DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/83/15

CONFIDENTIAL

January 19, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Somalia - Staff Report for the 1982 Article IV Consultation, Review Under Stand-By Arrangement and Program for 1983

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Somalia, together with a review under the stand-by arrangement for Somalia and program for 1983. Draft decisions appear on pages 32 and 33.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

SOMALIA

Staff Report for the 1982 Article IV Consultation, Review Under Stand-By Arrangement, and Program for 1983

Prepared by the Staff Representatives for the 1982
Article IV Consultation with Somalia

Approved by J.B. Zulu and W.A. Beveridge

January 18, 1983

Contents | Page

I.	Introduction	1
II.	Background	2
III.	Developments and Performance under the 1982 Financial Program	8
	1. Overview	8
	2. External sector policies and developments	10
	3. Fiscal policy and developments	14
	4. Monetary policy and developments	15
	5. Production, investment, and prices	16
IV.	The Program for 1983	18
	1. Overview	18
	2. External sector policies	20
	3. Fiscal policy	23
	4. Monetary policy	24
	5. Public enterprises	25
	6. Development planning	26
	7. Performance criteria	27
V.	Staff Appraisal	29
VI.	Proposed Decisions	32

Text Tables

1.	Use of Fund Credit During the Stand-By Arrangement, July 1, 1982-December 31, 1983	2

Contents

		Page
2.	Selected Economic and Financial Indicators, 1980-83	4
3.	Implementation Status of 1981 and 1982 Financial Programs	5
4.	Quantitative Peformance Criteria for July 1981-June 1982 Stand-By Arrangement	9
5.	Quantitative Performance Criteria, June 1982-June 1983	11
6.	Summary of the 1983 Financial Program	19

Charts

1.	Movements in Effective Exchange Rates, 1974-82	4a
2.	Financial Indicators, 1980-83	4b

Appendix I:

Table I.	Central Government Operations, 1980-83	34
Table II.	Monetary Survey, 1979-83	35
Table III.	Balance of Payments (Excluding Grants and Loans in Kind), 1979-83	36
Table IV.	Balance of Payments (Including Grants and Loans in Kind), 1979-83	37
Table V.	Debt Service Payments, 1979-87	38
Table VI.	Principal Assumptions for Fiscal Projections, 1982 and 1983	39
Table VII.	Principal Balance of Payments Assumptions, 1980-83	41

Appendix II:	Basic Data	42
Attachment I	Relations with the Fund	44
Attachment II	Financial Relations of the World Bank Group with Somalia	46
Attachment III	December 8, 1982 Letter of Intent	47

I. Introduction

The 1982 Article IV consultation discussions with Somalia were held in Mogadiscio during November 23-December 9, 1982. 1/ At the same time, discussions were held for the first semiannual review under Somalia's current 18-month stand-by arrangement. The Somali representatives included Mr. Abdullahi Ahmed Addou, Minister of Finance, Mr. Mohamud Jama Ahmed, Governor of the Central Bank, and other ministers and senior officials of ministries and agencies concerned with economic and financial matters. Staff members participating in the mission were Mr. S.M. Nsouli (head-AFR), Mr. H.R. De Zoysa (FAD), Ms. N. Calika (AFR), Mr. N.E. Weerasinghe (AFR), Mr. E.J. Zervoudakis (ETR), and Ms. J.M. Nueno (secretary-TRE).

Somalia's current 18-month stand-by arrangement, in an amount equivalent to SDR 60.0 million, 173.9 per cent of Somalia's quota of SDR 34.5 million, was approved by the Executive Board on July 12, 1982 (EBS/82/105, Supplement 1). The financial program which provides the basis for the arrangement covers the period July 1, 1982-December 31, 1983. So far, under this arrangement, Somalia has made two purchases amounting to SDR 25.0 million. 2/ The stand-by arrangement requires two semiannual reviews, the first before December 31, 1982 and the second before June 30, 1983, of the performance under the financial program. On the basis of these semi-annual reviews, understandings are to be reached between the Fund and Somalia for the remaining periods of the stand-by arrangement on economic and financial policies and on ceilings for the quantitative performance criteria for the subsequent half year. In the annexed letter dated December 8, 1982, the Minister of Finance and the Governor of the Central Bank of Somalia outline the progress made in implementing the financial program during the second half of 1982 and the policies and prospects for 1983. The quantitative targets for the performance criteria for the next six months of the program period, January 1-June 30, 1983, are also included. In addition, Somalia requests Fund approval for a multiple currency practice introduced on January 1, 1983. The proposed decision to approve the practice described in Section IV.2 until December 31, 1983 is in Section VI below.

Somalia's use of Fund resources under the existing stand-by arrangement is summarized in Table 1. Summaries of Somalia's relations with the Fund and the World Bank Group are provided in Attachments I and II.

1/ The last consultation discussions were held in May 1981. Somalia continues to avail itself of the transitional arrangements of Article XIV.

2/ A waiver of the performance criterion pertaining to the intensification of exchange restrictions due to the incurrence of external payments arrears was granted on December 27, 1982 (EBS/82/236).

Table 1. Somalia: Use of Fund Credit During the Stand-By Arrangement, July 1, 1982 - December 31, 1983

(In millions of SDRs)

	1982		1983				
	July	Nov.	Jan.	Feb.	May	Aug.	Nov.
Purchases							
Reserve tranche	--	4.75	--	--	--	--	--
Credit tranche							
Ordinary resources	6.83	--	3.79	--	--	--	--
Borrowed resources	8.17	--	6.21	8.75	8.75	8.75	8.75
Total	15.00	4.75	10.00	8.75	8.75	8.75	8.75
Scheduled repurchases	4.75	--	--	--	--	--	--
Net purchases	10.25	4.75	10.00	8.75	8.75	8.75	8.75
Total Fund holdings (cumulative)	91.29	96.04	106.04	114.79	123.54	132.29	141.04
Total holdings as per cent of quota	264.61	278.38	307.36	332.72	358.09	383.45	408.81

Sources: Treasurer's Department; and staff estimates.

II. Background

Somalia is basically a pastoral economy, with over 80 per cent of the population being dependent on the livestock and agricultural sectors for their livelihood. 1/ The livestock sector employs almost two thirds of the population and accounts for about 75 per cent of merchandise exports. The agricultural sector provides for a large proportion of the domestic consumption of cash crops, such as maize and sorghum, and the second major export commodity, bananas. With an extremely small industrial sector, Somalia is highly dependent on imports for consumer and investment goods.

1/ There are no official national income accounts for Somalia.

During the latter half of the 1970s, a number of exogenous factors adversely affected the growth of the Somali economy and contributed to an exacerbation of internal and external financial imbalances. A severe drought in 1974-75 led to a sharp drop in agricultural production and destroyed a large part of the livestock herd. The outbreak of regional hostilities in 1977-78 resulted in an inflow of refugees into the country, the loss of the use of a major grazing area, and the severance of relations with the Soviet Union, which, up to 1977, had been the major source of financial and technical assistance to Somalia. Reflecting these developments, government expenditures rose sharply, leading to a considerable widening of the budgetary deficits. These were financed by increased bank borrowing, with the result that the expansion in net domestic credit began to exert considerable pressure on the price level and the balance of payments. The rate of inflation rose from 10 per cent in 1978 to 59 per cent in 1980, while the overall balance of payments turned from a surplus of US$21 million in 1978 to a deficit of US$28 million in 1980. By the end of 1980, official reserves declined to the equivalent of four weeks of cash imports, about one eighth the end-1978 level. Moreover, at the end of 1980, Somalia had accumulated external payments arrears amounting to about US$45 million. The Somali shilling was pegged to the U.S. dollar at a rate of So. Sh. 6.295 between 1973 and mid-1981. Its effective exchange rate had appreciated by 28 per cent in nominal terms and 137 per cent in real terms between 1974 and the first half of 1981 (Chart 1).

In view of the mounting imbalances, in mid-1981 the Somali authorities adopted a major stabilization program, supported by a one-year stand-by arrangement from the Fund in an amount equivalent to SDR 43.13 million, 125 per cent of quota (EBS/81/146, Supplement 1). The program was designed to stimulate domestic production, slow down the rate of inflation, and attain a sustainable external sector position over the medium term. The targets of the program for 1981 included a reduction in the rate of inflation to 35 per cent and the containment of the balance of payments deficit to US$100 million (Chart 2 and Tables 2 and 3). To achieve these targets, the key measure of the program on the supply side was the devaluation of the Somali shilling on June 30, 1981 by 50 per cent in foreign currency terms (from So. Sh. 6.295 = US$1 to So. Sh. 12.59 = US$1) for all foreign exchange transactions, except for the imports of specified essential goods, which continued to be transacted at the old official rate. 1/

1/ Essential imports were defined to include basic foodstuffs, medicines, chemicals, manufacturing raw materials, spare parts, and agricultural inputs. Certain items for foreign embassies and foreign companies and transactions through nonresident accounts continued, however, to be transacted at So. Sh. 6.295 = US$1 until February 27, 1982.

Table 2. Somalia: Selected Economic and Financial Indicators, 1980-83

	1980	1981			1982			1983	
	Actual	Program	Review estimates	Actual	Program	Revised program	Preliminary actuals	Program	Revised program
	(Growth rate in per cent unless otherwise specified)								
Consumer price index	59.4	35.0	45.4	44.3	17.0	17.0	24.1	12.0	12.0
Trends in central government finance									
Total revenue and grants	4.8	61.6	44.0	25.2	29.7	60.6	55.9	16.8	19.4
Total expenditure	-5.3	33.2	24.3	10.1	19.6	44.9	47.3	13.7	5.6
Overall deficit/Total expenditure									
(ratio including loans in kind)	38.7	28.4	31.6	30.2	25.8	19.0	26.1	16.8	16.5
(ratio including loans in kind, excluding grants)	53.7	40.7	35.0	33.1	29.8	34.8	39.4	31.0	32.2
(ratio excluding loans in kind)	29.9	19.3	21.3	11.5	13.1	4.8	-4.5	3.0	-17.5
Trends in monetary aggregates									
Money and quasi-money	20.2	14.0	23.1	30.8	13.2	6.7	10.6	1.5	-5.9
Net domestic credit	31.2	17.3	17.0	17.2	22.6	11.2	11.2	7.2	5.0
Government (net)	54.5	18.6	18.2	18.3	9.9	-6.0	-6.0	-10.6	-13.0
Private	14.6	16.0	15.8	16.1	35.2	28.0	28.0	20.0	18.0
Net domestic assets	29.7	49.0	26.1	32.7	27.0	19.7	23.4	9.0	9.5
Interest rates									
Commercial bank lending rate (public enterprises)	7.5	10.0	10.0	10.0	10.0	12.0	12.0	12.0	12.0
Commercial bank lending rate (private enterprises)	9.5	10.0	10.0	10.0	10.0	12.0	12.0	12.0	12.0
Commercial bank maximum deposit rate	7.0	9.0	9.0	9.0	9.0	11.0	11.0	11.0	11.0
Development bank maximum lending rate	7.5	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Trends in external sector									
Exports, f.o.b.	25.8	29.2	9.5	-9.0	20.7	42.3	38.0	16.3	9.6
Imports, c.i.f.	2.4	21.1	-21.2	-28.7	14.9	11.5	-3.8	6.9	18.9
Non-oil imports, c.i.f.	-4.7	21.8	-20.4	-31.6	14.4	26.2	-12.1	7.6	37.5
Oil imports, c.i.f.	44.4	20.0	-23.1	-16.9	20.0	-44.0	24.1	--	-25.4
Nominal effective exchange rate (depreciation -)	-0.5	...	...	-3.5	...	...	-26.8	...	...
Real effective exchange rate (depreciation -)	36.1	...	...	23.4	...	...	-20.2	...	...
	(In millions of U.S. dollars unless otherwise specified)								
Current account balance	-75.0	-140.0	-48.0	-25.0	-69.0	-63.0	10.0	-51.0	3.0
Current account, excluding grants	-149.0	-190.0	-59.0	-33.0	-84.0	-78.0	10.0	-66.0	-12.0
Overall balance of payments	-28.0	-100.0	-16.0	-13.0	-44.0	-38.0	-37.0	-26.0	-52.0
Gross official reserves	25.0	...	...	42.0	...	56.0	43.0	81.0	47.0
(in weeks of imports)	(3.9)	...	...	(9.3)	...	(10.0)	(10.0)	(13.6)	(9.1)
External debt, including IMF	720.0	...	...	902.0	...	973.0	1,040.0	1,052.0	1,171.0
Debt service ratio	4.4	...	...	13.6	...	21.0	8.9	26.0	31.4
External payments arrears	44.6	37.0	15.5	15.5	--	--	--	--	--

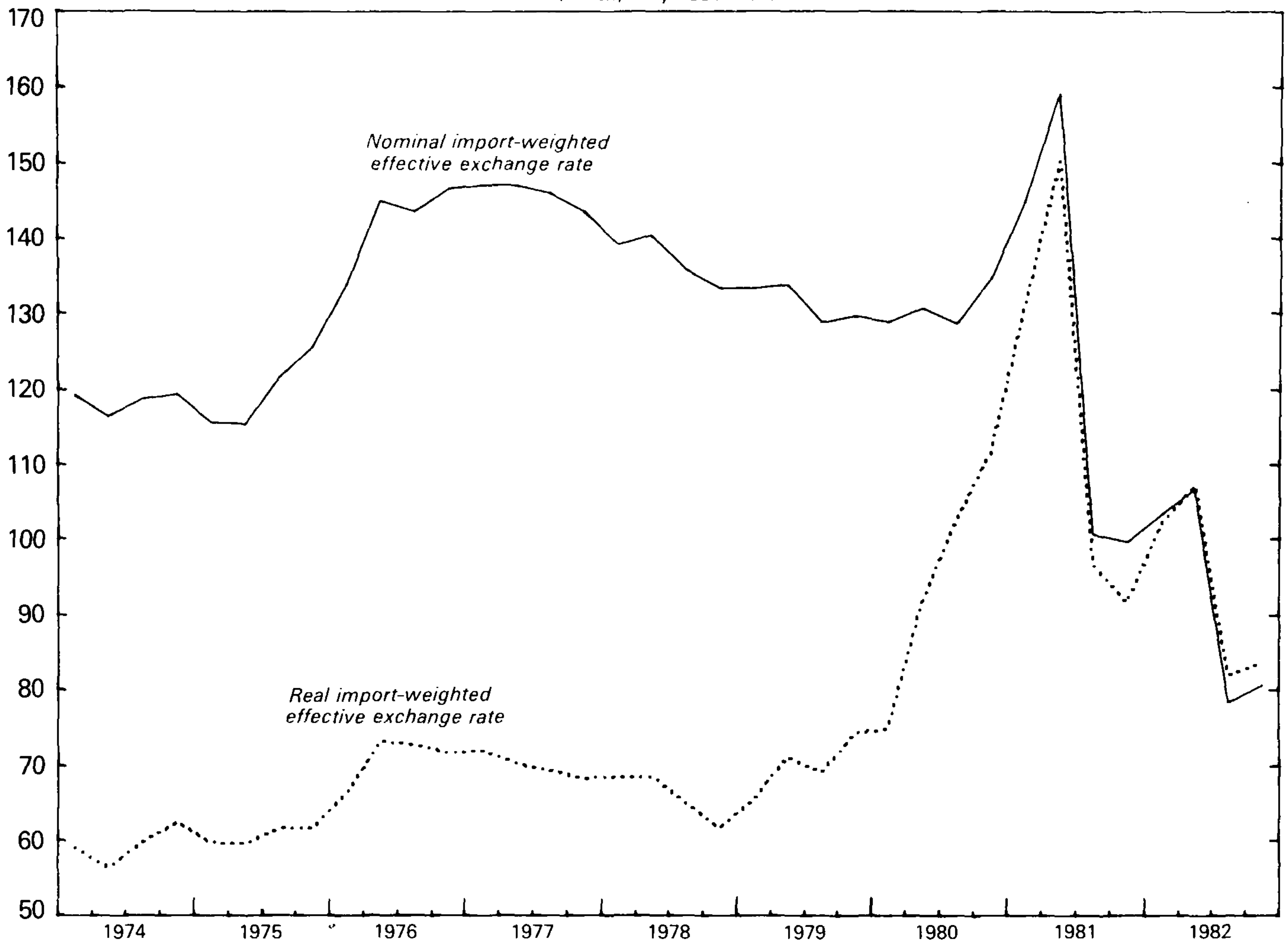
Source: Appendix I.

