



# Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 20-Dec-2019 | Report No: PIDC27852

**BASIC INFORMATION****A. Basic Project Data**

Country Somalia	Project ID P172057	Parent Project ID (if any)	Project Name Somalia Currency Exchange Project (P172057)
Region AFRICA	Estimated Appraisal Date Apr 28, 2020	Estimated Board Date Jun 25, 2020	Practice Area (Lead) Finance, Competitiveness and Innovation
Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance	Implementing Agency Central Bank of Somalia	

**Proposed Development Objective(s)**

The Development Objective of the project is to support the issuance of a new, legal, low denomination national currency notes to replace the counterfeit and old notes currently in circulation.

**PROJECT FINANCING DATA (US\$, Millions)****SUMMARY**

<b>Total Project Cost</b>	55.00
<b>Total Financing</b>	55.00
<b>of which IBRD/IDA</b>	0.00
<b>Financing Gap</b>	0.00

**DETAILS****Non-World Bank Group Financing**

Trust Funds	55.00
Special Financing	55.00

Environmental and Social Risk Classification

Concept Review Decision



Substantial

Track II-The review did authorize the preparation to continue

## B. Introduction and Context

### Country Context

**Somalia is a fragile country and one of the poorest in the world with GDP per capita at just over US\$330 and a fast-growing population of 14 million.**<sup>1</sup> Between 2016 and 2019, Somalia's real gross domestic product (GDP) is estimated to have grown at an average of 2.5 percent per year, falling below the annual population growth rate of 2.9 percent. The services sector is a key driver of growth in the economy, while agriculture (especially livestock) is a major source of livelihoods. Somalia is vulnerable to various shocks including natural disasters, epidemics. Almost two in three Somali households (66 percent) reported experiencing at least one type of shock in the past 12 months. The Somalia Poverty and Vulnerability Assessment finds that drought-exposed rural households are 24 percent more likely to be poor and more likely to be hungry.<sup>2</sup>

**The country has a unique opportunity to escape from decades of conflict and fragility, and the Federal Government of Somalia (FGS) is demonstrating a strong commitment to wide-ranging institutional and economic reforms. Public finances have continued to strengthen but faces a structural trade deficit that is supported by remittances and donor financing.** FGS domestic revenue grew to 3.9 percent of GDP in 2018 from 3.2 percent in 2017.<sup>3</sup> Broadening of the tax base to include services, coupled with improved tax administration, helped increase tax revenue, which in turn enabled FGS to increase spending (projected at 6.9 percent of GDP in 2019).<sup>4</sup>

**Remittance flows from the diaspora and aid inflows provide a crucial source of financing.** Remittances from the diaspora, estimated at US\$1.38 billion in 2018<sup>5</sup>, are an important component of income for the bottom 40 percent of households, supporting livelihoods for an estimated 15 percent of the population, and are generally more stable than aid flows and FDI. Increasing efforts to address money Laundering and combatting financing of terrorism is critical for Somalia to reestablish correspondent banking relationships and remove barriers to accessing financing, including for investment purposes.

**Somalia's economic growth has not been inclusive.** Poverty levels are stubbornly high, and unemployment is also widespread, especially among women and youths (in 2017, youth unemployment stood at 74 percent for young women and 61 percent for young men). Remittances and humanitarian aid alone are not sufficient to support the development of sustainable livelihoods that are necessary for poverty reduction and mitigation of political, social, and economic vulnerability. The medium-term outlook is for a moderate increase in GDP growth with greater emphasis on pro-poor programs, as outlined in the ninth National Development Plan (NDP9), which covers 2020–24.

<sup>1</sup> World Bank (August 2019), Somalia Economic Update—Building Education to Boost Human Capital.

<sup>2</sup> World Bank (April 2019), Somalia Poverty and Vulnerability Assessment—Findings from Wave 2 of the Somali High Frequency Survey.

<sup>3</sup> IMF (November 2019), Somalia: First Review under the Staff Monitored Program.

<sup>4</sup> The federal government reintroduced sales tax (replacing a presumptive tax), especially on telecoms, ports, and hotels; launched a Large and Medium Taxpayers Office (LMTO); and introduced risk-based assessment of imports.

<sup>5</sup> This is almost three times the country's foreign direct investment (FDI), nearly twice the level of development aid (at US\$ 874 million) and slightly higher than the level of humanitarian aid (at US\$1.14 billion).



**Key risks to the country and macroeconomic situation are related to limited progress in solidifying the federal system and address insecurity.** Key issues surrounding allocation of functions and responsibilities of federal government and the five Federal Member States (FMS), including resource sharing, remain critical and will need to be addressed in the new Constitution. The risk of spoiler groups including Al-Shabaab, continues to undermine the security situation.

