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SOMALIA

February 2017

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SOMALIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Somalia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 3, 2017 consideration of the staff report that concluded the Article IV consultation with Somalia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 3, 2017, following discussions that ended on November 21, 2016, with the officials of Somalia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 18, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Somalia.

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

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2016 Article IV Consultation with Somalia and Somalia Completes the First Review under the Staff–Monitored Program

On February 3, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Somalia.

Over the past five years, Somalia has marked important milestones in rebuilding its economy and normalizing relations with international financial institutions. In 2012, Somalia emerged from nearly two decades of civil war. However, the post-war social and economic conditions remain difficult, poverty is widespread, and more than half of the working-age population is unemployed. The Federal Government of Somalia (FGS), elected and recognized by the international community in 2012, continues to face weak institutional capacity, fragile security, and complex clan politics which complicate economic reconstruction. With donors' support, progress is being made in the FGS's efforts to improve security, capacity development, and state building.

The IMF resumed its relationship with Somalia in 2013 and has since been heavily involved in the provision of policy advice and technical assistance. The IMF Executive Board concluded the 2015 Article IV Consultation with Somalia in July 2015, the country's first in more than a quarter-century. And the IMF Managing Director approved a Staff-Monitored Program (SMP) in 2016, covering the period May 2016 through April 2017. The SMP aims to help Somalia's economic reconstruction efforts and focuses on reforms to strengthen macroeconomic policy management, economic governance, and institutional capacity. Given Somalia's weak administrative capacity, technical assistance is an integral part of the program.

Despite a very difficult political environment, the FGS continues to make significant efforts toward restoring its key economic and financial institutions. The government approved a public financial management (PFM) law, initiated electronic payments of civil service and police wages, submitted the 2015 financial statements of the FGS to the auditor general,

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

approved the 2016–20 PFM reform action plan, and adopted a draft National Development Plan (NDP). In connection with the authorities' currency reform plan, the Central Bank of Somalia (CBS) was recently reconstituted and has since fully staffed its cash management department, prepared a draft anti-counterfeit strategy, and adopted a detailed roadmap for currency reform. In addition, an external audit of the CBS's 2014 financial statement was completed.

The Somali economy is expected to continue to be sustained by donors' grants, remittances, and foreign direct investment, mostly by the Somali diaspora. Economic activity is projected to decelerate in 2016–17. Growth is projected to be 3.4 percent and 2.5 percent in 2016 and 2017, respectively. The deceleration in growth mainly reflects the impact of the drought on the agriculture sector, which will be partially offset by activities in the construction, telecommunications, and service sectors. Meanwhile, inflation is estimated to be 1.5 percent in 2016 and projected to pick up to 2.7 percent in 2017. The annual trade deficit during 2014–15 was about 55.5 percent of GDP and was largely financed by remittances and grants. For the same period, the current account registered an annual deficit of 8.6 percent of GDP and was covered mostly by foreign direct investment, mainly by Somali diaspora.

The fiscal position was strained in 2016. Budgetary grants and tax revenue fell short, reflecting delayed disbursements and weak tax collection performance. Meanwhile, expenditure on goods and services continued to increase, in part due to the election and security spending.

Going forward, the FGS will continue to implement measures to improve the fiscal framework, raise tax revenue, and implement structural reforms. The authorities plan to revise their National Development Plan, allowing it to become the FGS's key development policy tool.

Executive Board Assessment[2]

Executive Directors commended the authorities for the significant progress made in rebuilding the economy and restoring key economic and financial institutions in a difficult political and security environment. Directors emphasized that strong policy implementation is necessary to address the challenges ahead, boost economic activity, and improve livelihoods. Continued support by the donor community would also be vital in this regard.

Directors noted that budget execution remains difficult because of weak tax collection, poor public financial management, and delays in grant disbursements. They stressed that greater fiscal discipline and stronger budget execution would improve fiscal performance. Directors

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

welcomed the authorities' continued efforts to improve public financial management and contingent measures to deal with domestic arrears and limit delayed payments.

Directors underscored that steady improvement in tax collection would help mitigate the impact from volatility of grants and meet security and social spending needs. To broaden the tax base, they encouraged the authorities to swiftly adopt the Appropriation Bill to endorse the tax code.

Directors supported the authorities' currency reform strategy. They noted that this reform would limit counterfeiting, restore credibility of the national currency, and allow the central bank to conduct monetary policy. Directors concurred that sound and successful implementation of the currency reform hinges on careful preparation and planning. They advised the authorities to follow through on the currency reform roadmap as agreed with the staff.

Directors welcomed the plan to overhaul the financial sector and improve the operations of the central bank, as well as commercial bank accounting and reporting standards. They stressed that jump starting financial intermediation is critical to enhancing Somalia's economic growth. Directors welcomed the progress in advancing financial sector reform, including efforts to bring banks into compliance with prudential norms, and combating the financing of terrorism (AML/CFT). They stressed that aligning the AML/CFT law with international standards and ensuring an effective risk-based implementation would safeguard the flow of remittances into Somalia.

Directors welcomed the authorities' plan to continue to improve the national development plan (NDP). They emphasized that the NDP should give priority to social safety net and pressing humanitarian conditions.

Directors agreed that a steadfast effort to rebuild Somalia's key institutions and governance remains critical. They were encouraged by the increasing focus of the Financial Governance Committee (FGC) on institution building, governance, and reorganization of the Ministry of Finance and the central bank. Noting the significant shortcomings in economic data provision, they called for swift adoption of the long-delayed statistical law.

Directors urged continued strong policy implementation under the Staff-Monitored Program (SMP) and subsequent SMPs. This would help establish a durable economic track record as a basis for future program engagement with the Fund and eventual debt relief.

SOMALIA

January 18, 2017

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM

KEY ISSUES

Context and background. Over the past five years, Somalia has marked important milestones in rebuilding its economy and normalizing relations with international financial institutions. After more than two decades of a civil war that caused significant damage to the country's social and economic infrastructure, the Federal Government of Somalia (FGS) was elected and recognized by the international community in 2012. With donors' support, progress is being made in the FGS's efforts to improve security, capacity development, and state building. However, significant challenges remain ahead to rebuild the economy and institutions and improve social conditions. The IMF resumed its relationship with Somalia in 2013 and has since been heavily involved in the provision of policy advice and technical assistance, particularly in the context of the 12-month Staff-Monitored Program (SMP) which was approved by the IMF Managing Director in May 2016. Despite a very difficult political environment and complex clan politics, the FGS continues to make significant efforts toward restoring its key economic and financial institutions and keeping the SMP on track.

Macroeconomic situation, outlook, and risks. The Somali economy is expected to continue to be sustained by donors' grants, remittances, and foreign direct investment mostly by the Somali diaspora. Reflecting a looming drought, economic activity is expected to slow down in 2016–17. Revenue shortfalls and delays in pledged donors support are making budget execution difficult. Risks to the outlook and the program are tilted to the downside and stem mainly from fragile security, expenditure overrun in the lead-up to the presidential elections, weak revenue collection and administrative capacity, and repeated delays of the electoral process which could weaken donors' support to the FGS.

Review under the SMP. Performance under the SMP through the end of September 2016 was broadly satisfactory. Six out of seven quantitative benchmarks (set for the end of September) and all the structural benchmarks for the first review were met. In light of the broadly satisfactory program implementation so far, remedial measures to address the lone missed target, and the authorities' strong commitment to policy implementation under the SMP, staff support the completion of the first review of the SMP.

Focus of the Article IV Consultation and policy discussions. Discussions focused on: (1) fiscal policy and reform measures to improve fiscal discipline, budget execution, revenue mobilization, and contingent measures to avoid arrears; (2) currency reform and reviving of the financial sector; (3) the national development plan (NDP), inclusive growth and social safety net; (4) the economic implications of repatriating Somali refugees from Kenya; (5) institutional capacity building; and (6) remittances and money transfer businesses.

Key policy recommendations. The authorities are urged to: (1) pass the 2017 Appropriation Bill to endorse the tax code and step up efforts to mobilize tax revenue; (2) improve fiscal management and budget execution; (3) adhere to agreed plans to avoid arrears and limit delayed payments; (4) follow through with the currency reform roadmap and revive the financial sector; and (5) revise the NDP with more focus on required funding, social safety net program, capacity development, and humanitarian needs.

Authorities' views. The authorities agreed with staff's assessment and balance of risks. They also acknowledged that in the absence of remedial measures, the fiscal risks could be higher. They, however, remain committed to stronger fiscal discipline, avoiding new arrears, raising tax revenue, and implementing structural reforms. They felt strongly that currency reform and reviving the financial sector represent priority areas, while acknowledging that the preconditions for issuing a new currency must be in place first. The authorities plan to revise the NDP with a greater focus on funding needs, institution building, and developing social safety net programs—including those for Somali refugees—supporting existing humanitarian programs in coordination with donors. To mitigate risks to the program, they felt that continued progress under the SMP, and political, sustained, and coordinated international support—including with regards to security, peace, and capacity building—are needed.

Approved By
Adnan Mazarei (MCD) and Jan Sun (SPR)

Discussions were held in Nairobi, Kenya during September 21–27, 2016 and November 14–21, 2016. The staff team consisted of Messrs. Elhage (head), Samake, Kohler (all MCD), Dallari (FAD), Shaboyan (STA consultant), Muir (FAD consultant), Thiam (Resident Representative), and Mr. Mohamed (Resident Economist). Mr. Tlelima (Advisor to the Executive Director) attended meetings during the last four days of the mission. The team met with Finance Minister Mohamed Adan Ibrahim; Minister of Planning and International Cooperation Abdirahman Yusuf Ali Aynte; Central Bank Governor Bashir Issa Ali; Director General at the Office of the President Mr. Ali Omar; and other officials. The mission also met with representatives of bilateral and multilateral donors.

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BACKGROUND AND CONTEXT

1. Overview. Somalia is a fragile state that emerged in 2012 from a two decade-long civil war that caused significant damage to the country's social and economic infrastructure. Post-war social and economic conditions continue to be difficult, with poverty widespread and more than half the working-age population unemployed. The Federal Government of Somalia (FGS) continues to face weak institutional capacity, fragile security, and complex clan politics which complicate economic reconstruction.

2. The security situation remains fragile. The Al-Shabaab group has continued to launch sporadic attacks, despite recent gains by the Somali national army and African Union (AU) troops.

3. Political developments. The presidential elections have been postponed for the fourth time in a row.[1] The international community had expressed concern over repeated delays and pressed for a peaceful, transparent, and inclusive electoral process in order to send a strong signal of electoral order to the people of Somalia and international partners. They stressed the urgent need to swiftly conclude the electoral process by January 19 and warned of the risks of further delays (including compromising donors' support to the FGS).

4. Fund relations. The IMF recognized the FGS in April 2013. The IMF Executive Board concluded the 2015 Article IV Consultation with Somalia in July 2015, the country's first in more than a quarter-century.[2] Somalia's overdue financial obligations to the IMF were last reviewed by the Executive Board on December 2015. The next review was postponed to take into account the outcome of the 2016 Article IV discussions and the first review of the SMP and to be considered by the Executive Board together.[3] Somalia is in arrears to the Fund ($319.4 million, 537.6 percent of quota, as of the end of December 2016)[4] and is therefore ineligible for financial support from the Fund. IMF management approved a 12-month Staff-Monitored Program (SMP) in May (May 2016–April 2017, Countrty Report No. 16/136), marking another milestone in normalizing relations between Somalia and international financial institutions. The authorities have since continued to move forward with their reform agenda, making significant progress in areas recommended under the SMP and the 2015 Article IV recommendations (Box 1).

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[1]About 14,000 delegates selected by their clans elect parliament members who in turn elect the president among the designated candidates. Presidential elections were originally scheduled for August 2016 and have since been postponed four times between September 2016 and January 2017.

[2]Somalia–Staff Report for the 2015 Article IV Consultation (2015).

[3] Somalia– Review of Overdue Financial Obligations to the Fund and Further Review Following Declaration of Ineligibility (2015 and 2017). Somalia was declared ineligible for IMF resources at the time of the review of overdue obligations to the IMF by the Executive Board on May 6, 1988.

[4] SDR237.6 million (US$/SDR=0.743864 of December 30, 2016).

Box 1. Somalia: The 2015 Article IV Policy Recommendations and Follow-Up

On July 27, 2015, Somalia completed its first Article IV Consultation with the IMF since November 18, 1989. Executive 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 the Somali government to take decisive steps toward building fiscal discipline, underpinned by realistic budgeting and effective implementation systems, including commitment controls. On banking and financial policy, Directors welcomed the Central Bank of Somalia's (CBS) currency reform initiative, supported by the Fund's TA. They stressed that the elaboration of a financial sector roadmap would be a critical first step toward building credibility in licensing and supervising banks and money transfer businesses (MTBs).

The authorities have continued to move forward with their reform agenda by making significant progress in areas recommended by Directors. On May 16, 2016 IMF management approved an SMP to support the FGS and to establish a track record of policy implementation. Prior to the approval of the SMP, the authorities demonstrated tangible commitment by implementing key measures, including: (1) adopting an Appropriation Bill consistent with a zero-cash balance; (2) setting up an institutional framework for fiscal data reporting; (3) adopting an arrears-management strategy as part of their public financial management (PFM) reform; and (4) approving the key principles for currency reform.

Reform implementation momentum is continuing under the SMP.

- ***On fiscal policy and reforms***, the authorities completed electronic payments of civil service wages, submitted the 2015 financial statements to the Auditor General, and approved the 2016–20 public financial management (PFM) reform action plan. The implementation of the commitment system, which has been delayed, is expected to start in January 2017, and the stock-taking of existing bank accounts of Ministries, Departments, and Agencies (MDAs) is underway.

- ***On currency reform***, the CBS has reconstituted a fully staffed cash management department, and prepared a draft anti-counterfeit strategy and roadmap for currency reform.

- ***On financial sector policy***, the authorities achieved: (1) the completion of the audit of the financial statement of the CBS for 2014; (2) continue to reach out to foreign banks to recover missing, lost, or stolen assets; (3) the recruitment of a reputable Trusted Agent to work with MTBs on anti-money laundering and combating the financing of terrorism (AML/CFT), in addition to assisting the CBS to help secure confidence in the payment system and safeguard the continued flow of international remittances to Somalia; (4) banks are now complying with prudential norms; (5) as of September 2016, banks have started publishing quarterly financial statements; (6) the adoption of a foreign direct investment (FDI) law; and (7) under the World Bank's project "Core Banking System," a new financial infrastructure for CBS banking operations is being developed.

- ***On technical assistance*** (TA), efforts to restore key economic and financial institutions continue. From June 2013 to December 2016, the IMF delivered 66 TA missions, including training in its areas of expertise and 14 TA missions delivered support to the Financial Governance Committee.

ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

The Somali economy is expected to continue to be sustained by donors' grants, remittances, and investment by the Somali diaspora. Reflecting a looming drought, economic activity is expected to slow down, with inflation projected to pick up in 2016–17. Risks are tilted to the downside, emanating mainly from weak institutions and fiscal performance, and the fragile security situation.

5. **Economic activity is projected to decelerate in 2016–17, but will continue to be sustained by donors' grants, remittances, and Somali diaspora investment** (Table 1 and Text Table 1).[5] Economic growth recovered in 2014–15 and inflation was low. Growth is projected to be 3.4 percent in 2016 and 2–2.5 percent in 2017. The projected slower growth rate mainly reflects the impact of the drought on the agriculture sector[6] which will be partially offset by growing activity in the construction, telecommunications, and service sectors. Meanwhile, due in part to higher food prices, inflation is projected to pick up to 2.7–3 percent in 2017, up from 1.5 percent in 2016. The trade deficit (56 percent of GDP on average in 2014–15), which is projected to remain sizable, will be largely financed by remittances and grants. And, the current account deficit (8.6 percent of GDP on average in 2014–15) will be largely covered by foreign direct investment, mostly by the Somali diaspora.

Text Table 1. Selected Economic Indicators, 2014–17

(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017
	Est.		Proj.	Proj.
National income and CPI		(Percent)		
Real GDP growth	3.6	3.6	3.4	2.5
Inflation (CPI, eop)	1.3	1.4	1.5	2.7
Fiscal 1/ 2/				
Revenue and grants	2.5	2.3	3.0	3.8
Of which: grants	1.0	0.4	1.1	1.5
Total expenditure	2.5	2.2	3.0	3.8
Of which: Wages 3/	1.3	0.9	1.2	1.9
Overall balance	0.0	0.1	0.0	0.0
External sector and debt				
Current account balance	-8.1	-9.1	-6.4	-7.2
Trade balance	-54.2	-57.0	-55.0	-56.3
Remittances	22.9	23.3	23.5	24.2
Grants	23.8	25.1	25.6	25.4
Net foreign assets 4/	…	21.6	21.6	21.6
External debt 5/	85.1	81.8	79.9	…
Memorandum items		(U.S. dollar, million)		
Treasury deposits at the CBS	4.5	11.4	…	…
Stock of arrears	45.3	67.7	36.3	36.3

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/ Figure for 2017 includes: (1) salary payments for 12 months; (2) food allowances for security ($6 million)–previously in goods and services; and (3) salaries for new senate members ($4 million).
4/ Millions of U.S. dollars and for SMP definition see TMU.
5/ The figure for 2016 is based on information through October 2016.

