credit Facility Arrangement, which took place in September 2023. The Completion Point is expected to be reached by the end of the calendar year subject to meeting the remaining conditions of the program. Overall, the key reform pillars, which include instituting fiscal reforms (e.g., revenue mobilization, PFM), Central Bank modernization and financial sector reforms, and strengthening the legal and regulatory frameworks to create a conducive environment for economic development, are progressing well. Indeed, most of the agreed-upon benchmarks, performance indicators, and targets are on track.

5.2 The Journey to HIPC Completion Point

To achieve full and irrevocable debt relief, Somalia must meet Completion Point requirements. These include floating CP triggers, satisfactory financing assurances from creditors representing at least 80 percent of the NPV of debt, building debt management capacity of the government, and completing HIPC documentation for IMF and World Bank Boards.

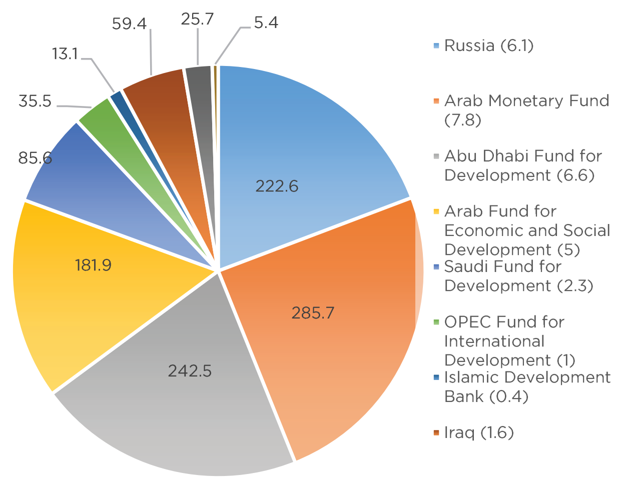
Out of 14 CP triggers, eleven have already been fulfilled successfully and the remaining 3 key reforms are on track. Regarding financing assurances, discussions with key creditors are underway.

Figure 18: Creditors, under discussion, % of total US$ 1,157m



Source: IMF, 2023

Figure 19: Debt Agreement Reached as end of Feb 2023



Authors' compilation based on IMF data

It is crucial to enhance the government's ability to manage debt. The World Bank and IMF's debt sustainability framework for low-income countries sets specific limits for debt stress. For Somalia, the two critical indicators are the NPV of external debt to GDP ratio (30 percent) and external debt service-to-revenue ratio (15 percent).

5.3.1 Access to concessional funding

When a country reaches the HIPC CP, it becomes eligible to receive concessional financing. This financing is a valuable resource for rebuilding and advancing development efforts. Concessional finance refers to the provision of finance by major financial institutions such as development banks and multilateral funds to developing countries at rates below the market rate. This is done to help speed up development objectives. The framework for concessional funding offered by international financial institutions (IFIs) involves mobilizing donor contributions to generate funds that are then allocated to recipient governments in the form of grants or subsidized loans. The funds are allocated while ensuring that the recipient governments can maintain an appropriate debt sustainability level.

Upon the CP, it is expected that the debt burden for Somalia will stand at 557 million USD (7 percent of GDP). To avoid debt distress in the medium term, the government should maintain a fiscal stance which is consistent with its medium-term debt sustainability.

5.4 Pre-requisites for access to concessional loans

- Enhanced government operations: key reforms should be pursued in the areas of domestic revenue mobilization (DRM), public financial management (PFM), and good governance. DRM needs to be strengthened to cover the government's operational costs. Additionally, it is vital to progress in payroll integration, procurement procedures, asset management, financial reporting, and tax exemption transparency.

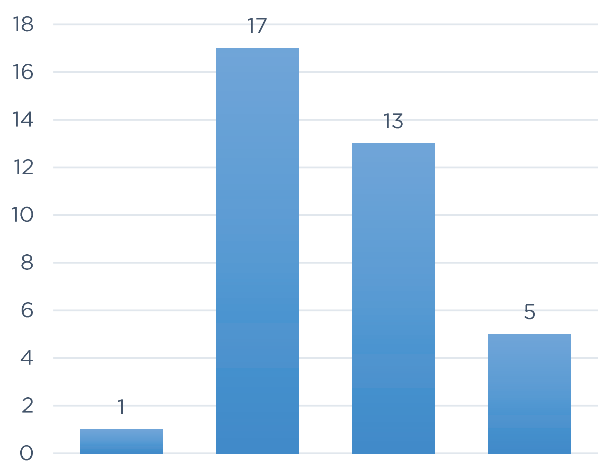
- Public debt management capacity development: the existing Debt Management Unit (DMU) at MoF, AGO, and CBS need to be well-resourced and capacitated with high-caliber technical staff to improve PDM functions and foster debt sustainability. It is essential to have transparency on all the terms and conditions of different borrowings to have a full view of costs and risks. Before dealing with any future creditor to obtain a loan, the FGS must make informed decisions regarding the financing terms of the loan, maturity, grace period, and debt servicing risks.

- Establish a national fiscal framework: A strong fiscal framework can help contain the deficit bias in fiscal policy. It can also support the efficient use of public resources by setting the conditions for efficient management of public investments and for monitoring the efficiency of public spending programs. Somalia should strengthen its domestic fiscal governance in the post-HIPC era through fiscal rules which are key to maintaining a prudent fiscal deficit to mitigate debt servicing risks and contingent liabilities (FMS borrowing). Thus, fiscal policy needs to be anchored on ensuring debt sustainability.

- Ensure that the country can honor any new debt liabilities, including concessional borrowing: a performance-based allocation (PBA) system is being utilized by the IFIs to determine the national allocations of concessional resources. Country Policy and Institutional Assessment (CPIA) is conducted as a diagnostic tool to assess the quality of public policies. With the current score of 2.1, Somalia needs to improve its rating by ensuring that it can fulfill the required criteria including effective macroeconomic, sectoral, and social inclusion policies, and public sector management. Implementation of such reforms is essential for future engagement with multilateral development banks and other financial institutions.

- Strengthen the implementation capacity of MDAs: project expenditure in the public budget should be prioritized based on clear cost-benefit analyses. Additionally, the delivery capacity of the implementing agency must be taken into account. In this regard, the National Development Plan (NDP) needs to be fully costed to inform the government budget and its flagship projects and programs. The costing can also facilitate the design and formulation of an investment plan for the government which, in turn, would ensure that any concessional resources available for Somalia are directed into productive spending. To this end, public investment management should be strengthened to improve the planning, allocation, and execution of investment projects.

Figure 20: Post-HIPC Countries by Debt Sustainability Level



Source: IMF, 2023

5.5 Concessional Financing Windows

Multilateral development finance institutions have concessional financing windows. Notably, the International Development Association (IDA), an arm of the World Bank Group; the African Development Fund (ADF), which is the concessional window of the African Development Bank; IMF standby credit facility and rapid credit facility. There are also specialist funds that concentrate on specific areas: among them, the International Fund for Agricultural Development (IFAD) which focuses solely on rural economies and food security; the Global Fund to fight AIDS, Tuberculosis, and Malaria; and GAVI for vaccination programs.

Both the multipurpose and specialized development funds have individual modalities of concessional financing, resource structures, and replenishment procedures. For instance, IDA's 20th replenishment cycle (IDA-20) has raised 93 billion USD and will be operational between July 2022 and June 2025. Similarly, the ADF-16 replenishment has 8.9 billion USD replenishment package. The allocation for Somalia in the current IDA cycle is 400 million USD. With a grant element of 69 percent, this IDA financing consists of 50-year loans (88 percent) and short-maturity loans (12 percent).

Critical factors should be considered regarding borrowing in the post-HIPC era to ensure that these resources contribute to Somalia's development and growth. Essentially, high borrowing should not necessarily hinder macroeconomic stability in the country. The new liabilities need to keep Somalia within debt sustainability thresholds in line with its macroeconomic fundamentals. A fiscal buffer against unanticipated shocks also needs to be created and maintained. In addition, borrowing should support growth catalyst activities such as projects that generate a strong growth impact to facilitate debt servicing. Hence, domestic revenue must cover the operational costs of the public sector, and expenditure rigidities in non-productive spending (recurrent costs) need to be avoided.

5.6 Lessons from Post-HIPC Countries

Of the 39 countries eligible for the HIPC Initiative, 36 have already received complete relief on eligible debt from the IMF and other key creditors after reaching the Completion Point. However, except for Honduras[28], all post-HIPC Completion Point countries are now in either high or moderate debt distress risk. This means that new external debt may not be sustainable for these countries due to persistent structural deficiencies and weak macroeconomic fundamentals. Generally, low-income countries face macroeconomic and fiscal challenges that hinder their ability to generate enough domestic revenue to service their debt, exposing them to greater liquidity and solvency risks. These challenges include narrow production bases and export structures, shallow financial markets, inefficient tax systems, high dependence on foreign aid, and weak policies and institutions in project and debt management. As a result, implementing sustainable macroeconomic policies becomes complicated, and the chances of scarce public resources being diverted towards unproductive uses increase.

While complete and irrevocable debt reduction is an important milestone for the country's development history and the future endeavor toward sustainable growth, post-HIPC experience shows that almost all nations that graduated from debt relief programs failed in achieving debt sustainability in the post-HIPC era. To this end, it does make sense for Somalia to avoid excessive borrowing after the Completion Point until the necessary key reforms are implemented and the right enabling environment, including institutional and human capacity, is created.

5.7 Formulating Development Strategies

Reaching the HIPC Completion Point offers opportunities for access to development funding, but it is important to consider how these funds will be utilized. The government must priorities productive projects and programs when allocating any future loans.

It is essential to promote investments in public infrastructure and prioritize development programs in productive sectors such as agriculture, livestock, and fisheries. This will create job opportunities and alleviate poverty in the country. In addition, it is necessary to enhance the government's limited institutional capacity to implement reforms in trade and investment areas. This can be achieved by improving the security and investment environment. The successful implementation of robust economic reform programs is important for creating an attractive investment environment and promoting industrialization.

Public-private partnerships (PPPs) can play a significant role in the social and infrastructure development of the country. Creating joint ventures between government and private entities can boost economic growth and create employment opportunities. However, for PPPs to work, good governance and enhanced public sector integrity are critical. To promote the development of natural resources such as petroleum and fisheries, it is essential to attract private investment by providing well-designed legal, institutional, and governance frameworks. Coordination between the Federal Government of Somalia (FGS) and Federal Member States (FMS) is also necessary for successful implementation.

To ensure successful implementation of government projects and programs, it is crucial to imbed them into the National Development Plan. The NDP, in turn, should accurately be costed and implemented. This involves a realistic evaluation of all aspects of the plan, including its pillars, interventions, and strategic objectives, to identify and prioritize investment opportunities within the country.

When the government plans its spending on projects, it must take into account the capacity of relevant government agencies to execute those projects. Currently, the success rate of completing projects is only about 40 percent, not including social benefit projects. Although budget support grants are anticipated to decline after HIPC, it is essential to allocate domestic revenue to cover ongoing expenses and enable future development spending. The most critical consideration when choosing investment projects is their cost-effectiveness, which should be assessed before making any decisions.

5.8 Post-HIPC Fiscal Sustainability

Somalia's fiscal policy is currently encountering several significant challenges. These include the low mobilization of domestic revenues (only 3 percent of GDP is generated), excessive dependence on donor grants, high spending demands in the security and social sectors, weak capacity for implementing expenditures, lack of an established fiscal federalism framework, low utilization of country systems (UCS), and high risks of weak governance and corruption.

After identifying the challenges, it is important for post-HIPC fiscal policy in Somalia to prioritize long-term fiscal sustainability, macroeconomic stability, socio-economic development, and climate shock resilience. Although debt reduction will make it easier for Somalia to access new sources of finance, the amount of grants is expected to decrease significantly, resulting in a shift towards concessional financing. To ensure fiscal sustainability, domestic revenue mobilization should be improved, which will allow the government to expand public services gradually and gain the trust of the citizens. Furthermore, enhancing public financial management to protect fiscal resources, promoting good governance, and implementing fiscal federalism will all contribute to fiscal sustainability. However, it is important to maintain a responsible budget deficit and only access concessional financing.

5.8.1 Designing a Medium-term Fiscal Framework

Fiscal frameworks are sets of rules, regulations, and procedures that influence the planning, approval, implementation, monitoring, and evaluation of budgetary policies. In the post-HIPC scenario, it is important to have fiscal rules that determine the limits within which the Somali government can make decisions regarding fiscal discipline in important fiscal areas such as budget balance, debt limits, revenue, expenditure, and fiscal buffer.

