AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE
DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

SOMALIA

Driving Somalia's Transformation

The Reform of the Global Financial Architecture

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The preparation of the Somalia Country Focus Report was led by Désiré Vencatachellum, Senior Director, Country Economics Department (ECCE), with Marcellin Ndong Ntah (Lead Economist, ECCE) as the project management Lead, IT support from Abir Bdioui (Consultant, ECCE), and administrative support from Tricia Effe Baidoo (Team Assistant, ECCE). The Somalia Country Focus Report was prepared by Vera Oling, Senior Country Economist, under the guidance of Edward Sennoga, Lead Economist for East Africa.

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Peer review comments were received from Friday Ouche Kanu, Consultant in the Macroeconomics Policy, Forecasting and Research Department led by Abdoulaye Coulibaly, Director, Officer in-Charge; Anthony Simpasa and Jaoui Fadel, Division Managers of the Macroeconomics Policy and Debt Sustainability Division and Microeconomic and Institutional Impact Assessment Division, respectively. Mr. Albert Mafusire, Principal Country Economist, Country Economics Department, and Mr. Edward Sennoga, Lead Economist, Country Economics Department. Mr. Anthony Simpasa and Mr. Jaoui Fadel, Division Managers of the Macroeconomics Policy and Debt Sustainability Division and Microeconomic and Institutional Impact Assessment Division respectively. Professor Sylvain Eloi Dessy (Department of Economics, University of Laval - Canada) or Dr Joseph Atta-Mensah, Senior Fellow from Africa Centre for Economic Transformation, acted an external reviewer.

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AfCFTA	African Continental Free Trade Area
AfDB	African Development Bank
CFR	Country Focus Report
DSA	Debt Sustainability Assessment
DSSI	Debt Service Suspension Initiative
EAC	East African Community
FDI	Foreign Direct Investment
G20	Group of 20 Industrialized Countries
GDP	Gross Domestic Product
GHG	Greenhouse gas emissions
HIPC	Highly Indebted Poor Countries initiative
ICT	Information and Communication Technology
IDA	International Development Association
IIAG	Ibrahim Index of African Governance
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
NDP	National Development Plan
NTP	National Transformation Plan
ODA	Official Development Assistance
PPG	Public and Publicly Guaranteed debt
PPP	Public-Private Partnership
SDGs	Sustainable Development Goals
SDR	Special Drawing Rights
TFP	Total Factor Productivity

EXECUTIVE SUMMARY

Chapter 1 highlights Somalia's recent macroeconomic performance and medium-term outlook. GDP growth recovered in 2023 driven on the supply side by the agricultural sector's recovery from drought and services, and on the demand side by growth in house-hold consumption and investment. The deceleration in the global initiation that was triggered by the multiple shocks arising from the geopolitical war in Ukraine eased food and fuel initiation in Somalia, from 6.8 percent in 2022 to 6.0 percent in 2023.

Somalia's economic outlook is positive. GDP growth is projected to recover to 3.7 percent in 2024 and 3.8 percent in 2025, driven by a recovery in livestock, services, private consumption, remittances, and investment. Somalia qualified for a USD 4.5 billion debt relief following the achievement of the HIPC Completion Point in 2023, improvement in debt sustainability from debt-distress. Admission to the East African Community (EAC) positions Somalia to benefit from regional trade and EAC security.

However, major downside risks to growth include Somalia's dispute with Ethiopia over the Red Sea port, climatic shocks, insecurity, and low domestic revenues, which will be mitigated by the ongoing tax mobilization reforms. The proposed withdrawal of the African Transition Mission in Somalia (ATMIS) forces at the end of their mandate in December 2024 also poses an elevated risk to security.

Chapter 2 analyzes Somalia's economic transformation in the context of the three decades of unrelenting civil wars over the 1980s-2000s. Somalia's overall average real annual GDP growth rate over the 1980-2022 period was 1.4 percent, well below Africa's average of 3.1 percent. As a result, GDP growth averaged 1.9 percent in the 1980s, before contracting to -2.9 percent in the 1990s—a clear indication of the economic downturn triggered by war. During the 2000s, GDP growth recovered to an average of 2.7 percent, and further grew to 4 percent over 2010-2019, preceding COVID-19 pandemic in 2020, which engendered a contraction of -2.6 percent. Growth rebounded to 3.3 percent in 2021. However, the impact of the multiple shocks dampened this recovery. Subsequently, growth declined to 2.4 percent in 2022. Torn by contact over three decades, Somalia has made very little progress in improving the business environment and building national and subnational institutions to support the innovations and efficiency of arms and industry to optimize full employment and job creation. Consequently, while Somalia remains resilient and has recorded modest real growth, per capita growth has been on a declining trajectory since 2009.

Somalia's structural transformation has changed marginally from the low productivity, labor-intensive agriculture sector to the highly productive industry sector, placing the country among the structurally undeveloped category at a nascent stage of structural change. The share of agriculture in total employment dropped marginally from 29.3 percent to 26.3 percent due to drought, insecurity, reliance on rained agriculture, which is susceptible to climatic shocks, and lack of mechanization. These movement of labour from the agriculture sector were absorbed in the services sector resulting to an increase from 53.8 percent to 56 percent during 2017 to 2022 supported by the expansion in trade, telecommunications, hotels, financial and mobile money transfer financial services over the same period. Employment in the industry sector recorded a modest employment growth, from 16.9 percent in 2017 to 17.7 percent driven by construction, manufacturing, and mining. Agriculture contributes 60.5 percent, the services sector 32.2 percent and industry 7.4 percent. Productivity in the services sector was the highest, averaging USD 1,820, followed Industry (USD 1,218) and agriculture (USD 1,000.

Structural transformation, labor transition and economic diversification are being hampered by insecurity, fragility, high cost of doing business, financing constraints, inadequate skills, technology, infrastructure, demographic challenges, informality, and weak institutional and coordination capacities. Regarding insecurity, the prolonged conflict since 1991 has impeded investments in Somalia's central and southern regions. Somalia still suffers from massive population displacement—over 4 million people as of 2023. In addition, there are regional geopolitical risks created in part by the tensions between Somalia and Ethiopia in the greater Horn of Africa region, following Ethiopia's signature of an MoU with Somaliland on 1 January 2024, granting Ethiopia access to the Gulf of Aden in the Red Sea.

Potential drivers of accelerated structural transformation include technology, industrialization, infrastructure development, human capital development. Opportunities include building resilience to climatic shocks, improving the business environment for private sector, identifying strategic value chains, improving domestic resource mobilization, as well as improving access to finance and coordination for the entities responsible for structural transformation.

Chapter 3 discusses Somalia's structural transformation financing requirements and the need for reforms in the international financial architecture. To accelerate financing structural transformation, Somalia should explore developing a Domestic Revenue (DRM) Strategy to guide mobilization targets and options for increasing the tax-to-GDP ratio. Shortfalls in domestic and external financing has necessitated the mobilization of more external financing by leveraging external debt, Foreign Direct Investment (FDI) and Official Development Assistance (ODA), which pose challenges of reliability and sustainability.

The challenges of domestic financing in Somalia include an absence of a domestic capital market and limited integration into the global financial system. Furthermore, Somalia was unable to mobilize external debt over the 2020-2023 period, owing to its high risk of debt distress. The channels for increasing climate financing mobilization, to achieve structural transformation, are mainly green finance/green bonds and blue bonds, social bonds, climate swaps, sustainable finance loans, blended finance, climate disaster risk insurance, and addressing fragility will unlock investment environment for financing projects from the global financial architecture.

Somalia's journey to achieve structural transformation will require both domestic and foreign resources to finance the SDG targets to reach 2030 goals in the areas of infrastructure, human capital, climate action, productivity and technological advancement and digitalization. Yet, at 3 percent of GDP, domestic resources mobilization is insufficient to drive structural transformation activities, hence the call for the reform of the international architecture to finance the four key areas highlighted of energy, education, infrastructure, and productivity. The justifications for reforms in the financial architecture include the inefficiencies in the existing global financial architecture, which prevent the equitable delivery of the much-needed development financing.

Somalia, alongside the other African countries, needs to advocate for the repurposing of Multilateral Development Banks (MDBs) and International Financial Institutions (IFIs) to make them more effective in providing affordable finance, including concessional financing, to accelerate structural transformation. For instance, if more SDRs are channelled through the AfDB, Somalia stands to benefit from more affordable financing of transformative projects

INTRODUCTION

The 2024 Country Focus Report (CFR) for Somalia assesses the stock of Somalia's structural transformation progress and the need for reforms to unlock and repurpose the global financial architecture and for financing structural transformation. This CFR mirrors the analysis in the African Development Bank's African Economic Outlook report for 2024. It explores the role of the global international financing architecture in accelerating structural transformation and examines the scope for harnessing internal and external financing to finance the drivers of structural transformation, including technology, infrastructure, human capital development, business environment, good governance, trade policy, business and urbanization to accelerate structural transformation. It analyses national-level financing, as well as obstacles to the acceleration of structural transformation activities in Somalia.

MACROECONOMIC PERFORMANCE AND OUTLOOK

1

KEY MESSAGES

- **Economic growth: Somalia's economy demonstrated resilience to multiple shocks, although the pace of structural transformation has been slow.** GDP growth recovered to 2.8 percent in 2023, from 2.4 percent in 2022, driven on the supply side by the agricultural sector's recovery from drought and by services and on the demand side by growths in household consumption and investment. The economic outlook is positive, with GDP growth projected to recover to 3.7 percent in 2024 and 3.8 percent in 2025, driven by recoveries in livestock, services, private consumption, remittances, and investment. However, key downside risks to growth include the dispute between Somalia and Ethiopia over the Red-Sea port, climatic shocks, insecurity, as well as low domestic revenues, which will be mitigated by ongoing tax mobilization reforms. Monetary policy is inexistent owing to wide-spread dollarization and currency counterfeiting. The Central Bank of Somalia is enhancing its supervisory and regulatory capacity in preparation for the introduction of a monetary policy and exchange rate regime. Inflation eased to 6.0 in 2023, from 6.8 percent in 2022 and 4.6 percent in 2021, largely due to the stability of global supply chains.
- **Public debt and HIPC Completion Point:** Somalia's public debt-to-GDP ratio dropped to 6.3 percent on 13 December 2023 upon reaching the HIPC Completion Point, from 64 percent in 2018. The country's debt classification improved from debt-distress to moderate. The HIPC Completion Point provided Somalia a total debt service savings of USD 4.5 billion, provided by the IMF (USD 343.2 million) IDA (USD 448.5 million) and African Development Fund (ADF) (USD 131 million), other multilateral creditors (USD 573.1 million) and Paris Club creditors (USD 3 billion). In March 2020, the AfDB delivered its full share of HIPC debt relief with the arrear's clearance, estimated at UA 88.15 million (USD122.6 million).
- **Social developments:** Somalia's poverty rate dropped to 54.4 percent in 2022, from 69 percent in 2021 but remains widespread, with the nomadic communities recording the highest poverty rate (78.4 percent). Accelerating structural transformation requires investments in human capital development.

1.1 Growth Performance

Economic growth: Somalia's GDP growth recovered to 2.8 percent in 2023, from 2.4 percent in 2022, driven on the supply side by the agricultural sector's recovery from drought and services, and on the demand side by growths in household consumption and investment Headwinds related to climate change shocks (drought and flash floods) that affected Somalia between 2021 and 2023, continued insecurity from Al-Shabaab militancy, lower demand for Somalia's export goods on account of the subdued global trade driven by multiple factors including China's lower economic growth, as well as continuation of geopolitical war in Europe. However, the deceleration in global inflation eased food and fuel inflation in Somalia, increased private consumption and positively impacted on GDP growth. In 2021, after the COVID-19 pandemic, the Federal Government of Somalia (FGS) embarked on economic reconstruction, which resulted in a GDP growth recovery to 3.3 percent, from –2.6 percent in 2020. However, drought and floods in 2022 and 2023 disrupted this growth momentum. The contraction in GDP in 2020 is explained by the disruption and lockdown of international borders, which constrained the service sector. Admission to the East African Community (EAC) as the eighth member in November 2023 positions Somalia to benefit from the EAC market and regional security support. The achievement of the HIPC Completion Point on 13 December 2023 has improved the country's debt classification from debt-distress to moderate. This will qualify Somalia for the new external financing in support of inclusive growth and structural transformation.

The projected growth outlook for 2024-2025 will be driven by livestock recovery, private consumption, remittances, and Foreign Direct Investment reflecting the gains from the 2023 HIPC Completion Point achievement, thus increasing fiscal space.

1.2 Other Recent Macroeconomic and Social Developments

Monetary policy, inflation, and exchange rate: Monetary policy is inexistent due to wide-spread dollarization and currency counterfeiting. The delayed implementation of the currency reform program commenced in 2021 is underway. The government will also introduce the new Somali Shillings to replace the US Dollars and counterfeited Somali Shillings by 2026, alongside the monetary policy and exchange rate regime. However, the Central Bank of Somalia is enhancing its supervisory and regulatory capacity in preparation for the introduction of a monetary policy and exchange rate regime. Inflation eased to 6.0 in 2023, from 6.8 percent in 2022 and 4.6 percent in 2021, largely due to the stability of global supply chains supported by a deceleration in energy and food import prices. The deceleration in global inflation and the return of rains improved livestock output and growth.

Fiscal and public debt: The overall fiscal deficit widened to 0.4 percent of GDP in 2023, from a zero-cash fiscal balance in 2022, depicting higher expenditure, stronger domestic revenue and a shift toward concessional financing in the post-HIPC period. In 2021, Somalia achieved a surplus fiscal balance of 1.1 percent of GDP, which was financed by the 2021 special drawing rights (SDR) allocation (USD 203 million or 4.1 percent of GDP). The fiscal deficit was financed by cash savings from government deposits with the central bank. Upon reaching the HIPC Completion Point, Somalia's public debt-to-GDP ratio dropped to 6.3 percent on 13 December 2023, from 64 percent in 2018. Somalia met 13 of the14 key reform areas agreed upon at the HIPC Decision Point in 2020 and maintained macroeconomic stability throughout the three years. The unmet target relates to adoption of a single import duty tariff structure for all ports. The attainment of the HIPC Completion Point qualified Somalia for the Multilateral Debt Relief Initiative (MDRI), which positioned it to benefit from the cancellation of all debt repayment claims from the African Development Bank Group and International Development Assistance (IDA), and post-HIPC assistance from the International Monetary Fund (IMF) and Paris Club creditors. The AfDB delivered its full share of HIPC debt relief with the arrear's clearance in March 2020, estimated at UA 88.15 million

(USD 122.6 million), including payments due through 30 June 2021. By March 2024, the FGS had received assurance from most bilateral and all multilateral creditors about 90 percent of the Present Value (PV) of the HIPC debt relief. The FGS should pursue a cautious fiscal policy to sustain debt sustainability, while expediting the formulation of the new revenue mobilization strategy.

From September 2023 to June 2024, Somalia experienced heavy rainfall and flash floods, which caused extensive damage to crops, livestock and property and triggered the displacement of over 1.3 million people. In addition, the geo-political tension between Somalia and Ethiopia and in the Horn of Africa region remain elevated. This follows Ethiopia's signature of an MoU with Somaliland, a breakaway region of Somalia, to access the Gulf of Aden. The agreement, signed on 1st January 2024, allows Ethiopia to establish a naval base and commercial maritime service in the Gulf of Aden, with Somaliland gaining a stake in Ethiopian Airlines and the possibility of Ethiopia's formal recognition of Somaliland.

