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CENTRAL BANK OF SOMALIA

# Policy Brief

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May 2023

**Somalia's  
External Sector**



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Central Bank of Somalia



# **Somalia's External Sector**

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## EXECUTIVE SUMMARY

The global economy has been slowly recovering from the setbacks brought about by the Covid-19 pandemic and the Russia-Ukraine crisis though significant headwinds remain. These include inflationary pressures, dwindling fiscal space, tighter monetary policy, restrictive financing conditions, and potential sovereign debt issues, particularly for emerging and developing economies.

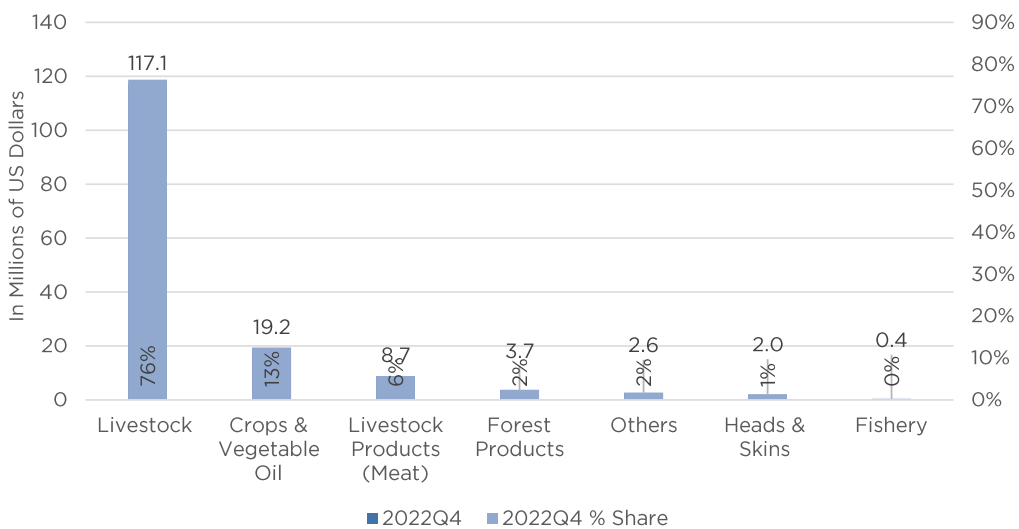
Closer to home, Somalia is slowly emerging from the adverse effects of the delayed elections and environmental shocks, including droughts, locust invasions, and floods. However, some significant challenges remain, chief among them is the deteriorating trade balance position of the country. In 2022, Somalia's estimated import basket had a total value of close to US\$6.4 billion while the country only managed to export a total value of around US\$704 million.

This shows that the country's economy was not only impaired by an enormous mismatch between the export and import values but also experienced a widening gap in the trade balance. This policy brief extensively discusses the importance of addressing this persistent trade deficit and suggests ways the country can increase the value of its exports, including through leveraging private sector investments to create higher value-added products.

## INTRODUCTION AND CONTEXT

Somalia is highly dependent on a few primary commodities whose demand suffers from seasonal effects and unpredictability. Moreover, these commodities are not efficiently produced or utilized. In 2022 (Q4), the country's exports amounted to US\$153 million, 76 percent of which were livestock (see Figure 1).

Figure 1: Leading Export Items in 2022Q4 (in millions of USD)



Source: MoF with CBS valuations and adjustments, 2022

The export of live animals is concentrated in few markets, which makes the country vulnerable to demand shocks. Also, the country is susceptible to recurring environmental shocks including periodic droughts, floods, locust invasions, and widespread deforestation as well as prolonged insecurity and fragility. Thus, pastoralists face significant challenges to safeguard and market their animals. For

