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INFORMATION

May 3, 1988

To: Members of the Executive Board
From: The Acting Secretary
Subject: Somalia - Staff Report for the 1988 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with Somalia, which will be brought to the agenda for discussion on a date to be announced.

Mr. Abu-zobaa (ext. 6946) or Mr. Scheuer (ext. 6940) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

SOMALIA

Staff Report for the 1988 Article IV Consultation

Prepared by the Staff Representatives for the 1988
Consultation with Somalia

Approved by G.E. Gondwe and Shailendra J. Anjaria

May 2, 1988

I. Introduction

The 1988 Article IV consultation discussions with Somalia were held in Mogadiscio during March 16-27, 1988. The Somali representatives were the Minister of Finance, Mr. Abdirahaman Jamae Barre, the Governor of the Central Bank of Somalia, Mr. Mahamud Mohamed Nur, the Vice-Minister of Finance, Mr. Mohamed Hassan Barre, the Director General of the Ministry of Finance, Mr. Ali Hassan Ali, and other officials from ministries and agencies dealing with economic and financial matters. The staff representatives were Messrs. N. Abu-zobaa (head), D. Ballali, D. Scheuer, H. Futamura (all-AFR), Ms. M. Carkovic (ETR) and Ms. Y. Coker (secretary-AFR). Mr. U. Dell'Anno, Fund Resident Representative in Somalia, assisted the mission. Mr. G. Zanini of the World Bank participated as an observer.

Somalia continues to avail itself of the transitional arrangements of Article XIV, Section 2.

The staff report for the last Article IV consultation was discussed by the Executive Board on September 22, 1986. Directors then welcomed the improved economic performance in 1985 and 1986 and encouraged the authorities to persist with the adjustment effort and to implement the needed structural and fiscal reforms. They commended the authorities for liberalizing the economy and for adopting a flexible, market-oriented exchange rate policy. They expressed concern at the increasingly difficult medium-term prospects and noted that Somalia would require debt relief and donor support of a highly concessional nature for a number of years to come. In this regard, Directors stressed the need for improved coordination between Somalia and the principal donors to permit a steady and timely disbursement of resources. While welcoming the elimination of the then overdue obligations to the Fund, Directors expressed serious concern at the continued existence of payment arrears generally.

On June 29, 1987 the Executive Board approved Somalia's request for a 20-month stand-by arrangement in an amount equivalent to SDR 33.15 million (75 percent of quota, representing an annual access of

45 percent of quota), with purchases phased into six equal installments. In addition, the Board also approved a request for a three-year arrangement under the structural adjustment facility (SAF), and the first annual arrangement thereunder. Upon Board approval Somalia purchased SDR 5.43 million under the stand-by arrangement, and obtained a disbursement of SDR 8.84 million under the first annual SAF arrangement. Total resources under the SAF were then projected to amount to about SDR 20.774 million over the three-year period. In early August the staff visited Mogadiscio and found that the program had been broadly on target through end-June 1987. A purchase on the basis of the June performance criteria was not made due to the accumulation of arrears to the Fund, although other performance criteria for that date were observed. However, after September 16, 1987, Somalia abruptly abandoned the Fund-supported program. The system of auctioning foreign exchange was also abandoned and the exchange rate was fixed at a substantially appreciated level. Subsequently, the authorities pursued strongly expansionary monetary and fiscal policies and introduced extensive price controls, among other measures.

Over the years Somalia has made extensive use of Fund resources. As of March 31, 1988 Somalia's outstanding obligations in the General Resources Account total SDR 108.3 million (245 percent of quota). Borrowing under the structural adjustment facility and Trust Fund loans outstanding were SDR 6.5 million, and SDR 8.8 million, respectively. Arrears to the Fund were SDR 23.8 million. Somalia has been overdue in its financial obligations to the Fund during most of the past three years. Complaints under Rules K-1 and S-1 were issued on October 25, 1985 and a notice of failure to settle Trust Fund obligations was issued on December 6, 1985. The complaints and the notice were withdrawn following full settlement of Somalia's overdue financial obligations to the Fund on April 22, 1986. The second and third complaints under Rule K-1 and notice of failure to settle a Trust Fund obligation were issued on July 22, 1986 and February 2, 1987, while a complaint under Rule S-1 was issued on April 7, 1987. The complaints and notice were withdrawn after Somalia settled all its overdue financial obligations to the Fund. A further complaint under Rule K-1 was issued on September 8, 1987 and a complaint under Rule S-1 and Trust Fund notice were issued on October 2, 1987. These complaints were considered by the Executive Board on October 7, 1987, and reviewed on December 7, 1987 and on March 7, 1988. During the March discussions, Directors decided to hold the next review two months later, with the expectation that Somalia would be declared ineligible to use the Fund's resources if its overdue obligations had not been discharged by then.

A summary of Somalia's relations with the Fund and the World Bank are presented in Attachments II and III, respectively.

II. Recent Economic Developments and Policies

1. An overview of developments during 1985-86

In 1985-86, following the serious economic setback of 1984 which was precipitated by the impact of the ban on Somali cattle imports into Saudi Arabia and a heavy debt burden resulting from the expiration of the grace period on a large number of loans, and aggravated by a major weakening of financial policies, Somalia embarked on a stabilization effort supported by a stand-by arrangement (covering the period February 22, 1985 to September 30, 1986) from the Fund. The setback had reversed most of the gains achieved during a previous adjustment effort during 1981-83. The 1985-86 program aimed at reducing the large internal and external imbalances that had re-emerged and at enhancing structural reforms in the economy. Partly as a result of favorable weather conditions, real GDP growth in 1985 was almost 3 percent above the program's target (Table 1) and over the two years substantial progress was made towards addressing the imbalances. Other objectives of the program were not fully attained mainly because of the failure to implement some fiscal measures and delays in disbursing foreign assistance.

The programs implemented in Somalia in recent years have been growth oriented and have involved an increase in public investment expenditure, which is financed entirely from external grants and loans, and this had implications for the budget deficit. ^{1/} Nonetheless, during the period 1985-86 the authorities generally pursued far more expansionary financial policies than envisaged in the program. This was particularly the case in 1985, when the overall fiscal position weakened as revenue, in terms of GDP, remained at the depressed level of 1984, while expenditure rose relative to GDP. The overall budget deficit on a commitment basis, excluding grants, was 14.4 percent of GDP compared with the program's target of 8.9 percent; including grants, it was 6.9 percent of GDP against 2.0 percent of GDP in the program (Table 2). When compared to 1984, the overall budget deficit, excluding grants, worsened from 11.3 percent of GDP to 14.4 percent of GDP; however, when grants are included, it improved from 8.2 percent to 6.9 percent of GDP, reflecting a more than tripling of external grants. This deficit was financed principally by external borrowing and debt relief, while domestic bank financing declined sharply. In 1985 the private sector was a recipient of a large credit expansion. Total domestic credit rose by 29 percent of initial money stock and broad money increased by 45 percent compared with program targets of 7 percent and 17 percent, respectively. Although falling short of the target of 20 percent, the rate of inflation decelerated from 92 percent in 1984 to 38 percent in 1985. In 1986 there was a tightening of financial policies,

^{1/} The public investment program increased by 285 percent in nominal terms, and by 39 percent in U.S. dollar terms from 1984 to 1986. In 1986 the overall deficit on a commitment basis, excluding PIP outlays and related external financing, was 3.7 percent of GDP.

Table 1. Somalia: Selected Economic and Financial Indicators, 1983-88

	1983	1984 ^{1/}	1985	1986	1987 ^{2/} Prog.	1987 Est.	1988 ^{3/} Proj.
(Growth rate in percent, unless otherwise specified)							
National income and prices ^{4/}							
GDP at constant factor cost	-13.0	9.7	6.7	-1.8	4.1	1.5	—
Consumer price index, December/December	48.9	82.0	30.4	30.7	22.0	42.1	42.4
Consumer price index, period average	36.4	92.9	37.8	35.8	...	28.1	35.5
Trends in central government finance							
Revenue	54.1	-6.4	38.1	81.4	33.7	2.3	17.7
Total revenue and grants	40.4	11.2	103.3	68.3	104.1	91.9	-1.4
Total expenditure	23.7	69.7	61.0	61.9	74.6	111.4	-22.9
Investment expenditure	-22.0	62.7	154.2	61.6	155.7	184.4	-5.7
Trends in monetary aggregates ^{5/ 6/}							
Net domestic credit	4.7	81.4	29.0	25.1	7.3	72.8	...
Government (net)	-5.9	48.1	15.9	6.9	-3.8	62.7	...
Private	10.7	33.3	13.1	18.2	11.1	10.1	...
Broad money	7.1	22.4	45.4	37.0	13.1	111.3	...
Counterpart funds	...	...	2.1	8.6	...	-7.2	...
Residents' foreign currency deposits	...	...	27.8	1.1	...	-1.0	...
Velocity	6.7	9.8	9.2	9.4	...	5.7	...
Interest rates							
Commercial bank lending rate							
Minimum	12.0	12.0	15.0	15.0	...	15.0	...
Maximum	14.5	14.5	21.0	22.0	...	22.0	...
Commercial bank deposit rate							
Ordinary savings	8.0	8.0	12.0	12.0	14.0	14.0	...
12-month time deposits	9.5	9.5	16.0	18.0	20.0	18.0	...
Maximum	11.0	11.0	18.0	24.0	24.0	24.0	...
Trends in external sector (in U.S. dollars)							
Exports, f.o.b.	-27.0	-38.0	50.0	1.8	16.2	-1.7	6.2
Imports, c.i.f.	-7.0	-9.8	-8.1	-4.3	11.2	39.9	-7.9
Nominal effective exchange rate (depreciation -)	-10.9	-8.1	-56.8	-48.2	...	-31.1	...
Real effective exchange rate (depreciation -)	10.5	59.6	-44.9	-34.1	...	-15.6	...
(In percent of GDP)							
Overall budget balance							
Including grants	-3.6	-8.2	-6.9	-7.4	-6.0	-14.6	-4.3
Excluding grants	-6.7	-11.3	-14.4	-15.8	-22.4	-33.0	-16.9
Balance of payments							
Current account balance ^{7/}	-19.0	-17.2	-11.9	-10.5	-4.9	-9.5	-8.4
Current account balance ^{8/}	-6.5	-4.5	-5.0	-5.8	-4.1	-6.4	-5.8
Current account balance, excluding grants ^{7/}	-38.1	-37.9	-33.1	-31.2	-29.6	-44.5	-39.7
Current account balance, excluding grants ^{8/}	-13.0	-9.9	-14.2	-17.3	-24.3	-30.0	-27.2
Overall balance ^{7/}	-11.1	-16.5	-5.4	-9.2	0.9	-6.7	-6.9
Overall balance ^{8/}	-3.8	-4.3	-2.3	-5.1	0.8	-4.5	-4.7
(In millions of U.S. dollars, unless otherwise specified)							
Current account balance	-147.0	-145.0	-111.0	-99.2	-52.5	-93.0	-85.5
Current account, excluding grants	-295.0	-319.0	-315.0	-294.9	-313.9	-436.3	-401.9
Overall balance of payments	-86.0	-139.0	-30.0	-87.0	9.7	-65.8	-69.8
Gross official reserves	15.8	6.3	11.6	26.6	34.6	15.6	15.6
External debt, including IMF	958.5	1,183.2	1,409.3	1,583.6	1,399.0	1,685.2	1,742.4
Debt service ratio ^{9/}	24.0	93.3	52.4	129.6	97.2	116.1	131.3
External payments arrears ^{10/}	82.8	117.8	67.0	167.5	57.0	150.6	...
External commercial arrears	...	33.0	16.1	9.5	1.5	...	...

