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Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 21-Jun-2024 | Report No: PIDDA00107

Public Disclosure Authorized

BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Operation ID	Operation Name	
Somalia	P501988	First Somalia Economic Resilience Development Policy Financing	
Region	Estimated Approval Date	Practice Area (Lead)	Financing Instrument
EASTERN AND SOUTHERN AFRICA	30-Jul-2024	Macroeconomics, Trade and Investment	Development Policy Financing (DPF)
Borrower(s)	Implementing Agency		
Republic of Somalia	Ministry of Finance		

Proposed Development Objective(s)

To promote economic resilience through more sustainable public finances and resilient private sector development.

Financing (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Financing	**125.00**

DETAILS

Total World Bank Group Financing	**125.00**
World Bank Lending	125.00

Decision

The review did authorize the preparation to continue

Explanation

B. Introduction and Context

Country Context

1. **Somalia continues to face multiple and overlapping shocks that reduce economic growth and contribute to widespread poverty.** Climate change is making periodic droughts and floods more frequent and severe and is inextricably linked to Somalia's social and political vulnerabilities. Combined with external market shocks, the COVID-19 pandemic, and domestic security challenges, have contributed to declining per capita GDP. Between 2019 and 2023, annual economic growth averaged only 2 percent, compared with a population growth rate of 2.9 percent. The legacy of state fragmentation and continued fragility and conflict have shaped the country's development trajectory. The public sector therefore has little fiscal space for investments that would generate economic growth and reduce poverty. And it lacks capacity to steer private sector dynamism towards creation of more and better jobs. Only one third of men and 12 percent of women are actively engaged in the labor market. In 2022, an estimated 55 percent of the Somali population lived below the national poverty line of US$741 per person per year.1

2. **Despite this difficult environment, the Federal Government of Somalia (FGS) continued to implement important economic reforms.** These reforms were centered on strengthening macroeconomic stability and economic governance in key sectors and culminated in reaching two significant milestones. In December 2023, Somalia reached the HIPC Completion Point and also became a member of the East African Community. The post-HIPC reform agenda remains broad and is focused on continuing improvements in core state functions, measures to support the development of the private sector and ensure sustainable and inclusive growth.

Relationship to CPF

3. The proposed Development Policy Financing (DPF) supports the objectives of the World Bank's Country Partnership Framework for Somalia (FY24–28) and incentivizes progress in reaching IDA's Turnaround Allocation (TAA) milestones. The proposed operation provides further impetus for state- and institution building reforms, needed to support transitioning of Somalia out of fragility. DPF Pillar A directly contributes to the CPF high-level outcome "macroeconomic stability and governance foundations." Pillar A is also fully aligned with the three focus areas of the TAA fragility mitigation driver "Strengthening institutions, sustaining economic reforms, and helping to build a stable political settlement". Pillar B contributes to three CPF pillars: "strengthen financial inclusion and growth," "increase access to infrastructure, energy, and digital services," and "strengthen urban resilience."

C. Proposed Development Objective(s)

To promote economic resilience through more sustainable public finances and resilient private sector development.

[1] Federal Republic of Somalia, Somalia National Bureau of Statistics, Somalia Poverty Report, 2023.

Key Results

4. To promote sustainable public finances, this DPF is expected to increase the FGS's ability to collect inland tax and customs revenue, contain the costs and risks of public debt, and strengthen public expenditure transparency and accountability. To enable resilient, private sector development, the DPF is expected to facilitate better access to microfinance and insurance products, as well as support increased fisheries exports. To further strengthen resilience of private sector to climate change, the DPF is expected to expand investments in renewable sources of energy and ensure investment projects take into account environment, social and climate risks.

D. Project Description

5. **The proposed operation is the first in a programmatic series of two operations to support economic resilience in Somalia.** The objective of Pillar A is to strengthen sustainability of public finances and ensure macroeconomic stability and fiscal space to support Somalia's large development needs in the context of high volatility to climate change and fragility, conflict, and violence. The objective of Pillar B is to enable economic resilience of the private sector through implementing structural reforms that enhance the environment for private sector-led growth and create conditions for job creation. The reforms supported in this operation build on the reforms anchored in the HIPC initiative and supported by DPFs approved in 2020–2023.[2]

6. **This DPF series promotes sustainable public finances to increase the fiscal space needed to foster economic growth and poverty reduction.** Clarifying the collection of taxes, fees, duties, and other government revenues as well as ensuring implementation of the income tax legislation are expected to mobilize more domestic revenues in support of country's significant development needs. Actions to strengthen the institutional arrangements for debt management will ensure that Somalia has a well-structured and staffed Debt Management Unit (DMU) that is capable of assessing the risks and costs of new public borrowing, managing the stock of debt that was not subject to debt relief, and ensuring transparency of all debt-related activities. Audit regulations will further align the functions of the Office of the Auditor General of the Federal Republic of Somalia (OAGS) with international standards and reinforce OAGS's autonomy in critical areas of staffing, operational and financial management, as well as delineate responsibilities between OAGS and FMS auditors general. There has been close collaboration with the IMF, AfDB, EU, and other development partners to ensure complementarity of support on sustainable public finances.