Somalia requires significant funding to support its development, but without proper fiscal regulations, there is a growing risk of debt service. In the 2024 fiscal year, budget support is expected to be limited, and even if the government maintains the same expenditure as the 2023 budget, there will still be a financing gap of around 200 million USD (2.1 percent of GDP) that must be somehow covered. To address this issue, the government should impose restrictions on budget deficits and work to boost domestic revenues while seeking budget support from donors as early as possible to secure firm commitments.

According to estimates, a deficit of 2-3.5 percent of GDP in the short term could help the FGS maintain its expenditure at 4.6 percent of GDP. It is important to balance the need for increased spending to support development with fiscal sustainability and capacity limitations.

5.9 Debt Sustainability Analysis

As mentioned previously, to determine sustainable debt levels in Somalia, two main debt indicators are used. These are the Present Value (PV) of external debt as a percentage of GDP (with a threshold of 30 percent) and external debt service as a percentage of revenue (with a threshold of 15 percent). With the HIPC Completion Point, the debt stock is expected to decrease in range of 4 to 7 percent of GDP. Therefore, the likelihood of breaching the threshold in the short-term is low. However, the debt burden indicator Somalia is likely to face the most pressure on is the 'debt service to revenue ratio'. If the necessary fiscal policy measures are not established, there is a risk of debt distress in the medium term regarding this indicator.

At present, the income generated from within the country (3 percent of the GDP) is not enough to cover the government's regular expenses (4.5 percent of the GDP) and fund development projects. Moreover, budget grants are expected to decrease significantly after the HIPC Completion Point, causing a financial gap. Therefore, it is necessary to look for other sources of funding to fill the deficit, which is predicted to be between 2.1 to 3.4 percent of the GDP from 2024 to 2028. Concessional financing is the best option for budget support loans and project loans. However, to ensure debt sustainability in the medium term (until 2030), a combination of policy measures needs to be implemented. The deficit should not exceed 3.5 percent of GDP to keep the debt service to revenue ratio below 10 percent. Key steps for consideration include:

1- Accessing only concessional financing with a grant element of at least 50 percent.

2- Domestic revenues should cover operational costs by 2027.

3- Borrowings should be directed into productive spending to support activities that generate returns.

If we miss any of these targets, our chances of exceeding the debt service to revenue threshold will increase, potentially leading to a heavy debt burden by 2025. However, we can still rely on some committed project grants for a while, although they will gradually decrease. To prevent this, it is important to increase domestic revenue mobilization by 25 percent annually and maintain recurrent costs at 4.6 percent of GDP. This way, we can ensure that domestic revenues cover operational expenses by 2027, allowing us more room for development spending.

It is important to take into account domestic public debt when assessing debt sustainability, since repaying that debt could make the overall budget deficit worse in the future. Debt burden can have negative effects on the economy by slowing down growth momentum. This comes with risks such as transfers, which automatically adjust to restore balance between total demand and supply caused by increasing public debt. Other risk factors include financial distress, the creation of fictional growth, debt-driven deflation, and political crises.

5.10 Challenges to Policy Reforms

Somalia faces some pressing policy challenges that need to be tackled. Domestic tax collection must be significantly improved. This will enable the government to provide satisfactory public services, resulting in improved legitimacy and public trust in the tax system. In this respect, promoting good governance and public integrity would enhance government legitimacy and improve service delivery. This would require a comprehensive approach that promotes transparency and accountability among public institutions to ensure that the government is working in the interest of its citizens.

5.11 Policy Implications

a- To prevent fraud, misappropriation of public funds, and other financial irregularities in the post-HIPC era, it is important for the Somali government to establish clear and comprehensive legal and regulatory frameworks that promote efficiency, transparency, accountability, and integrity. It is also necessary to invest in building the capacity of the civil service to ensure that they have the necessary skills, knowledge, and ethical values to effectively manage public funds and new liabilities with integrity. A public integrity strategy should be developed to combat corruption and restore trust in the government and public institutions.

b- To support sustainable development, post-HIPC fiscal policy should prioritize long-term fiscal sustainability, macroeconomic stability, socio-economic development, and climate resilience building.

c- In the short-term, domestic revenues should be increased to at least cover the government's operational costs.

d- It is important that borrowing in Somalia is done in a way that supports the country's development needs, while also protecting debt sustainability, preventing economic overheating, and allowing for sufficient buffers.

e- It is important to direct concessional resources towards activities that promote economic growth and yield a net positive return. Therefore, the government should prioritize development projects based on a cost-effectiveness analysis, while also considering the implementation capacity of the relevant MDAs. It is crucial to consider equitable distribution of resources to support the ongoing peace and state building efforts.

f- Lastly, it is recommended that a cooperative fiscal federalism framework is created to establish the roles and responsibilities of FMS in the post-HIPC fiscal framework. This should include areas such as borrowings, revenue mobilization, and expenditure responsibilities.

Table 2: HIPC Completion Point Triggers

SN	HIPC Completion Point Triggers	Progress
1	Satisfactory implementation for at least one year of Somalia's full poverty reduction strategy, as evidenced by an Annual Progress Report	Met
2	Maintain macroeconomic stability as evidenced by satisfactory implementation of the IMF-supported program.	Met
3	Publish at least two years of the audited financial accounts of the FGS.	Met
4	Issue regulations to implement the Public Financial Management Act's provisions on debt, public investment, and natural resource revenue management.	Met
5	Adopt and apply a single import duty tariff schedule at all ports in the FGS	To be met
6	Enact the Extractive Industry Income Tax (EIIT) Law.	Met
7	Ratify the 'United Nations Convention Against Corruption' (UNCAC).	Met
8	Publish at least four consecutive quarterly reports.	Met
9	Establish a national unified social registry (USR) as a functional platform that supports registration and determination of potential eligibility for social programs.	Met
10	FGS and FMS Ministers of Education (MOE) adopt an agreement defining their respective roles and responsibilities on curriculum and examinations.	Met
11	FGS and FMS Ministers of Health adopt a joint national health sector strategy.	Met
12	Enact the Electricity Act and issue supporting regulations.	Met
13	Issue Company Act implementing regulations on minority shareholder protection	Met
14	Publish two editions of the Somalia Annual Fact Book.	Met

Source: IMF, 2023

6 The Uprooting of Terrorism

Three main factors drive most of the challenges in Somalia: (1) destabilizing terrorist group holding swathes of land in the most productive parts of the country, crippling local production, major supply routes and limiting the movement of people and goods. (2) worsening climate-related shocks such as droughts, flooding, locust infestation leading to increased food insecurity and mass displacement across the country (3) lagging economic growth and limited domestic revenue effectively impeding the provision of essential services to the public. Therefore, freeing Somalia from the cruelty of terrorism is not only the key to achieving sustainable peace in the country but also a necessity for building a modern state capable of providing much needed services to the public and eventual sustainable development and prosperity.

The ongoing offensive against terrorism gathered pace and highlighted the superior capability and the preparedness of the armed forces to take over the security responsibilities and establish the long overdue state monopoly on violence. The involvement of local clan militias, as well as the support from the public and the international partners, served as a force multiplier. The military offensive was part of a triple-faceted strategy to meant to wage a total war against the terrorist group militarily, ideologically and financially.

6.1 Military Front

There are notable differences that set apart the current offensive from previous ones. To begin with, it is being spearheaded by Somalis and takes a more extensive approach. Additionally, the operations have stronger local ownership.

A series of successful military offensive was carried out in the central regional states of Hirshabelle and Galmudug, resulting in the liberalization of strategic districts and towns. The FGS has consolidated gains by facilitating peaceful relations between clans, providing humanitarian aid, and rebuilding essential infrastructure such as water wells, mosques, and hospitals. The government aims to implement a further comprehensive stabilization program to ensure basic social services such as healthcare, education, and justice are available in newly recovered areas.

Conflict, instability and terrorism remain a major obstacle to achieving sustainable peace and economic development in Somalia. The data below presents conflict incidents in Somalia from August 1, 2017, to August 31, 2023. Table 3 gives an overview of nationwide conflict incidents, while Table 4 details incidents specific to Mogadishu, the capital city.

Table 3: Distribution of conflict incidences in Somalia from 2017 to 2023.

Event Type	Frequency	Percentage	Cumulative %
Battles	9,607	51.96%	51.96%
Explosions/Remote violence	4,083	22.08%	74.04%
Protests	577	3.12%	77.16%
Riots	157	0.85%	78.01%
Strategic developments	1,133	6.13%	84.13%
Violence against civilians	2,934	15.87%	100.00%
Total	18,491	100.00%	

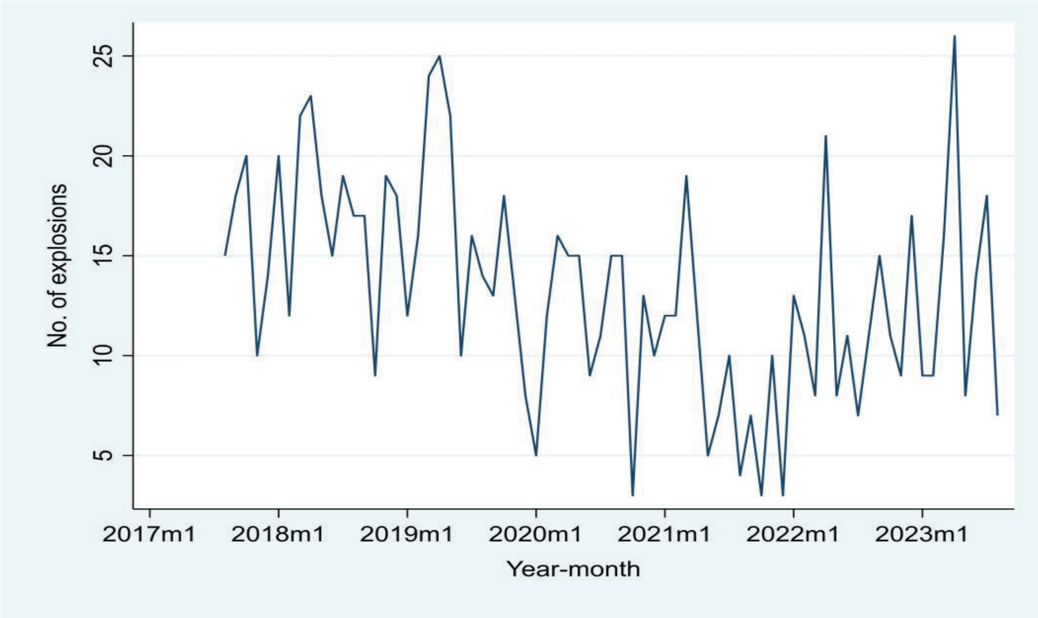
Explosions and violence against civilians orchestrated by terrorists, constituted almost 38 percent of all recorded conflict incidents. Battles were the most frequent conflict event in Somalia, accounting for over half of all recorded conflict event, with riots being the least common.

Table 4: Distribution of conflict incidences in the Banadir region (Mogadishu) from 2017 to 2023.

Event Type	Frequency	Percentage	Cumulative %
Battles	1,914	47.68%	47.68%
Explosions/Remote violence	969	24.14%	71.82%
Protests	112	2.79%	74.61%
Riots	21	0.52%	75.14%
Strategic developments	84	2.09%	77.23%
Violence against civilians	914	22.77%	100.00%
Total	4,014	100.00%	

As table above demonstrates, the level of explosions and violence against civilians in Mogadishu increases to 46 percent compared with nationwide figures. Explosions in Mogadishu constituted 24 percent of total explosion incidents in the country, while violence against civilians accounted for 31 percent. This meant not only loss of lives of civilians, but also infrastructure, business activities and movement of people and goods.