6. **Fiscal strains deepened in the lead up to the presidential elections** (Table 2a and 2b). Budgetary grants and

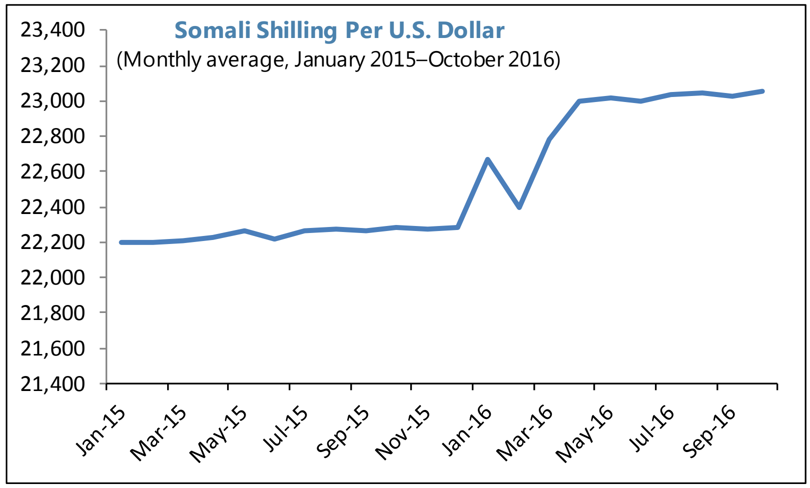
[5] Data for 2016 are still projections and the figures are subject to changes. With support from Sweden, the World Bank, and the IMF, the GDP estimates for 2012-15 and the CPI (weighting scheme) are expected to be updated and completed in 2017.

[6] The share of agriculture is more than 25 percent of GDP.

(continued)

tax revenue are projected to fall short in 2016, reflecting delayed disbursement and weak performance, respectively. Meanwhile, expenditures on goods and services increased, in part due to the presidential elections and security spending. To maintain the fiscal balance at zero (on cash basis), the authorities opted to delay some salary payments for November and December.[7]

7. The Central Bank of Somalia (CBS) is slowly resuming its activities (Table 3). Available data indicate that the gross assets of the CBS declined slightly between December 2015 and September 2016, largely reflecting the drop in cash held in vaults (from $13.3 million in December to $9.8 million).[8] Currently, there is no scope for monetary policy in Somalia and the CBS has no control over either the exchange rate or the supply of the Somali shilling (SOS). The CBS has not issued any banknotes since 1991, resulting in a largely dollarized economy.[9] The Somali Shilling/U.S. dollar exchange rate has remained stable (at about SOS 23,000 per U.S. dollar) since April 2016.



8. The financial sector is being revived. The Somali financial sector is rudimentary with limited intermediation.[10] It consists of six commercial banks—which mainly act as money exchange and trade financing institutions for their owners—and 12 Money-Transfer Business (MTBs).[11] In June 2016, the total assets of the six licensed commercial banks reached $214 million, up from $170 million 12 months prior, an increase of 26 percent. Bank capitalization increased sharply by an average of 24 percent.[12] However, two out of the six banks representing

[7] See ¶13–staff views on arrears and delayed payments.

[8] The decline during this period reflects, in part, the theft of $530,000 in August 2016 (see ¶20–21).

[9] Payments are settled in U.S. dollars, mobile phone platforms, and counterfeit SOS banknotes.

[10] Some intermediations have started recently and banks are also beginning to make more Islamic investments.

[11] There are 12 licensed MTBs, and 4 registered MTBs that are operating in Somalia. The MTBs provide international money transfer service, generally to households, and in many cases act as quasi-bank by providing financial services to handful of the population. Recent assessment of MTBs compliance carried out by the Trusted Agent (Box 1) found that MTBs are not fully implementing the existing compliance and their policies and practices are yet to be consistent with the regulations.

[12] All but one bank meet the minimum capital requirement of $5 million. 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. An additional 13 applications for commercial bank licenses are pending.

(continued)

about 12 percent of total assets have been reporting negative income, suggesting caution for pockets of vulnerabilities on their solvency. Bank loans—both in the forms of Islamic investment and traditional loans— increased on an annual basis to $51.4 million in June 2016 from $42.2 million in June 2015, a 22 percent increase.[13]

9. The authorities agreed that the outlook is subject to significant domestic and external risks, stemming from both global uncertainties and weaknesses in domestic factors (as detailed in the Risk Assessment Matrix–RAM, Box 2).[14]

- **External risks** include spillovers from the protracted conflicts in the Middle East which could weaken demand for Somali exports, reduce donor support, and decrease remittances. Tighter international regulatory and supervisory frameworks could also further slow remittances.

- **Domestic risks** include the loss of expenditure control and slowdown in reform implementation in the run-up to the presidential elections, which could weaken the fiscal position, in particular revenue collection; weak institutional capacity, which could undermine critical reforms to mobilize revenues and public financial management; drought conditions in some key regions of Somalia;[15] repeated delays in the electoral process, which could compromise donors' support to the FGS; fragile security; and poor financial system supervision, including the need to strengthen compliance with anti-money laundering and combating the financing of terrorism (AML/CFT) in line with international standards.

[13] MTBs activities remain strong. The gross inflows to Somalia in 2015 through MTBs were estimated at 14.6 percent of GDP.

[14] Staff has shared and discussed the RAM with the authorities.

[15] Mostly in the Northwest and Northeast pastoral livelihood zones, leading to shortages of water and food, and livestock deaths and migration.

Box 2. Somalia: Risk Assessment Matrix[1]

Nature/Source of Risks	Relative Likelihood	Impact if Realized	Policy Responses
Global Risks			
Weaker-than-expected global growth stemming from significant slowdowns in key advanced and emerging frontier economies.	**High/ Medium**	**Medium** (1) lower demand for exports. (2) possible reduction in donor support. (3) lower remittances.	(1) greater revenue mobilization. (2) swiftly adopt the ongoing World Bank reform on social safety nets.
Heightened risk of fragmentation/state failure/security dislocation in the Middle East and some countries in Africa.	**High**	**High** (1) lower remittances. (2) influx of refugees. (3) lower growth.	(1) improve business environment and national security. (2) greater revenue mobilization. (3) strengthen social safety nets.
Country-Specific Risks			
Poor financial system supervision Tightening regulatory and supervisory frameworks in advanced and emerging markets. Lack of credible supervision and weak AML/CFT international standard.	**Medium**	**Medium** (1) Cost-benefit consideration, prompting global banks to forego money transfer business, leading to higher cost of remittances, and lower formal remittances. (2) reduction in remittances, which support the livelihood of many Somalis.	(1) upgrade capacity in licensing, supervision, and regulation of banks and MTBs. (2) Ensure effective implementation of the AML/CFT framework. (3) strengthen governance structure of CBS.
Institutional risks Protracted insecurity, weak institutions, repeated delays in the presidential elections, and poor data availability.	**High**	**High** (1) destruction of economic infrastructure. (2) possible reduction in donor support. (3) lower growth.	(1) improve national security and economic statistics. (2) strengthen local capacity. (3) seek donors' support. (4) maintain the election dates.
Fiscal risks Loss of expenditure control and slowdown in reform in the run-up of the presidential elections, weak revenue collection.	**High**	**High** (1) lower revenue (including grants from donors). (2) arrears accumulation. (3) policy slippages and SMP off-track.	(1) maintain reform momentum. (2) greater revenue mobilization. (3) keep expenditure under control and improve PFM.
Failed currency reform Inadequate preparation of the currency reform.	**Medium**	**High** (1) increase in US dollar and SOS counterfeits. (2) further depreciation of SOS. (3) continued absence of monetary policy.	(1) follow through on currency reform agenda, while improving communication and mitigating other inherent risks.
Drought conditions Spread to the Northwest and Northeast pastoral livelihood zones.	**High**	**High** (1) shortage of water and food. (2) livestock deaths and migration.	(1) FGS to better coordinate and monitor humanitarian aid distribution across regions with focus on most affected regions.

[1] Based on the July 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 at the time of discussions with authorities. Non-mutually exclusive risks may interact and materialize jointly.

PROGRAM PERFORMANCE, MODALITIES, AND RISKS

Performance under the SMP is broadly satisfactory. All the structural benchmarks (SBs) and six out of seven quantitative benchmarks (QBs) set for the first review were met. The authorities and staff agreed to introduce two new SBs. Going forward, a worse-than-anticipated security situation could slow program implementation, repeated delays of the electoral process could weaken donors' support to the FGS, and fiscal risks, if realized, could be harmful in the absence of remedial measures. Staff support the authorities' corrective measures to address missed target and contingent plans to mitigate risks.

10. All SMP indicative quantitative targets for June 2016 (indicative targets) were met. On structural benchmarks, the only target for June ("The Minister of Finance to approve the 2016–20 public financial management (PFM) reform action plan") was also met.

11. Performance under the SMP through the end of September 2016 was broadly satisfactory. All the SBs and six out of seven QBs (set for the end of September 2016) for the first review were met (Memorandum of Economic and Financial Policies or MEFP ¶7, MEFP Table 1 and 2). Due mainly to the delayed disbursement of budgetary grants by two bilateral donors, new estimated arrears of approximately $10 million were accumulated in payments of wages and allowances at the end of September, but were subsequently paid in full as part of donors' grants was received.

12. The authorities have also advanced the implementation of their structural reforms, as spelled out in the MEFP ¶7 (bullets #3, 4, and 5). In addition, two out of three SBs set for December 2016 have been completed and one is in progress: (1) the issuance of commercial bank and MTB licenses now requires approval by the CBS Board of Directors; (2) a report on the process and design of an electronic payment system for the Somali National Army and Police with biometric screening capability is completed; and (3) the benchmark of achieving 100 percent of non-salary Recurrent Cost and Reform Financing reimbursement which has been delayed is expected to be completed by March 2017. A prime ministerial decree that requires all foreign grant agreements to be cosigned by the Minister of Finance (set for March 2017) has been completed. Moreover, an action plan to improve cash management, and a plan to modernize revenue and customs administration (both structural benchmarks for March 2017), are being developed. However, on data provision, the authorities agreed that while the business registry was technically completed (an SB set for the end of September 2016), to operationalize the process, the registry would need to be improved and consolidated. In addition, passage of the new Statistical Law would be critical.[16]

13. The SMP's key policy objectives remain unchanged. Staff support the authorities' corrective measures to address the missed QB. The authorities and staff also agreed to modify

[16] The law includes articles on statistical system, statistical confidentiality, cooperation between state agencies on data sharing.

the SB on CBS issuance of banknotes in light of the roadmap developed to launch the new currency. Also, two new SBs have been proposed in the areas of revenue measures and currency reform.

- ***Corrective measures to avoid new arrears.*** The QB on non-accumulation of new domestic arrears set for the end of September was missed.

  - In staff's view, this constitutes a temporary slippage that does not jeopardize the successful implementation of the program. In the absence of a program adjustor for a shortfall in grants, **staff support the authorities' corrective measures to avoid new arrears and limit delayed payments.**

  - Remedial measures include: (1) improve budget execution, through prioritizing the payment of salaries in December to Ministries, Departments, and Administrations (MDAs); (2) strict adherence to the new arrears management strategy; and (3) realistic revenue and grant forecasts and stronger resolve for improving domestic revenue mobilization, including greater enforcement of tax collections.

  - Delayed payments in Somalia have been a practice to manage liquidity. This has generally led to accumulation of arrears. In December, due to financing pressures in the lead up to the presidential elections and contingent spending,[17] the authorities delayed November and December 2016 salary payments until early 2017. Staff expressed concern over such a practice and recommended that the deferred amount be included in the 2017 budget and paid fully to avoid new arrears. While the FGS cash flow situation came under pressure due to unplanned expenditures, staff noted that deferred payments have been the result of delays in grant disbursement, and weak revenue performance, as well as weak public financial management (that is, using deferred payments as a means to manage treasury cash flows). Staff recommended that improving treasury single account (TSA), cash management, and arrears management be made high priorities for the 2017 budget measures (¶18). Moreover, staff stressed that the authorities should also remain current on all future bills and adhere strictly to the sequestration[18] provisions in the 2016 Appropriation Law.

  - In addition, further efforts to prevent new arrears and limit delayed payments include the effective start of the new payment process reforms and implementation of the commitment system roll-out (MEFP ¶12) in January 2017.[19] This is a significant shift from the current practice—which is mainly based on manual payment processing—to a

[17] On security, arrears, and transfers to regions.

[18] The sequestration rule refers to expenditure payment prioritization. In the event that treasury cash/liquidity is not sufficient to make all payments, salaries, and other current and capital expenditure payments should be made before payments of arrears.

[19] The delay in implementation of the commitment system also affected the schedule of the new arrears management strategy.

realtime tracking of payment obligations of all line MDAs. Also, the authorities intend to further strengthen the TSA system by evaluating existing bank accounts which would result in closing non-critical accounts and consolidating the rest. Staff believe that the effectiveness of these measures will solidify efforts to avoid new arrears and limit delayed payments.

- ***New SB on revenue measures***. A new SB on passing the 2017 Appropriation Bill has been introduced to endorse the tax code rate for income and sales taxes to help re-enforce the existing tax laws for income and sales taxes for telecommunications, electricity and water supply companies, as well as hotels (see ¶15 for more discussion). With the enforcement of this measure, staff believe that the projected revenue (¶17 and Text Table 3) can be achieved.

    - On the one hand, there is upside potential to the tax revenue measures resulting from the authorities' plan to enforce a Cabinet resolution (passed in 2016) which imposes fees on the telecommunications sector. This could raise significant revenue (up to 10–12 percent of tax revenue). In addition, the FGS is expected to generate some fiscal savings from the implementation of the new payment process.

    - On the other hand, revenue collection efforts could be impacted by the weak security and governance conditions.

    - Should downside risks materialize, to keep the program on track, staff agreed with the authorities to consider the following measures: (1) cutting non-priority spending on goods and services; and (2) use any buffers arising from improved PFM to safeguard against revenue shortfall.

- ***Modification of SB on currency reform***. The CBS has endorsed a new roadmap for currency reform (¶21 and Box 1) in which two QBs—a ceiling on issuance of banknotes other the SOS 1,000 and a ceiling on issuance of SOS banknotes that are not backed by foreign assets—are scheduled to be completed after July 2017 (that is, beyond the SMP period).[20] The authorities and staff agreed to propose a new SB to ("finalize the anti-counterfeit strategy by the end of March 2017"[21]), which is part of the currency reform roadmap.

[20] At the time of the SMP approval, the authorities adopted a guiding principle for a currency reform roadmap involving two phases. In the first phase (spanned through mid-2017, that is during the SMP period), the CBS would issue new SOS 1,000 banknotes whose value would not exceed the U.S. dollar assets on the balance sheet of the CBS. During the second phase, the CBS would issue higher SOS banknote denominations.

[21] Significant progress has been made in drafting anti-counterfeit measures. For example, the CBS is in the process of finalizing regulation establishing a National Anti-Counterfeit Center. In addition, the CBS is drafting a MoU on cooperation between the CBS and the Somali police.

14. The authorities and staff discussed risks to the program, program prospects, and Somalia's future engagement with the IMF.

- ***Risks.*** The authorities shared staff's assessment that while the uncertainties outlined in ¶9 and Box 2 will continue to be risks to the program, the cabinet reshuffle following the presidential elections could also challenge the implementation of the program. They also acknowledged that in the absence of appropriate corrective measures, fiscal risks could be higher. The authorities are, however, cognizant that strong commitment to the program, and sustained and coordinated international support—including with regards to security, peace, and capacity building—would help mitigate risks. As the FGS fiscal stance depends largely on donor inflows, other risks include persistent delays and revisions in grant disbursements. These could lead to arrears accumulation or cash rationing. The authorities and staff agreed that the corrective measures discussed to avoid arrears and delay payments could help mitigate such a risk. The authorities further stressed that donors' pledged grants disbursed on schedule would help avoid arrears and limit delayed payments. On the positive side, tax revenue collection could surprise on the upside (¶13).

- ***Program prospects.*** As the SMP will end in April 2017, discussions laid the groundwork for a successor SMP. The authorities and staff agreed to the measures for the fiscal and financial sectors outlined in ¶18 and MEFP ¶13; and ¶21 and MEFP ¶15, respectively. The repeated delays in the elections have affected the 2017 budget schedule (now expected to be approved by March 2017). Staff stressed that the completion of the second review hinges on the new authorities' commitment to the implementation of policies agreed on and Somalia's capacity to enforce existing laws, particularly on tax administration and tax collection. Lessons from this SMP and prioritization of the identified fiscal and financial sector measures will be discussed at the time of the second review. The second and final review of the SMP is expected to be completed by June 2017.

- ***Somalia's future engagement with the IMF.*** While the authorities and some donors are pushing for a quicker move for IMF financing support, staff explained that only after establishing a strong economic track record (successfully completing this, and subsequent, SMPs) and the clearance of arrears to the Fund,[22] will Somalia be eligible for an IMF Upper Credit Tranche (UCT) facility.

