

AFRICAN DEVELOPMENT BANK GROUP



SOMALIA

ADDENDUM TO COUNTRY BRIEF 2013-2015

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Acronyms and Abbreviations

| | |
|--------|--|
| ADF | African Development Fund |
| AU | African Union |
| CB | County Brief |
| CBS | Central Bank of Somalia |
| DMU | Debt Management Unit |
| DPs | Development Partners |
| DPF | Development Partners Forum |
| DRSLP | Drought Resilience and Sustainable Livelihood Programme |
| EFGISP | Economic and Financial Governance Institutional Support Project |
| ERP | Economic Recovery Plan |
| FGS | Federal Government of Somalia |
| FSF | Fragile States Facility |
| GDP | Gross Domestic Product |
| GEF | Global Environmental Facility |
| HDI | Human Development Index |
| HIPC | Highly Indebted Poor Country Initiative |
| HLPF | High Level Partners Forum |
| IFIs | International Financial Institutions |
| IGAD | Inter-Governmental Authority on Development |
| IMF | International Monetary Fund |
| IOM | International Organisation for Migration |
| I-PRSP | Interim Poverty Reduction Strategy Paper |
| ISP | Institutional Support Project |
| MDBs | Multilateral Development Bank's |
| MoFP | Ministry of Finance and Planning |
| PBA | Performance Based Allocation |
| PFM | Public Financial Management |
| PRSP | Poverty Reduction Strategy Paper |
| PSGs | Peace and State Building Goals |
| SDRF | Somali Development and Reconstruction Facility |
| SMP | Staff Monitored Programme |
| SEP | Somalia Enhanced Programme |
| TFG | Transitional Federal Government |
| TWG | Technical Working Group |
| UN | United Nations |
| UNESCO | United Nations Educational, Scientific and Cultural Organization |
| UNFPA | United Nations Fund for Population Activities |
| UNOCHA | United Nations Office for the Coordination of Humanitarian Affairs |
| UNSOM | United Nations Mission to Somalia |
| WHO | World Health Organisation |

INTRODUCTION AND PURPOSE

1. The Somalia Country Brief (CB) 2013-2015 was approved by the Boards of Directors in April 2013 (ADB/BD/WP/2013/24 – ADF/BD/WP/2013/18). The CB lays out the Bank’s scaled up programme of reengagement, through the Somalia Enhanced Programme (SEP). The Boards welcomed the Bank’s proactivity and positioning in strategic areas of interventions to support the process of recovery in Somalia¹. The Boards specifically approved: (i) *“the strategic and operational activities... under the Bank Group Somalia Enhanced Programme”*, and (ii) *“the exceptional use of Bank Group internal resources in line with the existing policy guidelines, to be utilized as seed money to mobilize additional funds from development partners for co-financing or parallel financing”*.

2. Since the approval of the CB, significant progress has been made by the Federal Government of Somalia (FGS), in the implementation of the Bank Group’s Programme, as well as in the reengagement efforts by the international community. **The purpose of this Addendum to the CB is to provide an update, including progress towards arrears clearance and debt relief, and, importantly, to seek the Boards approval for Somalia to use, on an exceptional basis, 50% of its ADF-12 Performance Based Allocation (UA 2.5m) and ADF-13 Pillar I resources from the FSF (UA 11m), in accordance with the policy guidelines.**

3. An exceptional approval of these funds is required because Somalia is a fragile state that is still in arrears with the Bank Group. The funds will be used primarily to finance implementation of the Bank’s *Economic and Financial Governance Institutional Support Project (ISP) – phase I and II – for Somalia (UA 8m) using a programmatic approach, and to augment (UA 5.5m) the resources already mobilised internally and externally for the inclusion of Somalia in the Bank’s Drought Resilience and Sustainable Livelihoods Programme (DRSLP).*

4. The *Economic and Financial Governance ISP* is a critical component of the wider international assistance to the Government’s PFM Reform Action Plan and reengagement agenda with the International Financial Institutions (IFIs). **Importantly, the ISP will contribute to building the capacity for Somalia to take ownership in the design and implementation of an IMF Staff Monitored Programme (SMP), which is essential in building the track record required to accelerate the process of arrears clearance and reengagement with the IFIs.**

RECENT DEVELOPMENTS IN SOMALIA

Political and Security

5. *Since coming into office in September 2012, the FGS has made progress in implementing the federal structure and consolidating national unity.* Under the auspices of the Turkish Government discussions are ongoing between Somaliland and the FGS. Following fighting in Kismayo amongst militias and the unilateral declaration of a Jubbaland State, an agreement was reached to form a Jubba Interim Administration. This decision was welcomed by some (i.e. Puntland) as a constructive way to resolve the tensions in the south of the Country. However, although other regions – including Somaliland and Bay – have shown reluctance to accept this decision, a process of dialogue is being undertaken to resolve this and other issues. This has culminated in both the organisation of a national conference on the country's political and federal future, as well as two targeted conferences on the Jubbaland issue. Discussions have centered on progress made and challenges in implementing the new constitution, federalism, elections, resource sharing, reforming government agencies and good governance.

¹ The strategic areas include strengthening governance and capacities; support to the re-engagement process of Somalia with the international financial community, through a comprehensive programme of arrears clearance and debt relief; the inclusion of Somalia in the Bank’s regional Drought Resilience and Sustainable Livelihood Programme (DRSLP); as well as infrastructure planning to support the recovery process.

6. ***The Brussels New Deal conference for Somalia, in September 2013, stressed the importance of inclusive politics for all Somalis, and mutual agreement in building a strong and effective federalism (see paragraph 13 to 15).*** In this context, it welcomed the establishment of the Jubba Interim Administration and expressed support to Vision 2016, which aims at the adoption of the Federal Constitution by end-2015 and the holding of elections by 2016.

