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Report No: PD000039

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED GRANT

IN THE AMOUNT OF SDR 94.5 MILLION (EQUIVALENT TO US$125 MILLION) TO

THE FEDERAL REPUBLIC OF SOMALIA
FOR THE

FIRST SOMALIA ECONOMIC RESILIENCE DEVELOPMENT POLICY FINANCING

July 2, 2024

Macroeconomics, Trade and Investment
Eastern And Southern Africa

Federal Republic of Somalia

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENT

Exchange rate effective as of May 31, 2024

Currency unit: Somali shilling (SOS)
US$1.00 = SOS 28,035

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank	IPF	Investment Project Financing
AM	Accountability Mechanism	ITAS	Integrated Tax Administration System
AML/CFT	Anti-money laundering/combatting the financing of terrorism	LIC	Low-income country
ASA	Advisory Services and Analytics	MECC	Ministry of Environment and Climate Change
CBS	Central Bank of Somalia	MFBE	Ministry of Fisheries and the Blue Economy
CEA	Country Environmental Analysis	MFI	Microfinance institution
CPF	Country Partnership Framework	MOF	Ministry of Finance
CPI	Consumer price index	MPF	Multi-Partner Fund
DPF	Development Policy Financing	NDC	Nationally Determined Contribution
DRM	Domestic Resource Mobilization	NDP	National Development Plan
EAC	East African Community	NEA	National Electricity Authority
ECF	IMF's Extended Credit Facility arrangement	NTP	National Transformation Plan
eKYC	Electronic know-your-customer	OAG	Office of the Auditor General
ESP	Electricity service provider	PFM	Public Financial Management
ESIA	Environment and Social Impact Assessment	PPA	Performance and Policy Action
EU	European Union	PV	Present Value
FCDO	Foreign, Commonwealth and Development Office	RCRF	Recurrent Cost and Reform Financing
FCV	Fragility, conflict, and violence	SCALED-UP	Somalia Capacity Advancement, Livelihoods and Entrepreneurship, through Digital Uplift Project
FGC	Financial Governance Committee	SERP	Somalia Enhancing Public Resource Management Project
FGS	Federal Government of Somalia	SDFP	Sustainable Development Finance Policy
FMDC	Fisheries Management and Development Council	SDR	Special Drawing Rights
FMIS	Financial Management Information System	SHIIP	Somalia–Horn of Africa Infrastructure Integration Project
FMS	Federal Member State	SNBS	Somali National Bureau of Statistics
GDP	Gross domestic product	SIHBS	Somalia Integrated Household Budget Survey
GHG	Greenhouse gas	SNBS	Somali National Bureau of Statistics
GRS	Grievance Redress System	SOMCAS	Somali Customs Automated System
HIPC	Heavily Indebted Poor Country	TAA	Turnaround Allocation
IDA	International Development Association	TSA	Treasury single account

IFC	International Finance Corporation	US$	United States dollar
IMF	International Monetary Fund	USAID	United States Agency for International Development

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FEDERAL REPUBLIC OF SOMALIA

First Somalia Economic Resilience Development Policy Financing

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Operation ID	Programmatic	If programmatic, position in series
P501988	Yes	1st in a series of 2

Proposed Development Objective(s)

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

Organizations

Borrower:	Federal Republic of Somalia
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (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

World Bank Group Financing

International Development Association (IDA)	125.00
IDA Grant	125.00

IDA Resources (US$, Millions)

	Credit Amount	Grant Amount	SML Amount	Guarantee Amount	Total Amount
National Performance-Based Allocations (PBA)	0.00	125.00	0.00	0.00	125.00
Total	**0.00**	**125.00**	**0.00**	**0.00**	**125.00**

PRACTICE AREA(S)

Practice Area (Lead)

Macroeconomics, Trade and Investment

Contributing Practice Areas

Governance; Finance, Competitiveness and Innovation; Energy & Extractives; Environment, Natural Resources & the Blue Economy

CLIMATE

Climate Change and Disaster Screening

Yes, it has been screened and the results are discussed in the Operation Document

