



# SOMALIA

## STAFF-MONITORED PROGRAM—PRESS RELEASE; AND STAFF REPORT

May 2016

In the context of the Staff-Monitored Program, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's information, following discussions that ended on April 5, 2016, with the officials of Somalia on economic developments and policies underpinning the IMF arrangement under the Staff-Monitored Program. Based on information available at the time of these discussions, the staff report was completed on May 17, 2016.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Somalia\*  
Memorandum of Economic and Financial Policies by the authorities of Somalia\*  
Technical Memorandum of Understanding\*  
\*Also included in Staff Report

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**Washington, D.C.**



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May 27, 2016

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Washington, D.C. 20431 USA

### **IMF Managing Director Approves Staff-Monitored Program for Somalia**

The Managing Director of the International Monetary Fund (IMF) approved on May 16, 2016 a Staff-Monitored Program (SMP) for the Federal Republic of Somalia, covering the period of May 2016–April 2017.<sup>1</sup>

Somalia is recovering slowly from nearly 25 years of civil war. Weak institutional capacity, complex clan politics, and a challenging security situation have complicated the country's economic reconstruction. As a result, social and economic conditions remain dire. With continued support from the international community and key donors, the Federal Government of Somalia has initiated important reforms to lay the foundation for the country's economic reconstruction. To help Somalia's economic reconstruction efforts and establish a track record on policy and reform implementation, the authorities have requested an IMF SMP.

The SMP is geared toward reestablishing macroeconomic stability, building capacity to strengthen macroeconomic management, rebuilding institutions, and improving governance and economic statistics. Given Somalia's weak administrative capacity, technical assistance is an integral part of the SMP.

Under the SMP, fiscal policy and reforms will aim to achieve a zero fiscal balance on a cash basis, while avoiding the accumulation of domestic arrears. The pursuit of these objectives will be underpinned by revenue measures, realistic pledged foreign grants, and prudent expenditure policy. Fiscal reforms will focus on strengthening public financial management, particularly by modernizing tax and customs administration, and budget planning and execution. Monetary and financial policy and reforms will focus on: (1) maintaining a floor on the central bank net foreign assets; (2) initiating the first stage of comprehensive currency reform; (3) strengthening the licensing, supervision, and regulation of the nascent

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<sup>1</sup> An SMP is an informal agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic program. SMPs do not entail financial assistance or endorsement by the IMF Executive Board.

commercial bank system and money transfer businesses; and (4) enhancing the framework for anti-money-laundering and combating the financing of terrorism (AML/CFT), which is critical for maintaining the flow of remittances to Somalia.

Somalia's external debt is high and virtually all in arrears, thus precluding access to external borrowing. In particular, Somalia remains unable to access IMF resources because of its continued arrears to the Fund. A strong track record of macroeconomic performance and implementation of reforms, together with a comprehensive strategy of arrears clearance and debt relief supported by Somalia development partners, is required for addressing Somalia's high debt overhang.

The Federal Government of Somalia has established very good cooperation with the Fund since Fund recognition of the Federal Government of Somalia three years ago. The IMF Executive Board concluded the first Article IV Consultation for Somalia in more than 26 years in July 2015. In addition, the Fund has delivered more than 50 technical assistance missions (including training) since 2013, and will intensify training under the SMP to improve institutional capacity.

IMF staff will work closely with the authorities to monitor progress in the implementation of their economic program. Successful completion of this program and subsequent SMPs could pave the way to an IMF-supported program of upper-credit tranche quality. Continued support from creditors and donors will remain critical for a full normalization and resumption of financial assistance from the IMF.



# SOMALIA

## STAFF-MONITORED PROGRAM

May 17, 2016

### KEY ISSUES

**Background and context:** Since 2012, Somalia has been recovering slowly from nearly 25 years of civil war. Weak institutional capacity, complex clan politics, and a challenging security situation have complicated economic reconstruction. As a result, social and economic conditions remain dire. The Federal Government of Somalia has initiated important reforms to lay the foundation for the country's economic reconstruction. The authorities have also been engaging with the Fund since April 2013. IMF Executive Directors concluded the first Article IV consultation in more than 25 years in July 2015. To help Somalia's economic reconstruction efforts and establish a policy implementation track record as an important step toward an eventual fund arrangement, the authorities have requested an IMF staff-monitored program (SMP). This SMP is guided by the conclusions of the July 2015 Article IV consultation.

**Program focus:** The SMP covers May 2016 to April 2017. It focuses on strengthening macroeconomic policy management and reforms to strengthen economic governance and institutional capacity. Given Somalia's weak administrative capacity, technical assistance is an integral part of the program.

#### **Program objectives and main recommendations:**

- *Rebuild institutions and economic statistics:* Keep up the pace of restoring key economic and financial institutions (national statistics, budget, treasury, debt management functions, and central bank). Adopt a statistical law and strengthen data collection infrastructure. Further intensify trainings to improve capacity.
- *Fiscal policy and reforms:* Achieve a zero fiscal balance on a cash basis while avoiding the accumulation of domestic arrears. Fiscal policy is underpinned by revenue measures, realistic pledged foreign grants, and prudent expenditure policy. Reforms will focus on strengthening public financial management, particularly by modernizing tax and customs administration and budget planning and execution.
- *Monetary and financial policy and reforms:* The central bank to maintain a floor on its net foreign assets, initiate the first stage of a comprehensive currency reform, and strengthen licensing, supervision and regulation of the nascent commercial bank system, and money transfer businesses.

## SOMALIA

**Risks to the SMP:** The main risks to the program stem from fragile security, weak institutional capacity, and slowdown in reforms in the run-up to the August/September 2016 national elections. The authorities' strong commitment to the implementation of the program and sustained international support would mitigate risks.

Approved By  
**Adnan Mazarei (MCD)**  
**and Steven Barnett (SPR)**

Discussions were held in Nairobi, Kenya during March 30–April 5, 2016. The mission consisted of Mr. Zandamela (head), Ms. Castellanos, and Messrs. Farah and Samake (all MCD), Dybczak and Dallari (both FAD), and Thiam (Resident Representative). Visits by Messrs. Lönnberg (MCM consultant) and Muir (FAD consultant) overlapped with the mission. Mr. Tlelima (OED) participated in the discussions. The mission met with Finance Minister Ibrahim, Central Bank Governor Ali, and other senior government officials. The mission also met with Somalia international partners based in Nairobi.

## CONTENTS

<b>BACKGROUND AND CONTEXT</b>	<b>5</b>
<b>RECENT ECONOMIC DEVELOPMENTS</b>	<b>7</b>
<b>OUTLOOK AND RISKS</b>	<b>9</b>
<b>POLICY DISCUSSIONS</b>	<b>9</b>
A. Fostering Fiscal Discipline	10
B. Structural Reform to Strengthen Nascent Institutions	12
C. Program Monitoring and Risks	15
<b>STAFF APPRAISAL</b>	<b>17</b>
<b>BOXES</b>	
1. Security: Strealiming the Fiscal Cost of Security in Somalia	11
2. Technical Assistance—Stocking and Challenges Ahead	13
3. Reform of the National Currency	16
<b>TABLES</b>	
1. Selected Economic and Financial Indicators, 2013–17	19
2a. Federal Government Operations, 2013–17 (Millions of U.S. dollars)	20
2b. Federal Government Operations, 2013–17 (Percent of GDP)	21
3. Summary Accounts of the Central Bank, 2013–15	22
4a. Balance of Payments, 2013–17 (Millions of U.S. dollars, unless otherwise indicated)	23
4b. Balance of Payments, 2013–17 (Percent of GDP, unless otherwise indicated)	24

## SOMALIA

5a. External Public Debt, 2013–15 (Millions of U.S. dollars)	25
5b. External Public Debt, 2013–15 (Percent of GDP)	26
6. Off-Budget Aid Disbursements, 2014–16	27
7. Completed TA, 2013–15	28
8. Planned TA in 2016	29

## APPENDICES

I. Risk Assessment Matrix	30
II. Letter of Intent	31
Attachment I. Memorandum on Economic and Financial Policies	33
Attachment II. Technical Memorandum of Understanding	42

## BACKGROUND AND CONTEXT

1. **Somalia is a fragile state emerging from a protracted civil war.** Weak institutional capacity, fragile security, and complex clan politics have complicated economic reconstruction. Social and economic conditions are difficult, and poverty is widespread. Despite these challenges, the Federal Government of Somalia (FGS)<sup>1</sup> has sought to reestablish key economic institutions, initiated important reforms to lay the foundation for economic reconstruction, and re-engaged with the IMF and other international partners.
2. **Recent political developments are encouraging.** After several months of negotiations, the Somali National Leadership Forum (NFL)<sup>2</sup> reached a consensus this April on the 2016 electoral modalities. This agreement could pave the way for an inclusive and credible electoral outcome as recommended by the international community.<sup>3</sup> The NFL decision has been endorsed by the cabinet, but is yet to be approved by the Federal Parliament. Meanwhile, the security situation remains fragile, despite recent gains by the Somali national army and African Union (AU) troops.<sup>4</sup>
3. **On July 27, 2015, the Executive Board concluded the 2015 Article IV consultation with Somalia, the first since November 18, 1989.** At that time, Executive Directors welcomed Somalia's re-engagement with the IMF. Directors recognized that Somalia is facing daunting challenges and they stressed that the first priority is to continue building institutions and administrative capacity. They also urged decisive steps to build fiscal discipline, underpinned by realistic budgeting and effective implementation systems, including commitment controls. On banking and financial policy, Directors supported the implementation of a currency reform with IMF technical assistance. However, they cautioned that it should not be implemented until prerequisites are in place. They stressed that elaboration of a financial sector roadmap will be a critical first step to build credibility in licensing, supervising, and regulating banks and money-transfer businesses (MTBs).<sup>5</sup>

<sup>1</sup> Hereafter, "FGS", "authorities", and "government" will be used interchangeably. The FGS consists of the states of Puntland, Jubbaland, South West and Galmudug. The Hirran/ Middle Shebelle—an interim regional administration—is expected to be declared a new state in the near future.

<sup>2</sup> The forum includes members of the cabinet and leaders from all Somali federal member states and interim regional administrations.

<sup>3</sup> The agreed electoral modality envisages the selection of 14,000 people from the states and interim regional administrations who will select the members of the new parliament. It also reserves 30 percent of parliament seats for women.

<sup>4</sup> Recently, the Somalia national army and AU troops freed several territories and villages from Al-Shabaab. Despite these gains, Al-Shabaab remains active in many regions in Somalia.

<sup>5</sup> By the end of April 2016, Somalia's overdue obligations to the IMF stood at \$334.6 million (535.7 percent of quota).



4. **The FGS has requested an IMF staff-monitored program (SMP) to support their policy and reform agenda and established a policy implementation track record as an important step toward an eventual fund arrangement.** In light of Somalia's weak capacity, the authorities' program focuses on anchoring economic policies and reforms, while strengthening institutions. The authorities' program is outlined in their letter of intent (LOI, Appendix II) and the accompanying memorandum of economic and financial policies (MEFP, Attachment I). The SMP is geared to reestablishing macroeconomic stability, building capacity to strengthen macroeconomic management, and improving governance and economic statistics. In particular, the program includes tax revenue measures to lift domestic revenue collection, PFM reforms to improve budget planning and execution, and currency reform to pave the way for effective monetary policy over the medium term. The IMF Trust Fund for Capacity Development in Macroeconomic Policies and Statistics for Somalia,<sup>6</sup> which was launched on February 6, 2015, will support the authorities' capacity building efforts. The authorities hope that successful completion of this, and subsequent SMPs, would lead to an IMF-supported program of upper-credit tranche quality. Moreover, the authorities acknowledged that the full normalization and resumption of financial support from the IMF will depend critically on the support of creditors and donors.
5. **The authorities have fully implemented key measures to prepare for the SMP.** They have: (1) adopted an Appropriation Bill that is consistent with a zero cash balance; (2) set up an institutional framework for fiscal data reporting; (3) adopted an arrears-management strategy as part of a public financial management (PFM) reform;<sup>7</sup> and (4) approved the key principles for currency reform. Further, as envisaged under the program, the government has recently submitted to parliament a draft PFM law (a structural benchmark), initiated electronic payments of civil service wages, and submitted the 2015 financial statements to the auditor general.