External Position and External Financial Flows: The current account deficit widened to 12.4 percent of GDP in 2023 from 11.6 percent in 2022, and 7.1 percent in 2021 driven by the growth of food imports bill, combined with the suspension of budget support by some development partners prior to the conclusion of the May 2022 elections, thus weaking the fiscal position. The current account deficit was financed by aid, remittances, and Foreign Direct Investment (FDI). Diaspora remittances marginally declined in 2023, stagnating at 5.2 percent of GDP. The government is implementing various public financial management (PFM) reforms to enhance domestic revenue mobilization, strengthen expenditure controls, and increase transparency and accountability in public finance. Harmonization of taxes across the Federal Government of Somalia (FGS) and Federal Member States (FMS) should improve tax administration. Somalia's undiversified exports are a major source of external vulnerability.

The financial sector is underdeveloped owing to the risks associated with anti-money laundering (AML), piracy, and legal and regulatory weaknesses in the Combating the Financing of Terrorism (CFT) framework. Several reforms to integrate Somalia into the international financial sector are underway. They include the revision of the 2016 AML/CFT law. The revision, approved by Cabinet in March 2024, is awaiting Parliamentary ratification. Other achievements include: the issuance of guidelines on money transfer limits by the Central Bank's National Anti-Money laundering committee, the rollout of the national switch linking all commercial banks and a national Quick Response (QR) code and the rollout of biometric digital national identity cards that will be linked to the AML/CFTs. Despite this, Somalia lacks **intermediary banking and correspondent banking** for linking it to the global financial architecture pending the implementation of AML/CFT laws. The AfDB Board in July 2024 approved a financial sector development program to support the Central Bank of Somalia (CBS) in building the capacity of the institutions, including the Financial Reporting Center, charged with the implementation of the AML/CFT laws. The AfDB will support the Somalia Development and Reconstruction Bank to extend financing to the SMEs. Regarding the financial profitability and soundness indicators from the Central Bank, the non-performing loans (NPLs) ratio stood at 4 percent in 2023, up from 3 percent in 2020, while credit to private sector grew by 24 percent to reach USD 412.1 million at end 2023. Moreover, the CBS Board of Directors approved the capital adequacy and liquidity ratios guidelines. At end September 2023, Somalia had registered 13 commercial banks, one (1) foreign bank branch, 14 money transfer businesses, and four mobile money operators. The banking sector remains profitable, with assets worth USD 1,689.2 million in September 2023, above liabilities amounting to USD 1,399.7 million.

Table 1: Macroeconomic Indicators

	2019	2020	2021	2022	2023 (e)	2024 (p)	2025 (p)
Real GDP Growth	3.6	-2.6	3.3	2.4	2.8	3.7	3.8
Real GDP Growth per Capita	-0.1	-6.0	0.1	-0.7	-0.3	0.6	0.7
Inflation	4.5	4.3	4.6	6.8	6.1	4.8	4.3
Overall Fiscal Balance, Including Grants (% GDP)	0.4	0.4	-1.1	0.0	-0.4	-0.3	-1.4
Current Account (% GDP)	-6.3	-7.0	-7.9	-11.6	-12.4	-10.4	-10.2
Total Population (Millions)	16.0	16.5	17.1	17.6	18.1		
Life Expectancy at Birth (Years)	57.1	56.0	55.3	56.1	57.4		

Source: Data from Domestic authorities; estimates (e) and prediction (p) based on authors' calculations. AfDB Statistics Department, April 2024

Social developments: Somalia's poverty rate improved to 54.4 percent in 2022, compared to 69 percent in 2021, but poverty remains widespread within the nomadic communities, which recorded the highest poverty rate of 78.4 percent, according to the 2023 Somalia Poverty Report. This is followed by poverty in rural and urban areas at 65.5 percent and 46.1 percent, respectively. Children comprise 60.5 percent of Somalia's population (aged below 18 years). According to the 2023 Multi-Dimensional Child Poverty (MDCP) report, 60 percent of children[1] face multinational child poverty mostly related to lack of improved water sources and sanitation facilities in Somalia. However, the largest deprivation under health standing at 54.4 percent is the lack of skilled birth attendants. According to the Somalia Health and Demographic Survey (SHDS) 2020, the maternal mortality ratio decreased to 692 per 100,000 births in 2020, from 865/100,000 in 2016. However, the female genital mutilation rate remained high— 98 percent for girls aged 5-11 Youth unemployment rate was higher—30.1 percent in 2022 compared to 21.7 percent national unemployment during the same time. The Somalia Integrated Budget Household survey of 2022 reveals that about 53.7 percent of the population are literate, while 65.5 percent of the population has no formal education. Furthermore, about 4 percent of the population have attained higher education, while only 25 percent of all primary aged children attend primary school.

[1] 2023 Multi-Dimensional Child Poverty (MDCP) analysis, https://nbs.gov.so/wp-content/uploads/2023/07/Analysis-of-Multi-Dimensional-Child-Poverty-MDCP-in-Somalia-using-Multiple-Overlapping-Deprivation-Analysis-MODA.pdf

Box 1.1: Impact of tighter international financial conditions

Over 2020-2023, Somalia relied on grants funding only due to its debt classification of being in high risk of debt distress. In this regard, the country has been receiving Official Development Assistance (ODA) mostly from the European bilateral countries and international financial institutions mostly with the Arab countries, remittances from Europe and the United States, thus exposing it to the global geopolitical conditions especially in the wake of the Russia-Ukraine war which has been a hinderance to international financial conditions. This war has subsequently led to tighter global financial conditions and increased limited grant resource for Somalia and higher cost of financing.

Over 80% of Somalia's export revenue comes from unprocessed agricultural products, mostly livestock exported to the Gulf and Saudia Arabia, oilseeds and bananas, thus exposing the country to the volatile commodity markets. Livestock export to the Middle East, mostly to Saudia Arabia constitutes over 70% of total exports. In 2022, Somalia's export value was USD1.8 billion, compared to USD 2.090 billion in 2023, largely due to the tighter global economic and financial conditions driven by the Russia-Ukraine war, which broke out in 2022, and the weak domestic business environment.

1.3 Macroeconomic Outlook and Risks

1.3.1 Outlook

Economic growth: Real GDP growth is projected at 3.7 percent in 2024 and 3.8 percent in 2025, driven by a recovery in livestock, services, private consumption, remittances, and investment. Foreign Direct Investment is projected to increase post-HIPC, thus increasing fiscal space. GDP per capita growth is only expected to improve to a positive in 2025 after years of decline. Admission to the EAC regional bloc qualifies Somalia for regional trade and security support. Attainment of the HIPC Completion Point has improved Somalia's debt classification from debt-distress to moderate, granting the country access to new external financing.

Monetary policy and inflation: The inflation outlook is favorable and projected to ease further to 4.8 percent in 2024 and 4.3 percent in 2025, from 6.1 percent in 2023, driven by improved crop yields, and falling global inflation rates. Somalia's economy remains highly dollarized since the currency board last issued the Somalia shilling notes in 1991, before the outbreak of the civil war. The IMF estimates that 90 percent of the country uses the US dollars as a medium of exchange alongside the Somalia shilling. Very old and counterfeit Somali shilling notes are commonly used for small value transactions in urban areas and remain the primary medium of exchange in rural areas, especially in the nomadic communities. The on-going currency reform due to be concluded in 2026 is creating the pre-conditions for the Central Bank to develop a monetary policy and exchange rate regime alongside the issuance of the Somali shillings currency notes.

Fiscal and current account balances: Fiscal deficit is projected to narrow from 0.4 percent of GDP in 2023 to 0.3 percent of GDP in 2024 but widen to 1.4 percent of GDP in 2025. The sixth review of the IMF Extended Credit Facility (ECF) program of December 2023 indicates that fiscal policy will be anchored on the medium-term fiscal framework aimed at maintaining the fiscal deficits up to 3.5 percent of GDP, financed by concessional loans, of which 1.5 percent of GDP will be sourced from multilateral creditors that are ready to provide concessional financing. Domestic revenue mobilization, public financial management, and budget execution are the leading medium-term priorities that will be used to create the fiscal space needed as grant resources will decline in the post-HIPC period, from 2024. Work has been ongoing to develop a new Tax Policy and Administration Roadmap by December 2024. This document will outline the priority pillars for domestic resources mobilization strategy for 2024-2027, tax modernization, income tax law, and revenues from large business owners. This will enable the government to meet all recurrent costs by 2027 Current accounts is projected to improve from 12.4 percent of GDP in 2023 to 11.4 percent and 10.2 percent of GDP in 2024 and 2025, respectively, driven by livestock exports.

1.3.2 Main downside risks to growth

- Inflationary pressures are driven by the higher commodity prices that are passed to domestic inflation through higher import bills, given Somalia's reliance on the imports, especially of fuel and food. High inflation poses a risk of lowering real wages and purchasing power and increasing poverty.
- Continued insecurity risk from the prolonged Al-Shabaab terrorist attacks deters potential foreign investors. Coupled with the regional dispute between Somalia and Ethiopia over the Red Sea port agreement has undermined bilateral trade, jeopardized security, and increased Somalia's security expenditure.
- The global economic slowdown is likely to hinder private-sector economic activities and contribute to lower domestic revenues, which will be mitigated by ongoing tax mobilization reforms.
- Vulnerability to climatic shocks, especially drought and flood, which ravaged the agriculture sector over the 2021-2023 period, poses a potential risk of slowing the agriculture sector's recovery.
- The ongoing withdrawal of the ATMIS forces at the end of their mandate in December 2024 poses an elevated insecurity risk. The government is implementing a stabilization program to liberate areas still under Al-Shabaab's occupation. However, these achievements are being quickly reversed by re-occupation by Al-Shabaab. The tension of threats of fragmentation by some Federal Member States (FMS) poses a risk to growth.

1.4 Policy Options for Fostering Robust and Resilient Growth Supporting Macroeconomic Stability and Economic Transformation

In the short term:

- To accelerate disinflation and achieve price stability during the ongoing dollarization of the economy, Somalia needs to fast-track its currency reform, which also aims to establish a monetary policy stance. The adoption of an accommodative monetary policy stance could further ease the inflation, which has been driven by the high food and fuel prices in the recent past. Unlike most African countries, Somalia's use of the US dollar as a means of exchange implies that the country is not highly exposed to exchange rate pressures.
- Regional dialogue at Horn of Africa level will help to resolve conflict and the Somalia-Ethiopia dispute over the Red Sea port, Dialogue will also help to restore regional peace by curbing the Al-Shabaab insurgency and the disruption of trade between Somalia and Ethiopia.
- To broaden the tax base to meet the Government's tax/GDP ratio rate of 0.4 percent of GDP per annum over the 2024-2027 period, Somalia should fast-track the implementation of its revenue-enhancing reforms, including improvements in the capacities for the development of a tax and non-tax revenue policy, and a Domestic Reve-

nue Mobilization (DRM) strategy.

- Somalia needs to promote import substitution industrialization and local production to address imported global food inflation whose high prices have been passed through to domestic prices, which have driven the high domestic food and fuel inflation in the Somalia in the last two years.
- FGS and Development Partners need to support small holder farmers to trigger and increase an agricultural revolution that can feed Somalia and Africa at large, including those in urban areas.
- Somalia needs to institute mechanisms that will grant farmers access to affordable finance, including for the production technologies, especially certified drought resistant seeds and animal breeds with the potential to adapt to extreme climatic conditions, as well as extension services and agricultural mechanization expansion.

In the medium to long term:

- The Federal Government of Somalia (FGS) should continue implementing the reforms related to the revision of the Anti-Money Laundering (AML) and Combatting the Financing of Terrorism (CTF) laws of 2016 to reinstate intermediary banking for Somalia, so as to attract foreign investment and reintegrate Somalia into the global financial architecture.
- The Government should implement governance reforms aimed at strengthening the capacities in public financial and debt management to avoid Somalia falling back to unsustainable debt levels, public investment management, and domestic resources mobilization to entrench fiscal and debt sustainability, thus strengthening macroeconomic management in Somalia.
- The Government need to strengthen capacity development for the implementation of the EAC common external tariff effective from 2027, to further improvement in domestic resource mobilization.
- Somalia should strengthen the institutional and human capacity building for public debt management and also strengthen tax policy and administration to maintain debt sustainability.
- Somalia should advocate for reforms in the global financial architecture, to accelerate debt restructuring. Key reforms include forming the expanded credit committee with private lenders to ease coordination challenges and establish the comparability of treatment formula to minimize technical disputes.
- Somalia need to create an enabling environment for attracting external financial flows to compliment development financing and accelerate Somalia's economic transformation.
- The Government should accelerate structural reforms and build resilience to help tackle the major constraints to growth, create jobs, attract investments, and improve productivity. In the aftermath of the COVID-19 pandemic, Somalia experienced a prolonged growth volatility, driven by cycles of climate related shocks (prolonged drought and floods) and locust infestations that have escalated food insecurity, insecurity, and fragility due to conflict engendered by massive internal displacement.
- Somalia needs to prioritize financial investments in climate disaster

TAKING STOCK OF SOMALIA'S STRUCTURAL TRANSFORMATION PROGRESS

2

KEY MESSAGES

- An endless civil war (1980s-2012) slowed Somalia's growth to an average GDP growth rate of 1.9 percent in the 1980s. The 1990s was characterized by clan wars, which resulted in an average real GDP contraction of 2.9 percent between 1990 and 1999—the worst economic downturn mirroring the GDP contraction of 2.6 percent in 2020 during the COVID-19 pandemic. Somalia needs to expediate the development of a domestic resource mobilization strategy to guide the diversification of domestic development financing sources.
- Somalia's average real GDP per capita growth stood at a low of -1.5 percent during 1990-2020, below Africa's average GDP per capita growth of -0.1 percent over the same period. The average GDP per capita deteriorated from zero in the 1980s and -4.5 percent in the 1990s, before recovering to -0.7 percent in the 2000s, and later to 0.8 percent until the outbreak of the COVID-19.
- Structural change is slow in Somalia and is characterized by the reallocation of economic activities from agriculture to the service sector, which is a sector with relatively low productivity and the largest share of employment. This implies that structural transformation is driven by services instead of the manufacturing/industry sectors. Of the total 6.8 million workers, only 34 percent equivalent to 2.3 million workers were in employment, with half or 1.23 million of those workers (51.6 percent) being employed in the services sector; followed by agriculture, 721,608 workers (31.4 percent), while Industry employed just 382,231 people (17 percent) between 1980 and 2012.
- Over the last 20 years from2000-2020, Somalia's Structural transformation transitioned by 12 percent, implying that its economy is yet to transition from the low-productivity, labor-intensive agricultural sector to higher, capital-intensive industry production.
- To accelerate structural transformation, investments should be increased for the four key SDG Goals, including SDG 4 (Quality education), SDG 7 (Energy), SDG 8 (Productivity), and SDG 9 (Infrastructure). The AfDB estimates a financing gap of USD 19.6 billion annually by 2030, and USD 3.4 billion annually by 2063 to fast-track the SDGs and Somalia's structural transformation.
- Somalia's labor productivity, as a measure of output per worker, has declined, with the agriculture sector recording the largest decline compared to services (highest productivity) and manufacturing (second highest productivity). From 2000 to 2020, productivity in the services sector averaged USD 1,820, followed by the industry sector's average (USD 1,218) and agriculture sector productivity average (USD 1,000), over driven by the increased investment in telecommunications, financial services and increased use of mobile money transfer and other digital financial services in the services sector, Over that period, the industry sector's productivity was lower than the services sector, owing to weak business regulatory environment and high cost of doing business (energy and transport infrastructure deficit and lack of access to credit, insecurity, while the productivity in agriculture was hampered by drought and flash floods, exacerbated by the limited investment in irrigation, and heavy reliance on rainfed agriculture.
- To accelerate its structural transformation, Somalia will need to identify strategic value chains for export diversification and industrial development within the agriculture economy, blue economy, green economy and extractive sector, as well as invest in energy and transport infrastructure and enablers for private sector development, workforce skill development and quality education. Furthermore, the country needs to sustain macroeconomic stability by improving public investment management, domestic resources mobilization and leveraging external low interests financing instruments, as well as improve trade facilitation to harness the EAC regional integration and the African Continental Free Trade Area.