OVERALL RISK RATING

Overall Risk	High

RESULTS		
Indicator Name	**Baseline**	**Target**
Results Indicator #1: Increase in inland tax and customs revenue collected (share of GDP)	1.95 percent (2023)	2.40 percent (2026)
Results Indicator #2: Cap on growth of debt service costs	US$17.7 million (2023)	US$25 million (2026)
Results Indicator #3: Increased number of audits conducted in line with the quality criteria set out in the new audit framework and published online	0 (2023)	2 (2026)
Results Indicator #4: Increased number of financial institutions under formal supervision	29 (2023)	42 (2026)
Results Indicator #5: Increased number of pastoralists and their dependents covered by drought index insurance	0 (2023)	180,000 (2026) of which 90,000 women
Results Indicator #6: Increased value of seafood export	US$15 million (2023)	US$18 million (2026)
Results Indicator #7: Number of new development projects processed under the Regulations	0 (2023)	5 (2026)
Results Indicator #8: Renewable energy capacity enabled (Megawatt)	0 (2023)	50 (2026)

**IDA PROGRAM DOCUMENT FOR A PROPOSED GRANT TO
FEDERAL REPUBLIC OF SOMALIA**

1. INTRODUCTION AND COUNTRY CONTEXT

1. **Legacies of state fragmentation and continued conflict have shaped Somalia's development trajectory.** The Federal Government of Somalia (FGS) was established in 2012 and has implemented important state- and institution-building reforms. The effectiveness of these reforms, however, has been affected by limited state presence and insecurity as well as an unfinished political settlement on key federal matters such as the distribution of resources and functional responsibilities among the FGS, the Federal Member States (FMS), and local authorities. Institutional capacity is gradually improving, supported by international community, but remains insufficient to deal with the multiple challenges facing Somalia. Limited administrative capabilities and perceptions of corruption have delayed the restoration of infrastructure and economic capacity that were destroyed during the civil war. Continuing conflict has limited growth prospects and revenue mobilization while keeping security costs high. Federal and state governments collect minimal revenue, despite moderate growth over the last years. The public sector therefore has little fiscal space for investments that would generate economic growth and reduce poverty or capacity to steer private sector dynamism towards creation of more and better jobs.

2. **Somalia continues to face multiple and overlapping shocks that reduce economic growth and contribute to widespread poverty.** Somalia is the world's second most exposed country to climate change impacts. For Somalia, the projections for temperature rise have the highest certainty.[1] Climate change is making periodic droughts and floods more frequent and severe and is inextricably linked to Somalia's social and political vulnerabilities. In addition, external market shocks, the COVID-19 pandemic, and domestic terrorist incidents have contributed to declining per capita GDP. Between 2019–2023, economic growth rates averaged only 2 percent, compared with a population growth rate of 2.9 percent. Only one third of men and 12 percent of women are actively engaged in the labor market. Persistent gender inequalities in labor market have been associated with high illiteracy rates of women, especially among rural and young women, poor health access, and early marriage which limit women's potential to participate in growth.[2] In 2022, an estimated 54 percent of the Somali population lived below the national poverty line of US$754 per person per year.[3]

3. **Somalia remains committed to address these challenges and pave the way out of fragility.** In December 2023, Somalia reached Heavily Indebted Poor Countries (HIPC) Initiative Completion Point, following implementation of macroeconomic and structural reforms. In March 2024, Somalia became a member of the East African Community (EAC), committing to harmonize its legislation with EAC members to benefit from improved trade integration. Sustaining momentum on state-building reforms post-HIPC will be supported by continuous progress on IDA's Turnaround Allocation (TAA) milestones, which are designed to help address key drivers of

[1] Hot conditions prevail throughout the year, in particular in the southwest near the border to Ethiopia, where annual mean temperatures surpass 29°C. Depending on the climate change scenario, temperature in Somalia is projected to very likely rise between 1.4–1.9°C by 2030, 1.5–2.3°C by 2050, and 1.4–3.4°C by 2080 compared to pre-industrial levels, with coastal regions being less affected than the rest of the country. The annual number of very hot days (days with daily maximum temperature above 35°C) is projected to rise very strongly and with high certainty all over Somalia.