7. ***Gains continue to be made on the security front.*** Due to strong international efforts and collaboration with Somali Authorities, piracy off the coast of Somalia has declined considerably over the last year. In the course of 2013, cracks have started to appear in Al Shabaab's leadership, including serious internal fighting that culminated in the assassination of some of Al Shabaab's top leaders. As a result, and coupled with the efforts by AMISOM and Somali Security forces, Al Shabaab continues to be pushed back; even though progress is slow, particularly in rural areas where Al Shabaab remains strong. The terror group's use of asymmetrical tactics, such as suicide bombs and improvised explosive devices, are proving tough to counter. Consequently, the UN Secretary General called on countries in Africa and the world to provide the AU-led peacekeeping force with further military assistance (such as attack helicopters and armored troop carriers) to enable it to effectively fight Al Shabaab militants. During the recent Brussels conference, donors agreed to scale up their support in reinforcing the Somali security forces. In addition, given the continued regional spill-over effects of insecurity in Somalia, troop contributing countries to AMISOM, such as Kenya and Ethiopia, have also recently expressed their renewed commitment to the fight against Al Shabaab.

Economic and Social

8. ***Economic recovery continues to be hampered by the still challenging security situation, poor infrastructure and limited financial resources in most regions of Somalia.*** The Somali economy remains heavily dependent on high levels of aid and remittances. According to UN sources, humanitarian and development aid in 2012 was US\$ 750m, which on a per capita basis is one of the highest in the world. With estimations of between US\$ 1-1.5bn per year, remittances are the single largest contributor to national capital inflows and wealth.

9. ***However, these remittance flows, which are a vital lifeline for the Country, have recently come under threat due to concerns regarding the compliance of Somali remittance agencies with global regulations to combat money laundering and the financing of terrorism.*** As a result, the Federal Government, the Bank and several other development partners are worried about the impact this might have on the livelihoods of those in Somalia who receive remittances, as well as the Somali economy in general. Thus, together with the Ministry of Finance and Planning (MoFP) and Central Bank of Somalia (CBS), the Bank and a number of partners are working closely to find a lasting solution to this serious problem, including the putting in place of adequate safeguards to ensure the transparent and documented flow of these funds.

10. ***Youth unemployment, the provision of social services such as education and health, and building sustainable livelihoods continue to be key economic development challenges.*** For example, it is estimated that about 75% of young people in Somaliland are unemployed, which is higher than Somalia's national average. Although Somalia's population in crisis is at its lowest since a famine was last declared in the Country in 2011 (due to successive seasons of good rainfall, low food prices, and a sustained humanitarian response), acute malnutrition continues to pose a threat to hundreds of thousands of children, especially in the south of the Country. A UN report² indicates that an estimated 870,000 people will be in crisis from August to December 2013. Delivering humanitarian assistance is also hampered by the still challenging security situation.

² By the Food Security and Nutrition Analysis Unit for Somalia (FSNAU), a project managed by UN's Food and Agriculture Organization (FAO), and the Famine Early Warning Systems Network (FEWS NET).

Progress in Peace, State Building and Economic Recovery

11. ***Since the approval of the CB, the FGS has made significant progress in its peace, state building and economic recovery programme.*** To deliver on its mandate the FGS initially developed a six pillar policy: (i) Full Stability (supremacy of the law, good governance and functioning institutions); (ii) Economic Recovery (livelihoods and economic infrastructure); (iii) Peace Building (social reconciliation); (iv) Service Delivery (health, education and environment); (v) International Relations (collaboration and reengagement); and (vi) National Unity (reconciliation and political dialogue). This policy was to be implemented through an initial focus on the priority areas of Security, Justice and Public Financial Management (PFM).

12. ***Subsequently a PFM Self-assessment and Reform Action Plan (carried out in April 2013 by the FGS with support from development partners) were prepared to provide a baseline on the Country's state of PFM systems, and a framework for international support.*** The Action Plan proposes a set of sequenced reform actions, built on four interlinked platforms, namely: budget accountability; effective budget execution and financial compliance; improved policy formulation, planning and preparation; and institutional structures (human resource management, IT systems and cross cutting issues). Key priorities of the Action Plan have also been adopted in the Somali Compact (see paragraph 13). As determined through a division of labour exercise with other development partners, the Bank is endeavoring to support the third platform – policy formulation, planning and preparation (see Box 3).

13. ***The Somalia New Deal Compact was endorsed on 16 September 2013 by the Federal Government and the international community.*** The Compact lays out the critical priorities under the five Peace and State Building Goals (PSGs) that have been endorsed as part of the New Deal principles for engagement in Fragile States, and also includes a Special Arrangement for Somaliland. The PSGs pillars are: (i) inclusive politics; (ii) security; (iii) justice; (iv) economic foundations; and (v) revenue and services. The Compact will guide international support to Somalia over the next three years (2014-2016)³. Development financial assistance will be mobilised and channeled through a proposed new financial architecture called the *Somali Development and Reconstruction Facility* (SDRF), which is expected to bring together several existing and new funds under a consistent governance platform.

14. ***The SDRF structure will have a common governance and monitoring framework, and financial support will be delivered through a number of financing windows and through the use of local systems and institutions.*** The four windows that have been proposed are the Special Financing Facility⁴ (with management support from Norway), and separate UN, World Bank and Bank windows, each focusing on particular thematic areas. The Bank will provide and mobilise development support through its financing window, which will be built around the SEP and whose details are being developed in coordination with the FGS and other relevant partners.

15. ***In order to rebuild the Somali economy and provide better service delivery, the FGS has developed a two-year Economic Recovery Plan (ERP) 2014-2015 that was presented alongside the Compact.*** The ERP aims to provide a common vision for Somalia's pathway to economic recovery. The Plan sets out principles that will guide the transition from emergency relief to early country recovery and development, identifies priority sectors and programmes for quick economic recovery, and also lays the foundations for subsequent growth and development. The ERP is based on existing sector strategies and policies, where these are available, so as to facilitate a quick and streamlined implementation.