2.1 Introduction

This section analyzes Somalia's economic transformation in the context of the three-decades of civil war (1980s-2000s). It assesses Somalia's overall average real annual GDP growth rate from 1980 to 2022, takes stock of Somalia's economic performance and transformation, as well as the drivers, bottlenecks, and opportunities for the country's structural transformation.

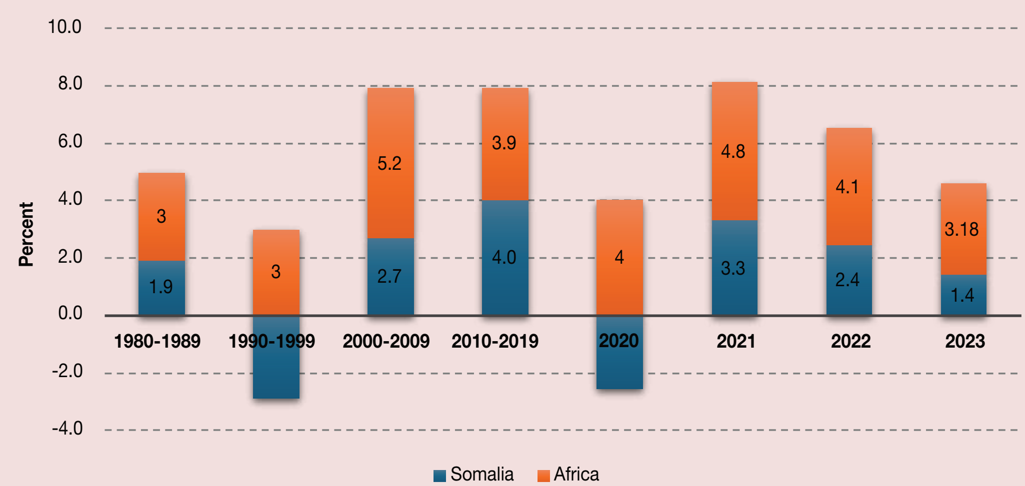
2.2 Taking Stock of Somalia's Economic Performance and Transformation

The Somali economy remains largely reliant on agricultural production, which is vulnerable to external shocks. The heavy dependence on primary commodities as the main source of export earnings is an impediment to structural transformation. The services sector, incorporating the financial and communication sub-sectors, plays a pivotal role in propelling growth. There is potential to leverage new growth drivers. But Somalia has not progressed beyond a factor-driven economic development model, consequently maintaining a narrow economic base since the 1960s. The outcome of the structural adjustment policies also fell far short of expectations, with reductions in government spending negatively impacting social services such as education and healthcare. Structural transformation and diversification are hindered by numerous factors and are also aggravated by conflict and fragility. Insurgencies have stunted private sector growth due to the insecure environment arising from political assassinations and military dictatorship. Exposed to conflict over the past three decades, Somalia has made little progress toward improving the business environment or building national and subnational institutions to support the innovations and efficiency in firms and industry.

2.3 Somalia's structural transformation: Drivers, bottlenecks, and opportunities

2.3.1 Somalia's structural/economic transformation

Figure 2.1: Somalia's Real GDP growth compared to Africa's, by decade (percentage)



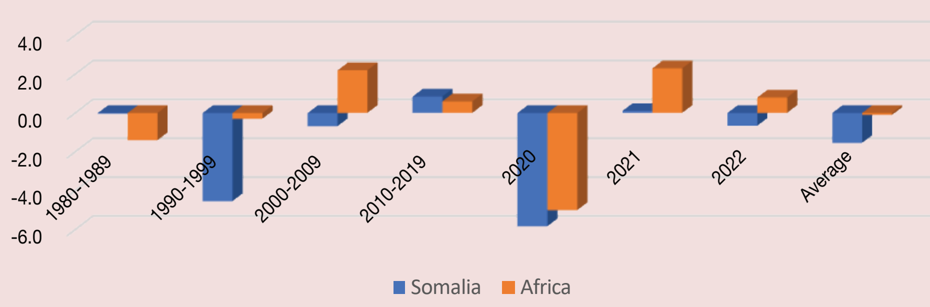
Note: The decades are based on simple averages. Source: AfDB, Statistics Department and IMF, World Economic Outlook database

From a historical perspective, Somalia was civil war-torn from the 1980s to 2012. It recorded an average GDP growth rate of 1.9 percent in the 1980s, but from 1990 to 1999, its worst decade, characterized by the clan wars, the country recorded a real GDP contracted on average by 2.9 percent—indicating its worst economic downturn mirroring the COVID-19 pandemic-driven GDP contraction of 2.6 percent in 2020. At the turn of the millennium, 2000-2009, average GDP growth recovered to 2.7 percent, further growing to 4 percent from 2010-2019. While growth rebounded to 3.3 percent in 2021 (See Figure 2.1), the impact of the Russia-Ukraine war dampened this recovery, as growth declined to 2.4 percent in 2022 due to the inflationary pressures from fuel, fertilizer and other commodity prices. Somalia's real annual GDP growth over 1980-2022 was 1.4 percent, lower than the African continent's average of 3.18 percent over the same period. This relatively poor growth performance is attributable to climatic shocks, including a two-year drought (2021-2023), which displaced over 4 million people; the COVID-19 pandemic; and the effects of prolonged conflict collapsed the social and economic infrastructure, further weakening the country's investment climate. Furthermore, the recent defection announcements by two Federal Member States is also hindering investment inflows. The weak GDP average growth rate resulted in weaker per capita income growth with attendant deterioration in human conditions.

The insecurity in Somalia has mutated over the last two decades, from a civil war in the 1980s to clan factionalism and warlordism in 1991, following the collapse of the Siad Barre regime, to the Al-Shabaab globalized ideological conflict of terror in the 2000s. This crisis resulted to the collapse of the State and subsequent catastrophe until 1992 when the UN mission to Somalia intervened largely to support humanitarian aid to most of the population that was displaced due to the insecurity and drought. Subsequently, in 2012 a Transitional Government was established, and since then the country has conducted three Presidential elections—the latest in May 2022.

Other structural problems, such as poor macroeconomic policies and heavy reliance on unprocessed livestock exports of a narrow range of primary products, amidst low and falling primary commodity prices, have also played a role in the achievement of the low rate of transformation. Somalia has an extensive number of livestock, estimated to be 50 million heads, with an export value of USD 500 million from USD 5.3 million heads of animals. Expectedly, livestock is the main driver of Somalia's real GDP growth with livestock exports representing over 90 percent of total exports and accounting for 25 percent of total employment. The main export destination is Saudi Arabia. Livestock exports rose by a factor of almost 10 between the 1980s and mid-2010s. Yet, it is observed that the export of unprocessed livestock products accounted for 76 percent of total exports in 2022, calling for more value addition

Figure 2.2. Somalia's Real GDP per Capita Growth compared to Africa's, by Decade (percentage)



Note: The decades are based on simple averages. Source: AfDB, Statistics Department and IMF, World Economic Outlook database

The average GDP per capita growth stood at a low of -1.5 percent over the two decades (Figure 2.2), below the African continent's average GDP per capita growth of -0.1 percent over the same period. The average GDP per capita deteriorated from zero in the 1980s to -4.5 percent in the 1990s, before recovering to -0.7 percent in the 2000s, and to 0.8 percent prior to the outbreak of the COVID-19. In 2020, the average GDP per capita growth dropped as low as -5.8 percent, the worst in any two-decade period, but rebounded to 0.1 percent growth in 2021, before contracting again to -0.7 percent in 2022, largely because of the prolonged drought that affected the agriculture sector and killed over 16 million livestock.

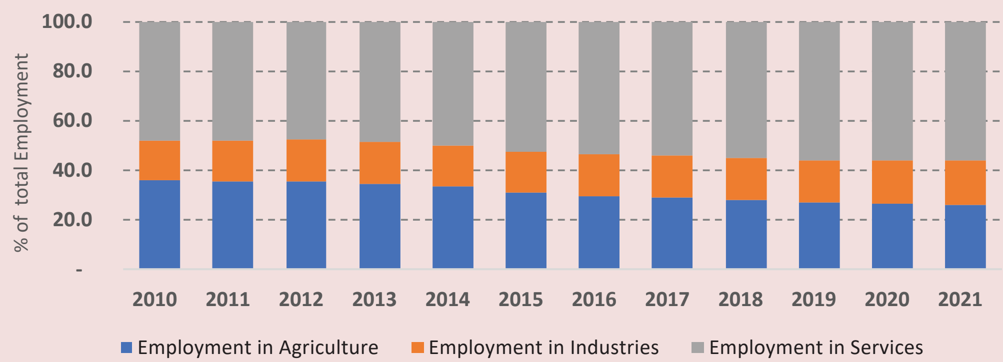
2.3.2. Unpacking Somalia's structural transformation through labor productivity decomposition

Somalia's employment transition from the low labor-intensive productivity to higher productivity and skill-intensive activities is still at a nascent stage. The agriculture sector, whose contribution to GDP stagnated at 60.5 percent between 2015 and 2022, employed 27.5 percent of the population due to drought, variation on rainfall as well as reliance on rainfed agriculture, which is susceptible to climatic shocks, and lack of mechanization. The services sector accounted for 32.5 percent of GDP between 2017 and 2022 but was the largest employer, employing about 55.3 percent of the workforce, while the industry sector's GDP contribution remained modest averaging 7.4 percent; with employment's average share of 17.2 percent over the period (Figure 2.3). From 2017 to 2022, agriculture's share in total employment dropped marginally from 29.3 percent to 26.3 percent due to drought and insecurity, while the share of employment in the services sector increased from 53.8 percent to 56.0 percent, supported by expansion in trade, telecommunications, hotels, financial services, and mobile money transfer financial services over the same period. Employment's share in the industry sector grew marginally, from 16.9 percent in 2017 to 17.7 percent in 2021, supported by construction, manufacturing, and mining. Especially employment in the manufacturing sub-sector, which is closely associated with structural transformation due to its high capacity and productivity output, only grew by less than one percentage point over the same period.

Unlocking the structural barriers to manufacturing, notably transport and energy infrastructure, will contribute to employment creation in higher value-added economic activities.

The agricultural sector, comprising crops and livestock, accounts for the largest share of GDP, followed by services (dominated by money transfer services) and telecommunications. The industry sector contributes the least to the economy. Consequently, Somalia relies on exports of unprocessed commodities—an indication of a narrow economic base. Nonetheless, the country has a strong private sector that is largely dominated by the informal sector. Women make up about 60 percent of the private sector. There is also a small but vibrant mining sector mostly involved in the extraction of salt and gemstones. The country has a nascent tourism sector, with beautiful sites that attract sizeable numbers of tourists.

Figure 2.3: Sectoral Share of Employment



Source: AfDB Statistics Department, December 2023

According to the 2022 Somalia Integrated Household Survey (SIHBS), men have a higher labor participation rate (39.4 percent) than to women (15.8 percent). Yet, Somalia's economy has largely been driven by agricultural production over the last three decades, largely based on livestock; services, including money transfer companies and telecommunications, which have been the silent economic drivers. The country also heavily depends on remittances and investments in telecoms for its foreign exchange inflows. Industry is the smallest contributor to the economy, with construction contributing the largest share. Without a manufacturing or industry sector, very little value is added to the agricultural and livestock products, implying heavy dependence on export of primary commodities, which is a critical structural bottleneck—a reflection of the country's narrow economic base.

Opportunities. Somalia's aspiration to a middle-income status by 2060 is highlighted in the proposed long-term Centennial Vision 2060 (CV) whose development process was launched by the FGS in 2023, with a related strategic goal of transforming Somalia into a middle-income country by 2060. The CV seeks to create a prosperous, secure, democratic, inclusive, and competitive country with a high quality of life. In addition, Somalia's strategic location, in the Horn of Africa, along the southern coastline of the gulf of Eden, a deep-water gulf of the Indian Ocean linking the Red-Sea offers opportunities for large-scale commercial fishing, as the gulf is richly endowed with sardines, tuna, kingfish, mackerel, and crayfish.

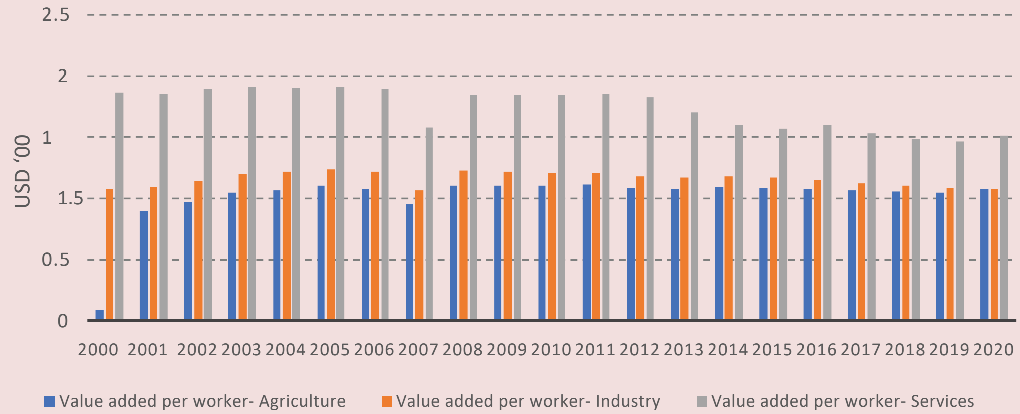
The gulf of Eden is also a key maritime trade route connecting the Indian ocean with the Mediterranean Sea through the Suez Canal shipping route, with an estimated 21,000 shipping vessels crossing the route annually. It is a shipping route for merchandise, including crude oil, from the Arabian sea. However, to sustain inclusive growth and structural transformation, Somalia needs to address insecurity and piracy along its maritime routes, as the country continues to endure the threat of Al-Shabaab militancy. Furthermore, the country faces structural constraints, macroeconomic challenges, as well as a threat to secession by some Federal Member States (FMS) including Puntland and Somaliland. The ongoing structural reforms, with the support of international partners, including the IMF, needs to be sustained in the post-HIPC era to improve the efficiency of public services, in the provision of public infrastructure, and to drive the country's economy toward private-sector-led growth, and competitiveness. The ninth National Development Plan (NDP-9) aims to improve the capacity for public effectiveness in key growth enabling sectors (notably, energy, transport, financial sector and telecommunication (that will drive economic transformation.