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

^{1/} Balance of payments data for interest and amortization payments, as well as the debt service ratio, are on an accrual basis beginning in 1984.

^{2/} EBS/87/122; balance of payments data are adjusted to reflect the closing of the financing gap.

^{3/} Data for 1988 are projections, except for fiscal data which are based on the 1988 budget.

^{4/} GDP estimates are based on National Accounts Aggregates, 1977-86 (1987), and IMF and World Bank staff estimates, and differ from estimates shown in SM/86/213 (1986 Recent Economic Developments), and from EBS/87/122 (Request for Stand-by Arrangement, and Request for Arrangements under the Structural Adjustment Facility).

^{5/} Change in relation to broad money at the beginning of the year. Beginning with 1985, broad money excludes resident foreign currency deposits and counterpart funds.

^{6/} Complete data for the Commercial and Savings Bank are available through September 1987 only, and 1987 monetary aggregates are partly estimated.

^{7/} Ratio to GDP in Somali shillings, converted to U.S. dollars at rates necessary to maintain the bilateral purchasing power parity vis-à-vis the United States at the 1986 level, based on the transactions weighted average of the free and auction market rates in 1986. The ratios for the 1987 program differ from those shown in EBS/87/122, which were based on the 1973 constant purchasing power exchange rate.

^{8/} Ratio to GDP in Somali shillings, converted to U.S. dollars at the average official exchange rate.

^{9/} Ratio to exports of goods and nonfactor services.

^{10/} End of period.

Table 2. Somalia: Summary of Government Operations, 1983-88 ^{1/}

Fiscal Year Ending December 31	1983	1984	1985	1986 Prelim. actual	1987 Pro- gram ^{3/}	1987 Prelim. estimate	1988 Budget ^{2/}
(In millions of Somali shillings)							
Total revenue and grants	5,359	5,959	12,116	20,388	40,648	39,129	38,573
Revenue	4,075	3,774	5,220	9,595	12,700	9,705	12,000
Tax	(3,371)	(2,979)	(4,577)	(8,517)	(11,900)	(8,372)	(10,439)
Import duty	2,198	1,816	2,551	4,656	6,270	4,307	5,600
Export duty	124	37	89	83	150	66	100
Other taxes	1,049	1,126	1,937	3,778	5,480	3,999	4,739
Nontax	704	795	643	1,078	800	1,333	1,561
Grants ^{4/}	(1,106)	(1,980)	(6,620)	(10,418)	(27,948)	(28,933)	(26,573)
Commodity import program	901	620	2,504	5,317	5,460	3,551	2,100
Transfers from local authorities	178	205	276	375	...	491	...
Total expenditure	6,636	11,264	18,134	29,366	50,757	62,089	47,882
Ordinary expenditure	4,539	7,927	9,923	16,150	17,951	25,095	13,466
Wages and salaries	(...)	(2,150)	(2,152)	(2,149)	(2,202)	(2,202)	(2,343)
Interest: Domestic	(...)	(385)	(486)	(648)	(1,150)	(800)	(200)
Foreign	(...)	(540)	(1,167) ^{5/}	(3,295)	(4,651)	(4,277) ^{6/}	(4,634) ^{7/}
Other expenditure	(...)	(4,852)	(6,118)	(10,058)	(9,948)	(17,816)	(6,289)
Investment expenditure	1,920	3,124	7,940	12,830	32,806	36,493	34,416
Development budget	(498)	(604)	(1,372)	(3,131)	(3,400)	(4,687)	(3,818)
Transfers to local authorities	177	213	271	386	...	501	...
Overall deficit, commitment basis							
Excluding grants	-2,383	-7,285	-12,638	-19,396	-38,057	-51,893	-35,882
Including grants	-1,277	-5,305	-6,018	-8,978	-10,109	-22,960	-9,309
Change in domestic counterpart of external							
Interest arrears (excluding debt relief)	--	1,800	-1,440	2,834	-1,898	2,260	3,536
Other adjustments to cash basis	--	--	300	-57 ^{8/}	...	...	-300 ^{8/}
Overall deficit, cash basis	-1,277	-3,505	-7,158	-6,201	-12,007	-20,700	-6,073
Financing	1,277	3,505	7,158	6,201	12,007	20,700	6,073
Foreign (net)	1,572	940	5,033	6,355	4,530	6,259	-1,336
Domestic	-295	2,565	1,045	-154	-500	9,114	918
Banking system (net)	(-295)	(2,573)	(875)	(657)	(-500)	(8,177)	(--)
Use of cash balances ^{9/}	(--)	(-8)	(170)	(-2)	(...)	(...)	(--)
Other domestic ^{10/}	(--)	(--)	(--)	(-809)	(...)	(937)	(918)
Debt relief	--	--	1,080 ^{11/}	--	...	5,327 ^{12/}	3,899 ^{13/}
Financing gap	--	--	--	--	7,977 ^{14/}	--	2,592
(In percent of GDP)							
Total revenue and grants	15.0	9.3	13.8	16.6	23.9	24.9	18.2
Of which: revenue	(11.4)	(5.9)	(6.0)	(7.8)	(7.5)	(6.2)	(5.7)
Total expenditure	18.6	17.5	20.7	24.0	29.9	39.5	22.5
Ordinary expenditure	(12.7)	(12.3)	(11.3)	(13.2)	(10.6)	(16.0)	(6.3)
Investment expenditure	(5.9)	(5.2)	(9.4)	(10.8)	(19.3)	(23.5)	(16.2)
Of which: development budget	1.4	0.9	1.6	2.6	2.0	3.0	1.8
Overall deficit, commitment basis							
Excluding grants	-6.7	-11.3	-14.4	-15.8	-22.4	-33.0	-16.9
Including grants	-3.6	-8.2	-6.9	-7.4	-6.0	-14.6	-4.3
Change in domestic counterpart of external							
Interest arrears (excluding debt relief)	--	2.8	-1.6	2.3	-1.1	1.4	1.7
Other adjustments to cash basis	--	--	0.3	--	--	--	-0.1
Overall deficit, cash basis	-3.6	-5.4	-8.2	-5.1	-7.1	-13.2	-2.9
External financing (net)	4.4	1.5	5.7	5.2	2.7	4.0	-0.6
Domestic financing	-0.8	3.9	1.3	-0.1	-0.3	5.8	0.4
Of which: banking system (net)	(-0.8)	(4.0)	(1.0)	(0.5)	(-0.3)	(5.2)	(--)
Debt relief	--	--	1.2	--	--	3.4	1.8
Financing gap	--	--	--	--	4.7	--	1.2
Memorandum item							
GDP at current market prices (in millions of Somali shillings)	35,725	64,350	87,557	122,605	169,920	157,033	212,361

Sources: Ministry of Finance; Central Bank of Somalia; and staff estimates.

^{1/} Based on an exchange rate of So. Sh. 26 per U.S. dollar in 1984, So. Sh. 39.5 per U.S. dollar in 1985, So. Sh. 71.9 per U.S. dollar in 1986, and So. Sh. 130 per U.S. dollar in the 1987 program. Preliminary estimates for 1987 are based on the average official exchange rate of So. Sh. 107.78 per U.S. dollar, and implicit transactions weighted average rates where applicable. The 1988 budget assumes So. Sh. 100 per U.S. dollar.

^{2/} Consolidates public investment program project and technical assistance loans and grants of US\$61.25 million, and US\$244.73 million, respectively.

^{3/} EUS/87/122.

^{4/} Includes cash, in kind, project, and commodity import program grants.

^{5/} Includes interest payable of So. Sh. 440 million (US\$11 million) that was subsequently rescheduled at the Paris Club meeting in March 1985.

^{6/} Includes interest payable of So. Sh. 2,711 million (US\$23.54 million) that was rescheduled at the Paris Club meeting in July 1987.

^{7/} Includes interest payable of So. Sh. 2,003 million (US\$20.03 million) that was rescheduled at the Paris Club meeting in July 1987.

^{8/} Provision for prior year expenses.

^{9/} Mainly cash in the regional Treasury vaults.

^{10/} Change in counterpart fund balances held with the Commercial and Savings Bank of Somalia.

^{11/} Consists of debt relief on amortization of So. Sh. 640 million (US\$16 million) and of So. Sh. 440 million (US\$11 million) on interest due.

^{12/} Consists of debt relief on amortization of So. Sh. 2,616 million (US\$24.82 million) and So. Sh. 2,711 million (US\$23.54 million) on interest due, at weighted average rates for effective payments.

^{13/} Consists of debt relief on amortization of So. Sh. 1,896 million (US\$18.96 million) and of So. Sh. 2,003 million (US\$20.03 million) on interest due.

^{14/} Expected to be closed through debt relief.

and the overall budget deficit rose only slightly to 15.8 percent of GDP, or 7.4 percent including grants. The programmed reduction in the budget deficit could not be achieved because improved revenue performance and increased foreign grants were more than offset by increased government expenditure. ^{1/} Net bank credit to the Government increased by about 7 percent of initial broad money stock or by 0.5 percent of GDP (Table 3). The deficit was also financed by an accumulation of arrears, amounting to about 2 percent of GDP, while the remaining financing requirement of about 4.7 percent of GDP was covered by foreign borrowing. Net bank credit to the Government increased by 12.1 percent, against a target of a small reduction, and credit to the rest of the economy expanded by 28.4 percent. Broad money rose by 38.3 percent. The December-December rate of inflation decelerated to 30.7 percent compared with the program target of 22.0 percent.

In 1985-86 the balance of payments pressures eased. Exports made a sharp recovery, while imports declined (Table 4). The external current account deficit, including grants (as measured by the exchange rate necessary to maintain the purchasing power parity at the 1986 level) declined from about 17.2 percent of GDP in 1984 (US\$145 million) to 10.5 percent in 1986 (US\$99 million). A reduction of 2 percentage points had been targeted in the program. The larger-than-targeted reduction reflected a shortfall in imports (8 percent lower than targeted) that was induced by lower levels of external cash assistance stemming from delays in disbursing these resources. The overall balance of payments deficit, which had fallen to US\$50 million in 1985 from US\$139 million in 1984, rose somewhat to US\$87 million in 1986. In 1985, this deficit was financed primarily through debt relief and drawings on the Fund (there was also a large repayment of arrears through net cash payments and debt relief), whereas in 1986 the balance of payments was mainly financed by an increase in debt service arrears.

