EBS/85/1 & Cor.1

CONFIDENTIAL

January 2, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Somalia - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from Somalia for a stand-by arrangement equivalent to SDR 22.1 million. Draft decisions appear on page 32.

This subject, together with Somalia's request for a purchase under the compensatory financing facility (document to be issued shortly) will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Ewart Williams (ext. (5)74380) or Ms. Calika (ext. (5)72936).

Att: (1)

INTERNATIONAL MONETARY FUND

SOMALIA

Request for Stand-By Arrangement

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultaton with the Fiscal, Legal, Research, and Treasurer's Departments)

Approved by A.D. Ouattara and W.A. Beveridge

January 2, 1985

I. Introduction

In the attached letter, dated November 8, 1984, the Somali authorities request a stand-by arrangement for one year in an amount of SDR 22.1 million (50 percent of Somalia's quota of SDR 44.2 million). Of this amount, SDR 11.05 million would be made available from the Fund's ordinary resources and SDR 11.05 million from borrowed resources. A purchase under the compensatory financing facility in the amount of SDR 33 million (74.7 percent of quota) is also being requested. The discussions of the program in support of the requested stand-by arrangement were held in Mogadiscio during October 23-November 7, 1984. The Somali representatives included Major General Mohamed Siad Barre, President of the Somali Democratic Republic, Dr. Mohamed Sheikh Osman, Minister of Finance; Dr. Omar Ahmed Omar, Governor of the Central Bank; and other ministers and senior officials of ministries and agencies concerned with economic and financial matters. The staff team consisted of Messrs. S.M. Nsouli (head-AFR), E. Williams (AFR), A.H. Mansur (FAD), E. Zervoudakis (ETR), P.R. Menon (RES), Ms. N. Calika (AFR), and Ms. L. Allardice (secretary-STAT). A World Bank mission visited Mogadiscio at about the same time; the two missions collaborated closely.

Since 1981 the Executive Board has approved two stand-by arrangements with Somalia; a one-year stand-by arrangement approved on July 15, 1981 for an amount of SDR 43.13 million (125 percent of quota, EBS/81/146) and an 18-month stand-by arrangement which came into effect on July 15, 1982 for an amount of SDR 60 million (173.9 percent of quota, EBS/82/105). Somalia made all the purchases under these arrangements as scheduled. As a result of these purchases Fund's holdings of Somali shillings subject to repurchase at end-1984 will amount to SDR 102.9 million, or 232.8 percent of quota. 1/ Assuming that all repurchases are made as scheduled, purchase of the full amount available under the proposed stand-by arrangement

1/ Somalia did not make any purchases under the oil facility and has no outstanding purchases under the compensatory financing facility.

and under the requested compensatory financing would raise the Fund's holdings of Somali shillings, subject to repurchase, at March 31, 1986, to SDR 136.9 million (309.8 percent of quota), or SDR 103.9 million (235.2 percent of quota), excluding purchases under the compensatory financing facility. Purchases under the stand-by arrangement will be phased in five installments; an initial drawing of SDR 2 million when the arrangement becomes effective; a second drawing of SDR 3 million upon observance of the March 31, 1985 performance criteria and three quarterly purchases of SDR 5.7 million each (Table 1).

The proposed access under the stand-by arrangement would not be sufficient to cover the 1985 financing gap. The World Bank is organizing a gap-fill exercise for Somalia to assist in covering the financing gap.

Summaries of Somalia's relations with the Fund and the World Bank are presented in Appendices II and III. Since mid-1983 and particularly in recent months, Somalia has experienced frequent difficulties in discharging its financial obligations to the Fund on schedule. Delays in payments during this period have ranged from a few days to over four months. Somalia is now current with the Fund.

The last Article IV consultation with Somalia was discussed by the Executive Board on April 30, 1984 (SM/84/71). Somalia continues to avail itself of the transitional arrangements of Article XIV.

II. Background

Against a background of virtual stagnation in economic activity and mounting domestic and external financial imbalances, the Government of Somalia launched in mid-1981 an adjustment effort aimed at promoting economic activity, reducing inflationary pressures, and strengthening the external sector position. These efforts, through end-1983, were supported by two successive stand-by arrangements. Notwithstanding a number of adverse exogenous factors, including the resumption of regional hostilities, unfavorable weather conditions, and a ban imposed in 1983 on Somalia's cattle exports by Saudi Arabia, the Somali authorities implemented effectively the policies envisaged, readapting them and intensifying them in the face of changing circumstances. 1/

The adjustment programs implemented involved major supply and demand-oriented measures. On the supply side, the key measures included two large devaluations and the pegging of the Somali shilling to the SDR basket adjusted by relative rates of inflation between Somalia and the five countries in the SDR basket; 2/ some relaxation of import controls, increases in agricultural producer prices and a liberalization of pricing and marketing policies. In an attempt to improve the efficiency of the public enterprise sector, three nonprofitable public enterprises were

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1/ Detailed analyses of the policies pursued and developments during the period are given in EBS/83/15, EBS/84/154, and SM/84/71.

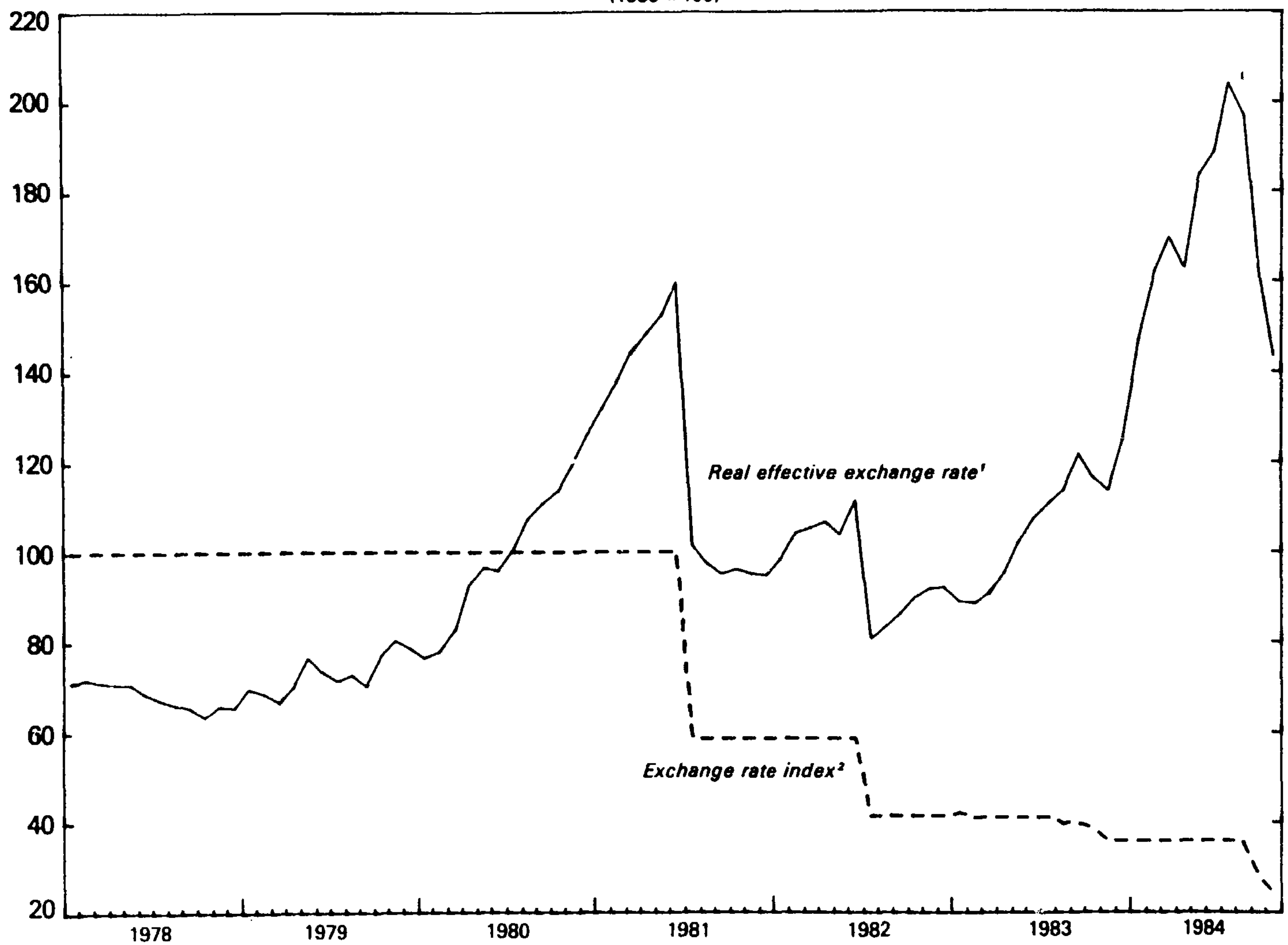
2/ Somalia's real trade-weighted effective exchange rate index is shown in Chart 1.

CHART 1

SOMALIA

INDEX OF REAL EFFECTIVE EXCHANGE RATE, JAN 1978 — OCT 1984

(1980 = 100)



[1] Trade weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices (information notice system), increases mean appreciation

[2] U.S. dollars per Somali shilling.

Table 1. Somalia: Use of Fund Credit, 1985-86

	Outstanding at beginning of arrangement Dec. 31, 1984	1985 Jan.-March	1985 April-June	1985 July-Sept.	1985 Oct.-Dec.	1986 Jan.-March	Total
	(In millions of SDRs)						
Transactions under tranche policies (net)		-1.24	0.07	1.49	1.11	-0.39	1.04
Purchases		2.00	3.00	5.70	5.70	5.70	22.10
Ordinary resources		(1.00)	(1.50)	(2.85)	(2.85)	(2.85)	(11.05)
Borrowed resources		(1.00)	(1.50)	(2.85)	(2.85)	(2.85)	(11.05)
Repurchases		3.24	2.93	4.21	4.59	6.09	21.06
Credit tranche		(2.32)	(2.19)	(2.56)	(3.41)	(3.41)	(13.90)
Enlarged access		(0.92)	(0.74)	(1.65)	(1.18)	(2.68)	(7.16)
Transactions under special facilities (net) 1/		33.00	--	--	--	--	33.00
Purchases		33.00	--	--	--	--	33.00
Repurchases		--	--	--	--	--	--
Total Fund credit outstanding (end of period)	102.91	134.66	134.73	136.22	137.33	136.94	
Under tranche policies	102.91	101.66	101.73	103.22	104.33	103.94	
Under special facilities	--	33.00	33.00	33.00	33.00	33.00	
	(As percent of quota)						
Total Fund credit outstanding (end of period)	232.83	304.66	304.82	308.19	310.70	309.82	
Under tranche policies	232.83	230.00	230.16	233.53	236.04	235.16	
Under special facilities	--	74.66	74.66	74.66	74.66	74.66	

Sources: Treasurer's Department; and staff estimates.

1/ Compensatory financing facility.

closed and in 1982, the Government established an Inter-Ministerial Commission to review all public enterprises with a view to determining which enterprises were viable and making recommendations to improve their operations. Steps were taken to strengthen the development planning process and the Government finished preparation of a medium-term recovery plan which included a public investment program for 1984-86. The three-year program was endorsed by the World Bank and other participants of a Consultative Group Meeting held in Paris in October 1983.

On the demand side, fiscal policies were tightened. A number of new revenue measures were introduced and the elasticity of the tax system was improved through the conversion of some specific taxes to an ad valorem basis. Expenditures were contained through austerity measures including the reduction in real salaries of the civil service, limitations on new government employment and through improvements in expenditure control. The rate of bank credit expansion was reduced significantly as a result of the reduction in government indebtedness to the banking system. Moreover, the structure of interest rates was revised upwards.

The measures taken contributed greatly to the improvement in financial and economic conditions. The external position was generally strengthened but a ban on cattle exports imposed in 1983, 1/ kept the current account deficit of the balance of payments at around 6 percent of GDP (Table 2). 2/ The overall budget deficit (including grants) was reduced from 9.1 percent of GDP in 1980 to 3.2 percent in 1983. Excluding grants, the deficit was reduced from 12.6 percent of GDP in 1980 to 5.8 percent in 1983. The deficit between domestic revenue and ordinary expenditures narrowed from 2.8 percent of GDP in 1980 to less than 1.0 percent of GDP over the three-year period. The improvement in the fiscal performance combined with the growth in net capital inflows allowed the central government to reduce its net indebtedness to the banking system.

The real rate of growth of the economy rose from about 2 percent in 1980 to 5 percent in 1981, and to 11 percent in 1982, before declining to a more sustainable rate of 4 percent in 1983. 3/ During this period, the

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1/ In May 1983, Saudi Arabia imposed a ban on cattle imports from Africa and other countries after the discovery of rinderpest in some imported cattle. During 1983 the Somali authorities took a number of measures to ensure that only healthy animals were exported. They also obtained reports from the United Nations Food and Agricultural Organizations (FAO) and the International Organization of Epizootics (IOE) that certified that there had been no proven cases of rinderpest in Somalia. For details, see SM/84/71 and SM/84/72. A temporary ban was also imposed by Saudi Arabia on Somali sheep and goat exports late in 1983. This ban, however, was lifted in February 1984.