2.3.3 Quantifying the role of structural transformation in Somalia's economic growth.

Labor productivity decomposition in different sectors

Somalia's labor productivity, as a measure of output per worker, has been on a declining trajectory over time, with the agriculture sector recording a steeper decline than services and manufacturing. Productivity in the services sector averaged USD1,820 from 2000-2020 (Figure 2.4), which is explained by the increased investment, generally from the private sector, in telecommunications and financial services, including increased use of mobile money transfer and other digital financial services. The industry sector, whose productivity is second lowest, below the services sector, averaged USD 1,218 between 2000 and 2020 due to factors holding back industry, notably manufacturing, a weak business regulatory environment, including high costs of doing business, lack of access to credit, insecurity, as well as inadequate energy and transport infrastructure. Agriculture recorded the lowest productivity (USD 1,000) due to prolonged drought and flash flooding, exacerbated by the limited investment in irrigation, and heavy reliance on rainfall for production amidst recurring climatic shocks, and lack of economic diversification amidst the prolonged droughts.

Figure 2.4: Sectoral Labor Productivity

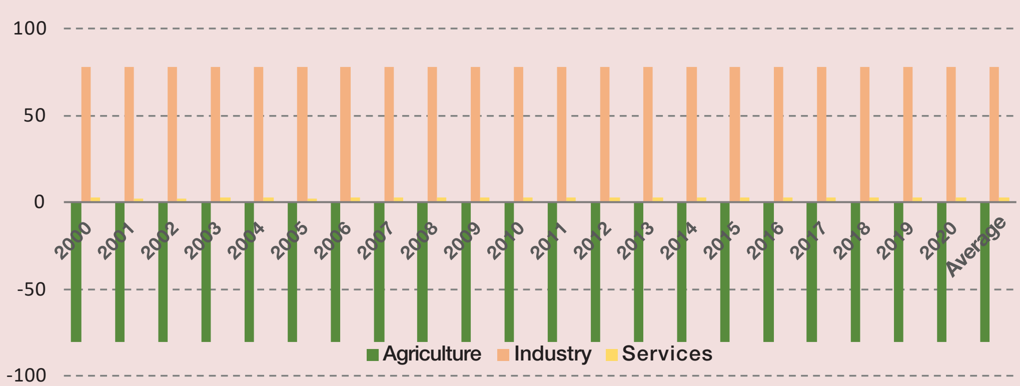


Source: African Development Bank database

Somalia's structural change is low, characterized by the reallocation of economic activities from agriculture to other relatively low productive sectors, mostly service sector

AfDB's databases indicate that between 2000 and 2020, Somalia had a total workforce of 6.8 million people aged 15-64, representing 34 percent of the total population. Of the 6.8 million workers, only 2.3 million (or 34 percent) were employed, with 1.23 million (51.6 percent) being employed in the services sector over the same period, followed by 721,608 (31.4 percent) employed in (31.4 percent) and the lowest number, 382,231 (17 percent) employed in the industry sector. This is above the economy-wide average. This shows that Somalia has recorded workforce migration from the relatively low productive agricultural sector with the highest contribution to GDP (60.2 percent average), to the services sector, which contributed an average of 32.5 percent of GDP but employs more than half of the workforce. This implies that the industry sector, which employs only 17 percent of the workforce but contributed about 7.4 percent of GDP, is the most productive sector. There will be gains in aggregate productivity reallocation of labor across sectors to the industry sector.

Figure 2.5: Labor Productivity Gap Relative to Average Percentage (2000-2020)



Source: https://dataportal.opendataforafrica.org/nbyenxf/afdb-socio-economic-database

Assessment of labor productivity gaps by sector

The labor productivity gap in the agriculture sector between 2000 and 2020 stagnated at an average of -80.5 percent, representing inadequate use of the actual labor productivity, which is producing output level below the potential output, thus showing inefficiency in workers' productivity due to inadequate innovation and technology, misallocation of inputs, and reliance on agro-processing. Similarly, the services sector's labor productivity gap averaged 2.6 percent. In the industry sector, there was a positive labor productivity gap averaging 77.9 percent over the same period, representing improvement in labor productivity attributable to wide use of skilled employees, modernized less labor-intensive production methods, use of IT and investment in automation and capital equipment.

Somalia's structural transformation has increased by 12 percent from the low-productivity, labor intensive agriculture sector to the high-productivity capital-intensive industry sector. Overall, during 2000-2020, structural transformation only transitioned by 12 percent, placing Somalia in the structurally undeveloped category—an indication that its economy is yet to transition from the low-productivity, labor-intensive agricultural sector to higher capital-intensive industrial production.

Total Factor Productivity (TFP). The disaggregation of Total Factor Productivity (TFP)[2] shows that Somalia's productivity growth since the 1980s-2020 period is split into three periods. The 1980s was a period of sluggish growth, while 1991-2004 is characterized by warlordism. The third, from 2012 to 2020, represents the post-war recovery period, with a transitional government and sluggish economic growth, including contraction of GDP and decline in TFP from the negative impact of the COVID-19 pandemic in 2020, and its aftermath (2021-2023), drought and the geo-political tensions.

Growth in income and jobs embodied in services exports: new evidence

This section applies the Mensah and de Vries (2024) framework to analyze and highlight the distribution of value-added Somalia's exports of services, to generate income and jobs embodied in exports.

Box 2.1: Learning from successful experiences in supporting growth and structural transformation.

Somalia compares well with regional peers in economic structure. The general trend is declining shares of employment in agriculture's contribution to GDP, with variations due to different policy choices and natural resources.

Somalia's economic composition and structural transformation pace are comparable to those of other countries at similar levels of development and reflect similar trends (e.g., declining shares of agriculture as GDP grows), with variations due to different policy choices and resource endowments. Compared with Ghana or Kenya, lower levels of GDP per capita are associated with higher relative contributions of agriculture to GDP. Somalia lags behind, with agriculture's share of GDP higher at 60.2 percent of GDP. The key hindrances to fast-track structural transformation include over-dependency on one or two primary commodities. This is the case with other countries in the Eastern African region.

For capital accumulation to happen, there is need for rapid industrialization to transition, as the success stories from East Asian countries have demonstrated. However, Somalia's transformation has been mainly propelled by agriculture as a main growth driver. However, the Services sector is the largest employer and contributor to the higher levels of

[2] TFP measures the aggregate production efficiency and is considered the most sustainable source of long-term growth

income per capita. This is somewhat similar to the case of China, whose transition process relied more on manufacturing, unlike India, which relied more on services.

This implies that Somalia is transitioning faster to the services sector, which lacks the technological advancement and spill-over linkages that the industry sector requires for export-oriented manufacturing and industrialization (Rodrik, 2015). Similarly, the services sector also limits technological spill-over and foreign exchange earnings. Moreover, this will create a weaker industry sector, since the growth of the services sector creates a limited job creation opportunities and value addition to agro-commodities. Lastly, a higher manufacturing value added to GDP provides export substitutes during commodity shocks.

2.3.4 Drivers of accelerated structural transformation

This section highlights the main drivers of Somalia's structural transformation over the past three decades for rapid growth and job creation. The section also outlines the potentials and policy options for the fast-tracking of Somalia's structural transformation. The African Economic Outlook 2024 suggested that accelerating the drivers of structural transformation has a corresponding effect of unlocking structural transformation and consequently economic growth and development. The following are the key drivers of structural transformation in Somalia.

Governance: Somalia's governance evolved from the 1991 outbreak of the civil war, to end of 2012, representing 20 years of transition marred by conflict, warlordism and statelessness. The post-war transitional government of 2012 adopted an interim constitution, appointed a new President and Prime Minister and created a federal system of governance, with six federal member states, and Mogadishu as administrative region. With the support of international actors, Somalia next embarked on state building following the end the transitional government in 2012, focusing on institutions facilitating a conducive business environment. Between 2013 and 2023, the FGS implemented various economic and financial governance reforms, including public financial management, debt management (including the HIPC Decision Point and Completion Point for debt relief from 2020-2023, as well as domestic resource mobilization. The governance of the Central Bank of Somalia was underscored to improve access to finance, as an enabler for enhanced structural transformation. The country's overall Ibrahim Index of African Governance (IIAG) score slightly improved to 23.2 in 2021, from an average of 22.2 in 2019 and 2020, driven by improvements in human development and security. However, in 2022 Somalia's Transparency International Corruption Perceptions Index score was low at 12 (on a scale of 0 'highly corrupt' to 100 'highly clean'), ranking the country among the world's most corrupt countries.

Exchange rate policy: Macroeconomic stability played a significant role in accelerating economic growth, especially the absence of a monetary policy, widespread dollarization, and exchange rate policies that curtailed Somalia's participation in the international financial architecture. With World Bank support, the country is implementing a currency reform project aimed to deliver a monetary policy and introduce new Somali shilling bank note to replace those last printed in 1991. Somalia needs to work on the regulatory framework to update the AML/CFT, which will pave the way for the establishment of the corresponding and intermediary banking relationships for Somalia's full participation in the global financial architecture.

Trade policy: Somalia is open for international trade. However, the country scores low on all global indicators, for instance, ranking lowest, 190th out of 190 countries in the last Ease of Doing Business report in 2020. Moreover, it ranked 134th out of 137 countries in the 2024 Bertelsmann Transformation Index, which is a measure of the development status of governance of political and economic transformation process in development and transition countries around the world.

Consequently, the World Bank ranked Somalia 1st out of 179 countries in the 2023 Fragile States Index making it unconducive for a full international trade. Somalia's EAC membership grants its private sector regional markets access for their products, while the COMESA membership presents an opportunity for accelerated multilateral regional trade. Somalia's admission to the EAC regional trading bloc provides an opportunity to harness the existing regional trading and Industrial policy, as outlined in the 6th EAC Development Strategy. It also presents opportunities for trade facilitation along major trade corridors, and special economic processing zones that will spur trade and bolster structural transformation. The EAC Regional Strategy for 2021/22-2025/26 has prioritized agro-industrialization for import substitution merchandise like pasta imports. Somalia's strategic location at the red-sea and Indian Ocean positions it as regional export hub to the gulf. The country has been seeking to accelerate its admission to the WTO since 2016 and Africa Continental Free Trade Area (AfCFTA) since 2020 to expand exports market access, subject to the governance rules-based trade issues being addressed.

Quality of public infrastructure as an enabler of structural transformation. Investment in physical capital especially infrastructure including energy, transport and water for production would increase labor productivity. Physical infrastructural investments such as roads, electricity, and railways are critical. Rehabilitation of dilapidated flood control infrastructure, development of irrigation and transport infrastructure, as well as expansion of existing factories are essential to enhance economic competitiveness.

Improving the business environment and labor market flexibility for private sector development. Somalia's business environment is inconducive. The 2020 World Bank's Ease of Doing Business report ranked Somalia as the world's lowest: 190th position out of 190 countries in 2019. This calls for the strengthening of the business climate and investment benchmark indicators, as conceptualized by the World Bank in 2022. The key areas for improving the business enabling environment for private sector development in Somalia should include reforms that enable Business Entry regulations for a free entry and exit, Business Location, Financial Services, Taxation, International Trade, Labor market regulation, Utility connections, Market Competition, Business Insolvency, and Dispute Resolution. The other areas of support to consider include improved access to access to financial services.

Urbanization: Somalia is one of the fastest growing countries, with an urban population of 45 percent in 2018 and an annual growth rate of 4.23 percent per year, according to UN-Habitat.[3] The main driver of the urbanization is internal displacement triggered by drought, insecurity, and a quest for better services. This explains the employment growth in the services sector (mostly merchandise trade) and limited employment in the industry sector. The main areas of employment in the in the services sector include merchandise trade, including wholesale and retail trade, telecommunications, financial services, and hotels. Investment in basic services like water, health, education, and a proper urban masterplan will help to unlock urbanization as a driver of structural transformation. The main reason for Somalia's rural-urban migration is search for water for the livestock during the drought. The provision of water will contribute to the growth of agriculture.

Technology: In 2021, Somalia's ICT development index was estimated at 21.4 out of 100, the lowest in comparison to its Eastern Africa regional peers: Djibouti (63.6), Burundi (23), Rwanda (40.1), Kenya (54.2), Tanzania (37.2) and Ethiopia (33.5) out of 100. The three-decade long war has hindered the expansion and rehabilitation of public

[3] UN-Habitat Somalia: https://unhabitat.org/somalia

infrastructure and regulatory frameworks, including for technological innovation. Up to the end 2024, the digital infrastructure backbone for internet broadband and mobile phone were mainly provided by the private sector. However, the internet backbone connecting cities and the different states, especially in Central and South, are inexistent.

Overall, Somalia recorded a significant increase in the percentage of mobile network users, which doubled to 65.2 percent[4] in 2017, from 38.7 percent in 2016, before marginal growth attributed to the stringent measures introduced in the wake of increased piracy. In January 2020, 7.55 million mobile connections were registered, an increase of 8.7 percent, compared to the previous year. About 75 percent of women aged 15-49 own a mobile phone and 64 percent of them use their mobile phones for financial transactions.[5] Advancement in technology has continued to increase through capital investments, and technological innovation, especially because Somalia is a hub for entrepreneurship. The advance in technological innovations through the mobile network has increased financial inclusion. For instance, Somalia had up to 11 Mobile Money Transfer businesses, and seven (7) mobile money operators licensed by the Central Bank of Somalia. However, last mile internet connectivity issues remain unresolved. With the improved technologies to boost value addition within the agriculture sector, specifically value addition in livestock products and industry efficiency gains arising from trade. In addition, creating productive jobs within the limits of technological innovation and Information and Communication Technology (ICT), joining hands with the private sector on board will go a long way in accelerating structural transformation. Harnessing Public Private Partnership in infrastructure development will also increase productivity and lower the cost of doing business.

Human capital development should be prioritized to improve the quality education, and skill development will offer workers the opportunity to upgrade their skills and improve labor force participation to raise Somalia's economic productivity. Owing to lack of data, Somalia is currently not ranked on the World Bank's Human Capital Index or Human Development Indicators. However, the National Bureau of Statistics (2022)[6] indicates that just over 53.7 percent of Somalia's population is literate. Illiteracy is mainly due to many factors including cultural aspects which inhibits women's participation in activities outside the homesteads. This was exacerbated by the COVID-19 pandemic, low primary and secondary school enrolment rates of 14 percent and 16 percent respectively. Low skill levels have translated into a high youth unemployment rate (30.1 percent in 2022). The skills challenge can be addressed through investment in education and vocational skilling, as well as technological progress, will contribute significantly to the acceleration of structural change, and increase the shift of economic activity from agriculture and services to industry sectors

Box 2.3: Potential and existing opportunities in agriculture/agribusiness and investment in renewable energy

The agricultural sector presents vast opportunities for structural transformation, as it currently contributes about 60.2% of GDP. Although the livestock subsector has occasionally been disrupted by drought and international export bans, it still contributes to about 78% of total exports, mainly unprocessed livestock products. Overtime, livestock value chains (beef, diary, leather, and leather products, among others) will drive productivity shift and value addition and boost higher value-added manufacturing, consequently boosting employment and job creation. Somalia is prioritizing agro-led manufacturing promoted by the Somalia Investment (SOMINVEST) as a potential to increase structural transformation. Agribusiness Opportunities are in Food Production

[4] United Nations Development Program (UNDP): Somalia Voluntary National Report 2022.

[5] Efforts are underway to issue digital identification cards, which would improve financial inclusion in Somalia.

[6] Somalia Integrated Household Budget Survey (SIHBS).

Sector, while agro-processing opportunities reside in edible oils processing, grain milling, inputs (seeds, fertilizers production and animal breeding), technological advancement, capital equipment and machinery, packaging and distribution. Export focused agro-processing, and manufacturing for economic diversification will require the development of strategic value chains to increase productivity shifts and value creation in cattle, sheep, goats and camels.