Somalia's external payments arrears--amounted to US\$117.8 million end-1984--were reduced substantially in the course of 1985 through rescheduling and repayments, declining to US\$67.0 million by end-1985. In 1986 there was a substantial accumulation of arrears partly because, in the absence of a stand-by arrangement covering the full year, the authorities were unable to arrange a Paris Club rescheduling, and by the end of the year total external arrears totaled to US\$167.5 million. Somalia's debt service ratio was 52 percent in 1985; in the absence of debt rescheduling, it rose to 130 percent in 1986.

During 1985-86, Somalia's exchange rate system experienced major modifications. In January 1985 the authorities introduced a market-

^{1/} Excluding expenditure on the public investment program and related financing from external loans and grants, the overall deficit on a commitment basis declined from 6.4 percent of GDP in 1984, to 4.1 percent in 1985 and to 3.7 percent in 1986. At the same time, revenue as a proportion of ordinary expenditure rose from 47 percent in 1984, to 55.6 percent in 1985, and 59.4 percent in 1986.

Table 3. Somalia: Monetary Survey, 1983-87

	<u>1983</u> Dec.	<u>1984</u> Dec.	<u>1985</u> Dec.	<u>1986</u> Dec.	<u>1987</u> Sept.	<u>1987</u> Dec. Prog.	<u>1987</u> Dec. Actual
(In millions of Somali shillings)							
Net foreign assets	-1,061.6	-2,585.6	-2,212.6	-9,680.1	-15,781.1	-10,653.6	...
Central bank	-1,815.4	-2,929.9	-5,698.2	-14,155.5	-28,063.7	...	...
Commercial bank	753.8	344.3	3,485.6	4,475.4	12,182.6	...	...
Domestic credit	5,260.8	9,616.2	11,516.9	13,904.3	15,922.4	14,852.0	...
Government (net)	1,805.0	4,378.1	5,421.8	6,079.1	7,560.7	5,579.1	14,255.9
Other	3,455.8	5,238.1	6,095.1	7,825.2	8,361.7	9,272.9	...
Public entities	1,163.0	1,511.2	2,071.2	3,730.4	4,354.8	...	...
Private sector	2,292.8	3,726.9	4,023.9	4,094.8	4,006.9	...	...
Broad money	5,348.1	6,677.8	11,606.9	16,051.7	25,093.1	18,640.2	...
Liabilities in local currency	...	6,622.6	9,346.8	13,043.6	20,673.6	14,752.3	...
Of which:							
Currency outside banks	1,355.5	1,899.8	3,787.5	5,169.1	9,586.1	...	...
Foreign currency deposits	...	55.2	1,874.4	1,976.8	2,945.1	515.3	...
Counterpart funds	...	...	295.7	1,031.3	1,474.4	3,372.6	94.5
Other items (net)	-1,148.9	352.8	-2,302.6	-11,827.5	-24,951.8	-14,441.8	...
Valuation adjustment	-1,551.6	-1,447.0	-6,124.1	-19,104.6	-39,387.0	-32,593.8	...
Medium- and long-term foreign liabilities	1,318.8	2,059.8	3,655.1	8,077.8	15,543.9	13,781.3	...
Other items	-916.1	-260.0	166.4	-800.7	-1,108.7	4,370.7	...
(Percent change to end of previous year)							
Domestic credit	4.7	82.8	19.8	20.7	14.5	6.8	...
Government (net)	-5.9	142.6	23.8	12.1	24.4	-8.2	134.5
Public entities	-2.7	29.9	37.1	80.1	16.7	...	...
Private sector	13.3	62.5	8.0	1.8	-2.1	...	...
Broad money	7.1	24.9	73.8	38.3	56.3	16.1	...

Sources: Central Bank of Somalia; and staff estimates.

Table 4. Somalia: Balance of Payments Estimates, 1983-87

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987 Prog.	1987 Est.
Exports, f.o.b.	100.0	62.0	93.0	94.7	113.6	93.1
Livestock	72.0	33.1	66.0	62.4	74.3	58.2
Bananas	15.0	14.1	13.0	17.0	21.8	20.5
Other	13.0	14.8	14.0	15.3	17.5	14.4
Imports, c.i.f.	-450.0	-406.0	-373.0	-357.0	-403.8	-499.4
Cash imports	-206.0	-156.0	-99.0	-108.1	-105.0	-110.9
Grants-in-kind	-147.0	-151.0	-158.0	-140.6	-215.4	-318.6
Loans-in-kind	-97.0	-99.0	-116.0	-108.3	-83.4	-69.9
Trade balance	-350.0	-344.0	-280.0	-262.3	-290.2	-406.3
Services (net)	4.0	-47.0	-55.0	-69.6	-58.7	-65.0
Interest	-21.0	-44.0	-49.0	-60.3	-47.6	-52.0
Other	-25.0	-3.0	-6.0	-9.3	-3.1	-13.1
Transfers (net)	199.0	246.0	224.0	232.7	288.4	378.3
Private	51.0	72.0	20.0	37.0	27.0	35.0
Official	148.0	174.0	204.0	195.7	261.4	343.3
Current account	-147.0	-145.0	-111.0	-99.2	-52.5	-93.0
Excluding official transfers	-295.0	-319.0	-315.0	-294.9	-313.9	-436.3
Capital account (net)	61.0	6.0	61.0	12.2	62.2	27.3
Official	100.0	46.0	73.0	64.2	62.2	57.2
Inflows ^{1/}	107.0	106.0	122.0	124.3	123.4	120.3
Outflows	-7.0	-60.0	-49.0	-60.1	-61.2	-63.1
Private (net)	-39.0	-40.0	-12.0	-52.0	--	-30.0
Overall balance	-86.0	-139.0	-50.0	-87.0	9.7	-65.8
Financing	86.0	139.0	50.0	87.0	-9.7	65.8
Central bank	47.0	13.0	28.0	15.0	-45.2	-23.5
Reserves	2.0	9.0	-2.0	16.0	-8.0	3.7
IMF	44.0	-3.0	32.0	-7.0	-0.2	-12.0
Other ^{2/}	1.0	7.0	-2.0	6.0	-37.0	-15.2
Commercial bank ^{3/}	39.0	29.0	-32.0	-8.0	--	...
Arrears ^{4/}	--	71.0	-98.0	80.0	-116.5	-18.5
Debt relief	--	26.0	152.0	--	152.0	107.8
Current maturities	...	--	43.0	...	67.0	48.4
Arrears	...	26.0	109.0	...	85.0	59.4

Sources: Central Bank of Somalia; Ministry of Finance; and staff estimates.

^{1/} For 1987, this includes US\$27.7 million of debt repayment to the Arab Fund in Somali shillings.

^{2/} Includes net drawings on the Arab Monetary Fund (AMF) and, for 1987, a bridge loan.

^{3/} No 1987 data for the Commercial Bank were available at the time of the Consultation.

^{4/} Includes changes in arrears with IMF, AMF, and others.

oriented exchange rate system for most transactions, except for the surrendered export receipts and for government transactions, which took place at an official exchange rate that was maintained on a transitional basis. Initially, the official exchange rate was depreciated by 28 percent in foreign currency terms (to So. Sh. 36 = US\$1) in order to reduce the differential between the free market and the official exchange rate. The action reduced the ratio of the two rates from about 3.5 to 2.5. The official exchange rate was to be adjusted on a monthly basis during the year so that it would become unified with the free market rate by the end of 1985. At the same time, there was a liberalization and simplification of the exchange and trade system, allowing residents and nonresidents to buy and sell foreign exchange freely and removing practically all controls on trade and payments, including virtually all licensing requirements for import and export transactions. A third exchange rate emerged after April 1985, when the commercial bank rate was not allowed to depreciate in line with the free market but was instead kept unchanged during the remainder of 1985. During the second half of 1985 the programmed adjustment of the official exchange rate was not carried out, and the rate remained fixed (at So. Sh. 40.1 = US\$1) from June to November 1985. In November 1985, the official exchange rate was depreciated by 22 percent in foreign currency terms to bring it in line with the program. However, the exchange rate unification did not take place as expected at the end of 1985.

During 1986 the divergence of exchange rates was reduced substantially, with most international transactions being carried out at market determined rates. Throughout the year, there was a series of depreciations intended to bring the official rate close to the commercial bank rate and the market rate. In September 1986, an auction system for foreign exchange for imports was introduced, with the auction resources being provided by the World Bank and bilateral sources. By the end of 1986, the auction rate had depreciated to So. Sh. 113.3 = US\$1. A month later, the commercial bank rate, which had been maintained at So. Sh. 84.4 = US\$1 since April 1985, was unified with the official exchange rate. The latter continued to be adjusted monthly until November 1986, when it was So. Sh. 90.5 = US\$1.

2. Developments and policies in 1987

In early 1987 the authorities moved to consolidate and strengthen their adjustment effort. In support of a program that the authorities had been implementing since March 1987, the Fund, as noted, approved a 20-month stand-by arrangement and a three-year structural adjustment arrangement and the first annual arrangement thereunder. The program aimed at achieving real GDP growth of at least 4 percent, reducing the annual rate of inflation to about 22 percent by the end of 1987, reducing the overall budget deficit (including grants) to 6.0 percent of GDP in 1987, limiting the expansion of net domestic credit to 6.8 percent and the growth of broad money to 13.1 percent during the year, as well as making significant progress toward viability of the balance of

payments over the medium term through a reduction of the external current account deficit, the regularization of external debt payments, and a reduction of external payments arrears.

A key element of the program was the consolidation and advancement of the gains achieved in the external sector, mainly with regard to progress toward unifying of the exchange rate system through the auction. To this end, on June 15, 1987 the authorities launched an enhanced Dutch auction system aimed at absorbing all transactions which hitherto had been carried out in the free market and the official market. A temporary exception was made for cash imports of petroleum products, which were to be transacted at a special petroleum accounting rate of So. Sh. 104 = US\$1. However, all petroleum products were priced domestically at import parity based on the auction rate. The unified exchange system was to operate on the basis of bimonthly import and service auctions, and the export earnings surrender requirement was raised from 50 percent to 100 percent. The auction continued to be funded by the World Bank and bilateral donors. In addition, up to 50 percent of the export earnings surrendered were to be channeled through the auction. Initially, the exchange rate appreciated from So. Sh. 146 = US\$1 at the preceding auction to So. Sh. 133.1 = US\$1 at the enhanced import auction, mainly because of the private sector's lack of familiarity with the new system and low participation in the auction. Subsequently, the enhanced import auction rate depreciated in an orderly fashion, reaching So. Sh. 148.6 = US\$1 at the September 1, 1987 auction. At the next auction on September 16, 1987 the rate depreciated sharply to So. Sh. 159.9 = US\$1. A small service auction was held on July 2; the rate of So. Sh. 113.8 = US\$1 that resulted from the auction represented a large appreciation from the previous import auction rate. Owing to lack of funds, another service auction was not conducted until August 16. At that and subsequent service auctions, the rate depreciated in line with or slightly above the enhanced import auction rate.