2/ The GDP ratios are calculated on the basis of GDP data converted into U.S. dollars on the basis of an exchange rate which keeps the real effective exchange rate for the Somali shilling at the 1980 level.

3/ Somalia has no official national income accounts. GDP data are based on staff estimates. For details, see SM/84/72.

Table 2. Somalia: Selected Economic and Financial Indicators, 1981-85

	1981	1982	1983 Prov.	1984 Est.	1985 Prog.
	(Growth rate in percent unless otherwise specified)				
National income and prices					
GDP at constant prices	4.9	10.9	4.1	3.0	4.0
Consumer price index	44.6	22.6	36.4	92.0	20.0
Trends in central government finance					
Revenue	58.4	15.0	57.5	-3.7	92.9
Total revenue and grants	41.8	41.4	40.4	22.4	121.7
Total expenditure	18.8	44.2	22.4	75.6	43.3
Trends in monetary aggregates 1/					
Money and quasi-money	30.8	15.7	7.5	56.1	17.4
Net domestic credit	19.7	10.3	4.6	78.5	6.7
Government (net)	10.3	-3.4	-5.8	47.0	0.6
Private	9.4	14.2	10.4	31.4	6.0
Net domestic assets	31.3	30.3	40.9	85.5	65.4
Interest rates					
Commercial bank lending rate					
Cooperatives, exporters, farmers	10.0	12.0	12.0	12.0	15.0
Others	10.0	12.0	12.0	12.0	19.0
Commercial bank maximum deposit rate	9.0	11.0	11.0	11.0	18.0
Development bank maximum lending rate	14.0	14.0	14.0	14.0	17.0
Trends in external sector (in U.S. dollars)					
Exports, f.o.b.	-14.3	20.2	-27.0	-40.0	81.7
Imports, c.i.f.	-8.3	14.7	-7.0	1.6	24.7
Nominal effective exchange rate (depreciation -)	-4.0	-27.3	-11.4	...	...
Real effective exchange rate (depreciation -)	21.3	-20.8	10.4	...	...
	(In percent of GDP)				
Overall budget balance					
Including grants	-5.0	-5.6	-3.2	-6.3	-2.0
Excluding grants	-7.1	-9.3	-5.8	-9.5	-8.9
Current budget balance					
Including grants	2.0	3.3	1.8	-2.0	6.7
Excluding grants	-0.2	-0.5	-1.0	-5.2	-0.2
Balance of payments					
Current account deficit					
Adjusted 2/	-4.5	-5.7	-6.2	-6.0	-5.8
Unadjusted	-4.4	-6.5	-5.9	-3.7	-6.2
Current account deficit, excluding grants					
Adjusted 2/	-11.5	-12.5	-12.5	-14.2	-15.4
Unadjusted	-11.2	-14.4	-11.8	-8.7	-16.4
Overall deficit					
Adjusted 2/	-0.6	-1.9	-3.9	-3.8	-1.9
Unadjusted	-0.6	-2.2	-3.7	-2.3	-2.3
	(In millions of U.S. dollars unless otherwise specified)				
Current account balance	-95.0	-131.0	-147.0	-145.0	-151.0
Current account, excluding grants	-245.0	-288.0	-295.0	-342.0	-400.0
Overall balance of payments	-13.0	-44.0	-93.0	-92.0	-57.0
Gross official reserves	42.0	14.0	16.0	7.0	25.0
(in weeks of cash imports)	(10.7)	(3.7)	(4.4)	(1.9)	(5.9)
External debt, including IMF	886.8	1,056.5	1,260.8	1,361.8	1,446.8
Debt service ratio	14.2	12.2	16.5	42.9	38.7
External debt servicing arrears 3/	15.5	...	...	50.5	--
External commercial arrears	...	...	...	20.0	10.0

Sources: Data provided by the Somali authorities; and staff estimates. GDP data are based on staff estimates derived from 1978 base using estimates of real GDP growth and the consumer price index as a proxy for the GDP deflator.

1/ Change in relation to broad money at the beginning of the year.
2/ GDP converted into US dollars by assuming the real effective exchange rate constant at the 1980 level.
3/ Does not include possible arrears of US$31.0 million in 1981, US$55.6 million in 1982, and US$82.8 million in 1983 in respect of suppliers' credits from Italy.

agricultural and livestock sectors benefited from the effects of the devaluations and the more liberal pricing and marketing policies, as well as from favorable weather conditions through 1982. In 1983 drought conditions affected adversely agricultural production. The rate of inflation was considerably reduced from 59 percent in 1980 to 23 percent in 1982. In 1983, however, a shortage in consumer imports and unfavorable weather conditions contributed to an acceleration in inflation to 36 percent.

III. Economic and Financial Developments in 1984

In 1984 there was a need to consolidate the progress made in 1981-83 and to implement further measures to tackle the underlying structural and institutional problems facing the economy. Thus, in early 1984, provisional agreement was reached between the Fund staff and the authorities on a three-year program to be supported by an extended arrangement. However, after reconsideration, the Government decided that the timing for implementation of the program was not appropriate and that a better policy was to take a more gradual approach in view of social and political considerations.

In the event the economic situation in Somalia deteriorated markedly as a result of expansionary financial policies and exogenous factors. The budgetary deficit rose sharply, due, in the main, to a marked rise in expenditures. The increased deficit was financed by recourse to the banking system. Further, credit to the nongovernment sector (including public enterprises) expanded rapidly. The effects of these policies were compounded by the continuation of the ban on Somalia's cattle exports to Saudi Arabia and the late arrival of rains. Reflecting these factors, economic growth decelerated to about 3 percent, inflation reached a record 92 percent, and the external position became increasingly difficult.

1. External sector policies and developments

During 1984 the authorities took three key measures aimed at improving the external sector position. First, in January the minimum export prices for livestock were lowered by an average of 20 percent. Since these prices were generally below the actual selling prices, this action was equivalent to a reduction in the foreign exchange surrender requirement. Accordingly, livestock exporters benefited from an increase in the proportion of foreign exchange receipts they could convert at the more depreciated parallel market rate. Second, the Government reintroduced the franco valuta system which was officially discontinued in 1981, to allow individuals with their own foreign exchange to import essential goods directly. Third, on September 15, 1984, the authorities devalued the official exchange rate by 32.5 percent in foreign currency terms, from So. Sh. 17.556 to So. Sh. 26 per U.S. dollar. However, this adjustment was not adequate to bring the exchange rate for the Somali shilling within the margins of the exchange arrangement introduced in

July 1983. 1/ Notwithstanding these measures, external sector conditions deteriorated in 1984, as reflected in a sharp reduction in exports, the virtual depletion of the banking system's foreign reserves, and the accumulation of external payments arrears.

Export receipts fell by 40 percent in 1984, mainly reflecting continuing marketing problems in Somalia's traditional export market for livestock (Appendix I, Table I). Somalia's cattle exports in 1984, normally accounting for one third of livestock export receipts, were only 5 percent of their peak level of 1982. Exports of goats and sheep, which account for the bulk of livestock export receipts, were also 20 percent lower than in 1983, partly on account of a temporary ban on these imports by Saudi Arabia and partly because of the delayed arrival of rains which induced livestock producers to keep the animals longer for fattening purposes. The growing over-valuation of the Somali shilling also had an impact on recorded export receipts. Since the surrendered portion of livestock export receipts (corresponding to the Government set minimum export prices) had to be exchanged at the official exchange rate, smuggling of livestock exports through neighboring countries may have taken place, despite the lowering of the minimum export prices. The currency overvaluation may also have contributed to the nonrepatriation of a share of the export proceeds from other commodities, including bananas.

Total imports increased by only 2 percent. Imports financed by the banking system's foreign exchange declined by about 22 percent, due to a severe shortage of foreign exchange on the official market. Imports through external accounts were halved, primarily as a result of the reopening of the franco valuta system. Franco valuta imports are estimated to have amounted to US$40 million. These three categories of imports were 5 percent lower than the level of imports financed through the banking system's foreign exchange and external accounts in 1983. The increase in overall imports resulted from an 8 percent increase in imports financed by loans and grants-in-kind, which were associated with commodity aid and the public investment program.

Although the deficit on the trade balance rose sharply in 1984, this was offset by a significant rise in both private and official transfers. Private transfers rose considerably due to the opening of the franco valuta system, as the counterpart of such imports represents transfers. Furthermore, Somalia's grants-in-kind increased and a cash grant of US$40 million, representing part of a grant of US$60 million from Saudi Arabia, was received during 1984 (Appendix I, Table II). Accordingly, the current account deficit, in U.S. dollar terms, remained unchanged at the 1983 level. Even though private capital outflows are estimated to have declined due to the rechanneling of some foreign exchange through franco valuta imports, the net capital account surplus declined due to an

1/ In July 1983, the Somali shilling was pegged to the SDR adjusted for inflation in Somalia and the five countries included in the SDR basket with 7.5 percent margins. However, the authorities ceased to implement this exchange arrangement following a depreciation by 13.1 percent in terms of the U.S. dollar during the latter half of 1983.

increase in scheduled amortization, thereby keeping the overall balance of payments deficit in 1984 to the 1983 level. The deficit in 1984, however, could not be financed by the banking system's net foreign assets, with the result that external payments arrears accumulated.

Although the bulk of Somalia's external debt, 1/ which is estimated at about US$1.4 billion at end-1984, is on concessional terms, a concentration of maturities has resulted in a sharp increase in debt service obligations. After allowing for a rescheduling of the debt obligations to Abu Dhabi, Saudi Arabia (other than to the Saudi Fund), Italy and China, and excluding foreign debt owed to Bulgaria and the Soviet Union, the scheduled debt service ratio (as a percentage of goods and services) is estimated at 43 percent 2/ in 1984 (Appendix I, Table III). The tight foreign exchange situation during 1984 resulted in the accumulation of external debt service arrears, which reached US$50.5 million at end-1984 (Appendix I, Table IV). The bulk of these arrears are related to debt owed to multilateral institutions, mainly the Islamic Development Bank, the Arab Monetary Fund, and the Arab Fund for Economic and Social Development and to the Saudi Fund.

The staff has recently become aware of the existence of certain arrears to Italian suppliers during 1981-83, when two previous stand-by arrangements for Somalia were in effect, under which the member made purchases totaling SDR 103.1 million. An agreement was reached in July 1982 between the Governments of Somalia and Italy, whereby 95 percent of the payments originally due during 1980-83, estimated at the time at US$63 million, were to be rescheduled on a long-term basis, and Somalia was to make a cash contribution equivalent to 5 percent of the value of the overdue payments to the Italian suppliers. In the event the Somali government did not make the stipulated 5 percent cash payment to the Italian suppliers and the loan agreement for US$63 million did not come into effect because of delays in finalizing the required documentation. An agreement was eventually signed in February 1984 waiving the requirement for the 5 percent cash contribution. In December 1984 an agreement was also reached between the Italian and Somali Governments, whereby payments originally due during 1980-March 1983, amounting to US$63 million, were converted into a long-term loan, while obligations arising from payments falling due from April 1983 until end-1986 were canceled. In the course of the negotiations of the proposed stand-by arrangement, the staff discussed the issue with the authorities who said that during 1982 and 1983 there were ongoing discussions with the Italian authorities with regard to the 5 percent contribution, and that their delay in submitting the documentation required to have the rescheduling agreement come into

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1/ Medium- and long-term public and publicly guaranteed debt. No data exist on military debt or private nonguaranteed debt; the latter is believed to be negligible.

2/ This figure also excludes obligations to Italian suppliers whose rescheduling or cancellation has been recently agreed with the Italian Government, as explained below.

effect, was related to those discussions. The arrears related to the Italian suppliers' credits amounted to US$31.0 million at end-1981, US$55.6 million at end-1982, and US$82.8 million at end-1983.

In view of the existence of these arrears the relevant performance criteria in the two last stand-by arrangements may be construed as not having been observed. As the procedures relating to misreporting and noncomplying purchases, laid down in the Guidelines adopted on November 6, 1984 apply to cases arising subsequent to that date, they do not apply to the case at hand.

Some commercial arrears were accumulated during 1984. Preliminary data provided by the authorities put the level of arrears at around US$20 million. A comprehensive survey to ascertain and verify the amount of these arrears is under way and is expected to be completed by end-March 1985.

2. Production and prices

Economic growth is estimated to have leveled off to about 2-3 percent in 1984, compared with about 4 percent in 1983. Despite the late arrival of rains and some pockets of drought in the north and some parts of the south, 1984 was viewed by the authorities as a very favorable year for the agricultural sector. The liberalization of marketing and pricing policies led to an increase in the area cultivated and to investment in agriculture. The manufacturing sector, however, suffered during the year from inadequate supplies of essential inputs arising from the foreign exchange shortage, and the cattle ban continued to have an adverse affect on trade activity.

With the slowdown in economic activity, the shortages of imported goods, and expansionary financial policies, the rate of inflation is estimated to have reached about 92 percent in 1984, compared with 36 percent in 1983. Between end-1983 and end-July 1984 the Mogadiscio consumer price index increased by 75 percent, with the food component of the index rising by 99 percent. The low agricultural stocks during the first seven months contributed significantly to this development. Subsequently, during August and September 1984, the index registered a decline with the food component registering the largest decrease, reflecting to some extent, the favorable agricultural output and the arrival of large quantities of food aid. Furthermore, the credit policy was less expansionary in the second half of the year. The authorities stressed that they did not view the consumer price index for the Mogadiscio area as being representative for the whole country. Preparations are under way to introduce a more comprehensive consumer price index that would reflect more accurately the inflationary pressures in Somalia.