The Blue economy also has potential for the under-ocean resources to achieve structural transformation especially the fisheries value chain, which earned Somalia USD 135million in 2015/2016 but remains constrained by the Unregulated and illegal fishing whose loss of revenue was estimated at USD 306 million in 2016, piracy and lack of cold chains, transport, and logistics. In March 2023, the government enacted the Federal Fisheries Law and the Investment and Investor Protection Act.

Renewable energy potentials exist in wind and solar energy along the coastlines. The Electricity Law 2023 paves the way for these resources that need to be harnessed to drive structural transformation include wind energy. Somalia has the longest coastline (3,300 km.) that offers vast opportunities in ports, shipping, and fishing industries port and marine transportation. Mogadishu's port alone contributes USD 98.6 million annually and accounted for 26% of the revenue for Fiscal Year 2020/2021.

Domestic resource mobilization (DRM). Tax base growth has to be used to finance structural transformation. Currently Somalia raises about 3 percent tax to GDP ratio, making it difficult to fully finance government operations. Efficiency gains from the domestic resource mobilization will provide the fiscal space to finance structural transformation projects. The FGS has pledged to broad the tax base to cover all its recurrent cost by 2027. This implies unavailability of the current DRM level for the financing of the structural transformation before 2027 and beyond. The government must explore other options to intensify the DRM, and options for grant financing, and for highly concessional financing.

Coordination mechanism: To achieve higher productivity and structural production, the challenges of weak governance coordination between the different government entities must be tackled. The industrial policy should be developed in coordination and coherence with the existing sector policies, including trade policy trade promotion, investment promotion and sectoral policies. Potential duplication of mandates emanating in part from the threat of defection by some Federal Member States (FMS) may constrain the direction of the vision for structural transformation. Mechanisms should be put in place for managing the coordination risks to structural transformation, similar to the way risks were adopted for managing the fiscal federalism. A coherent strategic planning structure for structural transformation should be developed, including at the strategic level, ensuring that the NDP-9 completion review incorporates recommendations that will promote industrialization and private sector development in the 2025-2029National Transformation Plan (NTP-10). Notably, NDP-9, was also an interim PRSP, did not provide a clear vision for structural transformation. There is an opportunity to include the coordination roles and responsibilities for structural transformation in the NTP-10, the successor of NDP-9.

2.3.5 Major constraints to accelerated structural transformation

i) Structural transformation, labor transition and economic diversification are constrained by insecurity, fragility, high cost of doing business, financing constraints, inadequate skills, technolo-

gy, infrastructure, demographic challenges, informality and weak institutional and coordination capacities. Regarding insecurity, Somalia has been experiencing a prolonged conflict for over three decades since 1991, making it difficult to establish investment, especially in the Central and Southern parts of the country. Somalia still suffers from massive displacement of more than 4 million as of 2023. Furthermore, there are regional geo-political risks created in part by the tensions between Somalia and Ethiopia and the greater Horn of Africa region following Ethiopia's signature of an MoU with Somaliland on 1st January 2024, granting Ethiopia access the Gulf of Aden in the Red-Sea.

Box. 3.0 Climate change experiences in Somalia

Since early 2022, more than 4 million people have been displaced from their homes due to climate shocks, notably drought and conflict triggered in part by a struggle for natural resources. Over the last two decades, Somalia has been facing extreme weather shocks, which have occurred in two-year cycles. The country also faces massive degradation of its forest cover, estimated at 686,000 hectares of tree loss between 2000 and 2017, which is equivalent to the loss of 6% of all trees in Africa, and an annual forest cover loss of 40,000ha. Given Somalia's semi-arid and dry landscape, further degradation to tree cover exposes the country to the declining water resources, as well as water scarcity and drought, which are the main drivers of internal displacement. More recently, in April-May 2024, Somalia experienced floods resulting from the heavy rains which had displaced about 203,438 people by end May 2024. By August 2023, nearly half of Somalia's population (8.4 million people) required humanitarian assistance, while 1.3 million became internally displaced due to drought, which also affected over 16 million livestock, thus contracting real GDP growth. The Humanitarian situation report of 12 May 2024 projected that the displacement would continue to June 2024, with 770,000 people requiring humanitarian support. Previously, in 2022/2023, Somalia experienced five consecutive failed rainy seasons resulting in a prolonged drought that put the country on the verge of a catastrophic famine. While it has established its USD 55.5 billion Nationally Determined Contributions in 2021 for climate action under the United Nations Framework covering a 10-year period to 2030 and created the Ministry responsible for the coordination of Climate Change in 2022, Somalia continues to put in place the required regulatory policy frameworks for climate action, but the policies related to land and environment remains weak. The old laws established before the 1991 war needs to be updated. Prior to this, in 2020/2021 and 2022/2023, the country experienced the negative impact of COVID-19 and impact of the Russia- Ukraine war.

ii) Climate change challenges: Somalia is one of the world's most vulnerable countries to climate change impacts. It ranked 179th out of 185 countries in vulnerability and climate preparedness on the 2023 Notre Dame (ND) Global Adaptation Initiative index. The ND-GAIN Index summarizes the vulnerabilities of countries to climate change and other global challenge in combination with its readiness to improve resilience. Details are provided in Box 3.

iii) Demographic challenges. Somalia faces the youthful populations pressure—Somalia's National Youth Policy 2017-2021 defines youth as persons aged between 15 and 40, which applies to about 81 percent of the total population. The youth unemployment rate (30.1 percent) was above the national unemployment rate of 21 percent in 2022. Interventions targeted at increasing the level of skills development, and their technology and opportunity will help to harness this demographic dividend (of youthful population) to expand the market for the manufacture of technological equipment.

iv) Political issues and coordination challenges of entities responsible for driving structural transformation remains weak. For instance, the Ministry of Commerce and Industry has insufficient budget and capacity to drive structural transformation. In addition, aspects of strengthening accountability and anti-corruption also need to be prioritised to achieve transformation.

v) *Informality:* T**he informal sector contributes more than 60 percent of GDP and is dominated by women.** According to the findings of the AfDB 2023 Country Diagnostic Note, informal cross-border trade (ICBT) is high, particularly involving agricultural products like livestock to markets in Kenya and the Gulf countries. ICBT is conducted by informal traders and formal firms evading regulations, bureaucracy and customs duties. The informal sector and the cross-border informal trade are critical for resilience, with the diaspora playing a significant role in providing start-up capital. However, the informality requires a concerted effort to address challenges for vulnerable groups like women, and improve formalization, government taxation and revenue collection from the informal sector.

vi) Somalia's private sector is dominated by the informal sector mostly micro, small, and medium-sized enterprises (MSME). The informality however presents disadvantages to these MSMEs—the impediments include high cost of doing business, complex business registration, land registration, poor access to credit, notably high energy tariffs, poor transport networks and inefficient logistics, and skills gaps. NDP-9 notes that skilled labor is essential to structural transformation and diversification, value-addition, and economic and export competitiveness. Informality also hinders tax collection from traders. The FGS has started rolling out the biometric national Identity Card that will be linked to business registration and taxes. Investment in institutional and human capacities to support the innovations and efficiency of entrepreneurship and to improve the business environment will go a long way in unlocking structural transformation.

vii) *Financing constraints:* Somalia's institutional capacity for domestic resource mobilization has been weak. The government has largely relied on donor grants for financing transformative projects, due the high risk of debt distress prior to reaching the HIPC Completion Point in December 2023. Over the last decade, up to 2024, Somalia has only increased its domestic resources by 1.4 percent of GDP, reaching the 3 percent tax to GDP ratio in 2023, which remains very low and can cover only wages, although the FGS has programmed to continue raising taxes to fully cover operational expenses by 2027. Regarding development bank financing, Somalia Development and Reconstruction Bank remains undercapitalized and therefore unable to extend financing to the productive sectors. The bank was revived only in 2012, following its collapse in the 1990s due to conflict.

viii) *Infrastructure deficit* constitutes a major constraint to structural transformation, especially in the electricity, water, and transport sectors. Moreover, Somalia lacks sufficient sea-port facilities to support backward-linkage to stimulate higher demand for manufacturing.

2.4. Finance to Fast-track Somalia's Structural Transformation: How much is at Stake? Somalia's Commitment to Structural Change

2.4.1 Identifying structural change strategy in the national development plan

Somalia's commitment to the acceleration of the structural transformation is anchored in Somalia's ninth National Development Plan (NDP-9) 2020-2024, whose priority sub-pillars include human capital development, private sector development, infrastructure development, trade policy and technology. NDP-9 also doubled as the Interim Poverty Reduction Strategy Paper but was not costed. Somalia continues to face a significant financing constraint to unlocking the drivers of structural transformation by 2030. There is a need for better access to finance as one of the key "pull" factors of Somalia's structural transformations. To achieve this, the country needs to mobilize significant external and internal resources to fast-track and sustain this process. This Report uses the benchmarks of the SDGs—notably, SDG 4 (Quality education), SDG 7 (Energy), SDG 8 (Productivity) and SDG 9 (Infrastructure)—as benchmark to estimate the financing needs for structural transformation.

In terms of performance against the SDG benchmark, Somalia had in 2022 recorded 48 percent achievement of its overall SDG targets. However, SDG 9, related to infrastructure had only achieved 5.59 percent of its 2030 target. The country achieved 55.6 percent of its SDG 4 2030 target, 43.3 percent for SDG 7, and 55.7 percent for SDG 8.

Figure 2.6: Estimated annual financing needs for the fast-tracking of Somalia's structural transformation by 2030 and 2063

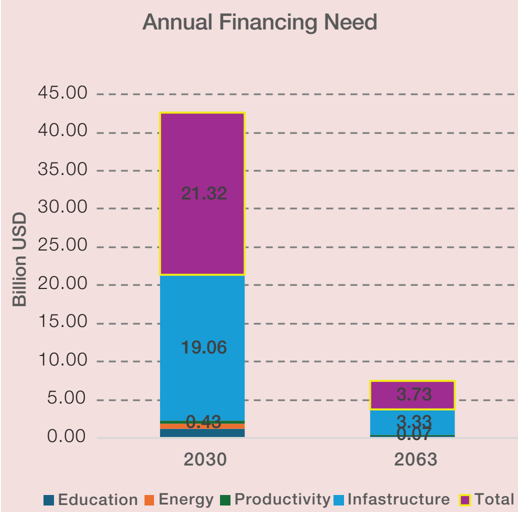
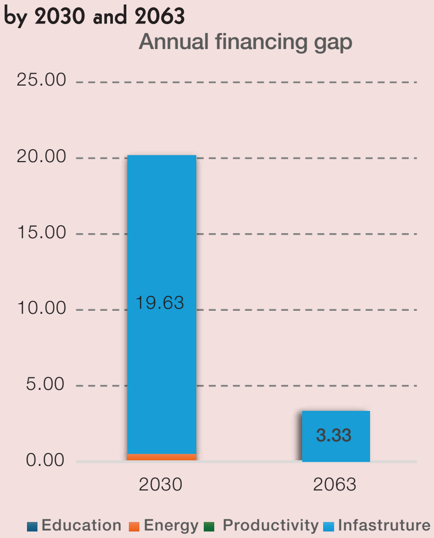


Figure 2.7: Estimated annual financing gap for the fast-tracking of Somalia's structural transformation by 2030 and 2063



Source: 2024 African Economic Outlook

Somalia will need to close the annual financing gap of US $19.63 billion to achieve structural transformation by 2030 and US $3.4 billion annually to achieve it by 2063.

2.4.2 Financing needs and financing gap

The Bank estimates the financing gap for the fast-tracking Somalia's structural transformation to be USD 19.6 billion annually by 2030, reducing to USD 3.4 billion annually by 2063.

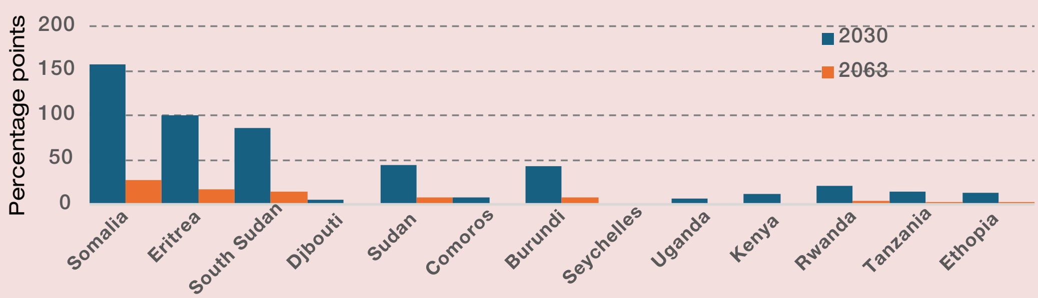
NTP-10 (the designated successor of NDP-9) takes into account the domestic resource mobilization efforts to accelerate structural transformation. In addition, external financing is needed to harness private sector and development finance. Based on the benchmark approach linked to SDG 2030 and AU 2063 targets, Somalia's estimated **financing need** for the four critical SDGs to achieve structural transformation by 2030 amounts to USD 21.3 billion annually, while the **financing gap** amounts to USD 19.63 billion annually (by 2030). When the 2063 deadline is used as reference, the annual **financing need reduces to USD 3.7 billion and the annual financing gap to USD 3.4 billion.** Additional off-budget grants will contribute to the financing of the SDGs. It is envisaged that NTP-10 will cost these by end of 2024.

2.4.3 Closing the financing gap through domestic resource mobilization

The Bank estimates that, to close the financing gap by 2030 and 2063, in the absence of other measures, Somalia's tax bracket needs to be broadened to meet the 157.3 percent requirement to achieve structural transformation by 2030 and by 27.5 percent by 2063 (Figure 2.8). Given that

Somalia raised its tax to GDP from 1.2 percent of GDP from 2013 to 3 percent a current tax-to-GDP ratio in 2023, it will be challenging for Somalia to meet this target. The country needs to explore innovative ways of broadening the tax base, including modernization, digitalization, and harmonization. Similarly, it should expand the tax base, improve tax revenue collection by modernizing systems and tax administration, and sustain reforms in public finance management (PFM) and domestic revenue mobilization (DRM) through the implementation of the Public Finance Management (PFM) Reforms Strategy and Action Plan (2021–2024)—aligned with Somalia's ninth National Development Plan (NDP-9), which focuses on fiscal discipline, transparency,

Figure 2.8: Tax-to-GDP Ratio Increase Required to Close the Estimated Annual Financing Gap in East Africa



Source: AEO database from AfDB Statistics Department, Sachs et all (2023), UNESCO, CIA, NASA, IMF, and World Bank

Key DRM reforms include modernization of the customs and tax administration, implementation of the Somalia Customs Automated System (SOMCAS), and rollout of Point of Sales (POS) machines. The improvements recorded through the implementation of the Revenue Act, and customs modernization reform roadmap include the automation of customs revenue collection and the adoption of a new income tax law. The income tax legislation for the extractive industry was also harmonized with Production Sharing Agreements for oil and gas reserves. To strengthen the legal and regulatory framework for the petroleum sector, the Extractive Industries Fiscal Regime Law was enacted in June 2023. The Audit Bill was enacted in September 2023 to provide a robust federal audit system.

One of the achievements of the PFM roadmap 2021-2024 was the facilitation of the integration of the anti-corruption measures into the NDP-9, to strengthen the government's commitment to transparency and accountability. The challenges of tax mobilization include insecurity, structural and institutional and human capacity constraints, lack of harmonization between state and federal member systems, informality, insecurity, and non-integration with the EAC bloc. The lack of integration has had long-term detrimental impact of constraining the country's economic growth potential and limiting its capacity to mobilize more substantial revenues from trade and investment within the region.