³ The Compact also reflects the priorities of Puntland's National Development Plan, and includes a Special Arrangement for Somaliland, based on its National Development Plan.

⁴ With a timeline of about two to three years, the SFF will focus on FGS salary payments, small-scale local development projects and enhancing PFM capacity. It will serve to build Country systems, provide a basic benchmark of credibility and stability, and build public confidence during the initial phase of Government consolidation.

16. *The FGS is currently working to integrate the financial pledges from Brussels into the 2014 Budget, in order to strengthen the Budget's alignment with the ERP and priorities of the Compact, and ensure that priority flagship projects in the ERP are funded and delivered in a transparent manner.* Development partners, in particular the IMF, the World Bank and the Bank, have also committed to support the FGS in taking steps to ensure the ERP meets the requirements of an interim Poverty Reduction Strategy Paper (I-PRSP), through broadening the consultations and ensuring further alignment with the existing national economic plans of Puntland and Somaliland. This will be a key milestone in the HIPC debt relief process. It will also lay a strong foundation for the subsequent development at an earlier stage of a full PRSP.

17. *It should be noted that the CBS is also included in the PFM reform agenda. Although the donor community has raised concerns over corruption and governance issues, following the recent resignation of the CBS Governor (see Box 1), some progress has been made, in particular through the Bank's initial PFM project: "Rebuilding Financial Management Systems in Somalia" (see Annex 3).* A CBS five-year strategic plan has been developed, the Central Bank Act and Financial Institutions Act were passed in 2012, and a SWIFT code is now operational. However, major human and institutional capacity gaps need to be addressed urgently, including in the areas of statistics and the production of the CBS's annual accounts. Other key priorities are to strengthen the financial sector supervisory and regulatory capacity, including the need for regulations on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).

Box 1: Renewed commitment to more Accountable and Transparent Governance

On 30 October 2013, the newly appointed Central Bank Governor of Somalia unexpectedly resigned from her position after seven weeks in the job. Her resignation came as a shock to the international community and raised some corruption and governance concerns.

On 7 November 2013, the Somali President convened a meeting with Development Partners (DPs), including the Bank, to discuss the events surrounding the Governor's resignation, and also agree on a way forward for the CBS. The President underlined his Government's willingness to organise an independent inquiry into some issues raised in the Governor's resignation letter, including irregular withdrawals of funds and personal security concerns.

In this context, while strongly committed to support the recovery process of Somalia, DPs are pressing for greater levels of oversight and enhanced safeguard measures in the management and use of public funds. Amongst other things, the DPs are:

Encouraging the Somali Government to reengage with the **World Bank/OECD STAR (Stolen Asset Recovery) Initiative** to support the recovery of national assets abroad;

Proposing a **complete overhaul of the CBS** (e.g. setting up of an independent, qualified, representative and professional CBS Board, and the appointment of a new CBS Governor through a formal, transparent and competitive recruitment process) with close support from the IMF, World Bank and the AfDB; and

Urging for enhanced transparency by publishing **all Government contracts**.

The Somali President has committed to act on these issues. He particularly emphasised the FGS's willingness to take steps to stamp out corruption and mismanagement of public funds, as in the case of the previous CBS Governor who was removed following allegations of corruption that were made in the UN Somalia and Eritrea Monitoring Group report of July 2013. Furthermore, it should be noted that the Bank's proposed *Economic and Financial Governance Institutional Support Project* will be critical in this process.

International Relations and Aid Coordination

18. *The international community continues its re-engagement programme with Somalia through broad recognition and support for the FGS.* The Somali Compact was strongly endorsed in Brussels by the international community, with pledges amounting to EUR 1.8 billion. A new UN Mission to Somalia – UNSOM – was established in June 2013, and is based in Mogadishu and led by a Special Representative of the Secretary General. UN agencies, bilateral and multilateral

partners are committed to returning to Mogadishu from Nairobi. A number of partners have established some form of presence close to Mogadishu International Airport. Countries such as the UK and Turkey have already established Embassies while others have promised to do so and have nominated Ambassadors.

19. *The existing aid coordination framework will remain in place until implementation of a new coordination and financing architecture (that is, SDRF) begins under the New Deal Compact.* Until now, donor coordination has been a significant challenge in Somalia given the Government's weak institutional capacity, the role of different regional entities (Federal Government, Puntland and Somaliland) in managing aid, and the challenging security environment that has forced donors to operate largely from Nairobi. In order to manage donor aid, the main active donors in Somalia have been coordinating under the Somalia Development Partners Forum (DPF), whose membership includes the UN agencies, the MDBs, about thirty Bilateral African and non-African representatives, and the NGO Consortium. The DPF meets regularly to deal with substantive operational and policy issues in relation to international assistance to Somalia and its coordination.

20. *Going forward, aid coordination will be structured under two main groups: the High Level Partners Forum (HLPF) and the Steering Committee of the SDRF (the Bank will be represented in both groups).* The HLPF will bring together the leadership of the Government and Development Partners. The Steering Committee will be the technical coordination forum with Government and will gradually replace current donor coordination mechanisms. Under the Steering Committee, programme coordination at the sector level will be articulated around the five PSG pillars and will be co-chaired by the FGS and international partners. The Bank will be active in the groups set up for PSGs 4 and 5 (see paragraph 13).