CHART 1

SOMALIA

MOVEMENTS IN EFFECTIVE EXCHANGE RATES 1974-82[1]

(Index, July 1981 = 100)



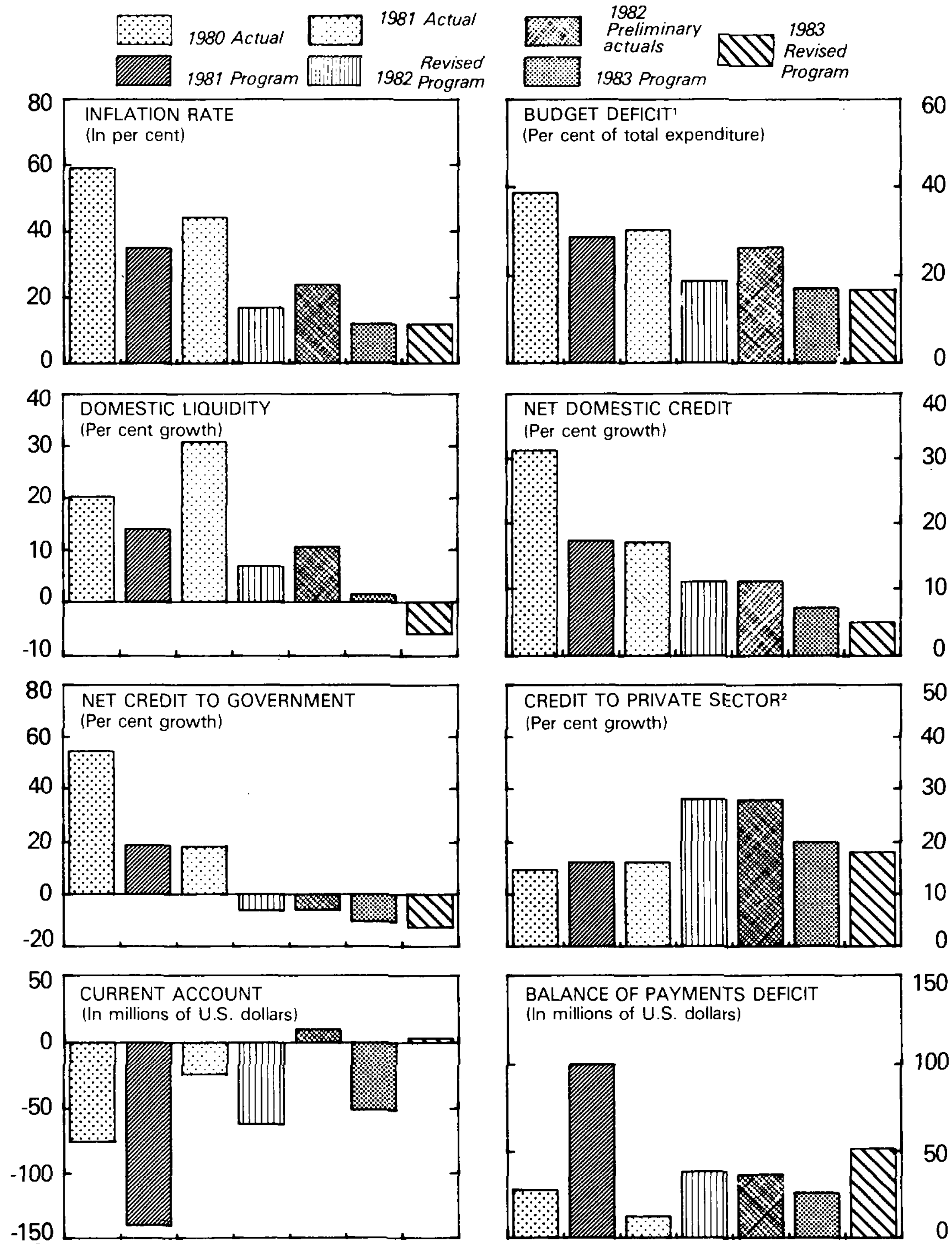
Source: Staff calculations

[1] Import weighted. Increase indicates appreciation, decrease indicates depreciation.

CHART 2

SOMALIA

FINANCIAL INDICATORS, 1980-83



Sources: Data provided by the Somali authorities and staff estimates.
[1]Including loans in kind
[2]Including public enterprises.

Table 3. Somalia: Implementation Status of the 1981 and 1982 Financial Programs

Program	Current Status of Implementation
1. Fiscal measures	
a. Reduce budgetary deficit, including loans in kind, to 28 per cent of expenditure in 1981 and 19 per cent of expenditure in 1982. Excluding loans in kind, reduce the deficit to 19 per cent in 1981 and 5 per cent in 1982.	Budgetary deficit, including loans in kind, reduced to 30 per cent of expenditure in 1981 and 26 per cent in 1982. Budgetary deficit, excluding loans in kind, reduced to 12 per cent in 1981 and a budgetary surplus of 5 per cent of expenditure in 1982.
b. Limit expansion in net domestic credit to the Government to 18 per cent in 1981 and reduce net credit to Government by 6 per cent in 1982.	Implemented in 1981 and 1982.
c. Improve collection rates by enactment of more stringent penalties for tax evasion and failure to file a return. Eliminate the concordato procedure. Introduce a 25 per cent ad valorem tax on livestock exports. Abolish the exemptions on import duties some public and private enterprises enjoy. Convert specific to ad valorem import and export duties. Levy import ad valorem taxes on the basis of letters of credit.	All enacted. The 25 per cent ad valorem tax on livestock exports was levied on a price which was lower than the actual export price. Exemptions of import duties were limited to infant industries.
d. Consider implementing long-term improvements in the tax system recommended in the 1980 IMF Tax Survey, i.e., simplification of import tax structure, rationalization of income tax structure for individuals, conversion of specific domestic excise taxes into ad valorem taxes, restructuring the tax system for public enterprises, and development of a domestic sales tax.	Preparations undertaken to introduce a general sales tax, convert specific excises to an ad valorem basis, and restructure the tax system of public enterprises.
e. Grant no cost of living increase in the public sector in the second half of 1981 and in 1982.	Implemented. In 1982, however, the development levy on the wages of government employees was abolished.
f. Limit the wage bill by limiting government hiring.	Implemented.
g. Take steps to eliminate the practice of providing automatic employment for all high school graduates.	Progress made by actively persuading high school graduates to seek employment elsewhere.
h. Station Ministry of Finance representatives at each ministry to review all expenditures before their authorization.	Implemented.
2. Monetary measures	
a. Increase interest rates on the average by three percentage points in mid-1981 and two percentage points in mid-1982.	Implemented.
b. Introduce external accounts denominated in U.S. dollars for Somali workers and exporters.	Implemented.
c. Reduce the rate of growth of domestic credit to 17 per cent in 1981 and 11 per cent in 1982, while providing more adequately for the credit needs of the private sector.	Implemented.
3. Pricing measures	
a. Increase producer prices for agricultural products 17 to 50 per cent in April 1981 and for bananas 107 per cent and 10-27 per cent, respectively, in June 1981 and July 1982. Review producer prices guaranteed by the Agricultural Development Corporation at the beginning of each growing season.	Implemented.
b. Allow agricultural producers to sell their produce at market-determined prices and maintain producer prices as minimum guaranteed prices.	Implemented. The Agricultural Development Corporation is operating as a price stabilization board.

Table 3 (concluded). Somalia: Implementation Status of 1981 and 1982 Financial Programs

Program	Current Status of Implementation
c. Move petroleum product prices to reflect exchange rate changes and changes in international petroleum prices.	Implemented. The price of gasoline was raised by 153 per cent in August 1981 and the prices of diesel fuel and kerosene raised by 125 per cent and 114 per cent, respectively, in January 1982.
d. Increase electricity tariffs to reflect the cost of electricity generation.	Implemented.
4. Public enterprises	
a. Abolish public enterprises determined to be not viable.	Three public enterprises abolished.
b. Set up a Public Investment Evaluation Unit to study the position of public enterprises and the role of the public sector in general.	The Public Investment Evaluation Unit set up.
5. Development planning	
a. Prepare a Five-Year Development Plan (1982-86).	Implemented.
b. Organize with the assistance of the World Bank a Consultative Group Meeting of donor countries for Somalia.	Steps taken to organize a Consultative Group meeting for Somalia in the first half of 1983.
6. External sector measures	
a. On June 30, 1981 devalue the Somali shilling 50 per cent in foreign currency terms for all foreign exchange transactions except the imports of specified essential goods. On July 1, 1982 unify the dual exchange rate system and devalue the Somali shilling 17 per cent on the export side and 34 per cent on the import side in foreign currency terms.	Implemented. Until the end of February 1982 certain transactions, other than the import of essential goods, were also effected at the appreciated exchange rate.
b. Change the peg of the Somali shilling from the U.S. dollar to the SDR on July 1, 1982.	Implemented.
c. Cease to issue licenses for own-foreign exchange imports and stop such imports.	Implemented.
d. Liberalize import licensing system and administer more flexibly restrictions on foreign exchange.	System introduced. The government monopoly on imports has been discontinued.
e. Eliminate external debt arrears through renegotiations or payments by June 30, 1982.	Implemented. During the second half of 1982, some external debt arrears were incurred. These were eliminated by the end of the year.
f. Limit new commitments on public and publicly guaranteed nonconcessional external debt with a maturity of 1-12 years to US$25 million.	Through December 1982 no such debt incurred.

Simultaneously, the producer price of bananas was more than doubled, while the producer prices for most domestically consumed agricultural crops were substantially increased in April 1981. As part of the program, the Government also ceased to issue licenses for own-foreign exchange (franco valuta) 1/ imports and liberalized private sector imports through official channels. External accounts denominated in U.S. dollars were also introduced. In addition, the Government closed down three public enterprises 2/ and decided to reassess the position of others. The Goverment also decided to take steps to strengthen the development planning process. To limit the growth in aggregate demand, the budgetary deficit was to be narrowed. A number of tax measures were taken, including the conversion of export and import duties from a specific to an ad valorem basis and the imposition of a 25 per cent tax on livestock exports. In view of the resistance of livestock exporters to this tax, the Government, after negotiations with livestock exporters, agreed to levy the tax on the basis of a price for duty purposes which was set lower than the actual export price. Tax collection procedures were to be improved and expenditure control enhanced. Monetary policy was also tightened, with emphasis being placed on the extension of credit to the private sector. In this context, the interest rate structure was revised upward.

As a result of the measures taken and favorable weather conditions, the performance of the Somali economy improved considerably during 1981. Led by the growth in the agricultural sector, economic activity accelerated. The rate of inflation fell to about 44 per cent. During the second half of 1981, the price index declined as food prices dropped due to the intensification of demand-management measures, the marketing of the record harvest, and the acceleration of own-foreign exchange imports based on licenses granted prior to June 30, 1981. The tightening of fiscal policy resulted in a narrowing of the overall government deficit (including expenditures financed by loans in kind) to 30 per cent of expenditure, from 39 per cent in 1980 and a program projection of 28 per cent (Appendix I, Table I). 3/ Total receipts fell short of projected receipts by about

---

1/ Own-foreign exchange imports started to be authorized in the mid-1970s. Foreign exchange for these imports was supplied primarily by workers' remittances and by underinvoicing of livestock exports. Demand for foreign exchange was generated principally by the private sector, for which import licenses were generally available once the importer was able to secure his own foreign exchange.

2/ These were the Livestock Development Agency, the Agency for Textiles and Household Appliances, and the National Agency for Building Materials.

3/ Excluding loans in kind, the overall deficit was 12 percent of expenditure, compared with a 19 per cent program projection and 30 per cent in 1980. The fiscal year coincides with the calendar year. This comparator is used in the absence of a reliable series of national income data for Somalia.

23 per cent due mainly to foreign grants not materializing as projected. On the other hand, expenditures were also 20 per cent lower than projected due in the main to strict implementation of expenditure controls and a sharp cutback in investment expenditures. The improved budgetary position and the increased external financing of the budget reduced the recourse of the Government to bank financing; net credit to the Government increased by only 18 per cent in 1981 compared with 55 per cent in 1980 (Appendix I, Table II). Even though credit to the private sector was allowed to grow at a faster pace than in the preceding year, the deceleration in the growth of net credit to the Government reduced overall domestic credit expansion to 17 per cent in 1981 from 31 per cent in 1980. However, because of a more favorable than projected balance of payments outcome, domestic liquidity grew by 31 per cent in 1981, compared with the program target of 14 per cent. The overall balance of payments deficit of US$13 million was almost one tenth the program projection, due mainly to a lower-than-expected level of imports (Appendix I, Table III). The decline in imports reflected the record agricultural harvest and the sharp curtailment in government capital outlays. The Central Bank's official international reserves increased to more than two months of cash imports at the end of 1981. Somalia's external debt arrears were reduced to US$15.5 million through rescheduling and cash payments.

All the quantitative performance criteria (on net domestic credit, net credit to the Government, losses to the Central Bank arising from the dual exchange rate market transactions, external payments arrears, and non-concessional external debt) under the program were observed, and Somalia purchased the entire amount available under the stand-by arrangement (Table 4).

III. Developments and Performance Under the 1982 Financial Program

1. Overview

The discussions focused on economic and financial developments during 1982, with particular emphasis on the performance under the 1982 financial program. The financial program for the calendar year 1982 was covered by two stand-by arrangements: (1) the one-year stand-by arrangement that ended on July 14, 1982 (EBS/81/146), and (2) the 18-month stand-by arrangement that came into effect on July 15, 1982 (EBS/82/105). The targets and policies of the original 1982 program were revised under the 18-month stand-by arrangement to take account of the further measures introduced at mid-year (Table 2).

During 1982 the Somali authorities continued their adjustment efforts, consolidating and building upon the progress made in 1981. The main elements of the financial program implemented included a further devaluation of the Somali shilling, the unification of the dual exchange rate system,

Table 4. Somalia: Quantitative Performance Criteria for July 1981-June 1982 Stand-By Arrangement

	1981			1982	
	June	Sept.	Dec.	March	June
	(In millions of Somali shillings)				
Net domestic credit 1/					
Ceiling		4,393.0	4,550.0	4,850.0	5,096.0
Actual	4,611.5	4,374.8	4,545.7	4,841.2	5,088.0
Net credit to Government 2/					
Ceiling		2,200.0	2,257.0	2,337.0	2,395.0
Actual	2,276.8	2,196.0	2,249.6	2,329.4	2,390.9
Foreign exchange loss 3/					
Ceiling		512.0	512.0	180.0	350.0
Actual	--	31.8	201.1	98.0	189.0
	(In millions of U.S. dollars)				
External payments arrears					
Ceiling		41.0	37.0	8.5	--
Actual	71.3	27.5	15.5	8.0	--
External debt 4/					
Ceiling		25.0	25.0	25.0	25.0
Actual	--	--	--	--	--

Sources: EBS/81/146; EBS/82/40; and data provided by the Somali authorities.

1/ Credit to the Government, public enterprises, and private sector less government deposits at the Central Bank.

2/ The banking system's claims on the Government, less government deposits, plus any budgetary use of local currency counterpart in respect of purchases from the Fund.

3/ The cumulative gross loss accruing to the Central Bank of Somalia during the calendar year from foreign exchange sales for imports at the rate of So. Sh. 6.295 = US$1.