Increase in DRM can be supported by tax policy capacity improvement. Somalia needs to develop a tax and non-tax revenue policy to improve tax compliance. Enacting the Income Tax Bill into law will also help to streamline taxable income and deductions. Also, a comprehensive reform strategy for increasing telecom sector revenues, as well as the development of a DRM strategy for widening the tax and non-tax revenue such as introducing the environmental related taxes to internalize environmental costs, will yield a tax increase. Lastly, the introduction of a new sales tax law, implementation of the

EAC CET (with effect from 2027), and strengthening of tax audits and tax enforcement, will improve compliance.

Revenue strengthening measures are also being implemented to broaden the tax base through the improvement of tax administration systems, and capacity strengthening activities should aim to finalize Revenue Administration Law regulations, Automate tax administration—including developing the Integrated Tax Administration System (ITAS) and establishing a gateway for tax payments through private banks— and complete the ad valorem customs reform, particularly to begin application of ad valorem tariffs that rely on invoice values, advancement of the customs reforms in the remaining ports. Moreover, the Federal Government of Somalia (FGS) needs to digitalize non-tax revenues (road tax and rental property tax) and develop a tax dispute resolution strategy. Lastly, the FGS should ensure the harmonization of inland revenue in Baidoa, fiscal federalism agreement, and strengthen exchange of information on tax matters. Taxpayer education and facilitation and capacity building will include strengthening cooperation with the business community to promote taxpayer compliance, taxpayer education, identification, and registration, the development of a DRM training curriculum for revenue staff, and job descriptions for revenue staff, together with a staff appraisal system to monitor and improve staff performance.

Looking ahead to 2025-2027, the FGS has planned some critical policy measures to strengthen inland revenues systems and capacity strengthening to contribute to tax administration harmonization. Key recommended actions include targeted policy dialogues, capacity building within tax administration, specialized technical assistance, and continued modernization of customs administration. The FGS plans further reforms to improve tax policy capacity, strengthen tax administration systems, harmonize inland revenue, and enhance taxpayer education and facilitation. An ambitious target of 10 percent annual tax-to-GDP ratio has been proposed under the NTP-10 over 2025-2029. Public expenditure prioritization and targeting, as well as expenditure rationalization, could help to create the fiscal space for the financing of Somalia's structural transformation. Furthermore, enhancement of public expenditure efficiency will facilitate the achievement of macroeconomic stability. Past revenue savings from cash balances and short-term advances obtained from the Central Bank of Somalia, and fiscal savings from debt relief upon the HIPC attainment, should bridge the gap.

Box 4: AfDB's support to economic transformation in Somalia

Since 2013, the Bank Group has been at the forefront of supporting Somalia's economic transformation through interventions in economic and financial governance projects. The AfDB has financed a series of institutional support projects and technical assistance aimed at strengthening institutional and human resources capacity of key institutions, as part contribution to the State building process. Notwithstanding, Somalia's tax-to-GDP ratio remains low, having increased from 1.2% in 2013 to 3.0% in 2023. The targeted institutional support aimed at deepening reforms for improving the institutional capacity of the Federal Government of Somalia and Federal Member States to: (i) improve domestic revenue administration; (ii) strengthen basic PFM functions notably budgeting, accounting, internal controls, public procurement, and external audit functions; and (iii) improve public debt management. The key results achieved from AfDB's support helped Somalia to strengthen its Inland tax administration capacity through the adaptation of critical tax policy measures, automation of tax administration functions such as registration, filing/assessment, payment, audit, and arrears management for Large and Medium Taxpayers, and establishment of key internal and external audit practices.

On average, the AfDB provides an estimated USD 1.8 billion development assistance annually to Somalia. The FGS Aid Information Management System (AIMS) platform data for 2020-2022 shows that the AfDB contributed 5.5% of total development assistance averaging USD 82.4 million per year, positioning the Bank ass the 6th out of 34 DPs in Somalia.

The AfDB's ongoing portfolio in Somalia comprises 18 operations totaling USD 237.83 million, covering the following sectors: transport (42%), agriculture (32%), multi-sector (10%), water and sanitation (9%), power (4%) and social (3%).

The non-lending works were demand-driven and comprised technical assistance for governance projects, feasibility studies for the road infrastructure projects and evidence-based knowledge work that helped to facilitate policy dialogue and policy reform. The delivered non-lending works include the following: i) A study: Somalia's Blue Economy and the Blue Economy Sectoral Investment Plan, whose recommendations formed the basis of the Somalia Blue Economy Investment Forum held in November 2023. The study also informed the Bank Group's dialogue at COP 28 in 2023. (ii) Financial sector Diagnostic study in 2021. To improve the impact of the interventions, the Bank Group undertook a Financial Sector diagnostic, which has helped to shape a new Financial Sector Development Project due for Board consideration in September 2024. Some of the non-lending advisory support work was financed by the Africa Legal support facility that provided support to develop the Petroleum Sector's Model Public Sharing Agreement. The AfDB provides ongoing support to the extractive sector, especially mining.

2.5 Concluding remarks and policy recommendations.

This chapter analyzed the financing need and gap for Somalia to achieve structural transformation by 2030 and 2063. It concludes that closing the financing gap requires concerted efforts from both external and internal players for resource mobilization. It highlights the AfDB's support to structural transformation, the key trends, challenges and overall estimates the financing as a percentage of GDP to fast-track Somalia's structural transformation and concludes with policy recommendations on the roles of government, private sector, regional institutions, Development Finance Institutions (DFIs) and Multilateral Development Banks (MDBs) in supporting Somalia's structural transformation. Somalia's long-term and medium-term plans reflect the SDGs and Africa 2063, yet growth has been low and inclusive, resulting in a high unemployment rate. Nevertheless, there has been a gradual shift of labor from agriculture to the services sector. We find that that the marginal structural transformation happening is driven by the services sector.

(a) Government's role

The government's key role is establishing the policies, strategies and regulatory framework required for accelerating the drivers of structural transformation and achieving overall macroeconomic stability. For Somalia, state-building and stabilization of insecurity are crucial to the achievement a conducive business environment, and structural transformation.

- ***National development planning.*** Somalia needs to establish policies and to prioritize and institutionalize endogenous development plans and policies from local, regional and global context, tailored to areas of Somalia's comparative advantage. Moreover, Somalia needs to consistently implement these policies, while avoiding policy reversals that tend to disrupt the progress of structural transformation.

- ***Role of fiscal and monetary policy in fostering macroeconomic stability.*** The FGS should continue implementing economic and financial governance reforms, including public financial management, debt management (including post-HIPC debt relief) and should intensify domestic resource mobilization and fiscal policy consolidation and expenditure rationalization. Fast-tracking the currency reform program intended to establish monetary alongside exchange rate and launch of Somali shillings will go a long way in building investor confidence in the country, while the promotion of reforms to enhance economic stability and improve the business environment is needed to accelerate structural transformation. The completion of the currency reform and establishment of a favorable exchange rate will help to increase investor confidence in Somalia.

• ***Prudent monetary policy development*** and fast-tracking the revision of the AML/CFT 2016 Act will facilitate the establishment of corresponding and intermediary banking relationships for Somalia's full participation in the global financial architecture.

• ***Launch an ambitious Sustained public investment in infrastructures*** to accelerate structural transformation. Investments in energy, transport, water, agriculture, and port infrastructure will help to improve the country's competitiveness and enablers of private sector development.

• ***Somalia should scale up domestic resource mobilization (DRM)*** and expediate the development of a domestic resource mobilization strategy to guide alternative domestic revenues sources. Broadening the tax base, and scope for domestic revenue mobilization by sustaining tax policy reforms and tax administration will facilitate structural transformation. Sustaining the PFM roadmap consolidation strategy initiated in 2020 is critical to containing the envisaged fiscal deficit.

• ***Accelerating Financial sector reforms,*** including re-capitalization of the Somalia Development and Reconstruction Bank to provide credit to SMEs, and strengthening the institutional governance of the Central Bank of Somalia with respect to supervisory and regulatory role, will facilitate the reintegration of Somalia into the global financial architecture. Development of the local Somali capital market will increase financing sources, as well as innovation, and increase options for long-term financing for the private sector.

Industry ratio to GDP improved to 7.4 percent in 2022, but the manufacturing value addition ratio to GDP was only 2.2 percent[7] in 2022. Yet, the **industrial policy revived in 2020 since the collapse of the government in 1991 is only three years old** and not fully operationalized. The Somalia Industrial Development Policy 2020-2030 aims to prioritize industry to enhance productivity, increase employment, boost economic growth and reduce poverty. It prioritizes the creation of industrial development zones, with water, roads, and electricity infrastructure, as well as marketing and distribution. Similarly, industrialization forms an integral part of NDP-9, designing a prudent costed industrialization strategy, anchored in the envisaged tenth National Transformation Plan (NTP-10), which provides the opportunity to prioritize, strategies and flagship investments projects. Identifying strategic value chains for export diversification and industrial development calls for the development of value chains within the agriculture economy, blue economy, green economy and extractive sector. Somalia's productive pipelines can be used to exploit its industrialization potential. For instance, livestock value chains (beef, diary, leather, and leather products, among others) will drive productivity shift and value addition, as well as boost value-added manufacturing, consequently creating employment and jobs.

• The FGS should seize the opportunity presented by Somalia's recent admission to the EAC regional trading bloc, notably the improved regional connectivity along trade corridors, and special economic processing zones that will spur trade and bolster structural transformation. The strategic location, with the longest coastline in the Horn of Africa, and the red-sea and Indian Ocean, positions Somalia as a regional hub for exports.

• Measures to expand exports revenue and intra-regional cross-border trade should target investments in infrastructure (roads, railways and electricity transmission through the East African Power Pool) and value addition, including for minerals, fisheries and agro-processing. This will subsequently increase exports revenues from processed goods to create productive jobs.

Policy implications for rural-to-urban population movement and transformation. Interventions for urban growth should target service delivery to the internally displaced people, including infrastructure for water, roads, education, health facilities, offices/commercial areas and services industrial areas and special economic zones. Urban planning should involve an orderly physical development and provide for future expansion, decent wages and decent low-cost housing, to promote the gradual rural-urban migration that will enable an employment shift from low agricultural productivity to agro-processing, as well as the development of agricultural values chains. Feeder roads are essential for linking agricultural areas, while paved roads and transport infrastructure should be planned to link highways, cities and peri-urban market areas to production areas. This will facilitate the movement of people and accelerate structural transformation.

A new growth model that supports the private sector as an engine for economic growth is needed. Somalia is currently focusing on a private-sector-driven growth model as an engine for development. Public infrastructure investments planning should be the focus of government policy to strengthen private sector environment.

Establish a holistic industrial strategy to operationalize the 2020 policy that promotes transformation from agriculture to a manufacturing-based, private-sector-led economy. The industrial strategy should identify value chains from within the local economic development, as well as Somalia's comparative advantage. Given that livestock and fishing are the mainstay of the economy, targeting agro-processing and export promotion for livestock value chains, fishing, cereals, seed oils and banana exports are the main activity around the Kismayo seaport. Industry should also focus on import substitution merchandise, including cereals, pasta and wheat processing, utilizing the current economic processing zones and industrial parks.

Prioritize investments in human capital development to provide adequate skills required to catalyze structural transformation, especially skills required for youth entrepreneurship to reap from Somalia's demographic dividend. This includes skills training to supply the workforce from all educational levels, but most importantly, it is important to invest at tertiary level to produce the skills set to match labor demand.

• ***Somalia should incentivize the private sector to catalyze private capital inflows in support of structural transformation.*** This includes the enablers of a conducive business environment, including fiscal tax incentives such as tax exemption for a restricted timeline, and blended innovative financing instruments, syndications, green and blue bonds. Enhance investment promotion and investor matchmaking schemes. In addition, improve business environment including reforms to facilitate a free entry and exit, financial services, taxation, international trade, labor market regulation, utility connections, market competition, business insolvency, and dispute resolution.

Somalia should harness natural capital and conservation to diversify the economy and spur growth, for instance, Somalia can close the financing gap by harnessing the revenue from its natural resources. Somalia is endowed with blue and green economy resources, including forest timber, fisheries, minerals and petroleum. According to the AfDB's Somalia Country Focus Report 2023, Somalia earned USD 95,523 million from these resources.

Fast-track the enablers of structural transformation to unlock structural change including Technology, high-quality and sustainable infrastructure, agricultural productivity, and economic and financial governance to reap institutional efficiency. The establishment of the right laws and regulatory framework to drive the participation of the private sector—the Public Private Partnership (PPP) laws, for instance—can facilitate concessions in the extractive sector, as well as private sector participation in adequate electricity generation and value chain development, will support industrialization and manufacturing for the acceleration of investment and structural transformation.

Strengthening regional integration and reform to diversify trade and exports markets, including lifting trade barriers and increased processing of agricultural products especially livestock value chains, will help Somalia to accelerate structural transformation. Leveraging the EAC community to deepen regional market for goods and services, as well as the standby force, could help Somalia in curtailing insecurity and enable the country to take advantage of the EAC, Horn of Africa and AfCFTA markets for its products.

(b) Role of private sector in driving structural transformation

For Somalia, the private sector can play a critical role in driving structural transformation through leveraging private sector investments in strategic sectors, promoting competition and innovation for the efficient allocation of resources. The private sector can seize the opportunities of Somalia's strategic location in the Horn of Africa, the AfCFTA and ongoing reforms to expand production, trade and investment in tourism to accelerate structural transformation.

(***c) Role of regional institutions in supporting the country's structural transformation agenda***

Regional institutions such as the East African Community, Horn of Africa, the African Capacity Building Foundation or the African Economic Research Consortium should focus on supporting the structural transformation agenda for Somalia through provision of knowledge-based analysis and capacity building, and mentoring.

(***d) Role of Development Finance Institutions (DFIs) and Multilateral Development Banks (MDBs) in supporting Somalia's structural transformation.***

Development finance is the most suitable for capital projects. In this regard, the DFIs and MDBs especially the African Development Bank, World Bank, IMF, Islamic Development Bank, European Investment Bank, and Asian Development Bank should support Somalia's NTP-10 flagship projects that are enablers for accelerating structural transformation in Somalia. Their role should not be limited to concessional financing; capacity building and technical assistance will go a long way in accelerating transformation.