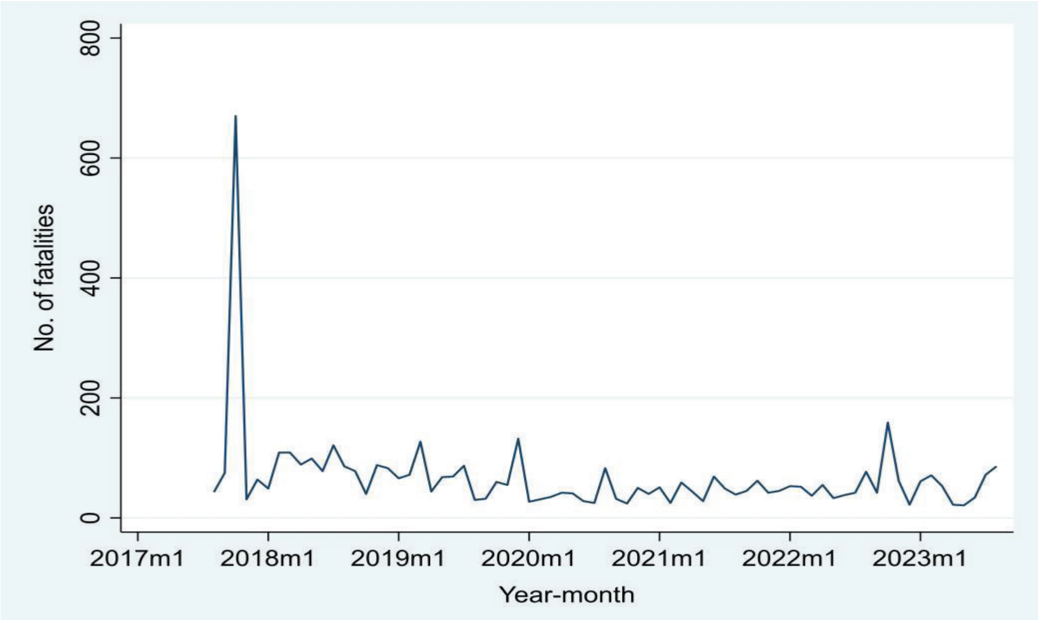
Figure 21: Year-Month: Number of Explosions in the Banadir Region.



Source: ACLED, 2023

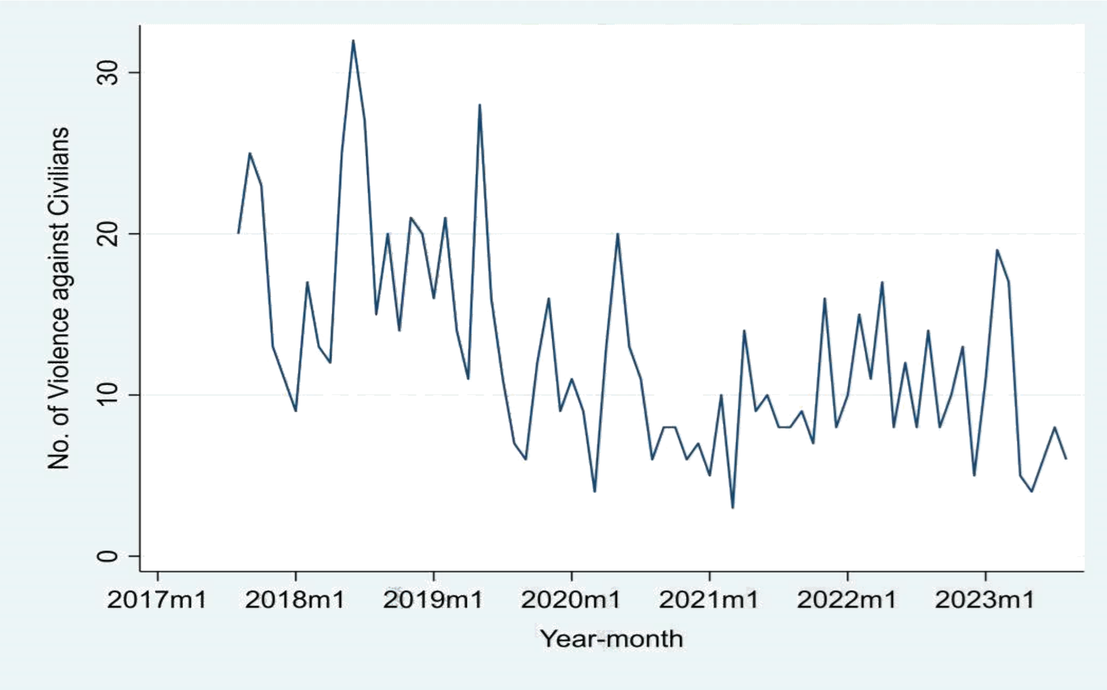
Figures 21 and 22 exhibit that in most of the months of 2023, the number of explosions and violence against civilians in Mogadishu has decreased. This decline can be attributed to the weakened position of Al-Shabaab and the government's concerted efforts to combat the terrorist group outside Mogadishu where they use to regroup and reinforce their terror activities. As the incidents are now in decline, the country is optimistic that further reduction in future conflict events would unlock acceleration of economic activities in major cities and towns.

Figure 22: Year-Month: Number of Violence Against Civilians in the Banadir Region.



Source: ACLED, 2023

Figure 23: Year-Month: Number of Fatalities in the Banadir Region.



Source: ACLED, 2023

The graph exhibits the total number of deaths resulting from conflict events in Mogadishu. From August 1, 2017, to August 31, 2023, Mogadishu experienced a total of 4,862 deaths. In contrast, all of Somalia witnessed a total of 32,515 fatalities within the same period, with Mogadishu alone representing 15%.

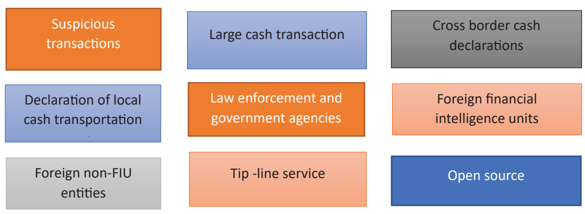
As the government has recently intensified its war against the terror group in central and southern regions of the country, liberating large areas from the terrorists, the number of conflicts, as well as explosions and violence against civilians in Mogadishu, has declined. This indicates that if Al-Shabaab is defeated, the security situation of the country will improve. In the short-term, this would result in positive spillovers for the country, resumption of intra-regional commercial activities, improved trade networks and ease of movement of people within districts and regions. In the long-term, it would result in improving the enabling environment to become conducive for speedy recovery and transformation of the economy.

6.2 The Financial Front

The multi-faceted strategy to eliminating the terror of Al-Shabaab and enhancing security involved the monitoring, tracking and closure of sources of terrorist funding and money laundering machinery. Pursuant to Article 20 and 21 of AML/CFT act 2016, Financial Reporting Centre (FRC) is mandated to receive, analyze, and disseminate information and intelligence related to money laundering and terrorism financing to the law enforcement and other intelligence bodies. The center is also mandated to prepare typology report on money laundering and terrorism financing and advice the government on the changing environment of AML/CFT regime.

The analysis unit performs the core functions of the Financial Reporting Center and is mandated for the receipt of suspicious transactions and other information related to money laundering and terrorism financing. The information received is then analyzed and disseminated to the law enforcement agencies and intelligence bodies. However, sources of information are not limited to the receipt of suspicious transactions reports from financial institutions and designated non-financial businesses and professions (DNFBPs) See the diagram below.

Sources of information

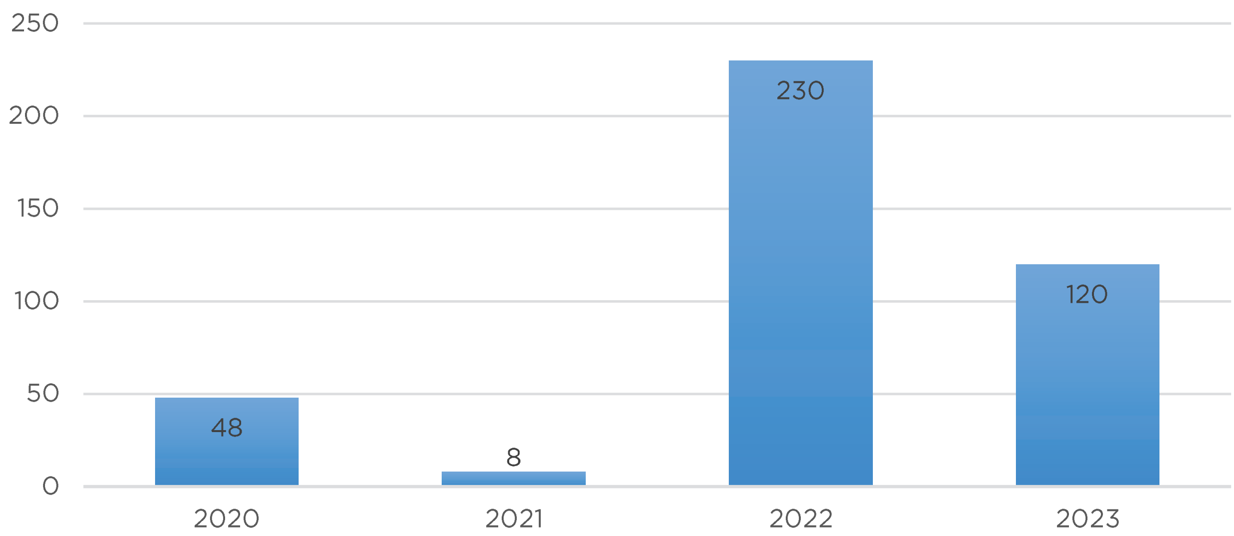


As per article 14 of the AML/CFT act, financial institutions are obligated to report to FRC transactions that are suspected to be linked to money laundering and terrorism financing or transactions that exceed the designated threshold of $ 10,000 US dollars. As the National Anti-Money Laundering (NAMLC) committee meetings intensified, the number of banks and Money transfer business (MTBs) complying with AML/CFT regime increased.

Frozen Accounts.

Guided by Article 21 sub article 3 of AML/CFT act, FRC has frozen over 250 bank accounts suspected to be linked to terrorism financing in third and fourth quarter of 2022 and first quarter of 2023. The center has also suspended numerous mobile money accounts. Financial information of the frozen accounts was analyzed and disseminated to the law enforcement agencies for further action. Table 6 demonstrates number of frozen accounts by year.

Figure 24: Frozen Bank Accounts



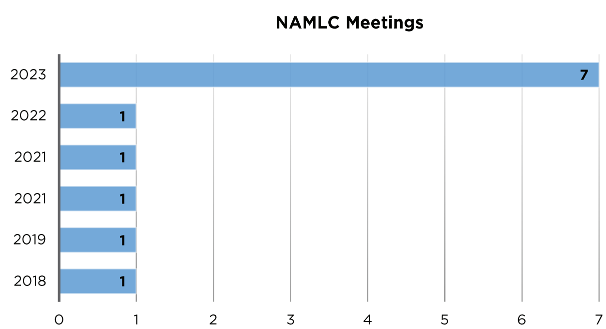
Source: Somalia Financial Reporting Centre, 2023

National Coordination and Policy Guidance

Coordination, policy guidance and strategic setting under the of the AML/CFT regime has intensified lately with the increased frequency of meeting of the National Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Committee (NAMLC). The NAML is a multi-institutional committee tasked under the 2016 AML/CFT Act for the development of the regime strategy, capacity building, facilitation of information sharing and promotion of domestic and international coordination.

Fulfilling its core mandate, the frequency of NAMLC meetings intensified with the direct and indirect involvement of both the President and the Prime Minister. The intensity of NAMLC's unprecedented efforts brought about tangible progress on the financial front of the war against terrorism.