[22] The clearance of arrears will be an important part of normalizing relations with the international community and establishing a roadmap to debt sustainability. The process will involve: (1) establishing a track record of cooperation with the Fund on policies and payments, including in the context of SMPs; (2) reconciling external debt; (3) preparing a poverty reduction strategy; and (4) mobilizing donor resources to finance debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative.

POLICY DISCUSSIONS

Discussions focused on critical near-term policy challenges:[23] *(1) improving fiscal policy and reforms, budget execution, and revenue mobilization; and identifying contingent measures to avoid new arrears; (2) instituting reforms toward Somalia's national currency and prepare for effective monetary policy over the medium term; (3) developing the financial sector; (4) the national development plan (NDP) and social safety net; (5) the economic implications of repatriating Somali refugees; (6) remittances and money transfer businesses; and (7) strengthening institutions and governance, as well as rebuilding macroeconomic statistics.*

A. Fostering Fiscal Discipline

Background

15. The 2017 fiscal framework is underpinned by stronger tax revenue mobilization (Text Table 2).[24] Projections will continue to be based on a zero-cash balance and no accumulation of new domestic arrears (as required under the SMP). Revenue and grants are projected to reach 3.8 percent of GDP (up from 3 percent in 2016), coming mainly from new tax measures (Text Table 3). Expenditures will include delayed payments of 2016 wages and allowances, and more transfers to states to support regional development efforts.

- **Revenue and grants.** Tax revenue is projected to reach $127.7 million (2.0 percent of GDP), up from a projected $89 million (1.4 percent of GDP) for 2016. Underpinned by a

Text Table 2. Somalia: Federal Government Operations, 2015–17 1/
(Millions of U.S. Dollars)

	2015	2016				2017
	Dec.	Sept.		Dec.		Dec.
	Prel.	Prog.	Prel.	Prog.	Proj.	Proj.
Revenue and grants	141.2	184.7	124.3	246.3	190.2	250.9
of which: grants	26.9	90.8	39.4	121.0	70.5	95.5
Expenditure	135.4	184.7	124.1	246.3	190.2	250.9
Current	133.1	167.4	119.8	223.2	185.6	241.3
of which: wages 2/	52.9	71.2	34.7	94.9	79.0	121.8
Capital	2.3	17.4	4.2	23.1	4.6	9.6
Overall balance	5.8	0.0	0.2	0.0	0.0	0.0
Memorandum items						
Arrears and delayed payments 3/	10.8	24.0	31.4	32.0	31.4	31.8
of which: arrears	10.8	24.0	31.4	32.0	31.4	0.0
New arrears 3/	33.1	0.0	10.0	0.0	0.0	0.0
Stock of dom. Arrears 3/	67.7	43.6	46.3	35.6	36.3	36.3

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

1/ Fiscal operations are recorded on a cash basis.
2/ Figure for 2017 includes: (1) salary payments for 12 months; (2) food allowances for security ($6 million)–previously in goods and services; and (3) salaries for new senate members ($4 million).
3/ Estimated arrears. The figure for September 2016 includes only wages, salaries and allowances.

[23] Somalia's macroeconomic and financial data are rudimentary, the economy remains highly fragile, and the entire economy is in need of rebuilding. As such, the authorities and staff agreed to focus the discussions on the near-term challenges.

[24] The 2017 projection is in line with the draft 2017 budget, which has yet to be endorsed by the Minister of Finance, approved by the Cabinet, and is expected to be adopted by the Parliament by March 2017. For the first three months of 2017, the authorities will operate on extended 2016 budget.

package of tax policy and tax administration measures agreed to with the authorities, the tax measures will generate $43.0 million. Grants projection is conservative and based on confirmed grants from traditional donors.

- **Revenue from telecommunication sector** (Text Table 3). The authorities aim to collect about $24.5 million in tax revenues from the telecommunication sector in 2017 (19.2 percent of tax revenue), up from the negotiated tax of $5.0 million collected in 2016. The projection comprises about $12–14 million from taxes on corporate profits and $10–12 million from sales taxes. Revenue from income taxes on telecom employees' salaries is not accounted for at this point; but could also come on stream later in 2017, representing an upside potential to 2017 revenues (see Box 3). Additional revenue collection from the telecom sector could be achieved but will require significant improvements in revenue administration and tax collection, while improving security for telecom operators.

- **Expenditure.** Expenditure projection is aligned with revenue. It allows for a zero-cash balance and accommodates a buffer to absorb deferred payments of salaries from 2016 amounting to $22.9 million.[25] The wage bill ($121.8 million) accounts for the full-year payment of civil servants and security forces and the salaries for the new Senate members. Increases for non-wage recurrent spending and investment will support the efforts to rebuild institutions and public infrastructure.

16. Significant progress has been made toward rebuilding Somalia's external debt statistics (Table 5a and 5b). With technical assistance (TA) from the African Development Bank (AfDB), the Debt Management Unit (DMU) has reconstituted the bulk of the country's external debt database either lost or destroyed during the conflict. Based on information through-end October 2016, from more than two-thirds of Somalia's creditors, outstanding public debt was estimated to be over $5 billion (nearly 80 percent of GDP), of which $4.7 billion in arrears (74 percent of GDP). In 2016, the debt comprises multilateral creditors ($1.4 billion or 22.9 percent of GDP), Paris Club creditors ($2.3 billion or 36.6 percent of GDP), and some non-Paris Club creditors ($1.3 billion or 20.5 percent of GDP).

Policy discussions

17. To achieve the fiscal targets for 2017, the authorities agreed on the need for: (1) strengthening fiscal discipline and improving budget execution; (2) implementing strong reform measures to tax law enforcement and improving revenue collection; and (3) following through with the expenditure prioritization rules. In this regard, they agreed to set a more realistic budget underpinned by a broader revenue base, conservative grants, and a prudent expenditure policy. Revenue windfalls (including additional grants for budgetary support) would

[25] Delayed payments that have lasted less than 90 days (hence, not considered as arrears under the SMP), and deferred to 2017.

be used to build up buffers (for contingent measures, including inflows of refugees) and pay down arrears. The authorities agreed that priorities should focus (MEFP, ¶12):

- ***On tax policy and reforms***, the authorities and staff reached an understanding on the need to collect higher nominal revenues compared to those in 2016, with the ultimate goal of progressively restoring revenues-to-GDP to levels comparable to peer countries. The authorities intend to identify a set of realistic revenue measures that can replace negotiated tax arrangements, and anchor revenue collection to the tax base and economic performance. In this context, the authorities agreed to implement the revenue measures listed in Text Table 3 during 2017.[26]

Text Table 3. Projected Yields from Tax Revenue Measures in 2017
(Million of U.S. Dollars, as of March 2017, unless otherwise indicated)

	Proj.1/
Total Tax revenue measures 2/	**43.0**
Tax rate increase	**7.3**
on petroleum products (+25%)	1.0
on tobacco (+100%)	0.3
on khat from $2 to $3 per kg	6.0
New tax: departure tax on outbound airline passengers	**3.6**
Improve tax collection	**32.1**
Tax on telecom companies	24.5
fees on vehicles' registration	3.0
sales tax on electricity companies	1.3
sales tax on hotels 2/	1.5
sales tax on consumer water industries 2/	0.3
income tax on employees of hotels and electricity companies	1.5

Sources: Somali authorities; and Fund staff estimates and projections.
1/ Projected yields to be collected in 2017.
2/ Implementation to start in April 2017.

- ***On expenditure policy and reforms***, the authorities are taking steps to enforce stronger fiscal discipline. These efforts include mainly cap on staff numbers set at the 2016 budget levels and a task force led by the Prime Minister to fully review the existing recruitment policies and examine the disparity between parliamentarian and civil service compensation levels. Also, to improve accountability and transparency, line ministries' spending will be aligned with the budget and off-budget grants will be published in an addendum to the budget.

[26] The projection conservatively assumes a revenue-base of the telecommunication sector of $96 million.

Box 3. Somalia: Illustrating Potential Revenue from the Telecoms Sector

Revenue from telecoms could be increased sharply. In the absence of formal taxation, the sector's contribution to the budget amounts to about $5 million in negotiated monthly fees and taxes (about 5.6 percent of 2016 projected tax revenue). At the same time, the sector's total annual revenues could amount to over $220 million according to the authorities (3.5 percent of projected 2016 GDP). Increased revenue generation would require more formal taxation and regulation, but also improved provision of public services to incentivize voluntary payment. For example, telecom companies currently provide their own security to guard their infrastructure.

An expert's report commissioned by the authorities estimated that annual revenue generation could range between $81 and $119 million (see Table).[1] These estimates are based on a population size of 10 million and peer-group comparable rates of penetration and per capita revenues that suggest sector-wide annual revenues of around $220 million. The revenue estimate is based on several taxes and fees, including a corporate tax, payroll-tax, a value-added tax, and fees on licensing and spectrum access. Importantly, several revenue sources are excluded due to the nascent development of the sector and government institutions. These include mobile money service fees (important in Somalia), fees from fixed line and broad-band services, and rent on public land, and taxes on handsets, which could also represent future revenue measures.

Somalia: Potential Revenue from the Telecom Sector, 2014
(Millions of U.S. Dollars)

	Scenarios	
	Low	High
Total market revenue 1/	162	221
Estimated potential revenue	**81**	**119**
Taxes and fees	51	61
Corporation income tax 2/	10	10
Payroll tax 3/	17	17
VAT 4/	24	33
Others	30	58
Licensing & spectrum	20	21
Other /5	10	37

Source: Lange, Peter; "*Telecommunications Contribution to Public Finance in Somalia;*" January 30, 2015.
1/ Assumes a population of 10 million, penetration rates from 22% to 52% and average revenue per user of $2.50 and $8.00 per month.
2/ Assumes pre-tax profit margin of 30% and a corportate income tax rate of 30%.
3/ Assuming total sector employment of 14,000 and an average tax rate of 12%.
4/ Assuming a VAT rate of 15%, the African average.
5/ Customs duties and other fees.

The authorities are targeting to collect about $24.5 million in taxes from the telecom sector, including $12–14 million from corporate profits and the rest from sales taxes. The authorities' new revenue measures are based on an annual telecom sector revenue estimate of $96 million, a sales tax of 15 percent and implementation of the new measures by April 1, 2017. The 2017 Appropriations Bill will endorse the tax code rate for sales tax (15 percent) and income tax (6, 12, and 18 percent). In addition, eventual passage of the Information and Communication Technology Law would also permit additional revenue generation from the licensing of telecom firms and issuance of spectrum, which is currently severely under paid for in Somalia.

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[1] Lange, Peter, "Telecommunications Contribution to Public Finances in Somalia", ICT Regulatory Technical Assistance (January 2015).

18. The authorities recognized that Somalia's fiscal policy framework needs to be strengthened considerably. To address the weak revenue base, volatile grants, and serious shortcoming in public financial management (PFM), they intend to implement a number of reform measures (MEFP, ¶13–15):

- ***Improving revenue administration and mobilization.*** [27] The need to lift the FGS tax level is a high priority. [28] The authorities are planning to introduce a modern system of taxpayer registration, strengthen audit and enforcement, while improving tax compliance. This also includes expanding the tax base, plans to harmonize customs' entry point across the country, as well as Inland Revenue Department and Customs administration.

- ***Improving treasury management***. This is critical for the effectiveness and credibility of the fiscal framework and the authorities will step up efforts to: (1) strengthen the TSA; (2) improve cash management; (3) operationalize the management of commitments and arrears; and (4) complete electronic payments.

- ***Strengthening fiscal federalism*** (Box 4). The authorities agreed to step up their efforts to improve the central-subnational fiscal coordination and achieve state-level consensus on issues related to fiscal federalism. They recognized that the slow progress on fiscal federalism undermines the FGS revenue stream and the country's development process. They concurred that the near-term focus should be on issues related to revenue sharing and harmonizing the FGS and state PFM systems, including revenue policies and expenditure responsibilities.

19. On debt policy, staff stressed the need to continue to refrain from external and domestic borrowing—including from the CBS—while re-establishing relationships with external creditors. In this regard, staff encouraged the authorities to continue strengthening the DMU's capacity while completing the public debt statistics (with TA from the African Development Bank–AfDB). The authorities have reached out to external creditors and reconstituted about two-third of their external debt database. They have also initiated efforts to improve the DMU's management and monitoring capacity (MEFP ¶25).[29]

[27] This includes tax and non-tax administration and customs administration.

[28] The FGS's tax level is among the lowest in the world (about 1.5-1.7 percent of GDP. The bulk of the FGS's tax revenue comes from Mogadishu's seaport (about 74 percent) and airport (12 percent), while corporations and others account for 2 percent and 12 percent, respectively.

[29] The authorities are preparing a request for training of the DMU's staff on debt management and improving their understanding of CPIA, DeMPA, and PEFA ratings.

Box 4. Fiscal Federalism in Somalia: Challenges and Opportunities

Fiscal federalism is a near-term concern for Somalia. It is a viable vehicle for nation building. The scope for fiscal federalism to help reducing poverty and addressing inequality in the distribution of resources is substantial. For example: the heavy dependence on trade taxes puts landlocked states and states without major ports at a disadvantage; less urbanized regions can raise comparatively less revenue from personal and business taxes; and areas more often subject to droughts are damaged by the volatility of trade in livestock, and suffer human losses that could be otherwise avoided. An effective system of fiscal federalism can help to address inter-regional inequity, avoid duplication in government intervention, and improve service delivery.

However, the establishment of a federal system is facing significant challenges.

- ***Political.*** While a successful federal fiscal system in Somalia requires strong political support, the authorities still need to decide on whether the federal system will emphasize the role of the federal government or will give more relevance to local institutions. When the power to tax and spend is assigned to local authorities, actions can be better tailored to local needs, responsiveness and accountability can be strengthened. However, pre-existing differences across states can be difficult to resolve, unless states with more resources voluntarily agree to share them with less well-off states. A centralized federal system may be more efficient, and more effective in countries where capacity is low. If a well-designed transfer mechanism is in place, a centralized solution can also reduce inter-regional inequality through fiscal transfers.

- ***Economic.*** At present, the low tax base reflects the geography of the country, with each state collecting taxes within its geographic boundaries. Absent an overarching legal architecture, individual states have assumed full revenues as well as expenditures powers. And administrative systems and practices are at different stages of development, reflecting in part the security situation. The balkanization of the fiscal system represents a concrete risk, with harmful consequences such as heightening competition in revenues collection (e.g. from the ports); increasing domestic trade barriers; and eroding the premises of goodwill and trust upon which a successful federal system is built.

The authorities need to move swiftly to establish a federal system. It is critical that agreements on the allocation of spending responsibilities, and the revenues authority between FGS and state governments are reached, as the state formation process progresses. The authorities should improve the central-subnational fiscal coordination. More specifically, this will include the development of the reporting framework between the central and subnational governments and the formalization and operationalization of the central-subnational dialogue on expenditure assignments and transfer options.

B. Strengthening Capacity at the Central Bank to Support Stability

The authorities and staff recognized that while currency reform is among the highest priorities for Somalia, rebuilding the capacity at the CBS and reviving the financial sector are equally critical.

Background

20. The authorities have recently reached a number of milestones in reform implementation (MEFP ¶7–8 and Box 1), particularly in the areas of: (1) CBS safeguards and governance; (2) currency reform; and (3) the financial sector. However, the near-term challenges ahead are daunting and include:

- ***CBS safeguards and governance.*** On August 17, 2016, some high- and mid-level staff at the CBS substituted $530,000 with counterfeit currencies (about 5 percent of the total CBS cash in the vault).[30] Following the incident, the authorities tightened their internal procedures. They adopted a number of measures, including removing the Director of Operations and two clerks from the cash operation department, appointing a new Director of Operations, tightening the vault operations procedure, and introducing a new layer of supervision at all times. The CBS continues to take measures to improve its financial reporting and accounting practice.

- ***Currency reform.*** Preparations are proceeding steadily with tangible steps already taken. In particular, a fully-staffed cash management department has been reconstituted; a draft anti-counterfeit strategy has been prepared, and the Board of Directors attended a seminar regarding currency reform in May 2016.

- ***Financial sector.*** The nascent financial sector is slowly being transformed (¶8) and important reforms have been implemented in the past two years (Box 1). However, significant challenges remain to reviving the financial sector, improving access to credit, and safeguarding the remittances inflows to Somalia. The authorities agreed with staff that the near-term key bottlenecks to financial development in Somalia include: (1) the absence of financial sector laws, including outdated contract and property laws; (2) a poor payment system and clearance house, and the absence of inter-banking system; (3) absence of a credit bureau and consumer protection laws; and (4) the absence of basic consistent CBS and commercial banks accounting and reporting, despite recent effort to improve financial reporting.

[30] This incident does not affect the Net Foreign Assets definition under the SMP (which excludes CBS cash in vault denominated in foreign currency). The authorities have also indicated that the incident will not bear any fiscal cost and will be reflected in the CBS financial statement as a capital loss. The CBS work with Somalia's national security agencies and the criminal investigation on this issue is still ongoing.