[2] Seventy-two percent of rural women older than 24 years have never attended school, while 50 percent of young women are unemployed, with no education or training. (https://blogs.worldbank.org/en/nasikiliza/examples-to-accelerate-gender-equality-in-africa-abound-we-could-apply-them-to-somalia-afe-0524).

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

fragility.[4] The FGS will continue to benefit from strategic high-level advice provided by the Financial Governance Committee (FGC) financed by the Multi-Partner Fund (MPF), as well as from capacity building support from development partners.

4. **The program development objective (PDO) of the First Somalia Economic Resilience Development Policy Financing (DPF) is to promote economic resilience through more sustainable public finances and resilient private sector development.** The DPF is financed by an IDA grant in the amount of SDR 94.5 million (US$125 million equivalent) and is the first of two operations in a programmatic series. The PDO will be achieved through implementation of the policy and institutional reforms supported by the two pillars of the DPF: (1) Pillar A: ensuring sustainable public finances; and (2) Pillar B: enabling resilient private sector development. The operation aligns with Somalia's Ninth National Development Plan for 2020–2024 (NDP9), as well as IDA20 policy commitments on governance and institutions, and fragility, conflict, and violence (FCV).

5. **The reforms supported by the DPF complement the World Bank's engagement in Somalia.** The programmatic DPF series is part of the World Bank's support to help Somalia construct a more stable, visible, and legitimate state, foster inclusive private-sector-led growth, and enhance resilience, with a long-term view to restoring the social contract and enabling Somalia's emergence from fragility, conflict, and violence.[5] Furthermore, this operation aligns with corporate commitments on climate co-benefits, reducing gender gaps, maximizing finance for development, and supporting Somalia's transition from fragility.

2. MACROECONOMIC POLICY FRAMEWORK

6. **The macroeconomic policy framework is considered adequate for development policy financing.** Despite multiple shocks, including persistent drought, the economy continues to grow, albeit at a rate that is lower than population growth rate. Completing the HIPC process and acceding to the EAC in December 2023 are expected to boost investors' confidence and support regional integration. De facto dollarization brings price stability in the context of limited capacity for monetary policy. The FGS is keeping spending within expected levels of domestic and external financing. As the FGS develops its core functions and systems, it will continue to rely on external grants to finance basic service delivery. Improvements in domestic revenue mobilization, expenditure management, and debt management ensure debt sustainability.

2.1. RECENT ECONOMIC DEVELOPMENTS

7. **The economy is rebounding gradually.** Following a prolonged severe drought and multiple external shocks, economic growth is estimated to have picked up to 3.1 percent in 2023, at par with population growth, from 2.4 percent in 2022 (Table 1). Favorable rains in 2023 led to improved agricultural production after six failed agriculture seasons due to drought. The number of food-insecure people declined by 40 percent compared to 2022, but still one in five Somalis were food insecure.[6] Although agropastoralism was historically the key driver of economic growth—accounting for nearly 40 percent of GDP and 80 percent of exports in the 1980s—its relative importance has declined with rapid urbanization in the past decade. Urban-based activities such as

[4] World Bank. Somalia - Country Partnership Framework for the Period FY24-28 (English). Washington, D.C.: World Bank Group.
[5] Ibid.
[6] Integrated Food Security Phase Classification Phase 3 and above.

telecommunications, wholesale and retail trade, construction, and financial services have been expanding rapidly and, although no supply-side GDP data yet exist, are believed to be the main contributors to GDP growth.[7]

8. **Despite sharp rebound in merchandise exports, external imbalances widened.** Improved climatic conditions boosted export recovery, with exports of goods and services increasing by 16 percent in 2023 compared to 2022, mostly on the account of livestock. Services and livestock are the main exports (56 percent and 27 percent of exports, respectively), followed by crops and oil, and fisheries. Imports of goods and services grew at slower pace, supported by high demand for construction materials and furniture and easing of global commodity prices which downsized food and oil imports. The trade deficit narrowed only marginally and remained large—a legacy of the conflict that destroyed much of the economy's productive capacity. Nevertheless, the current account deficit widened compared to 2022 as external grants declined.