4/ New commitments on nonconcessional public and publicly guaranteed external debt with a maturity of between 1-12 years, excluding any refinancing loans obtained through negotiations.

the pegging of the Somali shilling to the SDR, an easing of private sector imports, a liberalization of marketing and pricing policies, a review of the position of public enterprises, a tightening of fiscal and monetary policies, and a further increase in interest rates (Table 3). These measures were expected to contribute to maintaining the growth momentum of the economy, reducing the rate of inflation to 17 per cent and containing the current account deficit of the balance of payments to US$63 million and the overall balance of payments deficit to US$38 million. During 1982, the authorities pursued effectively the policies in the financial program and met all the quantitative performance criteria through end-September 1982 (Table 5). 1/ Reflecting these policies and continued favorable weather conditions, economic activity continued to expand at a rapid pace, the rate of inflation declined to about 24 per cent from 44 per cent in 1981, and the current account of the balance of payments recorded an estimated surplus of US$10 million, primarily due to a lower-than-expected demand for imports. The capital account, however, recorded a large deficit, instead of the expected surplus, due to a substantial capital outflow. Nevertheless, because of the improved current account position, the overall balance of payments deficit is now estimated to be on target at about US$37 million. 2/

2. External sector policies and developments

On July 1, 1982 the dual exchange rate system was unified and the Somali shilling was pegged to the SDR at the rate of So.Sh. 16.5 = SDR 1, 3/ which represented a further depreciation in foreign currency terms of 17 per cent on the export side and of 34 per cent on the import side. In domestic currency terms, this represented a depreciation of 21 and 51 per cent, respectively. The full effect of the devaluation and the unification was passed through to all imported and exported commodities.

The exchange rate adjustment was prompted by a number of factors. Due to increased competition in Somalia's traditional export markets and the effect of domestic inflation, the profitability of livestock exporters was being eroded in the beginning of 1982. The profit margin of the Banana Board was also seriously affected by the weakening of the Italian lira vis-à-vis the U.S. dollar, given that Italy is the main export market for Somali bananas. Moreover, expatriate workers, who had previously remitted part of their earnings via the franco valuta market, appeared to be reluctant to repatriate their earnings via banking channels due partly to widespread speculation that the Government would reactivate the franco valuta system. On the import side, applications for foreign exchange from the private sector, which had previously not had access to foreign exchange through official channels, increased sharply in the first half of the year.

1/ The data on the quantitative performance criteria for end-December have not yet been received.

2/ The discussion of developments in 1982 is based on preliminary estimates.

3/ With margins of 2.25 per cent around this rate.

Table 5. Somalia: Quantitative Performance Criteria, June 1982-June 1983

(End of period)

	1982			1983	
	June	Sept.	Dec.	March	June
	(In millions of Somali shillings)				
Net domestic credit 1/					
Ceiling		5,086.0	5,054.0	5,118.0	5,168.0
Actual	5,088.0	5,070.4	...	...	...
Net credit to Government 2/					
Ceiling		2,285.0	2,115.0	2,065.0	1,990.0
Actual	2,390.9	2,270.3	...	...	...
	(In millions of U.S. dollars)				
External debt 3/					
Ceiling		25.0	25.0	25.0	25.0
Actual	--	--	...	...	...

Sources: EBS/82/105; and data provided by the Somali authorities.

1/ Credit to Government, public enterprises, and private sector less government deposits with the banking system.
2/ The banking system's claims on the Government, less government deposits, plus any budgetary use of local currency counterpart in respect of purchases from the Fund.
3/ New commitments on public and publicly guaranteed external debt with a maturity of between 1-12 years, excluding any refinancing loans obtained through negotiations.

These factors adversely affected the balance of payments, which, during the first half of 1982, registered a deficit of US$61 million. Accordingly, further exchange rate action was deemed necessary to enhance the profitability of export industries, promote import competing activities, encourage remittances via banking channels, and reduce the reliance on administrative decisions in the allocation of scarce foreign exchange. Moreover, the move to an SDR peg was designed to assist in stabilizing Somalia's effective exchange rate, as the SDR basket is more reflective of the pattern of Somalia's international transactions than the U.S. dollar.

These measures contributed to a significant improvement in the current account during the second half of the year resulting in a projected surplus of US$10 million for the whole year compared with a targeted deficit of US$63 million. (Appendix I, Table III). 1/ Imports were considerably lower than projected due partly to larger-than-anticipated foreign aid in kind and continued favorable weather conditions that resulted in a lower-than-expected increase in food imports. Exports, on the other hand, are estimated to have risen by almost 40 per cent as envisaged in the program. Livestock export receipts rose sharply 2/, largely on account of a volume increase reflecting the effects of favorable weather conditions, improvements in shipping facilities, and the impact of the devaluations on export incentives, but remained somewhat lower than projected as underinvoicing of livestock exports was not reduced to the extent anticipated. Banana exports are estimated to have doubled in 1982, reflecting a volume increase by two thirds and a recovery of unit value from an exceptionally low level in 1981 caused by the depreciation of the lira against the U.S. dollar. Receipts from other exports tripled, as projected, following the resumption of operations in the oil refinery and a strong export performance of hides and skins, fish, and myrrh. The service account is estimated to have registered a surplus, reflecting mainly the rescheduling of interest payments on foreign debt and an increased inflow on the government and other service accounts. Accordingly, the deficit on the goods and services account was more than halved.

Of the estimated US$50 million in private transfers in 1982, only US$5 million was remitted through banking channels, while the remainder financed a private capital outflow stemming from the border conflict and

---

1/ To allow comparison with program targets, the exposition in this section is based on a balance of payments presentation on a cash basis. This excludes grants and loans in kind. A balance of payments including grants and loans in kind is presented in Appendix I, Table IV.

2/ Based on official preliminary data.

the associated political uncertainty. 1/ Official transfers were negligible compared with a program projection of US$15 million. Reflecting the capital outflow and a shortfall in cash loan disbursements, developments on the capital account were considerably less favorable than projected. However, because of the improvement in the current account position, the overall deficit, at US$37 million, is estimated to be on target. The deficit was fully financed by drawings from the Fund and from the Arab Monetary Fund. Consequently, gross official reserves at end-1982 are estimated to have remained virtually unchanged at US$43 million, equivalent to 10 weeks of 1982 imports.

In accordance with the objectives of the 1981/82 stand-by arrangement, external debt service payments arrears, which had amounted to US$45 million at end-1980 and US$16 million at end-1981, were eliminated by end-June 1982 through rescheduling and repayments. However, debt service payments to the African Development Bank and Fund amounting to US$744,000 and due before end-September 1982 were not effected on schedule, thereby resulting in an emergence of arrears. These payments were rescheduled by the African Development Bank and Fund in November 1982. As the accumulation of arrears constituted a nonobservance of the performance criterion pertaining to intensification of restrictions, Somalia was unable to effect the second purchase of SDR 10 million under the stand-by arrangement available from November 15, 1982. A waiver, however, was granted by the Board on December 27, 1982, and the purchase was effected on January 3, 1983.

Somalia did not contract any nonconcessional loans in 1982. However, foreign borrowing, primarily concessional loans in kind, amounted to US$113 million, 2/ bringing Somalia's total outstanding medium- and long-term debt (including the Fund and the Arab Monetary Fund) to an estimated US$1,040 million at end-1982. Debt service payments in 1982 are estimated to have amounted to 8.9 per cent of goods and services, compared with 13.6 per cent in 1981 (Appendix I, Table V). The relatively low debt service ratio in 1982 reflects rescheduling of debt service payments, primarily

---

1/ The estimate of the unrecorded (i.e., effected outside banking channels) portion of private transfers, US$45 million in 1982, was based on past trends. These unrecorded transfers came through the parallel market and financed a private capital outflow due to the uncertainties associated with the border conflict. Typically, Somali emigrants in neighboring countries sell part of their foreign exchange earnings to Somali merchants who, in turn, pay the families of Somali emigrants in Somalia. In the balance of payments presentation, the estimated value of these transactions is entered in the current account as private remittances (credit item) and in the capital account as a capital outflow (debit item). Excluding the unrecorded portion of private remittances, the current account registered a deficit of US$35 million. The overall balance of payments is not affected by this treatment of private remittances.

2/ Excludes balance of payments financing from the Fund and the Arab Monetary Fund.

by the Islamic Development Bank; in the absence of such rescheduling, the debt service ratio would have reached 30 per cent.

3. Fiscal policy and developments

The 1982 program provided for a continuation of a restrained fiscal stance. The fiscal situation improved considerably over the previous year due to a substantial increase in revenue and grants accompanied with a restrictive expenditure stance. The overall fiscal deficit of the Central Government in 1982 contracted to 26 per cent of total expenditure, as compared with 30 per cent in the previous fiscal year, but was higher than the target of 19 per cent due to an increase in loans in kind associated with investment projects beyond the level originally projected (Appendix I, Table I). Thus, the budget, excluding loans in kind, recorded a surplus of 4.5 per cent as compared with a deficit of 11.5 per cent in 1981 and a target deficit of 4.8 per cent in 1982. Given that the level of foreign financing more than doubled in domestic currency terms, it is estimated that there was a net repayment to the banking system in line with the program's target.

Revenue and grants, which rose by 56 per cent in 1982, remained lower than projected, almost totally due to a shortfall in imports. 1/ Revenue from import duties (customs duties and the statistical tax) fell marginally. The authorities noted, however, that the drop would have been larger had it not been for a change in customs valuation procedures, which based assessment for import duty purposes on letters of credit rather than on valuation lists, and for a rationalization of import duty exemptions. Revenue from export taxes, by contrast, increased strongly following a sharp rise in the volume of livestock exports as well as an increase in the price for duty purposes at the beginning of the fiscal year. Revenue from taxes on goods and services is estimated to have increased by some 50 per cent, benefiting from a full year's effect of an increase in a number of specific taxes and charges, the most important of which was the tax on sugar, as well as a substantial increase in domestic sugar production. The authorities explained that revenue from public enterprises is also expected to have expanded mainly due to the resumption of production of the oil refinery, the above-mentioned rise in the domestic production of sugar, and some improvement in the financial position of other public enterprises due to the measures taken. There was also a shortfall in grants, excluding the oil grant from Saudi Arabia, which accounted for So. Sh. 600 million of receipts.

The increase in expenditure has been kept to a lower rate than that of receipts and than that envisaged in the program. In 1982 total expenditure (including nonbudgetary expenditure) is expected to have increased by 47 per

1/ The principal assumptions on which the fiscal projections are based are given in Appendix I, Table VI.

cent compared with a programed increase of 45 per cent. Within this total, budgetary expenditure is estimated to have risen by only 19 per cent, remaining below the program target. The authorities noted that almost the whole of this increase was on account of the pressures exerted on government expenditures consequent on the recurrence of the border conflict with Ethiopia. Despite this, economies effected in nondefense expenditure have kept government budgetary operations under strict control. In regard to wages and salaries, the largest single item of nondefense expenditure, no cost-of-living adjustments were granted in 1982, although a development levy on government salaries was abolished. 1/ In addition, concerted efforts were made to eliminate unnecessary expenditures through an intensification of expenditure control procedures. Specifically, the Ministry of Finance stationed its own representative in every ministry to review all expenditures before their authorization to ensure that amounts authorized do not exceed allotments and to disallow the purchase of nonessential items. Extrabudgetary expenditure in 1982 is projected to have more than quadrupled due in part to a doubling of foreign financing (especially loans in kind) for development projects from the severely curtailed level of 1981 and to the effects of the devaluation on foreign-financed development projects.

4. Monetary policy and developments

During 1982, the major objective of monetary policy, to curtail excess demand pressures by reducing real monetary balances, was to a large extent realized. According to preliminary estimates, domestic liquidity in 1982 grew by 11 per cent compared with 31 per cent in 1981 (Appendix I, Table II). 2/ However, even though the balance of payments outcome is expected to be very close to the program target, the rate of expansion of domestic liquidity in 1982 is somewhat higher than originally projected mainly because of the increase in net domestic assets by 23 per cent (compared with 33 per cent in 1981) instead of the projected 20 per cent. Since credit developments in 1982 are expected to conform to the program projections, the higher-than-projected expansion in net domestic assets is due mainly to an original underestimation of valuation adjustments stemming from the devaluation in July 1982 and to interbank and intrabank floats resulting from accounting procedures and communication problems. On the other hand, the expansionary monetary impact of the dual exchange rate system that was in effect until until June 30, 1982 on net domestic assets was less than projected because of a lower level of essential imports and the inclusion of certain receipts in the appreciated exchange market.

1/ This is estimated to have resulted in an average increase of 10 per cent in wages of goverment employees. Nevertheless, average real wages fell when account is taken of the rate of inflation in 1982.

2/ Actual data available only through the end of September 1982.

In conformance with the program targets, the Government is expected to have reduced its net indebtedness to the banking system by 6 per cent during 1982, compared with an increase in its borrowing by 18 per cent in 1981. In line with their objective of encouraging private sector economic activity, the authorities have provided more adequately than in previous years for the credit needs of the nongovernment sector. By the end of 1982, credit to the nongovernment sector is expected to have grown as targeted by 28 per cent, compared with 16 per cent in 1981. About 58 per cent of the banking system's credit outstanding at end-1982 will thus be for the nongovernment sector, compared with about 51 per cent at the end of 1981.

In order to improve resource allocation, mobilize domestic savings, and encourage the inflow of savings of Somali workers abroad, on July 1, 1982, the Somali authorities increased interest rates on all loans and deposits of the Central Bank and the commercial bank by two percentage points. Consequently, the central bank discount rate and the Treasury bill rate is 8 per cent, interest rates on savings and time deposits range between 8 and 11 per cent, and the commercial bank's lending rates are between 12 and 14.5 per cent. Since the Development Bank's lending rates were almost doubled in 1981, to range between 10 and 14 per cent, they were kept unchanged in 1982.

Further, in order to induce a greater inflow of foreign exchange into external accounts denominated in U.S. dollars, livestock exporters were allowed to open such accounts starting in February 1982. Livestock exporters were allowed to use foreign exchange in these accounts to import goods, once import licenses were obtained from the Ministry of Commerce. At the end of September 1982, deposits in external accounts denominated in U.S. dollars amounted to US$2.7 million. At end-November 1982, the Mogadiscio branch had 29 external accounts denominated in U.S. dollars, 22 held by livestock exporters and 7 held by workers abroad; the cumulative letters of credit issued against external accounts through the Mogadiscio branch amounted to US$2.5 million.

5. Production, investment, and prices

The Somali economy continued to witness a strong growth performance in 1982. Economic activity picked up significantly in the agricultural sector in 1981 and continued to do so in 1982, based on data available for the first half of 1982. 1/ There are indications that weather conditions contributed to substantial additions to the livestock herd. In volume terms, the export data indicate that livestock exports increased by 13 per cent during 1982. Production of maize and sorghum, the two main staple crops,

1/ Although Somalia has no official national income accounts, preliminary estimates indicate that the agricultural sector accounts for about 55 per cent of domestic economic activity and the manufacturing sector for about 7 per cent. In the agricultural sector, livestock accounts for about 70-75 per cent of economic activity, crop production for about 15-20 per cent, and forestry and fishing for the rest.

which increased by about 45 in 1981, has continued to grow in 1982. The increase in staple crop production was due to two consecutive years of of good weather conditions, increased producer prices, and a liberalization of the marketing mechanism. Sugarcane production reached unprecedented levels in 1982; the production level attained during the first six months of the year has exceeded considerably levels attained over a 12-month period in previous years. Banana production, which had been declining for over five years, recovered rapidly in 1982, registering an estimated 43 per cent growth rate. The recovery of the banana sector, an export-oriented crop, is due mainly to increased incentives following the two devaluations. The fishing sector has also been expanding rapidly. In the manufacturing sector, the sugar factories recovered from the floods that had disrupted production in 1981, and the oil refinery, which had stopped production at the end of 1980, resumed its activities in April 1982. The latter was made possible by the crude oil grant from Saudi Arabia, which supplied the oil refinery with 30,000 metric tons of crude oil per month starting in April.

Pricing and marketing policies contributed significantly to the incentives for agricultural production. While, in the past, farmers were required to sell the main cereal products, such as maize and sorghum, intended for domestic consumption to the Agricultural Development Corporation (ADC) at the wholesale level, this requirement was waived in 1982 and agricultural producers were permitted to sell at market-determined prices. The ADC is now expected to operate as a price stabilization board, purchasing from farmers at minimum guaranteed prices and selling when the market price peaks; the selling price is set to cover its operating costs. The authorities noted that, since the ADC's role at its inception was that of a stabilization board, the movement away from that of an informal monopsonist brings it within the purview of its legal framework. The Government intends to review the producer prices guaranteed by the ADC at the beginning of each growing season to ensure the farmers an adequate return and to facilitate the stabilization role envisaged for the ADC. In addition, financial incentives for banana production were also considerably improved. The two recent exchange rate adjustments, which were passed on to producers, resulted in increases in producer prices of 107 per cent in June 1981 and 10-27 per cent in July 1982. In the view of the authorities, these adjustments have succeeded in restoring adequate producer incentives in the banana sector.