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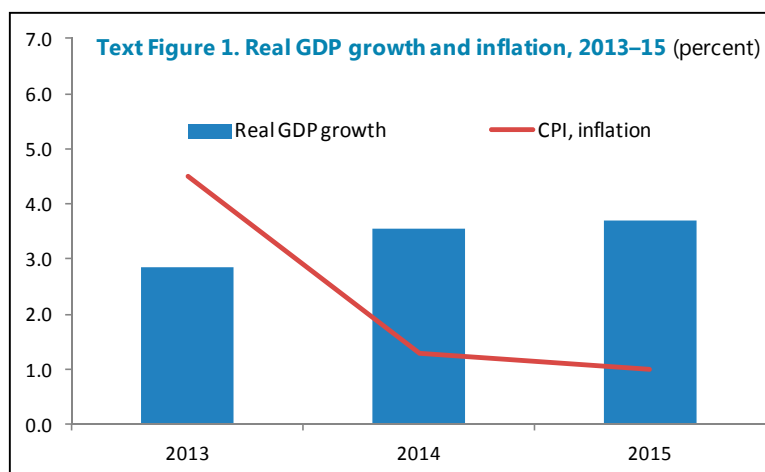
<sup>6</sup> Contributors include the Arab Fund for Economic and Social Development, Canada, United Kingdom, and Italy. Other donors are also considering to contribute.

<sup>7</sup> The elements of the strategy are: (1) strengthening the legal and regulatory framework; (2) improving the credibility and realism of the budget; (3) improving accounting and reporting; (4) strengthening commitment controls; and (5) improving cash management.

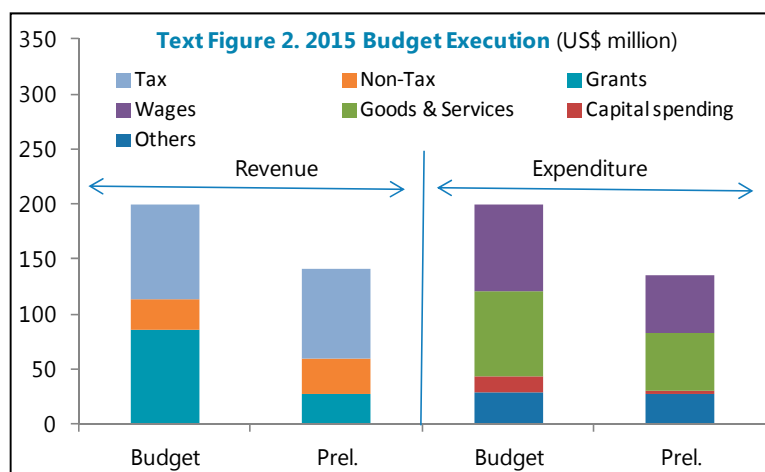
## RECENT ECONOMIC DEVELOPMENTS

*In 2015, economic activity continued to recover modestly, despite fiscal strain.*

6. **Based on rudimentary data, economic growth remained steady and inflation low.**<sup>8</sup> Real GDP growth is estimated at 3.7 percent in 2015, driven by the telecommunication and service sectors (Table 1). Consumer price inflation dropped from 4.5 percent in 2014 to 1.3 percent in 2015, thanks to lower commodity prices, including oil. Reflecting higher food imports following a weak agriculture harvest, the external current account deficit in 2015 is estimated at \$876 million (14.8 percent of GDP), slightly up from \$827 million (14.7 percent of GDP) in 2014. Foreign direct investment (in part by the Somali diaspora) and grants covered the deficit.



7. **Budget execution was difficult in 2015** (Table 2). Although domestic revenue was in line with the budget, grants fell short by \$58 million (1 percent of GDP), owing to weak budget planning and delays in disbursements by some bilateral donors.<sup>9</sup> As a result, the government accumulated (net) domestic arrears estimated at \$22½ million (0.4 percent of GDP)—mainly to defense forces and civil servants—bringing the stock at the end of 2015 to about \$68 million (1.1 percent of GDP). The overall fiscal balance (cash basis) recorded a small surplus owing to unspent earmarked donor funds.

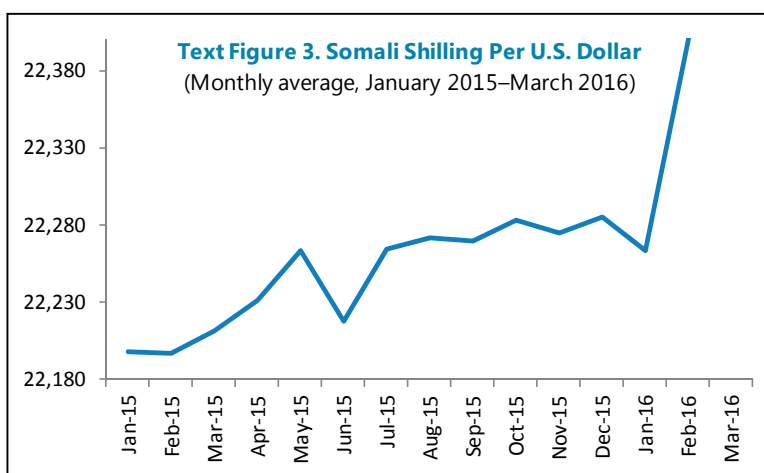


<sup>8</sup> GDP data have been compiled since 2012 based on qualitative assessments and broad assumptions due to the absence of appropriate source data. The consumer price index (CPI) for Mogadishu has been compiled since 2015 following IMF technical assistance with a basket of 312 items.

<sup>9</sup> The budget included unconfirmed pledged grants.

8. **The authorities are taking steps to rebuild public external debt statistics.** Somalia's external public debt database was lost or destroyed during the conflict. With technical assistance from the African Development Bank, the authorities have established a Debt Management Unit (DMU) at the Ministry of Finance to reconstitute the bulk of their external public debt data.<sup>10</sup> Based on up-to-date information from more than two-thirds of Somalia's creditors, outstanding public debt was estimated to be \$5 billion at the end of 2015 (85.1 percent of GDP).<sup>11</sup> The debt comprises multilateral creditors (\$1.5 billion or 24.7 percent of GDP), Paris Club creditors (\$2.3 billion or 38.5 percent of GDP), and some non-Paris Club creditors (\$1.3 billion or 21.9 percent of GDP).

9. **There is no scope for monetary policy in Somalia** (Table 3). The CBS has control over neither the exchange rate nor the supply of the Somali shilling (SOS). It has not issued any bank notes since 1991, and the bulk of payments are settled in U.S. dollars, mobile phone platforms, and counterfeit SOS notes.<sup>12</sup> Moreover, official international reserves are very low. From December 2014 to March 2016, the SOS/U.S. dollar exchange rate depreciated by 12.4 percent (that is, from 20,268 to 22,779), mostly owing to an influx of new counterfeit notes.<sup>13</sup>



10. **The financial sector is nascent.** Formal commercial banking activity is geographically concentrated in Mogadishu with each institution having only a few branches in other parts of the country, typically engaged in money transfers and trade finance. Six commercial banks are licensed by the CBS with assets of \$194.4 million and deposits of \$142.8 million. An additional 13 applications for commercial bank licenses are pending.<sup>14</sup> Industry capitalization is about 40 percent, measured on an unweighted basis, and all but one bank meets the minimum capital requirement of \$5 million. As of March 2016, there were 12 licensed MTBs.

<sup>10</sup> The DMU is working closely with international creditors to reconcile the country's external public debt—a task facilitated by the Somalia Technical Working Group, which includes representatives of key international and bilateral creditors.

<sup>11</sup> Almost all in arrears.

<sup>12</sup> U.S. dollar banknotes are estimated to represent more than 90 percent of currency in circulation. The use of neighboring country currencies is also prevalent in border areas.

<sup>13</sup> Somalia's exchange rate is classified, *de facto*, as free-floating.

<sup>14</sup> The Bank of Somaliland, which the CBS does not recognize, licenses, supervises, and regulates financial institutions operating in Somaliland.

## OUTLOOK AND RISKS

*Economic recovery is expected to continue in 2016 and inflation to remain low. Risks are tilted to the downside, emanating mainly from fragile security and weak institutions.*

11. **Real GDP growth is projected to remain steady and inflation low.** Real GDP growth is projected at 3.7 percent in 2016–17, driven by private investment from the diaspora and donor-financed public investment. Inflation is expected to remain at 1 percent, owing to continued low world commodity prices. Reflecting largely construction material and increased food imports, the external current account deficit is projected to be 15.8 percent of GDP in 2016–17, financed by foreign direct investment and external grants.

12. **The outlook is subject to significant domestic and external risks** (Appendix I–RAM). Domestic risks include a loss of expenditure control in the run-up to the August/September 2016 national elections, fragile security and weak institutional capacity which could undermine critical reforms in revenue mobilization, and public financial management. External risks include slower global growth and spillovers from protracted conflicts in the Middle East which could weaken demand for exports, reduce donor support, and decrease remittance inflows. Tighter international regulatory and supervisory frameworks could also slow remittances.

## POLICY DISCUSSIONS

*The SMP discussions centered on near-term policies to foster fiscal discipline, and structural reforms to prepare for effective monetary policy over the medium term, develop the financial sector, strengthen institutions and governance, and rebuild macroeconomic statistics.*

13. **The 2016 macroeconomic framework aims to sustain the economic recovery, while ensuring macroeconomic stability** (Text Table 1). Its objectives are to: (1) achieve a real GDP growth of 3.7 percent; (2) keep inflation at 1 percent; and (3) at a minimum, maintain the net foreign assets of the CBS at the end-December 2015 level. To attain these objectives, the government has adopted a balanced budget on a cash basis, and the CBS will implement a prudent currency reform.

**Text Table 1. Selected Economic Indicators, 2013–16**  
(Millions of U.S. dollars, unless otherwise indicated)

	2013	2014	2015	2016
			Prel.	Prog.
<b>National income and CPI</b>				(Percent)
Real GDP growth	2.8	3.6	3.7	3.7
Inflation (CPI, eop)	4.5	1.3	1.0	1.0
<b>Fiscal 1/ 2/</b>				(U.S. dollar, million)
Revenue and grants	2.1	2.6	2.4	4.0
Revenue	1.3	1.5	1.9	2.0
Grants	0.8	1.1	0.5	1.9
Total expenditure	2.2	2.7	2.3	4.0
Of which: Wages	0.9	1.4	0.9	1.5
Overall balance	-0.1	-0.1	0.1	0.0
<b>External sector and debt</b>				
Current account (% of GDP)	-16.8	-14.7	-14.8	-15.8
Net foreign assets 3/	...	...	21.6	21.6
External debt (% of GDP)	93.2	87.6	85.1	...
<b>Memorandum items</b>				(U.S. dollar, million)
Treasury deposits at the CBS	5.4	4.5	11.4	...
Stock of arrears	30.4	45.3	67.7	35.7
Sources: Somali authorities; and IMF staff estimates.				
1/ Covers only the Federal Government of Somalia's operations.				
2/ The fiscal aggregates are recorded on cash basis.				
3/ See definition in TMU paragraph 11 (Attachment II).				

## A. Fostering Fiscal Discipline

14. **The 2016 fiscal framework targets a zero-cash balance.**<sup>15</sup> It is underpinned by realistic revenue projections, new revenue measures, and prudent expenditure policies (Text Table 1).

- **Revenues and grants** are projected to increase by \$105 million (1.6 percent) relative to 2015. Domestic revenue is projected to increase by \$11.0 million (0.2 percent of GDP) to \$125.2 million, reflecting continued economic recovery (\$5 million or 0.1 percent of GDP) and new fiscal measures aimed at strengthening tax payment compliance by key businesses (Text Table 2).<sup>16</sup> Grants are budgeted at \$121 million (1.9 percent of GDP)—\$77 million by the multilateral donors and \$44 million by bilateral.

Regarding multilaterals, the World Bank is expected to provide \$54.1 million (including from a recently-established World Bank multi-donor trust fund), the European Union \$5.4 million; the UN Peace Building Fund (\$14.5 million), and the

African Development Bank (\$3 million). Bilateral donors have already disbursed \$20 million and confirmed their pledges for the remaining \$24 million.

- **Expenditure** is envisaged to rise commensurately with revenue and grants. The wage bill (\$95 million) provides for the full payment of all civil servants and security forces and the recruitment of new staff for key ministries and agencies.<sup>17</sup> The fiscal program provides for increases for non-wage recurrent spending and investment to support the efforts to rebuild institutions and public infrastructure, and for \$32 million to clear domestic arrears (\$24.7 million for wages, \$3.2 million to suppliers, and \$4.2 million on loan payments).<sup>18</sup> It also envisages reforms to streamline security spending to ensure its sustainability (Box 1).