With regard to the 1987-89 structural adjustment program, intended to extend Somalia's progress toward a more liberal economic system, a beginning was made during the first half of 1987. The Government liberalized the importation and distribution of veterinary drugs. In agreement with IDA, domestic trade in hides and skins was also liberalized, although the elimination of the Government's export monopoly was postponed pending a review of the impact of domestic liberalization. Support for private agricultural production (notably for bananas) was expanded through a new IDA-supported extension program; in agreement with IDA, food aid management was improved through the setting by the Agricultural Development Corporation of minimum buying prices for domestic grain and floor prices for food aid. Public enterprise reform has been proceeding but slowly, pending the preparation by IDA of an industrial rehabilitation project, and the fruition of the Government's efforts to seek joint ventures for a few public enterprises.

Apparently alarmed by the depreciation of the exchange rate of the Somali shilling, after September 16, 1987 the authorities abolished the auction system and abandoned the program. The Revolutionary Socialist Party of Somalia recommended a different set of policies, including the termination of the foreign exchange auctions, and the fixing of the exchange rate at a substantially revalued level of So. Sh. 100 per U.S. dollar. These measures were implemented by the Government on October 11. The 100 percent surrender requirement of export earnings was revoked on October 20, and instead the authorities authorized exporters to retain 40 percent of export proceeds in export promotion accounts, and to use them for any purpose except transfer to other foreign currency accounts. Without the benefit of the auction, the private sector now effects imports through export promotion accounts and external accounts, which are replenished through retained export earnings and remittances, respectively. The Central Bank makes no allocations of foreign exchange to the private sector.

The abandonment of the program had been preceded by the replacement of the Central Bank Governor and the Deputy Governor in August 1987. In late December 1987 a new Cabinet, including the Minister of Finance, was formed. Changes in the management approach and economic policies have continued after the formation of the new Cabinet. For example, on January 20, 1988, the responsibility for the management of foreign exchange was transferred from the Central Bank to the Ministry of Finance. About the same time, the Government reported the formation of a commission to study the introduction of price controls; effective February 7, 1988, the authorities imposed price controls at wholesale and retail levels on a long list of products, ranging from foodstuffs to such items as construction sand and stone, limestone, and marble.

A sharp economic and financial deterioration that began in mid-1987 accelerated following the authorities' shift in policies in September 1987. There was such an unprecedented expansion in government expenditure that for 1987 as a whole, fiscal policy turned more expansionary than in any previous year, including 1984, as domestic revenue stagnated and ordinary expenditure increased by 55 percent. The overall deficit on a commitment basis, both including and excluding grants, more than doubled in terms of GDP, to about 15 percent and 33 percent of GDP, respectively. New external arrears were accumulated and the deficit was financed by domestic bank credit. The stagnation in revenue (which in 1987 financed only 39 percent of ordinary expenditure) was led by an absolute decline in import duties, reflecting a deterioration in customs administration, notwithstanding the fact that cash imports were little changed from 1986, and that the average import duty rate base was revised upward by 29 percent during the year. Other tax revenue stagnated as well, owing in part to shortages of foreign exchange needed to import materials for local industries. Together domestic revenue and nonproject grants decreased by 11.1 percent, while ordinary expenditure and budgetary development expenditure increased by 54.5 percent. To finance the large budget deficit, the increase in net bank credit to the Government was twelve-fold in 1987, relative to 1986, an unprecedented

jump of So. Sh. 8.2 billion (or 5.2 percent of GDP). Most of this increase occurred during the final quarter of 1987, with December alone accounting for So. Sh. 5.6 billion. ^{1/} With an estimated doubling of currency in circulation outside banks, and a large growth in deposits, it is estimated that broad money increased by about 111 percent, against a rise of about 28 percent in nominal GDP. ^{2/} The rate of inflation, which was running at an annual rate of 21 percent in mid-1987, accelerated to an annual rate exceeding 42 percent toward the end of the year; the average inflation rate for 1987 was 28.1 percent. It should be mentioned that the impact of the large expansion in liquidity toward the end of the year was yet to be reflected fully on the price level. Despite a large increase in imports, particularly during the first half of the year, real GDP grew by only 1.5 percent in 1987, as the agricultural sector was adversely affected by the late arrival of the first rains, and subsequent flooding. Moreover, the drought in some rangeland areas resulted in a sharp decline in stocks that offset the increase in the livestock off-take rate.

Following the cessation of the adjustment effort, the external sector began to deteriorate rapidly toward the end of 1987, and the programmed improvement for the year as a whole did not occur. The external current account deficit declined only slightly from the 1986 level of about US\$100 million to US\$93 million, or about 10 percent of GDP, against the program target of about 5 percent of GDP. Excluding official transfers, the current account deficit widened markedly from 31 percent of GDP in 1986 to 45 percent in 1987, reversing the trend observed over the past few years. Exports declined by 2 percent in U.S. dollar terms to US\$93 million in 1987, mainly as a result of reduced exports of livestock, which continue to account for over 60 percent of Somalia's export earnings. Since the bulk of livestock exports takes place during the last quarter of the year, the loss of Somalia's export competitiveness resulting from the sharp appreciation of the Somali shilling may have discouraged exports or, more likely, pushed them increasingly into unofficial export channels. Between September 1987 and February 1988, the real effective exchange rate appreciated by 77 percent. Imports rose by 40 percent in U.S. dollar terms to US\$499 million, an increase of almost US\$100 million more than targeted in the program. The reason for this sharp rise was the more than doubling of official transfers in kind amounting to US\$319 million. About one third of this increase was related to Italy's Emergency Program for Somalia, which in 1987 was directed toward the Public Investment Program. In contrast, imports financed by foreign loans and grants in cash fell short by US\$20 million to US\$39 million because the disbursements of these resources from the World Bank, the United States,

^{1/} About So. Sh. 2.8 billion of this was borrowed by the Government to repay the Arab Fund, which allowed outstanding arrears and 1987 maturities amounting to US\$27.7 million to be settled in local currency.

^{2/} Complete monetary data are available only through September 1987. These are staff estimates made on the basis of incomplete data available through November 1987.

and other bilateral agencies were connected with the funding of the foreign exchange auction suspended in September 1987. Imports financed by "own" foreign exchange increased sharply (by 93 percent) to US\$72 million, as the free exchange system prevailing through mid-September 1987 allowed more transactions to be channeled through the legal markets. The overall balance of payments deficit narrowed from US\$87 million in 1986 to US\$66 million in 1987, again, largely as a result of higher than expected foreign assistance. The balance of payments deficit was financed through debt relief from members of the Paris Club and further accumulation of arrears to non-Paris Club creditors.

The program targeted a substantial reduction of outstanding arrears and a rescheduling of bilateral debts. Instead, new arrears to multilateral institutions, including US\$16 million to the Fund, were accumulated. Debt service due to multilateral institutions including the Fund during 1987 was equal to all of Somalia's exports in that year. However, Somalia obtained a large measure of debt relief from members of the Paris Club (principally, Italy, the United States, France and the United Kingdom), which rescheduled arrears outstanding at end-1986 and maturities falling due in 1987, amounting to US\$107.8 million (US\$59.4 million on arrears and US\$48.4 million on current debt service).

Cash payments on debt service during 1987 were limited to US\$61 million to multilateral institutions and US\$16 million to members of the Paris Club. About half of the payments made to multilateral institutions were made to the Fund, and most of the other half to the Arab Fund, which through an agreement concluded in late 1987, accepted payment of outstanding arrears and 1987 maturities in Somali shillings. Payments to members of the Paris Club were limited to clearing part of outstanding arrears before most of the remaining arrears and current maturities were rescheduled. By December 1987 bilateral agreements with Italy, France, the United Kingdom, and the U.S. had been signed and the authorities were about to sign the agreement with Japan. Somalia has not made any service payments to the special Paris Club account. There was yet no agreement with non-Paris Club creditors.

During 1987 Somalia's total multilateral and bilateral external debt increased by US\$102 million to US\$1,522 million (155 percent of GDP) (Table 5). As a result of the agreements with Paris Club creditors, which rescheduled US\$59 million of end-1986 arrears, total outstanding arrears declined by US\$17 million to US\$151 million in 1987 (Table 6). Debt relief provided by the Paris Club resulted in a substantial reduction in arrears, but since no payments were made to bilateral institutions or to non-Paris Club members, and only some of the accrued payments were made to multilateral institutions, the stock of arrears to non-Paris Club members increased by US\$52 million.

Table 5. Somalia: External Debt Outstanding, 1984-87

(In millions of U.S. dollars; end of period)

	1984	1985	1986	1987
A. Multilateral organizations excluding IMF/AMF	289.1	347.4	411.1	445.1
African Development Bank	1.9	4.4	4.4	4.0
African Development Fund	26.0	33.1	38.1	51.9
Arab Fund	72.3	78.0	79.3	54.9
European Investment Bank	2.9	8.1	9.6	9.7
IDA	144.2	176.6	229.7	273.3
IFAD	7.8	11.6	14.9	15.9
Islamic Development Bank	3.7	5.2	5.2	5.4
OPEC Fund	30.3	30.3	29.8	30.0
B. IMF (including Trust Fund)	101.6	142.5	156.3	181.9
C. Arab Monetary Fund (AMF)	49.5	49.5	49.5	52.8
D. Bilateral organizations	128.3	128.5	137.1	140.0
Kuwait Fund	71.0	82.5	85.6	86.9
Saudi Fund	57.3	46.0	51.5	53.1
E. OECD countries ^{1/}	397.9	524.7	612.8	648.6
France	25.8	41.3	50.9	66.9
Italy	295.6	250.5	244.9	251.2
Japan ^{2/}	0.4	6.8	71.2	78.0
U.S.A.	165.1	189.2	224.9	230.4
U.K.	0.0	19.5	19.6	20.7
Other ^{3/}	1.4	1.4	1.4	1.4
F. Other countries	53.8	53.8	53.8	53.8
Algeria	0.9	0.9	0.9	0.9
Iraq	43.3	43.3	43.3	43.3
Romania	3.0	3.0	3.0	3.0
Yugoslavia	6.6	6.6	6.6	6.6
Total multilateral and bilateral debt	1,020.2	1,246.3	1,420.6	1,522.2
Of which: debt in arrears	117.8	67.0	167.5	150.6
Total multilateral and bilateral debt Excluding IMF	918.6	1,103.9	1,264.3	1,340.3
Supplier's credit ^{4/}	103.0	103.0	103.0	103.0
Financial institutions ^{4/}	60.0	60.0	60.0	60.0
Total	1,183.2	1,409.3	1,583.6	1,685.2
Total excluding IMF	1,081.6	1,266.9	1,427.3	1,503.3
Memorandum items:				
Frozen debt	230.7	242.9	243.8	243.8
Abu Dhabi	94.3	94.3	94.3	94.3
People's Republic of China	73.3	74.9	75.8	75.8
Bulgaria	6.0	6.0	6.0	6.0
U.S.S.R.	57.2	67.7	67.7	67.7

Sources: Central Bank of Somalia; Ministry of Finance.

^{1/} Includes debt rescheduled in 1985.

^{2/} Figures shown for 1986-87 are as reported by Japan.