Policy discussions

21. Staff welcome the progress made in reform implementation while noting that the near-term challenges remain significant (MEFP ¶16). The near-term focus will be on:

- ***CBS safeguards and governance***. To avoid a repeat of the theft incident in August, the authorities are accelerating the improvement of the CBS governance, transparency, and organizational guidelines. These efforts include internal auditing, risk management, compliance, and oversight. The authorities intend to build on recent achievements and to address the near-term reform agenda on CBS governance and accounting.[31] A particular focus will be on establishing an Executive Committee and an Audit Committee.[32]

- ***Currency reform***. The authorities reaffirmed that credible and successful implementation of the currency reform hinges on careful preparation and planning. They outlined and discussed with staff a roadmap for the currency reform focusing on: (1) finalizing the counterfeit strategy; (2) deciding on the scope of exchange and conversion factors; (3) properly phasing in the legal framework; and (4) initiating the preparatory work for storage, distribution, and collection (including exploring alternative distribution channels, while closely considering the geographical distribution of the Somali people). The authorities stressed that for successful completion of the currency reform, adequate donor financing would be needed. Staff indicated that the IMF stands ready to continue providing the needed TA to ensure a successful launch of the new currency. The authorities agreed with staff that in near future, the CBS will need to decide on key macro-critical aspects, including: (1) the exchange rate regime to be adopted; (2) develop reserve management strategy; and (3) develop some monetary policy instruments.

- ***Financial sector reform***. The authorities are determined to swiftly improve CBS and commercial bank accounting and reporting standards in line with the provision of international financial reporting standards (IFRS), while strengthening its oversight position to arrive at full banking legislation, regulation, and supervisory rules for licensed institutions (banking and non-banking), including enforcement capacity. In addition, they are contemplating the preparation of a roadmap to revive an inclusive financial sector by the end of April 2017.

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[31] Staff indicated that the IMF stands ready to provide support as needed, including by sharing international experience and TA.

[32] The World Bank is providing support for the competitive hiring of skilled bankers, including work on pensions and severance packages.

C. Enhancing Inclusive Growth Amid Challenging Security Situation

The authorities welcomed the focus on: (1) the revision of the NDP; (2) the impact of correspondent banking relationship (CBR) withdrawals and remittances; (3) how to absorb the return of Somali refugees from Kenya; and (4) ways to improve financial sector development and access to credit and to ensure the flow of remittances through MTBs.

Background

22. Fostering inclusive growth will require bolder action in priority areas. The key near-term actions in this area include:

- ***NDP and inclusive growth***. In addition to the institutional and macroeconomic policies, it was agreed that, at current stage of development in Somalia, the NDP will underpin the FGS development strategy by laying out the foundations for sustained and inclusive growth and poverty reduction. The NDP will be critical for understanding the FGS development strategy and garnering development partners' support.[33] However, the authorities agreed with staff that the current draft has a number of shortcomings (MEFP ¶16 and Box 5), including: (1) sectoral consistency; (2) prioritization of development needs; (3) mapping of costing and financing; (4) a coherent safety net program; (5) a capacity development program; and (6) a financial sector development roadmap.

- ***Return of Somali refugees***. This is adding another challenge with significant humanitarian consequences. Somalia is also dealing with more than 1.1 million internally-displaced people (due to persistent insecurity and drought), as well as large numbers of refugees, mainly from Yemen. Additionally, the planned closure of the largest Somali refugee camp in Kenya (currently home to about 425,000 people) in May 2017 (as announced by the Kenyan authorities) will be even more challenging for the FGS (Box 6).[34]

- ***CBR withdrawals and remittances*** (Box 7). Remittances amounted to about 23 percent of GDP (average, 2013–15) and were, for the most part, received by about 40 percent of the Somali population. The MTBs, which represent more than 45 percent of all financial sector assets, channel inflows of remittances to the wider population. Although data are limited, anecdotal evidence suggests that the withdrawal of Somalia's CBR could significantly disrupt

[33] The international community is preparing to provide strong support to Somalia through the NDP. In this context, with the collaboration of the World Bank and the FGS, the UN agencies have developed a number of Joint programs to support key institutions, and social and economic sectors under the UN Multi-Partner Trust Fund for Somalia.

[34] The repatriation could increase the number of skilled workers and small business entrepreneurs, thereby boosting the fishing, farming, and livestock sectors.

the country's formal remittance inflows,[35] as well as the balance sheets of MTBs. While no data were available, staff were informed that the cost of transferring funds to Somalia has increased.

Box 5. National Development Plan, 2017–19

The authorities are finalizing a draft three-year National Development Plan (NDP). The NDP will replace the New Deal Compact which has served as the road map for peace and state building activities, and will serve as the new vehicle for boosting growth and reducing poverty for the period of 2017–19.

The draft NDP covers several important areas. The NDP focuses on poverty reduction with the aim to comply with the interim Poverty Reduction Strategy Paper and make progress toward the Sustainable Development Goals (SDGs). It will also help enhance social cohesion and provide steps toward stronger federalism. It provides a comprehensive diagnose of the Somalia economic and social conditions and its broad objectives are well identified. In particular, the NDP intends to: (1) consolidate peace, security, and rule of law; (2) build institutions; (3) lay the groundwork for the foundation for rapid, inclusive and sustainable growth; and (4) restore and protect Somalia's strategic infrastructure–transport, water, energy and sanitation.

However, there are a number of challenges ahead of finalizing the NDP:

- **On policy and strategy:** (1) the vision and mission should be clearly stated to avoid clashing priorities among member states; (2) modalities of fiscal federalism still under discussion, the development needs of different states are still unclear; (3) ensure that the medium-term strategy is consistent with sectoral strategies; and, (4) ensure that the preparatory work is inclusive.

- **On financing:** The draft NDP lacks discussions on costing and sources of funding and the need to mobilize more tax revenue to support development and reduce heavy reliance on external grants.

Stronger policy support for the NDP will be critical. The momentum for the finalization of the NDP should be maintained. The FGS is encouraged to increase consultation and engage in political buy-in for its development agenda. Efforts should be made toward building a peer review structure and generating international community support to ensure that the process is consistent with addressing poverty and the wider promotion of SDGs. The NDP should therefore target economic growth through mobilizing traditionally productive sectors and enhancing the private sector, while increasing the country's fiscal capacity. With the weakness in data sources in Somalia, it will be important to set appropriate procedures to ensure assessment and monitoring of the NDP.

[35] Anecdotal evidence suggests that the CBR withdrawal is constraining financial inflows to NGOs operating in Somalia. In particular, regulatory pressure on some U.S. and U.K banks has led to termination of some CBRs with MTBs.

Box 6. Closure of Somali Refugees Camp in Kenya—Some Economic Implications

The Kenyan authorities recently announced the planned closure of the Dabab camp, the country's largest Somali refugee camp. The closure of the camp which was initially announced for November 2016, has now been delayed to May of 2017. The delay does not affect the agreement by a tripartite commission comprising the UNHCR, the governments of Kenya, and FGS to carry out the voluntary repatriation of some 425,000 Somali refugees over a five-year period. Under this agreement Somali asylum seeker will no longer automatically be granted refugee status.

The closure of the Dabab camp will significantly affect the Somali economy:

- A number of non-government organizations raised concerns over downside risks, including an increased risk to security, as well as potential increases in unemployment and poverty. In particular, a number of returnees could be targeted as potential recruits by the militant jihadist group, Al-Shabaab, if the repatriation process is not carefully considered and executed. The returning population will put pressure on already scarce social services such as health, water, and education. Other risks associated with the returnees include a possible worsening conditions of the internally displaced population which will exacerbate the humanitarian needs.

- Some anecdotal views suggest that there are some advantages related to the returning refugees, specifically a potential boost in human capital. This includes the new skills that many of the returnees have acquired, as some were born and trained in Kenyan schools. The increasing number of newcomers will contribute to Somalia's economic activity through self-employment, as some refugees ran small businesses inside their camps. With some of the refugees hailing from productive areas of Somalia, their return could spark the revival of the fishing and farming sectors. Those who have been historically nomadic, meanwhile, will be able to integrate back to their nomadic societies, helping to boost the livestock sector which is vital to Somalia's economy.

To address the refugees challenges ahead, greater coordination and stronger support will be needed. The Somali National Task Force on Repatriation estimated the Somali refugees' repatriation cost at $200 million. Without the support of international donors, a sustainable and durable solution to this refugee crisis which could require some contingent fiscal costs for the FGS will not be manageable. The Somali government will need to strategically plan for the resettlement of refugees and displaced populations and to address this issue in its NDP. In order to embark on these actions, greater coordination with donors and stronger political support will be needed from all regional administrations to face the resettlement obligation in an unified manner.

Policy discussions

23. The authorities intend to revise the NDP to address a number of weaknesses in the current version and continue to respond to the CBRs (MEFP ¶16 and Boxes 5, 6, and 7).

- ***NDP and inclusive growth***. The authorities plan to revise the NDP and address identified weaknesses. In this context, they welcomed IMF support which will focus on: (1) the medium-term macroeconomic framework; (2) sectoral consistencies; (3) the costing and financing options of the NDP; and (4) institution and capacity development. They stressed that increasing attention will be paid to enhancing economic activity by: (1) strengthening financial sector reforms, including MTBs; (2) revising the NDP; and (3) improving the business environment to unlock private sector activities.

- ***Refugees.*** To mitigate the risks associated with the repatriation of refugees, including related humanitarian and contingent fiscal costs,[36] the FGS has improved collaboration with donors and Somali states and regions, while designing a voluntary repatriation program which will be in the revised NDP. They are cognizant that political consensus and donor support will be critical for successfully returning this group of refugees in an orderly manner.

- ***CBR.*** The authorities stepped up efforts to improve access to the international financial system. In this context, while customer due diligence and third-party auditing of MTBs are appropriate, the authorities acknowledged the need to strengthen the CFT legal framework in line with the FATF standard and ensure that Somali financial institutions (including MTBs) adhere to and effectively implement the AML/CFT law and guidelines.[37] In addition, they agreed that stronger collaboration between the FGS and the private sector, as well as international partners, would be critical.

[36] Given the size and forms of support from donors, the FGS' main short-term concern is more humanitarian than fiscal costs.

[37] The Somali Ministry of Internal Security is drafting new CFT legislation. The FGS is also developing additional CFT procedures and guidelines with the support of the IMF and the U.S. Treasury Department TA.

Box 7. Remittances and Money Transfer Businesses

The remittances of the Somali diaspora are large and significant. Official remittances from the Somali diaspora are estimated to be about $1.4 billion dollars per year (average, 2013–15) and could be even higher**.** This represents about 23 percent of the country's GDP and is the major funding source for both households and businesses. About 40 percent of Somalis rely on remittances for their daily needs. Remittances also play a key role in the financing of Somalia's trade deficits.

The absence of a functioning central bank has prompted remittance companies to work with little or no supervision from the authorities. The culture of non-regulation has made international banks handling transactions from Money Transfer Businesses (MTBs) uncomfortable due to risks and strong requirements by their governments to tighten regulations. Over the past two years, banks in Australia, the United Kingdom, and the United States have closed the accounts of some Somali remittance companies, citing legal and regulatory weaknesses, as well as risks of money laundering with possible financing of terrorism.

Additionally, the lack of a proper regulatory framework could increase risks to money transfers to Somalia. The inability to transfer money through the commercial banks will affect the transparency of such operations from one country to another with increasing risks of MTBs resorting to other underground systems. One of the major impacts of international banks suspending services to MTBs was the inability of individual account holders and aid agencies to send money, which reduced incomes in recipient households. According to some of the MTBs surveyed as part of an Oxfam report in the United States, this new regime of regulatory caution has led to reduced volume, a rising cost of transfers, and increased informality among the Somali remittances market. While no clear data provided by MTBs, fees and costs of transferring money have increased, as has physical transfer of cash remittances.

Efforts are underway to improve the regulatory environment. An important step was achieved when the Somali parliament approved the AML/CFT law on December 26, 2015. Implementation of the new law should help in limiting the threat of CBR withdrawal and closure of the accounts of Somali remittance companies by global banks. In addition, customer due diligence will be improved by recent efforts to involve a 'trusted third party agent' with the assistance of the World Bank working with the CBS to monitor transaction flows and provide independent third party audits of MTBs. The authorities are also in the process of introducing new CFT legislation in line with the Financial Action Task Force (FATF) standards.

Policies to ensure a sustained inflows of remittances will be critical. A strong collaboration between the authorities and private sector—as well as with international partners in working toward more transparency, supervision, and regulation—will safeguard an uninterrupted flow of remittances, while restoring relationships with international banks that work with Somali MTBs. Fundamentally, the authorities need to continue to improve regulation and supervision of the financial system, which, as it develops, will also improve transparency.

D. Keeping the Momentum in Capacity Building and Governance

Background

24. The Somali authorities' efforts to restore key economic and financial institutions are proceeding well. Capacity development activity has intensified in the past two years (Table 7 and Box 1). Somalia is among the largest beneficiaries of IMF TA which is funded from a multi-donor trust fund. The Somali authorities, however, noted that the needs for TA remain large and addressing them will be essential for a successful SMP. They indicated that an increase in the Fund's TA to Somalia, in coordination with other TA providers, will significantly improve capacity, empower local staff, and strengthen program monitoring.

25. The authorities recognized that governance is critical for institution building. In early 2014, they established the Financial Governance Committee (FGC) to advise the President of Somali on progress on PFM action plan including on public contracts, concessions, and procurement; and government assets recovery, as well as reforms at the CBS, and, recently, the monitoring of performance under the SMP.[38] In addition, at more regional and sectoral levels, donors are supporting the "Strengthening Somali Governance" (SSG) project that focuses on three objectives: (1) improve the legislative, oversight, and representational functions of Somalia's deliberative bodies; (2) improve the ability of targeted government institutions to carry out essential functions; and (3) increase citizen awareness of and engagement in government decision-making.

Policy discussions

26. The authorities and staff agreed that TA delivery should be intensified.

- ***Authorities' views.*** They recognized that TA delivery is helping to address weak capacity constraints, while supporting policymaking in Somalia (MEFP ¶20–22).[39] However, to withstand the near-term development challenges ahead, they have requested new TA (Table 8).

- ***Staff comments.*** Staff indicated that the Fund TA will continue to be aligned with Somalia's absorptive capacity, the authorities' program priorities, and the SMP's objectives, Staff argued that better coordination among the different TA providers to Somalia is needed, including a more concerted demand-approach to improve the effectiveness of TA delivery. In particular, drawing lessons from past experience and good practice, staff indicated that plans

[38] The FGC consists of senior national officials and international experts (including from IMF and the World Bank) and is chaired by the Minister of Finance.

[39] On PFM, the authorities have ensured that they will follow through the PFM TA guiding prioritization outlined in "Developing a PFM Reform Action Plan, 2016–2020" and endorsed by the FGS.

should be developed for each area of TA delivery and priorities should be identified and well sequenced over time, in collaboration with the IMF.

27. The authorities are determined to improving governance and institutions (MEFP ¶17–19). They are planning to reorganize the MoF, Ministry of Planning and International Cooperation (MoPIC), and CBS, and strengthen key legislative and regulatory frameworks. This will include reorganizing and re-enforcing key economic units (e.g., the recently established domestic arrears management committee, national statistics, and debt management unit) and departments (e.g., Customs, Inland Revenue, and the Treasury departments). In this regard, with the passage of the 2017 Appropriation Bill which will endorse the tax code rate for income and sales taxes, the authorities intend to introduce a more transparent regulation at the telecommunication sector. The FGC will also continue to review large procurements and concessions. Following the approval of the SMP, the authorities established the SMP Monitoring Committee in July 2016 which has since produced monthly reports on progress under the program. Also progress at the CBS is underway (¶20–21). Efforts to improve governance will include the establishment of the anti-corruption commission. The authorities also intend to keep up progress recorded under the SSG, including the monthly monitoring meeting.

OTHER SURVEILLANCE ISSUES

28. Somalia no longer maintains restrictions under Art. XIV, and the exchange restrictions and multiple currency practices identified at the time of the 1989 Article IV consultation are no longer in effect. Staff encouraged the authorities to consider at some point initiating the necessary steps for the country to accept its obligations under Article VIII. The authorities and staff discussed the current exchange system and regulation (see Informational Annex). Staff noted that, due to the absence of administrative measures controlling the level of the exchange rate and the inoperative status of the CBS in the foreign exchange market, the de facto exchange rate arrangement is classified as a free-floating arrangement. While the Somali Shilling is the official currency, the de facto currency in use in Somalia is the U.S. dollar. Most transactions are settled in U.S. dollars and shillings are used for small payments (¶7). Residents exchange U.S. dollars and shillings at a freely determined market exchange rate.[40] Also, neighboring countries' currencies are used in border areas. Mobile phone payments, with transactions denominated in U.S. dollars, are also widely used.

29. Progress on producing FGS statistics has been slow and data provided to the Fund have significant shortcomings that hamper surveillance (see Annex I–Informational Annex), particularly on monetary, national account, price statistics, and balance of payments data.