Figure 25: NAMLC Meetings per year



6.3 The Ideological front

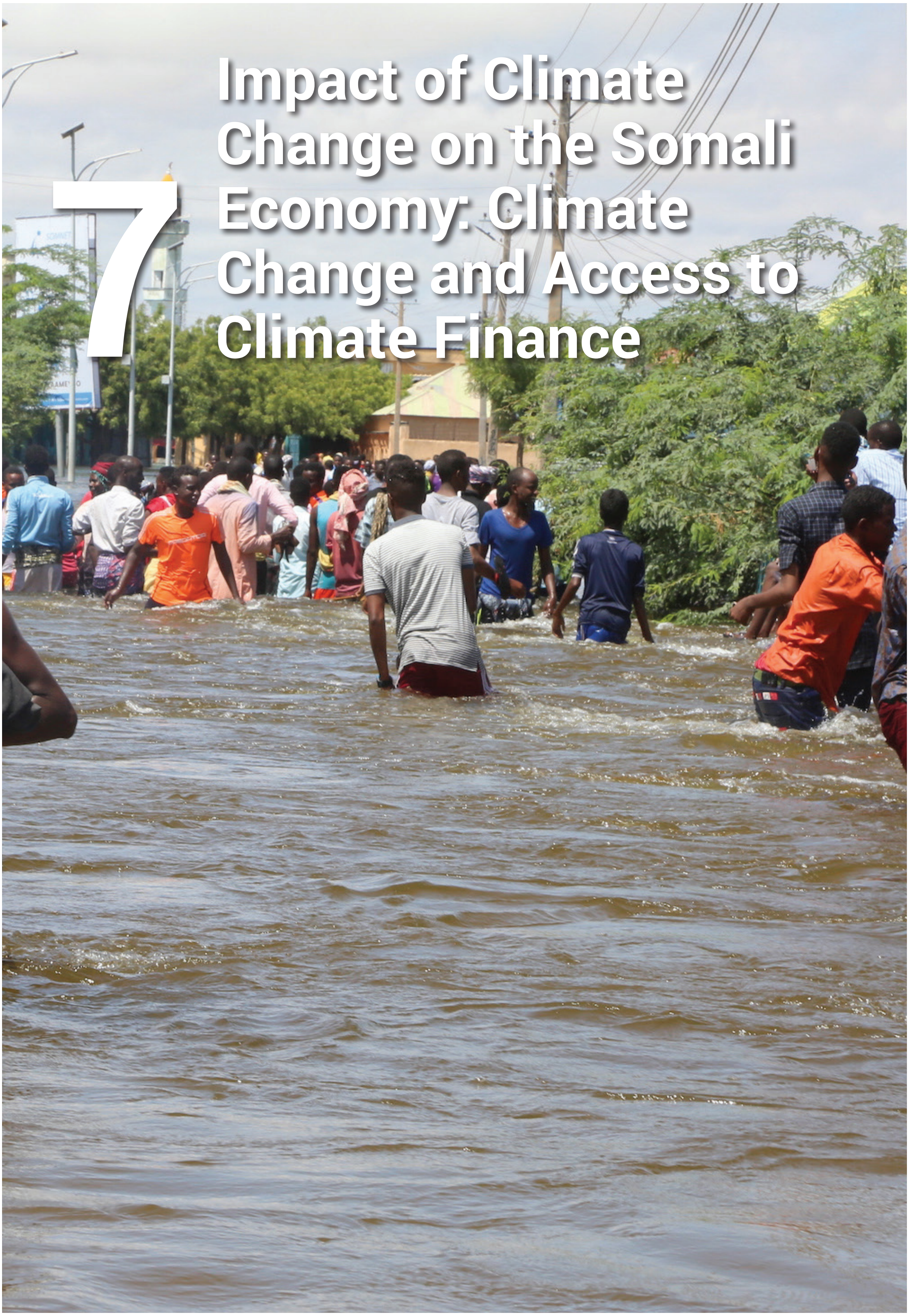
The current administration placed a significant importance on the ideological factor in the war against Al-Shabab. Since his re-election, the President promised that the government will no longer neglect the religious space and declared that Al-Shabab cannot claim stewardship of the Islamic religion. The Ministry of Endowment and Religious Affairs, under Sheikh Mukhtar Robow achieved in debunking the group's religious propaganda and gathered the Somali Ulema from various sectarian factions and held the first Somali Ulema Summit denouncing Al-Shabab as religious thugs and declaring them Kharijites. The first joint Fatwa against the group was released.

During the Holy month of Ramadan, the President sponsored the first National Competition on Quran recitation and awarded prizes to the winners. This action was well-received by the Somali public and proved the false claim by Al-Shabab that the government was at war with the religion and its followers. By reclaiming the religious space, it has helped deter youth from joining the group. In the President's almost year-long term, significant progress has been made in countering terrorism, and the government is committed to defeat Al-Shabab once and for all.

6.4 Policy Implication

In the past, al-Shabaab has been forced out of larger cities by slow offensives. However, their resilience and endurance in the face of such offensives was due to their ability to generate revenues both in areas they control areas already controlled by the government, like Mogadishu. In these areas, al-Shabaab has set up their own tax system and shadow sharia courts to some extent, allowing them to generate revenue and maintain their hold on power. Continuing the current moment placed on the financial front is crucial in defeating them. Tracking and closure of sources of terrorist funding and money laundering machinery will not only contribute to defeating al-Shabaab financially, but it would also contribute greatly to economic reforms being spearheaded by the government.

7 Impact of Climate Change on the Somali Economy: Climate Change and Access to Climate Finance



7.1 Introduction

Climate change has emerged as one of the most pressing global challenges of our time, affecting nations and economies worldwide. In the context of Somalia, a country already grappling with socio-economic fragility and security issues, the impact of climate change on the productive sectors of its economy is particularly significant. This chapter examines the far-reaching consequences of climate change on Somalia's economy, with a specific focus on its productive sectors. It also delves into the challenges related to climate policies, strategies, and institutions, as well as the issues surrounding access to climate finance. Drawing upon existing literature and empirical evidence, this chapter aims to provide insights into the current state of affairs and recommend potential pathways for addressing these challenges and beyond.

Somalia has established a number of institutional arrangements to improve the implementation of climate change adaptation and mitigation policies and measures. As such, the newly established Ministry of Environment and Climate Change has been designated as the national authority that is responsible for the formulation of national environmental and climate change policies, coordination of activities, and harmonization of entity plans i.e. the federal line ministries, FMS, international partners, and other stakeholders on environment and climate change governance, with regard to the review of the constraints and barriers related to institutional, legal, financial, technical, and human capacity affecting the implementation of commitments under the United Nations Framework Convention on Climate Change (UNFCCC).

The Ministry of Environment and Climate Change, along with the National Climate Change Committee (NCCC) and Cross-sectoral Committee on Climate Change (CSCC), are responsible for the enhancement and coordination of activities towards the efforts of mainstreaming climate resilient development initiatives.

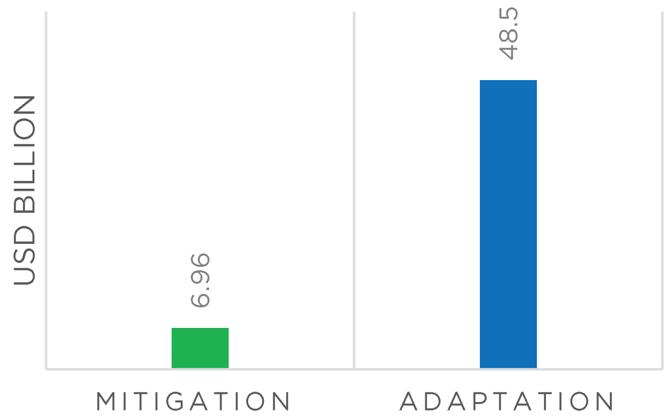
In terms of natural capital, Somalia possesses large per capita naturals which remain untapped. The Somali peninsula is endowed with considerable natural capital including land-based capital, soils, forest, and water resources with nine water basins and two permanent rivers which flow into the Indian Ocean[29].

Due to limitations of accessible data, the study made use of available natural capital data[30], hence there was a general decline registered in all three categories of natural capital including (a) renewable natural resources decreased by 4% from 18,565 million in 1995 to 17,792 million in 2018; (b) forest non-timber declined by 4% from 18,496 million to 17,731 million, and (c) fisheries declined from $69 million to $60 million during the same time due to the prolonged climatic shocks such as drought over the last 40 years, political insecurity, and locust invasion. In comparison to the other East African countries, the value of renewable natural resources increased by 3% in total value and 6% in all of Africa.

Nevertheless, Somalia is listed among the top ten countries most affected by climate variability[31]. It has been estimated that a tragic toll of nearly 50,000 lives have been devastated by climate-related impacts since early this year, 2023[32]. Climate-related losses, along with substantial financial setbacks, totaling around 3.25 billion USD[33] was recorded in 2018. Yet, Somalia is ranked amongst a group of countries that receive the least climate finance. An official total climate finance needs estimation for Somalia over the period 2021-2030 is USD 55.5 or 5.5 billion per year, whilst mitigation and adaptation finance needs are estimated at USD 6.96 and USD 48.5 billion respectively (See Figures 1&2)[34].

According to Somalia's Nationally Determined Contribution (NDC), Climate Finance needs are 5.55 billion per year. As can be observed from the following figures, the needs are highest in adaptation financing in water resources, agriculture, and disaster preparedness and management

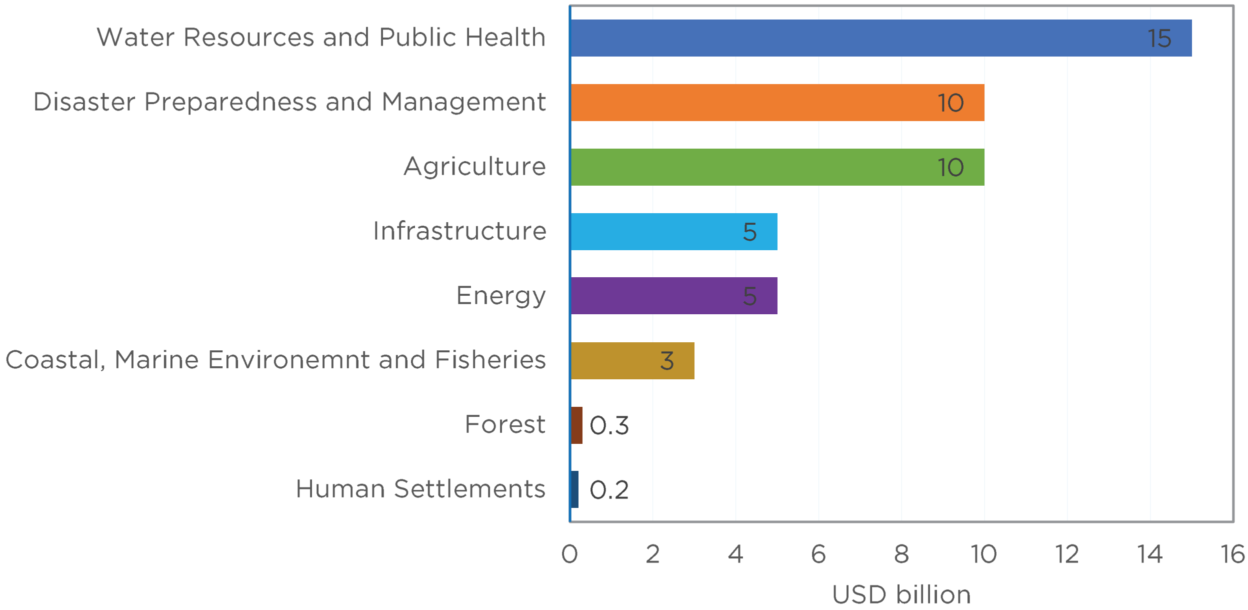
Figure 26: Total climate finance needs for 2021-2030 (USD billion)



Source: Reproduced from SPARC (2023,) Somalia: Financing Climate Adaptation in Fragile States under Somalia's Updated NDC 2021.

As Figure 25 depicts, adaptation finance needs are highest in water resources and public health, agriculture, disaster preparedness & management, and followed by a small but significant share in the other categories portrayed.

Figure 27: Adaptation finance needs for 2021-2030 (USD billion)



Source: Reproduced from SPARC (2023,) Somalia: Financing Climate Adaptation in Fragile States under Somalia's Updated NDC 2021.

