BANKIGA DHEXE EE SOOMAALIYA
البنك المركزي الصومالي
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Somalia's Post-HIPCS Priorities: Economic Prospects and Debt Sustainability

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Somalia's Post-HIPCS Priorities: Economic Prospects and Debt Sustainability

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June 2024

SOMALIA'S POST-HIPCS PRIORITIES: ECONOMIC PROSPECTS AND DEBT SUSTAINABILITY

EXECUTIVE SUMMARY

On December 13, 2023, Somalia achieved a historic milestone by reaching the Heavily Indebted Poor Countries (HIPC) Initiative completion point, becoming the 37th country to do so. This accomplishment has significantly reduced Somalia's external debt, from 64% of GDP in 2018 to less than 6% by the end of 2023. Public debt decreased from US$5.3 billion at the end of 2018 to US$0.6 billion at the end of 2023. The debt relief has not only normalized Somalia's standing with international financial institutions but has also paved the way for new external funding to support inclusive growth and poverty reduction. However, Somalia faces ongoing challenges in the post-HIPC era, including low domestic revenue, vulnerability to external shocks, and political instability. This policy brief delves into Somalia's reform journey, economic prospects, and the necessary steps to ensure debt sustainability and future economic prosperity.

1. INTRODUCTION

On December 13, 2023, Somalia reached a significant milestone by achieving the Heavily Indebted Poor Countries (HIPC) Initiative completion point. This accomplishment followed the successful implementation of crucial reforms aimed at rebuilding Somalia's economy and institutions. These reforms included a comprehensive poverty reduction strategy, enhancements in public financial management, improvements in governance, and effective resource management . As a result, Somalia has become the 37th country to achieve HIPC completion point status. This milestone reflects the country's remarkable progress in managing its external debt, which has decreased dramatically from 64 percent of GDP in 2018 to less than 6 percent by the end of 2023. Correspondingly, Somalia's public debt has been reduced from US$5.3 billion at the end of 2018 to US$0.6 billion by the end of 2023. Somalia has made significant strides in rebuilding its economy since 2012, following two decades of social conflict and civil war. The debt relief program provided a critical pathway for Somalia to bring its foreign debt to a sustainable level, enabling access to new financing to support social and economic development (IMF, 2023b). The debt relief process, which began in 2016, represented a historic opportunity for Somalia to emerge from a state of debt distress (IMF, 2024). From the initiation of IMF Staff-Monitored Programs in 2016 to reaching the HIPC completion point in 2023, Somalia has committed to maintaining macroeconomic stability, enacting fiscal stability reforms, implementing poverty reduction strategies, improving debt management, and enhancing governance.

Achieving the HIPC completion point allows Somalia to re-engage with global financial institutions, opening up medium- and long-term opportunities for investment and development. It also provides access to new external borrowing to finance development programs and support the ongoing state-building process. Despite reaching this important milestone, Somalia's governance and macroeconomic infrastructure remain fragile, which could pose challenges in the post-HIPC era. Therefore, this policy brief aims to discuss the debt relief process that Somalia has successfully navigated, as well as the challenges and opportunities that lie ahead in the post-HIPC era. It will also review the key reforms that critical economic institutions have undergone over the past decade. Finally, the paper will provide post-HIPC policy recommendations for key stakeholders, including the Federal Government of Somalia, the private sector, and international partners, to ensure debt sustainability and promote inclusive growth.

2. THE REFORM AND DEBT RELIEF JOURNEY: KEY REFORM MILESTONES

In May 2016, the IMF and the Federal Government of Somalia entered into a staff-level agreement on IMF Staff-Monitored Programs (SMP), spanning four consecutive years. This initiative aimed to rebuild the economy, establish a robust economic management track record, and normalize relations with international financial institutions (IMF, 2016). The program consists of four IMF SMPs, comprised of more than 50 benchmarks to implement within 12 months each SMPs program. These benchmarks encompassed various areas such as Somalia's public financial management plan, increasing domestic revenue, developing a poverty reduction strategy paper, automating payments and consolidating funds into single treasury accounts, establishing a financial reporting centre, a national anti-counterfeit centre, biometric registration for national security, and direct salary payments into bank accounts. During the SMPs, Somalia made substantial progress in implementing these benchmarks, achieving positive assessments from the IMF Staff-Monitored the programs. As a result of Somalia's commitment to economic reforms under the SMPs, the country qualified for debt relief under the Highly Indebted Poor Countries (HIPC) Initiative (IMF, 2020).