Text Table 2: New Tax Revenue Measures and Yields, 2016 1/ (Millions of U.S. dollars)	
Tax measures	Yields
<b>Total</b>	<b>4.0</b>
Collection from hotels	0.7
Tax collection agreements with money transfer businesses	0.8
Tax collection agreements with electricity companies	2.4
Tax collection agreements with water companies	0.1
Source: Somali authorities.	
1/ The implementation of these measures is planned to start in June 2016.	

<sup>15</sup> The 2016 budget and fiscal program of the SMP have the same levels of overall revenue and grants as well as expenditure. However, that of the program has lower domestic revenue and higher grants than the budget. Tax revenue has been revised down slightly owing to concerns over delays in telecom license sales and a prolonged decline in seaport and airport activities in view of recent Al-Shabaab terrorist attacks. The grants have been revised upward because of recent pledges by bilateral donors.

<sup>16</sup> The projected revenue yield in Text Table 2 reflects the outcomes of negotiations between the government and companies on scheduled payments, including arrears, based on existing tax laws. Further, improvements in the administration of the khat tax are expected to yield an additional \$2 million.

<sup>17</sup> The 2016 budget does not provide for a general wage increase, but envisages full payment of all wages and salaries due.

<sup>18</sup> The \$32 million was budgeted based on the availability of funding, and is mainly allocated to clear wage arrears to parliamentarians, civil servants and security forces.

### Box 1. Security: Streamlining the Fiscal Cost of Security in Somalia

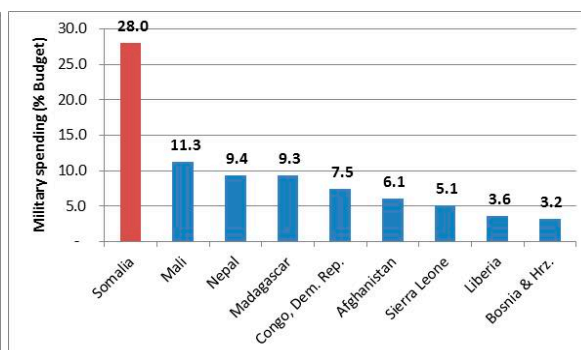
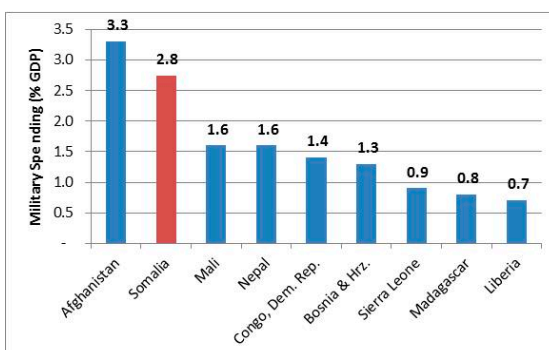
**Security spending weighs heavily on Somalia's budget.** High security costs crowd out spending in other critical areas and distract foreign aid away from much-needed general budgetary support. The 2016 *Somalia Security and Justice Public Expenditure Review* (supported by the United Nations and the World Bank) found that Somalia's military spending (excluding police and prisons) relative to its population is comparable to other conflict-affected countries. However, compared to its peer countries, Somalia's military spending is very high as a share of both GDP and on-budget expenditure. There is also large off-budget funding for security in Somalia.

**The government has started to streamline security costs.** In 2016, Somalia entered into agreements with donors that clarified the on-budget and off-budget security funding allocations. As a result, on-budget security spending declined from 38 percent of total budget in 2013 to 27 percent in 2016. Moreover, to further streamline security costs and procedures, the Ministry of Finance is planning to introduce an electronic payroll for soldiers, including biometric data collection. These measures are expected to reduce delays in salary payments and corruption.

#### Global Security Spending

Security spending in Somalia is among the world's highest...

...and is weighing heavily on fiscal spending.



Sources: FGS budget; Puntland budget; Somaliland budget; and World Development Indicators.

Note: "Security sector" consists of security sector institutions as defined by respective government budgets, and excludes justice institutions.

15. **The authorities are committed to addressing fiscal vulnerabilities.** They are cognizant of the risks posed by potential shortfalls in grants and domestic revenues. To mitigate these risks, the authorities are determined: (1) to cut non-priority spending in goods and services and capital in the event of a shortfall in revenue and grants; including through the adoption of a supplementary budget (2) to avoid accumulation of new domestic arrears by strengthening commitment control, the legal and regulatory framework; and by improving cash management; and (3) where possible, revenue windfall (including additional grants for budgetary support) will be used to build up buffers and pay down arrears.<sup>19</sup>

16. **The authorities intend to continue to rely on foreign grants to cover their financing need.** They will refrain from external borrowing and avoid selective-debt servicing to bilateral creditors as these would complicate external debt resolution. The authorities will also abstain from domestic borrowing, including from the Central Bank of Somalia (CBS). They will strengthen the DMU capacity and improve the public debt statistics with technical assistance from the African Development Bank and will increase efforts to reach out to creditors to reconstitute debt statistics.

## B. Structural Reform to Strengthen Nascent Institutions

### Technical assistance

17. **Reforms will focus on enhancing the efficiency and transparency of public and private sector activities.** The authorities are committed to putting in place a transparent and streamlined regulatory framework to foster private sector-led economic recovery. In the financial sector, the focus is on currency reform and addressing weaknesses in the licensing, supervision, and regulation of the financial sector, as well as in the governance structure of the CBS. Fiscal reforms focus on increasing domestic revenues and building transparent and efficient PFM. Addressing weaknesses in economic statistics is also a priority.

18. **Fund technical assistance will continue to be aligned with the authorities' program priorities.** Staff and the authorities have agreed that IMF technical assistance will be aligned with the program's objectives (Tables 7 and 8). There are large technical assistance needs in Somalia and addressing them will be essential for a successful SMP. The authorities have indicated that increased Fund technical assistance delivery to Somalia in coordination with other technical assistance providers will significantly improve capacity, empower local staff, and strengthen program monitoring (Box 2; MEFP, ¶125–27).

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<sup>19</sup> Preliminary information through end-April 2016 indicates that the government cleared \$25 million of the budgeted arrears payments.

## Box 2. Technical Assistance—Stocktaking and Challenges Ahead

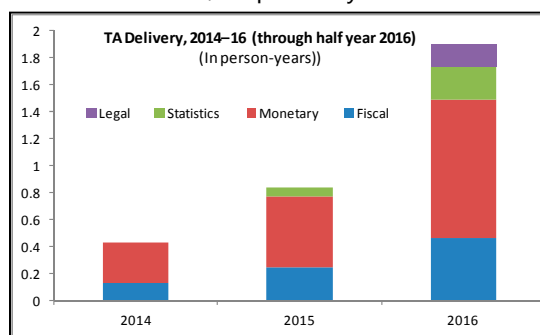
**A multi-donor trust fund was established in February 2015 to help rebuild Somali institutions and economic and financial infrastructures.** The recognition of the Federal Government of Somalia (FGS) in April 2013 has paved the way for the Fund to re-engage and provide technical assistance (TA) to Somalia. Through the three-year (2015–18) “Somalia Trust Fund for Capacity Development in Macroeconomic Policies and Statistics,” the IMF is providing TA to Somalia in its key areas of expertise. To avoid overlaps, the Fund is ensuring that TA delivery is both closely coordinated among development partners and able to adjust to Somalia’s changing priorities and needs. By end-April 2016, the Trust Fund had secured \$7.6 million (in commitments) from the Arab Fund for Social and Economic Development, as well as Canada, the United Kingdom, and Italy. Discussions are advanced with USAID and the European Commission that would secure additional commitments of \$2 million.

**Five priority areas have been identified:** (1) development of an integrated macroeconomic framework and policies; (2) establishment of a fully functional central bank; (3) modernization of tax and customs policy and administration; (4) strengthening of public financial management (PFM); and (5) building capacity for the production and dissemination of macroeconomic data.

**Since June 2013, the Fund has delivered about 50 technical assistance missions** (including training). During 2014 and 2015, 20 and 22 TA missions were delivered, respectively. Based on various scoping TA missions (in 2013 and early 2014), the work plan has recently refocused on PFM, financial management, currency reform, AML/CFT, and financial regulation and supervision.

**Fund TA has helped achieve meaningful progress in institution building and in producing key macroeconomic indicators,** most notably: (1) preparation of the first national budget in 2014 and the subsequent 2015 and 2016

budgets; (2) development of consumer price index, gross domestic product, and external sector statistics; and (3) preparation of central bank financial statements. The monitoring of the Trust Fund will continue to operate on a results-based management principle.



**Other multilateral organizations and bilateral partners are providing intensive TA in various areas.** In particular, among the multilateral partners, the World Bank is providing technical assistance on PFM, money transfer businesses, governance, peace and state building, and social economic data reconstruction, including household survey data. The African Development Bank is assisting on the public debt database reconstruction, and the UN and AU are providing technical assistance, mainly on security. Several bilateral partners are providing technical assistance on economic and social capacity building, and peace keeping and state building (including Canada, France, Germany, Italy, Japan, Kuwait, Norway, Russia, Saudi Arabia, Sweden, Turkey, the United Arab Emirates, the United Kingdom, and the United States).

**Despite the recent progress, there are daunting challenges ahead.** All economic and financial data remain rudimentary. The weak security situation, and a still-poor capacity associated with high turnover in the members of the economic team, will continue to complicate policymaking, dampen capacity development efforts, and affect surveillance effectiveness.



## Governance and Statistics

19. **The authorities are determined to improve governance** (MEFP, ¶13–15). Key priorities are the introduction of transparent and streamlined regulations for the private sector, including the telecommunication sector. Reforms in public financial management, as outlined in the 2016–20 Public Financial Management Reform Action Plan (PFMRAP), will help enhance the transparency of, and accountability for, government operations. Civil service reform and steps toward fiscal federalism—for example, tax harmonization across sub-national government—are important reforms aimed at improving the fiscal framework and supporting the development process. Further, the authorities are committed to strengthening governance in the financial sector, including the licensing, supervision, and regulation of commercial banks and MTBs.

20. **Rebuilding economic and financial statistics is a pillar of the authorities' program** (MEFP, ¶16). There are limited source data and coverage for national accounts, the fiscal and external sectors, and the banking system. To address these shortcomings, the authorities will submit to Parliament a new Statistical Law that will establish the institutional framework for improving the collection and dissemination of economic statistics. They will also establish a registry of companies to collect data and develop macroeconomic indicators.

## Fiscal Reforms

21. **The authorities will take steps to establish a modern PFM** (MEFP, ¶20–21 and Table 2). Key reform measures envisaged under the program, include adopting the 2016–20 PFMRAP (structural benchmark (SB) for end-June 2016); preparing a plan to identify the existing stock of domestic arrears and repayment schedule (SB for end-September 2016); implementing payment reforms to ensure 100 percent reimbursement of non-salary recurrent spending from the Recurrent Cost and Reform Financing facility (World Bank) (SB for end-December 2016); completing a report on the process and design of an electronic payment system for the Somali National Army and Police (end-December 2016); and completing an action plan to improve cash management (SB for end-March 2017); and modernizing the customs and revenue administration (SB for end-March 2017). To facilitate budget planning, the government will also require the Ministry of Finance to cosign all foreign grant agreements (SB for end-March 2017).

## Financial Sector Reforms

22. **Rebuilding the capacity of the CBS is critical for financial sector development** (MEFP, ¶22 and Table 2). The key priority is upgrading the CBS's capacity in the licensing, supervision, and regulation of commercial banks and MTBs. Other reforms will include the strengthening of the organizational and governance structure of the CBS, and its financial reporting and accounting practices.<sup>20</sup>

<sup>20</sup> The IMF is providing considerable technical assistance to strengthen CBS's capabilities in licensing, supervision and regulations of commercial banks, including preparing prudential regulations and introducing CAMEL ratings. The World Bank technical assistance focuses mainly on MTBs.