7. **To enable resilient private sector development and thus support climate adaptation and mitigation, the DPF includes reforms in key sectors of the economy.** Actions to strengthen the regulatory and supervisory framework for banks and, for the first time, microfinance institutions, will facilitate the development and introduction of new products and services—especially for small and micro borrowers. Improved regulation and supervision of all takaful affairs will protect the rights and interests of takaful customers and promote the development of the takaful market, resulting in increased number of pastoralists, including women, covered by takaful insurance. Enhancing the collaboration between federal and state levels in fisheries governance and setting export and import fisheries standards will support higher exports and sustainable exploitation of maritime resources. Establishing the core functions of the Ministry of Environment and Climate Change and introducing environment and social impact assessments (ESIAs) for investment projects will make the economy more resilient to climate change and reduce environmental costs. Putting in place clear framework for true

[2] The Somalia Reform and Reengagement DPF (P171570) and Supplemental Financing (P174064) and the Somalia Inclusive Growth and Development DPF series (P174089 and P179307).

cost recovery and optimized generation and transmission network development plan will incentivize private investment in renewable energy.

E. Implementation

Institutional and Implementation Arrangements

8. The Ministry of Finance has the lead responsibility for the coordination, monitoring, and ensuring ultimate completion of the prior actions. Monitoring of results from the proposed operation will build on mechanisms that the ministry developed for managing other policy reform commitments. Recognizing the government's capacity constraints, prior actions for the proposed operation were selected to complement the ongoing support provided under World Bank, IMF, and EU projects to minimize the additional workload associated with monitoring the actions in this proposed operation.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

9. **No prior actions are likely to have significant negative poverty and social impacts.** Higher FGS revenues and prudent management of public expenditure and debt, targeted under pillar A, will provide more resources to finance basic service delivery, enhancing the stability of the state and increasing economic resilience. Reforms under Pillar B are expected to enhance the resilience of the private sector by providing: 1) better access to microfinance, including for the under- and unserved economic segments as poorer households tend to own small and micro enterprises; 2) better access to drought-index insurance to pastoralists, who are the poorest group in Somalia, and access to insurance will enable them to better adapt to climate change; 3) more efficient electricity generation that will help contain prices faced by end-users, but levels of tariff rates that will be approved in the future are uncertain, requiring additional analysis to determine the distributional impacts.

Environmental, Forests, and Other Natural Resource Aspects

10. **No prior actions are likely to have significant adverse environmental costs.** Although the construction of new electricity generation facilities expected to be enabled by the DPF could pose some risks to the environment (such as possible carbon dioxide and sulfur and nitrous oxide emissions from power plants that may contribute to climate change, affecting ecosystems in multiple ways), the new requirement for investors to conduct environment and social impact assessments mitigates these risks significantly. The operation is consistent with Somalia's Nationally Determined Contribution (NDC). In the latest NDC, revised in 2023, Somalia has, contingent on international support, reiterated its commitment to 30 percent emission reductions against the business-as-usual scenario by 2030. On adaptation, the Somali government aims to enhance adaptive capacity, strengthen resilience, and reduce vulnerability to climate change through mainstreaming climate adaptation into sustainable development. The operation contributes to the NDC by supporting the government in the provision of enabling environment for meeting sector-specific adaptation indicators, including targets 2.3.1 ('Smart Agriculture, Livestock, and Land Use'), 2.3.2 ('Climate Smart Fisheries'), and 2.3.4 ('Climate Proofed Infrastructure, Built Environment, Transport, and Energy'). The operation is aligned with the goals of the Paris Agreement

on adaptation. Initial due diligence shows that the prior actions are likely to have only negligible impacts on greenhouse gas (GHG) emissions and are unlikely to have any adverse effect on the country's GHG emission targets.

G. Risks and Mitigation

11. **Overall risks to this operation are high.** Somalia's fragility can undermine the reform momentum, leading to frequent reform reversals, as reflected in **high political and governance risks**. The Finance Ministers Fiscal Forum, supported by the World Bank, has provided an important channel for advancing technical reforms by encouraging dialogue to help mitigate political and governance risks. Strengthening of the external audit function and other governance reforms, supported by the DPF and World Bank investment projects, as well as leveraging the Financial Governance Council, contributed to improvements in government accountability and mitigate governance risks. **High macroeconomic risks** reflect the government's low revenue mobilization, absence of discretion over spending, the absence of monetary policy tools, and other gaps in macroeconomic policy capacity which limit the ability to respond to economic shocks. Reforms supported as prior actions in Pillar A and the discipline of the IMF ECF program tend to mitigate macroeconomic risks. Strengthening fiduciary systems remains an ongoing government priority. **Fiduciary risks are substantial** due to Somalia's inadequate and nascent legal, policy and institutional framework, making the inherent fiduciary risks high. Audit regulations, supported by the proposed DPF, and the broader World Bank, IMF and other development partners' support for wide-ranging public finance management, transparency and accountability reforms at both federal and state levels reduce the residual risk to substantial. **Institutional capacity risks are substantial** as public sector institutions in Somalia remain underdeveloped—a legacy of state fragmentation and conflict, existing political divisions, and minimal revenue mobilization. Public sector capacity constraints are also being addressed through the implementation of the Pay and Grading Policy, professional development programs, merit-based recruitment, and performance management measures supported through World Bank investment projects (Recurrent Cost and Reform Financing (RCRF) Phase III (P177900) and Somalia Enhancing Public Resource Management Project (SERP, P177298). **Stakeholder risks are substantial** reflecting competing interests and political fragmentation. Substantial consultations with, and engagement of, multiple categories of stakeholders and establishment of a consultative process with the support from ongoing investment projects and analytical work will help mitigate the risk.

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APPROVAL

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