^{3/} Includes Norway and Denmark among others.

^{4/} Staff estimates. No data were provided during the 1988 consultation.

Table 6. Somalia: Summary Status of External Payments Arrears, 1986-87

(In millions of U.S. dollars)

	Outstanding end-1986		Scheduled debt service	Effective payments			Annual change in arrears	Arrears outstanding at end-1987	Debt rescheduling		Arrears outstanding at end-1987 after rescheduling
	Debt	Arrears		On arrears	On current service				On end-1986 arrears	On current service	
						Total					
Total	1,420.6	167.5	166.5	39.0	37.8	76.9	89.6	257.1	59.4	48.4	150.6
Nonreschedulable	616.5	50.6	93.3	23.2	37.8	61.1	32.2	82.8	—	—	82.8
Multilaterals (excluding IMF, AMF) ^{2/}	411.0	27.4	19.2	18.4	13.4	31.8	-13.6	13.8	—	—	13.8
IMF ^{3/}	156.3	4.8	44.9	4.8	24.4	29.3	16.6	21.5	—	—	21.5
AMF	49.5	18.4	29.2	—	—	—	29.2	47.5	—	—	47.5
Other	803.8	116.9	73.2	15.8	—	15.8	57.4	174.3	59.4	48.4	67.8
Kuwait and Saudi Funds	137.1	10.7	12.3	—	—	—	12.3	22.9	—	—	22.9
OECD ^{4/} ^{5/}	612.9	75.2	53.5	15.8	—	15.8	37.6	112.9	59.4	48.4	6.3
Other	53.8	31.0	7.5	—	—	—	7.5	38.5	—	—	38.5

Sources: Ministry of Finance; Central Bank of Somalia; and staff estimates.

^{1/} Excludes Abu-Dhabi, People's Republic of China, U.S.S.R., and Bulgaria.^{2/} Effective payments include an estimated US\$28 million paid in Somali shillings to the Arab Fund.^{3/} Includes Trust Fund.^{4/} Includes debt that had been rescheduled in 1985 and debt that had not been previously rescheduled.^{5/} Effective payments include an estimated US\$8 million of end-1986 arrears to Italy that were transformed into grants.

III. Report on the Discussions

The discussions were held against a background of a rapidly worsening economic and financial position, precipitated by the authorities' decision to abandon the adjustment effort, appreciate the exchange rate of the Somali shilling, and introduce price controls. The discussions focused on a review of developments and policies during 1987 and early 1988. In the light of this review, there was a thorough and frank discussion about the implications of the authorities' actions for 1988 and beyond, and the staff underscored the unsustainability of the authorities' current policies.

1. The overall policy stance

The Somali representatives explained that the abandonment of the program in September 1987 was a political decision by the Somali Socialist Revolutionary Party. They indicated that the decision was a reaction to the rapid depreciation of the Somali shilling which, at the September 16, 1987 auction, had depreciated by 7 percent to reach its highest level of So. Sh. 159.9 = US\$1, and to the general dislike of the auction as a means of managing the exchange rate. They also indicated that behind the decision was the belief that the depreciation of the shilling was the reason for the increasingly higher rates of inflation. The staff representatives responded that the abandonment of the auction system would not have been a cause of serious concern if the authorities had opted for a realistic, market-related, and flexible exchange rate. The problem stemmed from the appreciation of the rate and the rigidity with which it had since been administered. The staff representatives pointed out that highly expansionary fiscal and monetary policies had been pursued, particularly during the second half of 1987. The liquidity so created had caused the rate of inflation in Somalia to be much higher than those in Somalia's trading partner countries; thus, the Somali shilling had depreciated in line with the differential in the inflation rates, and that depreciation would continue as long as the differential persisted. It was noted that in 1985-86, the Somali shilling had depreciated even faster, but the rate of inflation had decelerated rapidly because the authorities had progressively reduced the rate of monetary expansion.

The Somali representatives reported that, faced with a rapidly deteriorating economic and financial situation, the Government was currently engaged in implementing selective measures intended to contain the situation. They indicated that these measures included the implementation of a very tight budget for 1988, a government requirement that the Commercial Bank collect all outstanding credit that fell due as a means of reducing credit expansion, and the introduction of a wide-ranging set of price controls earlier in the year. They hoped that these measures would be adequate to persuade donors to resume disbursements.

The Somali authorities did not indicate their intentions with regard to structural adjustment measures as outlined in the policy framework paper, although they had previously said that there was no change in the Government's policy at least in respect to the sector-specific policies.

2. Financial policies

The 1988 budget, introduced early in the year, calls for major improvements in tax administration and substantial cuts in expenditure. The overall deficit excluding grants is budgeted to decline from 33.8 percent of GDP in 1987 to 16.9 percent of GDP, and including grants, from 14.6 percent to 4.3 percent of GDP. Total revenue is budgeted to increase by 24 percent to So. Sh. 12.0 billion (5.7 percent of GDP) led by a 30 percent increase in import duties. Revenue is intended to cover 90 percent of ordinary expenditure on an accrual basis in 1988 (against only 39 percent in 1987). The Somali representatives reported that it was the stated policy of the Government that all ordinary expenditure be financed from domestic sources. They explained that the substantial increase in tax revenue would be achieved through improved administration, even though cash imports are not likely to increase and may even decline, and the basis for the assessment of import duties will be slightly lower than in 1987, given the assumption in the budget that the exchange rate will remain fixed at So. Sh. 100 = US\$1 throughout 1988. On a commitment basis, ordinary expenditure is budgeted to decline by 46 percent in nominal terms (from So. Sh. 25.1 billion in 1987, to So. Sh. 13.5 billion, or from 16.0 percent to 6.3 percent of GDP). The sharp budgeted decline in ordinary expenditure is led by a drastic reduction in nominal terms in outlays for goods and services and in miscellaneous outlays. According to Somali representatives, these expenditure savings are to be achieved through the elimination of purchases of new cars, office furniture, and fixtures, and as a result of the consolidation of seven ministries in December 1987, albeit without any reduction in staffing. The investment expenditure is budgeted to decline in nominal terms by 6 percent to So. Sh. 34.4 billion (or from 24 percent to 16 percent of GDP), to be financed entirely by grants and foreign loans. The budget provides for no external resources to finance ordinary expenditures.

The overall budget deficit is to be financed entirely from external sources, comprising net drawings on loans and debt relief from the 1987 rescheduling with the Paris Club. The budget proposals make no reference to domestic bank financing, thereby leaving a financing gap of So. Sh. 2.6 billion (1.2 percent of GDP).

The staff representatives emphasized that it would be difficult to implement such a budget successfully in the absence of supporting measures in the context of a comprehensive program.

The Somali representatives indicated that the Government had instructed the commercial bank to collect outstanding credit as a means

of reducing overall credit expansion. No details were provided on how the operation was being carried out, nor was it clear whether the operation was achieving its purpose, given a poor statistical base. Complete commercial bank data were available only through September 1987, and partial data, through November 1987. No indications were provided concerning the overall credit and monetary policy during 1988.

3. External policies

Under current policies, Somalia's balance of payments will face intense pressure in 1988. Exports are projected to show a 6 percent increase, to US\$99 million in 1988, mainly on account of a continued increase in banana exports, stemming from a large new investment in the sector in recent years. However, in the face of no further debt relief other than that negotiated with the Paris Club in 1987, and a likely reduction in nonproject aid, Somalia will not be able to maintain imports at the 1987 level and service its debts. Even on the basis of an optimistic scenario, whereby project aid remains at the 1987 level in real terms, and most of the nonproject aid already committed is disbursed to support minimum imports of about US\$460 million (a decline of 11 percent in real terms), Somalia would remain with a financing gap of the order of US\$156 million.

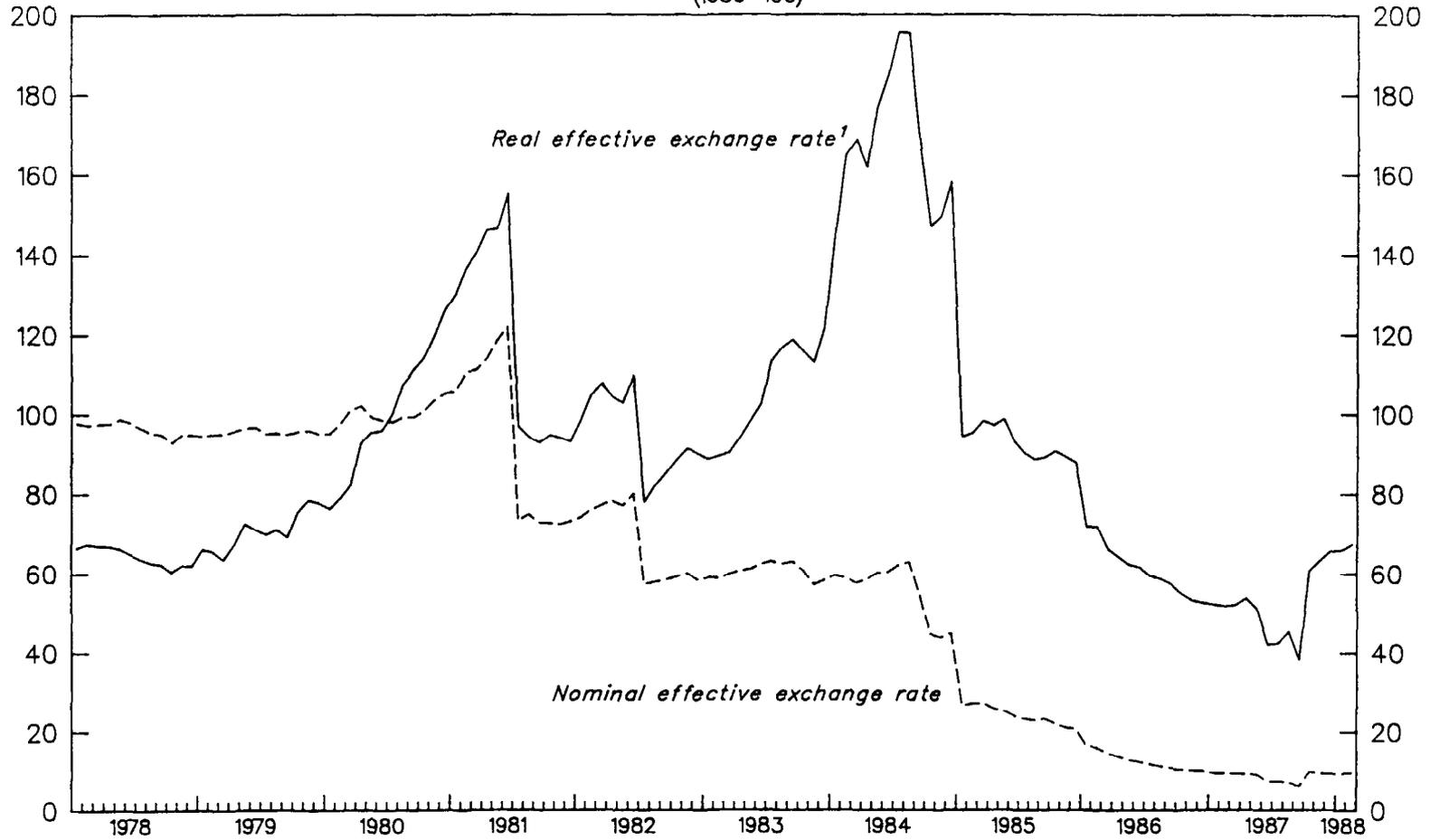
The Somali representatives indicated that the authorities' objective was to convince donors to resume disbursements on the basis of measures already taken, with particular reference to the 1988 budget. They stated that the Government was committed to the decision to maintain the exchange rate at So. Sh. 100 = US\$1. 1/

4. Overdue obligations to the Fund

The staff representatives drew the attention of the authorities to the large overdue financial obligations to the Fund, which have been rising rapidly since mid-1987, when the previous accumulation of arrears was cleared. These overdue obligations amounted to SDR 23.8 million (54 percent of quota) on March 31, 1988. The staff representatives summarized the sentiment of the Executive Board discussion on March 7 regarding Somalia's overdue obligations to the Fund, pointing out that the next Board review of Somalia's overdue obligation would take place after two months, with the expectation that Somalia would be declared ineligible to use Fund resources if its overdue obligations had not been discharged by then. The staff representatives strongly urged the authorities to clear the arrears before the next Board meeting. The Somali representatives took note of these remarks, but provided no indication that the arrears would be cleared.