21. *A Somalia Technical Working Group (TWG) on External Debt has recently been established, comprising both bilateral and multilateral creditors, and co-chaired by the FGS, as well as the IMF and the World Bank who have clear mandates in this area.* The Bank has been called on to play an active role and to sustain its technical assistance. The main objective of the TWG is to share information on the structure of the Country's external debt and the procedures for eventual debt relief, monitor the building of a credible track record of reforms, and identify gap-filling technical assistance. The TWG may also, over time, allow for an exchange of information on issues relating to IFI relationships (including the development of Somalia's poverty reduction strategy and its macroeconomic track record), arrears clearance, HIPC related issues, Paris Club and non-Paris Club bilateral debt relief, treatment of commercial debt, and the financing of debt relief. Box 2 provides an update on progress towards Arrears Clearance and Debt Relief.

Box 2: Progress towards Arrears Clearance and Debt Relief

The FGS has made considerable progress towards Arrears Clearance and Debt Relief in at least seven key areas: **Economic Recovery Plan (ERP), Macro-Fiscal Framework, PFM, Central Bank, Statistics, Debt Management and Preliminary Debt Reconciliation.**

The **ERP** will form the basis for the preparation of an I-PRSP, which is planned for completion by mid-2014. The ERP has also been used to develop a simple macro-fiscal framework whose main objectives are strong inclusive economic growth, maintaining price stability, and managing exchange rate volatility. This will provide a solid framework for planning and budgeting in all sectors.

The FGS is now working with the IMF to prepare a more detailed macro-policy framework, which will then lead to the preparation of a Staff Monitored Programme (SMP). At the first TWG meeting, on the margins of the World Bank/IMF Annual meetings (9 October 2013), the IMF expressed its commitment to put in place a SMP as soon as possible, using a pragmatic approach given the particular circumstances in Somalia and in line with commitments by the donor community to apply greater flexibility in dealing with Somalia. The SMP will provide the macro and policy framework necessary for the FGS to build the requisite track record of reforms. In this context, the IMF conducted a mission to Nairobi in October 2013 to participate in the 2014 budget process, and to initiate a capacity and TA needs assessment exercise. The outcome of the latter will require donor support for its implementation, so that the FGS can take ownership in accelerating the HIPC process. The Bank will also use the

outcome of the exercise to frame its programmatic approach for strengthening PFM.

The Bank's ***Economic and Financial Governance Institutional Support Project for Somalia*** (see Box 3) will support critical aspects of the overall reform efforts that are already on-going. Recent progress by the FGS in PFM and macro-fiscal reforms includes the:

preparation of 2012 annual financial statements,
submission to Parliament of the 2012 Audit Report within the statutory deadlines,
2013 budget approval by Parliament and its availability on the FGS website,
introduction of double entry accounting through an interim financial management information system (FMIS),
expanded Chart of Accounts to improve budgetary and financial statements,
embedding of budget controls and audit trails in the FMIS to improve the timeliness and availability of information for decision making, and to increase transparency through timely publication of fiscal reports,
establishment of an External Assistance Fiduciary Section,
development of an Audit Bill to strengthen the independence of the Office of the Auditor General, and
transparent recruitment of qualified candidates from the diaspora to fill the Auditor General and Accountant General positions.

The **Central Bank of Somalia** is also included in the PFM reform agenda. The CBS has now developed its own five-year strategic plan and basic regulatory framework. The Central Bank Act and Financial Institutions Act were passed in 2012, a SWIFT code is operational, and a Special Financing Facility (with management support from Norway) is using country systems for transparent and efficient payment of civil servant salaries.

A **Statistics Development Programme** has been initiated with support from development partners, including the Bank. It involves institutional capacity development and fast track data production, e.g. to develop an initial consumer price index for Mogadishu and to capture more trade data in order to construct a simple balance of payments.

The FGS is setting up a Debt Management Unit (DMU), with technical assistance from the Bank. The DMU is currently being supported by international experts to build capacity, enable the Government to play a leadership role in the arrears clearance process, reconstruct its debt database in preparation for HIPC milestones and, at a later stage, put in place debt management systems and processes. The FGS is already in the process of preparing a strategy for arrears clearance under the HIPC framework, and establishing a reconciled debt data base and debt management system.

An initial comprehensive estimate of Somalia's multilateral and bilateral debt was carried out with support from the World Bank. The overall external sovereign debt of Somalia towards public creditors is estimated at US\$5.7 billion, of which US\$1.5 billion is due to multilateral creditors (79% in arrears), US\$ 2.5 billion to Paris Club creditors (most of which is in arrears), and US\$1.6 billion to non-Paris Club bilateral creditors.

BANK PROGRAMMING AND RESOURCES 2013-2016

22. Since the CB approval, the Bank has made significant progress in implementing the SEP (see Table 1 and Annex 1 for further details). Due to its arrears status, Somalia has, so far, qualified for funds primarily from the Bank's FSF Pillar III (*UA 2.5m under ADF 12*):

- *UA 1.3m* was used to finance the PFM project *Rebuilding Financial Management Systems in Somalia*⁵ (approved in 2009) with the Transitional Federal Government (TFG).
- *UA 1m* is being used to finance (in partnership with UNFPA, World Bank, DFID and others) *statistical capacity building* in Somalia as a whole, including the Puntland and Somaliland regions⁶. This capacity is critical for, amongst other things, macro-fiscal planning and getting onto an IMF SMP.
- *UA 0.2m* is being used to place the two external debt experts in MoFP to set up and capacitate the Debt Management Unit (see Box 2). The DMU is intended to enable the Government to play a leadership role in the HIPC debt relief process.

⁵ Annex 3 provides a summary of the key achievements under this project and, thus, the lead role the Bank has played in supporting PFM reforms and capacity building.

⁶ Following a recent mission to Mogadishu to discuss the Somalia statistical system, the Bank is considering providing further support for building statistical capacity at the Federal level. The current top priority areas for capacity building are: (i) rehabilitation of physical facilities, (ii) development of a National Statistical System Strategy, and (iii) training and capacity building.