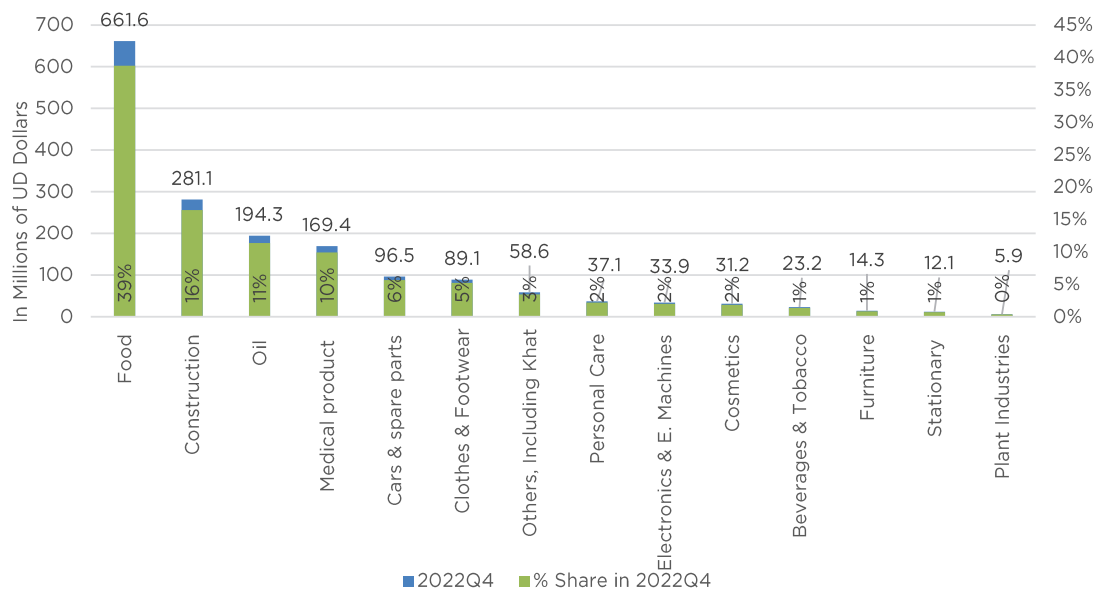
example, they do not have access to credit markets to mitigate the recurring shocks they face, including livestock and drought insurance. There are also widespread concerns around animal health and welfare due to weak quality assurance and poor access to facilities that can timely manage, reduce, and treat disease outbreaks. Also, there are information asymmetries, weak market, and value chain

leakages due to security challenges, poor transport, and infrastructure. Thus, pastoralists are caught in a low productivity and investment equilibrium due to the absence of an enabling environment.

On the flip side, Somalia also depends heavily on imports to meet its basic necessities, including food, construction materials, oil and

medicines (see Figure 2). In 2022Q4 alone, the country imported goods worth more than US\$1.7 billion. Thus, there is a significant value mismatch between the country's exports and imports. As a result, the country suffers from a persistent trade deficit. This deficit tends to increase at times of global shocks, which affect supply chains and input prices adversely.

Figure 2: Imports in 2022Q4 (in millions of USD)



**Source:** MoF with CBS valuations and adjustments, 2022

The country struggles to finance this significant deficit due to the absence of appropriate policy instruments, including sufficient foreign exchange reserves<sup>1</sup>. As of today, migrant remittances and official grants provide most of the necessary foreign exchange to finance import costs. However, remittance inflows face significant challenges, including global de-risking, tighter AML/CFT regimes, and lack of correspondent banking relationships. Thus, remittances, while critical, are also a vulnerable form of finance. Worst still, official grants are expected to decline significantly as Somalia reaches Completion Point of the IMF HIPC program.

Considering the above issues, it is abundantly clear that policymakers in Somalia should address the challenges associated with the country's external sector. According to the Prebisch-Singer hypothesis, the price of primary commodities suffers from secular decline in the long-run. Thus, countries should diversify into industrial goods to safeguard their terms of trade. The predictions of this hypothesis have been confirmed in numerous empirical studies. For example, a study by Harvey et al. (2010) based on 25 primary commodities covering the seventeenth to the twenty-first centuries has shown that, in the long-run, most primary commodities suffer from a significant secular decline in prices. This underlines the criticality of addressing Somalia's export composition as a matter of urgent priority.