- ***Monetary data.*** The CBS balance sheet is incomplete and the commercial banks' consolidated balance sheet is not yet available. IMF TA has intensified to improve the CBS data reporting since the 2015 Article IV Consultation. Recent progress has included the use

[40] The CBS also sets its own rate for accounting purpose but no transactions occur at that rate.

of U.S. currency for accounting purposes (instead of SOS) and timely reporting of CBS financial statements (both balance sheets and income statements using QuickBooks). However, despite improvements in timeliness and reporting, there are a number of shortcomings stemming from weak data sources, insufficient coverage, and capacity constraints. Finally, the CBS financial statements have yet to comply with the IFRS.

- ***National accounts, price statistics, and balance of payments***.[41] Progress since the last Article IV consultation has been very slow. A number of factors have limited IMF TA delivery to improve the national account and price statistics since the last Article IV consultation, including the long-standing new statistical law which has yet to be adopted by the parliament, and delays in the production of a high frequency survey by the World Bank, which only reached completion in September 2016.

- ***Authorities' views.*** The authorities are aware of the low quality data and pledged that, with the intensification of TA delivery, data provision will continue to improve under the SMP. They also explained that the delay in the passage of the new statistical law was due to circumstances related to the country's presidential elections.

STAFF APPRAISAL

30. Over the past five years, Somalia has taken important steps toward normalizing relations with the international financial institutions. Despite these efforts, Somalia's external debt is high and virtually all in arrears, thus precluding the country's access to external borrowing. Somalia is also in arrears to the Fund and is therefore not eligible for financial support from the Fund.

31. Since the approval of the SMP in May 2016, the authorities have remained committed to keeping the program on track. Staff welcome the significant progress made by the FGS in implementing policy reforms recommended under the SMP and at the time of the 2015 Article IV Consultation.

32. Notwithstanding the commendable progress made thus far, there are risks to the program. The authorities and staff agreed that the risks identified—including security, weaker fiscal position including low revenue collection, weak capacity, drought, and slow progress on policy and reform implementation—could challenge the program implementation. However, a stronger commitment to the program, and sustained and coordinated international support—including with regards to security, peace, and capacity building—would help mitigate these risks.

[41] Rudimentary current account data and lack of effective exchange rate data prevent a meaningful external stability assessment.

33. Improving fiscal management will be critical. To improve the credibility of fiscal policy, greater fiscal discipline and enhancing budget execution will be critical. This will require adhering to agreed measures to avoid arrears and limit delayed expenditure payments, while keeping expenditures in check. In this context, staff welcome the effort to move toward the development of a commitment control system and improve the TSA system. Staff also commend the authorities' resolve to improve revenue forecasting and prepare a realistic budgeting of grants.

34. Step up efforts to mobilize tax revenue. There is significant potential to raise tax revenue, notwithstanding the security uncertainties and poor governance. Over the medium term, higher revenue collection will provide buffers against the volatility of budgetary grants, as well as support the country's development needs. Staff welcome the authorities' plan to introduce new tax measures in 2017. In this context, the passage of the 2017 Appropriation Bill to endorse the tax code will be critical.

35. Swift resolutions to address critical challenges at the CBS and the financial sector will be essential. These include:

- ***Currency reform***. It is a high priority to limit the widespread prevalence of counterfeiting, while restoring the credibility of the national currency. Credible and successful implementation of the currency reform hinge on careful preparation and planning. In this regard, it is important that the authorities follow through on the currency reform roadmap agreed on with staff.

- ***CBS safeguards and governance***. The authorities' responses to avoid repeated theft incidents and their resolve to accelerate the improvement of the CBS governance, transparency, and organization are welcome. In this context, steadfast steps toward establishing an Executive Committee and an Audit Committee would be essential.

- ***Financial sector***. Reviving the nascent financial sector of Somalia will support inclusion and economic growth. Staff welcome the authorities' plan to prepare a roadmap to overhaul the financial sector and improve the CBS and commercial bank accounting and reporting standards.

36. Improving access to the international financial system will be critical. Bringing the AML/CFT law in line with the FATF standards and ensuring an effective risk-based implementation will be essential for securing access to the international financial system, while safeguarding the flow of remittances into Somalia. In this context, staff stress the importance of stronger collaboration between the FGS and the private sector, as well as international partners.

37. The authorities' plan to revise the NDP is welcome. It will highlight the FGS policy intention for inclusive growth and social justice, and build confidence and reinforce donors' support. The NDP will become the FGS' key development policy tool.

38. Somali refugees' issues are adding to the country's many challenges. Staff welcome the FGS strategy to strengthen collaboration with donors and Somali federal member states, while designing a voluntary repatriation program to mitigate the risks and humanitarian consequences. In this context, the FGS should continue to seek political consensus and donor support for the successful return of refugees and the orderly resettlement of those who have become displaced.

39. Steadfast effort to rebuild key institutions and governance is required. The authorities are urged to swiftly adopt the long-delayed statistical law. Reforms to build economic and financial data to guide policies will continue to be tailored to institutions and capacity development. In this context, the role of the FGC will be essential and progress in institution building, governance, and organization at the Ministry of Finance and the CBS need to be accelerated.

40. Data provision has significant shortcomings. The database remains weak, particularly in the areas of national account, price, balance of payment, monetary, and social statistics. While data provision will continue to improve and TA delivery will intensify under the SMP, the authorities' sustained efforts to upgrade institutional capacity and legal framework will be instrumental to filling the data gap.

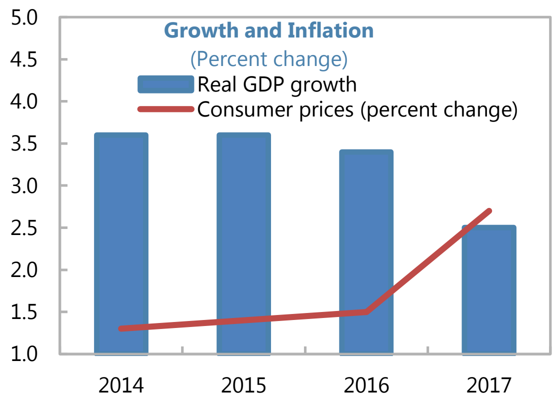
41. Staff support the completion of the first review of the SMP. In light of the broadly satisfactory program implementation so far, remedial measures to address the missed target, and the authorities' strong commitment toward policy implementation under the SMP, staff support the completion of the first review of the SMP. Staff also support the corrective measures to avoid new arrears in the future and recommend the proposed two SBs to help improve tax collection and strengthen the currency reform process.

42. Staff will continue to support Somalia through policy advice and technical assistance, particularly in the context of the SMP. This, and subsequent SMPs, are designed to build a track record of policy and reform implementation, achieve debt relief, and allow Somalia to graduate to the IMF Upper Credit Tranche facility. Staff recognize that this process will require a concerted effort and continued policy commitments on policy and reform implementation, along with the continued support of donors.

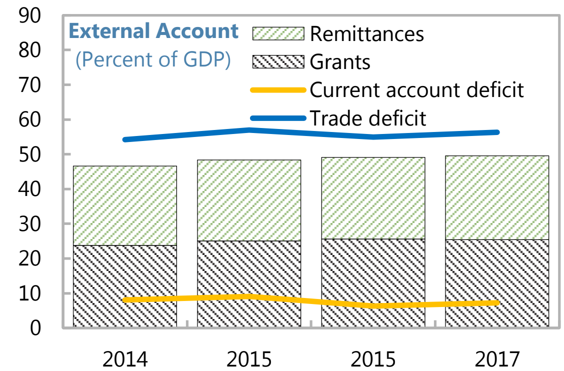
43. It is proposed that the next Article IV Consultation with Somalia be held on the standard 12-month consultation cycle.

Figure 1. Somalia: Economic Developments, 2013–17

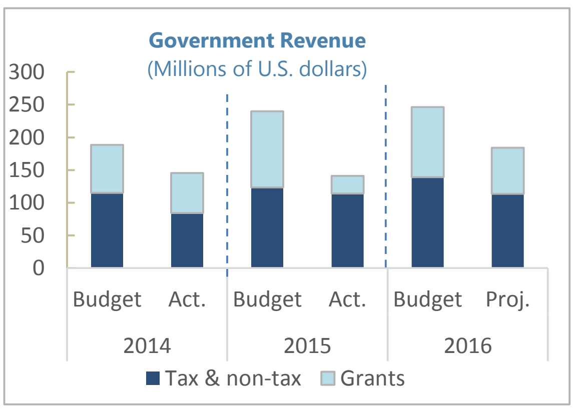
Due largely to drought, growth is expected to decline and inflation to notch up in 2016–17.



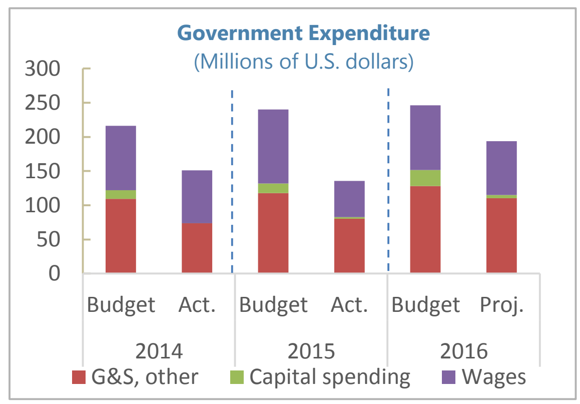
Ample remittances and grants finance a large trade deficit and limit the size of the current account deficit.



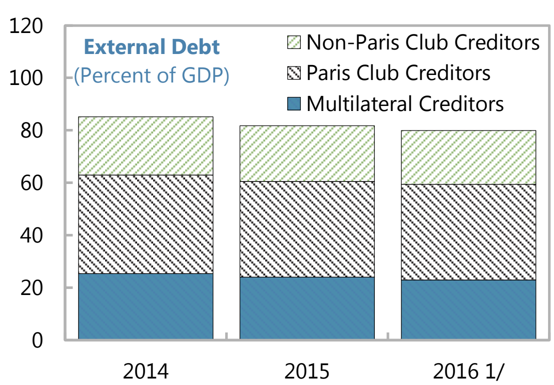
With small tax base, government relies heavily on grants, which are volatile…



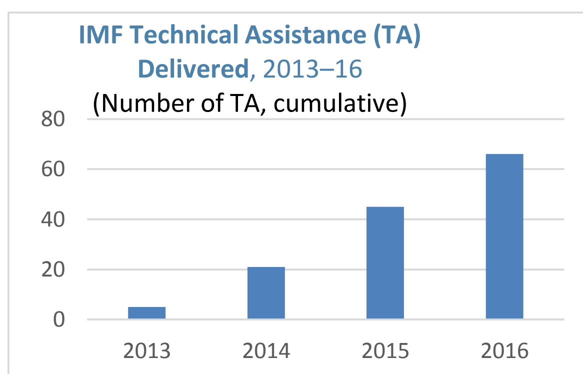
…making budget execution and priority spending difficult.



Somalia external public debt remains large and virtually all in arrears.



The IMF has continued to intensify TA support to Somalia since 2013 and the country is among largest beneficiaries of TA.



Sources: Somali authorities; and IMF staff estimates.
1/The above are based on rudimentary data and subject to changes.

Table 1. Somalia: Selected Economic and Financial Indicators, 2013–19
(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: Livestock)

		Est.			Proj.		
	2013	2014	2015	2016	2017	2018	2019
National income and prices							
Nominal GDP in millions of U.S. dollars	5,723	5,950	6,111	6,336	6,548	6,833	7,084
Real GDP, annual percentage change	2.8	3.6	3.6	3.4	2.5	3.5	3.5
Per capita GDP in U.S. dollars	429	436	436	442	445	453	458
Consumer prices (e.o.p., percent change)	4.5	1.3	1.4	1.5	2.7	1.9	1.9
			(Percent of GDP)				
Central government finances 1/							
Revenue and grants, *of which:*	1.9	2.5	2.3	3.0	3.8	4.3	4.7
Grants 2/	0.7	1.0	0.4	1.1	1.5	1.6	1.7
Expenditure, *of which:*	2.1	2.5	2.2	3.0	3.8	3.9	4.0
Wages and salaries	0.9	1.3	0.9	1.2	1.9	1.9	2.0
Capital expenditures	0.0	0.0	0.0	0.1	0.1	0.3	0.3
Overall balance 3/	-0.1	0.0	0.1	0.0	0.0	0.3	0.7
Stock of domestic arrears	0.5	0.8	1.1	0.6	0.6	0.4	0.3
			(Millions of U.S. Dollars)				
Central bank assets							
Total assets, *of which* :	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	...	...		
Domestice assets	20.8	20.6	22.0	...	...		
FGS, cash deposits	5.4	4.5	11.4	...	...		
			(Percent of GDP)				
Balance of payments							
Current account balance	-5.7	-8.1	-9.1	-6.4	-7.2	-8.7	-9.4
Trade balance	-48.9	-54.2	-57.0	-55.0	-56.3	-56.9	-57.6
Exports of goods and services	17.5	18.0	20.7	20.7	21.0	21.1	21.2
Imports of goods and services	66.3	72.2	77.7	75.6	77.3	78.0	78.8
Remittances	22.7	22.9	23.3	23.5	24.2	24.4	24.9
Grants	21.0	23.8	25.1	25.6	25.4	24.2	23.8
Foreign Direct Investment	4.5	4.8	5.0	5.4	5.7	6.0	6.2
Overall balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt 4/	89.3	85.1	81.8	79.9	...	...	...
Market exchange rate (SOS/USD, e.o.p.) 5/	20,600	20,265	22,286	23,030	...	...	...

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/ Including spending covered by recovered assets.
4/ The figure for 2016 is based on information through end-October 2016.
5/ The figure for 2016 is based on information through September 2016.

Table 2a. Somalia: Federal Government Operations, 2014–19 1/
(Millions of U.S. Dollars)

	2014	2015	2016						2017	2018	2019
			Initial	June		Sept.		Dec.			
	Est.	Prel.	Prog.	Prog.	Prel.	Prog.	Prel.	Proj.	Proj.	Proj.	Proj.
			(Cumulative from the start of the year)								
Revenue and grants	151.1	141.2	246.3	123.2	89.9	184.7	124.3	190.2	250.9	291.4	332.8
Revenue	84.3	114.3	125.3	62.6	58.2	93.9	84.9	119.7	155.4	178.8	212.8
Tax revenue	73.8	82.4	93.8	46.9	45.5	70.4	67.3	89.0	127.7	144.1	170.7
Tax on income, profit and capital gains	1.1	1.9	5.1	2.6	1.3	3.8	1.8	3.3	5.2	7.5	12.0
Taxes on goods and services	8.5	9.3	13.0	6.5	5.2	9.7	8.2	10.3	38.2	41.1	51.8
Trade taxes	64.3	71.1	75.7	37.9	39.0	56.8	57.2	75.4	84.3	95.5	106.9
Non-tax revenue	16.3	31.9	31.5	15.7	12.7	23.6	17.7	30.7	27.7	34.7	42.1
of which: Exceptional revenue 2/	5.8	0.0	0.0	0.0	0.4	0.0	1.0	6.0	1.9	0.0	0.0
Grants 3/	61.0	26.9	121.0	60.5	31.6	90.8	39.4	70.5	95.5	112.5	120.1
Bilateral	59.0	2.8	44.0	22.0	23.3	33.0	25.3	35.3	18.4	29.8	31.7
Multilateral	1.9	24.1	77.0	38.5	8.4	57.8	14.1	35.2	77.1	82.8	88.3
Total expenditure	151.1	135.4	246.3	123.2	89.6	184.7	124.1	190.2	250.9	268.1	286.0
Current	150.9	133.1	223.2	111.6	86.3	167.4	119.8	185.6	241.3	247.8	263.6
Wages and salaries 4/	77.2	52.9	94.9	47.5	22.3	71.2	34.7	79.0	121.8	130.8	139.5
Goods and services	57.6	53.0	77.6	38.8	30.0	58.2	45.6	64.6	64.4	79.1	84.4
Transfers to sub-national government	10.1	13.8	16.2	8.1	4.4	12.2	6.5	9.0	21.2	27.8	29.6
Contingency	3.8	2.6	2.4	1.2	1.0	1.8	1.6	1.6	2.1	2.1	2.1
Arrears and delayed payments	2.2	10.8	32.0	16.0	28.5	24.0	31.4	31.4	31.8	8.0	8.0
Capital	0.2	2.3	23.1	11.6	3.3	17.4	4.2	4.6	9.6	20.3	22.4
Overall fiscal balance	0.0	5.8	0.0	0.0	0.3	0.0	0.2	0.0	0.0	23.3	46.8
Memorandum items											
Accumulation of domestic arrears 5/	17.1	33.1	0.0	0.0	0.0	0.0	10.0	0.0	0.0	0.0	0.0
Arrears and delayed payments 5/	2.2	10.8	32.0	16.0	28.5	24.0	31.4	31.4	31.8	8.0	8.0
of which: arrears	2.2	10.8	32.0	16.0	28.5	24.0	31.4	31.4	0.0	8.0	8.0
Stock of domestic arrears (end of year) 5/	45.3	67.7	35.6	51.6	39.1	43.6	46.3	36.3	36.3	28.3	20.3

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

1/ The fiscal operations are recorded on cash basis.