23. **There is an urgent need for currency reform in Somalia** (MEFP, ¶23 and Table 1; Box 3).<sup>21</sup>

To lay the foundations for a return to monetary policy formulation, the CBS Board has adopted guiding principles of currency reform involving two stages. In the first stage (during the SMP period), the CBS will only issue new SOS 1,000 banknotes. The total value of the new bank notes will not exceed the U.S. dollar denominated assets on the balance sheet of the CBS. This reform is particularly important to the poorer segments of the population who do not have other means of exchange (such as electronic money transfers). In the second stage, the CBS will issue additional banknote denominations. The Fund will intensify its technical assistance to support the CBS in its planning and preparation for the implementation of the currency reform.

24. **The authorities are taking steps to restore monetary policy and improve financial intermediation.** Efforts to help the CBS to return to monetary policy formulation (through currency reform, establishing a proper accounting principles, strengthening supervision, and the governance structure) are underway. The authorities will also continue to enhance the Somali framework for anti-money laundering and combating the financing of terrorism (AML/CFT). At the same time, the authorities plan to establish, in collaboration with the World Bank, a trusted agent that will work with the CBS to ensure that financial transactions by Somali institutions (including MTBs) adhere to the AML/CFT Law and guidelines (MEFP, ¶24)—a key priority given the country’s reliance on remittances from the Somali diaspora.

### C. Program Monitoring and Risks

25. **The SMP will be monitored based on quarterly quantitative and structural benchmarks** (MEFP, Tables 1 and 2). The program covers May 2016 to April 2017. It will have two reviews (based on end-September 2016 and end-March 2017 test dates), as well as quarterly quantitative benchmarks for June 2016, and December 2016. The first review of the SMP will be based on end-September 2016 benchmarks (completion by end-December 2016) and the second review will be based on end-March 2017 benchmarks (completion by end-June 2017). The program quantitative and structural benchmarks are defined in the Technical Memorandum of Understanding (TMU, Attachment II).

26. **Program risks are as outlined in ¶12** and include fragile security and weak capacity, and a slowdown in reforms in the run-up to the national elections. Sustained and coordinated international support, including in security and capacity building, would help mitigate risks.

<sup>21</sup> The currency reform will be supported by extensive technical assistance from the IMF and other partners, which will also support the authorities’ efforts to address a number of critical issues in a sequenced manner.

### Box 3. Reform of the National Currency

#### Background

The de jure currency is the Somali shilling (SOS). According to law, the CBS is in charge and the sole issuer of the national currency. However, since the early 1990s, the CBS has issued no banknotes. Instead, a single denomination—SOS 1,000 (with a value of less than \$0.05)—has been widely distributed in different forms of counterfeit notes estimated to account for about 95 percent of SOS notes in circulation. Some versions were printed abroad, others in Somalia, typically funded by local businesses. Virtually all counterfeits in circulation are de facto accepted as a means of payment although counterfeits are readily identifiable. Such notes are generally held by the poorest segments of the population. The poor were also most affected by the significant loss of value of the Somali currency resulting from the protracted civil war.

The de facto currency in Somalia (excluding Somaliland) is the U.S. dollar estimated to account for about 95 percent of currency in circulation. Dollar banknotes are used as cash currency as are neighboring countries' currencies in border areas. Mobile phone payments, with 'air time' transactions denominated in U.S. dollars, are also widely used. 'Air time' serves as a transactional sub-denomination of the U.S. dollar, as do SOS notes. In Somaliland, the de facto monetary authority—Bank of Somaliland, an institution not recognized in the rest of Somalia—has issued its own currency since 1994. That currency is neither recognized nor co-circulating in the rest of Somalia.

With technical assistance from the Fund and others, the CBS Board of Directors approved, in March 2016, principles for a reform of national currency to restore the credibility of the Somali shilling, a precondition for the CBS to formulate a future monetary policy. Wide political pressure is also mounting for an early currency reform.

#### Requirements identified before currency reform can be carried out include

- Developing adequate technical capabilities and human capacity at the CBS under challenging security conditions.
- Mobilizing financial resources from international donors to fund the cost of reform.
- Achieving policy consensus and political support for the currency reform.
- Mitigating risks (including high inflation) by developing an appropriate communications strategy and seeking advice and technical support from the IMF and other development partners.

#### Key phases of the currency reform

##### *Phase I:*

- The issuance of a single denomination—the new SOS 1,000 banknote—once technical requirements are met (planning and preparation) and funding is secured.
- Actions to eliminate counterfeiting are also critical prior to the launch.
- Agreed SMP benchmarks limit the volume of new banknotes that can be issued for circulation. Prominently, new banknotes would only be issued against U.S. dollar-denominated assets on the balance sheet of the CBS.
- Somalia's de facto exchange rate regime will remain free floating.

##### *Phase II:*

- In the second phase, additional new banknote denominations would be issued, the number of which has not yet been determined by the authorities.
- Two factors will determine when Phase II can start: progress achieved in the course of Phase I, and assurance from donors for the necessary funding of the entire reform.
- Issuance of multiple higher banknote denominations will affect monetary conditions in Somalia and require a reassessment of the exchange rate regime and determination of the monetary policy framework. This will be undertaken in consultation with the Fund.

## STAFF APPRAISAL

27. **Somalia is recovering from a protracted conflict that hollowed out the country's state, social, and economic infrastructure.** Since 2012, the federal government has embarked on a process of rebuilding state institutions and rehabilitating the economic and social infrastructure. However, the country faces daunting challenges, including fragile security and domestic political situations, weak institutional capacity, and widespread poverty.
28. **Despite the difficult challenges, the authorities' efforts are bearing fruit.** The strengthening of institutional capacity for economic management has, since 2014, allowed for the preparation of annual budgets, production of key macroeconomic and financial indicators, and initiation of reforms to strengthen economic governance. These achievements have supported a modest but sustained economic recovery.
29. **Rebuilding economic and financial statistics and institutional framework are pillars of the program.** The authorities intend to quickly establish the institutional framework for improving the collection and dissemination of economic statistics. Accordingly, the adoption of a new statistical law will help lead to the publication of key economic and financial data by corporate, banks and MBTs. This should be accompanied by empowering the national statistical office with sustained training.
30. **The government is determined to lay the foundation for an economic recovery.** It is committed to addressing fiscal vulnerabilities, fostering financial sector development, and continuing to rebuild institutional capacity. The 12-month SMP starting in May 2016 will support the government's macroeconomic policy and structural reform agenda. The program focuses on mobilizing domestic revenue, strengthening PFM, reforming the national currency, and enhancing the capacity of the CBS to license and supervise the financial sector. Technical assistance from the IMF and other development partners will play a key role in meeting the program goals.
31. **Revenue mobilization and PFM reforms are critical for strengthening the fiscal framework.** The implementation of revenue-enhancing measures under the 2016 budget is critical for achieving the program's fiscal objectives. Along with continued improvements in tax and customs administration, this should help strengthen public finances. At the same time, the authorities should tighten expenditure-commitment control to avoid new domestic arrears, improve treasury management, and clear existing domestic arrears. Reforms to enhance the transparency of, and accountability for, government operations, including those outlined in the 2016–20 Public Financial Management Reform Action Plan, are also important.

32. **Currency reform is essential for reestablishing monetary control.** The authorities' plan to implement currency reform is appropriate as it envisages for adequate preparation of required logistics and financing. The authorities should adhere to the reform plans, particularly in the first phase, which is spanned over the SMP period. In this context, they should limit currency issuance to new SOS 1,000 banknotes (U.S. 4.5 cents). To ensure the credibility of the reform process, the authorities should swiftly secure financing for the reform and address mitigating risks by developing an appropriate communication strategy and seeking advice and technical support from the IMF and other development partners.

33. **Reforms to develop Somalia's nascent financial sector are critical for economic reconstruction.** The authorities should proceed with upgrading the CBS's capacity in the licensing, supervision, and regulation of commercial banks and money transfer businesses. The implementation of the nascent framework for AML/CFT (including regulations for a risk-based supervision of MTBs) is essential for facilitating remittance inflows. Further, the governance structure, along with the financial reporting and accounting practices of the CBS, should be strengthened.

34. **The SMP faces significant risks, but the authorities are committed to it.** Risks include fragile security, weak institutional capacity, and slowdown in reforms in the run-up to the forthcoming national elections. Nevertheless, staff believe that the authorities' commitment to the program, and sustained international support for security and capacity building, will mitigate these risks.

**Table 1. Somalia: Selected Economic and Financial Indicators, 2013–17**

(IMF Quota = SDR 44.20 million; Population: 14 million, 2015 estimate)  
 (Population growth rate: 2.5 percent, estimate; Per Capita GDP: US\$425, 2015 estimate)  
 (Poverty Rate: n.a.; Main Export: Livestoc)

	Est.			Proj.	
	2013	2014	2015	2016	2017
<b>National income and prices</b>					
Nominal GDP in millions of U.S. dollars	5,352	5,647	5,925	6,217	6,604
Real GDP, annual percentage change	2.8	3.6	3.7	3.7	3.9
Per capita GDP in U.S. dollars	402	413	423	433	449
Consumer prices (e.o.p., percent change)	4.5	1.3	1.0	1.0	2.5
(In percent of GDP)					
<b>Central government finances 1/</b>					
Revenue and grants, <i>of which</i> :	2.1	2.6	2.4	4.0	3.5
Grants 2/	0.8	1.1	0.5	1.9	1.2
Expenditure, <i>of which</i> :	2.2	2.7	2.3	4.0	3.5
Wages and salaries	0.9	1.4	0.9	1.5	1.4
Capital expenditures	0.0	0.0	0.0	0.4	0.4
Overall balance	-0.1	-0.1	0.1	0.0	0.0
Stock of domestic arrears	0.6	0.8	1.1	0.6	0.4
(In millions of U.S. Dollars)					
<b>Central bank assets</b>					
Total assets, <i>of which</i> :	87.0	83.8	90.6	...	...
Foreign assets	66.2	63.2	68.6	...	...
Cash and cash equivalent, in vault (U.S. dollar)	7.0	6.2	13.3	...	...
Domestic assets, <i>of which</i> :	20.8	20.6	22.0	...	...
Cash and cash equivalent, in vault (SOS)	0.4	0.0	0.6	...	...
FGS, cash deposits	5.4	4.5	11.4	...	...
(In millions of U.S. Dollars; unless otherwise specified)					
<b>Balance of payments</b>					
Exports of goods and services	779	819	859	899	954
Imports of goods and services	3,322	3,482	3,653	3,823	4,055
Net factor income	-425	-450	-467	-490	-521
Current transfers, <i>of which</i> :	2,069	2,286	2,385	2,433	2,579
Remittances 3/	1,300	1,359	1,393	1,428	1,463
Current account balance	-899	-827	-876	-981	-1,043
(In percent of GDP)	-16.8	-14.7	-14.8	-15.8	-15.8
Overall balance	0	1	-7	0	0
External debt	4,989	4,946	5,043	...	...
<b>Exchange rate</b>					
Market exchange rate (SOS/USD, period average)	19,276	20,227	22,247	...	...
Market exchange rate (SOS/USD, end of period)	20,600	20,265	22,285	...	...

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

1/ Budget data for the federal government. GDP data cover the territory of Somalia.

2/ Includes only donor support provided through local treasury systems.

3/ 2013 data from Barclays Bank, PLC.

**Table 2a. Somalia: Federal Government Operations, 2013–17 1/**

(Millions of U.S. Dollars)

	2013	2014	2015		2016	2017
	Est.	Est.	Budg.	Prel.	Prog.	Proj.
<b>Revenue and grants</b>	110.8	145.3	199.0	141.2	246.3	228.9
Revenue	69.2	84.3	113.9	114.3	125.2	148.4
Tax revenue	65.1	73.8	85.7	82.4	93.8	110.7
Tax on income, profit and capital gains	0.7	1.1	4.7	1.9	5.1	6.2
Taxes on goods and services	5.6	8.5	10.7	9.3	13.0	20.0
Trade taxes	58.7	64.3	70.3	71.1	75.7	84.6
Non-tax revenue	4.1	10.5	28.1	31.9	31.5	37.7
Grants 2/	41.7	61.0	85.2	26.9	121.0	80.5
<b>Total expenditure</b>	117.4	151.1	199.0	135.4	246.3	228.9
Current	117.4	150.9	184.3	133.1	222.2	202.8
Wages and salaries	50.4	77.2	79.1	52.9	94.9	94.9
Goods and services	56.0	57.6	76.1	53.0	77.0	78.6
Transfers to sub-national government	7.5	10.1	14.8	13.8	16.2	19.6
Contingency	3.5	3.8	2.6	2.6	2.1	2.1
Repayment of arrears and advances	0.0	2.2	11.5	10.8	31.9	7.6
Capital	0.0	0.2	14.8	2.3	24.1	26.2
<b>Overall balance</b>	-6.6	-5.8	0.0	5.8	0.0	0.0
<b>Financing</b>	...	5.8	...	...	...	...
<i>Liquidation of recovered government assets</i>	...	5.8	...	...	...	...
<b>Memorandum items</b>						
Accumulation of domestic arrears	...	17.1	0.0	33.1	0.0	0.0
Stock of domestic arrears (end of year)	30.4	45.3	33.8	67.7	35.7	28.2

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

1/ The fiscal operations are recorded on cash basis.