3. Financial policies

After pursuing tight financial policies during 1981-83, there was a marked shift in stance in 1984. On the fiscal side the overall budgetary deficit (including grants) of the Central Government on a budgetary deficit (including grants) of the Central Government on a commitment basis is estimated to have risen from So. Sh. 1.3 billion (3.2 percent of GDP) in 1983 to So. Sh. 5.0 billion (6.3 percent of GDP) in 1984 (Appendix I, Table V). On a cash basis, the overall deficit is estimated at So. Sh. 4.0 billion due to an accumulation of the domestic counterpart of the external payments arrears amounting to So. Sh. 920 million. The deficit between domestic revenue and ordinary expenditures is estimated to have risen from 1.0 percent of GDP to 5.2 percent of GDP. Reflecting these developments, borrowing from the domestic banking system is estimated to have increased to So. Sh. 2.6 billion in 1984, compared with a reduction in the net indebtedness to the banking system during the previous two years.

Total revenue is estimated to have declined by 3.7 percent in 1984, compared to an increase of 57.5 percent in 1983. This reflects a slight reduction and a change in the composition of nongovernment imports as well as a marked weakening in the tax administration, particularly with respect to import duties and excise taxes. One factor accounting for a major revenue loss was a change in the method of import valuation, from the basis of letters of credit to price lists denominated in Somali shillings. The authorities explained that, with the reopening of the franco valuta system, letters of credit could not be used as a basis for taxation.

By contrast, total expenditure rose by 76 percent as a result of large increases in both ordinary and investment expenditures. Expenditure on salaries and other personnel emoluments and allowances (excluding the Ministry of Defense for which no data are available) is estimated to have increased by only 8 percent in 1984, as no cost-of-living increase was granted in 1984 and the strict limits on new government employment were observed. Nonwage ordinary expenditure, which constituted about 40 percent percent of ordinary expenditure in 1983, increased sharply due to surging inflation and the depreciation of both official and parallel market exchange rates. Interest payments on the outstanding gross borrowing from the Central Bank registered a sizable growth in 1984. Investment outlays rose by 76 percent in 1984, the first year of the three year public investment program (1984-86). This increase was made possible by the availability of large amounts of foreign financial assistance pledged at the Consultative Group meeting in October 1983 and the efforts of donor countries and multilateral lending agencies to improve project implementation in Somalia.

The deterioration in the budgetary position was reflected in credit and monetary developments. Domestic credit is estimated to have increased by 79 percent in relation to the beginning money stock, compared with about 5 percent in 1983. Net credit to the government sector grew by 47 percent of the money stock, compared with a reduction of 6 percent in the previous year, while credit to the nongovernment sector grew by 31 percent, compared with 10 percent in the previous year (Appendix I, Table VI). Taking into account the contractionary impact of net foreign assets, the expansion in net domestic credit led to an acceleration in the growth of domestic liquidity from about 8 percent in 1983 to about 56 percent in 1984.

IV. The Program for 1985

1. Overview

Against this background, the Somali Government has decided to adopt a major economic and financial adjustment program for 1985, which is geared towards the promotion of an economic and financial environment that will stimulate economic activity with a concomitant improvement in resource allocation. The key quantitative objectives of the program for 1985 are to achieve a rate of economic growth of 4 percent, to bring down inflation from 92 percent in 1984 to 20 percent in 1985, and to reduce the overall deficit in the balance of payments by about one third (from US$92 million to US$57 million) as an initial step toward attaining a viable balance of payments position (Table 3). The program involves a major devaluation, a change in the exchange arrangement in order to ensure the determination of the exchange rate for most nongovernment transactions in accordance with market conditions, the liberalization of export and import restrictions, the de jure dismantling of all price controls, an acceleration in the reform of the public enterprise sector, the adjustment of the interest rate structure, and the reform of the banking system. The Government, in 1984, had started to implement a three-year public investment program, which will complement the envisaged gradual resurgence of private sector economic activity. The World Bank has examined the public investment program for 1985 and has considered it to be generally appropriate and consistent with Somalia's overall economic strategy.

The Government intends to pursue restrictive financial policies during the program period. In 1981-84 it introduced tax measures designed to expand the revenue base and improve the elasticity of the tax system and plans to introduce further such measures in 1985. Reforms to strengthen tax collection procedures will also be implemented during the course of the program. Concomitantly, the growth in ordinary expenditures will be severely constrained through a reduction in the size of the civil service, holding cost-of-living adjustments below the inflation rate, and further strengthening expenditure controls. Monetary policy is designed to meet the demands of the nongovernment sector while reducing real monetary balances.

2. External sector policies

The centerpiece of the adjustment program is the establishment of a free foreign exchange market and the virtual elimination of export and import restrictions. These changes are directed toward improving the allocation of resources, promoting export expansion as well as diversifying the structure and direction of exports, preventing shortages of imported goods stemming from insufficient flexibility in the exchange rate, enhancing the profitability of existing and potential import substituting industries, encouraging the inflow of workers' remittances, and reducing the potential capital outflow by increasing the opportunity cost of foreign exchange.

Table 3. Somalia: Summary of 1985 Financial Program

Objectives

1. Stimulate economic activity to achieve 4 percent real rate of growth in 1985.

2. Reduce the rate of inflation from 92 percent in 1984 to 20 percent in 1985.

3. Limit the current account deficit to US$151 million (6.2 percent of GDP) and the overall balance of payments to US$57 million (2.3 percent).

Policy Measures

1. External sector policy

   a. Adopt a freely floating system for the determination of the exchange rate for private sector transactions (excluding the surrender requirement for exports).
   b. Devalue the Somali shilling by 38 percent in domestic currency terms on January 1, 1985 for official transactions and the surrender requirement (35 percent).
   c. Discontinue the franco valuta system.
   d. Establish guideline prices for livestock exports.
   e. Eliminate virtually all trade restrictions.
   f. Unify the official exchange rate with the market exchange rate by end-1985.
   g. Discontinue the bonus scheme.
   h. Formalize verbal agreements on debt relief by mid-1985.
   i. Eliminate external debt service payments arrears by mid-1985.
   j. Secure resources to cover the financing gap for 1985.
   k. No new commitments for public and publicy guaranteed nonconcessional external debt with a maturity of 1-12 years.
   l. Accumulate no new short-term debt other than normal trade-related credits.
   m. Improve external debt management and data base.
   n. Reduce nongovernment commercial arrears by one-half during 1985.

2. Fiscal policy

   a. Reduce the overall deficit on commitment basis from So. Sh. 5 billion (6.3 percent of GDP in 1984) to So. Sh. 2 billion (2.0 percent of GDP in 1985).
   b. Confine expansion in net domestic credit to government to 1.3 percent.

Table 3. Somalia: Summary of 1985 Financial Program (continued)

2. Fiscal policy (continued)

   c. To ensure the projected 93 percent increase in revenue (most of which would derive from the effect of exchange rate changes on import duties):
      - convert all specific excise taxes to ad valorem basis;
      - abolish the 50 percent surcharge on imports through external accounts and apply 20 percent surcharge to nongovernment imports;
      - apply customs duties on basis of prices in letters of credit or up-to-date price list, whichever is higher;
      - apply income tax to public enterprises and abolish turnover tax, share of profit tax, and charges on depreciation of public enterprises; and
      - introduce structural and administrative reforms to improve tax collection.
   d. To limit the increase in total expenditure to 43 percent:
      - confine civil service salary increases to an average of 15 percent;
      - reduce civil service employment by 2 percent;
      - limit allocations for administrative expenses and contingency fund;
      - confine investment expenditures to a level consistent with available concessional financing.

3. Monetary policy

   a. Reduce monetary growth from 56.1 percent in 1984 to 17.4 percent in 1985.
   b. Limit the expansion in domestic credit to 6.7 percent of beginning money stock.
   c. Increase interest rate structure and keep the structure under review to ensure positive real interest rates at end-1985.
   d. Complete study on reforming banking system by mid-1985 and begin implementing recommendations of study.

4. Pricing and marketing policies

   a. Dismantle officially all price controls.

5. Public enterprises

   a. Prepare a breakdown of public enterprises into those which should be phased out of operation, privatized, or retained in public sector.

Table 3. Somalia: Summary of 1985 Financial Program (concluded)

5. Public enterprises (continued)

   b. Set up timetable to reform public enterprises.
   c. Continue instituting Boards of Directors at public enterprises.

6. Public investment program

   a. Overall objective: US$274 million:
      - domestic counterpart = So. Sh. 1,200 million
      - external borrowing = US$142 million
      - external grants = US$102 million.

Sources: Appendix V.

a. Exchange and trade system

On January 1, 1985, the Somali shilling was allowed to float for the bulk of private sector transactions, with the rate to be negotiated freely among buyers and sellers. Simultaneously, the official exchange rate, which will apply during a transitional period, was devalued from So. Sh. 26 per U.S. dollar to So. Sh. 36 per U.S. dollar, representing a depreciation of 28 percent in foreign currency terms. This depreciation reversed the appreciation in the real effective exchange rate since July 1983. During the first six months of the stand-by arrangement, the official rate will continue to be adjusted in accordance with the present system of pegging to the real SDR. Moreover, to reduce the differential between the official and the market rate, there will be an additional devaluation of So. Sh. 0.5 per U.S. dollar by the end of each month through end-June 1985.

The application of the official exchange rate will be restricted to the operations of the Central Bank, official transactions, 1/ and the surrender requirement for private export proceeds. All other transactions will be at the market determined rate. As the differential between the official and market rates will be significantly in excess of 2 percent, the system implies a dual exchange rate arrangement which, however, will be maintained for no longer than one year. The official rate will be unified with the market rate by the end of the program period, on the basis of a timetable to be agreed upon during the program's mid-term review.

As an integral part of this reform, the authorities have liberalized and simplified the exchange and trade system. 2/ Generally, foreign exchange may be bought and sold freely by both residents and nonresidents. The commercial bank will set up foreign exchange offices to facilitate such transactions. Practically all controls with respect to trade and current payments have been removed. Licensing requirements for virtually all import and export transactions have been abolished. The exceptions will involve certain commodities which, for reasons of public policy, will be either prohibited or subject to prior approval. 3/ Furthermore, traders will be permitted to export and import goods previously controlled exclusively by the state.

1/ Official transactions include, on the receipts side, official loans, grants, investment income, and foreign exchange receipts from embassies and international organizations. On the expenditure side, official transactions comprise external public debt service payments, imports by the Central Government, operational costs of the Central Bank, official travel, expenses of embassies abroad, and imports of crude petroleum and petroleum products.

2/ Details are given in Appendix V. This section provides a summary of key changes.

3/ Lists of exports and imports prohibited or subject to prior approval are given in Appendix V.

While export proceeds from commodities and invisibles will continue to be subject to repatriation and declaration, the surrender requirement for private sector exports will be reduced to 35 percent. The official rate will be used in converting the proceeds surrendered. The balance of the proceeds will accrue to the free market. The surrender requirement will be retained in order to ensure that the Central Bank can meet foreign exchange requirements for official transactions. Based on present projections, foreign exchange payments and receipts should be in balance and, consequently, no profits or losses to the Central Bank or to the government sector should, in principle, arise. Any foreign exchange needs by the nongovernment sector is to be secured through the market.

The new system authorizes the opening of export-promoting and import accounts denominated in foreign exchange with the commercial bank by Somali nationals or by foreign nationals, institutions, and companies. These export-promoting accounts may be credited with the nonsurrendered portion of foreign exchange receipts. Import accounts can be credited from export-promoting accounts or from external accounts. Export-promoting and import accounts may be debited for import payments, transfers to other such accounts in Somalia, and, within the existing regulations and limitations, for invisible payments. External accounts in U.S. dollars have also been established. Deposits into these accounts may be made only if they are transferred from outside Somalia. These accounts may be debited for any purpose and may be transferred freely to another external, export-promoting, or import account. In order to avoid a circumvention of restrictions on invisibles or capital flows, however, an export-promoting or import account may not be debited for transfer to an external account. In view of the changes in the exchange sytem, the bonus scheme for workers' remittances and capital inflows effected by Somali nationals will be abolished effective January 1, 1985, thereby ending the multiple currency practice that had been approved by the Fund until end-1984.

b. Balance of payments prospects

Both the current account and the overall balance of payments deficits, as ratios of GDP, 1/ are projected to show a slight decline in 1985. In U.S. dollar terms, the current account deficit will rise marginally, largely as a result of an increase in loan-financed imports associated with the investment program, while the overall balance of payments deficit is projected to narrow from US$92 million to US$57 million. 2/ The reform of the exchange system is expected to have an immediate beneficial impact on export proceeds. In particular, the reduction in the surrender requirement to 35 percent and the adjustment of the official rate to a more realistic level will encourage an increase in exports through an

1/ In calculating these ratios, GDP has been converted into U.S. dollars on the basis on an exchange rate which keeps the real effective exchange rate for the Somali shilling at its 1980 level.