3

FINANCING STRUCTURAL TRANSFORMATION IN SOMALIA: THE NEED FOR REFORMS IN THE INTERNATIONAL FINANCIAL ARCHITECTURE

KEY MESSAGES

- To finance transformative projects, Somalia would need to increase taxes by 157.3 percent of its tax-to-GDP ratio by 2030, and gradually sustain an annual increase in the tax-to-GDP ratio by 27.5 percent by 2063.
- To realize the financing requirements for structural transformation, Somalia needs to leverage the role of private capital. However, given the constraints to private sector development, Somalia should invest in reforms to remove the impediments to doing business.
- Lack of a domestic capital market in Somalia impedes domestic resources mobilization, implying that Somalia cannot rely on financial markets to mitigate the impact of exogenous shocks and/or to finance structural transformation. Somalia should fast-track the revision to the AML/CFT, which will facilitate the establishment of the correspondent/intermediary banking relationship for Somalia's full participation in the global financial architecture.
- To deal with debt and avoid falling back into a debt trap, Somalia's decision for borrowing externally should be informed by the delicate balance between the need for impact and the effective utilization of the external resources for transformational projects. In any case, Somalia needs to maintain debt sustainability levels within sustainable critical. Somalia urgently needs a medium-term debt management strategy to ensure timely sourcing of concessional borrowing.
- The Foreign Direct Investment (FDI) inflows increased from 5 percent of GDP in 2020 to 5.2 percent in 2021 and stagnated from then until 2023. FDI inflows are projected to increase to 5.4 percent between 2024 and 2027. To achieve these projected rates, Somalia needs to improve its weak Transparency International Corruption Index, which ranked the country lowest out of 195 countries, posing a challenge for (FDI).
- Somalia has one of the highest climate finance needs, by percentage of GDP, which is estimated above 80 percent. Its Nationally Determined Contributions (NDC) 2021 estimate was USD 55.5 billion for climate financing needs from 2021-2030 as, and USD 5.5 billion per annum for climate financing. These is much higher than the government can finance from domestic resources. To mobilize additional climate financing, Somalia needs to create a private climate sustainable financing strategy that will enable it raise climate-related financing from multilateral agencies. The government also needs to develop its capital market to provide the uptake of financing for climate-related financial capital markets to crowd in private sector investment, also to work on regulatory frameworks to enable Somalia to benefit from African Carbon Markets Initiative (ACMI).
- Somalia, alongside other African countries, needs to advocate for reforms in the global financial architecture to ensure a fairer, equitable and transparent system that can enable the allocation of more concessional resources to Africa through the AfDB under SDR.
- The G20 framework is taking longer to restructure the debt of most SSA countries, including Somalia, thus putting more fiscal constraints on the paths of countries in debt distress. SSA countries need to raise their voices about reforming their framework to effectively respond to their creditors needs.

3.1 Introduction

Over the last three decades, multilateral financial institutions have contributed significantly to the financing of Somalia's development agenda. However, the structural transformation requires the mobilization of both domestic and foreign resources to finance the SDG 2030 targets in the areas of infrastructure, human capital, climate action, productivity and technological advancement and digitalization. The strides Somalia has made toward increasing its domestic revenues between 2013 and 2023 only realized a modest increase (1.4 percent) thus raising the tax-to-GDP ratio to 3 percent in 2023 – five times lower than the SSA average of 15.6 percent of 2021. It is therefore imperative on the country to explore alternative financing options from the international financing architecture for meaningful investments in the transformative projects.

While the global financial architecture (GFA) has contributed to the Country's financing, the global financial architecture has demonstrated limited ability to deliver resources to scale. In response to these shortfalls, there have been calls for the global international financial systems to be reformed to offer a better pathway for highly concessional, equitable resources allocation. For instance, on 23 August 2021, the IMF issued 190 member countries a general Special Drawing Rights (SDR) allocation amounting to 650.billion to boost liquidity and help cushion countries that were struggling to cope with the negative impact of COVID-19. All African countries combined received an allocation of SDR 33 billion. representing 5 percent of the total SDR allocation, lower than the SDR allocation to the United States (USD 113 billion), Japan (USD 42 billion), China (USD 42 billion) and Germany (USD 36 billion). Somalia received an allocation of SDR 157 million (USD 203 million or 4.1 percent of GDP) in 2021.

The failure of the global financial architecture to equitably deliver the much-needed development financing to the low-income countries provides sufficient justification for reform. Like other African countries, Somalia has a huge financing gap to bridge for its development financing needs. Furthermore, Somalia has repeatedly been at the receiving end of extreme climatic shocks, and other exogenous shocks, including the COVID-19 pandemic in 2020-2021, followed by impacts of the Russian invasion of Ukraine. At the African Union Head of States Summit in February 2022, African leaders urged the IMF to provide the larger part of the SDR allocated to Africa.

Shortfalls in the external financing including external debt, Foreign Direct Investment and Official Development Assistance poses challenges of reliability and sustainability.

There have been calls for African countries, including Somalia, to increase their representation on the various international platforms, notably the United Nations, IMF, World Bank, World Trade Organization, and on other Partnerships, including the G20.

Another limitation has been with the global financial architecture being anchored in the higher cost of borrowing from the International financial capital markets, especially the cost of sovereign Eurobonds, which has been exorbitant for African countries, with yields ranging from 5 percent to 8 percent, compared to the yields for advanced economies, which averaged about 1.1 percent, while emerging market yields were 4.5 percent on average.

3.2 Internal Financing of Structural Transformation and the Constraints

3.2.1 Domestic resource mobilization

Domestic resource mobilization remains subdued, having slightly increased from 1.2 percent in 2013 to 3 percent in 2023 (in percent of GDP). To achieve sustainable transformation, Somalia needs consistently growth at above 7 percent for ten consecutive years. NTP-10 has proposed a GDP growth target of 10 percent per annum from 2025-2029, yet current taxes are very low. Somalia plans to increase tax-to-GDP ratio by 0.4 percent per annum to fully cover its recurrent expenditure by 2027. Somalia needs to widen its tax base to realize the estimated 157.3 percent tax/GDP required to achieve structural transformation by 2030, and gradually sustain an annual 27.5 percent increase in the tax-to-GDP ratio by 2063 (Figure 2.21). Given that Somalia raised its tax to GDP from 1.2 percent of GDP from 2013 to 3 percent a current tax-to-GDP ratio in 2023, it will be challenging for the country to meet this target. The country needs to explore innovative ways of broadening the tax base, especially through modernization, digitalization and harmonization. To achieve these targets, Somalia should prioritize the expansion of the tax base and improvement of tax revenue collection by modernizing systems and tax administration. Somalia has steadily progressed in public finance management (PFM) and domestic revenue mobilization (DRM) through the implementation of the Public Finance Management (PFM) Reforms Strategy and Action Plan (2021–2024).

3.2.2 Private capital for structural transformation

To realize the financing requirements for structural transformation, Somalia needs to leverage the role of private capital. However, given the constraints to private sector development, Somalia should invest in reforms to address the constraints to doing business, by simplifying both the complex land tenure system and the ease of business licensing requirements. The other challenges include the coordination role and duplication of mandates for the Ministries, Departments and regulatory agencies. Currently, the Ministry of Commerce is responsible for investment promotion. However, other Departments, including the Planning Ministry (MoPIED), also have a mandate of programming and coordinating inter-agency activities for private investment.

Policy recommendations

i) To accelerate structural transformation, Somalia should develop a Domestic Revenue (DRM) Strategy to provide revenue targets and options for doubling the tax-to-GDP ratio above the current 3 percent of GDP. The extensive PFM reforms, over the last 10-years, has not yielded sufficient tax revenues, perpetuating Somalia's reliance on the Development Partners for the implementation of the National Development Plan, since the country only managed to increase the tax-to-GDP ratio from 1.6 percent to 3.0 percent.

ii) The FGS should fast-track capacity building mechanisms and tax education to increase tax collection compliance

iii) Government should expediate the regulations for the new income tax law for the extractive industry, which was also harmonized with Production Sharing Agreements for oil and gas reserves. In addition, expediate the development of the regulations for the Petroleum Act (2020), which was designed to ensure that the petroleum resources are utilized for the benefits of citizens.

iii) Continue implementing the efforts toward good governance through full compliance with the provisions of the Anti-Corruption Law of 2019 to reduce corruption, which is a hinderance to investors.

iv) Somalia should work on strengthening the Central Bank institutional and regulatory environment, including by updating the 2016 AML/CFT, and should also boost domestic savings and build foreign exchange buffers. This will restore correspondence banking and intermediary banking, which are pre-requisites for reconnection to the global financial architecture.

v) There is need for reform of the governance structures of the multilateral development Banks, and International Financial Institu-

Reforms in the governance structures of the multilateral development Banks and International Financial Institutions are needed to mobilize resources for the financing of the SDGs and structural transformation.

tions, including the World Bank, IMF, AfDB and other regional Development Banks, to mobilize and allocate significant resources s for the financing of the global SDG goals.

3.3. External Financing of Structural Transformation: Constraints and the Need for Reforms in the Global Financial Architecture

3.3.1 External resources have contributed to the financing of Somalia's economic development and structural transformation to date. However, additional resources are required to accelerate Somalia's structural transformation.

Somalia has continuously harnessed external financing to meet its economic development needs. Some of the external resources that the country has used include inflows from remittances, which marginally declined from 21.5 percent[8] of GDP in 2021 to 20.5 percent of GDP in 2023, due to the low purchasing power of the diaspora, following the impact of the global inflation that reduced their purchasing power. This implies that remittances are not fully reliable, because its performance depends on the global economic performance.

The Official Development Assistance (ODA) inflows by end 2023 increased to 31.4 percent of GDP in 2023, from 21.5 percent of GDP in 2021. The increase in ODA was driven by the increased need for humanitarian assistance to the 8.3 million people impacted by the 2021-2023 prolonged drought and the Russia-Ukraine war brought the total UN appeal to USD 2.6 billion. These grants that were largely in the form of off-budget grants, directed to Civil Society and United Nations for Humanitarian needs excluded in most cases aspects of transformational projects. These external resource inflows from the ODA, remittances and exports, which totaled 15.6 percent of GDP in 2023, is insufficient to drive the scale of financing needed for structural transformation, the climatic shocks and continued fragility and insecurity risks.
The Foreign Direct Investment (FDI) inflows increased from 5 percent of GDP in 2020 to 5.2 percent in 2021 and stagnated between then and 2023. FDI inflows are projected to increase to 5.4 percent between 2024-2027, following the HIPC Completion Point achievement, lifting of the arms embargo and of the ban on the airspace. However, Somalia's most recent rating by the Transparency International Corruption Index is weak; the country ranks lowest out of 180 countries, posing a challenge for mobilizing (FDI) even after the country has reached the HIPC Completion Point.

Somalia's heavy reliance on external debt financing to meet its economic development needs and structural transformation resulted in the accumulation of arrears and an embargo on external borrowing from the HIPC Decision Point in 2020 to HIPC Completion Point in 2023, amidst political instability and challenging economic condition.
The institutional reforms required to sustain debt sustainability should target the International Financial Institutions, Multilateral Development Banks and external creditors willing to provide highly concessional financing to avoid getting Somalia back to unsustainable debt levels. The proposal for the global financial architecture should therefore target the provision of: (i) financial resources targeted at accelerating structural transformation through the reallocation of Special Drawing Rights, (ii) resources intended to cushion the country from falling back to unsustainable debt levels, (iii) financing for climate action and green growth; vi) resources provided in response to emergency shocks, including pandemics and climatic or natural disasters.

Reforming the International Financial architecture is justified by Somalia's high population growth rate (3.1 percent in 2022), which is comparatively higher than the 2.4 percent GDP growth rate of 2022. Furthermore, the emergence of several new philanthropic influencers in the provision of development financing presents an opportunity for the leverage of financing, for instance.
According to the 2024 AEO, two-thirds of

[8] IMF Country Report No. 23/438: Somalia Staff Report for the Sixth Review Under the Extended Credit Facility (ECF) Arrangement.

private philanthropies for sustainable development targeted African countries, allocating USD 2.9 billion annually between 2019 and 2020, above the allocation to Latin America (USD 0.4 billion). In this regard, Somalia equally stands a chance to benefit from some of these philanthropic financing inflows to Africa.

The increased frequency of climatic shocks justifies the need for reforms in the global financial architecture to leverage financing from climate trust funds, and global environmental windows.

Lastly, the AEO 2024 shows the empirical evidence from the International capital markets, which revealed that the African Eurobonds were issued with yields above 5 percent, and in 40 percent the cases the yields were at 8 percent in 2021. This is significantly higher than the 1.1 percent and 4.9 percent Sovereign bond yields for advance economies and emerging market economies, respectively. This implies that, like other African countries, Somalia would be disadvantaged if it chose to borrow from the global capital markets, compared borrowing from the World Bank or the African Development Bank. Another rationale for reforms in the global financial architecture is that debt restructuring under the G20 framework is taking longer, thus putting more fiscal obstacles in the paths of countries in debt distress.

The Private Sector (domestic and international) should collaborate with the Federal Government of Somalia (FGS), Federal Member States (FMS), MDBs and DFIs and other private sector actors to identify key investments project risks and propose ways of addressing these investment risks to accelerate private sector financing for structural transformation.

3.3.2 Mobilizing additional financial Architecture

Somalia's economic performance has been negatively impacted by various shocks over the last ten years to 2023 attributed to insecurity, recurrent climatic shocks including drought and flush floods, a rising population, locust invasions, COVID-19 pandemic, the impact of the Russia-Ukraine war, which disrupted the supply chain of fuel and food causing inflationary pressures in Somalia, as well as constant conflict, corruption, and weak governance and threats of defection from some member states. Somalia should leverage on a financial safety net to overcome these challenges. From the COVID-19 experience, Somalia was able to benefit from funds from global financial system (IMF SDR, as well as WHO) to respond to the pandemic. Yet, Somalia is constrained to participate in the global financial Architecture due to the following factors:

Lack of a domestic capital market in prevents Somalia from benefiting from Eurobonds from International capital markets. This implies that Somalia cannot rely on financial markets to mitigate the impact of exogenous shocks and to mobilize sovereign bonds to finance structural transformation. Somalia should strengthen the Central Bank's institutional and regulatory environment, including by updating the 2016 AML/CFT, and should also boost business confidence and build foreign exchange buffers.

Somalia faces a challenge of integration to the global financial architecture due to piracy, conflict, fragility, climate change, institutional barriers and poor business environment. Since 2023, various reforms have been launched to improve access to the global financial architecture. The main achievements include the rollout of the national switch linking all commercial banks and a national Quick Response code for connecting commercial banks, and adoption of the IBAN code for linking Somalia's Banks to the global financial architecture is pending implementation of AML/CFT law. Revisions to the AML/CFT are underway to facilitate the establishment of correspondent/intermediary banking relationship for the full participation of Somalia's financial sector in the global financial architecture. Coupled with this, the lack of a monetary policy and exchange rate also hinders Somalia from participating in the global financial architecture. However, these are being addressed with the support of the World Bank, under the ongoing currency reform project.

The proposed African Financial Stability Mechanism (AFSM), which is under development, seeks to cushion countries from debt related shocks through the provision of debt refinancing. It will complement the work of International Financing Institutions (IFIs) in ensuring that African countries have access to affordable finance in times of difficulties, especially in times of crises. Once commissioned, the AFSM will support regional member countries with short-term liquidity constraints by enhancing credit and augmenting liquidity on domestic and international debt markets.

Policy recommendations for mobilizing additional financial resources

i) Somalia should advocate for the implementation of specific reforms regarding the recycling of Special Drawing Rights (SDR) through MDBs, implementing the MDB capital adequacy reforms, and reforming credit rating methods, to increase financing for Somalia's structural transformation.

ii) Somalia should target various concessional financing sources, and borrow for transformation projects. The sources include philanthropic pathways, and global thematic trust funds, including the climate and environmental trust funds. Considerations should be given to addressing fragility to unlock investment environment for financing projects from the global financial architecture.

iii) MDBs and IFIs should be repurposed to make them more effective in providing affordable finance and highly concessional loans. For instance, if more SDRs could be channeled through the AfDB, Somalia and other African countries that stand to benefit from more concessional financing for transformative projects, should advocate for reforms in the global financial institutional for a more equitable, transparent, cheaper concessional financing—for instance, the SDR could be allocated through the AfDB.
iv) Somalia should develop platforms to syndicate financing for the domestic private sector from international financiers, including MDBs as DFIs, as sources of private finance.
v) Somalia should add its voice to calls for more inclusive governance of the GFA to enhance Africa's participation, as currently IFI system provides little voice for African countries.

vi) Access to Emergency financing facilities: Implement reforms to improve Somalia's access to these facilities through advocacy for the delinking of IMF financing from quotas, appeal for the inclusion of 'contingent' clauses in loan agreements with the IFIs, and creation of an African emergency finance facility.