2/ Includes only donors' support provided to the Federal government through treasury accounts at the Central Bank of Somalia.

**Table 2b. Somalia: Federal Government Operations, 2013–17 1/**

(Percent of GDP)

	2013	2014	2015		2016	2017
	Est.	Est.	Budg.	Prel.	Prog.	Proj.
<b>Revenue and grants</b>	2.1	2.6	3.4	2.4	4.0	3.5
Revenue	1.3	1.5	1.9	1.9	2.0	2.2
Tax revenue	1.2	1.3	1.4	1.4	1.5	1.7
Tax on income, profit and capital gains	0.0	0.0	0.1	0.0	0.1	0.1
Taxes on goods and services	0.1	0.2	0.2	0.2	0.2	0.3
Trade taxes	1.1	1.1	1.2	1.2	1.2	1.3
Non-tax revenue	0.1	0.2	0.5	0.5	0.5	0.6
Grants 2/	0.8	1.1	1.4	0.5	1.9	1.2
<b>Total expenditure</b>	2.2	2.7	3.4	2.3	4.0	3.5
Current	2.2	2.7	3.1	2.2	3.6	3.1
Wages and salaries	0.9	1.4	1.3	0.9	1.5	1.4
Goods and services	1.0	1.0	1.3	0.9	1.2	1.2
Transfers to sub-national government	0.1	0.2	0.3	0.2	0.3	0.3
Contingency	0.1	0.1	0.0	0.0	0.0	0.0
Repayment of arrears and advances	0.0	0.0	0.2	0.2	0.5	0.1
Capital	0.0	0.0	0.2	0.0	0.4	0.4
<b>Overall balance</b>	-0.1	-0.1	0.0	0.1	0.0	0.0
<b>Financing</b>	...	0.1	...	...	...	...
<i>Liquidation of recovered government assets</i>	...	0.1	...	...	...	...
<b>Memorandum items</b>						
Accumulation of domestic arrears	...	0.3	0.0	0.6	0.0	0.0
Stock of domestic arrears (end of year)	0.6	0.8	0.6	1.1	0.6	0.4

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

1/ The fiscal operations are recorded on cash basis.

2/ Includes only donors' support provided to the Federal government through treasury accounts at the Central Bank of Somalia.



**Table 3. Somalia: Summary Accounts of the Central Bank, 2013–15**

(Thousands of U.S. Dollars)

	2013	2014	2015			
	Dec.	Dec.	March	June	Sept.	Dec.
	Prel.	Prel.	Prel.	Prel.	Prel.	Prel.
<b>Assets</b>	<b>86,980</b>	<b>83,834</b>	<b>84,064</b>	<b>82,384</b>	<b>87,472</b>	<b>90,636</b>
Foreign assets	66,213	63,199	62,998	61,238	66,203	68,639
SDRs	28,228	26,557	25,286	25,779	25,731	25,398
Gold 1/	19,540	19,551	19,240	19,090	18,133	17,249
Foreign exchange 2/	11,425	10,897	10,897	10,897	10,897	12,695
Cash and cash equivalent (US\$)	7,020	6,195	7,575	5,472	11,442	13,296
Domestic assets	20,767	20,635	21,066	21,146	21,269	21,997
<b>Liabilities</b>	<b>86,980</b>	<b>83,834</b>	<b>84,064</b>	<b>82,384</b>	<b>87,472</b>	<b>90,636</b>
<b>Reserve money</b>	<b>2,221</b>	<b>2,392</b>	<b>711</b>	<b>733</b>	<b>608</b>	<b>1,044</b>
Currency outside CBS	774	709	709	709	580	580
Demand deposits	1,446	1,683	2	24	28	464
<b>Government</b>	<b>14,393</b>	<b>6,320</b>	<b>7,836</b>	<b>5,568</b>	<b>11,446</b>	<b>13,299</b>
Government deposits 3/	5,392	4,470	5,984	3,718	9,596	11,449
<i>Of which: Grants</i>	...	...	...	...	...	5,365
Asset recovery proceeds	9,001	1,851	1,852	1,850	1,850	1,850
<b>Other domestic liabilities</b>	<b>120</b>	<b>3,120</b>	<b>3,120</b>	<b>3,120</b>	<b>3,120</b>	<b>3,660</b>
Earmarked donor funds	...	3,000	3,000	3,000	3,000	3,000
MTF deposits	120	120	120	120	120	660
<b>Other ext. liabilities</b>	<b>360,838</b>	<b>341,107</b>	<b>325,118</b>	<b>331,796</b>	<b>331,507</b>	<b>327,739</b>
<i>Of which: IMF</i>	360,837	341,107	325,118	331,796	331,507	327,739
<b>Equity and reserves</b>	<b>-290,591</b>	<b>-269,105</b>	<b>-252,721</b>	<b>-258,832</b>	<b>-259,210</b>	<b>-255,106</b>
<b>Memorandum item:</b>						
Somali shillings per US dollar (end of period)	20,600	20,265	22,225	22,255	22,275	22,285

Sources: Central Bank of Somalia; and Fund staff estimates.

Note: The Central Bank of Somalia account data are still preliminary and incomplete.

1/ Gold valued at market price.

2/ Includes external assets recovery, official grants, and earmarked funds.

3/ Includes treasury and Development Bank deposits, and grants.

**Table 4a. Somalia: Balance of Payments, 2013–17**

(Millions of U.S. dollars)

	Prel.			Proj.	
	2013	2014	2015	2016	2017
<b>Current account balance</b>	-899	-827	-876	-981	-1,043
Trade balance	-2,543	-2,663	-2,794	-2,924	-3,101
Exports of goods and services, f.o.b.	779	819	859	899	954
Imports of goods and services, f.o.b.	-3,322	-3,482	-3,653	-3,823	-4,055
Income (net)	-425	-450	-467	-490	-521
Receipts	35	36	38	40	42
Payments	-460	-486	-505	-530	-563
Current transfers (net)	2,069	2,286	2,385	2,433	2,579
Private, <i>of which</i> :	1,495	1,574	1,660	1,671	1,769
Remittances 1/	1,300	1,359	1,393	1,428	1,463
Official 2/	574	712	725	761	810
<b>Capital account and financial account</b>	899	827	876	981	1,043
Capital account	150	150	150	157	167
Financial account (net)	749	677	726	824	876
Foreign direct investment (net)	689	617	666	756	804
Other net capital flows 3/	60	60	60	68	72
Errors and omissions	0	2	-7	0	0
<b>Overall balance</b>	0	1	-7	0	0
Change in the central bank net foreign assets 4/	...	-1	7	0	0
<b>Memorandum items:</b>					
Nominal GDP	5,352	5,647	5,925	6,217	6,604
External public debt	4,989	4,946	5,043	...	...

Sources: UN Comtrade; FGS estimates; and Fund staff estimates and projections.

1/ 2013 data from Barclays Bank, PLC.

2/ Includes direct budget support.

3/ Insurance and technical reserves.

4/ Excluding Somalia's net position with the IMF.

**Table 4b. Somalia: Balance of Payments, 2013–17**

(Percent of GDP, unless otherwise indicated)

	Prel.			Proj.	
	2013	2014	2015	2016	2017
<b>Current account balance</b>	-16.8	-14.7	-14.8	-15.8	-15.8
Trade balance	-47.5	-47.2	-47.2	-47.0	-47.0
Exports of goods and services, f.o.b.	14.6	14.5	14.5	14.5	14.4
Imports of goods and services, f.o.b.	-62.1	-61.7	-61.7	-61.5	-61.4
Income (net)	-7.9	-8.0	-7.9	-7.9	-7.9
Receipts	0.7	0.6	0.6	0.6	0.6
Payments	-8.6	-8.6	-8.5	-8.5	-8.5
Current transfers (net)	38.7	40.5	40.3	39.1	39.0
Private, of which:	27.9	27.9	28.0	26.9	26.8
Remittances 1/	24.3	24.1	23.5	23.0	22.2
Official 2/	10.7	12.6	12.2	12.2	12.3
<b>Capital account and financial account</b>	16.8	14.6	14.8	15.8	15.8
Capital account	2.8	2.7	2.5	2.5	2.5
Financial account (net)	14.0	12.0	12.3	13.3	13.3
Foreign direct investment (net)	12.9	10.9	11.2	12.2	12.2
Other net capital flows 3/	1.1	1.1	1.0	1.1	1.1
Errors and omissions	0.0	0.0	-0.1	0.0	0.0
<b>Overall balance</b>	0.0	0.0	-0.1	0.0	0.0
Change in the central bank net foreign assets 4/	...	0.0	0.1	0.0	0.0
<b>Memorandum items:</b>					
Nominal GDP (millions of U.S. dollars)	5,352	5,647	5,925	6,217	6,604
External public debt	93.2	87.6	85.1	...	...

Sources: UN Comtrade; FGS estimates; and Fund staff estimates and projections.

1/ 2013 data from Barclays Bank, PLC.

2/ Includes direct budget support.

3/ Insurance and technical reserves.

4/ Excluding Somalia's net position with the IMF.

**Table 5a. Somalia: External Public Debt, 2013–15**

(Millions of U.S. Dollars)

	Prel. 2013	Prel. 2014	Prel. 2015
<b>Total stock outstanding 1/</b>	<b>4,989</b>	<b>4,946</b>	<b>5,043</b>
<b>Multilateral creditors</b>	<b>1,557</b>	<b>1,505</b>	<b>1,464</b>
International Monetary Fund	360	341	328
World Bank	518	500	488
AfDB Group	145	135	129
Arab Fund for Economic and Social Development	178	181	171
International Fund for Agricultural Development	32	31	30
OPEC Fund for International Development	35	35	35
Arab Monetary Fund	278	271	270
Islamic Development Bank	11	11	13
<b>Bilateral creditors</b>	<b>3,433</b>	<b>3,441</b>	<b>3,578</b>
<b>Paris Club creditors 2/</b>	<b>2,232</b>	<b>2,239</b>	<b>2,279</b>
Denmark	2	2	2
France	380	361	341
Italy	571	590	609
Japan	119	99	111
Netherlands	7	6	6
Norway	2	2	2
Spain	37	38	38
United Kingdom	81	82	82
United States	895	918	945
Russia	138	141	144
<b>Non-Paris Club creditors 3/</b>	<b>1,201</b>	<b>1,202</b>	<b>1,299</b>
Algeria	2	2	2
Bulgaria	9	9	9
Iraq	66	66	66
Kuwait Fund and Central Bank	174	176	273
Libya	5	5	5
Romania	6	6	6
Saudi Arabia	105	105	105
Serbia	2	2	2
United Arab Emirates	832	832	832

Sources: Somalia Debt Management Unit; World Bank; and AfDB.

1/ Claims in currency of loan are converted to US\$ at year-end exchange rates (the main rates for end-2015 are: US\$/SDR 1.3857, and US\$/Euro 1.0887).

2/ For Paris Club creditors, extrapolations of known penalty interest rates were applied. The average penalty interest rate is about 3.4 percent. For Non-Paris Club creditors, late interest rate is only known for Kuwait. No penalty interest has been included for 2014.

3/ Data of Non-Paris Club creditors is preliminary and estimated from the World Bank debt database (WBXD).