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

improvement in the sector's profitability and a further increase in recorded receipts by reducing incentives for smuggling and underinvoicing. Export projections assume the continuation of the ban by Saudi Arabia on imports of cattle from Somalia. Somalia has already made some progress in market diversification, in particular through a trade agreement with Egypt, 1/ and the improved price competitiveness of Somali livestock is likely to facilitate penetration of other export markets. The projected sharp rise, by about 120 percent, in livestock export receipts reflects an increase in volume of about 80 percent and an increase in prices of about 24 percent. Export letters of credit will be required to show the full export price; to reduce underinvoicing, guideline prices close to the market prices will be set and letters of credit showing lower prices will be rejected. Sheep and goats will account for most of the volume increase while the volume of cattle exports will continue to be at low levels, reflecting the impact of the Saudi ban and the limited penetration of other markets. Banana exports are expected to rise by 27 percent, largely on account of increased domestic output and export volume.

Imports are projected to rise by 25 percent in U.S. dollar terms; about two thirds of that increase will be in the form of increased disbursements under project grants and commodity import programs. Cash imports, including private imports financed through foreign currency accounts and government imports financed by the banking system are projected to rise by 13 percent from the depressed level of 1984; excluding oil, whose importation had been severely curtailed in 1984, such imports are expected to rise by 4 percent.

Total transfers are projected to increase significantly. In view of the rationalization of the exchange system and the liberalization of the trade system, private sector transfers are anticipated to rise and to be channeled through the banking system. Official transfers are projected to rise sharply, in line with the envisaged financing of the public investment program. The net capital account surplus is also projected to increase, primarily as, with the reforms being introduced, net private capital outflows are anticipated to become negligible.

As noted in a previous section, Somalia has accumulated external payments arrears on external public debt amounting to US$50.5 million at end-1984. The authorities plan to eliminate these arrears through cash payment or rescheduling by mid-1985. These arrears exclude debt due to Abu Dhabi, Saudi Arabia (other than to the Saudi Fund), and China which have been indefinitely rescheduled based on verbal agreements. The authorities are attempting to formalize these verbal agreements by mid-1985. The preliminary estimate of external commercial arrears is US$20 million and the authorities have undertaken to reduce these arrears

1/ A trade agreement with Egypt was signed which provides for the export of 20,000 cattle during the period December 1984 to June 1985; the authorities expect that the agreement will be renewed and, possibly, provide for a larger volume of exports.

by one-half in 1985. A comprehensive survey of these arrears is to be completed by end-March 1985. During the mid-term review the results of this survey will be examined and the provision for the reduction in commercial arrears will be finalized on the basis of the above principle, i.e., reduction by one-half in 1985.

With this allowance made for the reduction in commercial arrears, the projected overall balance of payments deficit includes a financing gap of US$133 million. The authorities are seeking to reschedule a portion of debt service arrears outstanding at end-1984 and of scheduled debt service payments for 1985, amounting to US$33 million 1/. This would leave a residual financing gap of US$100 million. The World Bank has agreed to organize a gap-fill exercise to assist the authorities in filling this gap. As noted earlier, it is proposed that the stand-by arrangement will not enter into effect until assurances are secured that the financing gap will be covered.

2. Fiscal policy 2/

The aim of fiscal policy during the program period is to contain the growth in aggregate demand while directing resources to implement the public investment program and rehabilitate public sector infrastructure. The program envisages a reduction in the overall deficit to 2.0 percent of GDP in 1985, compared with 6.3 percent of GDP in 1984. 3/ In view of the large public investment program and the valuation effect resulting from the exchange rate action, external grants are projected to constitute about 46 percent of total receipts. The overall budgetary deficit excluding grants, is expected to be 8.9 percent of GDP in 1985 compared with 9.5 percent of GDP in 1984. 3/ At constant exchange rates, the programmed reduction in the overall deficit is from 11.9 percent in 1984 to 8.9 percent in 1985. The balance between domestic revenue and ordinary expenditure is programmed to move from a deficit of 5.2 percent of GDP in 1984 into virtual balance in 1985. Foreign financing (net) associated with the public investment program will be largely sufficient to finance this overall deficit and to enable the government to eliminate its domestic currency arrears associated with the external payments arrears accumulated in 1984. Government recourse to the banking system will be limited to So. Sh. 55 million. In the fiscal program as presented in Appendix I, Table V, external grants and loans available for budgetary support are based on existing commitments and do not take into account the gap-fill exercise (including any reschedulings other than US$10 million in interest payments). Should any resources from the gap-fill exercise be in the form of grants, loans, or government debt reschedulings, the net

1/ Comprising interest payments of US$11 million and amortization of US$22 million.

2/ The main assumptions on which the fiscal projections are based are given in Appendix I, Table VIII.

3/ These ratios assume the successful rescheduling of foreign interest payments equivalent to So. Sh. 400 million in 1985 (0.4 percent of GDP); otherwise they are on a before rescheduling basis.

indebtedness to the banking system will be reduced commensurately (except for So. Sh. 250 million) to ensure that fiscal policy is not weakened and the balance of payments adjustment is obtained.

Revenue is projected to increase by 93 percent to So. Sh. 7.6 billion, mainly reflecting the depreciation of Somali shilling and the liberalization of imports, which are expected to boost receipts from customs duties considerably. Several administrative changes will be made to increase revenue. In order to avoid loss of customs duties through underinvoicing, the Government will maintain an up-to-date price list for imported goods denominated in U.S. dollars. Customs duties will be levied on the basis of the prices in the letters of credit or the price list, whichever is higher. The exchange rate to be used for the conversion will be that applicable in the free market; in January and February the rate for customs duties purposes will be set at So. Sh. 60 per U.S. dollar, and in the subsequent months the actual *market determined average exchange rate will be used with a lag of two* months. The surcharges on imports financed through external accounts and on nonessential imports will be replaced with a general surcharge of 20 percent of the basic import duty which will apply uniformly to all imports. Based on the recommendations of the 1980 IMF Tax Survey, a general sales tax was introduced in June 1984, and its full year effect is expected to materialize during the program period. Also, the Government will convert the remaining specific excise duties to an ad valorem basis. In accordance with the recommendations of the 1980 IMF Tax Survey, the Government will revise the manner in which the public enterprises are taxed by replacing the current three tier system (involving a turnover tax, share of profit tax, and charges on depreciation) with an income tax. A tax advisor provided through the Fund's technical assistance program is in Somalia to assist in preparing the draft regulations to reform the income tax system and to start implementing structural reforms in collection, assessment, and audit. Technical assistance to improve tax collection procedures and simplify the tariff structure is also being provided by the USAID.

Total expenditure is projected to grow by 43 percent in 1985, which is about one third the rate of growth of total revenue and grants during the same period. Ordinary expenditures are programmed to decline, so that all of the increase in total expenditure is attributable to projected investment expenditure, largely due to the effects of the exchange rate actions. In order to ensure the attainment of expenditure targets, the budget for 1985, which was approved in mid-December 1984, before the reform of the exchange system, projected ordinary expenditure at So. Sh. 6.8 billion, and the development budget, which includes the domestic counterpart investment expenditure, at So. Sh. 1.0 billion. Allowing for exchange rate changes, ordinary expenditure will be around So. Sh. 7.7 billion compared with So. Sh. 7.9 billion in 1984. This reduction will be achieved by limiting allocations, strengthening expenditure controls and by containing the growth in the wage bill. To ensure adequate control over the various spending departments and to modernize and reform the budget system, the authorities will establish an Information Management

Unit within the Ministry of Finance, in line with the recommendations made by a Fund technical assistance mission.

Growth in the overall wage bill will be limited to 15 percent, implying that the real income of government employees will fall by about 5 percent in 1985. The authorities intend to reduce the size of the civil service by about one-third over the next few years, following the recommendations of a recently conducted USAID study on civil service in Somalia; to give immediate effect to this policy, about 1,000 civil service positions (about 2 percent of the total civil service employees), currently occupied, will be abolished in 1985. Attempts will be made to reallocate some of the employees whose positions have been abolished to agricultural programs financed by the Somali Development Bank, and to train others for positions in the private sector.

Projected investment expenditure (So. Sh. 8.6 billion) has been derived from the public investment program for 1985. This expenditure will be financed from project-tied external grants and loans, and the development budget in an amount of So. Sh. 1.2 billion. In the event that there should be a shortfall in foreign financing or if bottlenecks should arise in the process of implementation, the investment program will be scaled down after consultation with the World Bank.

3. Money and credit policy

Domestic credit is programmed to increase by 6 percent in 1985. Net credit to the Government is programmed to increase by 1 percent while credit to the nongovernment sector, including public enterprises, is programmed to increase by 10 percent, with emphasis given to encouraging private sector economic activity. Despite the reduction in domestic credit, net domestic assets are projected to increase by 45 percent, reflecting the large valuation adjustment stemming from the devaluation of the Somali shilling. Given the projected change in net foreign assets, the expansion in net domestic assets will imply an increase in domestic liquidity during 1985 of 17 percent.

The credit program provides for an increase of So. Sh. 55 million in bank credit to the Government, all of which is to occur in the first half of the year. If the gap-fill exercise results in resources to the Government during the first half of 1985, exceeding So. Sh. 250 million, the ceilings for net credit to the Government and net domestic credit for end-June 1985 will be adjusted downward by the amount of the excess. The indicative ceilings for end-September and end-December 1985 will be reexamined at the time of the mid-term review in light of the resources obtained from the gap-fill exercise. While in principle it is the intention to adjust these ceilings downward on the same basis as for June, it may be noted that if these ceilings were to be adjusted downward by the full amount of such resources, there could be a reduction in liquidity of 35 percent. To some extent, this will offset the large expansion in domestic liquidity in 1984 and facilitate the programmed reduction in inflation. However, the developments in the monetary sector will be monitored closely to ensure that the liquidity situation does not become so tight as to disrupt the workings of the foreign exchange market or adversely affect the level of economic activity.

With a view to improving financial intermediation, encouraging domestic savings, increasing migrants' remittances and stemming the tide of capital flight, the structure of interest rates was revised upward effective January 1, 1985 (Appendix V). Interest rates on all loans and deposits of the Central Bank and the commercial bank were raised by an average five percentage points. The central bank discount rate and lending rate to the Government were raised from 8 percent to 12 percent. The commercial bank's lending rates are now in a range of 15 to 20 percent; with the lower 15 percent applying to loans to cooperatives, small-scale farmers, and exporters, the rate 20 percent to credit to foreign enterprises, and 19 percent applying to the remaining loans. Interest rates on savings and time deposits have been increased to a range of 12 to 18 percent. Simultaneously, the Development Bank's lending rates have been raised on the average by about four percentage points, to vary between 14 and 17 percent. The interest rate structure will be reexamined at the time of the mid-term review and will be adjusted further should inflationary trends or international interest rates rise markedly from their present levels. The Government is determined to achieve real positive interest rates by the end of the program period.

During the program period, the effort to improve the process of financial intermediation, through the reform and expansion of the banking system, will continue. As part of this effort, a contract has been signed with Samuel Montague and Company under which a study on the managerial and accounting practices of both the Commercial and Savings Bank and the Development Bank is being prepared and overall advice on the reform of the banking system is being provided. The study's recommendations, aimed at improving these practices, will be reviewed in consultation with the Fund before end-June 1985 and those jointly agreed to will be implemented according to an appropriate schedule. Furthermore, with a view to introducing an element of competition into the banking industry, the Government abolished in mid-1983 the monopoly position of the state-owned commercial bank. During the program period, the Government intends to attract foreign banks into the country and is currently studying ways and means, including tax and investment incentives, to achieve this objective.

4. Pricing and marketing policies

During the last few years, the Government eased considerably the implementation of price controls. The Government intends to continue this policy of liberalization and to formalize it by issuing a decree on January 1, 1985 officially abolishing all price controls. This will eliminate any remaining uncertainties that have been associated with a possible resumption of enforcement of price controls, and hopefully contribute to a stimulation of private sector economic activity and an improvement in resource allocation. In addition, the Government will continue the policy whereby prices charged by public enterprises, including fuel prices, utility rates and prices of a few basic commodities sold by National Trading Corporation (ENC), are officially set so as to cover costs and provide for a suitable rate of return on investment. The Government intends during the program period to adjust such prices promptly in response to changes in costs and will fully pass through the effects of exchange rate changes.

A further step toward market determination of prices was recently taken by the ENC, which handles all concessional imports of wheat, rice, flour, and edible oil, as well as some imports into the public sector. Previously, the ENC sold these commodities at fixed prices to a few wholesalers whose selling prices were also fixed by the Government. Under current arrangements with the USAID, the ENC auctions off a portion of the commodities to the private sector. After a period of experimentation with the auctioning system, the Government will review the modalities whereby such a system can be expanded to commodity imports from other sources.

With the abolishment of the monopsony position of the Agricultural Development Corporation (ADC) in purchasing agricultural products at set prices, domestic grain production was left to be marketed mainly through private channels. Five percent of grain production is required to be sold to the ADC. The prices paid by the ADC are viewed as representing minimum-guaranteed producer prices and have been considerably lower than market prices. The reserve of the ADC is intended to protect farmers and consumers against crop failures and to dampen seasonal fluctuation in prices. The improved incentives to farmers have contributed to an increase in acreage under grain cultivation with a consequent increase in production.