In March 2020, the IMF approved a three-year arrangement under the Extended Credit Facility (ECF) to reach the HIPC decision point, with the aim of anchoring medium-term policies between the decision and completion points of the HIPC process[1]. This initiative led to a reduction of Somalia's debt from US$5.3 billion in 2018 to US$3.9 billion in 2022. Reforms during the HIPC process focused on strengthening public finances, enhancing central bank capacity, improving the business environment and governance, and advancing statistical capabilities. Somalia achieved satisfactory progress on thirteen of fourteen HIPC completion point triggers, including public financial management, domestic revenue mobilization, statistics, governance, and social welfare. To sustain these crucial reforms for Somalia's economic and social development, the IMF and the Federal Government of Somalia reached another staff-level agreement on economic and financial reforms for three years post-HIPC. This agreement includes approximately US$100 million under the Extended Credit Facility (ECF), aimed at advancing reforms that strengthen economic institutions, promote inclusive and sustainable growth, and align with Somalia's national development plan and long-term vision (IMF, 2023). International partners will support the government in formulating and implementing new monetary policies, including currency reforms to introduce new shilling notes as legal tender[2].

Looking ahead, Somalia aims to sustain these hard-won reforms with the continued support of international partners. The focus will be on ensuring inclusive and sustainable growth, addressing the remaining challenges in governance and macroeconomic infrastructure, and fostering an environment conducive to long-term development. International cooperation will be crucial in providing the financial, technical, and policy support necessary for Somalia to build on its progress and achieve lasting economic stability and prosperity.

2.1 Fiscal Sector Reforms

The Federal Government of Somalia (FGS) has demonstrated a strong commitment to fiscal sector reforms, which have been crucial in achieving the HIPC completion point. Central to these reforms has been the focus on fiscal stability and the implementation of poverty reduction strategies. Notable progress includes the passage of nine financial governance laws, which have provided a robust legal framework for managing public finances more effectively. These legislations include the Revenue Administration Act (2019), Public Financial Management Act (2019), Procurement Act (2016, amended 2020), Customs Act Amendments (2020), Statistics Act (2020), Petroleum Act (2020), Extractive Industries Income Tax Act (2023), Audit Act (2023), and Fisheries Act (2014 and 2023) (MoF, 2023).

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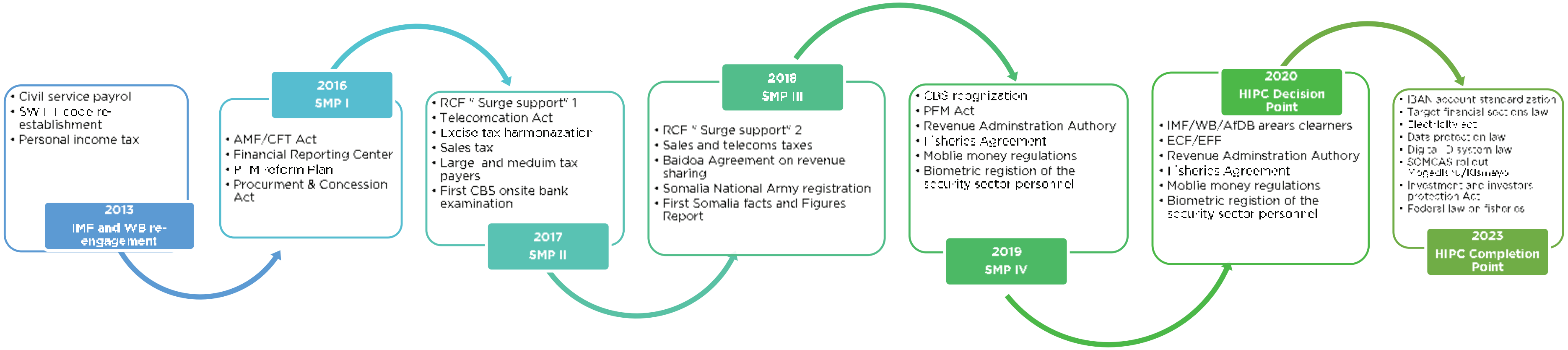
[1] IMF, 2020. "IMF Executive Board Approves 3-Year ECF and EFF Arrangements for Somalia". March 2020