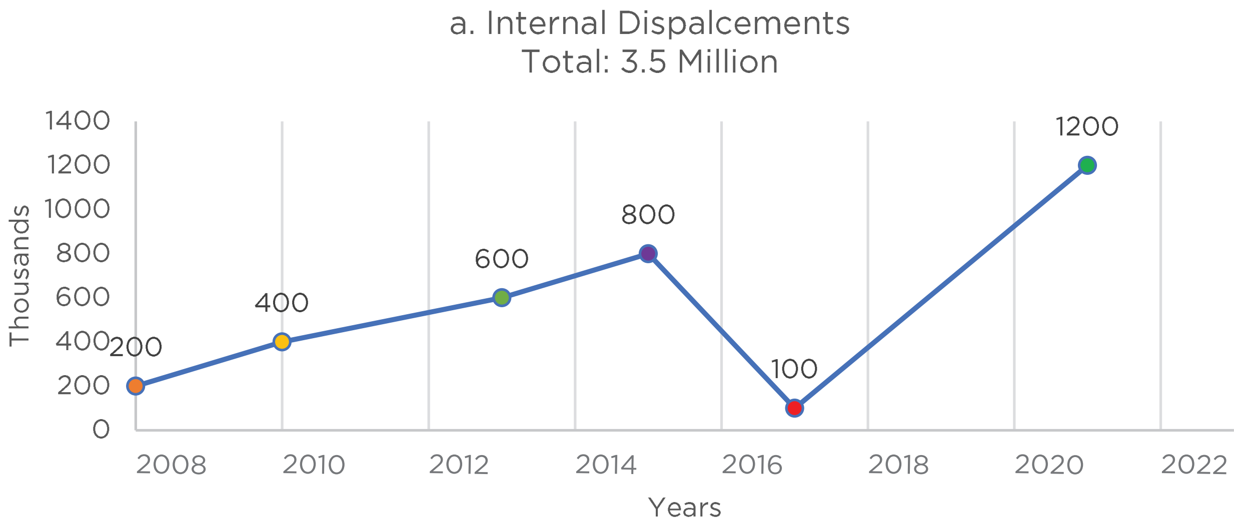
Climate Change and the Productive Sector (Agriculture, Fisheries and Livestock, Energy and Water Sector)

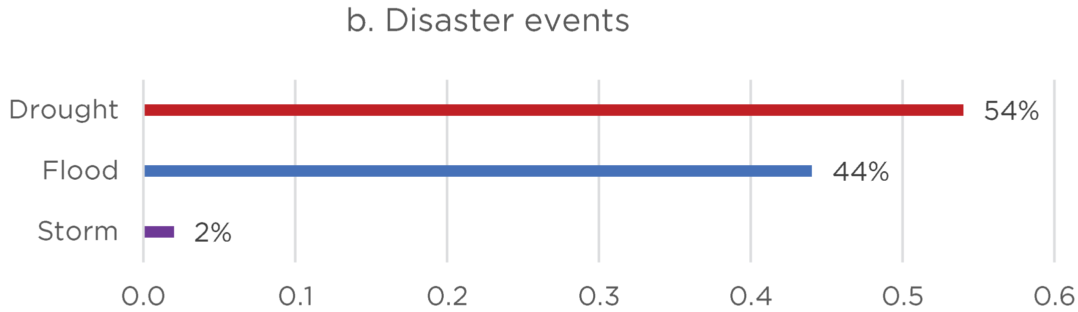
Somalia as an agro-pastoral community relies mainly on rain-fed agriculture, and climate change has led to increased droughts and erratic rainfall patterns. This has resulted in decreased crop yields, food insecurity, and reduced agricultural production. Livestock, an essential part of the Somali economy, has also been severely affected by droughts, leading to livestock losses and reduced incomes for many pastoralists.

Much as the country has faced varying degrees of climate shocks in recent years, drought in particular has enormously affected the country's population's well-being and the overall health of the economy. The figures below showcase the number of climate-related events between the periods of 2008 and 2021, along with the total number of people newly displaced each year due to the challenges of these disasters. In 2020 and 2021, displacement numbers increased further, with over 1.17 million people displaced internally since the end of 2021 (IOM 2022). The main drivers of the vast majority of climate-related disasters are droughts, floods, and storms, with drought being the sole key driver of displacement in 2022. Risks to both health and productivity have also been associated with rising temperatures and heat stresses.

As a consequence, the impact of recurrent droughts and climate-related disasters have been significant on poverty and the decline of the productive sectors. A World Bank study (2016-17) identified that drought had a significant and adverse impact on poverty, consumption, and hunger in Somalia. These climate impacts were particularly significant in rural areas where a majority of rural families rely on agriculture and have limited access to basic services and physical infrastructure

Figure 28: Climate-related events in Somalia (2008-2021)





	Storm	Flood	Drought
Disaster events	2%	44%	54%

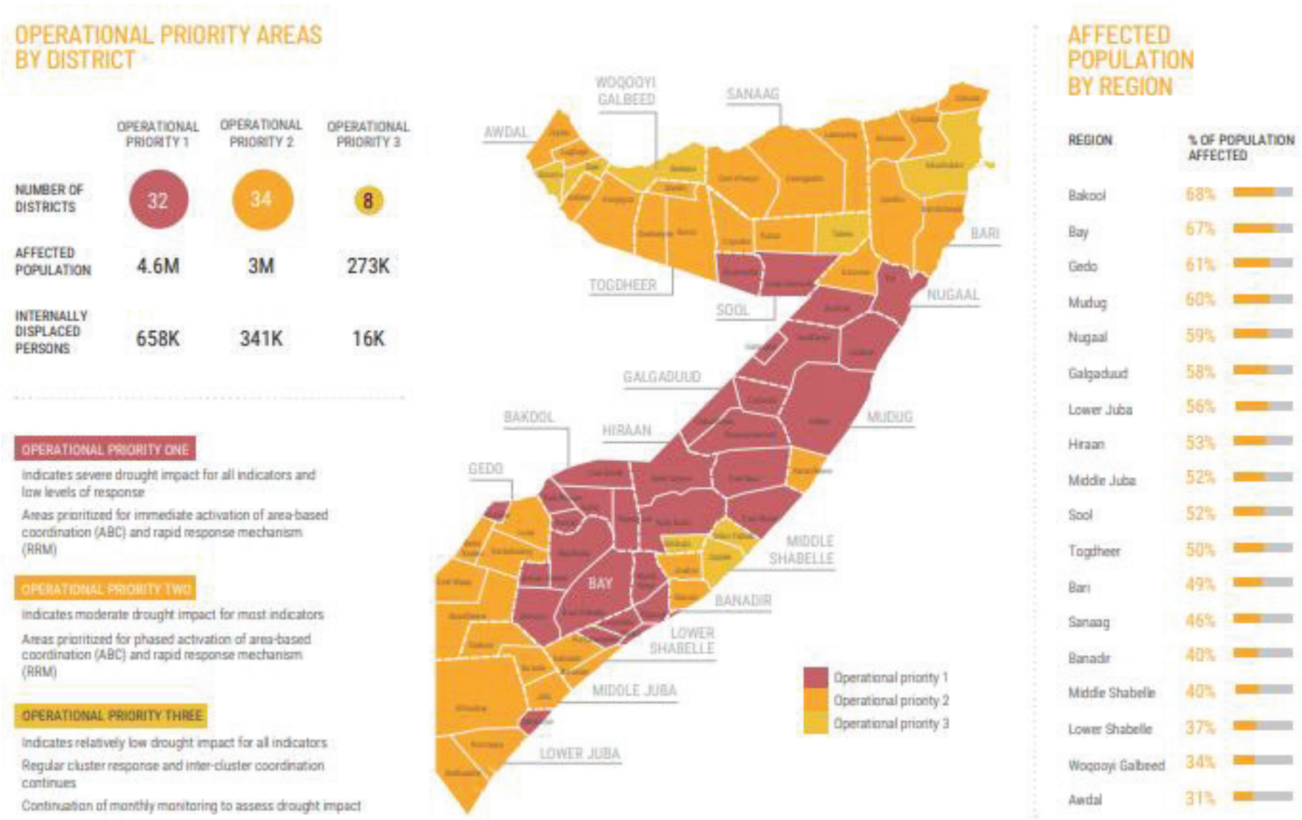
Percentage

Source: Somalia Climate Risk Review Report based on International Displacement Monitoring Centre Dashboard

The recent droughts and climate shocks in Somalia have impacted a remarkably high number of people such that 7.6 million people were directly affected by drought, including over 1 million displaced by drought (OCHA, 2022). Moreover, following four poor rainy seasons in succession, more than half the population needed humanitarian assistance. Economy-wide losses totaled over $3.25 billion. This level of impact undermined development gains made in previous years. The drought severely affected agricultural production, the main driver of Somalia's economy, with livestock and crop losses affecting 17 out of 18 regions in the country. There were significant price increases for key staples. l economy has been severely damaged in recent years by a series of droughts connected to signficant changes in the climate and weather patterns, as well as by high levels of conflict and insecurity. Climate and its related disasters have been Somalia's costliest natural disasters as the country is prone to climate shocks due to its arid and semi-arid nature.

The graphical map below shows the recent drought conditions, the number of people affected, and the impact of the droughts that affected the entire country.

Figure 29: Regions affected by drought in Somalia, 2022.

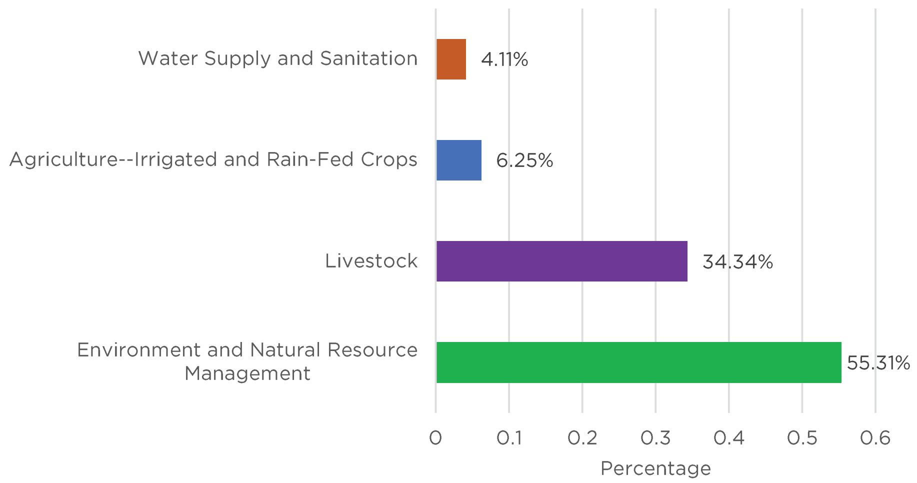


Source: Adopted from OCHA, 2022.

Climate change, as a global phenomenon, has led to rising sea surface temperatures and ocean acidification, impacting marine ecosystems. This has resulted in decreased fish populations and disrupted fishing patterns, thereby affecting the livelihoods of many Somali fishermen. Reduced fish stocks have also had a negative impact on the fishing industry, which contributes significantly to the economy.

The combination of recurrent droughts and reduced rainfall has led to water scarcity and decreased water availability for agricultural activities, domestic use, and livestock[35]. This, in turn, has established increased competition for water resources and reduced productivity in the productive sector. The scarcity of water has increased the prevalence of waterborne diseases[36], further impacting the health and economy of the country. Two extreme conditions have lagged the country's progression towards resilience and economic growth. These are the extremism of Al-Shabaab on the one hand and the extreme climate conditions on the other hand. Indeed, the extreme climatic conditions have reduced stream flows and hydroelectric power generation potential in Somalia[37]. This has led to increased dependence on imported fossil fuels, which puts additional pressure on the economy and contributes to greenhouse gas emissions.

Figure 30: Distribution of damages by sector (2011-2018)



Source: MoPIED, DINA, and World Bank report; Somalia Drought and Impact Assessment, 2018.

Rural-urban mobility has been on the rise recently due to conflicts and Climate-induced displacements. Recent studies[38] have shown that migration has increased not only because of conflict but also due to the impacts of climate change on livelihoods. This has resulted in a higher strain on urban centers, limited job opportunities, increased poverty, and social instability. The strain on resources and competition for scarce resources has also led to conflicts over access to water, land, and other resources[39]. Nevertheless, climate change has had severe implications for the productivity and economic stability of Somalia, exacerbating existing vulnerabilities and hindering development efforts. Addressing climate change through mitigation and adaptation measures is crucial to building resilience and ensuring sustainable economic growth in the country.

Like in the case of many Sub-Saharan African countries, climate change has disrupted Somalia's agricultural sector, which is crucial for the livelihoods of a large portion of the population. Exogenous factors like increased temperatures, erratic rainfall patterns, and prolonged droughts have reduced crop yields and led to soil degradation. Staple and edible crops like sorghum and maize, essential for food security, have been adversely affected. The resultant food shortages, price fluctuations, and food insecurity contribute to the socio-economic instability and overall macroeconomic performance of the country.

Somalia's extensive coastline supports a significant fisheries industry, but rising sea temperatures and ocean acidification are threatening fish stocks. As a result, coastal communities, reliant on fisheries, are experiencing economic challenges. A decline in fish catch leads to unemployment and poverty, compounding existing vulnerabilities. Moreover, Pastoralism, involving the herding of livestock has always been a traditional way of life in Somalia. However, climate change has led to reduced forage availability and increased water scarcity. Livestock deaths and a loss of income are common consequences, leading to economic distress for pastoralist communities. Resource conflicts over water and grazing lands are also on the rise.

Somalia's National Environment Strategy and Action Plan (NESAP 2022-2026)[40] highlights the following key strategic objectives.

- Improving environmental governance and enhancing resource mobilization for the effective management of natural resources and the environment
- Undertaking a comprehensive assessment of the state of Somalia's natural resources, environment, and potential climate risks implementation of the country's climate change policy
- Undertaking conservation initiatives to address urgent challenges in land degradation, biodiversity, aquatic & marine environment, and climate change.
- Enhancing public awareness, participation, and behavior change on environmental protection, conservation, and climate change.

