



# Strategic Post-HIPC Reforms for Somalia: Navigating Towards Sustainable Development

## Institute of Public Finance -Somalia (IPF-S)

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### **Executive Summary**

Somalia's attainment of the Heavily Indebted Poor Countries (HIPC) Completion Point in 2023 represents a pivotal moment in its pursuit of economic stability and sustainable development. The substantial debt relief has eased the fiscal burden, providing the government with an opportunity to redirect resources toward critical reforms and investments in key sectors. However, this milestone also introduces new challenges that, if not addressed promptly and effectively, could impede the nation's progress and undermine the gains achieved thus far.

This policy paper offers a comprehensive analysis of the key risks in Somalia's post-HIPC environment, incorporating the most recent data from the Federal Government of Somalia. The analysis focuses on crucial areas such as revenue mobilization, expenditure management, fiscal deficits, public debt, and economic growth projections for 2025–2027. The paper provides detailed recommendations aimed at fostering sustainable development and enhancing the nation's resilience to internal and external shocks.

## Key Findings:

- **Fragile Fiscal Position:** Despite notable improvements in domestic revenue mobilization, Somalia's fiscal position remains precarious. In FY2023, total revenue and grants amounted to \$738.0 million, achieving 77.6% of the target of \$950.6 million. Domestic revenue outperformed expectations at 116.3%, totaling \$329.5 million against a target of \$283.2 million, primarily due to enhanced tax administration. Income tax collections performed at 132%, taxes on local trade at 105%, and customs at 163.3%. However, non-tax revenue lagged significantly, performing at only 63.7%. The underperformance of external grants, achieving just 61.2% of the target, underscores Somalia's vulnerability due to its reliance on external assistance.
- **Expenditure Pressures and Fiscal Deficit:** Total expenditure in FY2023 was \$687.1 million, 70.3% of the appropriated budget of \$977.4 million. The lower expenditure was mainly attributed to donor-funded projects experiencing absorption constraints, leading to slower disbursements. In FY2024, expenditure is projected at \$755.6 million against a budget of \$1,079.3 million, a performance of 70.0%. The fiscal deficit is projected at \$8.2 million, equivalent to 0.007% of GDP, significantly lower than the initially anticipated deficit of \$38.5 million. This improvement is largely due to enhanced domestic revenue mobilization.
- **Economic Growth and Productivity Risks:** The economy is projected to grow at 3.7% in 2024, reaching 3.9% in 2025, and accelerating to an average of at least 4.1% over the medium term. Growth is expected to be driven by increases in remittances, construction activities, and trade. The size of Somalia's GDP is projected to expand from \$11.5 billion in 2023 to \$13.5 billion in 2025. However, the narrow economic base, with heavy reliance on a few sectors, and significant trade deficits—imports are projected at \$10.9 billion against exports of \$2.7 billion in 2025—highlight the urgent need for economic diversification and enhanced competitiveness.
- **Governance and Institutional Weaknesses:** Persistent challenges in public financial management (PFM) hinder effective policy implementation. Absorption constraints in donor-funded projects, due to limited capacity within implementing agencies, result in underutilization of available funds. Weaknesses in budget execution, financial reporting, and oversight mechanisms increase the risk of mismanagement and corruption, undermining public trust and the efficiency of public expenditure.
- **Security Risks:** Ongoing security challenges, including threats from extremist groups, continue to disrupt economic activities, deter investment, and strain public finances due to increased security expenditures. The instability hampers

the government's ability to implement reforms and deliver services effectively, further impacting economic growth and development.

- **Climate Change and Environmental Risks:** Somalia is highly susceptible to climate-related shocks such as droughts and floods, which severely impact agriculture and livestock sectors—the backbone of the economy. These environmental risks lead to food insecurity, displacement of populations, and increased humanitarian needs, placing additional pressure on limited government resources.