Economic activity was also stimulated by the recovery in public sector investment from the sharply curtailed level of 1981. According to the authorities, the pickup in investment was due to an improvement in the pace of project implementation. This investment was, for the most part, associated with an increase in loans in kind, which rose from US$77 million in 1981 to US$105 million in 1982. Although the Five-Year Development Plan (1982-86) was officially launched in 1982, the authorities indicated that the emphasis in terms of investment has been on the completion of ongoing projects rather than the initiation of new projects. The projects continued to be mainly in the areas of agriculture, livestock, and infrastructure. 1/

The favorable supply conditions, coupled with the tight financial policies pursued, have reduced inflationary pressures. The rate of inflation as measured by the consumer price index for Mogadiscio was nearly halved, falling from 44 per cent in 1981 to 24 per cent in 1982, but remained higher than the program's projection of 17 per cent. The main components behind the movement of the consumer price index were in rents and energy, both of which increased by around an estimated 70 per cent in 1982. The increase in rents is indicative of the urbanization process taking place in Mogadiscio and the increasing housing demand from foreign personnel working in Somalia. With regard to petroleum products, the price of gasoline was raised by 153 per cent in August 1981 and the prices of diesel fuel and kerosene by 125 per cent and 114 per cent, respectively, in January 1982. These increases are in line with the Government's energy conservation policies, which involve the adjustment of petroleum product prices at levels that reflect movements in international prices. In addition, electricity tariffs have been tripled in October 1982 to bring these tariffs in line with the cost of electricity generation. These increases were partly offset by a deceleration in the rate of inflation of the food component of the price index, which fell from 40 per cent in 1981 to an estimated 8 per cent in 1982.

IV. The Program for 1983

1. Overview

During 1983, the Somali authorities intend to intensify their adjustment efforts by undertaking additional measures and further tightening financial policies (EBS/82/105). The policies will continue to emphasize the promotion of economic growth, the reduction in inflationary pressures, and the strengthening of the external sector position (Table 6). In particular, the program aims at reducing the rate of inflation to 12 per cent in line with the original program projection. In the external sector, the program aims at achieving a current account surplus of US$3 million, compared with an original program projection of a deficit of US$51 million. The capital account, however, is now expected to record a deficit of US$55 million compared with an original projection of a surplus of US$25 million. This turnaround reflects two factors. First, a private capital outflow of US$30 million is now projected. This had not been envisaged in the original program and would have reached an estimated US$60 million were it not for the measures outlined below. Second, the net government capital account has been revised from an inflow of US$25 million to an outflow of US$25

1/ A more detailed discussion of the Plan is provided in Section IV.6 below.

Table 6. Somalia: Summary of the 1983 Financial Program

1. Principal objectives

a. Promote domestic production.

b. Reduce the rate of inflation. Target: 12 per cent in 1983.

c. Attain a current account surplus of US$3 million and limit the balance of payments deficit to US$52 million in 1983.

2. Principal measures

a. Pricing policy: continue to pursue liberal marketing and pricing policies.

b. Wage policy: grant cost-of-living increases to government employees averaging no more than 10 per cent in 1983.

c. Development policy: (i) concentrate on quick-yielding investment projects and completion of existing projects in agriculture, livestock, and infrastructure; (ii) contain the level of investment in line with the available foreign financing; (iii) elaborate the yearly investment plans within the context of the annual government budget exercise, taking into account the adjustment objectives; (iv) prepare a three-year public investment program within the context of the current Five-Year Development Plan (1982-86); (v) organize, with the assistance of the World Bank, a Consultative Group Meeting of donor countries for Somalia in early 1983.

d. Public enterprises: set up an Intra-Governmental Commission to evaluate and recommend the closure of inefficient public enterprises.

e. Fiscal policy: (i) reduce the budgetary deficit, including loans in kind, to 17 per cent of expenditure in 1983; (ii) reduce net domestic credit to Government by 13 per cent in 1983; (iii) levy the ad valorem import duties on nonessential dutiable items on the basis of a price 20 per cent higher than that declared in the letter of credit (January 1, 1983); (iv) limit new recruitment to government services and encourage high school graduates to seek employment in other areas; (v) effect structural changes in the tax system in accordance with the recommendations of the 1980 IMF Tax Survey, i.e., introduce a general sales tax on all domestic transactions, except certain basic or essential products, convert specific excises to an ad valorem basis, restructure the tax system of public enterprises, improve tax assessments, and strengthen collections.

f. Monetary policy: (i) reduce the rate of growth of domestic credit to 5 per cent in 1983, while continuing to redirect credit to meet the needs of the private sector; (ii) allocate credit to the productive sectors of the economy; (iii) increase and rationalize the interest rate structure on external accounts denominated in U.S. dollars (January 1, 1983).

g. External sector policy: (i) institute a bonus scheme, providing a 33 per cent premium above the official exchange rate, for workers' remittances and capital inflows effected by Somali nationals (January 1, 1983); (ii) grant priority in import licenses to those remitting foreign exchange under the bonus scheme (January 1, 1983); (iii) limit new commitments on public and publicly guaranteed nonconcessional external debt with a maturity of 1-12 years to US$25 million during 1983; (iv) undertake a study of the marketing process of livestock exports in order to eliminate underinvoicing.

million. This revision is based on more up-to-date information on debt amortization and cash loan disbursements. Because of the turnaround in the projection for the capital account, the balance of payments deficit for 1983 is now projected at US$52 million compared to an original program projection of US$26 million.

The program for 1983 includes a number of measures aimed at containing the private sector capital outflow and encouraging the inflow of remittances and capital flows through the banking system. In particular, a bonus scheme for workers' remittances and capital inflows effected by Somali nationals was instituted on a temporary basis effective January 1, 1983. Furthermore, priority in the granting of import licenses was accorded to individuals who remit foreign exchange under the bonus scheme, and the interest rate structure on external accounts denominated in U.S. dollars was rationalized and set at a competitive level. The measures will be reinforced with a tightening of financial policies. The budgetary deficit is to be reduced significantly below the 1982 level. The improved budgetary situation will allow the Government to reduce its net indebtedness to the banking system to a greater extent than originally envisaged, and the credit growth to the private sector will be curtailed beyond the original program target. These factors will contribute to a contraction in domestic liquidity.

In addition, the role of the public sector will continue to be reduced. To move faster on the issue of the elimination of inefficient public enterprises, an Intra-Governmental Commission has been set up to evaluate and recommend the closure of inefficient public enterprises. The liberal pricing policies, which have been beneficial to the agricultural sector, will continue in effect. The scope of imports that can be brought in by the private sector has been widened, as the state monopoly on imports has been abolished.

The authorities have requested the World Bank to organize a Consultative Group Meeting of donor countries for Somalia; the meeting is currently scheduled for March 1983.

2. External sector policies

A major problem in the external sector that had arisen in 1982 and continued to affect adversely the prospects for 1983 was the private capital outflow that was reflected in the low level of remittances through the banking system. Without additional measures, it was expected that the extent of the capital outflow would reach US$60 million in 1983, absorbing all the foreign exchange generated by the expected inflow of private remittances. The authorities were of the view that the capital outflow did not stem from economic factors but rather from the uncertainties associated with the border conflict. The authorities concurred, however, on the need to take additional measures to stem the capital outflow and rechannel private remittances through the banking system.

To this end, they have instituted, effective January 1, 1983, a bonus scheme, providing a 33 per cent premium (So. Sh. 5 per U.S. dollar) above the official exchange rate, for workers' remittances and capital inflows effected by Somali nationals, on a temporary basis. The cost of this scheme will be borne by the budget. In addition, they have instituted a system whereby priority in the granting of import licenses will be accorded to individuals who have remitted foreign exchange through the bonus scheme. Furthermore, the interest rate structure on external accounts denominated in U.S. dollars was rationalized. The authorities are of the view that these incentives, together with the tightening of financial policies, will result in an inflow of private remittances through the banking system of about US$30 million and, therefore, effectively reduce the private capital outflow to US$30 million from an expected US$60 million.

Due to the tightening of financial policies and the effect of the measures taken, the current account of the balance of payments in 1983 is projected to remain in near balance, 1/ compared with a deficit of US$51 million envisaged in the original program projections (Appendix I, Table III). 2/ The revision is accounted for mainly by a downward revision in the projected level of imports. Although non-oil imports are projected to rise considerably in volume terms, reflecting an increase in food imports following a return to more normal weather conditions and a continued expansion in economic activity, oil import payments are expected to be reduced due to an overaccumulation of oil stocks, which had resulted from substantial commercial imports in the early part of 1982. The authorities explained that these imports had been required, notwithstanding the Saudi Arabian crude oil grant that had started in April 1982, due to some initial problems in the operations of the oil refinery. Export receipts are projected to continue rising, due to a further expansion in livestock exports and a sharp increase in banana exports. The latter is mainly due to an expected large volume increase in response to improved producer incentives. Transfers are also expected to rise, reflecting an increase in both private remittances and official grants. The authorities were hopeful, however, that a considerably larger amount of official grants than the estimated US$15 million would be forthcoming from friendly governments.

The private capital outflow, though mitigated by the introduction of the exchange premium, is expected to continue in 1983. This, together with a downward revision of cash loan disbursements and an upward adjustment of scheduled amortization payments on the basis of more up-to-date information, results in a turnaround in the projection of the capital account to a deficit and accounts for the revision of the overall balance of payments deficit to US$52 million. The deficit will be financed by scheduled net drawings from the Fund (US$50 million) and the Arab Monetary Fund (US$6 million).

1/ Excluding the unrecorded portion of private transfers, the current account deficit would amount to US$27 million.

2/ Principal balance of payments assumptions are contained in Appendix I, Table VII.

The Somali authorities recognized that underinvoicing of livestock exports had persisted. The problem arises because livestock exporters use in their letters of credit the government-set minimum export prices, which have not been adjusted in U.S. dollar terms since 1979, instead of the actual selling prices. The authorities agreed that underinvoicing deprived the country of valuable foreign exchange resources, particularly since the nonsurrendered export earnings tended to be kept abroad owing to the uncertainty associated with the border conflict. They explained, however, that underinvoicing, which they estimated at only 10-15 per cent, had to be tolerated by the Government in view of the prevailing trading practices in the region. The difference between the selling price and that listed in the letter of credit (usually the government-set minimum export price) provides the foreign importers with a guarantee against shipping losses and deficient quality in terms of weight and health of the exported animals. The existence of this guarantee was considered essential by both the Saudi importers and the Somali exporters in view of the lack of shipping insurance facilities for livestock. However, given the lack of adequate information on the extent of underinvoicing and the need to base any measures to correct it on a comprehensive understanding of the marketing process, the authorities plan to undertake a study of the marketing process of livestock and the relation between the actual selling prices and the minimum export prices with a view to determining whether an increase in the minimum export prices can be effected without adversely affecting the competitiveness of livestock exports. The study is expected to be completed in May 1983.

Although most disbursed external public and publicly guaranteed medium- and long-term debt is on concessional terms, a concentration of maturities and Somalia's narrow export base are expected to result in a sharp increase in debt servicing. The debt service ratio, which, through reschedulings, was kept at 9 per cent in 1982, is projected to rise to 31 per cent in 1983 and 39 per cent in 1987 (Appendix I, Table V). The authorities recognize the importance of the problem and intend to seek debt relief from foreign creditors in order to contain the rise in the projected debt service ratio. In this regard, they noted that they had not contracted any loans on commercial terms in 1982 and did not expect to do so in 1983, although the program provides for a ceiling of US$25 million during 1983.

The medium-term prospects of the balance of payments will depend importantly on the Government's investment and growth objectives. In order to achieve a substantial increase in real growth and in the standard of living in Somalia, investment expenditures would have to be raised considerably above current levels. In view of Somalia's external position, this would imply widening current account deficits which would necesitate a considerable increase in grants and concessional loans. In the absence of such an increase in foreign assistance, even taking into account an expected sustained recovery of the export sector and a resumption of private remittances through banking channels, the sustainability of the balance of payments would imply a stagnating or declining per capita income over time.

3. Fiscal policy

During 1983, the authorities intend to pursue a tight fiscal policy, primarily through an austere expenditure policy. It is expected that the overall deficit of the Central Government will be reduced sharply to some 16.5 per cent of total expenditure, marginally lower than the original program target and considerably lower than the 26 per cent recorded in 1982 (Appendix I, Tables I and VI). As net foreign financing is expected to exceed the overall deficit, net bank credit to the Government is projected to contract by So. Sh. 275 million (13 per cent) as compared with an original program projection of So. Sh. 225 million (11 per cent).

During 1983 total revenue and grants are projected to increase by 19 per cent compared to an original program projection of 17 per cent and a 56 per cent increase in 1982. The oil grant from Saudi Arabia is expected to remain at the same level as in 1982. However, other grants are expected to rise substantially. Total revenue is projected to rise by 19 per cent, reflecting a number of factors. First, import taxes are assumed to increase on account of a higher domestic value of imports. Second, on January 1, 1983, the authorities increased the effective import duty rate on non-essential dutiable items by levying the ad valorem import duties on the basis of a price 20 per cent higher than that declared in the letter of credit. The increase in revenue from this source is expected to offset fully the foreign exchange bonus scheme. Third, export taxes are also expected to increase substantially on account of a further increase in the volume of livestock exports. Fourth, revenue from public enterprises is projected to rise sharply due to a higher capacity utilization of the sugar refineries, the full-year operation of the oil refinery, and improvements in the performance of other enterprises. Although in accordance with the recommendations of a Fund staff tax survey in 1980, the Somali authorities are introducing changes in the tax system of a structural nature (discussed below), no financial provision has been made for these structural reforms in 1983, as their effect is expected to materialize only over the medium term.

During 1983, total expenditure has been programed to grow at 6 per cent compared with an original program projection of 14 per cent and a growth of 47 per cent in 1982. Through strict expenditure control procedures, an austere incomes policy, and strict limits on government employment, nonwage budgetary expenditure is to be held slightly below 1982 level in real terms. With regard to wages, the authorities were of the view that a cost-of-living adjustment was necessary to maintain the quality of the civil service, particularly in view of the sharp decline in real government wages that had taken place in 1980-82. This decline was estimated at about 50 per cent. While the original program projection provided for a 15 per cent increase in government wages, the authorities concurred on limiting the adjustment to no more than 10 per cent in order to strengthen the budgetary position. Furthermore, the authorities intend to consider whether to grant the increase later in the year, depending on the evolution of the budgetary position. New recruitment to government service is to be severely limited, and high school graduates will be encouraged to seek employment in other areas. With regard to development expenditure, the authorities emphasized their intention to focus on new quick-yielding projects and the speedy completion of ongoing projects in agriculture, livestock, and infrastructure. Extrabudgetary expenditures are projected to decline by 16 per cent, in large part due to improved expenditure control and a shift in investment from the Government to the public enterprise sector.

Over the medium term, the objective of the authorities is to achieve a more balanced budgetary position through a restructuring of the tax and revenue system while containing the growth of expenditure to a lower rate than that of revenue. In regard to revenue, beginning in 1983, the authorities intend to introduce major changes in the tax system to make it more responsive to the structural changes in the economy and its growth. In accordance with the recommendations of the 1980 IMF Tax Survey, the authorities are introducing a general sales tax of 5 per cent to cover all domestic transactions except certain basic or essential products. At the same time, specific excises such as those on soft drinks, spirits, and soap will be converted to an ad valorem basis. In addition, in line with the recommendations of the tax survey, the tax system of public enterprises is to be restructured in order to reduce the excessive tax burden on public enterprises and rationalize the tax structure. The existing turnover tax (in practice applied to the net profit of enterprises), the profits tax, and the depreciation share contributed by enterprises are to be abolished. Instead, a profits tax at the rate levied on private enterprises, together with a flexible dividend policy, will be applied. The Government also intends to improve tax assessments and strengthen collections. In this regard, the authorities have requested technical assistance from the Fund for improving assessment and collection procedures of income taxes, an area where considerable evasion and revenue potential exists. With regard to expenditures, the authorities intend to contain the growth in expenditures through further improvements in expenditure control (primarily at the agency and regional levels) and a reduction in new government employment. The Government expects that, through the institution of vocational schools and an increase in economic activity, alternative employment opportunities for high school graduates will increase. At the same time, it is discouraging school leavers from seeking employment in government service and assisting them in finding alternative job opportunities. This, together with a declining level of defense expenditures, once border hostilities cease, would enable the government to devote a greater proportion of resources to the adequate maintenance of existing assets as well as providing more domestic counterpart funds for new investment.