**Table 5b. Somalia: External Public Debt, 2013–15**  
(Percent of GDP)

	Prel. 2013	Prel. 2014	Prel. 2015
<b>Total stock outstanding 1/</b>	<b>93.2</b>	<b>87.6</b>	<b>85.1</b>
<b>Multilateral creditors</b>	<b>29.1</b>	<b>26.6</b>	<b>24.7</b>
International Monetary Fund	6.7	6.0	5.5
World Bank	9.7	8.9	8.2
AfDB Group	2.7	2.4	2.2
Arab Fund for Economic and Social Development	3.3	3.2	2.9
International Fund for Agricultural Development	0.6	0.5	0.5
OPEC Fund for International Development	0.6	0.6	0.6
Arab Monetary Fund	5.2	4.8	4.6
Islamic Development Bank	0.2	0.2	0.2
<b>Bilateral creditors</b>	<b>64.1</b>	<b>60.9</b>	<b>60.4</b>
<b>Paris Club creditors 2/</b>	<b>41.7</b>	<b>39.6</b>	<b>38.5</b>
Denmark	0.0	0.0	0.0
France	7.1	6.4	5.8
Italy	10.7	10.4	10.3
Japan	2.2	1.8	1.9
Netherlands	0.1	0.1	0.1
Norway	0.0	0.0	0.0
Spain	0.7	0.7	0.6
United Kingdom	1.5	1.5	1.4
United States	16.7	16.3	16.0
Russia	2.6	2.5	2.4
<b>Non-Paris Club creditors 3/</b>	<b>22.4</b>	<b>21.3</b>	<b>21.9</b>
Algeria	0.0	0.0	0.0
Bulgaria	0.2	0.2	0.2
Iraq	1.2	1.2	1.1
Kuwait Fund and Central Bank	3.3	3.1	4.6
Libya	0.1	0.1	0.1
Romania	0.1	0.1	0.1
Saudi Arabia	2.0	1.9	1.8
Serbia	0.0	0.0	0.0
United Arab Emirates	15.5	14.7	14.0

Sources: Somalia Debt Management Unit; World Bank; and AfDB.

1/ Claims in currency of loan are converted to US\$ at year-end exchange rates (the main rates for end-2015 are: US\$/SDR 1.3857, and US\$/Euro 1.0887).

2/ For Paris Club creditors, extrapolations of known penalty interest rates were applied. The average penalty interest rate is about 3.4 percent. For Non-Paris Club creditors, late interest rate is only known for Kuwait. No penalty interest has been included for 2014.

3/ Data of Non-Paris Club creditors is preliminary and estimated from the World Bank debt database (WBXD).

**Table 6. Somalia: Off-Budget Aid Disbursements, 2014–16**

(Millions of U.S. Dollars)

	2014	2015	2016
	Actual	Est.	Proj.
Institutional Capacity Development (ICD)	7	13	16
Peace and Statebuilding Goals (PSG)	549	534	540
Inclusive Politics	26	40	32
Security 1/	43	63	62
Justice	10	11	19
Economic Foundations	131	137	173
Revenue and Services	340	283	254
Cross-cutting and Other 2/	95	94	95
<b>Total aid disbursement 3/</b>	<b>651</b>	<b>640</b>	<b>651</b>
Total federal budget expenditure	151	135	246
<i>Ratio of total aid planned disbursement to federal budget planned expenditure</i>	<i>0.2</i>	<i>0.2</i>	<i>0.4</i>

Source: ACU Aid Flow Mapping, February 2016.

1/ Includes Official Development Assistance only. Security and peacekeeping operations are excluded.

2/ Activities categorized as others could not be assigned to any PSG (e.g., inclusive politics, security, justice, economic foundations, or revenue and services).

3/ Includes some budget support. About 30% of development partners did not provide data.

Table 7. Somalia: Completed TA, 2013–15

Department	Activity	Start Date
<b>FAD</b>	Budget diagnostics (w/ MCD staff visit)	10/22/2013
	Initial assistance on budget preparation and execution (w/ MCD staff visit)	2/17/2014
	Budget preparation and execution (w/ MCD staff visit)	4/28/2014
	Budget preparation and execution (w/ MCD staff visit)	9/9/2014
	Public financial management	1/26/2015
	General tax policy	3/30/2015
	Budget execution (expert visit)	4/26/2015
	PFM diagnostic	6/8/2015
	Tax policy issues	9/29/2015
	Developing a Medium-term PFM Reform Strategy	6/8/2015
<b>LEG</b>	Procedures for CBS Management Committee	8/1/2015
	Amendment CBS rules of conduct and ethics	8/1/2015
	Administrative procedures for CBS supervisory decisions and supervisory penal	8/1/2015
<b>MCM</b>	Advisory on currency reform	8/26/2013
	Central bank accounting and financial reporting workshop	10/27/2013
	Support to the FGC Advisory Committee	12/9/2013
	Support to the FGC Advisory Committee	12/10/2013
	Meeting with the CBS Governor	1/20/2014
	Support to FGC	2/23/2014
	Support to the FGC	4/22/2014
	Advice to FGC	5/28/2014
	Support to the FGC	7/29/2014
	Supervision and regulation	9/1/2014
	Support to the FGC	9/8/2014
	Central bank modernization (FGC)	9/15/2014
	Support to the FGC	10/27/2014
	Supervision and regulation	11/10/2014
	Support to the FGC	12/2/2014
	CBS Board orientation course	12/4/2014
	Participation in the FGC meetings and MCD staff visit	1/26/2015
	Central Bank Governance	4/27/2015
	Central Bank Governance	6/15/2015
	Training on Bank Supervision and Regulations	7/27/2015
	Central Bank Governance and Support to the FGC	8/3/2015
	Training on Bank Supervision and Regulations	8/3/2015
	Banking Supervision and Regulation Training	9/14/2015
	Training on Bank Supervision and Regulations	11/5/2015
	Support to the FGC	11/22/2015
	CB governance and currency reform	12/7/2015
Support to the FGC	3/7/2016	
Currency reform	3/29/2016	
Support to the FGC	4/27/2016	
<b>STA</b>	Real sector statistics training	1/27/2014
	Consumer price index	1/12/2015
	National accounts	4/25/2015
	Multisector statistics	4/29/2015
	Balance of Payments	12/2/2015

Source: International Monetary Fund.

**Table 8. Somalia: Planned TA in 2016**

<b>Department</b>	<b>Activity</b>	<b>Start Date</b>
<b>FAD</b>	Budget preparation and execution (w/ MCD)	H1 2016
	Public financial management	H1 2016
	Tax policy	H12016
	Budget review workshop	H1 2016
<b>LEG</b>	Financial regulation	Q1 2016
<b>MCM</b>	Currency reform	Q2-Q4 2016
	Central bank accounting and reporting	Q2 2016
	Support to the Financial Governance Committee (FGC)	Q2-Q4 2016
	CBS governance	H1 2016
	Supervision and regulation	H1 2016
	Monetary policy and operations (w/ IDF)	H1 2016
	Central bank by-laws and regulation (w/ LEG)	Q2 2016
<b>STA</b>	Real sector statistics	H1 2016
	Consumer price index	H2 2016
	Balance of payments statistics	Q4 2016

Source: International Monetary Fund.



## Appendix I. Somalia: Risk Assessment Matrix<sup>1</sup>

Nature/Source of Risks	Relative Likelihood	Impact if Realized	Policy Responses
<b>Global Risks</b>			
Sharper-than-expected global slowdown in key advanced and emerging economies.	<b>Medium</b>	<b>Medium</b> (1) lower demand for exports (2) possible reduction in donor support (3) lower remittances.	(i) greater flexibility in SOS, (ii) reform formulate monetary policy, and (iii) greater revenue mobilization; (iv) strengthen social safety nets
Heightened risk of fragmentation/state failure/security dislocation in the Middle East and some countries in Africa.	<b>Medium</b>	<b>Medium</b> (1) lower remittances (2) influx of refugees (3) lower growth	(i) improve business environment and national security; (ii) greater revenue mobilization; and (iii) strengthen social safety nets
<b>Country specific risks</b>			
Tightening regulatory and supervisory frameworks in advanced and emerging markets.	<b>Medium</b>	<b>Medium</b> (1) de-risking, prompting banks to forego money transfer business, leading to lower remittances.	(i) upgrade capacity in licensing, supervision, and regulation of banks and MTBs; and (ii) strengthen governance structure of CBS
<b>Institutional risk</b> Protracted insecurity, weak institutions, and poor data availability.	<b>High</b>	<b>High</b> (1) destruction of economic infrastructure (2) lower growth	(i) improve national security; and economic statistics; (ii) strengthen local capacity; and (iii) seek donors' support
<b>Fiscal risks</b> Loose fiscal policy and slowdown in reform in the run-up of the elections	<b>High</b>	<b>High</b> (1) lower revenue (including grants from donors) (2) arrears accumulation.	(i) maintain reform momentum; (ii) greater revenue mobilization; and (iii) keep expenditure under control and improve PFM.
<b>Failed currency reform</b> Inadequate preparation of the currency reform	<b>Medium</b>	<b>High</b> (1) increase in SOS counterfeits (2) further depreciation of SOS (3) continued absence of monetary policy	(i) follow through the currency reform agenda while improving communication and mitigating other inherent risks
<b>Poor financial system supervision</b> Lack of credible supervision and AML/CFT.	<b>High</b>	<b>High</b> (1) reduction in remittance inflows, which support the livelihood of many Somalis.	(i) upgrade capacity in licensing, supervision, and regulation of banks and MTBs; and (ii) strengthen governance structure of CBS

<sup>1</sup>Based on the April 2016 Risk Assessment Matrix (RAM). The RAM shows events that could materially alter the baseline outlook (the scenario most likely to materialize in the view of Fund staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability of 10–30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with authorities. Non-mutually exclusive risks may interact and materialize jointly.

## Appendix II. Letter of Intent

Mogadishu  
May 17, 2016

Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431 USA

Dear Madame Lagarde:

1. As you are aware, Somalia's economic and social infrastructure has been severely damaged by a conflict that has lasted for a quarter of a century. Since 2012, the Federal Government of Somalia has embarked on an ambitious process of rebuilding the state and the economic and social infrastructure. Despite challenging security and economic conditions, our efforts are bearing fruit. With International Monetary Fund (IMF) technical assistance and policy advice, we have reestablished the core functions of our economic institutions, initiated reforms to improve our macroeconomic management, and laid the foundation for economic recovery.
2. The Somali government is committed to sustaining its efforts to rebuild the economy, improve social conditions, and move toward normalizing relations with international financial institutions. In this regard, it has formulated a reform program for the period May 2016–April 2017 that focuses on implementing prudent macroeconomic policies, while strengthening institutional capacity for macroeconomic management. As described in our Memorandum of Economic and Financial Policies (MEFP, Attachment I), our program's objectives are to support economic growth by enhancing governance and economic statistics, strengthening fiscal discipline, rebuilding capacity for monetary policy management, and fostering financial sector development. To assist us in this effort, we are requesting an IMF Staff Monitored Program (SMP). The government hopes that a successful execution of this, and subsequent SMP programs, will eventually allow us to move to an IMF-supported program of an upper credit tranche quality.
3. The government is convinced that the policies and measures set forth in the MEFP are appropriate for meeting the objectives of the program. However, we stand ready to adopt any additional measures that may become necessary. We will remain in close consultation with IMF staff on the adoption of such measures and in advance of any revisions to the policies contained in the MEFP. To facilitate the monitoring of the performance of the program, the government will regularly provide IMF staff with all necessary information, within the required deadlines specified in the attached Technical Memorandum of Understanding (TMU, Attachment II).

4. Finally, the government authorizes the IMF to publish this letter, the attached MEFP and TMU, and the related staff report, including placement of these documents on the IMF website, subject to the removal of market-sensitive information.