### **Key Recommendations:**

1. **Enhancing Revenue Mobilization:**
2. **Strengthening Public Financial Management:**
3. **Promoting Economic Diversification and Growth:**
4. **Prudent Debt Management:**
5. **Social Sector Investment and Human Capital Development:**
6. **Private Sector Development and Infrastructure Investment:**
7. **Governance and Institutional Reforms:**
8. **Social Inclusion and Gender Equality:**

Somalia's post-HIPC landscape presents both significant opportunities and challenges. The implementation of the recommended reforms is crucial for strengthening the country's fiscal and economic frameworks, enhancing governance, and building a resilient economy capable of withstanding internal and external shocks. Achieving long-term sustainable development and improving the well-being of all Somali citizens will depend on strong political will, effective coordination, and the active participation of all stakeholders, including the international community.

The government's commitment to increasing domestic revenue, improving public financial management, and investing in human capital lays a solid foundation for sustainable growth. However, addressing governance issues, security challenges, and environmental risks is imperative to ensure that economic gains translate into tangible improvements in the lives of the Somali people. Collaboration with development partners, regional organizations, and the private sector will be essential in mobilizing resources and expertise to support Somalia's development agenda.

By embracing these comprehensive reforms and fostering an inclusive approach to development, Somalia can harness its potential, reduce poverty, and achieve a prosperous future for all its citizens.

# 1. Introduction

Somalia's attainment of the Heavily Indebted Poor Countries (HIPC) Completion Point in 2023 marks a historic milestone in the nation's journey towards economic recovery and sustainable development. This achievement signifies the culmination of years of concerted efforts to stabilize the economy, reform public financial management, and engage constructively with international financial institutions. The substantial debt relief granted under the HIPC Initiative has not only alleviated the crippling debt burden but also opened new avenues for investment, economic reforms, and integration into the global economy.

## Background and Significance of HIPC Completion

The HIPC Initiative, launched by the International Monetary Fund (IMF) and the World Bank in 1996, aims to ensure that no poor country faces a debt burden it cannot manage. For Somalia, reaching the Completion Point under this initiative signifies that the country has met the necessary conditions for full and irrevocable reduction in debt under the HIPC framework. These conditions included the implementation of key structural and social reforms, maintaining macroeconomic stability, and developing a Poverty Reduction Strategy Paper (PRSP).

The debt relief reduces Somalia's total public debt from approximately \$5.2 billion to around \$706 million, decreasing the debt-to-GDP ratio from over 100% to about 6.1%<sup>[1]</sup><sup>[3]</sup>. This significant reduction enhances the country's creditworthiness, enabling access to new financing sources, attracting foreign direct investment, and fostering confidence among development partners.

## Current Economic Landscape

Despite this monumental achievement, Somalia's economy remains fragile and faces numerous challenges that threaten to undermine the gains realized from debt relief. The country grapples with persistent fiscal deficits, low domestic revenue mobilization, heavy dependence on external grants, and high expenditure pressures.

- **Fiscal Deficits and Revenue Mobilization:** In FY2023, total revenue and grants amounted to \$738.0 million, achieving 77.6% of the target of \$950.6 million<sup>[1]</sup>. While domestic revenue performed well, exceeding the target by 16.3%, the underperformance of external grants highlights vulnerabilities due to reliance on external assistance. The projected fiscal deficit of \$8.2 million in FY2024, although lower than anticipated, underscores the need for prudent fiscal management and enhanced revenue mobilization<sup>[2]</sup>.

- **Expenditure Pressures:** The government's expenditure is constrained by lower-than-expected disbursements in donor-funded projects, primarily due to absorption constraints within implementing agencies. In FY2023, total expenditure was 70.3% of the appropriated budget, reflecting challenges in executing planned activities[1].
- **Economic Growth Trends:** The economy is projected to grow modestly, with GDP growth rates of 3.7% in 2024 and 3.9% in 2025[2]. This growth is driven by sectors such as remittances, construction, and trade. However, the narrow economic base and limited diversification render the economy vulnerable to external shocks.