<sup>1</sup> It is largely accepted that countries should maintain reserves worth at least three months of imports.

## POLICY RECOMMENDATIONS

### **Policies to boost livestock investments, efficiency, and productivity:**

- Improve veterinary services (mass vaccination, health certificates, standardization of hygiene requirements, disease diagnosis, and prevention) to support livestock production and trade.
- Diversify destination markets and develop a modern marketing strategy to mitigate the risks associated with being heavily reliant on a few concentrated markets.
- Develop appropriate infrastructure, including roads, quarantine facilities, market linkages, holding facilities, and water points.
- Establish the necessary human capacity in livestock management and trade, including the ability to assess, monitor and improve the country's livestock production so that it can meet international standards.
- Re-establish the National Rangeland Agency to rehabilitate the country's rangelands and pastures through rotational grazing and the maintenance of reserves.
- Develop viable financial instruments that can mitigate the risks pastoralists face including appropriate insurance, credit, and saving products.
- Discourage private enclosures on traditionally open rangelands that damage grazing areas.
- Urgently address and get an amicable solution to the severe deforestation in Somalia, especially in the grazing lands resulting from deforestation to extract charcoal for domestic use.
- Improve the business environment through leveraging on private sector investments by strengthening public sector integrity, transparency and accountability.
- Enhance the investment climate of the country by strengthening the legal and regulatory framework, including the

protection of investors, rule of law, contract enforcement, and political stability.

- Facilitate increased access to trade finance, including letter of credit to make trading more efficient.
- Focus on political stability so that both domestic and international trade can be enhanced.

### **Policies that enhance value addition and small-scale industrialization:**

- There is a need to invest in processing raw products into value-added products that would generate increased revenues, SMEs growth, enhanced livelihood through employment and income generation as well as offer competitive products and services into the regional and global markets.
- Fish, livestock, bananas, and corn can be processed and value-added to products that would generate more revenues.
- Encourage domestic SME food production to meet increased domestic demand for food to promote import substitutions as well as address the huge bills for food importation that leads to trade imbalances and widening current account deficit. This will increase domestic production and consumption while addressing the recurrent food insecurities in the country.
- Concentrate on small-scale industrial enterprises. The country currently spends millions of dollars on toothpicks, napkins, pens and papers, bottled drinks etc., which can easily be manufactured within the country. However, this requires measured incentives by the government.

### **Polices that improve agricultural farming in areas and states that are conducive to agricultural activities:**

- Improve greenhouse farming and invest in irrigation schemes that would guarantee crop productivity in all seasons rather than relying on more unpredictable weather patterns.

- Uplift livestock breeds and introduce breeds which are more resilient, and which can flourish in Somalia's riverine regions. This will guarantee reliable high returns.
- Enhance policies that improve foreign relations that can boost Somalia's exports and create more (reliable) markets for the resources Somalia has comparative advantage in, including livestock and fisheries.

**Policies to address food insecurity and the heavy import of basic food necessities:**

- Encourage the country to transition from small-scale farming to more sustainable commercial farming, which can result in cheaper food supply, higher efficiency, and more diverse crops.
- Encourage the establishment of a viable light manufacturing sector through appropriate incentives and focus on agricultural processing to ensure food security.

**Policies to protect remittance inflows into Somalia:**

- Ensure that financial institutions within the country (chief among them Banks, MTBs, and Mobile Money Operators) maintain robust integrity, including AML/CFT regimes and KYC requirements consistent with best international practices. This will enable the establishment of correspondent banking relationships, which will galvanize Somalia's cross-border transactions.

**Policies to create strategic corridors and overriding strategic policy:**

- Establish selected strategic corridors to facilitate the flow of goods by enhancing access to key arterial routes and affordable energy sources.
- Pursue cohesive strategic policies by combining and adopting the recently developed strategies, including the National Investment Promotion Strategy, the National Industrial Policy, the SME Policy, and the National Export Strategy. At the moment, these policies seem fragmented and narrow.

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