The FRS has prepared numerous climate-focused policy documents, enacted laws and regulations, and planned strategic objectives aimed at dealing with climate variabilities and adaptation and mitigation measures along with several other significant nationally determined contributions and commitments. Table 1. Summarizes key policies, laws, and plans in place since the first initial commitment preparation draft in 2015.

Table 5. Existing Climate Policies, Strategies, and Laws in Somalia.

Key Climate Messages	Year/Enacted/Prepared	Policy, Plans, and Laws.
-Identifies climate change as a key driver of biodiversity degradation/loss and highlights the role of biodiversity in addressing climate change	2015	National Biodiversity Strategy and Action Plan
-Makes a general link between climate change and desertification	2016	Somalia National Action Program for the United Nations Convention to Combat Desertification
-Recommends preparation of a national disaster risk reduction strategy, coordinated with climate change and sustainable development policies	2018	Somali National Disaster Management Policy
-Recognizes high greenhouse gas emissions from diesel generators in use nationwide	2019	Power Master Plan for Somalia
-Outlines national guidelines on ameliorating the effect of climate change on waste management, biodiversity loss, coastal pollution, and general management of Somalia's natural resources at both the federal government and federal member state levels.	2019	National Environment Policy
-Identifies climate risks as key drivers of vulnerability and food insecurity in Somalia - Recognizes the need for resilience building and diversification of livelihoods, and the role of social protection in building household and community resilience and supporting livelihood recovery	2020	Somalia Social Protection Policy
-Require integration of climate change vulnerability assessment and priority adaptation and mitigation actions by developers and -proponents during the preparation of strategic environmental and social assessments - Require climate change vulnerability assessment and priority mitigation and adaptation actions to be included in environmental and social impact audits	2020	Environmental Social Impact Assessment Regulations
-Recognizes that addressing land degradation will contribute toward mitigating and adapting to climate change	2020	National Voluntary Land Degradation Neutrality Targets 2020
-Notes that food security and nutrition have remained critical or stressed over the years, in large part due to climate change and reliance on rain-fed agriculture	2020	Somalia National Food Fortification Strategic Plan (2019–2024)
-Aims to design drought monitoring and early warning system for adoption by the Somali government and relevant stakeholders - Recognizes the role of climate change in intensifying drought	2020	National Drought Plan
-Includes extensive references to the impacts of climate change on water resources, including the quality of groundwater -Assumes that mean annual rainfall shall increase by 1%, 3%, and 4% by 2030, 2050, and 2080, respectively (using the 1981–2000 reference period)	2021	National Water Resource Strategy (2021–2025)
-In one of its four objectives, calls for a comprehensive assessment of the state of Somalia's natural resources, environment, and potential climate risks	2022	Somalia National Environment Strategy and Action Plan (2022–2026)
-Makes links between a changing climate and the occurrence of La Niña resulting in prolonged, persistent drought and food insecurity	2022	Somalia Drought Response Plan
-Refers to climate change and its management as one of the functions of the act	2023	National Environmental Management Act
-Under preparation with the support of the Somalia Crisis Recovery Project	2023	Food Security Crisis Preparedness Plan

Source: MoECC 2022, NDC 2021, and World Bank report on Somalia's Climate risk profile, 2023.

7.2 Prioritization of Climate Change and Access to Climate Finance

Climate change poses a significant threat to the development of Somalia due to overdependence on crops, livestock production, water, and forestry resources which are very susceptible to weather and climate variations. The National Development Plan (NDP-9) identifies resource use conflicts, environmental degradation, and climate-related disasters such as droughts and floods as the key challenges to the stability and development of the country. The plan prioritizes most strategic interventions with multiple benefits including economic benefits alongside environmental sustainability, conflict reduction, strengthened governance, and Interventions including strengthening Somali institutions' commitment and capacity for effective political and environmental governance.

Somalia has committed to remaining low emitter and contributing to global climate change mitigation efforts in the context of sustainable development and poverty eradication. This is elaborated in the country's updated nationally determined contributions (NDC, 2021) that describe priority mitigation actions in the agriculture, forestry, energy, transport, and waste sectors.

Access to climate finance in Somalia is still limited due to various factors that hamper the development of institutional frameworks and financial systems needed to access climate finance. Additionally, limited data and information on climate change impact and vulnerability in Somalia also pose challenges in mobilizing climate finance.

Box. 1. Climate change challenges in developing effective policies and strategies in Somalia.

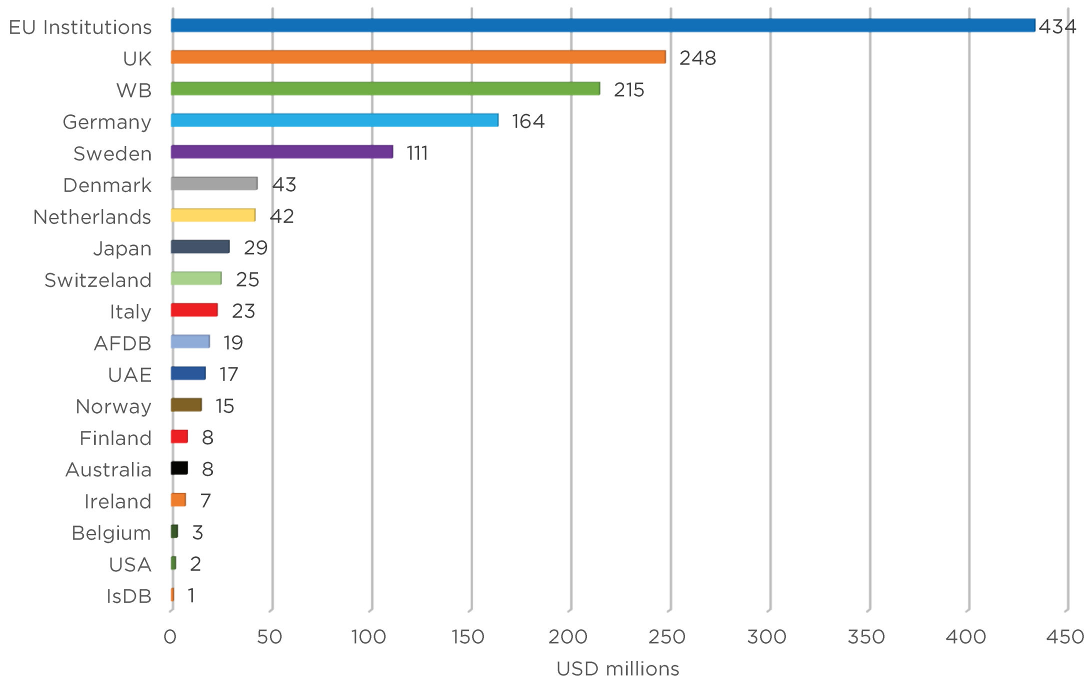
o Institutional Weakness
The country lacks a robust institutional framework for climate adaptation and mitigation. Weak coordination among government agencies impedes the formulation of coherent climate policies and their execution.
o Lack of a Comprehensive Strategy
Somalia lacks a comprehensive national strategy for climate change adaptation and mitigation. This hinders its ability to prioritize actions and secure international climate funding.
o Limited Capacity
Somalia faces limitations in terms of capacity and resources to prepare, submit, and manage climate projects that would attract international climate funding. This lack of expertise and infrastructure makes it challenging to tap into climate finance sources effectively.
o Complex Financing Mechanisms
International climate financing mechanisms are complex and bureaucratic, making it difficult for a country like Somalia to navigate these systems effectively. This complexity can discourage or delay access to much-needed financial resources.

Source: SPARC 2023

International climate finance mechanisms, such as the Green Climate Fund (GCF) and Adaptation Fund, can provide financial resources to Somalia. However, the FGS has established the Ministry of Environment and Climate Change as the National Designated Authority (NDA) to facilitate the funding process and develop a national adaptation and mitigation strategy. Currently, Somalia does not have an active and capable NDA, which restricts its ability to access these funding sources. Furthermore, the lack of capacity and technical expertise in climate change planning and project implementation is a key barrier to accessing climate finance, hence needs to strengthen its capability approach. Nonetheless, Somalia needs to build institutional capacity and strengthen its technical skills to effectively design and implement climate adaptation and mitigation projects that align with international funding criteria.

Despite these challenges, there have been some efforts to mobilize climate finance in Somalia. The International community and development partners have supported climate change adaptation projects in the country, focusing on sectors such as sustainable agriculture, renewable energy, and water resource management. The development partners have also helped in building the capacity of government officials and civil society organizations to access and implement climate finance projects.

Figure 31: Development Partners and Main Climate Change Contributors (in Million USD$, 2006-2020)



Source: SPARC 2023

7.3 The Importance of Climate Finance and Strategies for Attraction in Accessing Climate Finance

The East African region has experienced severe and adverse effects of climate change with increased vulnerabilities in the face of changing weather patterns, prolonged droughts, and coastal threats. As climate change becomes an escalating concern, access to climate finance has become imperative for building resilience and mitigating these impacts. This elucidates the significance of climate finance and outlines strategies for improving access to these vital financial resources for mitigation and adaptation schemes.

According to UNFCCC, Climate Finance has been defined as the local, national, or transnational financing from public, private, and alternative sources of financing to support mitigation and adaptation actions that will address climate change. Thus, Climate Finance encompasses financial resources, investments, and mechanisms designed to support climate change mitigation and adaptation activities. For the Somali Government, it holds immense significance due to several compelling reasons:

- Climate Vulnerabilities: Somalia's geographical and climatic conditions expose it to a range of climate-related vulnerabilities, including droughts, floods, and rising sea levels. Climate finance is essential for addressing and mitigating these impacts.
- Economic Resilience: Access to climate finance can bolster Somalia's economic resilience. The funds can be allocated towards climate-resilient infrastructure, sustainable agriculture, and other projects that help protect livelihoods and stimulate economic growth.
- Conflict Resolution: Climate-induced resource-based conflicts are on the rise, particularly in pastoralist communities. Climate finance can help address these conflicts, contributing to peace and security.
- Capacity Building: Enhancing the capacity of government agencies and local institutions is critical for effectively accessing and utilizing climate finance.

Box. 2: Enhancing Access to Climate Finance:

- Institutional Strengthening:
  - Invest in capacity building for government agencies and local institutions responsible for climate finance management.
  - Develop a national framework for climate finance management to ensure efficiency and accountability.
- Comprehensive Climate Data:
  - Improve climate data collection and analysis for evidence-based project development.
  - Collaborate with international organizations and institutions for data sharing and capacity building.
- Local-Level Initiatives:
  - Promote community-based climate resilience projects, tailored to the specific vulnerabilities of local communities.
  - Encourage community engagement and participatory approaches in climate project design and implementation.
- Bilateral and Multilateral Collaboration:
  - Foster partnerships with donor countries, international organizations, and climate funds to facilitate access to climate finance.
  - Formulate joint projects and agreements for enhanced financial and technical support.
- Private Sector Engagement:
  - Encourage private sector investments in renewable energy, sustainable agriculture, and climate-resilient infrastructure.
  - Develop public-private partnerships to leverage resources and expertise.
- Climate Risk Insurance:
  - Explore climate risk insurance mechanisms to manage financial risks associated with extreme weather events.
  - Evaluate the feasibility of incorporating climate insurance into national risk management strategies.

Source: SPARC 2023

In spite of having struggles of meager resources and climate challenges among other governance issues, the following (Box 3) summarizes the success stories of African countries that are successfully mobilizing climate finance and their common characteristics that facilitated the attraction of climate finance from various institutions. Relearning and retooling new methods of climate finance attraction from these regional countries is a profound opportunity for Somalia and its ministries and other agencies involved in designing climate change and climate finance policies and planning, measures, reporting and evaluation of climate impact.

Box. 3. Climate Finance System Enablers in Attracting Climate Finance.

Successful characteristics of African countries that are mobilizing climate finance:

- Strategic Partnerships
  - Leveraging and developing partnerships with international organizations
  - Proactively submitting proposals to partners to support NDC and climate change strategy implementation
- Strategic policies & regulatory frameworks
  - Defined national climate change and sustainable development plans/strategies backed by detailed investment plans and projects
  - Aligned regulatory framework to enable implementation
- Institutional coordination
  - Established dedicated institutions for coordinating the national climate agenda
  - Governance mechanisms involve all actors (government, private sector, civil society, investors, partners)
- Fiduciary systems
  - Developed financial and fiduciary systems
  - Clear legal framework for investors to operate in
  - Dedicated national structure in charge of coordinating and allocating climate finance flows
- Capacity building systems
  - Developed education strategy for future green jobs
  - Continuous capacity building of various actors to develop robust project proposals for climate financing
- Innovation & technology
  - Innovating in way of mobilizing climate finance
  - Leveraging own assets to create new opportunities
  - Realizing technology transfer to develop own green industry

Source: SPARC 2023

7.4 Conclusion and Recommendations

The impact of climate change on Somalia's economy, particularly its productive sectors, is undeniable. The challenges extend beyond the direct economic consequences and include issues related to climate policies, strategies, and institutions, as well as access to climate finance.