## Persistent Challenges

Several structural issues continue to impede Somalia's path toward sustainable development:

1. **Governance and Institutional Weaknesses:**
2. **Security Risks:**
3. **Climate Change and Environmental Risks:**
4. **Socioeconomic Challenges:**

## Opportunities in the post-HIPC Era

The post-HIPC landscape presents unique opportunities for Somalia to redefine its economic trajectory:

- **Increased Fiscal Space:** The debt relief provides the government with additional fiscal space to invest in critical sectors such as infrastructure, education, and healthcare, which are essential for economic growth and poverty reduction.
- **Access to New Financing:** Improved creditworthiness enhances Somalia's ability to access concessional financing and attract foreign direct investment, facilitating capital inflows needed for development projects.
- **Regional Integration:** Somalia's recent admission into the East African Community (EAC) opens new avenues for trade, investment, and cooperation. Adopting regional policies, such as the EAC Customs External Tariff, can boost trade and economic integration [17].
- **International Support and Partnerships:** The international community has expressed continued commitment to support Somalia's development agenda. Strengthening partnerships with development partners can provide technical assistance, capacity building, and financial resources.

## Purpose and Structure of the Policy Paper

This policy paper aims to provide a strategic roadmap for Somalia to navigate the post-HIPC environment effectively. It offers:

- **Comprehensive Analysis:** An in-depth examination of the key risks and challenges facing Somalia, incorporating the latest data and insights from government reports and international assessments.
- **Targeted Recommendations:** Evidence-based policy recommendations to address identified challenges, focusing on enhancing revenue mobilization, strengthening public financial management, promoting economic diversification, prudent debt management, and investing in social sectors.
- **Implementation Framework:** Guidance on developing action plans, resource mobilization strategies, and monitoring mechanisms to ensure effective implementation of reforms.
- **Focus on Sustainability and Inclusivity:** Emphasis on fostering sustainable development that is inclusive, equitable, and resilient to shocks, aligning with the National Development Plan and international development goals.

The successful implementation of the recommended reforms requires strong political will, effective governance, and collaborative efforts among all stakeholders. By addressing the structural challenges and capitalizing on the opportunities presented in the post-HIPC era, Somalia can set a solid foundation for sustainable economic growth, reduce poverty, and improve the well-being of its citizens.

The journey ahead is challenging but attainable. With strategic planning, commitment to reform, and support from the international community, Somalia can overcome obstacles and achieve its vision of a stable, prosperous, and self-reliant nation.

## 2. Key Risks in the Post-HIPC Environment

### 2.1. Fragile Fiscal Position

Somalia's fiscal position remains fragile due to persistent deficits, low domestic revenue mobilization, and high expenditure pressures.

#### Revenue Performance

- **FY2023:** Total revenue and grants amounted to \$738.0 million, achieving 77.6% of the target of \$950.6 million [1]. Domestic revenue exceeded expectations at 116.3%, totaling \$329.5 million against a target of \$283.2 million. This was

primarily due to improved tax administration, with income tax performing at 132%, taxes on local trade at 105%, and customs at 163.3%. Non-tax revenue underperformed at 63.7%.

- **FY2024 Projections:** Total revenue and grants are projected at \$747.3 million against a target of \$986.6 million, implying a performance of 75.7%<sup>[2]</sup>. Domestic revenue is projected at \$357.5 million against a target of \$345 million, a performance of 103.6%. External grants are projected at \$389.8 million against a target of \$641.5 million, implying a performance of 60.8%.