3.3.3 Dealing with Somalia's Public Debt

Somalia did not contract new external debt between 2020-2023, because of its high debt distress status. Somalia's total external debt, amounting to USD 5.3 billion in 2015, was owed to multilateral and bilateral creditors; with 28 percent or USD 1.5 billion owed to IFIs, including the World Bank, IMF and the AfDB, and USD 3.8 billion owed to bilateral creditors date back to the 1970s, mainly the Russian Federation and the United States. In addition, USD 2.3 billion was a liability to the Paris Club members (USA, Japan, the United Kingdom, Italy, Russian Federation, France). Somalia also owed USD 1.5 billion to non-Paris members (UAE, Saudi Arabia and China). Of the USD 1.5 billion debt to IFIs, USD 1.2 billion was accumulated arrears. From 2015 to 2018, a Debt Management Unit with the support of TAs compiled the debt data, reaching agreement with 21 creditors owed 80 percent of the debt. This was accompanied by a three-year program IMF staff management program, followed by a successor program from 2018-2020, at which point a HPIC Decision Point was reached in 2020. Arrears clearance and ultimately the HPIC Completion Point was reached on 13 December 2023. The achievement of the HIPC Completion Point provided Somalia with total debt service savings of USD 4.5 billion, which resulted in a sharp reduction of the country's external debt, from 64 percent of GDP in 2018 to under 6.3 percent in 2023. Debt relief has freed the fiscal space for Somalia to access critical development that will help in building resilience, reducing poverty, and creating economic opportunities. The debt relief came from the IMF (USD 343.2 million), International Development Association (USD 448.5 million), and the African Development Fund (USD 131 million). Somalia also enjoyed debt relief from other multilateral creditors (USD 573.1 million), as well as bilateral and commercial creditors (USD 3.0 billion). [9]

The findings of a study using secondary data from 1991 to 2020 to assess the long run relationship between external debt and economic growth in Somalia found that both external debt and foreign aid have positively influenced growth. The study confirmed that despite the challenges, Somalia had significantly gained from the positive effect of external debt on its economic growth. The recommendations noted that while the external loans taken between 1991-2020 had contributed to growth, the government should at the end of the HIPC debt relief process cautiously evaluate the returns from any future loans that should be taken. Ideally, loans should be taken on highly concessional terns. Post-HIPC, the country's decision for borrowing externally should be informed by the delicate balance between the need for impact and the effective utilization of the external resources for transformational projects. IN any case, Somalia needs to maintain debt sustainability levels within sustainable critical.

The IMF projects a gradual rise in the external debt present value, from 6.3 percent in 2024 to 6.5 percent in the medium term, increasing further to 8.6 percent in the long term, but remaining sustainable below the 30 percent threshold. Similarly, debt service ratio is expected to rise in the long term, as debt service is expected to resume. The IMF has signed a new 3-year ECF arrangement with Somalia for the 2025-2027 period. The World Bank and other multilateral institutions will provide highly concessional financing from June 2025. . The AfDB will provide grants in 2024. For the 2025 allocation, the mid-term review of ADF Deputies in October will determine if AfDB will continue with grants through 2025, or switch to ADF loans.

Policy recommendations on debt sustainability

- Post-HIPC, the Federal Government should borrow cautiously by taking more concessional loans, instead of high-interest commercial loans, to avoid falling back into a debt trap.

- Government should expediate the development of the Medium Debt Management Strategy to guide future borrowing.

Somalia recorded total public debt reduction to the sustainable level of 6.3 percent of GDP in 2024, and improvement in debt sustainability classification to a moderate risk of debt distress. However, the Government should pursue policy options to maintain the slowdown of the growth of future debt within sustainable levels of debt distress

- Somalia should pursue GDP-growth-enhancing reforms, including expediating diversification of exports to increase the export revenue to improve debt service, and prevent deterioration in public finances.

- Ensure that fiscal authorities establish fiscal consolidation measures to limit the growth in the Somalia's budget deficits beyond the programmed levels, and consequently arresting debt growth

-FGS needs to scale up domestic revenue mobilization and, through awareness and compliance, widen the tax base to increase the tax-to-GDP level from 3 percent in 2023 and 6 percent by 2028.

- Advocate for reforming the World Bank/IMF

[9] According to the IMF, the USD 4.5 billion debt service savings include debt relief of USD 4.2 billion under the Enhanced HIPC initiative, USD 115.1 million under the Multilateral Debt Relief Initiative (USD 96.4 million from IDA and USD 18.7 million from ADF), USD 164.3 million under beyond-HIPC debt relief from the IMF, as well as commitments from Paris Club creditors to provide post-HIPC debt relief to cancel most of their outstanding debts.
Osman Abdulkadir Nor, Liban Omar Sagal 2023: The impact of external debt on Economic Growth in Somalia

Debt Sustainability Analysis framework to allow shocks, and hence reduce the cost of borrowing.

- Government should sequence borrowing based on a bankable public investment analysis and consider debt restructuring if debt reaches unsustainable levels.
- Somalia needs to build in-house capacity in the conduct of Debt Sustainability Analyses and in debt negotiations. During distress, ensure timely access to sovereign debt restructuring.

- Invest debt resources in effective utilization in transformative projects.

3.4 Financing Climate Actions

Somalia's need for climate financing is anchored in the updated 2021 Nationally Determined Contributions (NDC)[10] amounting to USD 55.5 billion from 2021 to 2030 to be partly funded by mobilizing private sector finance. In 2022, the Ministry of Environment and Climate Change (MoECC) was established to lead the country's efforts in implementing climate related adaptation and mitigation measures. The MoECC currently focuses on building the institutional capacity for effective coordination of climate change activities, which center around responding to prolonged droughts, floods and displacement of about 4 million people amidst political instability. In this regard, there are no medium-term plans to create a bank dedicated to financing climate change mitigation in Somalia. Somalia is just emerging from a 30-year conflict that destroyed the private sector fund The country's priorities are state-building and resilience.

The AfDB's Country Focus Report 2023 put the total climate finance received by the Federal Government of Somalia between 1985 and 2018 at USD 392.97 million .About USD 377.63 million,[11] representing 96 percent of the total amount, came from the public sector; only 4 percent was from the Private Sector and International Finance Institutions. Yet, the climate-related economic recovery cost related to drought episodes are high. For instance, it was costed at USD 3.25 billion[12] in 2018, and USD 1.77 billion for economic recovery in 2023.

Somalia has one of the highest climate finance needs, by percentage of GDP, which is estimated at above 80 percent (Guzmán et al., 2022).[13] (However, most of the country's financing inflows comes from the public sector, and not private sector, owing to lack of a monetary policy, and exchange rate concerns. Somalia has no capital market. This makes it difficult for the country to increase the financing uptake for climate-related financing from the financial capital markets. To actively unlock private climate financing and crowd in private sector investment, Somalia should strengthen the Central Bank's institutional and regulatory environment including by updating the 2016 AML/CFT, as well as boost domestic savings and build foreign exchange buffers.

Plans are underway to crowd in private sector investment through various innovative instruments deployed to mobilize private sector finance.

Climate change is a critical driver for accelerating structural transformation, and as such, climate action should be prioritized as part of the reform efforts for the achievement of the global financial architecture. Development of a private sustainable climate financing plan will help to create a resilient pathway to attract financial flows to the country. Considerations should be given to financial instruments and innovations such as green finance/green bonds and blue bonds, climate swaps, and sustainable finance loans and social bonds, blended finance, and climate disaster risk insurance.

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[10] https://unfccc.int/sites/default/files/NDC/2022-06/Final%20Udated%20NDC%20for%20Somalia%202021.pdf

[11] World Bank data 2021.

[12] Somalia Drought and Impact, and Needs Assessment report: https://www.gfdrr.org/sites/default/files/publication/GSURR_Somalia%20DINA%20Report_Volume%20I_180116_Lowres_0.pdf.

[13] The State of Climate Finance in Africa: Climate Finance Needs for African Countries 2022 https://www.climatepolicyinitiative.org/wp-content/uploads/2022/06/Climate-Finance-Needs-of-African-Countries-1.pdf

According to the 2024 AEO, the recently launched African Carbon Markets Initiative (ACMI), established in 2022 at the COP 27, aims to unlock USD 6 billion worth of carbon credits set up as export commodity to trade in Africa's voluntary market. The initiative was jointly set up by the Global Energy Alliance for People and Planet (GEAPP), Sustainable Energy for All, and the United Economic Commission for Africa (UNECA) under the overall guidance of the UN Climate Change High Level Champions. The Carbon market functions in two ways: The regulators set a fixed cap on total emissions and allow producers to trade allowances through an auction, or a project developer sets up a project to avoid emissions such as reducing gas flaring, by planting more trees to remove carbon dioxide from the atmosphere. There is an independent verification of projects, leading to certification, after which the developer sells the credits to firms. The carbon markets support biodiversity, food security, and health; reduce carbon emissions; provide jobs and bolster climate resilience. To achieve green growth, significant private sector finance has to be mobilized.

As discussed in the Somalia Country Focus Report 2023, the MDBs and DFIs have a role to play in the mobilization of private sector finance by providing more concessional low interest loans with longer repayment periods. Especially for Somalia that has had repeated floods and drought due to its location on the Indian Ocean and Red Sea shores, with its semi-arid vegetation.

The role of Multilateral institutions in financing should be emphasized, as most climate actions in Somalia is financed by the multilateral financing mechanisms of the United Nations Framework Convention on Climate Change financing initiatives and instruments, including the Global Environment Facility (GEF) used by the United Nations Development Program (UNDP) and the Green Climate Fund (GCF). Recently, the African Development Bank issued two rounds of calls for proposals from the Climate Action Window, and it was quickly oversubscribed. The operationalization of the GCF requires the intermediary of accredited entities such as the International Union for Conservation of Nature (IUCN), the European Investment Bank (EIB), the World Bank and UNDP.

3.5 Summary and Policy Recommendations

Government should consider amending Somalia's laws to seek private sector financing instruments, including the Africa Carbon Markets Initiative (ACMI), and innovations such as green bonds and blue bonds, climate swaps, and sustainable finance loans and social bonds, blended finance, climate disaster risk insurance.

FGS should strengthen institutional capacity and civil servants' skills in mobilizing additional financing for their climate resilient projects. Strengthen the regulatory framework for Environment and Climate Change to harness climate-resilient low-emission investments from global climate funds, and the African carbon market initiative.

Beyond the multilateral institutions, climate financing and climate actions window financing, from the United Nations Framework Convention on Climate Change financing initiatives and instruments, including the Climate Action Window, Global Environment Facility (GEF) used by UNDP and, the Green Climate Fund (GCF), Somalia requires the intermediary of accredited entities such as the International Union for Conservation of Nature (IUCN), the European Investment Bank (EIB), the World Bank and UNDP to operationalize its global financial.

All partners need to emphasize the development of bankable green projects to crowd in global climate funds and private investment

and finance.
IFIs should allocate more SDR to Africa for issuances through concessional financing, engaging with the governments to identify innovative ways to provide affordable capital for green growth and blue economy and climate change investments.

Somalia should explore the green and blue economy, natural resources and fisheries, forest, wind and solar energy, as well as hydro investments for the development of strategic value chains to accelerate structural transformation. The FGS and FMS should accelerate the PPP regulatory frameworks to guide the issuance of investor concessions for fishing and renewable energy investments. Sustainable exploitation of the 3,300 km. coastline with intense sunshine and wind to provide solar and wind power, and hydro energy projects, will spur industrialization along strategic trade corridors and accelerate structural transformation.

Government and Development Partnerss should mobilize private sector financing for the transformation of climate justice by enhancing domestic resources mobilization and concessional financing. Establish measures to incentivize private finance for climate and green growth.

Somalia should add its voice to and benefit from the implementation of a mandatory requirement for countries to adopt policies for the greening the wealth of countries.

ANNEXES

ANNEX I: INCLUSIVE GROWTH

The African Development Bank defines inclusive growth[14] as economic opportunities that are available to all, particularly the poor. Some of the indicators used to measure inclusive growth include poverty levels, human development indicators and social development indicators, including unemployment.

Somalia has one of sub-Saharan Africa's highest poverty rates, ranking sixth highest across the continent, with 54.4 percent of the population living below the poverty line in 2022 (Somalia Poverty Report, 2023). Although Somalia's poverty rate has been on a declining trajectory, from 69 percent in 2017, it remains high, meaning that many Somalians are excluded from economic growth.

The high poverty rate was perpetuated by extended periods of conflict, which has contributed to the increased vulnerability of the Somalian population, particularly in IDP settlements where seven out of ten people are poor. More than 4 million Somalians, representing 25 percent of the population, are internally displaced, with regional variations in the poverty rate, ranging from 39.4 percent in the Awdal region to 87.4 percent in Middle Shabelle. Child poverty is a concern, with 23 percent of children aged under five suffering from malnutrition in 2020 and more likely to be living in poverty than the youth or adult population. An estimated 59.2 percent of children aged 0-17, or 34 percent of the entire school-age population, were living in poverty—a high rate compared to youth in the 18-35 age bracket whose poverty was 45 percent in 2023. The rate for adults aged 70and above was at 45 percent (Somalia Poverty Report, 2023).

GDP growth performance has been low since 2017, averaging 1.9 percent between 2017 and 2023, lower at 2.4 percent compared to 4.1 percent over 2013-2018, due to multiple shocks of climate change, COVID-19, and food and fuel inflation triggered by Russia's invasion of Ukraine. Prior to the COVID-19 pandemic in 2020, when GDP growth contracted by 2.6 percent, Somalia was experiencing a moderate GDP growth. For instance, in 2019 and 2018 GDP reached 3.6 percent and 5.1 percent respectively. However, this growth has not translated into inclusion as evidenced by the lower per capita income levels in comparison to those of the other EAC countries. Thus, Somalia's GDP per capita slightly increased by USD 19 to USD 667 in 2022, up from USD 648 in 2021.[15] The country continuously faces an economic and humanitarian crisis, with an estimated 4 million displaced persons, about 700,000 of them internally displaced due to the floods of April-May 2024, while 80 percent of the population is projected to be vulnerable to shocks such as natural disasters, conflicts, and economic disruptions. Most of the population depend on overseas remittances, humanitarian assistances.

Education attainment levels are very low. The National Bureau of Statistics (2022)[16] reveals that only 53.7 percent of the population is literate, with higher literacy among males (63.6

[14] African Development Bank: Measuring Inclusive Growth: From Theory to Applications in North Africa, 2016.
[15] Somalia National Bureau of Statistics (SNBS), Report of the annual Gross Domestic Product (GDP) for the year 2022'.
[16] Somalia Integrated Household Budget Survey (SIHBS).

percent) than among females (45.3 percent). Regional literacy rate disparities are pronounced, with rural areas lagging behind at 49.1 percent, compared to urban areas (60.9 percent). At 14 percent, the gross enrolment rate (GER) for the primary level in 2020 was lower than secondary level, which declined from 18 percent in 2016 to 16 percent in 2020. For the tertiary level, the training enrolment facilities have declined, from 86 facilities in the1990s to 56 TVETs. Of the 2 million youth aged 18-24 who were eligible for TVET and higher education, only 103,400 were enrolled

Consequently, the youth unemployment was high (30.1 percent) in 2022, above the national

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[17] UNDP 2014. https://www.undp.org/sites/g/files/zskgke326/files/migration/so/Gender-in-Somalia-Brief-II--2014.pdf.

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