The Government is now examining how the two institutions (the ADC and the ENC) can be restructured, reduced in size and scope, but strengthened managerially and technically to perform the functions of price stabilization and the operation of a buffer stock system for maize and sorghum. The World Bank has offered technical assistance in this area and discussions on the scope of this assistance will begin soon. The progress made in this regard and possible action will be examined in the context of the mid-term review of the program.

At present the provision of agricultural inputs, including tractor services, seeds, chemicals and fertilizers is mainly the function of the Tractor and Farm Machinery Rental Agency (ONAT) and the ministries of agriculture and livestock, forestry and range. A study of the input supply needs in the agriculture and livestock sector has just been completed and is under review by the Government. The study proposes sweeping changes in the structure and operation of ONAT and the development of a diversified private distribution system.

5. Public enterprises

In 1984 the Government continued with the restructuring of the public enterprise sector. Steps were taken to transfer to workers' co-operatives a number of enterprises, including the petroleum distribution agency, a brick factory, and a fruit processing factory. In addition, a number of enterprises were targeted as being suitable for foreign participation in joint venture arrangements. In the agricultural sector, lands administered by government agencies were passed on to participating farmers.

In August 1984 the Government of Somalia passed a law which, in effect, reclassified employees of state industrial enterprises as private sector employees. As a result of this law: (1) state enterprises are permitted to enter directly into wage agreements with their employees; (2) introduce incentive arrangements to boost productivity; and (3) directly hire, modify, and terminate employment contracts of their work. This law is intended to facilitate the restructuring of the operations of some public enterprises where previously, for example, staff reductions were prohibited by laws governing all public sector employees. In order to decentralize and give autonomy in decision making, the Government decided to institute a Board of Directors for each public enterprise. Accordingly, several Boards of Directors were appointed during 1984 and the process will continue in 1985.

The Government intends to accelerate the reorganization of the public enterprise sector in 1985. By April 1985, existing public sector enterprises will be classified into three categories: (i) those to be phased out of operation; (ii) those to be privatized or converted into joint ventures; and (iii) those to remain in the public sector. The resulting classification of enterprises will be examined during the mid-term review and a specific timetable for divesture, privatization and rehabilitiation of individual enterprises will be finalized in consultation with the World Bank. In addition, the tax system for public enterprises will be reformed effective January 1, 1985, in line with the recommendations of the Inter-Ministerial Commission on the reform of the public enterprises and of the 1980 IMF Tax Survey. At present there are no direct government subsidies to public enterprises but losses are covered by the banking system. The new pricing arrangements as well as other measures to improve operating efficiency will increase the profitability of these enterprises and reduce their bank credit needs. The program to improve financial accountability and to introduce unified accounting procedures will be continued in 1985.

6. Public investment program

Public investment in 1984, the first year of the 1984-86 program, was targeted at US$290 million. The Government has not yet completed an in-depth review of capital spending in 1984, but partial data suggest that, due to problems of project preparation, management and coordination between government agencies, the actual level of public investment was much lower than anticipated. A recent World Bank mission found that in the preparation of the public investment program for 1985, there was some improvement in the process of investment programming; sectoral committees carefully reviewed each and every project for inclusion in the program, and there were intensive discussions on the size, composition, and financing of the program among the Ministries of Planning and Finance, and the sectoral ministries.

The public investment program for 1985 is projected at US$274 million, to be financed through foreign loans (US$142 million), foreign grants (US$102 million) and a budgetary contribution of So. Sh. 1,200 million. The budgetary contribution represents the local currency counterpart of external grants earmarked for specific projects. If there should be a shortfall in available financing or if physical or other constraints arise in the implementation of the program, the authorities have agreed to scale down the investment effort in consultation with the World Bank.

The composition of the 1985 public investment program is broadly consistent with the 1984-86 public investment program endorsed by the Consultative Group Meeting in 1983. Following discussions with the World Bank, the authorities have decided to exclude two projects: the Romsoma ranch development project and Somitfish, a fisheries development project, from the 1985 public investment program. These two projects will be reviewed by the authorities in order to establish their economic viability. On the advice of the World Bank, the authorities have decided to move to the 1985 investment program two projects which were initially included in the supplementary investment program. These are (i) a livestock marketing project, to be financed from grants from the USAID, which is aimed at improving animal health and marketing facilities for export of live animals, and (ii) a project study involving the rehabilitation of irrigation facilities in the Shebelli area. With these adjustments, the World Bank has informed the authorities that the level and composition of the 1985 public investment program is broadly consistent with the country's development needs and objectives.

The authorities have also decided to seek the advice and assistance of the World Bank in the preparation of their next three-year (1986-88) roll over public investment program. The first draft of this program is expected to be prepared by June 1985 and to be finalized, also in consultation with the World Bank, by September 1985 for submission at the next Consultative Group Meeting for Somalia.

7. Performance criteria

The program includes as quantitative performance criteria: (1) quarterly ceilings on net domestic credit, with quarterly subceilings on net domestic credit to the Government; (2) a ceiling for 1985 on external nonconcessional debt contracted or guaranteed by the Government with maturities of 1-12 years; (3) a ceiling on the stock of external payments arrears; and (4) a target for the reduction in external commercial arrears. The performance criteria further include the standard provisions relating to multiple currency practices, bilateral payments arrangements, and restrictions on payments and transfers for current international transactions or import restrictions for balance of payments purposes. The performance criteria are shown in Table 4. The ceilings for net domestic credit and net credit to the Government for the first half of 1985 constitute performance criteria; those for the second half of the year are indicative. Performance critiera for the second half of 1985 will be set during the semiannual review of the program, taking into account the developments in the budget and the results of the gap-fill exercise. The end-June 1985 ceilings on net domestic credit and net credit to the Government will be adjusted downward to the extent that the domestic currency equivalent of the additional external financing (grants, loans, and debt rescheduling) received by the government during the first half of 1985 in the gap-fill exercise exceeds So. Sh. 250 million.

V. The Medium-Term Prospects

The medium-term prospects of the Somali economy will depend critically upon the continuation of the adjustment effort, readapting and intensifying economic and financial policies in view of the changing domestic and external environment, as well as the continuation of external financial aid. The decision of the authorities to introduce a market-determined exchange rate will contribute to a strengthening of Somalia's external position by eliminating the distortion arising from exchange rate inflexibility. Nonetheless, the heavy external debt service burden will need to be reduced over time to avoid crowding out the private sector in the foreign exchange market and to release foreign exchange to the production sectors, to contribute to the expansion of the productive capacity of the country.

Assuming the continued pursuit of appropriate economic and financial policies, the balance of payments projections for 1985-89 indicate that the overall balance of payments should improve from a deficit of US$57 million in 1985 to surpluses of about US$25 million in 1987-89. The current account deficit is expected to decline from the equivalent of 6.2 percent of GDP in 1985 to 2.3 percent of GDP in 1989; the current account deficit excluding official transfers is also expected to decline in terms of GDP, falling from 16.4 percent in 1985 to 12.3 percent in 1989.

Following the expected sharp recovery in 1985, exports are projected to rise at an average annual rate of 12 percent. This relatively high rate of growth largely reflects the projected recovery of livestock exports which are expected to grow at an annual rate of 13 percent, as a result of a increase in prices by about 2 percent, a gradual recovery of exports of sheep and goats to their 1982 level, and the market diversification of cattle exports expected over this period; the effects of the Saudi cattle ban are expected to be largely reversed by 1987. Banana exports are also expected to grow by 12 percent annually in value terms and by 10 percent in volume terms, reflecting enhanced price incentives to producers.

Table 4. Somalia: Quantitative Performance Criteria

(End of period)

	1984	1985			
	Dec. Proj.	March	June	Sept. 1/	Dec. 1/
		(In millions of Somali shillings)			
Net domestic credit 2/	9,577	9,703	9,840	9,995	10,150
Net credit to Government 2/	4,393	4,415	4,448	4,448	4,448
		(In millions of U.S. dollars)			
External debt 1-12 year maturity 3/	--	--	--	--	--
External debt service payments arrears 4/	50.5	...	--	--	--
Reduction in commercial arrears	...	...	...	...	10.0

Source: Central Bank of Somalia; and staff estimates.

1/ Indicative ceilings.

2/ Net domestic credit comprises credit to government, public enterprises, and private sector less goverment deposits with the banking system. Net credit to Government comprises 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, plus losses accruing to the Central Bank from the operations of the dual exchange rate system. The end-June 1985 ceiling on net domestic credit and net credit to Government will be adjusted downward to the extent that the domestic currency equivalent of the additional external financing (grants, loans, and reschedulings) received by the Government during the first half of 1985 in the gap-fill exercise exceeds So. Sh. 250 million.

3/ New commitments of public and publicly guaranteed nonconcessional external debt with a maturity of between 1 and 12 years.

4/ Excluding debt to Abu Dhabi, Saudi Arabia (other than the Saudi Fund) and China frozen on the basis of verbal agreements.

Following an increase of 25 percent in 1985 due to the import liberalization policy and a sharp expansion of imports for the public investment program, annual import growth is projected to level off at about 4 percent a year for the remainder of the period. Imports in the form of grants and loans in kind are projected to rise by one third in 1985, but subsequently remain constant in real terms. Cash imports, namely those financed by the banking system and through foreign currency accounts, are projected to fall in 1986 by 11 percent on the assumption that pent-up demand and the replenishment of stocks are satisfied in the previous year. Cash imports are projected to rise at an annual rate of 7 percent in subsequent years.

Private transfers are expected to rise 10 percent annually during 1986-89. With the tight financial policies pursued and the improvement in domestic economic conditions, private capital outflows are projected to subside and be reversed starting in 1986.

The total level of foreign aid is projected to rise by 22 percent in 1985 and remain constant in real terms during 1985-89 with an increasing proportion being in the form of grants. The increase in 1985 is primarily associated with the investment program. Official transfers, in particular, are expected to rise, mainly on account of project-related grants, from a level of US$250 million in 1985 to US$320 million in 1989. Reflecting, on the other hand, a conscious policy to reduce reliance on foreign borrowing even on concessional terms, in view of Somalia's excessively high debt service ratio, loan disbursements are projected to decline in real terms.

Somalia's external debt service ratio (in percent of exports of goods and services) is expected to rise from 39 percent in 1985 to about 44 percent in 1987-88 due to a concentration of maturities, including repurchases from the Fund, but decline subsequently to 32 percent by 1989. The decline will be aided by the expected shift to grant financing and the projected export recovery.

VI. Staff Appraisal

Against a background of virtual stagnation in economic activity and mounting domestic and external financial imbalances, the Government of Somalia in mid-1981 launched a major adjustment effort. Substantial demand and supply-oriented policies were effectively implemented during 1981-83 in the context of two consecutive stand-by arrangements. Over the three year period, the policies pursued contributed to a pick-up in economic activity, a reduction in inflationary pressures, and a strengthening in the external sector position.

Economic and financial conditions deteriorated during 1984. The relaxation in demand-management policies led to a substantial widening of the budgetary deficit and a sharp acceleration in domestic credit expansion. The continuation of the Saudi ban affected Somalia's cattle exports and the failure to continue with the flexible exchange rate policy in 1984, hindered the redirection of these exports to other markets. Although the devaluation effected in September 1984 was a step in the right direction, it was not sufficient to redress the difficult situation. The shortfall in export proceeds forced a compression of imports through the banking system, which exacerbated the imbalances in the economy. In 1984 economic activity decelerated, inflation reached a record level, and the external sector situation became increasingly difficult. The Central Bank virtually depleted its reserves and Somalia experienced difficulties in meeting its commercial and debt service obligations (including repurchases to the Fund). Accordingly, despite some debt rescheduling, external payments arrears were accumulated.

The policies to be pursued during 1985 are designed to contribute to the emergence of an economic and financial environment that will stimulate private sector economic activity with a concomitant improvement in resource allocation. The adjustment program involves a major liberalization in the areas of exchange and trade, prices and public enterprises, while the public investment program aims at completing on-going projects and complementing the envisaged gradual resurgence of private sector economic activity. In 1985, these policies are expected to contribute to promoting economic growth, reducing the rate of inflation, and strengthening the external sector position with a view to making progress toward the attainment of a viable balance of payments position. However, given the limited resource base of the country, Somalia will remain dependent on foreign financial assistance for the foreseeable future.

In the external sector, the floating of the exchange rate for private transactions and the virtual elimination of trade restrictions will increase incentives, facilitating the expansion and diversification of exports and enhancing the profitability of import-substituting industries. It is expected that the market exchange rate will fluctuate initially but may appreciate, compared to the one prevailing in the present narrow parallel market, as the free foreign exchange market expands and pent-up demand for imports is satisfied. The staff supports the intention of the authorities to accelerate the depreciation of the official exchange rate in the first six months of the program period and to unify the official with the market rate by the end of the program period. In these circumstances, approval of the resulting multiple currency practice until end-1985 is recommended.