**Table 1: Revenue Performance and Projections (FY2023–FY2024)**

Table 1: Revenue Performance and Projections (FY2023–FY2024)

Item	FY2023 Actual (\$m)	FY2023 Target (\$m)	% Performance	FY2024 Projected (\$m)	FY2024 Target (\$m)	% Performance
Total Revenue & Grants	738.0	950.6	77.6%	747.3	986.6	75.7%
Domestic Revenue	329.5	283.2	116.3%	357.5	345.0	103.6%
External Grants	408.5	667.4	61.2%	389.8	641.5	60.8%

Source: Federal Government of Somalia Budget Reports FY2023–FY2024<sup>[1][2]</sup>

### Dependence on External Grants

The slower-than-anticipated inflow of grants in FY2024 is mainly due to:

- Continued absorption constraints in projects financed by multilateral agencies.
- Reduced revenues in source countries due to challenges related to ongoing geopolitical conflicts, such as the Israel-Palestine conflict.
- A natural decline in budget support grants following Somalia's receipt of HIPC debt relief in 2023.

## Expenditure Pressures

- **FY2023:** Total expenditure amounted to \$687.1 million against an appropriated budget of \$977.4 million, implying a performance of 70.3%<sup>[1]</sup>. The lower expenditure was primarily due to donor-funded projects experiencing absorption constraints.
- **FY2024 Projections:** Expenditure is projected at \$755.6 million against a budget of \$1,079.3 million, a performance of 70.0%<sup>[2]</sup>. Expenditure financed from domestic resources is projected at \$490.6 million against a budget of \$592.8 million, implying a performance of 82.8%. Donor-funded project expenditure is projected at \$264.9 million against a target of \$486.5 million, a performance of 54.5%.

## Fiscal Deficit

- **FY2024 Projection:** The fiscal deficit is projected at \$8.2 million, equivalent to 0.007% of GDP <sup>[2]</sup>. This is significantly lower than the initially anticipated deficit of \$38.5 million, attributed to improved domestic revenue mobilization.

## Public Debt Performance

- **2023:** Total public debt declined to \$706 million, or 6.1% of GDP, from \$3.9 billion, or 37.4% of GDP in 2022<sup>[3]</sup>. No new borrowing is expected in 2024, and the government is committed to prudent debt management to ensure fiscal sustainability.

## 2.2. Economic Growth and Productivity Risks

### Growth Projections

- The economy is projected to grow at 3.7% in 2024, reaching 3.9% in 2025, and accelerating to an average of at least 4.1% over the medium term <sup>[2]</sup>. This growth is driven by increases in remittances, construction activities, and trade.

**Table 2: Macroeconomic Projections (2025–2027)**

Variable	2025	2026	2027
Nominal GDP (\$m)	13,541	14,686	15,913
Real GDP (\$m)	11,541	12,002	12,495
Real GDP Growth (%)	3.9%	4.0%	4.1%
Inflation (%)	3.8%	3.6%	3.4%
Exports (\$m)	2,749	3,096	3,468
Imports (\$m)	10,877	11,806	12,891
Remittances (\$m)	2,867	3,157	3,501
Official Development Assistance (\$m)	3,917	4,025	4,235

Source: Ministry of Finance, Budget Strategy Paper FY2025–FY2027[2]

## Challenges

- **Narrow Economic Base:** The economy relies heavily on remittances, agriculture, and trade, with limited diversification.
- **Trade Deficit:** The trade deficit remains substantial, with imports significantly outweighing exports.

## 2.3. Governance and Institutional Weaknesses

### Public Financial Management Challenges

- Absorption constraints in donor-funded projects due to limited capacity in implementing agencies.
- Weaknesses in budget execution, financial reporting, and oversight mechanisms.

### Corruption Risks

- High risk of mismanagement and corruption due to gaps in transparency and accountability.
- Somalia ranks low on the Corruption Perceptions Index, indicating pervasive corruption[11].

## 2.4. Security Risks

- **Impact on Economic Activities:** Ongoing security challenges disrupt economic activities and deter investment.
- **Resource Allocation:** Increased security expenditures strain public finances.

## 2.5. Climate Change and Environmental Risks

- **Vulnerability to Climate Shocks:** Frequent droughts and floods adversely affect agriculture and livestock sectors, leading to food insecurity and displacement[10].
- **Environmental Degradation:** Unsustainable practices contribute to reduced agricultural productivity.