- Addressing these challenges is imperative for the sustainable development and resilience of Somalia's economy in the face of a changing climate.
- Effective policies, strategies, and access to climate finance are essential elements in mitigating the adverse effects of climate change and building a more prosperous and resilient future for the country.

  While access to climate finance is still limited in Somalia, addressing both demand and supply side barriers and mobilizing funding for climate change adaptation and mitigation projects calls for an immediate effect.
- Establishing a culture of collaboration, coordination, and coherence within and among MDAs, FGS, and member states,
- Strengthening the national designated authority, building technical capacity, and improving data collection and analysis are crucial steps toward increasing access to climate finance in Somalia.

Access to climate finance is critical for Somalia to address the recurrent challenges of climate change and build a more resilient and sustainable future. This outlines the significance of climate finance and offers strategies for enhancing access, ultimately promoting economic development, conflict resolution, and climate resilience. By adopting these strategies, the Somali Government can effectively leverage climate finance to address the profound impact of climate change on its people and economy.

8 Post-HIPC Policy Priorities

Identifying a list of actionable short-to-medium term post-HIPC policy action priorities are critically important because the Federal Government of Somalia (FGS) has been undertaking ambitious reforms, for a number of years now, under the auspices of various IMF programs. These wide-ranging reforms have enabled the country to reach 'Decision Point' of the Heavily Indebted Poor Countries (HIPC) initiative in March 2020. As a result, the country's arrears to international financial institutions (e.g., IMF, WB, AfDB) were subsequently cleared. Paris club members followed suit with a debt relief of around 75%. The country is now negotiating with non-Paris Club creditors to secure similar arrangements. Provided these are achieved and the country succeeds in satisfying the few remaining conditionalities of the ongoing IMF program, Somalia is on course to reach HIPC Completion Point by the end of the year 2023.

In light of the substantial challenges which the country is faced with, the proposed list of policy actions are not meant to be exhaustive but indicative of where the 'low hanging fruits' can be found given the resource constraints. The list of policy actions are not written in order of criticality.

8.1 Formulate Comprehensive National Development Strategies

Somalia is at a historic cross-road. On the one hand, the country is poised to reach HIPC Initiative Completion Point, where the country's external soverign debt is expected to be reduced significantly. This is an uncharted territory, which demands new tools and mechanisms to sieze this milestone as a rare opportunity to advance the country's national development agenda, while, also avoiding the potential pitfalls associated with the post-HIPC development financing landscape, including relapsing into new debt distress. On the other hand, the country's readiness for the post-HIPC era is at its infancy. Somalia's recent vehicle for development – namely, national development plans (NDPs) have fallen short of achieving their set targets and milestones. For example, both recent NDPs, while they were catalyst for igniting post-civil war Somali-owned and Somali-led development discussions, they lacked an overarching long-term anchor to guide them. This was further complicated by lack of complementary sectoral strategies, full costing, clear prioritization and sequencing. These limitations and, above all, uncertainty over the country's political, security and economic policy direction rendered the effective and timely implementation of these plans untenable.

Recent progress on the fight against terrorism and improved cooperation between FGS and FMSs resulting in a number of agreements meant at further enhancing statebuilding efforts provide a conducive environment for the formulation of a robust, forward-looking and comprehensive Post-HIPC development strategy. This conducive environment is accentuated by the following factors: (1) to develop Centennial Vision 2060 (CV2060) – a long-term development blueprint to guide the nation's development plans and strategies, and (2) to conduct a midterm review of NDP-9.

In light of the above observations, it is imperative to immediately undertake the following policy actions:

1. **Formulate a Post-HIPC stand-alone development strategy, covering the immediate six years following the Completion Point:**

- It should feed into the remaining period of the NDP-9, subsequent NDP-10, which is the first implementation strategy of CV2060
- It should be reflective of the context and realities on the ground, in addition to being fully costed, prioritized and sequenced
- It should serve as a vehicle for medium-term government priorities, flagship programs and projects
- It should be a national mechanism to cultivate home-growth solutions, which in turn serves as the basis for Somalia's engagement with its international partners.

2. **The CV2060 should be reaffirmed as the base on which all policies, NDPs and other development strategies, are anchored. The Vision should:**

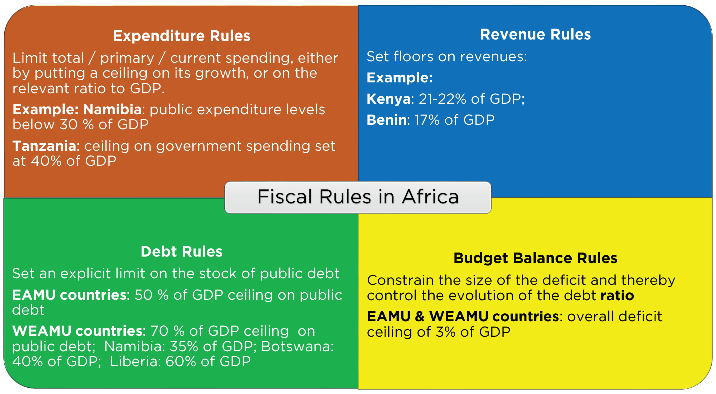
- serve as a tool to instill national unity, growth- mindset and promote core national values and the building of a capable state
- identify the national devlopment model, baseline and targets to be pursued, including timelines
- be responsive to the country's needs and address development challenges
- have dedicated resource envelope, scalable with alternative funding sources and modalities
- enable the consistent application of standards and alignments at all levels and actors.

8.2 Adopt A Robust Fiscal Framework, Enhance PFM & Pursue Prudent Macroeconomic Policies

Fiscal frameworks are clearly laid out rules (see Table 6), regulations and procedures aimed at supporting a robust budgetary process and, ultimately, a prudent fiscal policy. It is largely accepted that robust fiscal frameworks are a necessary precondition for using public resources efficiently. In addition, they can help limit deficit bias and, thus, support macroeconomic stability. As the post-HIPC policy environment is fast approaching, we urge the Ministry of Finance of the FGS to anchor its fiscal policy in a set of prudent and transparent rules including (see Annex 1 for more details):

8. A clear domestic revenue floor
9. A clear ceiling on both critical, operational (e.g., compensation of employees, goods & services etc.) and discretionary spending
10. A clear floor on the overall fiscal balance

Table 6: Types of Fiscal Rules



Source: Author's compilation based on IMF fiscal department data and reports.

The above proposal is streightforward and it is not something new because it was already in place as part of the conditionalities of the IMF ECF program. Thus, we would not be re-inventing the wheels. However, we urge the government to urgently establish a dedicated and independent body to support a prudent fiscal management. In addition to the above, the following actions are critical to support the whole fiscal regime to ensure that it is fit for purpose in terms of delivering much needed public services to the Somali people:

1. **Domestic revenue mobilization should be advanced as a matter of priority**

- The tax base should be widened
- All tax exemptions should be made more transparent
- Tax capacity, the ability of the government to finance its operations, should be strengthened (including at FMS level)
- Legal capacity, the ability to secure and enforce property rights, should be improved
- Public adminstration capacity, the ability to use government resources effectively and efficiently, should be built (including at FMS level)
- Informality within the private sector should be minimised through incentive-based policies and structural reforms
- Existing tax laws and regulations should be updated and made more robust and forward looking
- Improve the capacity to levy broad-based taxes, especially direct taxes and moderanize customs
- Capacity building is urgently needed on all fronts and at all levels (FGS & FMS)

2. **Strengthen transparency and accountability**

- Tax evasion should be addressed
- All forms of corruption should be curtailed, including petty corruption
- The trust of the general public and 'tax morale' should be enhanced

3. **Maintain a fiscal buffer and improve public investment management**

- Strengthen countercyclical tools to protect against unexpected shocks
- Improve public investment management to safeguard the interests of the nation
- Minimise the earmarking of revenue and deductions at source

4. **Fiscal federalism framework is needed as a matter of priority**

- Finalize a viable tax-, revenue-, and resource-sharing arrangements and institutions appropriate for the country's structure and needs
- Expend public services at all levels (including at FMS level)

5. **Strengthen the integrity of public financial management (PFM)**

- Establish clear and comprehensive legal and regulatory frameworks that enhance the efficiency, transparency, accountability, and integrity of PFM. This includes establishing a legal framework for the appointments to institutional leaderships, contracts, and management of public assets and resources, enacting laws that criminalize corruption and other financial crimes, and enforcing these laws.

- Implement adequate internal controls at all aspects of PFM to prevent fraud, misappropriation of public funds, and other financial irregularities. This includes strengthening procurement procedures, enhancing asset management, and improving financial monitoring, cash forecasting, and tax exemption transparency.

- Build and invest in human capacity in relation to PFM, ensuring that PFM personnel have the necessary skills, knowledge, and ethical values to manage public funds effectively and with integrity.

- Engage all relevant stakeholders, including FMS, civil society organizations, the private sector, and the media, to promote transparency, accountability, and integrity in PFM so public officials can be held accountable for their actions.

- Promote financial disclosure by public officials, including the publication of asset declarations, to enhance transparency and accountability in PFM.

- The existing Procurement Act should be fully implemented, including the establishment of the National Procurement Board.

- Strengthen oversight mechanisms, including Inter-Ministry Coordinating Committee, the auditor general's office, parliamentary committees, and other independent oversight bodies, to ensure that PFM systems and practices are aligned with international best practices and standards. These oversight bodies should have sufficient powers and resources to conduct audits and investigations and hold public officials accountable for their actions.

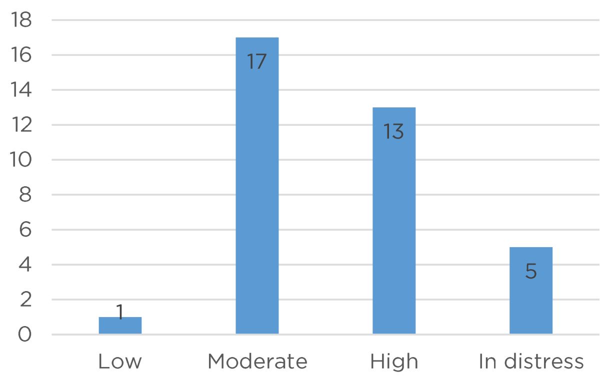
- Enhance the transparency of budget processes by involving stakeholders in the formulation and implementation of the budget, providing clear and comprehensive information on budget allocations and expenditures, and ensuring that budgets are realistic and aligned with development objectives.

- Engage international bodies and join international initiatives to learn best practices in relation to PFM integrity. For example, join the Extractive Industries Transparency Initiative (EITI) and other global transparency and accountability initiatives.

8.3 Adopt A Medium-Term Debt Sustainability Framework & Strengthen Debt Management Capacity

In a post-HIPC environment, it is imperative that the FRS does not fall into a new debt trap, which will cause significant damage to the credibility of the country and will lead to exclusion of concessional financing. As of December 2022, Somalia's total debt stock was \$4.4 billion (Paris Club members = \$2,7 b. [60%]; Non-Paris Club = \$735 m. [17%], & Multilateral creditors = \$1 b. [23%]). Out of the 39 countries that initiated the HIPC process, 36 have so far managed to reach post-completion point. Unfortunately, the overwhelming majority of these countries are now in either high or moderate debt distress. Somalia should thread carefully in relation to taking on new debt obligations.

Figure 32: Debt sustainability assessment of post-completion point HIPC countries[41]



Source: IMF, 2023

As a matter of priority, the FGS should continue advancing its governance, public financial management and other critical reforms as these are necessary for both (future) debt sustainability, but also, for securing access to concessional financing. Somalia's stuctural deficiencies are immense. They include narrow domestic production capacity, low and undiversified exports, high import propensity, weak financial sector, absence of capital markets, weak tax systems and lack of fiscal space, high dependence on foreign aid, weak institutions, political instability, and significant human capacity constraints. Put together, these structural weaknesses underline the fact that the country can easily fall into solvency and liquidity risks unless the right mix of policies are pursued in a timely manner.