4. Monetary policy

During 1983 the major objective of monetary policy will be to continue to curtail excess demand pressures by reducing real monetary balances. The growth in domestic credit in 1983 will be limited to 5 per cent instead of the 7 percent initially projected, due mainly to an expected improvement in the budgetary position (Appendix I, Table II). Net domestic credit to the Government will be curtailed by 13 per cent rather than the 11 per cent initially projected. In addition, credit to the nongovernment sector will be allowed to expand by 18 per cent, compared with the initial program projection of 20 per cent. This rate of credit expansion is deemed consistent with the Government's objective of encouraging private sector activity through the adequate provision of credit to the private sector. Moreover, in allocating credit to the various sectors of the economy, the monetary authorities will continue to emphasize the productive sectors--agriculture, livestock, industry, and fishing--with a view to encouraging export and import-competing activities. The credit targets in 1983, along with the projected contractionary impact of the change in net foreign assets, will result in a decline of domestic liquidity of 6 per cent instead of the original program projection of an expansion of 2 per cent.

In order to induce a greater inflow of funds from abroad into external accounts denominated in U.S. dollars, the authorities will continue to disseminate information about these accounts in the Gulf area and in Somalia. They also, in order to encourage an inflow of savings into these accounts, established, effective January 1, 1983, an interest rate structure for ordinary savings and time deposits for external accounts which will be competitive with similar deposits in the international market. Interest rates on these external accounts will range between 9 and 11 per cent, depending upon maturity terms. This interest rate structure will be kept under review, and changes in it will be effected as needed in order to keep it in line with interest rates on similar accounts overseas.

Regarding domestic interest rates, although the authorities acknowledged that these remained negative in real terms, they do not consider that any changes in the existing structure are necessary at this time. They regard the prevailing interest rates, which were revised upward in mid-1982, to be consonant with economic conditions in the country and with their program target of 12 per cent inflation in 1983. They noted that interest rates had been nearly doubled during the last two years while the rate of inflation had been declining. They were of the view that this was contributing to improved financial intermediation and improved resource allocation.

5. Public enterprises

The Government of Somalia remains committed to improve the productivity and profitability of public enterprises and to keep in operation only economically viable enterprises. They noted that, as a reflection of their determination, three public enterprises that were deemed financially unviable were closed in 1981. In this connection, the authorities stressed that the Government would not subsidize the operations of public enterprises. Accordingly, the retail price of sugar was increased by about 80 per cent in 1982, promoting the profitability of the two public enterprises engaged in sugar production. Electricity charges were tripled in 1982, enhancing the financial position of the public enterprise engaged in this activity. The tax system applied to public enterprises has also been revised and rationalized with a view to reducing the excessive tax burden and promoting production. 1/

The authorities noted that, although the measures taken in the last two years have contributed to an improvement in the operations of some enterprises, the Government is determined to proceed in 1983 with the closure of those enterprises deemed to be not viable. In this regard, an Intra-Governmental Commission composed of representatives from the Central Bank, the Ministry of Finance, the Ministry of Commerce, and other ministries responsible for various public enterprises has been set up in order to evaluate the financial position of public enterprises and to prepare a report indicating which enterprises should be phased out of operation. The authorities noted, however, that, given the sensitivity of the social issues inherent in such decisions, the Government will have to move with caution. In addition, the authorities stated that a Public Investment Evaluation Unit, which was set up by the Ministry of Finance with technical assistance from the World Bank in mid-1982, is looking at the broader issues of the role of the public sector in general.

6. Development planning

Commenting on the Five-Year Development Plan (1982-86), the authorities explained that the plan places considerable emphasis on the development of the agricultural sector (including livestock and fishing) and of infrastructure. The plan aims at achieving an annual growth rate in real terms of 4.2 per cent, through an increase in real gross fixed capital formation and a greater utilization of existing capacity. With regard to the sectoral allocation of planned investment, the agricultural sector will account for 51 per cent, infrastructure for 19 per cent, and manufacturing and mineral resources for 11 per cent of total outlays. The level of investment under the plan is presently estimated to be US$2,291 million in nominal terms. Funding from domestic sources is estimated to be US$390 million (17 per cent). Foreign financing that has already been committed or assured is around US$1,335 million (58 per cent), leaving a gap of about US$566 million (25 per cent) for which financing has to be secured.

The authorities recognized the importance of assessing the impact of the implementation of the plan on domestic and external financial stability. They noted that, for this purpose, the plan incorporated for the first time a macroeconomic framework. Furthermore, they concurred on the importance of undertaking only those projects that had been subjected to rigorous feasibility studies. In implementing the plan, the authorities intend to contain the level of investment in line with the foreign financing available

---

1/ The details of the reform are discussed in Section IV.3 above.

by being flexible with respect to the new projects that will be initiated and the pace of implementation of ongoing projects. Furthermore, they intend to elaborate yearly investment plans in the context of the annual government budget exercise to adapt to changing circumstances and ensure the consistency of the investment plans with the objective of re-establishing domestic and external financial stability.

The World Bank, which recently reviewed the 1982-86 Development Plan, is of the view that "the Plan, as currently drafted, does not constitute an operational document nor does it provide a policy framework for Somalia's development. The World Bank has recommended to the Government to prepare a public investment program (PIP), the central objective of which should be to direct available resources to those development activities with the greatest promise for augmenting domestic commodity production, increasing exports, replacing imports, and generating domestic revenues. The PIP should provide the central instrument for managing and monitoring the national development effort, and its core would comprise the medium-term program for rehabilitation and consolidation of the economy. It would substitute the curent development budget, and along with the current budgets, would constitute the means by which available financial resources (both local currency and foreign exchange) would be channelled to their highest priority uses. Such a public investment program would have to incorporate a consistent macroeconomic framework, a level of investment that is based on a realistic assessment of domestic and external resources availability, and an allocation of investment and selection of projects based on appropriately formulated economic criteria, with emphasis on projects aimed at utilizing existing productive capacities and at rehabilitating and expanding the production base." According to World Bank staff, the Government in initial discussions with the World Bank has expressed its reluctance to formulate such a program. However, it is expected that this issue will be discussed with the World Bank during a forthcoming official Somali mission to Washington in January.

The authorities indicated that they are collaborating with the World Bank in preparation for the Consultative Group Meeting of donor countries for Somalia. The meeting is currently scheduled for March 1983. In this regard, the authorities stated that they are prepared to formulate a three-year investment program within the context of the Five-Year Development Plan. At present, the Ministry of National Planning and the Ministry of Finance, together with technical assistance provided by the World Bank, are in the process of preparing a document for the meeting.

7. Performance criteria

The program includes as quantitative performance criteria: (1) quarterly ceilings on net domestic credit, with quarterly subceilings on net credit to the Government, through end-June 1983, and (2) a ceiling on external debt contracted or guaranteed by the Government with maturities of 1-12 years through end-December 1983 (Table 5). The performance criteria further include the standard provision relating to multiple currency practices, bilateral payments arrangements, and restrictions on payments and transfers for current current international transactions or import restrictions for balance of payments purposes. There will be a further review before June 30, 1983, of the performance under the financial program.

V. Staff Appraisal

Faced with a stagnation in economic activity and mounting domestic and external financial imbalances, the Somali authorities launched in mid-1981 a major adjustment program that has met with considerable success. Reflecting in the main the devaluation of the Somali shilling, increases in producer prices, the upward revision of the domestic interest rate structure, and a considerable tightening of fiscal and monetary policies, as well as good weather conditions, the economic situation improved significantly in 1981. The pace of economic activity picked up, the rate of inflation decelerated sharply, and the current account and the overall balance of payments deficits narrowed markedly.

During 1982, the Somali authorities effectively continued with the pursuit of their adjustment efforts. Financial policies were tightened further. On the fiscal front, the authorities were able to contain budgetary expenditures in real terms by restricting employment in the government sector, not granting cost-of-living adjustments, and improving expenditure control. The tax measures introduced, the impact of the devaluation, and the grant of oil from Saudi Arabia contributed to a growth in receipts that exceeded considerably that in expenditures. These developments, together with the expansion in loans in kind, enabled the Government to curtail its net indebtedness with the banking system. This, in turn, allowed for a significant drop in net domestic credit growth, even though credit to the nongovernment sector grew at a faster pace, providing more adequately than in previous years for the credit needs of the production sector. The ensuing reduction in the rate of growth of domestic liquidity brought about a significant contraction in real money balances. The financial policies were reinforced by the additional measures taken at mid-year aimed at promoting structural adjustment, which included the further devaluation of the Somali shilling, the unification of the dual exchange rate system, an upward revision in the domestic interest rate structure, and a significant liberalization of marketing and pricing policies. Reflecting the policies and measures taken as well as good weather conditions, economic activity continued to expand in 1982 and inflationary pressures to subside. Furthermore, the export performance improved and import demand declined, leading to a strengthening in the underlying balance of payments position; for the first time in a number of years, the current account of the balance of payments recorded a surplus. Because of this development, the overall balance of payments outcome is estimated to be on target, notwithstanding the private capital outflow generated by uncertainties associated with the border conflict.

The authorities are intent on continuing to pursue with determination their adjustment efforts in 1983 and have taken a number of significant steps to accelerate the adjustment process. The immediate problem facing the Somali economy is the potential in 1983 for the continuation of the private capital outflow. To stem this outflow, the authorities intend to intensify the restrictive stance of their financial policies and to implement a number of measures that will have a direct bearing on the capital outflow. Specifically, the bonus scheme is expected to encourage the inflow of remittances and capital from abroad through the banking system. Because of the transient character of the factors affecting capital flows and the intention of the authorities to discontinue the bonus scheme in due course, the staff recommends approval of the resulting multiple currency practice through end-December 1983. The authorities' decision to grant priority in the import licensing system to individuals who remit foreign exchange under the bonus scheme should act as an added incentive for remittances to be channeled through the banking system. Furthermore, the rationalization and setting of interest rates on external accounts on a basis that is competitive with similar accounts in financial centers abroad can contribute to the attraction of savings of Somali expatriates.

On the financial front, the authorities will pursue a considerably more restrictive fiscal policy stance than in the previous year. The continued enforcement of expenditure controls, the strict limits on government employment, and a minor cost-of-living adjustment to government salaries are expected to contain the growth in expenditures and enable the Government to continue contracting its net indebtedness vis-à-vis the banking system. Furthermore, the growth of credit to the nongovernment sector, though significantly reduced compared with 1982, is being maintained at a rate that will meet adequately the credit requirements for the continued expansion in economic activity. The resulting decline in the absolute level of domestic liquidity is essential for narrowing the excess demand pressures and limiting the monetary balances financing the capital outflow. In that regard, the recent increases in the domestic interest rate structure, coupled with the deceleration in inflation, can be expected to have a salutary impact on the mobilization of savings, resource allocation, and financial intermediation.

The widened role being envisaged for the private sector is reflected in the intention of the authorities to continue to pursue in 1983 liberal marketing and pricing policies, which have already proved to have been beneficial to the agricultural sector, and in the easing of imports that can be brought in by private importers, as the state monopoly on imports has been abolished. The reduction in cost-price distortions has already had a beneficial impact on the performance of public enterprises, although a number of them continue to suffer from low capacity utilization, low productivity, and inadequate technical and managerial staff. The institution of a high level intragovernmental commission authorized to evaluate and recommend the closure of inefficient public enterprises is, in the view of the staff, a positive step indicative of the seriousness of the authorities in pursuing their objective of keeping in operation only viable enterprises.

The Somali authorities recognize the importance of their investment strategy for the promotion of economic growth and for the attainment of a sustainable balance of payments position. The authorities have proceeded cautiously in implementing the Five-Year Development Plan, launched in 1982, with the emphasis thus far being on the continuation of on-going projects. The authorities have indicated that they are prepared to formulate a three-year public investment program in the context of the Five-Year Development Plan and intend to discuss the matter further with the World Bank. The staff hopes that rapid progress will be made in that area. The program will have to include a consistent macroeconomic framework, projects that have been subjected to rigorous project evaluation, an allocation of investment based on appropriately formulated economic criteria, and a pragmatic assessment of domestic and external financial resource availability. In the opinion of the staff, such a public investment program constitutes an essential framework for the elaboration of a medium-term adjustment strategy. In this context, the structural tax measures being undertaken can be expected to contribute to the mobilization of domestic resources over the medium term. Furthermore, the viability of Somalia's external position over the medium term will depend critically on the continuation of grants and loans on concessional terms. In this respect, the staff notes the intention of the authorities to review at the forthcoming Consultative Group Meeting the potential financing that donor countries might be willing to provide. In addition, the Somali authorities plan to explore early in 1983 with creditors the possibility of rescheduling or canceling a part of Somalia's external debt as the debt servicing burden is rising rapidly.

The staff is impressed by the seriousness and determination with which the Somali authorities carried out their adjustment efforts during 1981 and 1982. The program proposed by the authorities for 1983 is indicative of their resolve to accelerate the adjustment process and to introduce appropriate measures in the face of changing circumstances. The staff considers the policies and measures outlined in the attached letter as being appropriate for the attainment of the objectives set out in the letter and proposes the following draft decisions for approval by the Executive Board.

VI. Proposed Decisions

Article IV Consultation

1. The Fund takes this decision relating to Somalia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Somalia, in the light of the 1982 Article IV consultation with Somalia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policy).

2. On January 1, 1983, Somalia introduced a bonus scheme, described in EBS/83/15, which gives rise to a multiple currency practice. In view of the comprehensive policies for balance of payments adjustment adopted by Somalia and, in particular, the intention of the authorities to eliminate that practice, the Fund grants approval for the retention of the multiple currency practice until December 31, 1983.

Review Under Stand-By Arrangement

1. Somalia has consulted the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Somalia (EBS/82/105, Supplement 1, December 20, 1982) in order to establish performance criteria subject to which purchases may be made by Somalia under the stand-by arrangement during January 1-June 30, 1983.

2. The letter from the Minister of Finance and the Governor, Central Bank of Somalia, of December 8, 1982, shall be annexed to the stand-by arrangement for Somalia, and the letter of April 15, 1982, attached to the stand-by arrangement, shall be read as modified and supplemented by the annexed letter.