## Sectoral and Institutional Context

**The Somali financial sector is rapidly transforming from a low base in response to market demand and technological change.** Even though there is more financing in the system than before with commercial bank credit to the private sector reaching US\$161.4 million in 2018 compared to US\$66.1 million in 2016 the banking sector is estimated to meet around seven percent of demand for credit. Bank deposits have more than tripled in the last four years to just over US\$350 million recorded in the first quarter of 2019, indicating increased confidence in the formal banking institutions by the public in general. Despite the recent performance, this growth is from a low base and financial intermediation is still limited – in 2018, private sector credit was a meager two percent of GDP. The financial system serves a range of needs. Mobile money has become the dominant retail payment system. Money Transfer Businesses (MTBs) remain critical for international flows, for private and public flows alike. With World Bank support, the CBS is implementing a number of reforms, including introduction of mobile money regulations and a new Payment Systems Law, and updating the Financial Institutions Law. Diagnostic work on credit referencing and moveable collateral registries have been initiated.

**Dollarization of both the banking and mobile money systems is contributing to disparities in financial access and opportunities to improve livelihoods across the population.** The CBS has not issued legal tender Somali banknotes since the collapse of the state in 1991 and the IMF estimates that almost all the current SOS banknotes in circulation are counterfeit. Lack of a legitimate Somalia Shilling is devastating the poorer households who do not earn income in hard currency (except the 15-20 percent of the population that receive remittances and those working in the formal service sector). Most households run very small businesses and sell their products and services in local currency, hence to participate in the dollar system requires them to convert their illegitimate Shillings into dollar. In addition, trade in livestock and fishery, internally displaced people (IDPs), small-traders, street vendors and sellers of food items such as vegetables, dairy, meat, bread, etc. continue to rely on the shilling. Given the poverty levels in the country, over 80 percent of transactions in local markets are low value transactions (around US\$ 0.25 on average). This forces the few households that earn in dollar to cash-out their dollars and convert it into Shillings in order to transact in such markets. The CBS estimates household holdings of shillings and shillings used in local food/khat market as representing about 36 percent of the shillings circulating in urban centers. About 57.4 percent is held by small scale exchange dealers.

**There is strong demand for new and legal domestic currency.** Almost 90 percent of Somalis surveyed in the 2017 World Bank Survey indicated their interest in mobile money being available in local currency.<sup>6</sup> The lack of a legitimate local currency undermines the prospects for building household wealth and formal financial inclusion for a substantial proportion of the population. The prevalence of counterfeits has negatively impacted the livelihood of many rural and urban communities in most Federal Member States and in the Benadir/Mogadishu region. Withdrawing old and counterfeit shillings from circulation and introducing a new currency is a complex exercise that will require a robust network of exchange points and strong coordination among key stakeholders. MTBs have a wide network that extends to even hard to reach rural areas (including areas with the presence of Al-Shabab) and is accessible to nomads and IDPs.

<sup>6</sup> World Bank/Altai Consulting (2017); Mobile Money in Somalia Household Survey and Market Analysis.



**The new Somali shilling will be used in parallel with the US dollar.** The proposal is to print Somali shillings of low denomination in order to address the pressing needs of the poor and reduce transactions costs. Dollarization remains entrenched in the Somali economy and this will remain in the foreseeable future. Providing legal tender bank notes would counter the use of counterfeit banknotes and encourage the development of a Somali shilling payment system. Political leaders in Somalia are leading the efforts to secure financing for this important national project and FGS has requested the WB to coordinate the overall effort and fund raising to support the project. The World Bank is considering further engagement with the FGS on this project, subject to the availability of funding from other development partners. It is estimated that the total financing needed for a project would exceed the US\$41 million that was initially estimated by the IMF and would most likely be in the region of US\$55 million, which would also include technical assistance support.

#### Relationship to CPF

**The currency exchange project is envisioned as part of the broader World Bank financial sector engagement in Somalia.** The proposed project directly contributes to the Somalia CPF for FY19–22, especially to Focus Area 2 (Restoring Economic Resilience and Opportunities) and Objective 2.2 (Increase Access to Finance for Inclusion and Digital Development). The CPF's objective on increasing financial and digital access directly relates to Somalia's National Development Plan (NDP) which sets out the country's priorities for national recovery and development for 2017–2019, particularly on increasing access to finance and markets.

**The project is also aligned with the 2018–2020 Financial Sector Roadmap developed by the CBS, in partnership with the International Monetary Fund (IMF) and World Bank. The proposed project complements ongoing initiatives and operations in Somalia to deepen the financial sector.** By supporting the currency exchange process, the project will improve access to a national legal tender currency by the poor who do not have access to the US dollar, enable their inclusion in the formal financial system by supporting a shilling-denominated payments system, contribute to savings mobilization in local currency and provide the basis for the CBS to build reserves.