Sincerely yours,

/s/

Mohamed Adan Ibrahim  
Minister of Finance

/s/

Bashir Issa Ali  
Governor of the CBS

Attachments:

1. Memorandum on Economic and Financial Policies
2. Technical Memorandum of Understanding

## Attachment I. Memorandum on Economic and Financial Policies

### INTRODUCTION

- This memorandum reviews recent economic developments and outlines our policies and reforms for May 2016—April 2017, for which we are requesting the support of an IMF staff monitored program.**
- Somalia is a fragile state emerging from a protracted civil war.** In 1991, armed opposition groups toppled the government, resulting in a protracted civil conflict and the implosion of the central government. In the 25 years since, the situation has been very difficult and volatile. A provisional constitution was adopted in August 2012 and traditional elders across the country elected a 275-member Federal Parliament. In September 2012, Parliament elected Mr. Hassan Sheikh Mohamud as President, leading to the formation of the Federal Government of Somalia (FGS) in October.
- Since then, the government has taken important steps to rebuild the country's economic institutions.** Somalia now has a functioning Central Bank, a Cabinet, and several government agencies that have been working together, including in developing the economic infrastructure of Somalia. Although these institutions need substantial human and technical capacity, significant progress has been achieved in building the institutional framework and in preparing basic macroeconomic statistics.
- Because of the protracted conflict, however, state institutions remain impaired, the economy is severely underdeveloped, and poverty is pervasive.** The legacy of the destruction of both physical infrastructure and human capital will continue to limit Somalia's growth potential. Weak capacity in government institutions and shortages in accurate and timely statistics hampers policy formulation and implementation. Moreover, a generation where non-payment of taxes was the norm poses challenges to revenue mobilization. Nevertheless, the reestablishment of the basic functions of the country's economic institutions, aided by the international community, provides us with an opportunity to improve macroeconomic management and rebuild institutional capacity.
- Our program aims to facilitate economic recovery and improve the livelihood of our population.** To this end, we will embark on policies and reforms to strengthen our fiscal framework, rebuild the financial system, and improve governance. The SMP, in support of our program while establishing a policy implementation track record as an important step toward an eventual fund arrangement, will also facilitate Somalia's re-engagement with the international community, including the international financial system.

## RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

6. **Notwithstanding capacity constraints, the policies undertaken in recent years have supported macroeconomic stability.** In 2015, broad-based economic growth was estimated at 3.7 percent, and inflation remained low at 1 percent. However, due mainly to shortfalls in pledged budget support, the government accumulated new domestic arrears. While the external current account deficit was large at about 15 percent of GDP, the deficit was financed mainly by foreign direct investment (FDI), including increasing inflows from the Somali diaspora.
7. **The government has taken strong measures to improve revenue collection and public financial management (PFM).** We enhanced tax and customs administration, including by training the staff of tax-collecting agencies. On PFM, we underpinned the 2016 budget with more realistic revenue measures, introduced an electronic system for paying salaries of civil servants and phased in the implementation of the Somalia Financial Management Information System. We have strengthened the legislative framework with key legislations passed by Parliament, including the Foreign Investment Law, Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Law, the Audit Law, and the Procurement Law. We established the National Interim Procurement Board to review large concession contracts and ensure transparency.
8. **We have implemented reforms to enhance the governance of the Central Bank of Somalia (CBS).** The CBS Board of Directors has approved new by-laws and regulations to safeguard the autonomy and accountability of the Central Bank, including: (1) setting up an audit committee to report directly to the Board of Directors; (2) establishing an Internal Audit Department reporting to the Governor; and (3) the auditing of the 2014 CBS financial statements, which is in progress.
9. **We have implemented the preconditions for initiating discussions on an SMP.** In particular: (1) on January 11, a presidential decree approved an Appropriation Bill that is consistent with a zero-cash balance; (2) with the IMF technical assistance, significant progress has been made in developing an appropriate institutional framework for data reporting; (3) on March 10, Cabinet approved an arrears management strategy; and (4) on March 17, the CBS Board of Directors approved a road map for currency reform.

## PROGRAM OBJECTIVES AND POLICIES

10. **Our objectives are to establish the building blocks for macroeconomic stability and economic recovery.** Therefore, our program focuses on building a sound framework for macroeconomic management, notably strengthening PFM, creating a modern tax and customs administration, implementing an arrears management strategy, reforming the national currency, and improving the licensing and supervision of financial institutions to foster confidence in commercial banks and money transfer businesses (MTBs). The program design recognizes our limited institutional capacity, and envisages capacity building as an essential component. Furthermore, we are preparing a national development plan, which is compliant with the Interim Poverty Reduction Strategy Paper, for the period 2017–19 to guide delivery of aid.

11. **The program for the period May 2016–April 2017 will lay a foundation for sound macroeconomic management.** It focuses on: (1) realistic budgeting and budget execution that avoids the accumulation of new arrears; (2) improving PFM; (3) raising revenue; (4) reforming the national currency; (5) improving commercial banks and MTBs licensing and supervision; (6) facilitating international remittances to Somalia; and (7) developing a statistical system.
12. **Our key macroeconomic objectives for 2016 are to:** (1) achieve real GDP growth of 3.7 percent, supported by the continued expansion of agriculture, telecommunication, and services; (2) limit inflation to 1 percent; and (3) not allow net foreign assets of the CBS to fall below a continuous floor. Given the reality of very low foreign reserves, the CBS will use any recovered CBS foreign assets to increase its net foreign reserves. While the external current account deficit is projected to remain large, we expect FDI and grants to cover the deficit.

## A. Governance and Statistics

13. **Enhancing the governance of key institutions is critical.** The focus is reorganizing the Ministry of Finance, Ministry of Planning, and CBS and strengthening key legislative and regulatory frameworks. In particular, we plan to primarily reorganize and re-enforce, with donors' assistance, key economic units (including the recently established strategic unit, arrears management committee, national statistics, debt management unit) and departments (customs, Inland Revenue, and the Treasury departments). Donors' technical assistance is expected to provide guidance on best practice and appropriate regulatory framework. The CBS will develop and implement key by-law needed for effective supervision and regulation of banking and MTBs.
14. **We will strengthen institutional capacity, enhance governance, and foster strong private sector led growth.** The authorities will strengthen the anti corruption committee established in 2011 by re-enforcing the oversight of the committee and defining a roadmap. We will continue to introduce appropriate regulations for the private sector (for example, a law governing the telecommunications sector), and formalize administrative procedures. Strengthening fiscal governance is a priority as well. We will submit to Parliament a draft Public Financial Management Bill, already approved by the Cabinet. PFM reforms will continue as outlined in the 2016–20 Public Financial Management Reform Action Plan (PFMRAP) in paragraph 20. We are introducing automated payroll systems for the National Army and Police, and strengthening civilian oversight over their budget resources. Regarding fiscal federalism, we will begin discussions toward harmonizing taxes across sub-national governments, establish channels for intergovernmental transfers, and define basic principles for a national fiscal framework.
15. **We will continue to enhance governance in the financial sector.** Over the next 12 months, the CBS intends to further strengthen the licensing, supervision, and regulation of the nascent Somali commercial banking system. Moreover, we will modernize the CBS's accounting and financial reporting system.

16. **We will continue to rebuild our economic and financial statistics.** In particular, we will submit to Parliament a new statistical law that establishes an institutional framework for data compilation, reporting, and dissemination. Further, we are developing statistical collection infrastructure, including by establishing a list of business enterprises that will form the basis for conducting statistical surveys to collect basic economic statistics.

## B. Fiscal Policy and Reforms

17. **Our fiscal policy in 2016 aims to strengthen the role of the budget as a policy tool.** The 2016 budget targets a zero-cash balance. It contains new tax policy measures, realistic revenue forecasts, and prudent expenditure policies. We will execute the budget in conformity with the law. In the event of revenue or grant shortfalls, we will cut spending in conformity with the rules for sequestering (prioritizing) expenditures, and if required, submit a revised budget to Parliament. In light of low domestic revenue and large reconstruction needs, we will continue to rely on donor grants (on budget), which are projected to reach \$121 million, and abstain from domestic and external borrowing. Where possible, we will direct any revenue windfalls to arrears payments.

18. **We have implemented important tax policy measures to raise revenue.** The new measures and improvements in tax and customs administration are expected to yield additional revenue of \$11.7 million, and increase overall tax revenue to \$94.1 million (from \$82.4 million in 2015). The measures seek improved collections in income and profit taxes, and an improved collections modality for the khat tax, as well as negotiated collections from electricity and water companies and MTBs.

19. **We will improve tax and customs administration as part of our effort to strengthen the fiscal framework.** In particular, we plan to introduce a modern system of taxpayer registration to improve tax compliance and expand the taxpayer base. Accordingly, we plan to strengthen audit and enforcement. In this regard, we will complete by the end of March 2017 a plan to modernize tax and customs administration. We will also outline other specific reform measures with the support of IMF technical assistance and other development partners.

20. **We are committed to bringing our PFM systems closer to regional and international standards.** Our priorities outlined in our PFM RAP are concentrated on a small group of core PFM reform initiatives that are prerequisites for effective resource management and a credible budget. These are directed to strengthen: (1) the formulation of macro-fiscal policies and revenue mobilization; (2) the preparation of credible annual budgets; (3) expenditure control. To tighten expenditure commitment control, we have established a monthly allotment ceiling for ministries, departments, and agencies that are in line with our revenue outlook.; (4) accounting and fiscal reporting, as well as external auditing; and (5) cash management.

21. **We will implement several PFM reform measures during May 2016–April 2017** (Table 2). These include: (1) approval by the Minister of Finance of the PFM RAP by the end of June 2016; (2) preparation of a plan to identify existing domestic arrears and a repayment schedule by the end of September 2016—the plan will include the identification and verification of existing

arrears and the formulation of an arrears-clearance schedule; (3) achievement of 100 percent of non-salary Recurrent Cost and Reform Financing reimbursement by the end of December 2016; (4) completion of a report on the process and design of an electronic payment system for the Somali National Army and Police with biometric screening by the end of December 2016—this structural benchmark will involve the selection of a consulting firm to prepare a report on the feasibility and the processes needed to introduce electronic allowances payments, with biometric screening, for the Somali National Army and Police; (5) completion of an action plan to improve the policy and processes for cash management function by the end of March 2017—this action will involve taking stock of the reforms and changes introduced with the assistance of development partners (including the IMF), identifying weaknesses, and proposing action plan to address them; (6) completion of a plan to modernize the revenue and customs administration by the end of March 2017—this structural benchmark be achieved by establishing a modern system of tax registration and tax administration, including assessment, audit and enforcement, together with investment in modern ICT system for collecting revenue; and (7) issuance of a Prime Ministerial decree to endorse the Minister of Finance to cosign all foreign grant agreements by the end of March 2017.

### C. Financial Sector Policies and Reforms

22. **We will undertake financial sector reforms to underpin economic recovery.** Accordingly, we will: (1) prepare monthly financial statements of the CBS by mid-2016; (2) strengthen the organizational and governance structure of the CBS; (3) implement new accounting and financial reporting systems and practices at the CBS; and (4) strengthen the licensing, supervision, and regulation of financial institutions. We are also preparing a medium-term strategy to improve payment systems.

23. **The reform of the national currency is a high political priority.** The economy is largely cash-based and highly dollarized. The CBS has not been in a position to issue legal tender currency since the early 1990s. As a result, virtually all Somali Shilling (SOS) currently in circulation are counterfeit notes. Therefore, the existing currency situation is insufficient for the needs of the Somali economy. In particular, the poorer segments of the population are suffering. In March 2016, the Board of Directors of the CBS decided on the principles for currency reform in two stages. Supported by the IMF and a development partner, the CBS has initiated technical work on a comprehensive currency reform. In its first phase, the CBS will issue new SOS 1,000 banknotes. In a second phase, additional denominations will be issued. We welcome the IMF's commitment to providing considerable near-term technical assistance to support our currency reform. However, the CBS and the government lack the funds needed to finance the reform. Grants from international donors will be critical not only for the procurement of new banknotes on the international market but also for implementing this reform. We will also reach out to other central banks for additional technical support and advice to underpin this necessary project.



24. **We intend to advance reforms to foster financial intermediation.** We have phased out the provisional licensing, and we will take steps toward a risk-based approach to the licensing and supervision of commercial banks. We will also implement the AML/CFT framework with the support of a development partner, including the issuance of regulations for a risk-based supervisory approach to MTBs.. Further, we are working with the World Bank to establish a trusted agent to conduct joint examinations with CBS staff on MTBs to facilitate the flow of remittances to Somalia.

## TECHNICAL ASSISTANCE

25. **Technical assistance delivery is addressing weak capacity constraints and supporting policymaking.** In recent years, a large number of our staff and institutions have benefitted from technical assistance supported by development partners. Technical assistance in 2014–15 encouraged the Ministry of Finance to prepare a realistic 2016 budget. Further improvements in the consumer price index, gross domestic product, and external sector statistics, however, are needed. The preparation of CBS financial statements is gradually restoring its credibility and capacity for managing monetary policy. With IMF technical assistance, we also started enhancing the banking regulation and supervisory regime.

26. **The government has identified the following priorities for technical assistance:**

(1) internal controls, payments, and commitments; (2) cash management and treasury single account (TSA); (3) procurement; (4) accounting and reporting; (5) modernization of tax and customs administration; (6) external auditing; (7) natural resource and concessions management; (8) restoring traditional central banking operations; and (9) building capacity for the production and dissemination of macroeconomic statistics.