3. Accordingly, paragraphs 4(a), (b), and (d)(ii) of the stand-by arrangement shall be amended to read:

"(a) during any period until June 30, 1982, in which the data at the end of the immediately preceding performance period indicate that

(i) the limit on total net domestic credit of the banking system described in paragraph 18 of the annexed December 8, 1982 letter is not observed; or

(ii) the limit on net bank credit to the Government described in paragraph 18 of the annexed December 8, 1982 letter is not observed; or

(b) (i) if Somalia fails to observe the limits on contracting of new public and publicly guaranteed external debt described in paragraph 26 of the annexed December 8, 1982 letter; or

(d) (ii) introduces new multiple currency practices, or modifies the existing multiple currency practice described in paragraph 24 of the annexed December 8, 1982 letter, or"

Table I. Somalia: Central Government Operations, 1980-83

(In millions of Somali shillings)

	1980 Actual	1981 Actual	1982 Revised program	1982 Revised outturn	1983 Program	1983 Staff estimates
Total revenue and grants	1,884	2,360	4,130	3,679	4,825	4,392
Revenue	1,421	2,251	3,325	2,999	4,000	3,557
Tax	(1,192)	(2,002)	(...)	(...)	(...)	(...)
Nontax	(229)	(249)	(...)	(...)	(...)	(...)
Transfers from local authorities	--	12	--	17	--	10
Grants 1/	463	97	205	63	225	225
Oil grant	--	--	600	600	600	600
Total expenditure	3,072	3,382	5,100	4,980	5,800	5,258
Budgetary expenditure	1,832	3,081	3,765	3,666	4,350	4,158
Ordinary	(1,670)	(2,795)	(...)	(...)	(...)	(...)
Development	(162)	(286)	(...)	(...)	(...)	(...)
Other expenditure 2/	1,108	301	1,310	1,314	1,425	1,100
Transfers to local authorities	132	--	25	--	25	--
Overall deficit (-)	-1,188	-1,022	-970	-1,301	-975	-866
Financing	1,188	1,022	970	1,301	975	866
Foreign (net) 3/	504	681	1,105	1,431	1,200	1,141
Domestic	684	341	-135	-130	-225	-275
Banking system	(671)	(347)	(-135)	(-135)	(-225)	(-275)
Cash balances 4/	(13)	(-6)	(--)	(5)	(--)	(--)
Memorandum item						
Overall surplus/deficit (excluding loans in kind)	-802	-307	-210	158	-150	655
Overall deficit/total expenditure (in per cent)						
(i) Including loans in kind						
Including grants	38.7	30.2	19.0	26.1	16.8	16.5
Excluding grants	53.7	33.1	34.8	39.4	31.0	32.2
(ii) Excluding loans in kind						
Including grants	29.9	11.5	4.8	-4.5	3.0	-17.5
Excluding grants	47.1	15.1	23.4	14.3	19.6	4.5

Sources: Data provided by the Somali authorities; and staff estimates.

1/ Excluding grants in kind.
2/ Obtained as a residual; includes errors and omissions.
3/ Includes loans in kind.
4/ Includes net deposits, advances, and remittances.

Table II. Somalia: Monetary Survey, 1979-83

(In millions of Somali shillings and in per cent; end of period)

	1979	1980	1981				1982				1983
	Dec.	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.	Dec.
	Actual	Actual	Actual				Actual			Estimate	Program
						(In millions of Somali shillings)					
Net foreign assets	318.2	144.8	143.7	105.2	441.0 1/	126.4 1/	-292.2 1/	-640.8 1/	-768.7 1/	-410.4 1/	-1,200.8 1/
Domestic credit	2,957.1	3,879.5	4,183.8	4,611.5	4,374.8	4,545.7	4,841.2	5,088.0	5,070.4	5,054.0	5,308.0
Government (net)	1,231.4	1,902.4	2,023.0	2,276.8	2,196.0	2,249.6	2,329.4	2,390.9	2,270.3	2,115.0	1,840.0
Private 2/	1,725.8	1,977.2	2,160.8	2,334.6	2,178.8	2,296.0	2,511.8	2,697.1	2,800.1	2,939.0	3,468.0
Of which: public enterprises	1,276.1	1,551.1	1,632.0	1,625.8	1,663.4	1,721.4	1,896.5	1,727.7	1,921.6		
Broad money	2,812.9	3,381.1	3,726.1	4,020.5	4,400.6	4,421.2	4,153.7	4,480.6	5,047.6	4,888.0	4,601.6
Other items (net)	462.3	643.2	601.3	696.2	415.2	250.9	395.3	-33.4	-745.9	-244.4	-494.4
Revaluation of net foreign assets 3/	--	--	--	--	1.9	1.9	1.9	1.9	-173.7	-173.7	-173.7
Dual exchange rate effect 4/	--	--	--	--	155.2	95.3	70.3	-20.7	-20.7	-20.7	-20.7
Other items (net)	462.3	643.2	601.3	696.2	258.1	153.7	323.1	-14.6	-551.5	-50.0	-300.0
						(Percentage changes from end of previous year)					
Domestic credit	72.4	31.2	7.8	18.9	12.8	17.2	6.5	11.9	11.5	11.2	5.0
Government (net)	295.8	54.5	6.3	19.7	15.4	18.3	3.5	6.3	0.9	-6.0	-13.0
Private 2/	22.9	14.6	9.3	18.1	10.2	16.1	9.4	17.5	22.0	28.0	18.0
Broad money	37.4	20.2	10.2	18.9	30.2	30.8	-6.1	1.3	14.2	10.6	-5.9
Other items (net)	-23.9	39.1	-6.5	8.2	-35.4	-61.0	57.6	-113.3	-397.3	-197.4	-102.3

Sources: IMF, International Financial Statistics; data provided by the Central Bank; and staff estimates.

1/ Includes valuation adjustments.

2/ Public enterprises and private sector.

3/ Due to revaluation of net foreign assets on June 30, 1981 and July 1, 1982.

4/ Based on transactions in the appreciated exchange rate market amounting to So. Sh. 187.0 million in receipts and So. Sh. 31.8 million in payments at end-September 1981, So. Sh. 296.4 million in receipts and So. Sh. 201.1 million in payments at end-December 1981, So. Sh. 369.4 million in receipts and So. Sh. 299.1 million in payments at end-March 1982, and So. Sh. 369.4 million in receipts and So. Sh. 390.1 million in payments at end-June 1982.

Table III. Somalia: Balance of Payments (Excluding Grants and Loans in Kind), 1979-83

(In millions of U.S. dollars)

	1979	1980	1981	1982 Prog.	1982 Prel. est.	1983 Prog.	1983 Rev. prog.
Goods and services	-229	-206	-97	-128	-40	-122	-72
Exports, f.o.b.	106	133	121	172	167	200	183
Livestock	75	102	105	127	125	142	135
Bananas	12	8	6	15	12	26	18
Other	19	24	10	30	30	32	30
Imports, c.i.f.	-323	-331	-236	-290	-227	-310	-270
Franco valuta	-34	-55	-60	--	--	--	--
Other	-289	-276	-176	-290	-227	-310	-270
Trade balance	-217	-198	-115	-118	-60	-110	-87
Services (net)	-12	-8	19	-10	20	-12	15
Transfers (net)	79	131	72	65	50	71	75
Private	36	57	64	50	50	56	60
Official	43	74	8	15	--	15	15
Current account	-150	-75	-25	-63	10	-51	3
Capital account	32	26	-4	25	-47	25	-55
Private (net)	4	--	--	--	-45	--	-30
Official (net)	28	26	-4	25	-2	25	-25
Receipts	(31)	(36)	(16)	(40)	(8)	(...)	(30)
Payments	(-3)	(-10)	(-20)	(-15)	(-10)	(...)	(-55)
Errors and omissions	19	22	16	--	--	--	--
Overall balance	-99	-28	-13	-38	-37	-26	-52
Financing	99	28	13	38	37	26	52
Central Bank (net)	85	43	33	38	37	26	52
Assets	79	26	-17	-19	-1	-25	-4
Liabilities	6	17	50	52	38	51	56
Use of Fund credit	(--)	(4)	(30)	(49)	(31)	(40)	(50)
Commercial bank (net)	14	-16	-20	--	--	--	--
Memorandum items:							
Gross official reserves	51	25	42	56	43	81	47
(in weeks of imports)	(8.2)	(3.9)	(9.3)	(10.0)	(10.0)	(13.6)	(9.1)
Gross foreign assets 1/	89	79	116	130	117	155	121
(in weeks of imports)	(14.3)	(12.4)	(25.6)	(23.3)	(26.8)	(26.0)	(23.3)

Sources: Data provided by the Somali authorities; and staff estimates.

1/ Of the banking system.

Table IV. Somalia: Balance of Payments (Including Grants and Loans in Kind), 1979-83

(In millions of U.S. dollars)

	1979	1980	1981	1982 Prog.	1982 Prel. est.	1983 Prog.	1983 Rev. prog.
Goods and services	-300	-336	-313	-248	-323	-199	-305
Exports, f.o.b.	106	133	121	172	167	200	183
Livestock	75	102	105	127	125	142	135
Bananas	12	8	6	15	12	26	18
Other	19	24	10	30	30	32	30
Imports, c.i.f.	-394	-461	-453	-410	-510	-387	-503
Foreign exchange	-289	-276	-176	-290	-227	-310	-270
Franco valuta	-34	-55	-60	--	--	--	--
Grants in kind	-15	-69	-140	-65	-178	-22	-133
Loans in kind	-56	-61	-77	-55	-105	-55	-100
Trade balance	-288	-328	-332	-238	-343	-187	-320
Services (net)	-12	-8	19	-10	20	-12	15
Transfers (net)	94	200	212	130	228	93	208
Private	36	57	64	50	50	56	60
Official	58	143	148	80	178	37	148
Current account	-206	-136	-101	-118	-95	-106	-97
Capital account	88	87	73	80	58	80	45
Private (net)	4	--	--	--	-45	--	-30
Official (net)	84	87	73	80	103	80	75
Receipts	(87)	(97)	(93)	(95)	(113)	(...)	(130)
Payments	(-3)	(-10)	(-20)	(-15)	(-10)	(...)	(-55)
Errors and omissions	19	22	16	--	--	--	--
Overall balance	-99	-28	-13	-38	-37	-26	-52

Sources: Data provided by the Somali authorities; and staff estimates.

Table V. Somalia: Debt Service Payments, 1/ 1979-87

(In millions of U.S. dollars, unless otherwise noted)

	1979	1980	1981	1982	1983	1984	1985	1986	1987
Amortization, excluding Fund	2.9	6.9	18.3	10.0	58.6	60.0	57.0	73.1	97.1
Fund repurchases	--	--	--	--	--	4.0	16.4	28.6	26.2
Total	2.9	6.9	18.3	10.0	58.6	63.9	73.5	101.8	123.3
Interest payments, excluding Fund	1.0	1.9	8.9	6.7	16.3	19.4	23.1	28.4	32.9
Fund charges	--	--	0.4	3.3	4.9	4.8	4.2	2.7	1.4
Total	1.0	1.9	9.3	10.0	21.2	24.2	27.3	31.1	34.3
Total debt service	3.9	8.8	27.6	20.0	79.8	88.1	100.8	132.9	157.6
Exports of goods and services	153	204	203	227	254	285	319	357	400
Debt service ratio	2.5	4.4	13.6	8.9	31.4	30.9	31.6	37.2	39.4

Sources: IBRD; and data provided by the Somali authorities.

1/ On public and publicly guaranteed medium- and long-term loans. In the case of the Fund, projections for the period 1983-87 are based on the assumption that all purchases under the current stand-by arrangement will be made on schedule. In the case of creditors other than the Fund, the projections are based on commitments as of end-March 1982 and on additional disbursements, based on new commitments, of US$50 million in 1983 and 1984, US$100 million in 1985, US$150 million in 1986, and US$200 million in 1987 at an average interest rate of 4 per cent, a grace period of 5 years and a maturity of 15 years. Exports of goods and services during 1983-87 are assumed to rise at an annual rate of 12 per cent.

Table VI. Somalia: Principal Assumptions for Fiscal Projections, 1982 and 1983

Revenue 1/

Taxes on income and profits (6.5 per cent). 1982: Revenue from ordinary tax is assumed to increase by 13 per cent. Since the development levy was abolished in February 1982, only the first half year's collections are taken into account. Collections for other income taxes are forecast as twice first half year's collections. A factor of 5 per cent has been applied to the total for improvements in tax administration. 1983: Receipts are projected to increase by 15 per cent. This reflects a rising level of economic activity and the progressive nature of the tax system.

Property taxes (6.3 per cent). Revenue from these taxes are assumed to increase by 10 per cent in both 1982 and 1983.

Taxes on goods and services (13.9 per cent). Revenue from these taxes is projected to increase by 50 per cent in 1982 and 5 per cent in 1983. The large increase in 1982 reflects the increase in the specific rate on sugar and a substantial increase in domestic production. The increase in 1983 is on the basis of a further increase in output.

Import taxes (51.4 per cent). 1982: Collections are assumed to decline over 1981 in spite of a strong increase in the second half of 1981. 1983: A 10 per cent increase is assumed. 2/

Export taxes (2.2 per cent). Export taxes in 1982 and 1983 have been calculated on the basis of increased volume in each year and the new rates for livestock (sheep, goats, cattle, and camels) applied to these volume figures.

Stamp tax (8.6 per cent). Revenue from this tax is projected to rise by the extent of the devaluation in the second half of 1982 and by 10 per cent in 1983.

Nontax revenue (11 per cent). Nontax revenue is projected to rise by 41 per cent in 1982 and by 10 per cent in 1983. The increase in 1982 reflects mainly an increase in receipts of public enterprises as a result of the expected increase in output of the sugar and oil refineries. The

---

1/ Based mainly on 1981 and 1982 (January-June) actuals. Percentages in parentheses refer to share in total revenue in 1981.

2/ Also included in the revenue estimate is a sum of So. Sh. 200 million to fully finance the bonus scheme for workers remittances and capital inflows. This is based on an import level of US$270 million, of which one half would constitute nonessential dutiable imports taxable at an average duty rate of 50 per cent.

increase in 1983 represents a further rise in receipts from public enterprises in line with the expansion of the economy. In addition, So. Sh. 200 million arising from the Saudi oil grant has been treated as public enterprise profits.

Other receipts

Transfers from local authorities. 1982: Revenue from this source is assumed at So. Sh. 17 million (position as at end-June 1982). 1983: These are assumed at So. Sh. 10 million.

Grants. These are assumed at So. Sh. 205 million for 1982 and So. Sh. 225 million for 1983 (as in EBS/82/105, p.28).

Oil grant. This is assumed at So. Sh. 600 million for 1982 and 1983, respectively.

Expenditure

Wages. 1982: These are calculated on the basis of 35 per cent of ordinary expenditure and actuals for first half year. 1983: The wage bill is projected to increase by 10 per cent.

Nonwage expenditure. It is assumed that these expenditures are equally divided between imported and domestic purchases. 1982: The cost of imported goods is assumed to increase by 20.7 per cent in the second half and local goods by 10 per cent. 1983: The cost of imported goods is projected to increase by 20 per cent and local goods by 10 per cent.

Other expenditure. These are projected at So. Sh. 1,614 million in 1982 and So. Sh. 1,100 million in 1983.

Financing

Foreign financing. These are assumed at levels consistent with balance of payments data.

Cash balances. These are based on a projected utilization of So. Sh. 5 million in 1982 and nil in 1983.

Table VII. Somalia: Principal Balance of Payments Assumptions, 1/ 1980-83

(Annual percentage changes in U.S. dollar terms, unless otherwise noted)

	1980	1981	1982 Program	1982 Preliminary estimates	1983 Initial program	1983 Revised program
Exports, f.o.b.						
Livestock						
Value (in millions of U.S. dollars)	102	105	127	125	142	135
Volume	9.2	-4.4	2.0	13.3	2.0	2.9
Price	23.5	8.1	18.6	5.0	9.6	5.0
Value	34.9	2.9	21.0	19.0	11.8	8.0
Bananas						
Value (in millions of U.S. dollars)	8	6	15	12	26	18
Volume	-36.6	-7.6	83.4	65.0	66.6	48.1
Price	9.4	-19.8	36.3	21.2	4.0	1.3
Value	-30.2	-25.9	150.0	100.0	73.3	50.0
Imports, c.i.f. 2/						
Non-oil						
Value (in millions of U.S. dollars)	266	182	260	160	280	220
Volume	-17.0	-28.2	21.8	-10.2	2.4	31.0
Price	14.8	-4.8	3.6	-2.1	5.2	5.0
Value	-4.7	-31.6	26.2	-12.1	7.6	37.5
Oil						
Value (in millions of U.S. dollars)	65	54	30	67	30	50
Volume	-14.5	-26.7	-44.4	24.1	--	-25.0
Price	68.9	13.4	--	--	--	--
Value	44.4	-17.0	-44.4	24.1	--	-25.0

Sources: Data provided by the Somali authorities; and staff estimates.

1/ The percentage changes in the case of program projections are as initially stated in the program.

2/ Excluding grants and loans in kind.