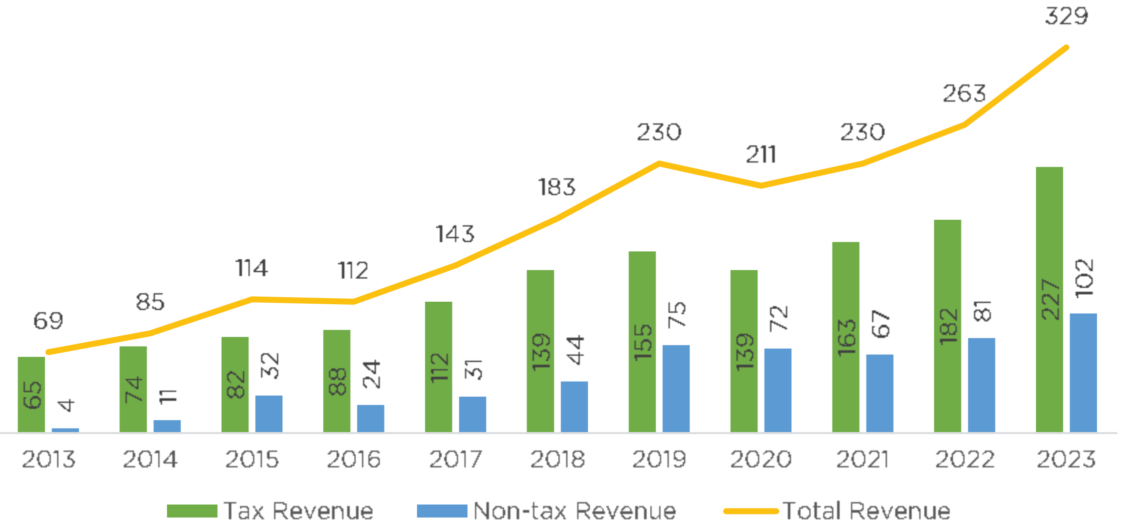
[2] IMF, 2023. "IMF Reaches Staff-Level Agreement with Somalia on a 36-Month Extended Credit Facility Arrangement". November 2023.

Figure 1: The Reforms and Debt Relief Process over the Past Decade



Source: IMF, 2023

Figure 2: The Performance of Federal Government Revenues between 2013 & 2023, (In Millions of US Dollars)

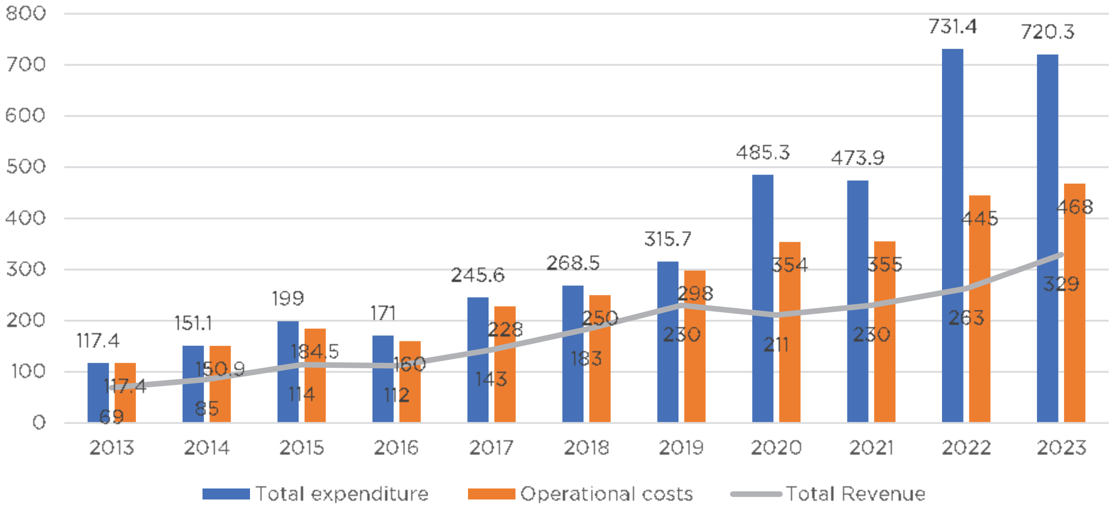


Source: MoF, 2023

Domestic revenue has seen a remarkable increase, growing fourfold from US$69 million in 2013 to US$329 million in 2023. Major domestic revenue sources include administrative fees, taxes on goods and services, taxes on international trade, and taxes on capital gains, profits, and income. Non-tax revenue sources include visa fees, passports, work permits, airport fees, over-flight fees, business licenses, and customs harbor fees.