1/ The standard index developed in connection with the information notice system indicates that from the October 1987 Board discussion of the Complaint under Rule K-1 through February 1988, the Somali shilling appreciated in real effective terms by 11 percent. Since exchange rate developments are discussed in this paper, no separate information notice is being issued (Chart 1).

CHART 1
SOMALIA
NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, JANUARY 1978—FEBRUARY 1988
(1980=100)



Source: IMF, Information Notice System.

¹Trade weighted index of nominal exchange rate deflated by seasonally adjusted consumer prices; increase means appreciation.



5. Overall assessment and recommendations

In light of the above discussions, and in view of the authorities' stated objectives, the staff representatives stressed that Somalia should return as soon as possible to a path of sustained and credible adjustment, by adopting a comprehensive adjustment program, and completing the implementation of measures under the structural adjustment program. A comprehensive program would require the adoption of a realistic exchange rate policy, measures to strengthen the budgetary policy, including a substantial reduction of the budget deficit, and a resumption of free market pricing at all levels. Given the weakness of the data base and the apparent deterioration in the capacity of the authorities to ensure the implementation of agreed policies, the staff representatives emphasized the need for extensive technical assistance to enhance the prospect of successful implementation of any adjustment program.

IV. Medium-Term Balance of Payments Prospects

Somalia's medium-term balance of payments prospects remain difficult. Under current policies the rate of real growth is expected to slow significantly from the 1.5 percent rate achieved in 1987, domestic and external imbalances are expected to widen, the rate of inflation to remain high, and the balance of payments pressures are likely to intensify.

The assumptions underlying the medium-term scenario are: (1) a continuation of policies pursued since September 1987, with no comprehensive program that could receive Fund support (2) no debt relief other than that agreed in 1987 with members of the Paris Club (3) a possible reduction in nonproject aid in the absence of appropriate comprehensive policies. Under this scenario, Somalia's balance of payments indicates large financing gaps through 1993 (Table 7). Total exports in U.S. dollar terms are projected to grow by 6 percent in 1988, and to increase slowly thereafter, at an average of about 3 percent per year for the period 1989-93. Livestock exports are projected to increase by 3 percent per year during the period. Banana exports are expected to grow by 17 percent in 1988, continuing this sector's strong performance of recent years, and by about 3 percent annually thereafter, as current exchange rate policies could discourage faster growth in future years. Since imports are dependent on foreign grants and loans, the projections indicate a cumulative decline of 29 percent in 1988-89 and thereafter an annual increase of about 1-2 percent. The steep decline in 1988-89 is due to the reduction in non-project aid and to the winding down of the Italian Emergency Program in 1989. Subsequently, the assumption is that the volume of nonproject aid would remain at the 1988 level through 1993, implying a nominal dollar increase of about 3 percent per annum. Project aid is assumed to remain at the 1989 nominal dollar level through 1993, implying a reduction in real terms. Cash imports (about 20 percent of total imports) are projected to

Table 7. Somalia. Medium-Term Balance of Payments, 1987-93

(In millions of U.S. dollars)

	1987 Est.	1988	1989	1990	1991	1992	1993
				Projected			
Exports, f.o.b.	93.1	98.9	101.9	104.9	108.1	111.8	114.7
Livestock	58.2	60.0	61.8	63.6	65.6	67.5	69.6
Bananas	20.5	24.1	24.8	25.6	26.3	27.1	27.9
Other	14.4	14.8	15.3	15.8	16.2	16.7	17.2
Imports, c.i.f.	-499.4	-459.7	-355.3	-359.6	-364.1	-368.7	-373.5
Cash imports	-110.9	-70.0	-60.0	-61.7	-63.5	-65.3	-67.1
Grants-in-kind	-318.6	-311.4	-216.5	-218.6	-220.8	-223.0	-225.4
Loans-in-kind	-69.9	-78.3	-78.8	-79.3	-79.9	-80.4	-81.0
Trade balance	-406.3	-360.8	-253.4	-254.7	-256.0	-257.3	-258.7
Services (net)	-65.1	-71.0	-71.4	-70.1	-68.9	-70.0	-76.0
Interest	-52.0	-60.0	-61.1	-59.2	-57.5	-58.0	-63.4
Other	-13.1	-11.1	-10.3	-10.9	-11.4	-12.1	-12.6
Transfers (net)	378.3	346.4	252.4	255.5	257.7	260.9	264.3
Private	35.0	38.8	30.9	31.9	31.9	32.9	33.9
Official	343.3	316.4	221.5	223.6	225.8	228.2	230.4
Current account	-93.0	-85.5	-72.4	-69.3	-67.2	-66.5	-70.4
Excluding official transfers	-436.3	-401.9	-293.9	-292.9	-293.0	-294.5	-300.8
Capital account (net)	27.3	15.7	17.2	20.1	3.9	4.0	22.6
Official	57.2	15.7	17.2	20.1	3.9	4.0	22.6
Inflows	120.3	78.3	78.8	79.3	79.9	80.4	81.0
Outflows	-63.1	-62.6	-61.6	-59.2	-75.9	-76.4	-58.4
Private (net)	-30.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-65.8	-69.8	-55.2	-49.2	-63.3	-62.4	-47.9
Financing	65.8	69.8	51.0	37.9	45.3	38.8	-19.6
Central Bank	-23.5	-74.7	-45.3	-26.9	-10.1	-6.6	-3.7
Reserves	3.7	--	--	--	--	--	--
IMF	-12.0	-42.0	-45.3	-26.9	-10.1	-6.6	-3.7
Other ^{1/}	-15.2	-32.7	--	--	--	--	--
Commercial Bank ^{2/}	--	--	--	--	--	--	--
Arrears ^{3/}	-18.5	-50.2	-50.2	-50.2	...	...	...
Debt relief	107.8	39.0	...	...	...	...	...
Current maturities	48.4	39.0	...	...	...	...	...
Arrears	59.4	...	...	...	...	...	...
Gap	...	155.6	150.7	126.4	73.4	69.0	51.6

Source: Central Bank of Somalia, Ministry of Finance; and staff estimates.

^{1/} Includes net drawings from the Arab Monetary Fund and a bridge loan.

^{2/} No 1987 data for the Commercial Bank were available at the time of the consultation.

^{3/} For 1988-90, this includes the elimination of the stock of end-1987 arrears.

decline in 1988-89 as cash grants and loans decrease in tandem with grants and loans in kind. The implication of this scenario for total imports is a cumulative decrease in real terms of the order of 37 percent by 1993.

On this basis, the current account deficit declines from about 10 percent of GDP in 1987 to about 7 percent of GDP during 1988-93. The financing gap for 1988 (US\$156 million) is unusually large because, despite the US\$39 million in debt relief from the 1987 Paris Club rescheduling, the debt service obligation remains large, including almost US\$100 million of obligations to the IMF and the Arab Monetary Fund (AMF) as well as payment of a bridge loan contracted in 1987. Payments to the IMF and AMF are concentrated in 1988-89. This scenario also assumes that all payments arrears would be eliminated during 1988-90. The resulting external financing gaps are projected to decline from US\$151 million in 1989 to about US\$52 million by 1993.

Somalia's debt service burden will remain onerous throughout the medium term. After taking into account the recent debt rescheduling, the debt service ratio for 1988 is projected at 74 percent (excluding IMF and AMF). In the absence of new debt rescheduling this ratio is projected to increase to an average of 88 percent for the period 1989-93. Moreover, when payments to the IMF and AMF are included, the respective debt service ratios are 131 percent and 104 percent.

V. Staff Appraisal

During 1985-86 Somalia made steady progress toward recovering from the severe economic setback experienced in 1984 through the implementation of a Fund-supported program. Although the results fell short of the program's objectives because of delays in disbursing foreign assistance, the authorities' failure to implement some of the fiscal measures, and the pursuit of more expansionary policies than programmed, considerable progress was achieved in addressing some of the serious imbalances that had emerged. Somalia moved toward a market-related exchange rate system, and during 1986 the divergences between the exchange rates were considerably narrowed, with most transactions being carried out at market-determined exchange rates. The rate of inflation was reduced from 92 percent in 1984 to 30 percent in 1986, and there was some improvement in revenue collection and the overall fiscal balance. The external sector also performed relatively well; exports made a sharp recovery, and both the current account and the overall balance of payments deficits narrowed.

Somalia's recovery and growth path was to be consolidated and strengthened through a program adopted in early 1987. In support of the program the Fund approved a 20-month stand-by arrangement and a three-year structural adjustment facility and the first annual arrangement thereunder in June 1987. The program aimed at achieving an annual real GDP growth of at least 4 percent, reducing the overall budget deficit

(including grants) to 6 percent of GDP in 1987, limiting monetary expansion so as to reduce the annual rate of inflation to 22 percent by the end of 1987, as well as making progress toward viability of the balance of payments over the medium term through a further contraction of the external current account deficit, a reduction of external payments arrears, and a regularization of external debt service payments. A key element of the program was the advancement of the system of a market-determined exchange rate and the unification of the system through the auction.

Through mid-1987, these objectives appeared achievable. Not only were the performance criteria for end-June met, but there was a large inflow of imports related to donor response to Somalia's adjustment program, the rate of inflation had decelerated to an annual rate of 21 percent, and movement toward the unification of the exchange rate system was being achieved through an enhanced auction system adopted in mid-1987 that absorbed all transactions hitherto carried out in the free, official, and auction markets. In addition, the combination of higher levels of imports and favorable weather conditions indicated that the target for real GDP growth was also achievable. Despite this progress, after September 16, 1987, apparently alarmed by the depreciation of the Somali shilling on that day, the authorities discarded the auction system and abandoned the program. This action followed the decision of the Revolutionary Socialist Party of Somalia, which recommended a different set of policies including the abolition of the foreign exchange auctions, and the fixing of the exchange rate at a sharply appreciated rate of So. Sh. 100 per U.S. dollar. These developments were accompanied by an apparently overall weakening of commitment to adjustment. For the remainder of 1987 and early 1988, the authorities pursued policies that moved Somalia further away from the adjustment path. This shift in policies was accompanied by extensive personnel changes at senior and middle management levels.