SOMALIA - Basic Data

Area and population

Area	637,700 square kilometers
Population: Total (mid-1981 estimate)	4.90 million
Growth rate (1972-81)	6.7 per cent

	1979	1980	1981	1982 Prel.	1983 Proj.
	(Annual percentage changes)				
Selected economic indicators					
Exports, f.o.b.	-3.2	25.5	-9.0	38.0	9.6
Imports, c.i.f.	43.2	17.0	-1.7	12.6	-1.4
Government revenue and grants	22.8	4.8	25.2	55.9	19.4
Government expenditure	37.1	-5.3	10.1	47.3	5.6
Domestic credit	72.4	31.2	17.2	11.2	5.0
Domestic liquidity	37.4	20.2	30.8	10.6	-5.9
Import-weighted effective exchange rate (depreciation -)					
In nominal terms	-4.2	-0.5	-3.5	-26.8	...
In real terms	6.1	36.1	23.4	-20.2	...
	(In millions of Somali shillings)				
Government finance					
Total revenue	1,526	1,421	2,251	2,999	3,557
Transfers from local authorities	--	--	12	17	10
Grants (excluding grants in kind)	271	463	97	663	825
Budgetary expenditure	-1,797	-1,832	-3,081	-3,666	-4,158
Transfers to local authorities	...	-132	--	--	--
Other expenditure	-1,447	-1,108	-301	-1,314	-1,100
Overall deficit (-)	-1,447	-1,188	-1,022	-1,301	-866
Financing	1,447	1,188	1,022	1,301	866
Foreign (net) 1/	527	504	681	1,431	1,141
Domestic	920	684	341	-130	-275
Banking system	(920)	(671)	(347)	(-135)	(-275)
Cash balances	(--)	(13)	(-6)	(5)	(--)
Overall deficit as per cent of expenditure	44.6	38.7	30.2	26.1	16.5

1/ Includes loans in kind.

SOMALIA - Basic Data (concluded)

	1979	1980	1981	1982 Prel.	1983 Proj.
	(In millions of Somali shillings)				
Money and credit (end-year)					
Foreign assets (net)	318	145	126	-410	-1,201
Domestic credit	2,957	3,879	4,546	5,054	5,308
Government (net)	1,231	1,902	2,250	2,115	1,840
Other	1,726	1,977	2,296	2,939	3,468
Money and quasi-money	2,813	3,381	4,421	4,888	4,601
Other items (net)	462	643	251	- 244	-494
	(In millions of U.S. dollars)				
Balance of payments					
Exports, f.o.b.	106	133	121	167	183
Livestock	75	102	105	125	135
Bananas	12	8	6	12	18
Other	19	24	10	30	30
Imports, c.i.f. 1/	-394	-461	-453	-510	-503
Franco valuta	-34	-55	-60	--	--
Other	-360	-406	-393	-510	-503
Trade balance	-288	-328	-332	-343	-320
Services (net)	-12	-8	19	20	15
Transfers (net)	94	200	212	228	208
Private	36	57	64	50	60
Official 2/	58	143	148	178	148
Current account	-206	-136	-101	-95	-97
Capital account	88	87	73	58	45
Private (net)	4	--	--	-45	-30
Official (net) 3/	84	87	73	103	75
Disbursement	(87)	(97)	(93)	(113)	(130)
Amortization	(-3)	(-10)	(-20)	(-10)	(-55)
Errors and omissions	19	22	16	--	--
Overall balance	-99	-28	-13	-37	-52
Outstanding external debt (end-year)	597.0	720.0	902.0	1,040.0	1,171.0
Gross international reserves of Central Bank (end-year)	51.0	25.0	42.0	43.0	47.0
In number of months of non-franco valuta imports, c.i.f.	1.7	0.7	1.3	1.0	1.1
	(1977 = 100)				
Mogadiscio Consumer Price Index (annual averages)	136.2	217.1	313.2	388.7	435.3

1/ Imports, c.i.f. includes loans and grants in kind.
2/ Including grants in kind.
3/ Including loans in kind.

SOMALIA - Relations with the Fund
(As of December 31, 1982)

Date of membership:	August 31, 1962
Quota:	SDR 34.5 million
Fund holdings of currency as per cent of quota:	SDR 96.0 million, or 278.4 per cent of quota
Credit tranches	SDR 30.7 million, or 89.0 per cent of quota
Enlarged access	SDR 30.8 million, or 89.3 per cent of quota
SDR position:	SDR 0.7 million, equivalent to 5.3 per cent of net cumulative allocation of SDR 13.7 million
Trust Fund loans outstanding:	
Total	SDR 10.7 million
First period	Nil
Second period	SDR 10.7 million
Direct distribution of profits from gold sales:	US$3.02 million
Gold distribution:	16,261 fine ounces
Intervention currency and the rate:	U.S. dollar; pegged to the SDR at So. Sh. 16.5=SDR 1 with exchange margins of 2.25 per cent around this fixed relationship.

Staff visits and other contacts:

Technical assistance	
Exchange rate study mission	January 1980
Fiscal Affairs--revenue study mission	March 1980
Bureau of Statistics--compilation of government finance statistics mission	September 1980
Bureau of Statistics--compilation of monetary statistics mission	February 1982
African and Exchange and Trade Relations--implementation of new exchange rate system mission	June 1982

SOMALIA - Relations with the Fund (concluded)

Stand-by arrangements

On February 27, 1980 the Board approved Somalia's request for a one-year stand-by arrangement (EBS/80/24) for SDR 11.5 million. Under this arrangement Somalia made drawings amounting to SDR 6.0 million. On July 15, 1981 a one-year stand-by arrangement (EBS/81/146) for SDR 43.13 million was approved by the Board. On March 26, 1982 the Board approved the review and program for January-June 1982 of the stand-by arrangement (EBS/82/42). Somalia's current 18-month, SDR 60.0 million stand-by arrangement (EBS/82/105) was approved by the Board on July 12, 1982.

Last Article IV consultation

May 1981; Board discussion of staff report (EBS/81/147 and SM/81/155) took place on July 15, 1981.

Other technical assistance

Since August 1982, under the CBD technical assistance program, an advisor has been serving at the Central Bank as advisor on overall economic policies and on monitoring Somalia's economic program.

Board Decision

The Executive Board's decision (Decision No. 6914-(81/105)) on the last Article IV consultation, adopted July 15, 1981, was as follows:

1. The Fund takes this decision relating to Somalia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1981 Article XIV consultation with Somalia, in the light of the 1981 Article IV consultation with Somalia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the termination of a bilateral payments agreement with a Fund member, and the elimination of broken cross rates.

3. On June 30, 1981, Somalia introduced a dual exchange rate system, described in SM/81/147, which gives rise to a multiple currency practice. In view of the comprehensive policies for balance of payments adjustment adopted by Somalia, which are to be supported by a stand-by arrangement from the Fund (EBS/81/146), and, in particular, the intention of the authorities to eliminate that practice in consultation with the Fund, the Fund grants approval for the retention of the multiple currency practice until June 30, 1982.

Financial Relations of the World Bank Group with Somalia

Date of membership, IBRD: August 31, 1962

Capital subscription, IBRD: SDR 18.9 million

IDA credits 1/	Committed	Disbursed
	(In millions of U.S. dollars)	
Agriculture, livestock, and rural development	58.5	27.3
Education	22.2	16.3
Energy	6.0	2.2
Industry	5.0	4.4
Transportation	50.7	46.1
Utilities	6.0	5.7
Total	148.4	102.0
Repayments	1.0	...
Debt outstanding (including undisbursed)	147.4	...
IFC operations	0.4	0.4

Promotion missions (mainly for banana rehabilitation, gypsum development, fishing project) in November 1980, April 1981, and March 1982; appraisal mission in July 1980 for Somali Molasses Company.

Source: World Bank.

1/ Through September 30, 1982.

CONFIDENTIAL

December 8, 1982

Mr. J. de Larosière
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosière:

1. Since 1981 the Government of Somalia has been implementing a major stabilization program to correct the structural and financial imbalances facing the economy. As you will recall, on July 15, 1981 the Executive Board approved Somalia's request for a one-year stand-by arrangement, equivalent to 125 per cent of Somalia's quota of SDR 34.5 million, in support of a program to stimulate domestic production, reduce inflationary pressures, and achieve a sustainable external position over the medium term. Under the program, the Somali shilling was devalued by 50 per cent in foreign currency terms for all foreign exchange transactions except for imports of specified essential goods, licenses for own-foreign exchange (franco valuta) imports were discontinued, a 25 per cent ad valorem tax on livestock exports was introduced, producer prices were increased, a review of the financial position of public enterprises was initiated, and the development planning process was strengthened. Fiscal and monetary policies were substantially tightened; in this context, the interest rate structure was revised upward. In addition, nonresident accounts were introduced.

2. As a result of the measures taken and favorable weather conditions, the performance of the Somali economy improved significantly during the program period. Led by the growth in the agricultural sector, economic activity accelerated in 1981. The rate of inflation as measured by the consumer price index fell from 59 per cent in 1980 to about 44 per cent in 1981, with the price level recording a decline during the second half of 1981. The tightening of fiscal policy resulted in a narrowing of the overall government deficit, excluding loans in kind, to about 12 per cent of total expenditure compared with a program projection of 19 per cent and 30 per cent in 1980. Expenditures were curtailed considerably below projections in line with the Government's policy to limit expenditures in light of the evolution of revenues during the year. With the improved budgetary position, net credit to the Government from the banking system increased by only 18 per cent in 1981 compared with 55 per cent in 1980. During the second half of 1981, credit to the Government was actually curtailed by 1 per cent. Consequently, domestic credit expansion was reduced to 17 per cent in 1981 from 31 per cent in 1980, even though credit to the private sector was allowed to grow at a faster pace than in the preceding year. However, because of a more favorable balance of payments outcome than projected, domestic liquidity grew by 31 per cent. With a lower-than-expected level of imports, the overall balance of payments

deficit was reduced to US$13 million compared to US$28 million in 1980 and a program projection of US$100 million. At the same time external payments arrears which amounted to US$44.6 million at end-1980, were reduced to US$15.5 million at end-1981.

3. During the first half of 1982 the agricultural sector continued to benefit from favorable weather conditions. Inflation declined to an annual rate of about 30 per cent. Tight fiscal and monetary policies were continued, with net credit to the Government expanding by only 6 per cent, while net domestic credit to the private sector (including public enterprises) was allowed to expand by 18 per cent in order to promote economic growth. Net domestic credit grew by 12 per cent in line with the program target. The slowdown in domestic credit growth, together with a larger decline in net foreign assets than projected, led to an increase in domestic liquidity of only 1 per cent during the first half of 1982. The balance of payments deficit reached US$61 million, almost double the amount projected. The cumulative effect of domestic inflation, with its adverse impact on the profitability of livestock exports, resulted in a lower-than-projected level of livestock exports, and workers abroad did not repatriate their earnings via official channels as projected after the elimination of the system for own-foreign exchange imports. Somalia, however, did eliminate all external debt arrears by the end of June 1982 and did not contract any new nonconcessional external debt with a maturity of between 1 to 12 years. The official reserves of the Central Bank at the end of June 1982 were equivalent to only one week of programmed 1982 imports.

Developments Under the Program

4. In order to consolidate and build upon the progress made during 1981/82, the Government of Somalia decided in mid-1982 to continue with its stabilization policy to promote economic growth and establish over the medium term domestic and external financial stability. In support of this program, on July 12, 1982 the Executive Board approved an 18-month stand-by arrangement equivalent to SDR 60.0 million (173.9 per cent of Somalia's quota). Almost simultaneously with the adoption of the new program, there was a recurrence of the border conflict. Even though the border conflict has had adverse consequences on the economy, we have adapted our policies to ensure that the program remained on track in 1982, as evidenced by the observance of the quantitative performance criteria for end-September. There was a further increase in production, a decline in inflationary pressures, and the balance of payments outcome for 1982 is expected to be on target. During the remainder of the program period, notwithstanding the impact of the border conflict, we shall continue to follow policies in the context of our current stand-by arrangement that are consistent with the objectives of our financial and economic program.

5. In accordance with our letter of intent of April 15, 1982, on July 1, 1982 we unified the dual exchange rate system, devalued the Somali shilling further by 17 per cent on the export side and 34 per cent on the

import side in foreign currency terms, changed the peg of the Somali shilling from the U.S. dollar to the SDR, and increased the interest rate structure of the Central Bank and the commercial bank by two percentage points. The program provided also for an easing of import restrictions, implementation of a liberal pricing policy, an increase in producer prices, a review of the position of public enterprises, and a tightening of fiscal and monetary policies. All the measures that were to be taken at the beginning of the program were implemented except for the increase in producer prices for maize, sorghum, sesame, and cotton. The Government decided instead to waive a requirement that farmers sell these products to the Agricultural Development Corporation (ADC), so that the latter would effectively operate as a price stabilization board, and to conduct a thorough review of the minimum guaranteed producer prices. Indeed, a key element of the Government's program is the liberalization of marketing and pricing policies by allowing agricultural producers to market their produce freely at the wholesale and retail levels at market-determined prices, so as to further reduce the role of the Agricultural Development Corporation and increase the market orientation of the economy. Producer prices in the banana sector were further increased by 10 to 25 per cent in July 1982. All the quantitative performance criteria for the first quarter of the program ending September 1982 were met, and the Government expects to meet the quantitative performance criteria for the second quarter ending December 1982.

6. During the first six months of the program period, despite the border conflict, the performance of the Somali economy continued to improve. This was due to both the relatively favorable weather conditions and the measures which the Government implemented. Reflecting these factors, and in particular the exchange rate changes introduced on July 1, 1982, total export receipts are now expected to increase during the whole of 1982 by 38 per cent, close to the program projection. Import payments are expected to decline by 4 per cent in 1982, compared with a projected increase of 12 per cent, due to a decline in demand for food imports because of an increase in domestic agricultural production, an increase in loans and grants in kind, and an overstocking of goods brought in before the own-foreign exchange import system was discontinued. Consequently, the estimated trade balance deficit in 1982 is US$60 million, compared with a program projection of US$118 million. Taking into account the service account and the inflow of remittances through nonofficial channels, a current account surplus of US$10 million is expected to be recorded, compared to a program projection of a deficit of US$63 million. The border conflict and the associated uncertainty has in part caused some capital outflow, which has taken the form of the nonrepatriation of remittances through official channels. Although, as a result, the capital account has incurred a considerably larger deficit than projected, the better-than-projected current account outcome is now expected to result in an overall balance of payments deficit of US$37 million in 1982, in conformance with the original program target.

7. During 1982, the Somali Government has serviced external debt on schedule. As of end-June 1982, all external payments arrears had been eliminated. During the third quarter, other than service payments that were effected on schedule, US$30.2 million had been originally scheduled for payment by end-September 1982. The amount of US$21.4 million due to the Islamic Development Bank was rescheduled before end-September through a signed agreement. The amount of US$0.7 million due to the African Development Bank and Fund was requested to be rescheduled before end-September 1982, and the Boards of Directors approved the rescheduling in November 1982. The amount of US$0.8 million due to Yugoslavia was also rescheduled before end-September. The balance, representing the scheduled amounts due to Iraq, Saudi Arabia, and U.A.E., was rescheduled on the basis of verbal agreements prior to end-September, in accordance with prevailing practices in the region. Accordingly, we firmly maintain that there were no arrears at end-September 1982. However, if in the view of the Fund these arrangements are considered to give rise to arrears, we request a waiver until end-December 1983, pending the securing of the appropriate documentation.

8. During the second half of 1982 the Somali Government did not contract any new nonconcessional external debt with a maturity of between 1 and 12 years.

9. Despite the border conflict, government budgetary operations, excluding loans in kind, recorded a surplus amounting to 4 per cent of total expenditure. This is in sharp contrast to a projected budget deficit equivalent to 5 per cent of total expenditure. Total receipts rose by 56 per cent in 1982 due to the Saudi Arabian oil grant, the impact of devaluation and improved administrative procedures on import duties, the tax on livestock exports, the improved performance of public enterprises, and taxes on goods and services. Expenditures, on the other hand, rose at a much slower rate (47 per cent) in 1982. No cost-of-living adjustment was granted to civil servants in 1982, although a development levy on their salaries was abolished. Additionally, an attempt was made to eliminate unnecessary expenditures through an intensification of expenditure control procedures. The economies thus effected enabled us to offset the increase in defense expenditures resulting from the border conflict. The budgetary surplus, together with external (cash) borrowing, also enabled the Government to achieve a net contraction of its indebtedness to the banking system in 1982 by 6 per cent, in keeping with program targets.