Despite significant reforms implemented by the FGS since 2013 to enhance revenue, it remains insufficient to cover the government's recurrent expenditures. Somalia's domestic revenue is notably the lowest in Africa, particularly among East African economies, with a tax revenue-to-GDP ratio of less than 3 percent, contrasting sharply with Africa's average of 15 percent (Volz et al., 2020).

Figure 3: Comparison of Fiscal Receipts and Operational Costs 2013–2023, (In Millions of US Dollars)



Source: MoF, 2023

The operational costs of the FGS have escalated significantly, outpacing the growth in domestic revenues, largely due to a fivefold increase in salary payments over the past decade. This imbalance between high expenditures and inadequate domestic revenue has forced the FGS to heavily rely on external grants to finance its operations (MoF, 2023).

2.2 Financial Sector Reforms

Over the past decade, the Central Bank of Somalia (CBS) has been dedicated to rebuilding the country's financial infrastructure. It has implemented various measures to strengthen the finance sector and enhance financial inclusion. These efforts include improving access to credit for the private sector and addressing risks associated with money laundering and terrorism financing through initiatives like the Targeted Financial Sanctions Law and its implementing regulations. On the regulatory front, the CBS has been proactive, developing and the Federal Parliament of Somalia has enacted nine key legal frameworks since 2012. These include foundational laws such as the Central Bank of Somalia Act (2012), the Financial Institutions Act (2012), and more recent legislation like the Anti-Money Laundering and Countering the Financing of Terrorism Act (2016) and the Targeted Financial Sanctions Act (2023). Additionally, drafts of bills such as the Insurance Bill and the National Payment Systems Bill are under consideration, demonstrating ongoing regulatory development. The CBS Board of Directors have also endorsed 13 crucial regulations and guidelines for commercial banks, 5 regulations and guidelines for MTBs, 4 AML/CFT –related regulations and guidelines, and one for mobile money regulation, including the revised Capital Adequacy Regulation and the Regulation on Liquidity Risk Management. In July 2023, the Board issued guidelines on risk-based Know-Your-Customer and customer due diligence approaches, as well as reporting requirements for large cash transactions and suspicious transactions by commercial banks.

Table 1: CBS reforms and achievement areas in the last decade

Fiscal agent services for the government	Licensing and supervision in the financial sector	Digitization
• CBS systems upgrade & interconnectivity with MoF systems. • Opening branches in FMS. • Connectivity with international banking system. • Recovery of frozen assets. • Implemented automation of payment and single treasury accounts	• Stronger regulatory framework for the supervision of financial sector institutions. • Licensing & supervision of domestic banks, international, MTBs & MMOs. • Launched the SOMQR Code and national ID system (for KYC). • Implemented a stronger framework for Anti Money Laundering & Countering the Financing of Terrorism.	• Established a National Payment System. • Implemented International Bank Account Numbers (IBAN). • Standardized national Quick Response code.

Source: MoF, 2023

In recent achievements, the CBS has made significant strides by introducing a national payments system, implementing International Bank Account Numbers (IBAN), integrating an AML/CFT compliance module into the national payment system, and launching the SOMQR Code. These advancements have enhanced the country's financial sector profile, leading to Türkiye's Ziraat Katilim Bank becoming the first international bank to open a branch in Somalia in 2023, marking a milestone after half a century (CBS, 2023). The CBS continues to oversee, license, and regulate a growing number of entities within Somalia's financial sector. As of the end of 2023, it had licensed 13 domestic banks and foreign bank branch with total assets amounting to US$1,795.5 million, 13 Money Transfer Businesses (MTBs), and 4 Mobile Money Operators (MMOs). Despite implementing significant reforms aimed at modernizing Somalia's financial sector and ensuring its stability, the Central Bank of Somalia (CBS) has faced challenges in effectively carrying out its functions, so the reform momentum must be maintained. By sustaining these fiscal and financial reforms and addressing the existing challenges, Somalia can build a more resilient and inclusive economy. International support remains vital in this endeavor, providing the necessary resources and expertise to help Somalia navigate its post-HIPC journey toward sustainable development.