The establishment of a secondary market for the free determination of the exchange rate applicable to the bulk of private transactions constitutes a significant improvement in Somalia's exchange system. However, there are still certain impediments to the operation of that free market, particularly the requirement that all transactions take place through the commercial bank, whose management and accounting procedures need to be upgraded. At the time of the mid-term review, therefore, the staff will examine the experience with the operation of the system, particularly with respect to the commercial bank's efficiency in fulfilling its assigned role. It will also be vital to keep under constant review the implications for the budget and for the allocation of resources generally, of the differential in the rates between the official and free markets.

The normalization of external trading arrangements will, in part, depend on the elimination of external commercial arrears. The staff welcomes the initiation of a survey to determine the amount of these arrears and urges the authorities to take steps to eliminate these arrears as quickly as possible. Presently the program provides for a reduction of these arrears of US$10 million during the program year. This figure will be revised in the context of the mid-term review to ensure that at least one half of the external commercial arrears confirmed by the survey are eliminated in 1985.

Despite the external policy measures and some considerable debt relief already obtained, a balance of payments financing gap of US$100 million remains for 1985, even after an amount of US$33 million of arrears and debt service payments is officially rescheduled. The World Bank has undertaken, in the light of Somalia's strong adjustment effort, to mount a gap-fill exercise to assist in the closing of the financing gap. External non-project grants and concessionary loans will be needed to fill this gap, as outstanding external debt is largely due to multilateral institutions and is not generally subject to rescheduling. Closing this financing gap is a prerequisite for the successful implementation of the program.

The liberalization on the external sector will be accompanied by the official dismantling of all price controls, removing present uncertainties about the possible resumption of price controls which had been relaxed. Furthermore, prices charged by public utilities will be regularly adjusted to cover costs and especially to reflect promptly changes in the exchange rate. The staff urges the authorities to proceed rapidly with the planned reforms in the public enterprise sector as these would provide more scope for private sector initiative and generally make a more rational use of scarce managerial and technical resources.

These supply oriented policies are to be reinforced with a public investment program which is intended to direct available resources to the completion of on-going development activities and for augmenting domestic commodity production, increasing exports, and replacing imports. The program, the level and composition of which is deemed to be appropriate by the World Bank, is to be virtually completely funded from abroad, under present commitments. If there should be a shortfall in available financing or if physical constraints should manifest themselves in the process of implementing the public investment program, the authorities have undertaken to scale down the investment effort on the basis of criteria agreed with the World Bank.

Financial policies will generally aim at containing the growth in demand in accordance with the expected availability of domestic and external resources. The overall budgetary deficit will be reduced sharply facilitating a sharp reduction in government recourse to bank credit. Structurally in view of the financing of the investment program, and the envisaged exchange rate action, the budget will be more dependent than in previous years on external grants. However, the overall deficit (excluding grants), adjusted for exchange rate effects is projected to decline from 11.9 percent of GDP in 1984 to 8.9 percent in 1985.

The fiscal policies to be adopted under the program will require determined efforts on the part of the authorities, especially in view of the existing administrative limitations in the areas of expenditure control and revenue collection. The nominal reduction in ordinary outlays in the face of higher interest payments, will be difficult to achieve in view of the magnitude of the exchange rate action and the anticipated inflation. In these circumstances the authorities need to guard against the emergence of domestic payments arrears which could undermine the degree of fiscal adjustment envisaged. The authorities are also planning a sharp expansion of investment expenditure which may well place strains on the economy's resource base. On the revenue side, although the principal revenue increase will be a direct result of the exchange rate change, a number of policy initiatives are being undertaken. These, together with determined administrative efforts to secure all revenue due to the Government, will be crucial to the successful implementation of the program.

As the fiscal program described is almost fully financed without the resources which result from the gap-fill exercise, the authorities intend to use any gap-fill resources accruing to Government to reduce the outstanding credit from the banking system. This will ensure that fiscal policy does not become more expansionary and in so doing, jeopardize the inflation and balance of payments targets. For these reasons the program provides that the credit ceilings for June 1985 will be adjusted downwards for any gap-fill resources (in excess of So. Sh. 250 million) that accrue to the Government in the first six months of the year. The staff expects that the bulk of the gap-fill resources will be forthcoming in the second half of the year and has projected that full adjustment of the credit ceilings could lead to a reduction in the money supply of about 35 percent. Thus, the indicative credit ceilings for September and December 1985 will be re-examined in the light of the resources obtained from the gap-fill exercise.

A major adjustment in the interest rate structure is earmarked as a step toward achieving positive real interest rates by the end of the program period. The staff welcomes the efforts that the authorities plan to undertake to improve the operations of the state-owned commercial bank and to attract reputable foreign banks into the country.

The program proposed by the Somalia authorities represents a comprehensive adjustment effort but would require strict implementation and close monitoring. Thus, the mid-term review scheduled to begin in April will provide an important opportunity to reassess whether program assumptions are still valid and program objectives are still attainable. As mentioned earlier, the mid-term review will also provide an opportunity for assessing the exchange rate policy and the movement in the spread between the official rate and the rate in the free market.

Without the additional resources for closing the financing gap, the balance of payments situation will be extremely weak resulting in shortages of critical imports for the private sector or a new accumulation of arrears. The World Bank, which has taken the lead in the gap fill exercise, has already contacted major donors to inform them of the strong adjustment effort that Somalia is about to undertake and to seek pledges of concessionary assistance. An unofficial meeting of donors, under the chairmanship of the World Bank, has been scheduled for January 23, 1985. The staff believes that official Fund endorsement of the program will be of great help in convincing donors to commit the necessary resources to finance the gap. In these circumstances, the staff supports the authorities' request that the arrangement be approved in principle before the financing gap is closed. The arrangement would become effective on the date not later than 15 days after it was approved by the Fund, after the Fund finds that satisfactory arrangements have been made for the financing of the expected balance of payments gap in 1985.

As to the extent of access, Somalia has already made significant purchases from the Fund since 1981 and is likely to have need for Fund supported programs in the future. The Fund will probably play a role in mobilizing external financial support from other sources and the staff feels that the proposed access, equivalent to 50 percent of quota, is justified.

VII. Proposed Decisions

I. Stand-by arrangement

1. The Government of Somalia has requested a stand-by arrangement for a period of one year from , 1985 for an amount equivalent to SDR 22.1 million.

2. The Fund approves the stand-by arrangement attached to EBS/85/1, which shall become effective not later than 15 days after the date of this approval, on the date on which the Fund finds that satisfactory arrangements have been made for the financing of the expected balance of payments deficit in 1985.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

II. Exchange arrangements

1. On January 1, 1985, Somalia introduced a dual exchange rate system, described in EBS/85/1, which gives rise to a multiple currency practice, subject to approval under Article VIII, Sections 2(a) and 3.

2. The Fund notes the intention of the Government of Somalia to eliminate this multiple currency practice in the context of the adjustment program described in EBS/85/1, and grants approval of the practice through December 31, 1985.

Table I. Somalia: Balance of Payments, 1982-89

(In millions of U.S. dollars)

	1982	1983	1984 Prel. est.	1985 Projections	1986 Projections	1987 Projections	1988 Projections	1989
Goods and services (net)	-338	-346	-412	-480	-451	-454	-472	-498
Exports, f.o.b.	137	100	60	109	127	154	166	178
Livestock	(106)	(72)	(35)	(78)	(91)	(113)	(120)	(126)
Bananas	(14)	(15)	(11)	(14)	(16)	(18)	(20)	(22)
Other	(17)	(13)	(14)	(17)	(20)	(23)	(26)	(30)
Imports, c.i.f.	-484	-450	-457	-570	-561	-593	-626	-664
Foreign exchange	(-199)	(-186)	(-145)					
Foreign currency accounts	(-5)	(-20)	(-10)	(-220)	(-195)	(-208)	(-223)	(-240)
Franco valuta	(--)	--	(-40)	(--)	(--)	(--)	(--)	(--)
Grants in kind	(-157)	(-147)	(-157)	(-229)	(-243)	(-259)	(-275)	(-293)
Loans in kind	(-123)	(-97)	(-106)	(-121)	(-123)	(-126)	(-128)	(-131)
Trade balance	-347	-350	-397	-461	-434	-439	-460	-486
Services	9	4	-15	-19	-17	-15	-12	-12
(of which: interest payments)	(-14)	(-21)	(-27)	(-31)	(-32)	(-30)	(-27)	(-26)
Transfers	207	199	267	329	357	377	398	420
Private	50	51	70	80	84	88	93	97
Official	157	148	197	249	273	289	305	323
Current account balance	-131	-147	-145	-151	-94	-77	-74	-78
(excluding official transfers)	(-288)	(-295)	(-342)	(-400)	(-367)	(-366)	(-379)	(-401)
Capital account	84	68	53	94	98	101	98	103
Private	-39	-32	-20	--	5	10	12	15
Official	123	100	73	94	93	91	86	88
Disbursements	(132)	(107)	(106)	(121)	(123)	(126)	(128)	(131)
Amortization	(-8)	(-6)	(-33)	(-27)	(-30)	(-35)	(-42)	(-43)
Capital subscriptions and other	(-1)	(-1)	(-1)	(--)	(--)	(--)	(--)	(--)
Errors and omissions	3	-14	--	--	--	--	--	--
Overall balance	-44	-93	-92	-57	4	24	24	25
Financing	44	93	92	57	-4	-24	-24	-25
Central Bank, net	64	51	21	-15	-19	-24	-24	-25
Assets	(28)	(-2)	(9)	(-15)	(--)	(1)	(1)	(-5)
Liabilities	(36)	(52)	(12)	(--)	(-19)	(-25)	(-25)	(-20)
of which:								
Use of Fund credit	[34]	[44]	[-4]	[2]	[-19]	[-25]	[-25]	[-20]
Purchases	[34]	[44]	[--]	[17]	[6]	[--]	[--]	[--]
Repurchases	[--]	[--]	[-4]	[-15]	[-25]	[-25]	[-25]	[-20]
Commercial bank, net	-20	42	--	--	--	--	--	--
Accumulation of arrears 1/	--	--	71	-61	-10	--	--	--
External debt servicing	--	--	(51)	(-51)	(--)	--	--	--
Commercial	--	--	(20)	(-10)	(-10)	--	--	--
Debt service arrears to be rescheduled	--	--	--	10	--	--	--	--
Debt service payments to be rescheduled	--	--	--	22	--	--	--	--
Financing gap	--	--	--	100	25	--	--	--

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

1/ Excluding arrears related to Italian suppliers' credits noted in Table 2 in the text.

Table II. Somalia: Foreign Financing, 1983-89

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988	1989
	Actual	Projections					
Grants	148	197	249	273	289	305	323
Project grants	9	36	80	87	95	103	112
Saudi oil grants	39	20	20	21	22	23	24
Commodity aid program	18	16	49)	)	)	)	
United States	(18)	(11)	(32))	)	)	)	
Other	(--)	(5)	(17))	)	)	)	
Food grants	81	85	80)	135)	142)	149)	157
Food aid - refugees	(78)	(75)	(80))	)	)	)	
Food aid - budgetary support	(3)	(10)	(--))	)	)	)	
Cash grants	1	40	20	30	30	30	30
Loans (net)	101	73	94	93	91	86	88
Disbursements	107	106	121	123	126	128	131
Cash	(10)	(--)	(--)	(--)	(--)	(--)	(--)
PL 480	(16)	(16)	(17)	(17)	(18)	(19)	(19)
Project loans	(81)	(90)	(104)	(106)	(108)	(110)	(112)
Amortization	-6	-33	-27	-30	-35	-42	-43
Memorandum items:							
Grants in kind	147	157	229	243	259	275	293
Project loans and grants	90	126	184	193	203	213	224

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

Table III. Somalia: External Debt Service Payments, 1983-89

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988	1989
	Actual	Projections					
Debt service (total, after relief) 1/	29.5	60.0	74.3	90.2	108.2	113.3	88.5
Amortization	8.9	33.5	43.0	57.9	78.0	85.7	62.6
Interest	20.6	26.5	31.3	32.3	30.2	27.6	25.9
Debt service (after relief, excludes IMF and AMF)	20.9	46.6	50.1	55.9	59.8	65.8	65.8
Amortization	5.5	27.3	26.6	29.9	35.2	41.8	42.6
Interest	15.4	19.3	23.5	26.0	24.6	24.0	23.2
Debt service ratio (total, after relief)	16.5	42.9	38.7	42.1	44.3	43.6	32.1
(Including private remittances)	12.8	28.6	27.2	30.3	32.6	32.1	23.7
Memorandum items:							
Exports of goods and services							
Excluding private remittances	179	140	192	214	244	260	276
Including private remittances	230	210	273	298	332	353	373

Sources: Data provided by the Central Bank; IBRD Debt Reporting System; and staff estimates.

1/ Debt relief corresponds to frozen debt, under verbal agreement, owed to Abu Dhabi, Saudi Arabia (other than to the Saudi Fund), and China; frozen debt to Bulgaria and USSR; rescheduling with concessional terms and no service payments until the end of 1987 of portion of debt to Italy in relation to suppliers' credits; and cancellation of all other debt to Italy.