2/ Includes drawdown of cash balances and liquidation of recovered government assets.

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

4/Figure for 2017 includes: (1) salary payments for 12 months; (2) food allowances for security ($6 million)–previously in goods and services; and (3) salaries for new senate members ($4 million).

5/ Estimated arrears. The figure for September 2016 includes only wages, salaries and allowances.

Table 2b. Somalia: Federal Government Operations, 2014–19 1/

(Percent of GDP)

	2014	2015	2016		2017	2018	2019
			Initial	Rev.			
	Est.	Prel.	prog.	Proj.	Proj.	Proj.	Proj.
Revenue and grants	2.5	2.3	3.9	3.0	3.8	4.3	4.7
Revenue	1.5	1.9	2.0	1.9	2.4	2.6	3.0
Tax revenue	1.2	1.3	1.5	1.4	2.0	2.1	2.4
Tax on income, profit and capital gains	0.0	0.0	0.1	0.1	0.1	0.1	0.2
Taxes on goods and services	0.1	0.2	0.2	0.2	0.6	0.6	0.7
Trade taxes	1.1	1.2	1.2	1.2	1.3	1.4	1.5
Non-tax revenue	0.3	0.5	0.5	0.6	0.5	0.5	0.6
of which: Exceptional revenue 2/	0.1	0.0	0.0	0.1	0.0	0.0	0.0
Grants 3/	1.0	0.4	1.9	1.1	1.5	1.6	1.7
Bilateral	1.0	0.0	0.7	0.6	0.3	0.4	0.4
Multilateral	0.0	0.4	1.2	0.6	1.2	1.2	1.2
Total expenditure	2.5	2.2	3.9	3.0	3.8	3.9	4.0
Current	2.5	2.2	3.5	2.9	3.7	3.6	3.7
Wages and salaries 4/	1.3	0.9	1.5	1.2	1.9	1.9	2.0
Goods and services	1.0	0.9	1.2	1.0	1.0	1.2	1.2
Transfers to sub-national government	0.2	0.2	0.3	0.1	0.3	0.4	0.4
Contingency	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Arrears and delayed payments	0.0	0.2	0.5	0.5	0.5	0.1	0.1
Capital	0.0	0.0	0.4	0.1	0.1	0.3	0.3
Overall balance	0.0	0.1	0.0	0.0	0.0	0.3	0.7
Memorandum items							
Accumulation of domestic arrears 5/	0.3	0.5	0.0	0.0	0.0	0.0	0.0
Arrears and delayed payments 5/	0.0	0.2	0.5	0.5	0.5	0.1	0.1
of which: arrears	0.0	0.2	0.5	0.5	0.0	0.1	0.1
Stock of domestic arrears (end of year) 5/	0.8	1.1	0.6	0.6	0.6	0.4	0.3

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

1/ The fiscal operations are recorded on cash basis.

2/ Includes drawdown of cash balances and liquidation of recovered government assets.

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

4/ Figure for 2017 includes: (1) salary payments for 12 months; (2) food allowances for security ($6 million)–previously in goods and services; and (3) salaries for new senate members ($4 million).

5/ Estimated arrears. The figure for September 2016 includes only wages, salaries and allowances.

Table 3. Somalia: Summary Accounts of the Central Bank, 2013–16 1/

(Thousands of U.S. Dollars)

	2013	2014	2015				2016		
	Dec.	Dec.	March	June	Sept.	Dec.	March	June	Sept.
	Act.	Act.	Est.	Est.	Est.	Est.	Prel.	Prel.	Prel.
Assets	**86,980**	**83,834**	**84,064**	**82,384**	**87,472**	**90,636**	**94,426**	**88,401**	**86,838**
Foreign assets	66,213	63,199	62,998	61,238	66,203	68,639	71,939	66,605	64,867
SDRs	28,228	26,557	25,286	25,779	25,731	25,398	25,767	25,516	25,515
Gold 2/	19,540	19,551	19,240	19,090	18,133	17,249	17,250	17,250	17,250
Foreign exchange 3/	11,425	10,897	10,897	10,897	10,897	12,695	13,826	13,327	12,321
Cash and and cash equivalent (US$)	7,020	6,195	7,575	5,472	11,442	13,296	15,096	10,512	9,781
Domestice assets	20,767	20,635	21,066	21,146	21,269	21,997	22,487	21,796	21,971
Liabilities	**86,980**	**83,834**	**84,064**	**82,384**	**87,472**	**90,636**	**94,426**	**88,401**	**86,838**
Reserve money	**2,221**	**2,392**	**711**	**733**	**608**	**1,044**	**1,843**	**2,419**	**1,644**
Currency outside CBS	774	709	709	709	580	580	580	580	580
Demand deposits	1,446	1,683	2	24	28	464	1,263	1,839	1,064
Government	**14,393**	**6,320**	**7,836**	**5,568**	**11,446**	**13,299**	**15,026**	**9,818**	**9,696**
Government deposits 4/	5,392	4,470	5,984	3,718	9,596	11,449	13,176	7,968	7,846
Of which: Grants	…	…	…	…	…	5,365	6,496	5,997	4,991
Asset recovery proceeds	9,001	1,851	1,852	1,850	1,850	1,850	1,850	1,850	1,850
Other domestic liabilities	**120**	**3,120**	**3,120**	**3,120**	**3,120**	**3,660**	**3,660**	**3,660**	**3,660**
Earmarked donor funds	…	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
MTF deposits	120	120	120	120	120	660	660	660	660
Other ext. liabilities 5/	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Equity and reserves	**70,246**	**72,002**	**72,398**	**72,964**	**72,298**	**72,633**	**73,897**	**72,504**	**71,838**
Memorandum item:									
Somali shillings per US dollar (end of period)	20,600	20,265	22,211	22,218	22,269	22,286	22,779	22,994	23,030

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

1/ Based on the Central Bank of Somalia (CBS) financial statements. The CBS' account data are still preliminary and incomplete.

2/ Gold valued at market price.

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

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

5/ Excluding Somalia's overdue financial obligations to the IMF.

Table 4a. Somalia: Balance of Payments, 2013–19

(Millions of U.S. dollars)

	Prel.			Proj.			
	2013	2014	2015	2016	2017	2018	2019
Current account balance	-327	-480	-555	-404	-472	-595	-667
Goods balance	-1,978	-2,227	-2,540	-2,503	-2,640	-2,768	-2,889
Exports of goods, f.o.b.	801	819	1,012	1,052	1,114	1,173	1,230
Imports of goods, f.o.b.	2,779	3,046	3,552	3,555	3,754	3,941	4,119
Services, net	-818	-997	-941	-979	-1,046	-1,117	-1,192
Service credits	199	251	254	258	261	268	273
Service debit	1,017	1,248	1,195	1,237	1,307	1,386	1,466
Income (net)	-32	-31	-29	-30	-31	-33	-34
Current transfers (net)	2,501	2,775	2,955	3,109	3,245	3,323	3,448
Private (net), including remittances 1/	1,300	1,361	1,424	1,489	1,581	1,669	1,763
Official 2/	1,201	1,413	1,531	1,620	1,664	1,654	1,685
Capital account and financial account	327	480	555	404	472	595	667
of which							
Foreign direct investment	258	283	306	339	373	409	439
Errors and omissions	0	1	-7	6	0	0	0
Overall balance	0	1	-7	6	0	0	0
Change in the central bank net foreign assets /3	…	-1	7	-6	0	0	0
Memorandum items:							
Nominal GDP	5,723	5,950	6,111	6,336	6,548	6,833	7,084
External public debt 4/	5,110	5,066	4,996	5,063	…	…	…

Sources: Authorities, Direction of Trade Statistics, UN Comtrade, and Fund staff estimates and projections.

1/ 2013 data from Barclays Bank, PLC.

2/ Includes direct budget support.

3/ Excluding Somalia's net position with the IMF. Negative sign means increase in reserves.

4/ Data for 2016 is through end-October.

Table 4b. Somalia: Balance of Payments, 2013–19

(Percent of GDP, unless otherwise indicated)

	Prel.			Proj.			
	2013	2014	2015	2016	2017	2018	2019
Current account balance	-5.7	-8.1	-9.1	-6.4	-7.2	-8.7	-9.4
Goods balance	-34.6	-37.4	-41.6	-39.5	-40.3	-40.5	-40.8
Exports of goods, f.o.b.	14.0	13.8	16.6	16.6	17.0	17.2	17.4
Imports of goods, f.o.b.	48.6	51.2	58.1	56.1	57.3	57.7	58.1
Services, net	-14.3	-16.8	-15.4	-15.5	-16.0	-16.3	-16.8
Service credits	3.5	4.2	4.2	4.1	4.0	3.9	3.9
Service debit	17.8	21.0	19.6	19.5	20.0	20.3	20.7
Income (net)	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Current transfers (net)	43.7	46.6	48.4	49.1	49.6	48.6	48.7
Private (net), including remittances 1/	22.7	22.9	23.3	23.5	24.2	24.4	24.9
Official 2/	21.0	23.8	25.1	25.6	25.4	24.2	23.8
Capital account and financial account	5.7	8.1	9.1	6.4	7.2	8.7	9.4
of which							
Foreign direct investment	4.5	4.8	5.0	5.4	5.7	6.0	6.2
Errors and omissions	0.0	0.0	-0.1	0.1	0.0	0.0	0.0
Overall balance	0.0	0.0	-0.1	0.1	0.0	0.0	0.0
Change in the central bank net foreign assets /3	0.0	0.0	0.1	-0.1	0.0	0.0	0.0
Memorandum items, in millions of USD:							
Nominal GDP	5,723	5,950	6,111	6,336	6,548	6,833	7,084
External public debt 4/	5,110	5,066	4,996	5,063	…	…	…

Sources: Authorities, Direction of Trade Statistics, UN Comtrade, and Fund staff estimates and projections.

1/ 2013 data from Barclays Bank, PLC.

2/ Includes direct budget support.

3/ Excluding Somalia's net position with the IMF. Negative sign means increase in reserves.

4/ Data for 2016 is through end-October.

Table 5a. Somalia: External Public Debt, 2013–16

			Prel.	
	2013	2014	2015	2016 /1
Total stock outstanding 2/	**5,110**	**5,066**	**4,996**	**5,063**
of which: arrears	4,752	4,742	4,702	4,688
Multilateral creditors	**1,556**	**1,507**	**1,468**	**1,449**
International Monetary Fund	360	341	328	326
World Bank	520	502	491	484
AfDB Group	142	135	130	136
Arab Fund for Economic and Social Development	178	181	171	151
International Fund for Agricultural Development	32	31	30	30
OPEC Fund for International Development	35	35	35	35
Arab Monetary Fund	278	271	270	275
Islamic Development Bank	11	11	13	13
Bilateral creditors	**3,554**	**3,559**	**3,528**	**3,613**
Paris Club creditors 3/	**2,232**	**2,239**	**2,233**	**2,317**
Denmark	2	2	2	2
France	380	361	341	369
Italy	571	590	571	577
Japan	119	99	102	117
Netherlands	7	6	6	6
Norway	2	2	2	2
Spain	37	38	38	39
United Kingdom	81	82	82	85
United States	895	918	945	973
Russia	138	141	144	147
Non-Paris Club creditors 4/	**1,322**	**1,320**	**1,296**	**1,297**
Algeria	2	2	2	2
Bulgaria	9	9	9	9
Iraq	66	66	66	66
Kuwait Fund and Central Bank	296	294	273	273
Libya	5	5	5	5
Romania	6	6	3	3
Saudi Arabia	105	105	105	106
Serbia	2	2	2	2
United Arab Emirates	832	832	832	832

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

1/ Estimation for 2016, based on information through end-October 2016.
2/ Claims in currency of loan are converted to US$ at period-end exchange rates.
3/ 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.
4/ Data of Non-Paris Club creditors is preliminary as a large portion is estimated from the World Bank debt database (WBXD).

Table 5b. Somalia: External Public Debt, 2013–16
(Percent of GDP)

		Prel.		
	2013	2014	2015	2016 1/
Total stock outstanding 2/	**89.3**	**85.1**	**81.8**	**79.9**
of which: arrears	83.0	79.7	76.9	74.0
Multilateral creditors	27.2	25.3	24.0	22.9
International Monetary Fund	6.3	5.7	5.4	5.1
World Bank	9.1	8.4	8.0	7.6
AfDB Group	2.5	2.3	2.1	2.1
Arab Fund for Economic and Social Development	3.1	3.0	2.8	2.4
International Fund for Agricultural Development	0.6	0.5	0.5	0.5
OPEC Fund for International Development	0.6	0.6	0.6	0.6
Arab Monetary Fund	4.9	4.6	4.4	4.3
Islamic Development Bank	0.2	0.2	0.2	0.2
Bilateral creditors	**62.1**	**59.8**	**57.7**	**57.0**
Paris Club creditors 3/	**39.0**	**37.6**	**36.5**	**36.6**
Denmark	0.03	0.03	0.03	0.03
France	6.6	6.1	5.6	5.8
Italy	10.0	9.9	9.3	9.1
Japan	2.1	1.7	1.7	1.9
Netherlands	0.1	0.1	0.1	0.1
Norway	0.04	0.04	0.03	0.03
Spain	0.6	0.6	0.6	0.6
United Kingdom	1.4	1.4	1.3	1.3
United States	15.6	15.4	15.5	15.4
Russia	2.4	2.4	2.4	2.3
Non-Paris Club creditors 4/	**23.1**	**22.2**	**21.2**	**20.5**
Algeria	0.03	0.03	0.02	0.02
Bulgaria	0.2	0.2	0.1	0.1
Iraq	1.2	1.1	1.1	1.0
Kuwait Fund and Central Bank	5.2	4.9	4.5	4.3
Libya	0.1	0.1	0.1	0.1
Romania	0.1	0.1	0.04	0.04
Saudi Arabia	1.8	1.8	1.7	1.7
Serbia	0.03	0.03	0.03	0.03
United Arab Emirates	14.5	14.0	13.6	13.1

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

1/ Estimation for 2016, based on information through end-October 2016.

2/ Claims in currency of loan are converted to US$ at period-end exchange rates.

3/ 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.

4/ Data of Non-Paris Club creditors is preliminary as a large portion is estimated from the World Bank debt database (WBXD).

Table 6. Somalia: Off-Budget Aid, 2014–16
(Millions of U.S. Dollars)

	2014 Act.	2015 Act.	2016 Proj.
Total aid 1/	**1,218**	**1,177**	**1,197**
Humanitarian aid	672	594	577
Developmental aid	546	583	620
Support for peacekeeping 2/	439	624	600
Total estimated grants	**1,657**	**1,801**	**1,797**
Total federal budget expenditure 3/	151	135	190
Percent of federal budget expenditure to total grants	*12.4*	*11.5*	*15.9*

Sources: Authorities and ACU Aid Flow Mapping.

1/ Includes Official Development Assistance only and excludes on-budget grants.

2/ Bilateral military aid is not captured in the table.

3/ The figure for 2015 is preliminary and 2016 is based on the revised budget.

Table 7. Somalia: Completed TA, 2013–16 1/

Department	Activity	Start Date
FAD	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	3/30/3015
	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
	Developing a PFM Reform Strategy and Action Plan	Mar-16
	PFM capacity development and reporting	Apr-16
	Fiscal reporting, cash forecasting, and PFM legal framework	Jun-16
	Workshop on taxation of extractive industries and fiscal decentralization	Aug-16
	Workshop on key PFM Reforms	Sep-16
	Budget execution control, cash and arrears management	Sep-16
	Budget execution and preparation	Nov-16
LEG	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 penalties	8/1/2015
	Central bank governance	6/1/2016
MCM	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

Source: International Monetary Fund.

1/ Based on information through November 2016.

Table 7. Somalia: Completed TA, 2013–16 (concluded) 1/

Department	Activity	Start Date
MCM	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 anc currency reform	12/7/2015
	Support to the FGC	3/7/2016
	Currency reform	3/29/2016
	Support to the FGC	4/27/2016
	Training on Bank Supervision and Regulations	3/11/2016
	Board Orientation Course	5/25/2016
	Currency reform	5/25/2016
	Support to the FGC	6/12/2016
	Banking Supervision and Regulation Training	9/15/2016
	Banking Supervision and Regulation Training	12/4/2016
STA	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	Jul-15
	Balance of Payments	Dec-15
	National accounts and business register	Apr-16
	Balance of Payments	Jul-16
	Consumer price index	Oct-16
	National account	Nov-16

Source: International Monetary Fund.

1/ Based on information through November 2016.