The abandonment of the program and the revaluation of the Somali shilling were followed by an unprecedented increase in government expenditure that made the fiscal year 1987 as a whole more expansionary than any previous year, including 1984. The rate of inflation, which had decelerated in mid-1987, had almost doubled by the end of the year. The introduction of extensive price controls has exacerbated the situation. There has also been a weakening of Somalia's capacity to implement and monitor a program because of the ongoing personnel changes. The cumulative impact of these developments appears to have erased many of the gains made since 1984. It is a matter of serious concern that after five stand-by arrangements, the first having been approved by the Fund in 1980, and more than SDR 200 million of Fund resources made available to Somalia under these arrangements and other facilities, Somalia appears to have achieved little in terms of adjustment.

Prospects for 1988 and the medium term will rest principally on the authorities' will to reverse the decisions taken in recent months and

return quickly to the path of adjustment with growth. Under current policies, and in the face of an increasingly overvalued exchange rate, Somalia is likely to witness an accelerated development of internal and external imbalances in 1988, involving a rapid increase in inflation, an erosion of production incentives, and a drop in real incomes and the overall rate of economic growth. Over the medium term, the widening imbalances would slow considerably the rate of real GDP growth and exports, which would further reduce growth prospects and Somalia's capacity to service its large external debt. Furthermore, Somalia's import capacity and growth are likely to be negatively affected by reductions in external assistance as well. Under this scenario, no medium-term viability is foreseen.

The authorities are aware of the difficulties brought upon Somalia because of these policies, but at the moment they appear preoccupied with finding ways and means for the resumption of donor support without the benefit of a comprehensive adjustment program. In response to the authorities' concern with the possible position of the Fund in this regard, the staff indicated that the Fund does not stand in the way of bilateral relations between members. The staff, however, has emphasized that such assistance, and whatever selective measures may be implemented, are not a substitute for a comprehensive adjustment program.

In the staff's view the measures taken during the latter part of 1987 and early 1988, particularly with regard to the exchange rate and price controls, are likely to have a very detrimental effect on Somalia's economic prospects in 1988 and in the medium term. The staff also believes that the objectives outlined in the budget for 1988, involving a sharp reduction in expenditure in nominal terms and an increase in revenue, are not attainable in the absence of other supporting measures and, particularly, under conditions of an overvalued exchange rate. The staff urges the authorities to return as soon as possible to the adjustment path in order to regularize Somalia's relations with its creditors, before the full impact of current policies results in an intractable situation.

Following the abandonment of the auction-determined float and the abolition of the free exchange market, Somalia introduced restrictions on the availability of foreign exchange for current international transactions. Somalia also maintains exchange restrictions evidenced by external payments arrears. The staff encourages the authorities to adopt policies that would permit the elimination of these restrictions as soon as possible. In the meantime, the staff does not recommend that the Executive Board grant approval for the retention of these restrictions under Article VIII, Section 2(a).

The Article IV consultation with Somalia will remain on the 12-month cycle.

SOMALIA—Basic DataArea and population

Area	637,700 square kilometers
Population: Total (mid-1987 estimate)	5.7 million
Growth rate	3.0 percent

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u> Prelim. actual	<u>1987</u> Prel. est.
<u>GDP at 1977 factor cost 1/</u>					
Annual rate of growth (percent)	-13.0	9.7	6.7	-1.8	1.5
<u>Prices (percent change)</u>					
Mogadiscio consumer price index (period average)	36.4	92.2	37.8	35.8	28.1
<u>Government finance</u> (In millions of Somali shillings)					
Total revenue	4,075	3,774	5,220	9,595	9,705
Transfers from local authorities	178	205	276	375	491
Grants (excluding direct food aid for refugees)	1,106	1,980	6,620	10,418	28,933
Ordinary expenditure 2/	-4,539	-7,927	-9,923	-16,150	-25,095
Transfers to local authorities	-177	-213	271	386	501
Investment expenditure	-1,920	-3,124	-7,940	-12,830	-36,493
Overall balance	-1,277	-5,305	-6,018	-8,978	-22,960
Change in domestic counterpart of external interest arrears	—	1,800	-1,440	2,834	-2,260
Other adjustment to cash basis	...	...	300	-57	...
Financing	1,277	3,505	7,158	6,201	20,700
Foreign (net)	1,572	940	5,033	6,355	6,259

1/ Based on National Accounts Aggregates 1977-86, Ministry of Planning, 1987; and Fund and World Bank staff estimates.

2/ On a commitment basis from 1985.

SOMALIA - Basic Data (continued)

	1983	1984	1985	1986 Prelim. actual	1987 Prelim. est.
<u>Government Finance (cont'd)</u> (In millions of Somali shillings)					
Domestic	-295	2,565	1,045	-154	9,114
Banking system	(-295)	(2,573)	(875)	(-657)	(8,177)
Cash balances	(-)	(-8)	(170)	(-2)	(...)
Other	-	-	-	-809	937
Debt relief	-	-	1,080	...	5,327
<u>Money and credit (end of period) 1/</u> (Percent change)					
Domestic credit	4.7	82.8	19.8	20.7	68.3
Government (net)	-14.0	142.6	23.8	12.1	134.5
Other	18.2	51.6	16.4	28.4	16.9
Money and quasi-money 2/	7.1	22.4	45.4	37.0	111.3
<u>Balance of payments 3/</u> (In millions of U.S. dollars)					
Exports, f.o.b.	100	62	93	95	93
Imports, c.i.f. 4/	-450	-406	-373	-357	-499
Trade balance	-350	-344	-280	-263	-406
Services and private transfers (net)	55	25	-35	-32	-30
Current account balance	-295	-319	-315	-295	-436
Capital account (net)	209	180	265	208	370
Official 4/	248	220	277	260	400
Private	-39	-40	-12	-52	-30
Allocation of SDRs	-	-	-	-	-
Overall deficit	-86	-139	-50	-87	-66
<u>Gross official foreign reserves (end of period)</u>					
	15.8	6.3	11.6	26.6	15.6
In weeks of imports	1.8	0.8	1.6	3.9	1.6
<u>External public debt</u>					
Disbursed and outstanding 5/ (end of period)	958.5	1,183.2	1,409.3	1,583.6	1,685.2
Debt service as percent of exports of goods and nonfactor services 5/ 6/	24.0	93.3	52.4	129.6	116.1

1/ Data for 1987 are partly estimated.

2/ From 1985 data exclude resident foreign currency deposits and counterpart funds.

3/ On a commitment basis from 1985.

4/ Including loans and grants in kind.

5/ Excludes special bilateral agreements with the U.S.S.R. and Bulgaria, and loans from the People's Republic of China and Abu Dhabi that have been frozen by mutual consent.

SOMALIA - Basic Data (concluded)

IMF data

Data of membership	August 31, 1962
Quota	SDR 44.2 million
Intervention currency and the rate	U.S. dollar; official rate: (March 31, 1988) So. Sh. 100.000 = US\$1
SDR/Local currency equivalent	Official rate: SDR 1 = So. Sh. 138.255

March 31, 1988
(In millions of SDRs)

Total outstanding purchases	<u>108.31</u>
Under tranche policies	<u>75.71</u>
Ordinary	(14.10)
Enlarged access	(61.61)
Compensatory financing	32.60
Oil facility	—
 Total Fund currency holdings (in percent of quota)	 <u>345.05</u>
Excluding CFF and oil facility (in percent of quota)	 271.29
 Net cumulative SDR allocation	 <u>13.70</u>
 Holdings of SDRs	 —
 Trust Fund loans outstanding	 <u>6.54</u>
 Structural adjustment loans outstanding	 <u>8.84</u>

SOMALIA - Relations with the Fund
(As of March 31, 1988)

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) General Resources Account:

- | | |
|---|----------------------------------|
| (i) Quota: | 44.20 |
| (ii) Total Fund holdings of Somali shillings: | 152.51 (345.04 percent of quota) |
| (iii) Fund credit: | 108.31 (245.03 percent of quota) |
| Of which: credit tranches | 14.10 (31.89 percent of quota) |
| enlarged access | 61.61 (139.38 percent of quota) |
| compensatory financing facility | 32.60 (73.75 percent of quota) |

(b) Special Disbursement Account:

- | | |
|--------------------------------|-------------------------------|
| (i) Structural adjustment loan | 8.84 (20.00 percent of quota) |
|--------------------------------|-------------------------------|

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

(a) Present stand-by arrangement:

- | | |
|--|-------|
| (i) Duration June 29, 1987 - February 28, 1989 | |
| (ii) Amount | 33.15 |
| (iii) Utilization | 5.53 |
| (iv) Undrawn balance | 27.62 |

(b) Last stand-by arrangement:

- | | |
|---|------|
| (i) Duration from February 22, 1985 to September 30, 1986 | |
| (ii) Amount | 20.1 |
| (iii) Utilization | 20.1 |
| (iv) Undrawn balance | -- |

SOMALIA - Relations with the Fund (continued)

(c) Previous stand-by arrangements during the last ten 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

(d) Special facilities (current year and past two years):

(i)	Compensatory financing facility (effective February 22, 1985)	
	Amount:	32.6
	Utilization:	32.6
(ii)	Structural adjustment loan (effective June 29, 1987)	
	Amount:	8.84
	Utilization:	8.84

IV. SDR Department

(a)	Net cumulative allocations:	13.70
(b)	Holdings:	None

V. Administered Accounts

(a)	Trust Fund loans	
(i)	Disbursed:	10.69
(ii)	Outstanding:	6.54
(b)	SFF Subsidy Account	None

SOMALIA - Relations with the Fund (continued)VI. Financial obligations due to the Fund

	Overdue financial obligations 3/31/88	<u>Principal and interest due</u>			
		<u>Apr.-Dec.</u> 1988	1989	1990	1991
Principal	<u>16.17</u>	<u>28.95</u>	<u>35.03</u>	<u>20.19</u>	<u>7.22</u>
Repurchases	<u>15.02</u>	<u>26.92</u>	<u>32.91</u>	<u>19.04</u>	<u>7.15</u>
TF repayments	1.15	2.03	2.12	1.15	0.07
Charges and interest including SDR ,TF, and SAF (provisional)	<u>7.65</u>	<u>4.70</u>	<u>5.30</u>	<u>3.04</u>	<u>1.85</u>
Total	<u>23.82</u>	<u>33.65</u>	<u>40.33</u>	<u>23.23</u>	<u>9.07</u>

VII. Somalia has used Fund resources since 1964.

B. Nonfinancial RelationsVIII. Exchange rate arrangement

On January 1, 1985, Somalia established a dual exchange rate system whereby the official rate applied to all official transactions, and the surrendered portion of export receipts, and the market rate applied to all other transactions. The official exchange rate, which was set at So. Sh. 36 = US\$1 on January 1, 1985, was pegged to the SDR adjusted for relative price developments vis-à-vis the five countries included in the SDR basket. The daily exchange rate was to be maintained within margins of 7.5 percent around the fixed real-term relationship to the SDR with indicative bands of 2.25 percent. Moreover, for the official rate, there was to be an additional devaluation of So. Sh. 0.5 per U.S. dollar each month. In the second half of 1985, agreement on the exchange regime for the official exchange rate was not reached, and the rate remained at So. Sh. 40.6083 = US\$1 from June 5 to November 1, 1985. On November 2, 1985, the official rate was devalued by So. Sh. 1.8917 per U.S. dollar bringing it in line with the earlier agreement to devalue by So. Sh. 0.5 per U.S. dollar per month. On January 21, 1986 the official rate was devalued by So. Sh. 12 per U.S. dollar, and for the months of March-November, 1986 the rate was further devalued in accordance with decisions reached in November 1985 and January 1986 to devalue the rate

SOMALIA - Relations with the Fund (continued)

by So. Sh. 4 on the first of each month. These monthly devaluations continued to November 1986, at which time the official rate was So. Sh. 90.5 = US\$1. This rate was maintained through June 14, 1987.