23. On the knowledge front, the Bank is undertaking a number of Infrastructure Needs Assessments in the energy, transport, ICT, agriculture, and water and sanitation sub-sectors. These assessments are included as key deliverables under the ERP. The ultimate goal will be to develop a *Somalia Infrastructure Action Plan*, which will feed into the Country's full PRSP. In addition, the Bank has been working on a *Human and Institutional Capacity Building* position paper, which may feed into the planned development of a broad Capacity Building Framework that is being driven by the Prime Minister's Office and supported by UNDP.

24. The Bank is preparing the *Economic and Financial Governance Institutional Support Project* (see Box 3), which will deliver key aspects of the Government's PFM Reform Action Plan (priorities of this Plan have also been adopted under PSG 5 – revenue and services – of the *Compact*). This operation will be a follow up of the Bank's previous PFM project with the TFG. On approval of this Addendum, the project will be funded using 50% of *Somalia's PBA determined grant allocation under ADF 12*.

Box 3: Economic and Financial Governance Institutional Support Project (EFGISP) – phase I

Following the finalisation of the PFM Reform Action Plan, the FGS and development partners undertook a *division of labour exercise* to ensure that partners properly align their support to effectively implement the Plan (the EFGISP PAR gives a detailed description of the results of this *division of labour exercise*). It was decided that the Bank would support the Plan's third platform concerned with policy formulation, planning, and preparation. Subsequently, a Bank team conducted a number of missions to Mogadishu, during the third quarter of 2013, to discuss with the Authorities the design of the EFGISP.

The EFGISP's overall development *objective* is to establish a macroeconomic and budget framework that will promote fiscal discipline, strategic and efficient allocation and use of public resources, and contribute to macroeconomic stability. The EFGISP has the following three *components*: (i) enhancing macroeconomic management and policy planning, (ii) improving the budget formulation process; and (iii) supporting capacity development and project management.

The EFGISP will assist FGS to build legitimacy by enabling it to demonstrate capacity to fulfill core state functions, of which management of the economy and public resources is a centerpiece. The Project will also contribute to Somalia's re-engagement with the international community, especially by *supporting the Country's process towards arrears clearance and the HIPC initiative*. This will be achieved through activities supported under the project, including: the process of debt reconciliation (led by the DMU), and the re-establishment of a basic macro-economic framework and budgeting function. These activities will also lay the foundation for the FGS to reach agreement on an IMF SMP, which in turn will be essential for building the required macro-fiscal track record needed to attain arrears clearance and debt relief under the HIPC and Multi-lateral Debt Relief Initiatives.

Finally, the EFGISP is aligned with the Somalia CB 2013–2015; particularly with *Pillar II - strengthening governance and capacities*, which covers support to PFM reforms and strengthening government's policy planning and implementation capacities, and *Pillar III – facilitating Somalia international re-engagement, especially through the arrears clearance process*. The operation is also consistent with the Bank's Ten Year Strategy (2013-22) and ADF-operational priorities – Governance and Accountability; all of which emphasise the need to pay special attention to Fragile States and to promote governance through strengthening PFM systems for inclusive growth.

25. During ADF-13, the Bank plans to use resources from Pillar I (about *UA 5.5m*) and Pillar III (about *UA 2.5m*) of the FSF to continue supporting Somalia's PFM reform agenda through a second phase of the *Economic and Financial Governance Institutional Support Project*, and in the context of the programmatic approach adopted. Phase II will likely focus on continued technical assistance and capacity building (e.g. for PFM – including at a Regional level, Central Bank, statistics, DMU etc.) required to accelerate the process of putting in place an SMP and creating the conditions for assisting the FGS in building a track record of reforms. The support will also take into account the outcome of the ongoing needs assessment exercise by the IMF.

26. In addition to the *UA 12m* that the Bank has committed from its surplus account for the DRSLP, ADF-13 resources will be used to augment additional resources that are mobilised. For example, the Bank is currently applying for funds from the *Global Environmental Facility* (GEF), and the *Swiss Agency for Development and Cooperation* has also recently expressed an interest in contributing about *UA 3m* to this programme. Full appraisal of the Somalia component of the

DRSLP is expected in early 2014, at which time the Bank will also explore ways that this project can address gender issues.

27. Following further progress by the Somali Government in building a track-record of reforms, Management envisages, if necessary, coming back to the Board at a later stage to request access for Somalia to utilise additional ADF-13 resources (to the extent allowed by the rules and guidelines), including *50% of its ADF-13 PBA resources (about UA 7.5m)*. In line with the PSGs, these resources could eventually be used to support the *Socio-Economic Reintegration of Youth-at-Risk* project, which is currently being discussed with IOM and USAID, as well as potential Bank support to infrastructure development (i.e. policy and institutional support), based on the outcome of the ongoing needs assessments. Furthermore, another potential area of support from ADF-13 resources could include Somalia’s arrears clearance within the agreed international comprehensive framework.

Table 1: Bank’s Somalia Programme and Resources 2013-2016 (UA m)

| Project | Cost | Resources | Status |
|--|-------------|---|------------------------------|
| Building statistical capacity in Somalia | 1 | ADF 12 Pillar III FSF | On-going |
| Economic and Financial Governance Institutional Support Project | 2.5 | 50% of Somalia’s ADF 12 PBA | Board approval December 2013 |
| Economic and Financial Governance Institutional Support Project (Phase II) | 8 | ADF 13 Pillar I & Pillar III FSF | Identification in 2014 |
| Drought Resilience and Sustainable Livelihoods Programme | 35 | Bank’s 2012 surplus account ADF 13 Pillar I FSF and 50% of PBA External resources (GEF, Bilaterals) | Under appraisal |
| Water Resources Management and Investment Plan for Somaliland | 1.8 | AWF | Being finalised |
| Arrears Clearance Support and Debt Management Unit - TA | 0.2 | ADF 12 Pillar III FSF | On-going |
| Socio-Economic Reintegration of Youth-at-Risk | 3 | ADF 13 50% of PBA | Identification in 2014-2016 |
| Infrastructure development (i.e. policy/institutional) | 3.5 | ADF 13 50% of PBA | Identification in 2014-2016 |
| Arrears clearance before end-ADF13 ⁷ | 71.3 | ADF 13 Pillar II FSF | Progressing |