Table 8. Somalia: New TA Requested 1/

Department	Activity	Description
FAD	**Revenue**	i. Roadmap/strategy for revenue mobilization ii. Tax policy development iii. Fiscal Federalism, specifically on fiscal regimes for extractive industries
	GFS	GFS and chart of accounts
	PFM	i. Follow up on previous FAD TA on cash and arrears management. In addition, the authorities requested TA to ensure that the ministry of finance has proper organizational structure ii. The development of the medium-term fiscal framework, the preparation of the credible annual budget, and strengthening fiscal reporting.
STA	**Trade statistics**	Support the national statistics department capacity to collect/compile export/import data
	National account	Assist in the estimation of GDP at both current and constant prices using the xpenditure approach.
LEG	**Currency reform**	Legal aspects of currency reform and currency management
	Legal drafting on CFT	Assist with the strengthening of the CFT framework
MCM	**Central bank accounting**	Review the Central Bank's Chart of Accounts and provide training on the implementation of the bank's IFRS reporting and produce the Balance Sheet and Income Statement of the central bank on a regular basis
	Central bank operations	Provide training to finance and accounting teams on the payment system
	Supervision and regulation	Follow up on previous TA provided by MCM
	Internal audit	Risk management, internal controls, and effective oversight and development of internal control operations manual
	Currency Reform	Follow up on TA provided by MCM

Source: Somali Authorities.

1/ New TA requested by the Somali authorities and not yet included in the Trust Fund.

Appendix I. Letter of Intent

Mogadishu, December 27, 2016

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

Dear Madame Lagarde:

The Federal Government of Somalia (FGS) values the International Monetary Fund's (IMF) continued support to Somalia through the Staff–Monitored Program (SMP) and technical assistance. Since the approval of the SMP in May 2016, we have continued to make efforts on reform and policy implementation. Given the daunting challenges ahead, continued support from the IMF and donors will be critical.

Somalia's economic and social infrastructure was severely damaged by conflicts that lasted for a quarter of a century. Since 2012, the FGS has embarked on an ambitious process of rebuilding the state, as well as its economic and social infrastructure. Despite challenging security and economic conditions, our efforts are bearing fruit. With 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.

The Somali government remains committed to sustaining its efforts to rebuild the economy, improve social conditions, and move toward normalizing relations with the international financial institutions. In this regard, it has formulated a reform program under the SMP for the period May 2016–April 2017 that focuses on implementing prudent macroeconomic policies, including initiating an important currency reform, 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 implementation of monetary policy, and fostering financial sector development.

To address the economic and social challenges Somalia is facing, the FGS has continued moving forward by making tangible efforts in reform implementation supported by the SMP. The FGS hopes that the successful completion of this, and subsequent SMPs, as well as building a track record of policy implementation could, in the future, lead to an IMF-supported program of upper-credit tranche quality.

The government is convinced that the policies and measures set forth in the MEFP are appropriate for meeting the objectives of the program. We remain committed to the implementation of these objectives and 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).

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/	/s/
Bashir Issa Ali Governor of the Central Bank of Somalia	Mohamed Adan Ibrahim Minister of Finance of Somalia

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

This memorandum reviews recent economic developments and outlines our policies and reforms for 2017—19 in regard to Somalia's Staff-Monitored Program (SMP) with the International Monetary Fund (IMF) for the 12-month period, May 2016—April 2017.

A. Background

1. **Somalia is a fragile state emerging from decades-long civil war.** In 1991, armed opposition groups toppled the government, resulting in a protracted civil conflict and the implosion of the central government. Nearly 25 years later, a provisional constitution was adopted in August 2012 and 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. The FGS was subsequently formally recognized and reengaged with the International Financial Institutions. The formation of all federal member states was concluded in October 2016 laying down the foundations for federalism.

2. **Since the approval of the SMP in May 2016, the government has taken important steps to rebuild the country's economic institutions.** Somalia now has functioning key administrative institutions, a Cabinet, and FGS agencies and federal member states administration 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.

3. **Because of the protracted conflict, however, state institutions remain weak, 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 for long. Weak capacity in government institutions and shortages in accurate and timely statistics hamper policy formulation and implementation. Moreover, a generation where non-payment of taxes was the norm, and the lack of policy consensus on fiscal federalism pose challenges to revenue mobilization and weaken the ability of the FGS to support economic activity. 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.

4. **Our program aims to facilitate economic recovery and improve the livelihoods of the Somali people.** 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.

B. Recent Economic and Financial Developments

5. Notwithstanding capacity constraints, the policies undertaken in recent years have supported macroeconomic stability. Economic growth recovered to about 3.5 percent in 2014–16 and inflation remained low. However, reflecting mainly revenue shortfalls and delays in pledged budget support, budget execution has been difficult.

6. The government has consistently improved fiscal, financial, and statistical institutions and capacities.

- ***On fiscal measures*,** we started training the staff of tax-collecting agencies in the area of tax and customs administration. On public financial management (PFM), the government has approved a new PFM law, introduced an electronic system for paying the salaries of civil servants, submitted the 2015 financial statements to the auditor general, and phased in the implementation of the Somalia Financial Management Information System (SFMIS). At the same time, the implementation of the commitment system and related payment reforms, including a Treasury Single Account (TSA) are well advanced.

- ***On financial sector measures***, to enhance the governance of the Central Bank of Somalia (CBS), its 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. On currency reform, the CBS has reconstituted a fully staffed cash management department and prepared a draft anti-counterfeit strategy.

- ***On governance and transparency***, we have strengthened the legislative framework with key legislation passed by Parliament, including the Foreign Investment Law, Anti-Money Laundering (AML) Law, the Audit Law, and the Procurement Law. We received training to assist the CBS to build confidence in the payment system, and safeguard the continued flow of international remittances to Somalia and to work with MTBs on anti-money laundering and combating the financing of terrorism (AML/CFT). We established the National Anti-Money Laundering Committee (NAMLC) to oversee the efforts of the Federal Government of Somalia in monitoring transactions. The Financial Reporting Center was established to liaise and directly work with financial institutions, including MTBs, to receive and analyze information concerning money laundering and terrorism financing. We established the National Interim Procurement Board to review large concession contracts and ensure transparency.

- ***On capacity development***, we have intensified staff training at the Ministry of Finance (MOF), CBS, and Ministry of Planning and International Cooperation (MOPIC), delivered by both multilateral organizations and bilateral donors. In this regard, we benefited from more than 60 IMF technical assistance missions and workshops over the past two years.

C. Program Performance

7. Program performance under the SMP has been satisfactory.

- The government has met all SMP indicative quantitative targets for June 2016 and the structural benchmark (SB) target (The Minister of Finance to approve the 2016–20 PFM reform action plan) was also met.

- Six out of seven quantitative performance indicator targets for the first review (end-September, Table 1) were met. However, due mainly to the delayed disbursement of budgetary grants by two bilateral donors, new budgetary arrears of $10 million were accumulated through the end of September, but were settled in November. We remain confident that the following measures will help avoid future arrears: we will (1) continue to improve budget execution, through prioritizing the payment of salaries to Ministries, Departments, and Administrations (MDAs), (2) adhere strictly to the new arrears management strategy; and (3) increase the realism of our revenue and grant forecasts and take steps to improving domestic revenue mobilization, including greater tax collections.

- The government has met all the SBs set for the first review (end-September, Table 2). The newly-established SMP Committee will monitor progress in the implementation of policy measures spelled out in the MEFP: (1) the Ministry of Finance has prepared a plan to identify existing domestic arrears and a payment schedule; and (2) the MOPIC is strengthening the recently established business registry to support the collection of macroeconomic statistics. However, this process would be completed upon the passage of the new Statistical Law which would include articles on statistical system, statistical confidentiality, cooperation between state agencies and data sharing. Also, the government is making progress on completing an action plan to improve cash management and on a plan to modernize revenue and customs administration (both SBs for March 2017).

- The government is keeping the reform momentum and has completed a number of structural measures set for the second review (test date: end-March 2017), including: the completion of a report on the process and design of an electronic payment system for the Somali National Army and Police, complete with biometric screening capability, is on track (set for December); and the issuance of a Prime Ministerial decree that requires all foreign grant agreements to be cosigned by the Minister of Finance (set for March 2017) has been completed.

- Progress has been made on advancing the implementation of reforms to the payment processes necessary to achieving 100 percent of non-salary recurrent cost and reform financing (RCRF) reimbursement (set for December 2016). A pilot program involving approximately ten MDAs is underway to modernize payment processes, and commitment control will be made mandatory for all MDAs starting January 2017. Furthermore, to address liquidity issues sufficient cash has been reserved to meet the claims for payment from the pilot MDAs. These reforms will be key for the success of the RCRF program to achieve the SMP benchmark.

D. Economic and financial policies for 2017–19

8. 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, following through measures outlined in the arrears management strategy to avoid future arrears, continuing national currency reform, and improving the licensing and supervision of financial institutions to foster confidence in commercial banks and money transfer businesses (MTBs). Program design recognizes our limited institutional capacity, and envisages capacity building as an essential component. Furthermore, we are preparing a national development plan (NDP), which is compliant with the Interim Poverty Reduction Strategy Paper, for the period 2017–19 to guide delivery of aid.

9. Economic recovery is expected to resume in 2018-19 after slowdown in 2017. Growth is projected to decelerate to 2.0–2.5 percent and inflation to tick up to 2.7–3.0 percent in 2017 Thereafter, growth is expected to recover to 3.5–4.5 percent in 2018–19. The weak growth rate in 2017 reflects mainly the impact of the drought on the agriculture sector. Nonetheless, the construction, telecommunications, and service sectors will remain the engines of growth. We will not allow the net foreign assets (as defined in the TMU) to fall below a continuous floor. Given the reality of very low foreign reserves, the CBS will use recovered CBS foreign assets to increase its net foreign reserves. While the trade balance is projected to remain large, we expect remittances and grants to continue to cover the deficit.

10. Our program will lay the foundation for sound macroeconomic management. It focuses on: (1) developing and maintaining a fiscal framework consistent with a zero-cash balance, while avoiding arrears accumulation and improving budget execution; (2) improving PFM; (3) raising revenue; (4) continuing the national currency reform; (5) improving commercial banks and MTBs regulation, and licensing and supervision; (6) facilitating remittances to Somalia; and (7) developing a statistical system.

Fiscal Policy and Reforms

11. Our fiscal framework for 2017–19 aims at strengthening the role of the budget as a policy tool. In line with the SMP, the 2017 budget will target a zero-cash balance. Any revenue (including budgetary grants) windfall will be used to build up buffers for contingent measures, including paying down arrears.

- On the revenue side, in light of low domestic revenue and weak tax administration capacity, we will continue to require donor grants (on budget) while abstaining from domestic and external borrowing. The projected budgetary grants for 2017 will be based on confirmed and committed pledges. The tax revenue in 2017 is projected to reach $126 million, up from $89 in 2016 (representing a 0.5 percent of GDP increase). This increase is underpinned by a reform agenda aiming at replacing negotiated taxes with the existing tax law, and strengthening tax administration:

- ***The tax policy measures*** will: (1) increase khat tariff from $2/kg to $3/kg; (2) double the tariff on imported tobacco products; (3) harmonize visa charges and introduce a departure tax; and, (4) increase the tariff rate on petroleum products by 25 percent. In the telecommunication sector, negotiated taxes will be replaced by the adherence to the existing sales tax law. By end-March 2017, we will pass the 2017 Appropriation Bill to endorse the tax code rate for income and sales taxes. This measure will broaden the tax base and improve revenue collection by implementing existing tax law for payroll income tax and sales for telecommunications, electricity supply, water supply, and hotel.

- ***Tax administration*** will include tax compliance on income tax –on hotels, telecommunication firms, financial institutions, electricity companies; sales tax measures (on telecommunication services, electricity and water companies); a bed tax on hotels; and an increase in the road tax compliance. Efforts to improve tax compliance and widen the tax base will also include plans to modernize tax and customs administration SB for end of March 2017, introduce a modern system of taxpayer registration, strengthen audit and enforcement.

- On the expenditure side, we will execute the budget in conformity with the Appropriation 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. Where possible, we will direct any revenue windfalls to the payment of arrears. Provisions for arrears will be carefully managed to ensure settlement of current liabilities are prioritized.

12. Our fiscal policy will be supported by near-term structural measures to strengthen the foundation of fiscal institutions and policy tools ("getting the basics right").

- ***On expenditure management and budget execution***, our near-term priority will be to pass the PFM Bill and improve the government's expenditure management. Enhancements of cash management, payment processes, and public procurement are also underway. Moreover, to tighten expenditure commitment control, we will provide quarterly allotment ceilings for ministries, departments, and agencies that are in line with our revenue outlook. We will also continue to improve the preparation of credible annual budgets and focus on accounting and fiscal reporting, as well as external auditing.

- ***On treasury management***, significant progress has been made on some of these structural reform measures including the development of commitment control system with a mandatory roll out planned in January 2017. To strengthen the TSA, a stock-taking of the existing bank accounts belonging to MDAs is underway resulting in the closing of non-critical accounts and consolidation under the TSA. An action plan for the electronic payment system for the Somali National Army and Police with biometric screening (PFM, SB #4) has been drafted.

- ***On the management of arrears***, we will update the arrears management plan to reflect developments since October 2016 and establish plans to settle outstanding arrears.

- ***On revenue***, we will harmonize the custom entry points across the country in the medium term; reform the Inland Revenue and Customs administration in line with the roadmaps currently being prepared; and consider introducing a pre-shipment inspection regime for customs.

- ***On fiscal federalism***, we continue discussions with the federal member states toward harmonizing taxes across sub-national governments, establish channels for intergovernmental transfers, and define basic principles for a national fiscal framework.

13. We will implement the remaining PFM and any additional reform measures agreed to under the SMP, by end of March 2017 (Table 2). These include: (1) reaching 100 percent of non-salary Recurrent Cost and Reform Financing reimbursement by the end of December 2016; (2) completion of a report on the process and design of an electronic payment system for the Somali National Army and Police, complete with biometric screening capability, by the end of December 2016; (3) 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 an action plan to address them); and (4) completion of a plan to modernize the revenue and customs administration by the end of March 2017 (this SB will be achieved by establishing a modern system of tax registration and tax administration, including assessment, audit, and enforcement).

14. To lay the foundations for improving our fiscal revenue and to support credible currency reform, we agreed with the IMF staff to add two new SBs. On fiscal reform, we will pass the 2017 Appropriation Bill to endorse the tax code rates for Income and Sales Taxes (by end March 2017) to implement existing tax law for Payroll (Income) Tax and Sales Taxes. On currency reform, in line with our ongoing currency reform roadmap, we will "finalize the anti-counterfeit strategy" (by the end of March 2017).

Financial Sector Reforms

15. We will implement a package of reforms in 2017 to restore financial institutions and the credibility of the Somalia national currency. These reforms will be centered on commercial banks, CBS governance, transparency, and organization, and currency reform.

- ***On the financial sector development***, we will continue the overhaul of the nascent financial sector by identifying the bottlenecks to inclusive financial sector development and financial intermediation and define a roadmap for financial sector reform by end-April 2017. Meanwhile, we will endorse the new regulation governing commercial bank branches and the commercial banks asset quality classification and provision regulation. We will continue banks' onsite examination. We will also improve commercial bank accounting and reporting standards in line with the provision of international financial reporting standard (IFRS), and strengthen CBS oversight. In this context, we will: (1) prepare monthly financial statements of the CBS by March-2017; (2) continue to strengthen the organizational and governance structure of the CBS(establish an Executive Committee and an Audit Committee, finalize the terms of reference for main departments and the competitive recruitment with the World Bank Capacity Injection Project, and completion on the "Core Banking" project with the World Bank support); and, (3) implement new accounting and financial reporting systems and practices at the CBS.

- ***Currency reform*** is a high priority**.** The economy is largely cash-based and highly dollarized, and the CBS has not been in a position to issue legal tender currency since the early 1990s. As a result, virtually all Somali Shillings (SOS) currently in circulation are counterfeit. In March 2016, the Board of Directors of the CBS decided on the principles for currency reform in two stages. The CBS has initiated technical work on comprehensive currency reform. A number of reforms have been implemented since May 2016. We completed the currency reform roadmap in November 2016 and we will strictly adhere to it. The roadmap includes the completion of the following milestones by July 2017: (1) finalizing the counterfeit strategy; (2) deciding on the scope of exchange and conversion factors; (3) properly phasing in the legal framework; and (4) initiating the preparatory work for storage, distribution, and collection. We welcome the IMF's commitment to provide considerable near-term technical assistance to support our currency reform. However, the CBS and the government lack the funds needed to finance this 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.

- ***On other reforms at the CBS***, the short-term priorities will focus on governance, transparency, and overall CBS re-organization. On governance, we will initiate the internal audit, risk management, compliance, and oversight procedures.

Policies for Growth and Social Inclusion

16. The ultimate goal of our economic policies is to attain inclusive and sustainable growth and to reduce poverty. In addition to the institutional and macroeconomic policies outlined above, we are preparing our NDP which will underpin our development strategy. The NDP for the period mid-2017–2019 will lay out our medium-term strategy to build the foundations of sustained and inclusive growth and poverty reduction. We are committed to complete the preparation of the NDP and submit it for Cabinet approval. During the preparation phases, we identified areas need improvements in the current NDP draft and our work will focus on the following critical issues and missing steps: (1) ensure that the underlying medium-term macroeconomic framework is coherent and fully consistent with sectoral strategies; (2) ensure that the preparatory work continues to be inclusive—in this regard, we will intensify our consultation and cooperation with member states, as well as our international partners; (3) a comprehensive safety net program to support the most vulnerable members of the population, including IDPs returnees (to this end, we will work with the World Bank and the UN , who are already providing social safety net program support to Somalia). In this context, the NDP will discuss the social and economic implications of the repatriation of Somali refugees (from Kenya) and the Yemeni refugees living in Somali; and finally (4) the NDP will outline updated plans to continue to rebuild economic and financial data, and institutions. Based on the recently published World Bank and MoPIC Household survey, it will also assess the current poverty outcomes and discuss strategies to achieve the Sustainable Development Goals (SDGs); (5) the NDP will outline the critical role of fiscal federalism, including a plan to achieve it; (6) the NDP will discuss the objectives of the ongoing currency reform, the need to restore the CBS and its monetary instruments, and development of the financial sector; and (7) on financing, the NDP will discuss its costing and funding in coordination with donor communities. It will also discuss ways to safeguard the Somali diaspora remittance inflows to support economic development and social inclusion.