10. Project implementation proceeded at a better pace than originally envisaged. Accordingly, loans in kind increased significantly in 1982. Taking these loans into account, the budget deficit reached 26 per cent of total expenditure. However, in view of the nature of the financing associated with the investment projects, the reduction in government outstanding borrowing from the banking system remained as programmed.

11. As bank credit to the Government is estimated to decline by 6 per cent in 1982, the banking system has been able to expand domestic credit to the private sector (which includes public enterprises) by 28 per cent in

line with the objective of promoting economic activity. Domestic credit expanded by 11 per cent in 1982 compared with 17 per cent in 1981. Since, however, in 1982 net domestic assets are expected to expand more than projected, due in part to an original underestimate of the amount of the valuation adjustments stemming from the devaluation in July 1982, domestic liquidity is expected to expand by 11 per cent rather than the projected 7 per cent. This development, however, remains in line with the objective of curtailing excess demand pressures by reducing excess real cash balances. The restrained financial policies pursued and favorable supply conditions caused the rate of inflation in 1982 to decline to about 24 per cent from 44 per cent in 1981.

12. To improve resource allocation, mobilize domestic savings, and encourage the inflow of savings of Somali workers abroad, the interest rates on all loans and deposits of the Central Bank and the commercial bank were raised by two percentage points on July 1, 1982. Consequently, the Central Bank discount rate and the Treasury bill rate is 8 per cent, interest on savings and time deposits ranges between 8 and 11 per cent, and the commercial bank's lending rates are between 12 and 14.5 per cent. The Development Bank's lending rates, which were almost doubled in 1981, range between 10 per cent and 14 per cent. In February 1982, in order to induce a greater inflow of foreign exchange into nonresident accounts denominated in U.S. dollars (external accounts), we allowed livestock exporters to open such accounts with funds resulting from the difference in their letter of credit values and the actual value they received from their exports. Foreign exchange in these accounts was allowed to be used to import goods once import licenses were obtained from the Ministry of Commerce. During the second half of 1982 nonresident accounts denominated in U.S. dollars began to grow, and livestock exporters began to use these accounts to import goods. At the end of September 1982, nonresident deposits denominated in U.S. dollars amounted to about US$2.7 million. This amount, however, excluded the amounts that were used by livestock exporters to obtain letters of credit to import. Through end-November 1982, letters of credit issued against external accounts in the Mogadiscio branch of the commercial bank amounted to US$2.5 million.

Prospects and Policies for 1983

13. During 1983 we intend to continue to pursue with determination our adjustment policies in order to consolidate and build upon the progress achieved since 1981. Despite the intensification of our border conflict, we are determined through an additional effort to realize the overall targets of the program as envisaged at its inception. In the area of fiscal policy, we intend to offset the impact of higher defense expenditures with an increased revenue effort and expenditure savings in other areas. Regarding monetary policy, we will continue to implement a tight credit policy aiming at a reduction of the excess real domestic liquidity. Reflecting the demand restraint implied by these financial policies, as well as a continued improvement in production, we expect that in 1982 the

rate of inflation will decline to 12 per cent and that the external current account will remain in near balance compared with an initial program projection of a deficit of US$51 million. Because of the additional measures we are taking, in particular the bonus scheme described below, we expect to have an increase of inward remittances and capital inflows of about US$30 million in 1983 reflected in the form of a reduced net capital outflow. However, the projection for net external loan disbursements has been revised from US$25 million to a net external debt repayment of US$25 million. Notwithstanding this revision, the measures we are taking are expected to contain the projected balance of payment deficit to US$52 million. This deficit is expected to be financed by the scheduled purchases from the International Monetary Fund and the Arab Monetary Fund.

14. Fiscal policy: During 1983, we intend to pursue a tight fiscal policy that is expected to result in a budgetary surplus (excluding loans in kind) of 17 per cent of expenditures compared to our original program target of a deficit of 3 per cent. 1/ This will be achieved primarily through a strict control on expenditure outlays supported by further action to increase the Government's revenue potential. Accordingly, it is expected that during 1983 2/ net domestic credit to the Government from the banking system will be reduced by So.Sh. 275 million, 13 per cent below the level prevailing at the end of 1982 and substantially lower than the original program projection.

15. Recognizing Somalia's limited resource base, the control of budgetary expenditure must remain the major area of our efforts in 1983. We are, nevertheless, aware that the major part of our budgetary outlays involve expenditures that are not easily amenable to sudden or large adjustments. The largest single item accounting for the increase in budgetary expenditures has been increased outlays for defense purposes and the additional costs that have to be borne by the budget following border conflicts. We will, nevertheless, take measures to contain these expenditures to the barest minimum necessary. In regard to administrative outlays, the largest single item is the wages and salaries of government employees. The wages of civil servants have declined by over 50 per cent in real terms during 1980-82. The erosion in real wages had prompted us to indicate in our letter to you of April 15, 1982 that these wages may be increased by an average of 15 per cent starting January 1, 1983. While this is a necessary step to maintain the quality of the civil service, we nevertheless feel that the budgetary situation does not permit a salary adjustment of this magnitude. Accordingly, we shall consider granting a salary increase of a maximum of 10 per cent depending on the evolution of the budgetary situation. At the same time, we are limiting severely new employment and encouraging high school graduates to seek other avenues of employment. It is also our intention to emphasize the productive character

1/ Including loans in kind, the deficit would amount to 16.5 per cent of expenditures compared with a program target of 16.8 per cent.

2/ The fiscal year coincides with the calendar year.

of new investment projects in 1983. The emphasis, therefore, would be on new investment and the speedy completion of existing projects in agriculture, livestock, and infrastructure. Reflecting these developments and policy measures, we expect expenditures to rise to some So.Sh. 5,300 million or by 6 per cent in 1983.

16. In regard to revenue, the Government intends to improve tax assessments and strengthen collection procedures. In this regard, we are requesting technical assistance from the Fund for improving assessment and collection procedures in income taxes--an area where considerable revenue potential exists. At the same time, a vigorous attempt will be made to progressively move tax payments on to a current basis. We also expect revenues to increase from larger contributions by public enterprises and an expansion in economic activity. Furthermore, in accordance with the recommendations of the 1980 IMF Tax Report on Somalia, we are introducing effective January 1, 1983 a general sales tax to cover all domestic transactions except certain basic or essential products. Concurrently, specific excises such as those levied on soft drinks and spirits will be converted to an ad valorem basis. In addition, in concurrence with the recommendation of the tax report, we are restructuring the tax system of public enterprises by abolishing the current levies imposed on such enterprises and applying the same basis and rates of taxation for private enterprises. As described below, the Government will also introduce on January 1, 1983 a bonus scheme to attract remittances and capital inflows effected by Somali nationals through the banking system. To fully offset the potential cost of this scheme, the Ministry of Finance will levy the ad valorem import duties on nonessential dutiable items on the basis of a price 20 per cent above that stated in the letter of credit. Reflecting these policies and measures, we anticipate that revenue and grants in 1983 will increase by 19 per cent to So.Sh. 4,400 million.

17. Monetary policy: In 1983 monetary policy will continue to aim at curtailing excess demand pressures by reducing the excess real domestic liquidity while providing adequately for the credit needs of the economy. With the expected improved budgetary position, the rate of growth of domestic credit in 1983 is to be reduced to about 5 per cent, less than the 7.2 per cent originally projected. Net domestic credit to the Government will be curtailed by 13 per cent rather than the 11 per cent initially projected, while credit to the nongovernment sector will be allowed to expand by 18 per cent, compared with the original program projection of 20 per cent. This rate of credit expansion, together with the projected change in net foreign assets, will lead to a decline in domestic liquidity of 6 per cent in 1983 instead of the original projection of a growth of 2 per cent. The tighter monetary stance being adopted is expected to contribute to limiting the extent of the capital outflow.

18. For the purpose of monitoring the program, net domestic credit, which is expected to amount to So.Sh. 5,054 million at end-December 1982, will not exceed So.Sh. 5,118 million at end-March 1983 and So.Sh. 5,168 million at end-June 1983. Net domestic credit will include net credit to the Government and credit to public and private enterprises. Within the global ceiling, net bank credit to the Government (defined as the banking system's

claims on Government, less government deposits, plus any budgetary use of local currency counterpart in respect to purchases from the Fund), which is expected to amount to So.Sh. 2,115 million at end-December 1982, will not exceed So.Sh. 2,065 million at end-March 1983 and So.Sh. 1,990 million at end-June 1983.

19. In order to induce a greater inflow of savings into nonresident accounts denominated in U.S. dollars from abroad, we plan to establish effective January 1, 1983 an interest rate structure for ordinary savings and time deposits for nonresident accounts which will be competitive with similar deposits in the international market. Interest rates on nonresident accounts will be 9.0 per cent for deposits, 9.5 per cent for 3-month time deposits, 10.0 per cent for 6-month time deposits, 10.5 per cent for 12-month time deposits, and 11.0 per cent for 24-month or longer deposits. This interest rate structure will be kept under review and adjusted as warranted in line with movements in interest rates for similar accounts in international financial centers. Regarding domestic interest rates, the Government does not consider that at this time there is a need for a revision in the present structure, which was revised upward in mid-1982. Since then, the rate of inflation has declined and is projected to fall to 12 per cent in 1983. We consider the present domestic interest rate structure to be consonant with the economic conditions and our policy objectives.

20. Pricing policies: During the program period, the Government of Somalia will continue to follow liberal pricing and marketing policies aimed at encouraging domestic production. While, in the past, farmers were required to sell the main cereal products, such as maize and sorghum, intended for domestic consumption to the Agricultural Development Corporation (ADC) at the wholesale level, this requirement has been waived. Instead, the ADC now effectively operates as a price stabilization board, purchasing from farmers at minimum guaranteed prices and selling when the market price peaks; the selling price is set to cover its operating costs. Since the ADC's role at its inception was that of a stabilization board, the movement away from that of an informal monopsonist brings it within the purview of its legal framework. The Government intends to review the producer prices guaranteed by the ADC at the beginning of each growing season to ensure the farmers an adequate return and to facilitate the stabilization role envisaged for the ADC. It is not expected at this juncture that current producer prices will be raised for the 1983 growing season. The producer price for bananas depends on the export price realized for that commodity and the exchange rate; the two recent exchange rate adjustments, which were passed on to producers, have succeeded in restoring adequate producer incentives in the banana sector. Further, in pursuit of our energy conservation policies, we will continue to set petroleum product prices at levels that fully reflect international prices. In addition, electricity tariffs have been tripled in October 1982 to bring these tariffs in line with the cost of electricity generation.

21. Development planning: The Five-Year Development Plan (1982-86) places considerable emphasis on the development of the agricultural sector and of infrastructure. For the first time, the plan has been elaborated within

the context of a macroeconomic framework in order to assess the impact of the implementation of the plan on domestic and external financial stability. The investment envisaged in the plan has been reviewed and updated in the process of the preparation for the Consultative Group Meeting scheduled for March 1983. The size of the investment program of the plan in nominal terms is presently estimated to be US$2,291 million. Funding from domestic sources is estimated to be US$390 million (17 per cent). Foreign financing that has already been committed or assured is around US$1,335 million (58 per cent), leaving a gap of about US$565 million (25 per cent) for which we are seeking financing.

22. We are collaborating closely with the World Bank in preparation for the Consultative Group Meeting. In this context, the World Bank has recommended that a three-year investment program be prepared. We intend to do so within the context of the framework set out in the Five-Year Development Plan. In implementing the plan, we will contain the level of investment in line with the foreign financing available by being flexible with respect to the new projects that will be initiated and the pace of implementation of ongoing projects. Furthermore, yearly investment plans will be elaborated in the context of the annual government budget exercise to adapt to changing circumstances and ensure the consistency of the investment plans with the objective of re-establishing domestic and external financial stability.

23. Public enterprises: The Government continues to remain committed to improve the productivity and profitability of public enterprises and to keep in operation only economically viable enterprises. We have already closed down three public enterprises that were deemed not to be viable. Currently, we are studying the impact of recent changes in the exchange rate and pricing policies on the operations of public enterprises. We have also recently set up an intragovernmental commission composed of representatives from the Central Bank, the Ministry of Finance, the Ministry of Commerce, and other ministries responsible for various public enterprises in order to evaluate the financial position of public enterprises and to prepare a report indicating which public enterprises should be phased out of operation. While the decision on the viability of public enterprises will be based on the economic efficiency of their operations, the social services that some of these enterprises provide will also be taken into account.

24. External sector policies: The substantial exchange rate adjustments effected since mid-1981 have succeeded in bringing the exchange rate in line with the domestic cost-price structure. However, for reasons relating to the border conflict and associated uncertainties, there has been a capital outflow that has been financed by workers' remittances outside official channels. In order to attract workers' remittances and foreign assets held abroad by Somali nationals into Somalia through the banking system, we intend to introduce, effective January 1, 1983, a bonus scheme whereby a premium of So.Sh. 5 per U.S. dollar will be applied to all inward remittances and capital inflows effected by Somali nationals. This scheme is being introduced on a temporary basis. We, therefore, seek Fund approval for this multiple currency practice until end-December 1983, with the understanding that we intend to review and reach understandings with the Fund during the

next semi-annual review on the need for the continuation of this practice. Furthermore, as an added incentive, we plan to announce that Somali nationals bringing in foreign exchange through this scheme will be given priority in the issuance of import licenses.

25. Underinvoicing of livestock exports has continued to some extent, despite the exchange rate actions taken in 1981 and 1982. In accordance with the understanding reached with the Fund, we are in the process of setting up a monitoring apparatus in cooperation between the Central Bank and the Ministry of Finance to review letters of credit of livestock exporters with a view to making progress toward eliminating underinvoicing. This monitoring will be undertaken in the context of the foreign exchange law that requires the surrender of all foreign exchange export proceeds. In this connection, and in light of the limited information available on the extent of underinvoicing, we are forming a study group including representatives from the Central Bank, the Ministry of Finance, the Ministry of Livestock, and the Ministry of Commerce to prepare a report on the marketing process of livestock and the relation between the actual selling prices and the minimum export prices with a view to determining whether an adjustment in the minimum export prices is warranted. It is expected that the report will be completed by May 1983.

26. Somalia's external debt disbursed and outstanding at the end of 1981 amounted to US$800 million, most of which is on concessional terms. The estimated debt service payments in 1982 were equivalent to 9 per cent of exports of goods and services. Somalia did not enter into any new commitments on public or publicly guaranteed nonconcessional external debt with a maturity of between 1 and 12 years during 1981 or the first half of 1982. Based on present commitments, the debt service ratio is projected to rise to 31 per cent in 1983. Furthermore, we shall limit new commitments on public and publicly guaranteed nonconcessinal external debt with a maturity of 1 to 12 years to no more than US$25 million during the remainder of the program period through December 31, 1983, excluding any refinancing obtained through negotiations. With a view to containing the projected increase in debt servicing, we intend to seek renegotiations of the terms of our outstanding debt.

27. Exchange and trade system: With the exception of the above-described premium, the Government of Somalia does not intend to introduce any multiple currency practices or impose new or intensify existing restrictions on payments and transfers for current international transactions or enter into any bilateral payments arrangements with a Fund member. Furthermore, the Government does not intend to introduce new or intensify existing restrictions on imports for balance of payments reasons.

28. The Government of Somalia will conduct with the Fund a mid-term review to be completed before June 30, 1983. During that review, developments affecting the implementation of the program will be reviewed and understandings reached with the Fund for the remaining period of the program, July 1-December 31, 1983, regarding policies on public enterprises and exchange rate policy, as well as the ceilings on net domestic credit, on net credit to Government, and on external borrowing.

29. The Somali Government believes that the policies set forth in our Letter of Intent of April 15, 1982 and supplemented by this letter are adequate to achieve the objectives of the program and will take any further measures that may become necessary for this purpose. We will continue to consult with the Fund in accordance with Fund policy in this respect.

Sincerely yours,

Mohamud Jama Ahmed
Governor, Central Bank of Somalia

Abdullahi Ahmed Addou
Minister of Finance