SOMALIA’S ELIGIBILITY FOR SUPPLEMENTAL SUPPORT FUNDING AND 50% OF ITS ADF 12 PBA ALLOCATION

Strategy for Countries in Arrears and Guidelines to Access FSF Pillar I and PBA Resources

28. According to the Bank Group’s Operations Guidelines of the Fragile States Facility (paragraph 3.1.11) exceptional support for countries in arrears “*would be allowed in the absence of debt regularisation in transitional countries with chronic arrears showing a firm commitment to regularise their debts.*” Furthermore, paragraph 3.1.12 states that “*in such arrangements, which must be approved by the Board of Directors, an eligible country could be allowed to utilise all its supplemental funding to support operations plus a maximum of 50% of its PBA determined grant allocation for capacity building prior to debt regularisation, in line with the Bank’s proposals for technical assistance.*”

⁷ Somalia’s arrears to the Bank Group at end-2016 (end of ADF-13) are projected to be UA 71.3m, of which UA 52.8m will be arrears to ADF. Resources to clear ADF arrears still need to be mobilised from non-ADF sources.

Exceptional Eligibility for Supplemental Support Funding under ADF 12 & 13

29. A country's eligibility for FSF Supplemental Support Funding (Pillar 1) is outlined in the Bank Group's Strategy for Enhanced Engagement in Fragile States and the Operations Guidelines of the FSF. The *first stage* assesses a country's: (i) commitment to consolidate peace and security, and (ii) unmet social and economic needs. A country that meets the first-stage criteria is then subjected to a *second-stage filtering* process that is intended to capture the country's commitment to: a rigorous programme to improve macroeconomic conditions and pursue a sound debt policy, sound financial management practices and transparency of public accounts. Somalia's current position in meeting these criteria is summarised in Annex 2.

30. Based on the assessment in Annex 2, Somalia easily meets the *first stage criteria*. Furthermore, the assessment shows that Somalia has also, over the last year, demonstrated strong commitment and leadership in putting in place the key elements required to meet the *second stage criteria*. Going forward, Somalia will need to continue building a track record of reforms to consolidate the *second stage criteria*. This process is on-going and includes the Bank's proposed support to the PFM agenda.

31. Given the commitment and leadership that the FGS has already demonstrated in a relatively short time, and the need for the Bank Group to play a strong, proactive and innovative role in the sustained support from the international community, Management is of the view that Somalia exceptionally qualifies for *FSF Pillar I funding under ADF-12 and ADF-13*.

32. However, Somalia was not allocated any funds for FSF Pillar I under ADF-12, due to the unfavorable country context that prevailed at the time. Given the positive evolving situation discussed both in the Country Brief 2013-2015 and this Addendum, the eligibility for FSF Pillar I resources under ADF-13 is now much more promising. Somalia is, thus, seeking approval for utilising these funds in line with the principle of 'predictability of resources' contained in the *Somali Compact*. This will allow Management to better adhere to the programmatic approach adopted in support to PFM and the recovery process of Somalia.

Exceptional Eligibility for 50% of its PBA allocation

33. It should be noted that Somalia's arrears clearance will require full and exceptional support from the international community, given the particularly extreme and fragile situation of the country. Based on the exceptional qualification of Somalia for FSF Pillar I funding discussed above, and given the leadership and firm commitment that the FGS has demonstrated towards regularising the external debt of the country (see Box 2), Management is also of the view that Somalia would be eligible to "...a maximum of 50% of its PBA determined grant allocation for capacity building prior to debt regularization..." (see paragraph 28).

34. Somalia is, therefore, seeking approval to utilise *50% of its ADF-12 PBA*, amounting to UA 2.5m. It should also be recalled that this is in line with the approved CB 2013-2015, which clearly stated that through the SEP, the Bank "*will mobilise to the maximum extent possible the Bank's internal resources*" in support of the rebuilding of Somalia.

35. As discussed earlier, these resources will be used to finance capacity building under the Bank's *Economic and Financial Governance Institutional Support Project* for Somalia. This Project is a key component of wider international assistance to the Government's PFM Reform Action Plan, to putting in place an IMF SMP and, ultimately, progress towards arrears clearance (see Box 3).

CONCLUSION AND RECOMMENDATIONS

Conclusion

36. Significant progress has been made in Somalia since the approval of the Somalia Country Brief (CB) 2013-2015. This includes progress in consolidating peace, security, and building national unity. With the support of development partners, Somalia has also vigorously embarked on a programme of economic recovery, including the implementation of key macro-economic and public financial management reforms. However, Somalia remains at a critical juncture, facing unique reconstruction and development challenges that require creative and exceptional approaches, as well as substantial resources.

37. To consolidate the progress Somalia has made to date, the Bank, as a strategic and trusted partner, needs to play a significant role in supporting, amongst other things, the proposed PFM reforms. These reforms will help build the necessary track record for arrears clearance and debt relief, and will also prepare the ground for donors to use country systems in accordance with the *Somali Compact*.

38. On the basis of the Government's initial steps and commitment to the reform agenda (including the arrears clearance process), and taking into account Somalia's extreme and fragile economic, social and humanitarian situation, Management is of the view that the Board's approval, on an exceptional basis, of Somalia's eligibility to *FSF Pillar I funding* and *50% of its ADF-12 PBA allocation* is warranted. The Board's approval will also allow Management to better adhere to the programmatic approach adopted in support to PFM and the recovery process of Somalia. In addition to these funds, the Bank will continue to mobilise resources, to the maximum extent possible, from both internal and external sources for sustained implementation of the Somalia Enhanced Program (SEP).