Table IV. Somalia: External Debt Servicing Arrears, End-1984 1/

(In thousands of U.S. dollars)

Creditor	Interest	Principal	Total
A. Multilateral	5,725	18,986	24,711
African Development Bank	134	318	452
African Development Fund	155	39	194
Arab Fund for Economic and Social Development	2,096	2,315	4,411
Arab Monetary Fund	2,330	2,160	4,490
Islamic Development Bank (Proj.)	679	686	1,365
Islamic Development Bank (FTF)	168	11,245	11,413
OPEC	162	2,223	2,385
B. Bilateral	6,230	13,968	20,198
Kuwait Fund	922	1,044	1,965
Romania	635	--	635
Saudi Arabia	3,848	9,594	13,442
Yugoslavia	825	3,331	4,156
C. Financial institutions	4,450	1,133	5,583
Crédit Lyonnais	4,450	1,133	5,583
Total	16,405	34,087	50,492

Source: Ministry of Finance.

1/ Debt to Abu Dhabi, Saudi Arabia (other than to the Saudi Fund), and China is assumed frozen on the basis of verbal agreements.

Table V. Somalia: Central Government Operations, 1982-85

	1982	1983	1984 Staff est.	1985 1/ Program
	(In millions of Somali shillings)			
Total revenue and grants	3,816	5,359	6,562	14,549
Revenue	2,588	4,075	3,926	7,574
Tax	(2,275)	(3,721)	(3,341)	(6,870)
Nontax	(313)	(354)	(585)	(704)
Grants 2/	1,056	1,106	2,440	6,760
Of which: Oil grant and Commodity Import Program	(600)	(901)	(720)	(2,760)
Transfers from local authorities	172	178	196	215
Total expenditure	5,366	6,567	11,530 3/	16,524
Ordinary expenditure	2,750	4,470	7,940	7,700
Investment expenditure	2,461	1,920	3,370	8,560
Of which: Development budget	(348)	(498)	(850)	(1,200)
Transfers to local authorities	155	177	220	264
Discrepancy	--	69 4/	--	--
Overall balance 3/				
Excluding grants	-2,606	-2,314	-7,408	-8,735
Including grants	-1,550	-1,277	-4,968	-1,975
Changes in domestic counterpart external arrears	--	--	920	-1,840 5/
Financing (cash)	1,550	1,277	4,048	3,815
External financing (net)	1,724	1,572	1,460	3,760
Domestic financing	-174	-295	2,588	55
Banking system	(-150)	(-295)	(2,588)	(55)
Cash balances	(-24)	(--)	(--)	(--)
	(In percent of GDP)			
Memorandum items:				
Total revenue and grants	13.7	13.5	8.4	14.9
Revenue	9.3	10.3	5.0	7.7
Grants	3.8	2.8	3.1	6.9
Total expenditure	19.2	16.6	14.7	16.9
Ordinary expenditure	9.9	11.3	10.1	7.9
Investment expenditure	8.8	4.8	4.3	8.8
Current account balance				
Excluding grants	-0.5	-1.0	-5.2	-0.2
Including grants	3.3	1.8	-2.0	6.7
Overall balance				
Excluding grants	-9.3	-5.8	-9.5	-8.9
Including grants	-5.6	-3.2	-6.3	-2.0
Foreign financing (net)	6.2	4.0	1.9	3.8
Bank financing	-0.5	-0.7	3.3	0.1

Sources: Ministry of Finance; and staff estimates.

1/ Based on assumed average official exchange rate of So. Sh. 40 per U.S. dollar and an annual inflation rate of 20 percent.
2/ Includes cash grants as well as grants in kind including project grants, Saudi oil grant, commodity import program, and budgetary support in the form of food aid.
3/ Commitment basis.
4/ Difference between estimates of fiscal deficit derived from revenue and expenditure and that from the financing side.
5/ Assumes that all domestic counterpart external arrears (US$46 million) will be paid in 1985.

Table VI. Somalia: Monetary Survey, 1982-85

	1982 Dec. Actual	1983 Dec. Actual	1984 March Actual	1984 June Actual	1984 Sept. Projection 1/	1984 Dec. Projection 1/	1985 Dec. Proj. 1/
			(In millions of Somali shillings)				
Net foreign assets	-519.3	-2,227.6	-2,544.4	-2,717.3	-3,157.5	-3,845.0	-7,973.0
Central Bank	-1,947.3	-3,134.2	-3,402.9	-3,435.3	-4,623.5	-5,188.0	-11,072.0
Commercial bank	1,428.0	906.6	858.5	718.0	1,466.0	1,343.0	3,099.0
Domestic credit	5,023.8	5,260.8	6,676.3	8,070.7	9,031.0	9,577.0	10,150.0
Government (net)	2,100.0	1,805.0	2,965.7	3,815.7	4,434.9	4,393.0	4,448.0
Other	2,923.8	3,455.8	3,710.6	4,255.0	4,596.0	5,184.0	5,702.0
Public enterprises	(1,300.0)	(1,163.0)	(1,225.7)	(1,430.6)	(...)	(...)	(...)
Private sector	(1,623.8)	(2,292.8)	(2,484.9)	(2,824.4)	(...)	(...)	(...)
Broad money	5,116.1	5,500.9	6,299.9	6,884.1	8,720.5	8,589.0	10,081.0
Other items (net)	-611.5	-2,467.6	-2,168.0	-1,530.6	-2,847.0	-2,857.0	-7,904.0
Valuation adjustments	-514.1	-1,551.6	-1,570.4	-1,062.0	-2,369.0	-2,369.0	-7,397.0
Other items (net)	-97.4	-916.0	-597.6	-468.6	-478.0	-488.0	-507.0
			(Percentage changes from end of previous year)				
Domestic credit	10.5	4.7	26.9	53.4	71.7	82.0	6.0
Government (net)	-6.7	-14.0	64.3	111.4	145.7	143.4	1.3
Other	27.3	18.2	7.4	23.1	33.0	50.0	10.0
Broad money	15.7	7.5	14.5	25.1	58.5	56.1	17.4

Sources: Central Bank of Somalia; and staff estimates.

1/ Data for September 1984 are actual for the Central Bank.

Table VII. Somalia: Principal Assumptions Underlying the Medium-Term Balance of Payments Projections, 1985-89

1. General

Real GDP growth in Somalia during 1985-89 is assumed 4 percent per annum and world inflation 4 percent per annum. A flexible exchange rate will be pursued, and the trade and exchange system will remain liberalized.

2. Exports

Livestock - The export volume of sheep and goats is assumed to rise by 67 percent in 1985, 12 percent in 1986, and by 3.5 percent in subsequent years; these assumptions imply that by 1988-89 the export volume will be restored to its 1982 level. Cattle exports are assumed to rise from 7,200 units in 1984 to 46,400 units in 1985 (still only 30 percent of its 1982 level) mainly on account of exports to Egypt; and by 21 percent in 1986 as new export markets are penetrated; it is further assumed that by 1987, the effects of the Saudi ban will be largely eliminated resulting in an export volume of 107,000 (70 percent of the 1982 level), while in subsequent years a volume increase of 3.5 percent is assumed. The export volume of camels, which account for less than 5 percent of livestock export proceeds are assumed to rise by 30 percent in 1985 (still being 50 percent below the 1982 level), and rise by 20 percent in 1986 and by 3.5 percent in subsequent years.

The export unit value of sheep and goats is projected to rise by 27 percent in 1985 as a result of the establishment of guideline prices and by 2 percent in subsequent years. In the case of cattle, it is assumed that the price in 1985 will rise by 50 percent and by 2 percent in subsequent years. In the case of camels, it is assumed that the price will rise by 5 percent during 1985-86 and by 2 percent in subsequent years.

Bananas - They are projected to rise, in volume terms, by 25 percent in 1985, 11 percent in 1986 and by 5 percent in subsequent years. The unit value is projected to rise by 2 percent per year.

Other exports - These mainly consist of hides and skins, myrrh, fruits and vegetables, forest products and petroleum products. They are projected to rise by 21 percent in 1985 (17 percent in real terms) and by 15 percent in subsequent years (11 percent in real terms).

2. Imports

Cash imports, i.e. imports financed directly by the banking system and through foreign currency accounts are projected to rise by 12.8 percent (9 percent in real terms) in 1985 from the depressed level in 1984. Following a reduction of 11 percent in 1986 on the assumption that in the

Table VII. Somalia: Principal Assumptions Underlying the Medium-Term Balance of Payments Projections, 1985-89 (concluded)

2. Imports (continued)

previous year pentup demand was satisfied and stocks were replenished, they are projected to rise at an annual rate of 7 percent in subsequent years.

Imports financed through grants and loans in kind are projected to rise by one-third in 1985 and remain constant in real terms (rising by 4 percent) in subsequent years, with their composition changing in favor of grants (Table II).

3. Private transfers

Private transfers are assumed to rise by 14 percent (10 percent in real terms) in 1985 and by 10 percent (6 percent in real terms) in subsequent years as a result of the liberalization of the exchange and trade system and the improvement in domestic economic conditions. It is assumed that private capital outflows financed by private remittances will subside in 1985 and be reversed in subsequent years.

Table VIII. Somalia: Principal Assumptions for Fiscal Projections, 1985

General

Real growth of GDP is assumed to be 4 percent for 1985 with the average rate of inflation at 20 percent. The average exchange rate used for official transactions is assumed to be So. Sh. 40 per U.S. dollar for 1985. For projecting the components of ordinary expenditure, 1983 actuals have been taken as the base.

1. Receipts 1/

a. Taxes on income, profits, and property (5.6 percent)

Receipts are projected increase by about 4 percent in real terms from the estimated level of 1984.

b. Taxes on goods and services (11.9 percent)

Revenue from these taxes is projected to increase at 4 percent in real terms from the estimated level of 1984. This projection implicitly takes into account the effect of converting all remaining domestic excise duties from specific to ad valorem basis. In addition, the introduction of the general sales tax, the full year effect of which is expected to be realized in 1985, is expected to yield So. Sh. 250 million.

c. Taxes on imports (64.6 percent)

These taxes are based on the projected levels of nongovernment imports during the program period. The imports are evaluated at the average market determined exchange rate for 1985 which is assumed to be So. Sh. 60 per U.S. dollar and the average import duty is assumed to be 50 percent of the value of imports with an additional surcharge of 20 percent on the import duty. Significant provisions have been made for potential slippages to allow for the effects of administrative deficiencies and possibilities for evasion through smuggling.

d. Export taxes (3.3 percent)

Revenue from this tax is based on the projected value of livestock exports. Collection rate is assumed at 8 percent of value of livestock exports, and the exports are evalued at the average market rate of So. Sh. 60 per U.S. dollar.

1/ Percentages in parentheses refer to share in projected total revenue in 1985.

Table VIII. Somalia: Principal Assumptions for Fiscal Projections, 1985 (continued)

e. Other taxes (5.3 percent)

Estimated to be So. Sh. 400 million in the program year compared with So. Sh. 309 million in 1983.

f. Nontax revenue (9.3 percent)

Projected to be So. Sh. 704 million in 1985 based on the information provided by the Somali authorities. This indicates an increase of more than 20 percent compared with the previous year and reflects the effects of recent increases in telegram and telephone rates.

g. Transfers from local authorities

Projected to be So. Sh. 215 million based on the data provided by the authorities; this indicates an increase of about 10 percent compared with the transfers from local authorities in 1984.

h. Grants

These are shown in Table II. The grants may be classified as cash grants, oil grants, grants under commodity import program, project grants, and budgetary support in the form of food aid. The domestic currency counterpart of the oil and commodity grants is fully reflected in the value of grants evaluated at the average official exchange rate of So. Sh. 40 per U.S. dollar. This implicitly assumes a full pass through of the exchange rate and international prices of those commodities when sold in the market.

2. Expenditure

a. Wages 1/

These are calculated on the basis of a wage bill estimated at 40 percent of ordinary expenditure in 1983. In 1984, no cost of living adjustment has been allowed and the total wage bill is estimated to have remained unchanged at the level of the previous year. The wage bill is projected to be growing by 15 percent in 1985.

b. Nonwage domestic expenditure 1/

These are assumed at 40 percent of ordinary expenditure in 1983. Real nonwage domestic expenditure for 1985 is assumed to be about

1/ Components of ordinary expenditure.

Table VIII. Somalia: Principal Assumptions for Fiscal Projections, 1985 (concluded)

10 percent lower than the level of 1983, and nominal expenditure is derived from the 1983 level with adjustments for inflation and size in real terms.

c. Expenditure incurred in foreign exchange

This is based on the assumption that its share was about 20 percent of ordinary expenditure in 1983. Projected expenditure in 1985 is assumed to remain at the level of 1983 in real terms, and this allows for interest payments on external loans falling due in 1985.

d. Investment expenditures

Projected total investment expenditure is based on a core public investment program which has been reviewed by the World Bank. Average implementation rates for the projects financed by external grants is assumed to be 80 percent and the same for projects financed by external loans is assumed to be 70 percent. Average official exchange rate is estimated to be So. Sh. 40 per U.S. dollar.

e. Transfers to local authorities

Projected transfers to the local authorities are based on the estimates provided by the Somali authorities, which allows for an increase of 20 percent in 1985 from the level of transfers in 1984.

f. Changes in domestic counterpart external arrears

The program allows for the elimination of all domestic counterpart external arrears by the end of the program. External payment arrears which are liabilities of the central government are estimated to be US$46 million at end-1984.