E. Governance and Statistics

17. Enhancing the governance of key institutions is critical. The focus will be on reorganizing the MoF, MOPIC, and CBS, and strengthening key legislative and regulatory frameworks. In particular, with the assistance of donors, we plan to primarily reorganize and re-enforce key economic units (including the recently established domestic arrears management committee, national statistics, and debt management unit) and departments (Customs, inland revenue, and the Treasury). Donors' technical assistance is expected to provide guidance on best practices and an appropriate regulatory framework.

18. We will strengthen institutional capacity, enhance governance, and foster strong private sector-led growth. We will establish the anti-corruption commission as stipulated in the Anti-Corruption Commission Establishment Act, which is currently undergoing public consultations. 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. The Financial Governance Committee will continue to review large procurements and concessions, and will play an enhanced role in reviewing progress in public financial management reforms. It will also provide advice on asset recovery, the management and disposal of Government assets.

19. We will continue to rebuild our economic and financial statistics. In particular, we will submit the new Statistical Law that establishes an institutional framework for data compilation, reporting, dissemination, and sectoral regulation to the Parliament for approval. Further, we commit to taking specific actions to improve statistical data by: (1) completing the list of business enterprises that will form the basis for conducting statistical surveys to collect critical economic statistics that will support broadening the tax base and developing FDI statistics; (2) collecting data on the value and volume of exports and imports using internationally recognized systems and improving coordination among statistical agencies at the Ministries of Finance, Commerce, Transportation, and the CBS and MOPIC; (3) start collecting remittance data from money transfer businesses (MTBs); and (4) re-establishing cooperation with the Immigration Department to collect traveler data.

F. Technical Assistance

20. Technical assistance delivery is addressing weak capacity constraints and supporting policymaking. In recent years, a large number of our staff and institutions have benefited from technical assistance supported by development partners. Technical assistance in 2014–16 helped the Ministry of Finance to prepare a realistic 2016 budget. However, further improvements in the consumer price index, gross domestic product, and external sector statistics are needed. With the preparation of financial statements, the CBS 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.

21. The government has identified the following priorities for technical assistance: (1) internal controls, payments, and commitments; (2) cash management and the 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) advancing central banking operations; and (9) building capacity for the production and dissemination of macroeconomic statistics.

22. During the program period, we are requesting IMF technical assistance in: (1) tax policy, revenue, and customs administration; (2) budget preparation and execution; (3) reforms in cash management and forecasting, and the TSA; (4) planning and implementing Treasury management and reforms, including a GFS compliant Chart of Accounts; (5) internal controls; (6) fiscal federalism; (7) bank licensing, supervision, and regulation; (8) currency reform; (9) banking operations; and (10) macroeconomic statistics. We will make specific requests to the IMF for assistance. As we advance on reform priorities, it is becoming increasingly critical for technical assistance to be provided on the ground with access to expert advice and implementation support.

G. Relations with International Creditors and debt relief

23. We recognize the importance of normalizing relations with international creditors. This will in due course 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.

24. We understand that Somalia is ineligible for financial assistance from the IMF, pending the clearance of its longstanding arrears. We note that arrears clearance will be an important part of normalizing our relations with the international financial community, and with the help of the IFIs we are looking to establish a roadmap to public debt sustainability. We have also been informed that the process will involve establishing a track record of economic management, cooperation with the Fund on policies and payments. Going forward, we know that a successful completion of these steps will, help Somalia move towards debt relief under the HIPC Initiative.

25. Government records on external debt were lost or destroyed during the conflict, but are being reconstituted. With technical assistance from the African Development Bank, our Debt Management Unit (DMU) has engaged with Somalia's external creditors to collect loan information. This has allowed for the reconstruction of about two-thirds of our external debt database and we are still waiting to receive additional creditors' information to finish reconstructing the external debt database. We will continue to improve the DMU's debt management and monitoring capacity given its criticality for future debt sustainability assessment. In this context, we will monitor Somalia rating on the Country Policy and Institutional Assessment (CPIA) and Public Expenditure and Financial Accountability (PEFA) and the Debt Management Performance Assessment (DeMPA).

H. Program Monitoring

26. Our SMP Monitoring Committee will continue to monitor the implementation of our program with the help of quarterly quantitative benchmarks (Table 1) **and SBs** (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).

Somalia: Indicative Targets Under the Staff-Monitored Program, 2015–17 1/

(Millions of U.S. dollars)

	2015	2016								2017
	Dec.	March	June			Sept. 2/			Dec.	March 3/
	Est.	Prel.	Prog.	Prel.	Status	Prog.	Prel.	Status	Prog.	Prog.
Fiscal										
Fiscal balance (cash basis; floor)	5.8	0.0	0.0	0.3	Met	0.0	0.2	Met	0.0	0.0
Accumulation of new domestic expenditure arrears (ceiling) 4/	33.0	0.0	0.0	0.0	Met	0.0	10.0	Not met	0.0	0.0
Contracting of new domestic debt (ceiling) 4/	0.0	0.0	0.0	0.0	Met	0.0	0.0	Met	0.0	0.0
Contracting or guaranteeing of new nominal external non-concessional borrowing (ceiling) 4/	0.0	0.0	0.0	0.0	Met	0.0	0.0	Met	0.0	0.0
Central Bank of Somalia (CBS)										
Net foreign assets of the CBS (floor) 4/ 5/	21.6	21.6	21.6	23.5	Met	21.6	21.6	Met	21.6	21.6
Issuance of banknotes other than SOS 1,000 (ceiling) 4/ 6	0.0	0.0	0.0	0.0	Met	0.0	0.0	Met		
Issuance of SOS banknotes that are not backed by foreign assets denominated in U.S. dollars of the CBS (ceiling) 4/ 6/	0.0	0.0	0.0	0.0	Met	0.0	0.0	Met		
Memorandum item										
Contracting or guaranteeing of nominal external concessional borrowing (ceiling).	0.0	0.0	0.0	0.0	Met	0.0	0.0	Met	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.
6/ Removed after September 2016 test date.

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

Benchmarks	Target dates	Macroeconomic Rationale	Status
Actions to Prepare for the SMP			
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
Structural Measures			
Public Financial Management (PFM)			
1. Minister of Finance to approve the 2016–20 PFM Reform Action Plan	Jun-16	Bring PFM systems closer to regional and international standards	Met
2. Prepare a plan to identify existing domestic arrears and repayment schedule.	Sep-16	Adopt an arrears management strategy	Met
3. Achieve 100 percent of non-salary Recurrent Cost and Reform Financing reimbursement.	Dec-16	Enhance budget planning and execution	Delayed
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	Met
5. Complete an action plan to improve the policy and processes for cash management function	Mar-17	Enhance cash management	On track
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	Met
Tax Policy			
7. Complete a plan to modernize the revenue and customs administration	Mar-17	Improve tax compliance and expand the tax base	On track
8. Pass the 2017 Appropriation Bill to endorse the tax code rates for Income and Sales Taxes	Mar-17	to help re-inforce existing tax law for payroll income tax and sales for telecommunications, electricity and water supplies, and hotels	On track
Financial Sector			
9. Require approval by the Board of Directors of the CBS to issue commercial bank and MTB licenses	Dec-16	Enhance financial licensing and supervision	Met
10. Finalize the anti-counterfeit strategy	Mar-17	To support the anti-counterfeiting strategy	On track
Macroeconomic Statistics			
11. Establish and maintain a business registry to support the collection of macroeconomic statistics	Sep-16	Develop economic statistics	Met

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.

A. Quantitative Benchmarks

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.

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.

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 new 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.

B. 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. Trade data, production data.	Monthly Quarterly	6 weeks after the end of each month 6 weeks after the end of each quarter

Statement by Maxwell Mkwezalamba, Executive Director for Somalia,
Dumisani Herbert, Alternate Executive Director, and
Tanka Tlelima, Advisor to Executive Director
February 3, 2017

Our authorities highly appreciate Fund efforts towards normalization of Somalia's relations with the Fund, and other international financial institutions (IFIs). They thank staff for the constructive discussions during the Article IV Consultation and SMP review mission and are broadly in agreement with staff's assessment and policy recommendations.

Background and Context

1. Somalia continues to face a difficult rebuilding process from two decades of civil conflict, which is further complicated by the fragile security situation. The civil war has not only destroyed the country's social and economic infrastructure but has also impaired the country's ability to service its debt, comprising mostly of arrears. As a result, Somalia's external debt burden, estimated at about 80 percent of GDP, remains a key binding constraint. In this context, approval by the Fund management of the Staff-Monitored Program (SMP) in May 2016 was a key milestone towards normalization of relations with the IFIs. The authorities are hopeful that their efforts will ultimately pave the way for debt relief.

2. Since the approval of the SMP, the authorities have continued to rebuild their economic institutions. While significant progress has been achieved in building the institutional framework and preparing basic macroeconomic statistics, more is still needed in the form of human and technical capacity.

3. Due to the protracted civil conflict, state institutions remain weak, the economy is severely underdeveloped, and poverty is pervasive. At the same time, the lack of consensus on the desired fiscal federalism poses challenges to revenue mobilization, and weaken the ability of the Federal Government of Somalia (FGS) to support economic activity.

4. Against this background, our authorities will embark on policies and reforms to strengthen the fiscal framework, rebuild the financial system, and improve governance with the aim to facilitate economic recovery and improve livelihoods. Supported by the SMP, the authorities' program is aimed at establishing a track record of policy implementation, which will serve as an important step towards an eventual Fund financing arrangement.

Program Performance

5. Despite facing immense challenges, our Somali authorities remain committed to the SMP program objectives. All SMP indicative targets for end-June 2016 were met, including a structural benchmark (SB) requiring approval of the 2016–20 public financial management (PFM) reform action plan by the Minister of Finance. At the same time, six

out of seven quantitative benchmarks set for the first review, end-September 2016, were met. The delayed disbursement of pledged budgetary grants resulted in accumulation of new budgetary arrears amounting to $10 million through the end of September, but were nonetheless settled in November. In addition, the authorities have met all SBs set for the first review. Moreover, two out of three SBs for end-December 2016 have been completed.

6. Going forward, to avoid slippages and allow for timely remedial action when needed, the authorities have established a new committee to monitor progress in the implementation of planned reforms under the SMP. Meanwhile, to avoid accumulation of arrears in the future, the authorities will use conservative revenue and grant forecasts, and maintain tight controls on expenditure. In addition, they are confident that the measures outlined in their new arrears management plan will help avoid future buildup of arrears.

Recent Economic Developments, Outlook, and Risks

7. The Somali economy continues to depend on donor grants, and remittances and investment by the Somali diaspora. Economic activity is projected to have decelerated from 3.6 percent in 2015 to 3.4 percent in 2016. Further deceleration to about 2.5 percent is projected in 2017. The slowdown in activity is attributed to the impact of drought on the agricultural sector. In contrast, economic activity is expected to be stronger in the construction, telecommunications, and service sectors. Meanwhile, inflation has remained under control, although higher food prices due to the drought are likely to exert upward inflationary pressure. At the same time, execution of the government budget was complicated by delays in pledged budget support, which resulted in cutting of non-priority spending and delays in salary payments. The trade deficit is projected to remain large and financed by remittances and grants.

8. The outlook for the Somali economy is subject to significant downside risks emanating from both global uncertainties and domestic factors. In particular, external risk factors have a potential to reduce donor support and remittances, which would have devastating effects on the economy. On the domestic side, the fragile security situation on account of terrorist attacks remains a major threat. However, the authorities are committed to improving national security, with the support of the international community.

Fiscal Policy and Reforms

9. To achieve the fiscal targets for 2017, the authorities intend to strengthen fiscal discipline and improve budget execution; continue to implement public financial management (PFM) reforms and improve revenue collection; and maintain expenditure prioritization rules. The budget process will be strengthened to ensure that expenditure commitments are in line with available resources. In this regard, a realistic budget, based on a broader revenue base, conservative grants, and prudent policy, consistent with a zero-cash balance, will be set. In addition, attempts will be made to avoid arrears'

accumulation and any revenue windfalls will be utilized to build up buffers and paying down arrears

10. On the revenue side, the authorities will identify a set of realistic measures to replace negotiated tax arrangements, and anchor tax collection more closely to the tax base. To this end, they have commissioned a study, which has estimated up to $119 million potential revenue from the telecommunications sector, compared to $5 million in negotiated monthly fees and taxes currently collected. In this regard, the authorities intend to take the necessary steps to collect additional revenue from the telecommunication sector, in the form of corporate and sales taxes, departing from the current system of negotiated tax payments. However, the authorities understand that progress in this area will require significant improvements in revenue administration and tax collection, while improving security for telecommunication operators. As capacity of the key state institutions is being rebuilt, more progress will be possible.

11. On the expenditure side, the authorities are taking necessary actions to enforce stronger fiscal discipline. Among others, these include a cap on the number of civil servants, and a task force led by the Prime Minister to review the existing recruitment policies and disparities in compensation levels. In addition, to improve accountability and transparency, line ministries' spending will be aligned with the budget, while off-budget grants will be published in an addendum to the budget.

Strengthening Central Bank Capacity and Governance

12. Our Somali authorities have continued to make considerable progress in strengthening capacity and governance of the Central Bank of Somalia (CBS). Following an incident of theft in August 2016, the authorities have moved swiftly to take corrective measures. In particular, they are accelerating the reforms aimed at improving governance, transparency, and organizational guidelines at the CBS. Specifically, these measures include internal auditing, risk management, compliance, and oversight.

13. Notwithstanding progress made in the implementation of reforms, near-term challenges remain significant. One of the key priorities is currency reform, against the background of a predominantly dollarized environment as a legacy of the civil war. While there is considerable social and political pressure for the CBS to undertake urgent currency reforms, the authorities are convinced that credible and successful implementation of the currency reform hinges on careful preparation and planning. In addition, adequate donor financing would be needed for successful completion of currency reform.

Enhancing Inclusive Growth

14. The Somali authorities believe that bold action will be required to boost inclusive growth. In this context, the revised National Development Plan (NDP) 2017–19, which addresses the weaknesses identified by staff, will serve as the new vehicle for boosting growth and reducing poverty for the period 2017–19. In particular, the NDP will focus on, amongst others, the following key areas: how to absorb the return of Somali refugees

from Kenya; remittances; and the impact of withdrawal of correspondent banking relationship (CBR).

15. The imminent return of Somali refugees from Kenya is expected to have a significant impact on the Somali economy and the authorities' capacity to provide basic social and economic services. As recently announced by the Kenyan authorities, the country's largest Somali refugee camp will be closed in May 2017, which will result in the repatriation of more 400,000 refugees. This raises concerns about potential risks including increased unemployment and poverty. To mitigate the associated risks, political consensus and support by the international community will be critical.

16. Remittances from the Somali diaspora, channeled through the money transfer businesses (MTBs), are a major source of funding for both households and businesses in Somalia. Over the past two years, the key correspondent banks have closed the accounts of some Somali remittance companies, citing legal and regulatory weaknesses, as well as risks of money laundering with possible financing of terrorism. In response, the authorities have stepped up efforts to improve access to the international financial system, including approval of the AML/CFT law on December 26, 2015. Implementation of the new law is expected to limit the threat of CBR withdrawal and closure of the accounts of Somali remittance companies by global banks. In addition, customer due diligence will be improved by recent efforts to involve a 'trusted third party agent' with the assistance of the World Bank working with the CBS to monitor transaction flows and provide independent third party audits of MTBs. Efforts are underway to introduce new CFT legislation consistent with the Financial Action Task Force standards.

Capacity Building and Governance

17. The Somali authorities continue to make progress towards restoring key economic and financial institutions with support from IMF TA, funded from the multi-donor trust fund. Capacity development activity has intensified in the past two years. However, the need for TA remains large. Increased Fund TA, in coordination with other TA providers, will be essential in further improving capacity and strengthening program monitoring. As part of an effort to enhance governance, the authorities are planning to reorganize the Ministry of Finance, Ministry of Planning and International Cooperation, and CBS, and strengthen key legislative and regulatory frameworks.

Conclusion

18. Our Somali authorities are firmly committed to implementing their reform program and advance the country's development agenda. This will not only create opportunity for the citizens, but will help in counteracting potential radicalization of the country's youth. The authorities are therefore determined to establish a sufficient track record of sound economic management, supported by successful completion of the current and subsequent SMPs. They, however, recognize the important role of the international community and continue to appeal for a speedy process towards debt relief.