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EBS/85/1
Correction 1

CONFIDENTIAL

January 24, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Somalia - Request for Stand-By Arrangement

The following corrections have been made in EBS/85/1 (1/2/85):

Page 17, line 9: for "42 percent"
read "80 percent"

line 10: for "57 percent"
read "24 percent"

Page 39, section 2, first para., line 2: for "27 percent"
read "67 percent"

line 12: for "130 percent"
read "30 percent"

second para., line 2: for "47 percent"
read "27 percent"

Corrected pages are attached.

Att: (2)

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

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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.

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.