The following key policy actions are needed to be in place:

6. FGS should develop a medium-term debt management strategy (MTDS)

- This strategy would guide the government's debt decisions and operations (i.e., what to borrow, how to manage risks, how best to meet financing needs, what borrowed funds can be used for etc.) given the macroeconomic framework and structural factors.
- In addition to showing clear cost-risk trade-off preferences, the MTDS must accomplish two basic objectives: (a) addressing the government's financing needs in a way consistent with minimum cost and risk, and (b) pursuing a viable domestic debt management given the structure of the economy.

7. FGS must develop a robust debt management capacity

- Staff should have the necessary technical capacity to negotiate complex debt deals with terms and conditions that have intertemporal implications with regards to risks and costs.
- Appropriate oversight and transparency tools must also be established (see below).

8. Establish public debt management legal framework

- A comprehensive legal framework is needed to establish, among others, the following: (1) who has the mandate to borrow or to issue guarantee(s), (2) who has the authority to conduct debt management activities, (3) the roles and responsibilities of various entities and actors relevant for public borrowing, (4) public disclosures and transparency requirements, and (5) the scope, purpose, and circumstances of all new borrowing, including appropriate restrictions/limits and underlying terms and conditions. Having a clear public debt management act will provide a clear framework for strategic debt management and robust debt sustainability. Such law should mandate the government to seek independent professional debt advice to be shared with public institutions such as the Parliament for transparency and accountability purposes.

9. The FGS should take all necessary steps to prevent the creation of contingent liabilities (CLs)

- In countries such as Somalia, there are usually three main reasons for contingent liabilities – (1) state or local governments not being able to meet their debt obligations, (2) a large and guaranteed public infrastructure project (e.g., PPP) failing, or (3) a systemically important entity such as a domestic financial institution going under. CLs are, therefore, potential fiscal obligations contingent on the occurrence of particular adverse events. In a post-HIPC environment, it is important to prevent contingent and direct implicit and explicit liabilities.

8.4 Initiate Urgent Reforms to Address Somalia's Structural Trade Deficit

The Somali economy is a consumption-driven economy with a significant import dependency. As a result of infrastructure-related challenges, the country produces practically little and, therefore, cannot satisfy domestic demand. The overwhelming majority of the country's needs are met by imports of goods including building supplies (23% of total imports), gasoline, electronics, food items (30% of total imports), clothes and footwear (10% of total imports) and cars and spareparts (9% of total imports). The country's exports are overwhelmingly dominated by agriculture (11%) and livestock (78% of total exports), both highly vulnerable to shocks. Given the significant mistmach between the values of exports and imports, the country suffers from a persistent structural trade deficit. The trade deficit is more than 70% of GDP while the current account deficit is around 15% of GDP. Currently, remittances and donor grants, which account for more than 50% of GDP, are the two principal financing sources of the current account. In a post-HIPC environment, donor grants will not be available so it is imperative to initiate a robust reform agenda aimed at tackling the structural trade deficit as a matter of priority.

The two primary obstacles undermining the domestic market and production are infrastructure-related challenges and security-related impediments. As a result of these issues, the domestic production base is largely in tatters and the domestic market is economically fragmented with huge pricing variations. Transaction costs are excessively high as a result of significant market imperfections. Trade and competitiveness are severely curtailed. Informality is widespread further undermining competitiveness and causing distortions, including varied production costs.

In light of the above observations, the following key policy actions are needed to be in place:

- Improve access to road networks and affordable energy. Initially, focus on selected strategic corridors to support the flow of goods to boost trade within the country.
- Revise, combine and implement Somalia's recently developed strategies and policies (the National Investment Promotion Strategy, the National Industrial Policy, the SME Policy, and the National Export Strategy) into one integrated and comprehensive strategy with clear action plans.
- Adopt the 'low hanging fruit' principle by focusing on two specific attainable goals and targets:
    - o Concentrate on establishing and nurturing a viable small-scale industry, which can cost-efficiently produce at small scale. For example, Somalia spends millions of dollars importing napkins, tissues, basic toys, toothpick, pens and papers, bottled drinks etc. This will boost government revenue, create employment opportunities, and boost innovation and productivity in addition to reducing the trade deficit. However, for this to happen, an enabling environment must be created which addresses issues such as corruption, tax regulations, lack of reliable electricity and energy, crime and theft, access to finance, and inadequate infrastructure.
    - o Focus on export diversification and value chain enhancement. Initially, Somalia should diversity away from its heavy reliance on Gulf Cooperation Council countries by cultivating new trading partners. At the same time, the country should enhance value chains in sectors such agriculture, livestock, and fisheries so that basic value addition can take place (e.g., diary production, meat processing, extraction of animal fats, production of vegetable oils, and basic processing of grains etc.).
    - o Only when the two above interventions have been implemented should Somalia engage in regional integration. Otherwise, the country will keep hemorrhaging foreign exchange to the detriment of its trade balance but also the country will lose significant revenues. Also, prior to any regional integration, Somalia must advance a national trade strategy that supports the country's trade-related institutions including harmonizing and modernizing its customs and border control procedures.
- Promote private sector development by creating a conducive environment for entrepreneurship and investment
- Address the risks and costs of doing business by lowering the barriers of formalization through simplification of business procedures and provision of targeted registration support to informal firms. Formalization can also be reduced by providing advisory services (e.g., public procurement opportunities, management support, financial advice etc.) and offering access to social safety nets to the owners and operators of informal firms.
- Tackle (petty) corruption by tax officials and ensure data protection so that businesses are confident that their information is kept confidential.

8.5 Urgently Build On Ongoing Public Integrity Measures

Public integrity is the key foundation to build a just and prosperous society. In a nut shell, public integrity is concerned with the consistent adoption and application of clear and shared values for maintaining and pursuing the public interest over the private interests in the public sector. In the absence of public integrity, corruption thrives to the detriment of trust in, not only the government, but also public institutions at large. The corrosive and destructive consequences of corruption are summarized in Table 2 below.

Table 7: Corruption and its effects

Consequences of corruption		
	Waste of public resources and inefficiencies	Increased poverty
	Increased inequality	Undermines trust in public institutions
	Abuse of power	High embezzlement rates
	Conflicts and grievances	Insecurity
	Political instability	Widespread discontent
	Political and social polarization	Disillusionment and hopelessness
	Impunity and lack of accountability	Diminished state capacity and failure

Given the adverse consequences of weak public integrity, a comprehensive integrity system must be put in place, which can effectively address the root causes of misappropriation, embezzlement, and abuse of power. At the same time, it must promote transparency, accountability, and good governance across the public sector including the legislative, administrative, executive, and judiciary and their public officials and agents. To cultivate a culture and system of public integrity, a five-pronged approach is universally accepted as very effective tool according to the OECD recommendations of the Council on Public Integrity:

I. A whole society approach is needed: to consistently protect public integrity, all key stakeholders including businesses, private citizens and government and non-government actors must stand together and confront anything that weakens public integrity.

II. A purpose-driven leadership is indispensable to uphold public integrity: the leadership and management of public institutions and organizations must lead from the front, meaning that they must play an active and visible role in the pursuit of the integrity agenda. This also means that they must embody integrity, ethical behavior, incorruptibility, and morality.

III. For the public sector to be able to uphold integrity, it must consistently pursue a merit-based recruitment at all levels: This means that it has to employ qualified people that are committed to genuine public service and the public interest. Public sector organizations must put in place robust performance management to promote a culture of accountability and productivity.

IV. Public sector officials must be given a significant capacity building so that they are trained to apply integrity standards: They should be given enhanced understanding of anti-corruption measures through appropriate training programs and educational initiatives. There should also be wider public awareness campaigns to strengthen and promote a culture of public integrity.

V. A culture of public integrity requires transparency and openness to flourish: On the one hand, all key government operations, including budgeting, procurement, and decision-making processes, particularly those concerning public assets and resources, must be done in a transparent manner. On the other hand, there should be complete openness on integrity so that it is safe to report incidents of corruption/misconduct in public office.

In the context of Somalia, there are three specific risks and opportunities for corruption and mismanagement. These are: (1) public procurement, (2) public infrastructure projects, and (3) public policy capture. The first can be addressed using established tools including transparency, accountability, and oversight mechanisms. The second also requires consistent application of integrity, transparency, and good governance. The third risk is arguably the most destructive and has long-lasting implications for the recovery of the country. The solution for policy capture is effective stakeholder engagement, openness around policymaking and merit-based recruitment of senior officials. Lastly, a significant corruption risk remains the sale and disposal of public properties and assets, which requires mitigation.

Ultimately, a culture of accountability is critically important to mitigate the drivers of corrupt behaviour. Also, the oversight mechanisms must be urgently strengthened, including empowering the judiciary, media, and civil society so that public officials can be held accountable, and the culture of impunity can be effectively eradicated. Finally, the legal and institutional frameworks must be strengthened by re-establishing the Anti-Corruption Commission and the Judicial Services Commission as a matter of priority. Both must be populated with highly qualified and competent professionals and must be made independent from political and other interests.

8.6 Reinforce and Maintain CBS Reforms

Significant and transformative reforms have been implemented by the Central Bank of Somalia (CBS). These reforms were guided by several overarching and ambitious strategic documents including the 'Financial Sector Development Roadmap' and 'CBS Strategic Plan 2020-24'. The broad accomplishments so far are as follows:

i. Institutional capacity: The CBS has become a function-based and policy-oriented organization. It adopted a new and modern organizational structure in 2019, which is in line with international standards. It has adopted modern HR-standards including merit-based recruitment and performance management. This has enabled it to recruit, on merit and competitive basis, three senior executives. All professional staff have been given clear job descriptions, all divisions and departments have clear objectives, and all staff have agreed annual performance objectives supported by a dedicated and tailored individual training plan.

ii. Governance and internal controls: The CBS has managed to modernize its internal controls. It has strengthened and automated its bank operations and accounting systems. All internal operations of the bank are strictly guided by the following policies: HR policy, financial management policy, foreign account management policy, procurement policy, ICT policy, and audit rotation policy. These policies have, in turn, led to the development of an overarching operations manual and several procedures aimed at strengthening the internal controls and financial accountability of the institution. As a result of these ground-breaking reforms, the CBS has managed to achieve a clean audit opinion from its external auditors. This achievement confirms that CBS' financial statements are deemed to be fair and appropriately represented. For transparency reasons, the CBS publishes all its accounts, full financial statement, and external audit opinion on its website.

iii. Fiscal agent services to the FGS: The CBS has significantly upgraded its core banking system, which has removed the need for cash payments. The system interface between the Ministry of Finance and CBS has been upgraded. CBS has become a member of the international SWIFT system and it has managed to re-establish its accounts with the Federal Reserve Bank of New York.

iv. Payment, clearing and settlement systems: The CBS launched an ambitious National Payment System (NPS) in 2021, enabling licensed commercial banks to transact with each other electronically through a settlement system managed by CBS. In 2023, all licensed commercial banks were supported by CBS to adopt the International Bank Account Numbers (IBAN) system.

v. Financial sector supervision and licensing: The CBS has successfully managed to strengthen its regulatory framework for the financial sector. All commercial banks and money transfer businesses that operate within the FRS are now licensed and regulated by CBS. This means that they are under CBS supervisory regime and are subject to both onsite and offsite inspections. The very important mobile money sector too has now been brought under CBS regulatory purview. All key financial laws (FIL, NPS, Insurance) are now being finalized and will soon be submitted to the Cabinet.

Considering the tremendous achievements above, it is imperative to sustain the reform momentum to give our country the best opportunity to obtain an inclusive economic growth. Given the criticality of the CBS for the future welfare of this nation, the following policy interventions are immensely important:

- CBS requires capitalization as a matter of priority: the institution can never become a fully functioning central bank unless it is capitalized. This will enable it to finance its operational budget needs. This will protect the integrity and operational independence of the institution. Also, CBS requires foreign exchange reserves to be able to perform monetary policy (also key for price stability, trade financing, economic stabilization etc.).
- Until sustainable capitalization is implemented, the CBS' current financing arrangement (1.5% fiscal service charge) must be protected, and the institution must be supported to develop a viable revenue generation model.

- CBS' existing strong governance must be guarded by ensuring that the future leadership of this organization are chosen on merit basis. This means that reform-minded individuals with strong integrity must be appointed to lead this important institution.
- A whole-government approach is needed to finalize the currency exchange project, including addressing the financing gap. This project is critical for financial inclusion.
- Fast-track the national identification system to support financial sector integrity and correspondent banking relationships. A national ID is particularly important for Somalia's upcoming mutual evaluation, which is expected to take place in 2024.
- Support the CBS in its ongoing efforts to expend its activities and operations to the FMS, including the rehabilitation and re-opening of its regional branches.

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