# 3. Recommendations for Post-HIPC Reforms

## 3.1. Enhancing Revenue Mobilization

### Strategic Objectives

- Increase domestic revenue annually by at least 0.3 percentage points of GDP.
- Cover operational costs with domestic revenue by 2027.

### Priority Interventions

- **Digitization of Non-Tax Revenue Management System:** Implement electronic systems to improve efficiency and reduce leakages.
- **Enhancing Tax Audits:** Strengthen audit capabilities to prevent tax evasion.
- **Harmonizing Tax Systems:** Align Federal Government and Federal Member States' tax systems per fiscal federalism principles.
- **Implement EAC Customs External Tariff (CET):** Adopt the CET starting in 2026 as part of East African Community commitments [17].
- **Capacity Building:** Invest in training for revenue staff to enhance skills and efficiency.
- **Strengthening the Social Contract:** Improve visibility of service delivery to encourage voluntary tax compliance.

## 3.2. Strengthening Public Financial Management

- **Budget Reforms: Program-Based Budgeting:** Implement on a pilot basis to align expenditures with strategic objectives.

- **Performance Reporting:** Require MDAs to provide quarterly budget utilization reports, including performance against key indicators.
- **Improving Absorption Capacity:** Address constraints in implementing donor-funded projects to ensure effective utilization of funds.
- **Internal Controls and Audit:** Strengthen internal audit functions and empower the Office of the Auditor General for independent oversight.

### 3.3. Promoting Economic Diversification and Growth

- **Sectoral Focus: Agriculture:** Boost production through infrastructure rehabilitation and adopting climate-resilient practices.
- **Support to SMEs:** Utilize institutions like the Somalia Development and Reconstruction Bank and Gargaara to boost SMEs and household incomes.
- **Regional Integration:** Implement commitments to boost trade following Somalia's entry into the East African Community.
- **Investment Climate Improvements:** Simplify regulations, improve access to finance, and strengthen legal frameworks to attract investment.

### 3.4. Prudent Debt Management

- **Debt Sustainability:** Maintain public debt within sustainable levels, adhering to targets set in the Interim Poverty Reduction Strategy Paper (IPRSP).
- **Avoid Unsustainable Borrowing:** Adopt prudent borrowing practices to finance fiscal deficits without accumulating unsustainable debt.
- **Develop a Comprehensive Debt Strategy:** Focus on concessional borrowing and explore alternative financing options, such as diaspora bonds.

### 3.5. Social Sector Investment and Human Capital Development

- **Education and Health Investments:** Increase budget allocations in line with strategic plans for education and health sectors. Improve access and quality by building schools, training teachers, and expanding healthcare services.
- **Social Protection Systems:** Expand safety nets to support vulnerable populations. Implement disaster risk management systems for early warning and rapid response to climate-induced disasters.

### 3.6. Private Sector Development

- **Enhancing Business Environment:** Simplify business regulations and reduce bureaucratic hurdles. Improve access to finance and strengthen property rights.

- **SME Support:** Provide incentives, access to finance, and capacity-building programs for SMEs to stimulate job creation.

### 3.7. Infrastructure Investment

- **Reconstruction of Energy and Road Infrastructure:** Prioritize projects with immediate high-growth impact to lower the cost of doing business.
- **Public-Private Partnerships (PPPs):** Develop a legal and regulatory framework for PPPs to attract private investment. Identify and prioritize infrastructure projects suitable for PPP arrangements.

### 3.8. Governance and Institutional Reforms

- **Efficiency and Productivity:** Require every MDA to develop a five-year strategic plan. Implement measures to improve coordination and productivity in FGS and FMSs.
- **Fiscal Federalism:** Allocate transfers to FMSs based on agreed grant allocation formulas. Harmonize budgetary policies to ensure coherence between federal and state levels.
- **Anti-Corruption Measures:** Enact and enforce anti-corruption laws, and establish an independent anti-corruption commission[13]. Promote transparency initiatives and open government practices.