BOX 1: SOMALIA'S DEBT COMPOSITION

At the beginning of Debt Relief Program - End-2016

Somalia has been making significant progress in rebuilding its economy since 2012, after two decades of social conflict and civil war. At the end of 2016, the country's total external debt was estimated to be above US$5 billion, representing 79 percent of the GDP. The country owes US$3,613 million (57 percent of GDP) of its outstanding debts to bilateral creditors while liabilities to multilateral creditors constitute a total amount of US$1,449, representing 22.9 percent of GDP.

At the Completion Point, End-2023

Since 2016, Somalia has embarked on a long journey of economic and financial reforms to achieve the Heavily Indebted Poor Countries (HIPC) initiative completion point beyond the HIPC framework has resulted in the cancellation of all Paris Club debt. Somalia's debt will amount to approximately US$638 million, or 5.5 percent of GDP, by the end of 2023 (MoF, 2023).

Table 2: External Public Debt at beginning and Debt relief (% Change of GDP) in Millions of US dollars

	At the beginning of the debt relief program- end-2016		**At completion Point, end-2023**	
	Millions of US Dollars	Percent of GDP	Millions of US Dollars	Percent of GDP
Total	5,063	79.9%	637.8	5.5%
Multilateral	1,449	22.9%	405.6	3.5%
Bilateral	3,613	57.0%	232.2	2.5%

Source: MoF, 2023 and CBS, 2016

3. LESSONS FROM POST-HIPC COUNTRIES AND SOMALIA'S MAIN CHALLENGES

In 1996, the World Bank and IMF launched the Heavily Indebted Poor Countries (HIPC) initiative with the goal of alleviating unmanageable debt burdens for eligible low-income nations. This debt relief program provides these countries with the opportunity to address critical development needs by reducing their debt obligations. The HIPC process involves two main stages: the decision point, where a country becomes eligible for interim debt relief, and the completion point, where it receives full and irreversible debt relief after meeting specific triggers. Historically, most low-income countries reached the HIPC completion point before 2011. However, within a decade of completing the debt relief program, many of these countries found themselves at high risk of falling back into debt distress. This trend underscores the challenges in achieving long-term debt sustainability in the post-HIPC era. Weaknesses in macroeconomic infrastructure, policies, and institutional capacities in project and debt management have rendered new foreign debt unsustainable for these nations. Insufficient domestic revenue generation further exacerbates their vulnerability to liquidity and solvency risks.

Somalia, in addition to these broader challenges faced by low-income economies, contends with significant security, economic, and political hurdles that could impact its development trajectory and debt sustainability following HIPC relief. To mitigate the risk of relapsing into debt distress, Somalia must exercise caution in its external borrowing practices post-relief. It is imperative for the country to prioritize implementing essential reforms and creating a conducive environment that supports sustainable economic growth and fiscal stability. By focusing on these reforms and fostering an enabling environment, Somalia can enhance its resilience against debt vulnerabilities and pave the way for long-term economic development.

Three main binding constraints that need to be addressed for Somalia to achieve sustainable economic development include:

1. **Weak Revenue Mobilization and Fiscal Sustainability:** Somalia faces significant challenges in generating sufficient domestic revenue to fund its recurrent expenditures and development initiatives. Despite efforts to improve revenue collection, domestic revenue remains among the lowest in Africa. This low revenue base limits the government's ability to invest in essential infrastructure, education, healthcare, and other critical sectors necessary for sustainable development. Addressing this constraint requires enhancing tax administration capabilities, broadening the tax base, combating tax evasion, and improving fiscal discipline to ensure sustainable public finances.

2. **Vulnerability to External Shocks and Economic Resilience:** Somalia's economy is highly vulnerable to external shocks, including global trade disruptions, fluctuations in external aid flows, and climate-related disasters such as droughts and floods. These shocks can destabilize the economy, exacerbate poverty, and hinder long-term development efforts. Building economic resilience involves diversifying the economy away from dependency on agriculture and livestock, promoting industrialization and manufacturing, improving infrastructure to withstand climate impacts, and implementing robust risk management strategies. Enhancing resilience will help mitigate the adverse effects of external shocks and support sustainable economic growth.

3. **Political Instability and Governance Challenges:** Persistent political instability, conflicts between federal member states and the federal government, and governance deficiencies pose significant barriers to Somalia's economic development. Political tensions and uncertainties undermine investor confidence, disrupt policy implementation, and hinder

progress in economic reforms. Achieving sustainable economic development requires strengthening political institutions, promoting inclusive governance structures, enhancing transparency and accountability, and fostering peaceful political dialogue. Resolving governance challenges will create a conducive environment for private sector investment, promote economic diversification, and ensure sustainable development outcomes.