Recommendations

39. The Board of Directors are invited to:

- Take note of the progress made in implementing the Somalia Enhanced Program (SEP), which was discussed in the Somalia Country Brief 2013-2015 and approved in April 2013;
- Grant exceptional approval for Somalia's eligibility to access Fragile States Facility (FSF) supplemental support funding (Pillar 1), in accordance with the Bank's Strategy for Enhanced Engagement in Fragile States and the Operations Guidelines of the FSF; and, following which,
- Grant exceptional approval for Somalia to use 50% of its ADF-12 PBA allocation.

Annex 1: Bank's Somalia Programme and Resources 2013-2016 (UA m)

| | Cost | ADF 12 | | | | | | ADF 13 | | | |
|---|------|------------|----------|----------|----------|-----|--------------|------------|----------|----------|----------|
| | | 50% of PBA | Pillar 1 | Pillar 2 | Pillar 3 | AWF | Bank Surplus | 50% of PBA | Pillar 1 | Pillar 2 | Pillar 3 |
| | | 2.5 | 0 | 0 | 2.5 | 1.8 | 12 | 7.5 | 11 | 18.5 | 2.5 |
| Rebuilding PFM Systems in Somalia (approved in 2009) | 1.3 | | | | 1.3 | | | | | | |
| Building statistical capacity in the three regions of Somalia | 1 | | | | 1 | | | | | | |
| Economic and Financial Governance Institutional Support Project | 2.5 | 2.5 | | | | | | | | | |
| Economic and Financial Governance Institutional Support Project (II) | 8 | | | | | | | | 5.5 | | 2.5 |
| Drought Resilience and Sustainable Livelihoods Programme ⁸ | 35 | | | | | | 12 | 2.5 | 5.5 | | |
| Water Resources Management and Investment Plan for Somaliland | 1.8 | | | | | 1.8 | | | | | |
| Arrears Clearance Support and Debt Management Unit - TA | 0.2 | | | | 0.2 | | | | | | |
| Socio-Economic Reintegration of Youth-at-Risk ⁹ | 3 | | | | | | | 1.5 | | | |
| Infrastructure development (i.e. policy/institutional) | 3.5 | | | | | | | 3.5 | | | |
| Arrears clearance before end-ADF13 | 71.3 | | | | | | | | | 18.5 | |

⁸ A further UA 15m still needs to be mobilised from the GEF and other partners (e.g. the *Swiss Agency for Development and Cooperation* has already expressed an interest in contributing about UA 3m to this programme).

⁹ A further UA 1.5m still needs to be mobilised for this project.

Annex 2: Eligibility Criteria for FSF Supplemental Support Funding

| First Stage Criteria | |
|--|--|
| Commitment to Consolidate Peace and Security | <ul style="list-style-type: none"> (i) On 1 August 2012, the National Constituent Assembly of Somalia adopted the Provisional Constitution, a key milestone towards the end of the political transition. And on 20 August 2012, the Somali Parliamentary elections effectively marked the end of the transition period. (ii) The new Parliament elected Hassan Sheikh Mohamud as the President of the Federal Republic of Somalia on 10 September 2012, and a new Federal Government was formed. (iii) The FGS has a recognised degree of authority and legitimacy both at home and abroad where it has been recognised by the international community, including the UN, AU, IMF, World Bank and many other organisations and countries (for instance, the USA, UK). (iv) The FGS has made strong efforts to enhance national unity. Under the auspices of the Turkish Government discussions are on-going between Somaliland and the FGS. An agreement was reached in August 2013 to form a Jubba Interim Administration. The Somali Compact includes Puntland and has a Special Arrangement for Somaliland. (v) An AU-led peacekeeping force continues to support Somali Security Forces in the fight against Al Shabaab, and has managed to reclaim significant territory over the last few years. |
| Unmet Social and Economic Needs | <ul style="list-style-type: none"> (i) Somalia is one of the poorest countries in the world as it ranked 165 out of 170 countries in 2010 (Human Development Report 2012¹⁰). <i>Unfortunately, there is no reliable and consistent information on the change in Somalia's GDP since 1990. However, all indications (e.g. large drop in major exports such as bananas and livestock) are that there has been a significant contraction in the economy.</i> (ii) Although the worst of the 2011 famine has since passed, as of September 2013, over 2m Somalis still faced acute food insecurity (UNOCHA, 2013¹¹). (iii) Most Somali's live in rural areas and only 7% of these have access to water sources and 23% have access to sanitation facilities (Human Development Report, 2012). (iv) The nutritional status of the population is very poor. Data for the 2001 to 2009 period shows that median rates of global acute malnutrition have remained at Serious (10 to <15%) or Critical (15 to <20%) levels (WHO Classification, 2000), with a national median rate of 16%. (v) Secondary school participation – measured by the gross enrolment rate in South Central Somalia – is only 6% for boys and a very low 3% for girls (UNESCO Survey of Secondary Education in Somalia 2008¹²). |
| Second Stage Criteria | |
| Improving Macroeconomic Conditions and Pursuit of Sound Debt Policy | <ul style="list-style-type: none"> (i) FGS has developed a two-year Economic Recovery Plan (ERP) for the 2014-2015 period. The ERP will now provide a framework for planning and budgeting in all sectors. (ii) The ERP will form the basis for the preparation of an I-PRSP, which is planned for completion by mid-2014. The ERP has also been used to develop a simple macro-fiscal framework whose main objectives are strong inclusive economic growth, maintaining price stability, and managing exchange rate volatility. This will provide a solid framework for planning and budgeting in all sectors. (iii) The FGS is working with the IMF to finalise a sound macro-policy framework over the next few months, which will then lead to the preparation of a Staff Monitored Programme (SMP). At the first TWG meeting, the IMF expressed its sense of urgency and commitment to put in place a SMP as soon as possible, based on rudimentary requirements and in line with its commitment to apply greater flexibility in its approach to Somalia. (iv) The FGS has made considerable progress towards Arrears Clearance and Debt Relief. This track record has been built in six areas: Economic Recovery Plan (ERP), Macro-Fiscal Framework, PFM, Central Bank, Statistics and Debt Management (see Box 2 for details). (v) The FGS has set up a Debt Management Unit (DMU), with support from the Bank Group, that is initially staffed by international experts to build capacity, enable the Government to |