### 3.9. Social Inclusion and Gender Equality

- **Climate Change Interventions:** Develop a climate change policy. Promote the use of alternative clean energy sources.
- **Gender Equality Initiatives:** Enhance women's economic participation through access to finance, education, and legal rights. Implement policies addressing the needs of marginalized groups to promote social cohesion.
- **Youth Employment:** Implement vocational training and education programs tailored to market needs. Encourage youth entrepreneurship through mentorship programs and startup incubators.

## 4. Implementation and Monitoring Mechanisms

### Action Plan Development

- **Prioritization of Reforms:** Sequence interventions based on urgency, impact, and resource availability.

- **Stakeholder Mapping:** Identify key actors, including government agencies, private sector, civil society, and international partners.

## Resource Mobilization

- **Domestic Resources:** Enhance revenue collection and rationalize expenditures to fund reforms.
- **External Support:** Align donor assistance with national priorities and seek technical and financial support.

## Monitoring and Evaluation (M&E)

- **Establish M&E Frameworks:** Set clear indicators and targets for each reform area.
- **Regular Reporting:** MDAs to provide quarterly reports to the Office of the Prime Minister and Ministry of Finance.
- **Stakeholder Engagement:** Involve civil society, private sector, and international partners in the reform process.

## 5. Conclusion

Somalia's post-HIPC landscape presents both significant opportunities and challenges. By implementing the recommended reforms, Somalia can strengthen its fiscal and economic frameworks, enhance governance, and build a resilient economy capable of withstanding internal and external shocks. These reforms are crucial for achieving long-term sustainable development and improving the well-being of all Somali citizens. Success will depend on strong political will, effective coordination, and the active participation of all stakeholders, including the international community.

## 6. References

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## 7. Appendices

### Appendix A: Detailed Fiscal Data

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**Table A1: Revenue and Expenditure Performance (FY2023–FY2024)**

Item	FY2023 Actual (\$m)	FY2024 Projected (\$m)
<b>Total Revenue and Grants</b>	738.0	747.3
- Domestic Revenue	329.5	357.5
- Income Tax	(132% performance)	
- Taxes on Local Trade	(105% performance)	
- Customs	(163.3% performance)	
- Non-Tax Revenue	(63.7% performance)	
- External Grants	408.5	389.8
<b>Total Expenditure</b>	687.1	755.6
- Expenditure from Domestic Resources		490.6
- Donor-Funded Project Expenditure		264.9
<b>Fiscal Deficit</b>	50.9	8.2

Source: Federal Government of Somalia Budget Reports FY2023–FY2024<sup>[1]</sup><sup>[2]</sup>

## Appendix B: Macroeconomic Assumptions for the Medium-Term (2025–2027)

Table B1: Macroeconomic Projections (2025–2027)

Variable	2025	2026	2027
Nominal GDP (\$m)	13,541	14,686	15,913
Real GDP (\$m)	11,541	12,002	12,495
Real GDP Growth (%)	3.9%	4.0%	4.1%
Inflation (%)	3.8%	3.6%	3.4%
Exports (\$m)	2,749	3,096	3,468
- Exported Goods	1,205	1,392	1,590
- Exported Services	1,544	1,704	1,878
Imports (\$m)	10,877	11,806	12,891
- Imported Goods	8,339	9,027	9,839
- Imported Services	2,538	2,779	3,052
Remittances (\$m)	2,867	3,157	3,501
Official Development Assistance (\$m)	3,917	4,025	4,235
- On-budget Aid (\$m)	291	200	100
- Off-budget Aid (\$m)	3,626	3,825	4,135
Foreign Direct Investment (\$m)	731	793	859

Source: Ministry of Finance, Budget Strategy Paper FY2025–FY2027<sup>[2]</sup>