Addressing these binding constraints requires coordinated efforts from the Somali government, international partners, civil society, and the private sector. Strategic investments in institutional capacity building, infrastructure development, human capital, and inclusive economic policies are essential to overcoming these challenges and unlocking Somalia's potential for sustainable economic growth and prosperity.

4. OPPORTUNITIES FOR DEBT RELIEF IN SOMALIA

The debt relief program has provided Somalia with a way to bring its foreign debt to a manageable level and obtain new financing to aid in social and economic development. The process began in 2016 and has presented a significant opportunity for Somalia to overcome its debt challenges. This opportunity to further engage the country's international financial institution, unlocking high financing for development, opens the way for access to new external financing to support inclusive growth and poverty reduction

1. **Reduction in Debt Stock:** The debt relief program was important in alleviating excessive debt burdens, marking Somalia as the 37th country to achieve the HIPC completion point statutes. This milestone reflects the country's remarkable progress in managing its external debt, which has decreased dramatically from 64 percent of GDP in 2018 to less than 6 percent by the end of 2023. Correspondingly, Somalia's public debt has been reduced from US$5.3 billion at the end of 2018 to US$0.6 billion by the end of 2023.The debt relief provided to Somalia reduces the country's external debt repayments to sustainable levels. Moreover, upon reaching the HIPC Completion Point, Somalia become eligible for Multilateral Debt Relief Initiative (MDRI). This initiative cancels 100 percent of the eligible debt owed to the IMF, the World Bank, and the African Development Bank, significantly reducing the country's debt burden.
2. **Accessing New Funds:** With manageable debt level, Somalia can access new funds from international financial institutions (IFIs) like the International Monetary Fund (IMF) and the World Bank and African Development Bank. Upon achieving debt relief, Somalia improves its creditworthiness and gain better access to concessional financing from both Multilateral and Bilateral partners.

5. POST-HIPC POLICY RECOMMENDATIONS

To fully capitalize on the post-HIPC world and advance towards sustainable economic development, Somalia should prioritize the following policy recommendations in a sequenced manner, beginning with immediate actions and progressing to more substantial structural reforms:

For the Federal Government of Somalia:

1. **Advance Fiscal Sustainability:** Increase and diversify domestic revenue sources, establish a comprehensive and unified tax collection system with adequate revenue sharing mechanism, advance fiscal federalism, natural resource sharing, and develop a medium-term expenditure framework (MTEF) for budget planning.
2. **Improve Business Environment:** Establish transparent governance, promote private investment, and create special economic zones or industrial parks.
3. **Complete Reforms:** Focus on customs harmonization and transparent natural resource management.

4. **Invest in Infrastructure and Human Capital:** Prioritize strategic infrastructure investments and human capital development to stimulate growth and reduce poverty.
5. **Strengthen Debt Management:** Continue economic reforms and develop a comprehensive debt management strategy to avoid unsustainable debt levels.
6. **Engage International Partners:** Collaborate with international partners to sustain reforms and support inclusive growth.
7. **Form a Public Debt Committee (PDC):** Set up a PDC comprising representatives from the Ministry of Finance, Central Bank, and other relevant ministries. This committee should oversee debt policy, approve borrowing plans, and ensure coordination across government bodies.
8. **Develop a Medium-Term Debt Strategy (MTDS):** Formulate and implement an MTDS that aligns with the country's economic goals and ensures debt sustainability. The strategy should outline borrowing plans, risk management strategies, and debt reduction targets.

For the Private Sector:

1. **Engage in Public-Private Partnerships (PPPs):** Collaborate with the government on infrastructure projects to boost growth and create jobs.
2. **Promote Entrepreneurship:** Support SMEs through access to finance and mentorship programs.
3. **Invest in Innovation and Technology:** Embrace innovation to drive efficiency and unlock new economic opportunities.

For International Partners:

1. **Provide Targeted Development Assistance:** Align aid with Somalia's national priorities, focusing on resilience to climate shocks and poverty reduction.
2. **Continue Technical Assistance:** Strengthen government institutions and public financial management.
3. **Invest in Sustainable Development Goals (SDGs):** Provide humanitarian aid while investing in resilience-building programs to help communities adapt to climate change.

Somalia's achievement of the HIPC completion point marks a new chapter in its economic development. By addressing the outlined challenges and leveraging opportunities, Somalia can build a sustainable and inclusive economic future.

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