¹⁰ Available from <http://www.undp.org/content/undp/en/home/librarypage/hdr/Somalia-human-development-report-2012/>

¹¹ Available from <http://reliefweb.int/sites/reliefweb.int/files/resources/OCHA%20Somalia%20Humanitarian%20Bulletin%20September%202013.pdf>

¹² Available from <http://unesdoc.unesco.org/images/0021/002167/216761e.pdf>

| | |
|---|--|
| | <p>play a leadership role in the arrears clearance process, reconstruct its debt database in preparation for HIPC milestones and, at a later stage, put in place debt management systems and processes. Identification of multilateral and initial bilateral debt has already been successfully undertaken.</p> <p>(vi) A Technical Working Group (TWG) has been established to drive and oversee the debt arrears clearance process. The TWG is co-chaired by the FGS, World Bank and IMF, and includes a small group of around 30 major official creditors, both bilateral and multilateral (see paragraph 21 for further details).</p> |
| Sound Financial Management Practices | <p>(i) In April 2013, the FGS carried out a PFM Self-Assessment, which provided a baseline on the state of PFM systems.</p> <p>(ii) The baseline assessment was used to develop a PFM Reform Action Plan that proposes a set of sequenced actions built on four interlinked platforms, namely: budget accountability; effective budget execution and financial compliance; improved policy formulation, planning and preparation; and institutional structures (human resource management, IT systems and cross cutting issues).</p> <p>(iii) Recent progress includes, amongst other things, the: *preparation of 2012 annual financial statements, *submission to Parliament of the 2012 Audit Report within the statutory deadlines, *2013 budget approval by Parliament and its availability on the FGS website, *introduction of double entry accounting through an interim financial management information system (FMIS), *expanded Chart of Accounts to improve budgetary and financial statements, *embedding of budget controls and audit trails in the FMIS to improve the timeliness and availability of information for decision making, and to increase transparency through timely publication of fiscal reports, and *establishment of an External Assistance Fiduciary Section.</p> <p>(iv) A Statistics Development Programme has been initiated with support from Development partners involving institutional capacity development and fast track data production (e.g. to develop an initial consumer price index for Mogadishu and to capture more trade data in order to construct a simple balance of payments).</p> |
| Transparency of Public Accounts | <p>(i) FGS has prioritised enhancing public financial integrity institutions as one of its top three priorities. This commitment has been evidenced by the recent submission to Parliament for approval of both a mini-budget for the last quarter of 2012, and its subsequent adoption through the <i>Mini Budget Proclamation Act 2012</i>, and the 2013 Budget, which was also passed by Parliament through the <i>Budget Proclamation Act 2013</i> and is now being executed.</p> <p>(ii) FGS is also in the process of strengthening the offices of the Accountant General and Auditor General by building capacity through recruitment of qualified and experienced staff. In this regard, a top priority is the transparent recruitment of qualified candidates from the diaspora to fill the Auditor General and Accountant General positions.</p> <p>(iii) An Audit Bill is being prepared to strengthen the independence of the Office of the Auditor General</p> <p>(iv) The Central Bank of Somalia is included in the PFM reform agenda and has now developed its own five-year strategic plan and basic regulatory framework, and is also conducting regular reporting.</p> <p>(v) The Central Bank Act and Financial Institutions Act were passed in 2012, and a SWIFT code is operational.</p> <p>(vi) A Somali Reconstruction and Development Facility is to be set up as part of the Somali Compact (see paragraph 14). The SDRF will have a common governance and monitoring framework, and financial support will be delivered through a number of financing windows and through the use of local systems and institutions. Already one of the financing windows, the Special Financing Facility, is operational, and the FGS is already paying salaries through this window in a credible, transparent, and efficient manner.</p> |

Annex 3: Key achievements of the Bank's PFM project 'Rebuilding Financial Management Systems in Somalia' (approved in 2009)

The following activities were funded by the Bank, in addition to in-kind contributions (staff time) from other regional Governments:

1. A Budget Department was established at the Ministry of Finance, staffed with qualified professionals, and made operational in late 2010;
2. Skill training for the staff of the Budget Department of the Ministry of Finance and line ministries was conducted at the Horn Economic and Social Policy Institute (HESPI) headquarters, with participation from the Ministry of Finance of Ethiopia;
3. A Central Bank Act was drafted, endorsed by the Council of Ministers and approved by Parliament in May 2011;
4. A Financial Institutions Act was developed through a consultative process, approved by the Council of Ministers and enacted by Parliament in May 2011;
5. The first national Budget in two decades was formulated for 2011, prepared up to international standards and executed by a Somali team from the Budget Department of the Ministry of Finance in 2011;
6. A PFM bill was drafted through a consultative process and reviewed at technical level, endorsed by the Council of Ministers, and submitted to Parliament for approval in June 2011;
7. A review of performance under the 2011 Budget and formulation of the 2012 Budget was conducted by a team from the Budget Department of the Ministry of Finance and other ministries in November 2011;
8. A Treasury Department was established, and the assigned staff were trained and equipped with necessary tools and equipment in October/November 2011; and
9. Further hands-on-training and secondment was provided to the new Treasury staff, in November/December 2011, by the Ministry of Finance of Uganda.