27. **During the program period, we are requesting IMF technical assistance in:**

(1) macrofiscal forecasting, policy analysis, and planning; (2) tax policy, revenue, and customs administration; (3) budget preparation and execution; (4) reforms in cash management and forecasting, and the TSA; (5) planning and implementing treasury reforms; (6) internal controls; (7) fiscal federalism; (8) bank licensing, supervision, and regulation; (9) currency reform; and (10) macroeconomic statistics. We will make specific requests to the IMF for assistance.

## RELATIONS WITH INTERNATIONAL CREDITORS

28. **We recognize the importance of normalizing relations with international creditors.** In due course, this will help address the burden of external debt and arrears. Given the urgency of meeting Somalia's social and reconstruction needs, a substantial reduction in the debt burden is an essential element of our economic strategy. Therefore, we will make every effort to establish a sufficient track record of sound economic management with successful completion of this and subsequent SMPs.

29. **Government records on external debt have been lost or destroyed during the conflict, but are being reconstituted.** With technical assistance from the African Development Bank, our Debt Management Unit has engaged with Somalia's external creditors to collect loan information. This has allowed the establishment of an external debt database. We are still waiting to receive additional creditor information.

30. **We are seeking advice from international partners on moving toward arrears clearance and the Heavily Indebted Poor Countries (HIPC) debt relief initiative.** We will continue to reach out to bilateral and other creditors to inform them of the government's desire for a comprehensive resolution of its debt burden.

## PROGRAM MONITORING

31. **The government and the CBS will closely monitor the implementation of its program for May 1, 2016—April 30, 2017 with the help of quarterly quantitative benchmarks** (Table 1) **and structural benchmarks** (Table 2). The program will have two reviews to assess its performance based on the test dates of September 30, 2016 and March 31, 2017. The quantitative benchmarks are defined in the TMU (Attachment II).

**Table 1. Somalia: Indicative Targets Under the Staff-Monitored Program, 2015-17** 1/

(Millions of U.S. dollars)

	2015	2016			2017	
	Dec. Est.	March Prel.	June Prog.	Sept. 2/ Prog.	Dec. Prog.	March 3/ Prog.
<b>Fiscal</b>						
Fiscal balance (cash basis; floor)	5.8	6.0	0.0	0.0	0.0	0.0
Accumulation of new domestic expenditure arrears (ceiling) 4/	33.0	0.0	0.0	0.0	0.0	0.0
Contracting of new domestic debt (ceiling) 4/	0.0	0.0	0.0	0.0	0.0	0.0
Contracting or guaranteeing of new nominal external borrowing (ceiling) 4/	0.0	0.0	0.0	0.0	0.0	0.0
<b>Central Bank of Somalia (CBS)</b>						
Net foreign assets of the CBS (floor) 4/ 5/	21.6	21.6	21.6	21.6	21.6	21.6
Issuance of banknotes other than SOS 1,000 (ceiling) 4/	0.0	0.0	0.0	0.0	0.0	0.0
Issuance of SOS banknotes that are not backed by foreign assets denominated in U.S. dollars of the CBS (ceiling) 4/	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Cumulative from the beginning of the year.

2/ Test date for the first review of the SMP.

3/ Test date for the second review of the SMP.

4/ Monitored on continuous basis starting from January 1, 2016.

5/ Calculated using program exchange rates. See Technical Memorandum of Understanding (Attachment II) for definitions of the program targets.

**Table 2. Somalia: Prior Actions and Structural Benchmarks under the Staff-Monitored Program, May 2016–April 2017**

Benchmarks	Target dates	Macroeconomic Rationale	Status
<b>Actions to Prepare for the SMP</b>			
1. Approve an Appropriation Bill for 2016 consistent with a zero cash balance budget by a presidential decree		Enhance budget planning and execution	Met
2. Set up an institutional framework for fiscal data reporting		Improve fiscal data reporting	Met
3. Approve an arrears management strategy by the cabinet		Improve arrears management	Met
4. Approve a roadmap for currency reform by the Board of Directors of the Central Bank of Somalia (CBS)		Bring confidence to the Somalia Shilling and the CBS to start formulating policies	Met
<b>Structural Measures</b>			
<b>Public Financial Management (PFM)</b>			
1. Minister of Finance to approve the 2016–20 PFM Reform Action Plan	Jun-16	Bring PFM systems closer to regional and international standards	
2. Prepare a plan to identify existing domestic arrears and repayment schedule.	Sep-16	Adopt an arrears management strategy	
3. Achieve 100 percent of non-salary Recurrent Cost and Reform Financing reimbursement.	Dec-16	Enhance budget planning and execution	
4. Complete a report on the process and design of an electronic payment system for the Somali National Army and Police with biometric screening	Dec-16	Improve fiscal reporting	
5. Complete an action plan to improve the policy and processes for cash management function	Mar-17	Enhance cash management	
6. Issue a Prime Ministerial decree to endorse the Minister of Finance to cosign all foreign grant agreements	Mar-17	Improve revenue budgeting and planning	
<b>Tax Policy</b>			
7. Complete a plan to modernize the revenue and customs administration	Mar-17	Improve tax compliance and expand the tax base	
<b>Financial Sector</b>			
8. Require approval by the Board of Directors of the CBS to issue commercial bank and MTB licenses	Dec-16	Enhance financial licensing and supervision	
<b>Macroeconomic Statistics</b>			
9. Establish and maintain a business registry to support the collection of macroeconomic statistics	Sep-16	Develop economic statistics	

## Attachment II. Technical Memorandum of Understanding

1. This technical memorandum of understanding (TMU) sets out the framework for monitoring the performance of the Federal Government of Somalia (FGS) and the Central Bank of Somalia (CBS) under the 2016 Staff-Monitored Program (SMP). It specifies the quantitative benchmarks on which the implementation of the SMP will be monitored. In addition, the TMU establishes the terms and timeframe for transmitting the data that will enable IMF staff to assess program implementation and performance.

### QUANTITATIVE BENCHMARKS

#### A. Quantitative Indicators

2. The quantitative benchmarks (Table 1 of the MEFP) are the following:
- a) Floor on the fiscal balance (on a cash basis).
  - b) Ceiling on accumulation of new domestic expenditure arrears of the FGS.
  - c) Ceiling on new domestic debt contracted by the FGS.
  - d) Ceiling on new external debt contracted or guaranteed by the FGS or the CBS.
  - e) Floors on CBS's net foreign assets.
  - f) Ceiling on issuance of banknotes other than SOS 1,000.
  - g) Ceiling on issuance of SOS banknotes that are not backed by foreign assets denominated in U.S. dollars of the CBS.
3. Quantitative indicators have been set for the end of June 2016, end of September 2016, end of December 2016, and end of March 2017. All quantitative benchmarks are cumulative from January 1, 2016.

#### B. Definitions and Computation

4. **For the purposes of the SMP, the government is defined as the Federal Government of Somalia.** This definition excludes public entities with autonomous legal personalities whose budgets are not included in the Federal Government budget.
5. **Government revenue** includes all tax and non-tax receipts transferred into the FGS general accounts at the CBS and excludes grants. It is measured on a cash basis, and cumulative from January 1, 2016.
6. **The fiscal balance**, on a cash basis, is defined as the difference between: (a) the sum of central government revenue (as defined in paragraph 4) and grants; and (b) total current expenditure plus capital expenditure (excluding foreign-financed off budget investment).

7. **New domestic expenditure arrears of the government** are defined as budgeted federal government payments to residents determined by contractual obligations that remain unpaid 90 days after the due date. Under this definition, the due date refers to the date in which payments are due according to the relevant contractual agreement, taking into account any contractual grace periods.

8. **Debt** is defined for program purposes in accordance with Executive Board Decision No. 15688-(14/107), Point 8(a) and 8(b), adopted on December 5, 2014.

- For program monitoring purpose, the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:
  - (i) Loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
  - (ii) Suppliers’ credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and
  - (iii) Leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property.
- Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.

9. **Domestic debt** is defined as short-term and medium-to-long-term borrowing from residents of Somalia, including the CBS. The definition of domestic debt excludes temporary advances for liquidity management from the CBS, and domestic expenditure arrears as defined in paragraph 6. Temporary advances will be fully repaid within 90 days.

10. **Benchmarks for external debt** are cumulative ceilings on contracting or guaranteeing of nominal external non-concessional borrowing by the government from January 1, 2016. External debt is defined by the residency of the creditor.

11. **The CBS's net foreign assets are defined as the difference between the CBS's gross foreign assets and gross foreign liabilities.** Gross foreign assets are defined as: (1) gold valued, over the program period, at the market price of December 31, 2015 (\$1,060.80 per ounce); plus (2) foreign exchange (including recovered CBS assets, non-earmarked budget and earmarked donor grants); minus (3) government budget grant deposits at the CBS in foreign currency; minus (4) other earmarked foreign currency deposits by residents of Somalia. Somalia's net position to the IMF is excluded from the definition of net foreign assets. Gross foreign liabilities under the SMP are set at zero. Relevant exchange rates against the U.S. dollar at December 31, 2015 will be used to convert foreign assets and liabilities denominated in currencies other than U.S. dollars.

## PROGRAM MONITORING

### *Program-Monitoring Committee*

12. The Somali authorities shall maintain a program-monitoring committee composed of senior officials from the Ministry of Finance, the Central Bank of Somalia, and the Ministry of Planning and International Cooperation. The IMF Resident Representative will have observer status on this committee. The committee shall be responsible for monitoring the performance of the program, recommending policy responses, informing the Fund regularly on program performance, and transmitting the supporting materials necessary for the evaluation of benchmarks. The committee shall provide the Fund with a monthly progress report on the program within four weeks of the end of each month, using the latest available data.

### *Data Reporting to the Fund*

13. To allow monitoring of developments under the program, the Ministry of Finance, the CBS and the Ministry of Planning and International Cooperation will provide to the Resident Representative's office of the IMF the following information contained in the data reporting table below.

## Somalia: SMP Data Reporting, May 2016–April 2017

Reporting Agency	Type of Data	Description of Data	Frequency	Timing (within period specified)
Central Bank of Somalia	CBS balance sheet	Detailed balance sheet of the CBS.	Monthly	3 weeks after the end of each month
	Monetary survey	Banking system balance sheet and consolidated balance sheet of commercial banks.	Quarterly	4 weeks after the end of each quarter
	Balance of payments	Exports, imports, invisible transactions, remittances, and capital and financial account flows.	Quarterly	2 months after the end of each quarter
	Revenue and expenditure	The detailed reports on CBS cash revenues and expenditures in U.S. dollars, and on aggregated basis (including both recurrent and capital spending).	Quarterly	3 weeks after the end of each quarter
		Disbursements and repayments: (1) scheduled; and (2) actual interest and principal on debt of the Government and the CBS, by creditor.	Monthly	30 days after the end of each month
	CBS temporary advances to the FGS	Provide monthly amounts and terms of the temporary advances to the Ministry of Finance.	Monthly	1 week after the end of each month
	Budget grants	Provide data on the amounts of on-budget grants.	Monthly	1 week after the end of each month
Ministry of Finance	FGS budget operations	The detailed revenue and expenditure by budget line and a completed summary table on Government operations.	Monthly	4 weeks after the end of each month
		The outstanding appropriation, allotment, commitment, and Recurrent Cost and Reform Financing non-salary reimbursement for fiscal year 2016-17.	Monthly	4 weeks after the end of the month
		The monthly cash plan.	Quarterly	4 weeks after the end of each quarter
		The disbursements of loans.	Monthly	4 weeks after the end of each month



## Somalia: SMP Data Reporting, May 2016–April 2017 (continued)

	Domestic arrears	A table providing the end-of-period stock of domestic arrears accumulated during the program period by charts of accounts.	Monthly	4 weeks after the end of the month
	Domestic debt	The amount of new domestic debt contracted by Government.	Monthly	4 weeks after the end of the month
	External debt	The amount of new external debt contracted or guaranteed by Government.	Monthly	4 weeks after the end of the month
	Structural benchmarks	A table with a description of the status of implementation of the structural benchmarks in Table 2 of the MEFP.	Monthly	4 weeks after the end of the month
National Statistics Office	CPI and other economic indicators	Indicators to assess overall economic trends, such as the consumer price index.	Monthly	6 weeks after the end of each month
		Trade data, production data.	Quarterly	6 weeks after the end of each quarter