The posted rate at the commercial bank, which had been maintained at So. Sh. 84.4 per U.S. dollar since April 1985, was unified with the official rate on October 1, 1986. Beginning on September 1, 1986, the Central Bank initiated bimonthly foreign exchange auctions. The weighted average rate at the June 3, 1987 (Dutch) auction was So. Sh. 146.0 per U.S. dollar, and the lowest successful bid was So. Sh. 133.0 per U.S. dollar. The free market rate during the last two weeks of May 1987 averaged So. Sh. 161 per U.S. dollar. On June 15 the surrender requirement for exports was increased from 50 to 100 percent, and the markets were unified under the enhanced bimonthly auction for imports, and a separate service auction. The weighted average import and service auction rates were So. Sh. 159.9 per U.S. dollar, and So. Sh. 164.8 per U.S. dollar, respectively, at the September 16 auctions. On October 11, 1987 the auctions were officially terminated, and an official rate of So. Sh. 100 per U.S. dollar was set. On October 20, 1987 the export surrender requirement was reduced to 60 percent, and export promoting account holders were permitted to use, but not sell, retained export earnings.

IX. Article IV Consultation, Review of Stand-By Arrangement, and 1987 Stand-by Arrangement

Discussions for the 1986 Article IV consultation and final review of the 1985 stand-by arrangement were held in Mogadiscio on July 9-21, 1986. The staff report (SM/86/225 and Correction 1) and the review under the stand-by arrangements (SM/86/217) were discussed by the Executive Board on September 22, 1986. Discussions for the current stand-by and structural adjustment arrangements were held in Mogadiscio on February 27-March 12, 1987, and the request for stand-by arrangement and arrangements under the structural adjustment facility (SM/87/122 and supplements I-III) were discussed by the Executive Board on June 29, 1987. The decisions adopted were as follows:

1986 Consultation

Executive Board Decision - September 22, 1986

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 1986 Article XIV consultation with Somalia, in the light of the 1986 Article IV consultation with Somalia conducted under Decision No. 5392-(77/63) adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

SOMALIA - Relations with the Fund (continued)

2. Somalia maintains a restriction on the making of payments and transfers for current international transactions as evidenced by the accumulation of some commercial arrears, and multiple currency practices, subject to Fund approval under Article VIII, Sections 2(a) and 3, as described in SM/86/234. The Fund notes the intention of the Government of Somalia to eliminate the multiple currency practices, which were approved through December 31, 1986 (Executive Board Decision No. 8282-(86/81), adopted May 12, 1986), in the context of the adjustment program described in EBS/86/93. The Fund grants approval of the restriction evidenced by the accumulation of commercial arrears through December 31, 1987 or the next Article IV consultation with Somalia, whichever is earlier.

Review of Stand-By Arrangement

1. The Government of Somalia has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Somalia (EBS/85/1, 1/2/85) as amended, and paragraph 35 of the letter attached thereto as modified by paragraph 20 of the letter dated April 22, 1986, from the Minister of Finance and the Governor of the Central Bank of Somalia, concerning deviations in the observance of the performance criteria under paragraph 4 of the stand-by arrangement, and in order (a) to review progress made by Somalia in realizing the objectives of its program, (b) to reach understandings on the balance of payments gap, exchange rate and budgetary and petroleum pricing policies that the authorities will pursue during the period through September 30, 1986, and (c) to establish suitable performance criteria for the rest of the program.

2. The letter dated September 16, 1986, from the Minister of Finance and the Governor of the Central Bank of Somalia, setting forth policies and measures that the authorities will pursue, shall be annexed to the stand-by arrangement for Somalia and the letters of November 8, 1984, and April 22, 1986, shall be read as modified and supplemented by the letter dated September 16, 1986.

3. Somalia will not make purchases under the stand-by arrangement that will 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, during any period in which the data at the end of the preceding period indicate that:

(a) the limit on total domestic credit of the banking system described in paragraph 10 of the letter of September 16, 1986, or

(b) the limit of net credit from the banking system to the Government described in paragraph 10 of the letter of September 16, 1986, is not observed.

SOMALIA - Relations with the Fund (continued)

4. The Fund decides, pursuant to paragraph 4 of the stand-by arrangement, that the review contemplated in paragraph 35 of the letter of November 8, 1984, as modified by paragraph 20 of the letter of April 22, 1986, is completed and that no additional understandings are necessary; and that notwithstanding the nonobservance of the performance criteria on net credit to the Government for April 30, 1986, Somalia may resume to make purchases under the stand-by arrangement.

1987 Stand-By Arrangement

Executive Board Decision - June 29, 1987

I. Exchange System

1. The Fund notes that, as described in EBS/87/122, Somalia will introduce a dual exchange system (including a Dutch system for auctioning foreign exchange and a special rate for petroleum imports) which gives rise to exchange restrictions and multiple currency practices, subject to approval under Article VIII, Sections 2 (a) and 3. The Fund also notes that Somalia maintains a restriction on payments and transfers for current international transactions evidenced by a small amount of commercial payments arrears.
2. The Fund urges Somalia to adopt measures to eliminate the restrictive multiple currency practices and the restriction arising from commercial payments arrears and, in the meantime, grants approval of exchange restrictions as well as the changes in these practices and restrictions as described in EBS/87/122, until December 31, 1987 or completion of the next Article IV consultation for Somalia, whichever is earlier.

II. Stand-By Arrangement

1. The Government of Somalia has requested a stand-by arrangement, for a period of 20 months from June 29, 1987 for an amount equivalent to SDR 33.15 million.
2. The Fund approves the arrangement set forth in EBS/87/122.
3. The Fund waives the limitation in Article V, Section 3 (b)(iii).

III. Structural Adjustment Facility - Request for
Three-Year and First Annual Arrangements

1. The Government of Somalia has requested a three-year structural adjustment arrangement, and the first annual arrangement thereunder, under the structural adjustment facility.
2. The Fund approves the arrangements set forth in EBS/87/122.

SOMALIA - Relations with the Fund (concluded)

X. Technical Assistance:

- (a) FAD: From December 1983 to March 1986 an Advisor from the FAD assisted the Ministry of Finance as tax advisor.
- (b) CBD: From October 1984 to December 1987 a consultant on external debt assisted the Ministry of Finance. The Central Bank was assisted by a research advisor since August 1985, and a training advisor since December 1985, both of whose assignments ended in 1986.
- (c) Other: A Bureau of Statistics mission reviewed in May 1985 the coverage, sectorization, and classification of monetary accounts. In June 1986 technical assistance for the auction market was provided by a staff member from ETR.

XI. Resident Representative/Advisor:

Mr. Umberto Dell'Anno assumed his post as resident representative to Somalia on June 23, 1987.

SOMALIA: Financial Relations with the World Bank Group

Date of membership, IBRD
Capital subscription, IBRD

August 31, 1962
SDR 18.9 million

As of February 29, 1988, IDA had approved 36 credits amounting to US\$426.7 million (original principal less cancellations and adjusted for exchange rate changes) of which US\$395.6 million had been disbursed, US\$121.2 million remained undisbursed, and US\$295.5 million in borrower's obligations were outstanding.

The following table summarizes the World Bank's lending operations as of February 29, 1988.

Sector	Fully Dis- bursed <u>1/</u>	Disbursing credits		Total Credits	Total Obliga- tions <u>4/</u>
		Dis- bursed <u>2/</u>	Undis- bursed <u>3/</u>		
<u>(In millions of U.S. dollars)</u>					
Agriculture, livestock, fisheries and rural development Of which: ASAP <u>5/</u>	37.6 (...)	107.2 (55.0)	73.2 (20.0)	218.0 (75.0)	144.1 (55.0)
Education and tech- nical assistance	22.0	9.9	1.0	32.9	31.1
Energy	6.0	16.9	20.1	43.0	22.9
Industry	4.5	—	—	4.5	4.5
Transportation	49.3	29.6	26.6	105.5	75.8
Utilities	6.0	16.6	0.3	22.8	17.1
Total	125.4	180.2	121.2	426.7	295.5
IFC operations	0.9	...	...	...	...

1/ Original principal less cancellations.

2/ Total disbursements adjusted for exchange rate changes.

3/ Undisbursed credits adjusted for exchange rate changes.

4/ Total disbursements less repayments and cancellations adjusted for exchange rate changes.

5/ Agricultural sector adjustment program.

Somalia: Social and Demographic Indicators 1/

<u>Area</u>	<u>Population (1986)</u>	<u>Density</u>	
637.7 thousand square km	5.5 million	8.6 per sq. km	
	Rate of growth: 3.0	18.4 per sq. km of arable land	
<u>Population characteristics</u>		<u>Health</u>	
Life expectancy at birth - male	45.7	Population per physician (1980)	17,500
female	45.7	Population per hospital bed	...
Infant mortality rate (age under 1, in percent)	15.3		
Child death rate (age 1-4, in percent)	3.3		
<u>Income distribution</u>		<u>Distribution of land</u>	
Percent of national income highest quintile	...	Percent area exploited by largest 11 percent of farmers	...
lowest quintile	...	Percent area exploited by smallest 12 percent of farmers	...
<u>Access to safe water</u>		<u>Access to electricity</u>	
Percent of population - urban	58.0	Percent of dwellings - urban	...
rural	21.8	rural	...
<u>Nutrition</u>		<u>Education</u>	
Calorie intake percent of requirements	89.3	Adult literacy rate (percent)	...
Per capita protein intake (grams per day)	63.5	Primary school enrollment rate	21.0
		Secondary school enrollment rate	14.0

Source: Data provided by the Somalia authorities, and the World Bank.

1/ Data refer to the most recent estimates between 1982 and 1986 unless otherwise specified.

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