#### C. Proposed Development Objective(s)

The Development Objective of the project is to support the issuance of a new, legal, low denomination national currency notes to replace the counterfeit and old notes currently in circulation.

#### Key Results (From PCN)

**Achievement of PDO will be measured by the following indicators<sup>7</sup>:**

- # of Somali shilling denominated transaction accounts and mobile money wallets opened by bank and non-bank payment service providers
- New legitimate and freely circulating Somali Shilling that is accepted for business and individual transactions across the Federal Republic of Somalia.
- Nationally accepted designs for each of the four denominations (SOS 1,000; SOS 2,000; SOS 5,000; and SOS 10,000) of banknotes.
- # of banknotes in the four denominations printed.
- # of banknotes in the four denominations exchanged.

#### D. Concept Description

<sup>7</sup> To be confirmed during preparation/appraisal



The currency exchange is envisaged as a project with a scope that combines traditional exchange of banknotes with several legal and structural reforms involving banking, digital financial inclusion and payment systems. Support will be provided to the FGS towards implementation of four components:

**Component 1 – Currency design and planning of implementation activities:** The CBS will issue banknotes with low denominations and appropriate security features, namely SOS 1,000, SOS 2,000, SOS 5,000, and SOS 10,000. The CBS has already begun to work on the design of the new currency and has completed the currency specifications including size, security features, and other specifications. The new series of banknotes will have much improved security features compared to the series from 1983–90 and will be difficult and time-consuming to copy by both traditional and computer-based printing methods. Typically, local counterfeiters do not exhibit sophisticated techniques and use crude in-house techniques. At this stage, the project will fund planning activities by the CBS, including development of a clear logistics and communication plan.

**Component 2 – Currency exchange implementation:** Through this component the CBS will implement all currency exchange activities. **Printing of banknotes will be procured internationally through a competitive tendering process. There are several specialized currency printing firms with facilities in the U.K., US, Germany, Switzerland and Russia that would be eligible to bid for this project.** Delivery of the banknotes will be done by the vendor(s)<sup>8</sup> via air or ship to Mogadishu, upon clearance by the CBS/Currency Management Unit. Transportation from the harbor/airport to this facility would be arranged with Somali security and AMISOM forces. In addition, the communication consultant hired under the project will execute all communication activities by coordinating with key stakeholders. The new banknotes will be distributed through MTBs and the process is expected to not to exceed 90-100 days.

**Component 3 – Ongoing technical assistance:** Subject to securing adequate funding, the project will finance TA to the CBS to ensure sustainability of the project. The CBS organizational reform and governance (including having a well-functioning currency management unit) and stronger financial sector regulations (including mobile money operators) will be needed to ensure that new national currency can be managed appropriately and achieve the development objectives of ‘a sound and stable legal tender national currency’.

**Component 4 – Financial management, and monitoring and evaluation:** This component would finance all the costs pertaining the Project Implementation Unit (PIU) within implementing entity; financial management, and monitoring and evaluation (M&E).

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	TBD
Summary of Screening of Environmental and Social Risks and Impacts	

<sup>8</sup> CBS intends to have 1 – 2 printers, splitting the printing work, to reduce risk and the printing time.



Environmental and Social Risk Classification (ESRC)

Substantial

Environmental Risk Rating

Moderate

There may be some potential negative environmental impacts associated with the printing of new currency notes as well as the destruction of the old currency notes. As the mechanics for printing new notes and destructing old notes is not yet specific, these impacts are not yet known. The environmental risk rating will be adjusted as this information is known.

Social Risk Rating

Substantial

Overall, the project is expected to have positive social outcomes. The key social risks related to the proposed operations relate to activities under component 2 on component 2 on currency exchange implementation. As withdrawal of old and counterfeit and exchange with the new currency depends on robust community engagement and communication campaign for awareness, the challenges of ensuring the project reaches hard to serve community members (such as minorities, people with disabilities or widows, IDPs and pastoralists) may lead to exclusion. Similarly, the timing of the currency exchange processes could lead to the exclusion of mobile families. Security concerns and the remoteness of the project target areas can also combine to provide a significant challenge for monitoring and supervising project implementation. This can include challenges for community and stakeholder engagement, grievance redress and other risk mitigation protocols. The risks of Gender Based Violence (GBV), and Sexual Harassment (SH) for women travelling to currency exchange points as well as exposing women traders and girls to Sexual Exploitation and Abuse (SEA) by project workers and the police involved in anti-counterfeiting activities is also possible.

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