3. Financing

a. Foreign financing

These are assumed at levels consistent with the projected implementation of public investment programs and the balance of payments data.

b. Cash balances

Assumed to be nil during the program period.

c. Bank financing

This is derived as a residual item.

SOMALIA - Fund Relations
(As of November 30, 1984)

I. Membership status

(a) Date of membership:	August 31, 1962
(b) Status:	Article XIV

A. Financial Relations

(Amounts in millions of SDRs, unless otherwise indicated)

II. General Department

(a) Quota:	44.2
(b) Total Fund holdings of Somali shillings:	147.9 (334.5 percent of quota)
(c) Fund credit:	103.6 (234.5 percent of quota)
Of which: Credit tranches	31.6 (71.5 percent of quota)
enlarged access	72.0 (163.0 percent of quota)

III. Current Stand-by or Extended Arrangement and Special Facilities

(a) Current stand-by or extended arrangement:	None
(b) Previous stand-by arrangements during the last 10 years	
(i) Duration from July 15, 1982 to January 14, 1984	
(ii) Amount:	60.0
(iii) Utilization:	60.0
(iv) Undrawn balance:	--
(i) Duration from July 15, 1981 to July 14, 1982	
(ii) Amount:	43.1
(iii) Utilization:	43.1
(iv) Undrawn balance:	--
(i) Duration from February 27, 1980 to February 26, 1981	
(ii) Amount:	11.5
(iii) Utilization:	6.0
(iv) Undrawn balance:	5.5
(c) Special facilities (current year and past two years):	None

SOMALIA - Fund Relations (continued)

IV. SDR Department

(a) Net cumulative allocations:	13.7
(b) Holdings:	0.05 (0.3 percent of net cumulative allocations)

V. Administered Accounts

(a) Trust Fund loans	
(i) Disbursed:	10.7
(ii) Outstanding:	10.7
(b) SFF Subsidy Account	None

VI. Overdue Obligations to the Fund: None

VII. Somalia has used Fund resources since 1964

B. Nonfinancial Relations

VIII. Exchange rate arrangement:

Since July 1, 1983, the Somali shilling has been pegged to the SDR adjusted for relative price developments vis-à-vis the five countries included in the SDR basket. The daily exchange rate is maintained within margins of 7.5 percent around the fixed real-term relationship to the SDR with indicative bands of 2.25 percent. Since the adoption of the system, the Somali shilling has been devalued 41 percent against the U.S. dollar. On October 31, 1984, the mid-point between buying and selling rates for the U.S. dollar was So. Sh. 26.0000 per US$1.

IX. Last Article IV Consultation:

Held in Mogadiscio December 3-19, 1983 and in Washington January 16-20, 1984; Executive Board discussed the staff report (SM/84/71 and SM/84/72) on April 30, 1984.

The Executive Board's decision (Decision No. 7331-(84/69)), adopted April 30, 1984, was as follows:

1. The Fund takes this decision relating to Somalia's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1983 Article XIV consultation with Somalia, in the light of the 1983 Article IV consultation with Somalia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

SOMALIA - Fund Relations (concluded)

2. The approval by Decision No. 7331-(83/84), adopted February 22, 1983, of Somalia's multiple currency practice arising from a bonus scheme described in EBS/83/15, which was extended by Decision No. 7594-(83/185) adopted December 29, 1983, is further extended until December 31, 1984.

X. Technical assistance:

(a) FAD:	Beginning in December 1983 an advisor from the FAD panel has begun assisting the Ministry of Finance as a revenue advisor.
(b) CBD	Beginning in October 1984 a consultant on external debt has begun assisting the Ministry of Finance.
(c) Other:	None.

XI. Resident Representative/Advisor: None.

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, fisheries and rural development	72.0	41.0
Education	33.0	23.3
Energy	24.0	7.3
Industry	5.0	4.5
Transportation	73.7	52.2
Utilities	21.0	15.9
Total	228.7	144.2
Repayments	1.7	...
Debt outstanding (including undisbursed)	227.0	...
IFC operations	0.3	0.3

Source: World Bank.

1/ Through September 30, 1984.

Somalia - Stand-By Arrangement

Attached hereto is a letter dated November 8, 1984 from the Minister of Finance and the Governor of the Central Bank of Somalia, with attachments, requesting a stand-by arrangement and setting forth

a. the objectives and policies which the Government of Somalia intends to pursue for the period of this arrangement;

b. the policies and measures that the Government of Somalia intends to pursue through June 30, 1985; and

c. understandings of the Government of Somalia with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the Government of Somalia will pursue for the remaining period of this arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of twelve months from __________, 1985 Somalia will have the right to make purchases from the Fund in an amount equivalent to SDR 22.1 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. a. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 2.0 million until April 30, 1985, SDR 5.0 million until July 31, 1985, SDR 10.7 million until October 31, 1985 and SDR 16.4 million until January 31, 1986.

b. None of these limits shall apply to a purchase under the stand-by arrangement that would not increase the Fund's holdings of Somalia's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under this arrangement shall be made from ordinary resources and from borrowed resources in the ratio of 1 to 1, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Somalia shall not make purchases under this arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 percent of quota, or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period through June 30, 1985 in which the data at the end of the preceding period indicate that:

(i) the limit on total net domestic credit of the banking system or the limit on net credit from the banking system to the Government, both specified in paragraph 21 of the attached letter; or

(ii) the limits on external payments arrears specified in paragraphs 11 and 14 of the attached letter

is not observed; or

(b) during any period after June 30, 1985, until the review contemplated in paragraph 35 of the attached letter has been completed; or

(c) after June 30, 1985, until suitable performance criteria have been established in consultation with the Fund as contemplated by paragraphs 21 and 35 of the attached letter, or after such performance criteria have been established, while they are not being observed; or

(d) during the entire period of this stand-by arrangement, if the limit on contracting or guaranteeing nonconcessional external loans with a 1 to 12 year maturity or the limit on the accummulation of new short-term debt other than normal trade-related credits, described in paragraph 13 of the attached letter, is not observed; or

(e) during the entire period of this stand-by arrangement, while Somalia has any overdue financial obligation to the Fund, or if Somalia

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices other than the elimination of the dual exchange rate system, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Somalia is prevented from purchasing under the arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Somalia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Somalia's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Somalia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Somalia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Somalia, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G(4)(b) of the Fund's Rules and Regulations. Somalia will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G(4)(d).

8. Somalia shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Somalia shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Somalia's balance of payments and reserve position improves.

(b) Any reductions in Somalia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the arrangement Somalia shall remain in close consultation with the Fund. These consultations, including those pursuant to the provisions of paragraph 35 of the attached letter, may include correspondence and visits of officials of the Fund to Somalia or of representatives of Somalia to the Fund. Somalia

shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Somalia in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 35 of the attached letter Somalia will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Somalia has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Somalia's balance of payments policies.

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

November 8, 1984

Dear Mr. de Larosière:

1. Against a background of virtual stagnation in economic activity and mounting domestic and external financial imbalances, the Government of Somalia launched, in mid-1981, a significant adjustment effort. Over the next two and a half years, substantial supply- and demand-oriented measures were implemented in the context of two Fund-supported stand-by arrangements. The policies pursued contributed to a pickup in economic activity and a reduction in domestic and external financial imbalances. All the quantitative performance criteria were observed. In 1984, the economic and financial situation became increasingly difficult. This reflected in part the continuation of the import ban on cattle in our main export market and the late arrival of rains. In these circumstances, there was a slowdown in economic activity, a sharp rise in the rate of inflation, as measured by the Mogadiscio consumer price index, to an estimated annual rate of about 92 percent, and a worsening in the external sector position. As the international reserves of the Central Bank declined precipitously, the Government of Somalia was unable to service fully its external debt obligations. After debt relief, arrears amounting to an estimated US$50.5 million are projected to be outstanding at the end of 1984. Demand management policies also suffered a setback. On the budgetary side, there was a slippage in revenue collection while ordinary expenditures rose sharply. The overall budget deficit on a commitment basis quadrupled, rising from So. Sh. 1.3 billion in 1983 to about So. Sh. 5.0 billion in 1984. While in the two previous years the Government had been able to reduce its net indebtedness to the banking system, in 1984 the net credit to the government sector rose by 143 percent. Further, credit to the private sector (including public enterprises) was allowed to expand by 50 percent. The rapid expansion of domestic credit contributed to a 56 percent expansion in domestic liquidity, compared with 7.5 percent in 1983.

The 1985 Adjustment Program

2. Overview: In view of the growing imbalances, the Somali Government has decided to adopt a major adjustment program for 1985. The key objectives of the program will be to achieve a rate of economic growth of 4 percent, compared with a rate of 2-3 percent in 1984; to reduce inflation from 92 percent in 1984 to about 20 percent in 1985; and to effect an improvement in the external sector position to achieve a reduction in the deficit of the balance of payments to about US$57 million, as a step toward attaining a viable balance of payments position over the medium term.

3. To achieve these objectives, a comprehensive policy package with measures on both the demand and supply sides will be implemented. In order to reduce the existing distortions in the economy, the exchange rate of the Somali shilling that applies to private transactions will be floated, to allow it to be determined by market forces; trade restrictions emanating from licensing requirements will be virtually eliminated; liberal pricing and marketing policies will be pursued; the ongoing reforms in the public enterprise sector will be accelerated; and the public investment program, the composition and level of which is viewed as appropriate by the World Bank, will be put in place. The program involves generally quick-yielding projects that can be expected to complement the envisaged gradual resurgence of private sector economic activity by reducing physical bottlenecks in the agricultural sector and improving communications, transportation, and port facilities.

4. These supply-oriented policies will be accompanied with the pursuit of restrictive financial policies aimed at curtailing the growth of aggregate demand. On the fiscal front, the Government has already adopted a number of tax measures that are expected to contribute to expanding the revenue base and improving the elasticity of the tax system. Reforms, intended to strengthen tax collection procedures, will be introduced. Furthermore, the measures in the external sector are expected to contribute to a sharp expansion in domestic revenues. Simultaneously, the growth in ordinary expenditures will be severely constrained, implying a severe cut in real terms. There will be a sharp reduction in allocations of non-wage expenditures, the growth of the wage bill will be contained to below the expected inflation rate, and strict expenditure control will be exercised. On the monetary front, there will be an expansion in domestic credit of 6 percent, compared with an expansion of 82 percent in 1984.

5. <u>External sector policies</u>: A key objective of Somalia's policies is to achieve a viable balance of payments position over the medium term and to pursue external sector policies consistent with a sustained rate of economic growth under conditions of financial stability. Nonetheless, Somalia is expected to continue to be dependent on external financial assistance, including debt relief, for the foreseeable future. The external sector policies are expected to contribute to a recovery and renewed expansion of exports, the stimulation of domestic import substitution industries, and to an increase in private remittances and private capital inflows. However, imports will also need to increase significantly, partly because of the expansion of the public investment program and partly to meet the requirements of a higher level of economic activity. In 1985 the current account deficit is expected to be limited to about US$151 million and the overall balance of payments deficit to US$57 million.

6. Under the program, Somalia will adopt, effective January 1, 1985, a market system for the determination of the exchange rate of the Somali shilling and will eliminate virtually all trade restrictions, as detailed in Attachment I. Simultaneously, the franco valuta system will be abolished and replaced by a new system, which will involve the establishment of a free foreign exchange market. Under the system, exporters will be allowed to retain in export-promoting accounts, denominated in foreign currency, 65 percent of their export proceeds. Import accounts denominated in foreign exchange will be established and external accounts liberalized. The deposits in these accounts may be used for import purposes or sold to other individuals at a rate negotiated between the buyer and the seller. Virtually all licensing requirements for exports and imports will be abolished.

7. An official exchange rate will apply during a transitional period to the surrendered portion of export receipts and to official transactions as defined in Attachment I. A foreign exchange budget has been estimated, showing that the foreign exchange needs of the government sector (including oil imports) can be met from the foreign exchange receipts of the public sector and the 35 percent surrender requirements. Thus, the inflow and outflow of foreign exchange for the official market will be matched, and consequently, no profits or losses to the Central Bank or to the government sector should, in principle, arise.

8. In the official market, the Somali Government will devalue the Somali shilling from So. Sh. 26 = US$1 to So. Sh. 36 = US$1, effective January 1, 1985. This rate will more than fully reverse the appreciation in the real effective exchange rate since July 1983. During the first six months of the stand-by arrangement, the official rate will continue to be adjusted in accordance with the present system of pegging to the real SDR. Moreover, there will be an additional devaluation of So. Sh. 0.5 per U.S. dollar by the end of each month through end-June 1985. The Somali government is fully committed to unify the official rate with the market rate. Accordingly, during the first mid-term review mission, which is scheduled to take place in April 1985, the Government of Somalia will reach understandings on a timetable for gradually unifying the rates in the two markets by the end of the program period, after reviewing the experience with the market system in the first months of its operations.

9. In view of the envisaged liberalization of the exchange system, Somalia will abolish, effective January 1, 1985, the bonus scheme for workers' remittances and capital inflows effected by Somali nationals, ending thereby the multiple currency practice that had been approved by the Fund until end-1984. The maintenance of an official exchange rate will give rise to a multiple currency practice for which we request Fund approval until end-1985. During the period covered by the stand-by arrangement, the Government does not intend to: (1) introduce further