9. **Inflationary pressures have eased.** Overall inflation averaged 6.1 percent in 2023 compared to 6.8 percent in 2022. As agriculture output increased, food inflation slowed sharply to 0.7 percent in 2023 from 13.9 percent in 2022 in Mogadishu.[8] However, supply-side challenges have kept food inflation high in Somaliland. The easing of global commodity prices reduced domestic fuel and energy prices during 2023, though these remain above pre-2022 levels, contributing to sticky overall inflation. De facto dollarization has served the country well, contributing to price stability as the Central Bank of Somalia (CBS) develops its core functions and gradually builds capacity. Although the Somali shilling is the official currency, notes in circulation are largely counterfeit and used for low-value transactions. The shilling/US dollar exchange rate is fully market determined and has stayed relatively stable. The CBS does not conduct currency transactions.

10. **The financial sector has steadily grown over the past years as the authorities have established a modern regulatory framework.** During the first 11 months of 2023, credit to private sector, deposits, and banking sector total assets increased by 41 percent, 16 percent, and 18 percent, respectively. However, the sector remains heavily concentrated with the five largest banks accounting for majority of total lending (87 percent), and with over 50 percent of loans concentrated in trade financing (25 percent), real estate (15 percent), and construction (12 percent) in 2023. With limited innovation in products and services, slow development of financial infrastructure, banks prefer to hold cash and are risk averse to undertake lending activities in productive sectors. Remittances continue to grow, albeit at a slower pace partly attributed to the impact of elevated global prices on the purchasing power of the diaspora community. The lack of formal correspondent banking relationships continues to hinder remittance and other cross-border financial transfers and integration of Somalia in the global financial system. Several new laws and regulations are under development and efforts to strengthen oversight and institutional capacity continue to be made.

11. **The FGS has remained committed to fiscal prudence.** The FGS budget ended in small surplus in 2023 on account of continuing improvements in revenue collection and prudent spending. Domestic revenue increased by 0.3 percentage point of GDP in 2023 in a year, reaching 2.8 percent of GDP, and for the first time was sufficient to cover employee compensation (Table 2). Higher customs rates on luxury goods and the implementation of spectrum fees and other non-tax sources contributed to better revenue collection. The safeguarding of fiscal sustainability is being supported through IDA's Sustainable Development Finance Policy (SDFP).[9] Nevertheless, the

[7] Somali National Bureau of Statistics is currently developing the first production accounts for Somalia, expected to be released in the third quarter of 2024.

[8] Nationwide inflation is not available, and Mogadishu inflation is used as a proxy of national inflation.

[9] The two approved FY23 performance and policy actions (PPAs) were implemented and included adherence to zero non-concessional borrowing and for the Ministry of Finance to issue regulations on the Customs Reference Values and Customs

bulk of the revenue is external grants, which declined in 2023 as financing of cash transfers fell with improvement of food security. The wage bill and security costs accounted for the bulk of FGS spending, limiting the FGS's capacity to finance investments that could reduce poverty or increase economic growth. Spending on social services is dominated by cash transfers administered under the Baxnaano social safety net program (financed by IDA grants). The FGS is dependent on external financing through budget support grants to maintain a balanced budget. In 2023, IDA (US$75 million) and the European Union (EU) (US$10 million) provided budget support.

12. **Despite unfinished political settlement, intergovernmental transfers continued to increase, supported by the existing intergovernmental platforms at the technical and policy levels.** Revenue sharing and functional responsibility across levels of government remain to be defined, awaiting constitutional amendments. Nevertheless, agreements reached at technical level support improvements in intergovernmental fiscal relations. During the National Consultative Council in March 2023, all but one FMS reached an agreement on resource sharing based on continued technical and political engagement through the intergovernmental Finance Ministers Fiscal Forum. In August 2023, the Forum agreed to harmonize taxes on personal income, corporate income, rental income, and capital gains, and it adopted a formula for the FGS to share the budget support it mobilizes through intergovernmental grants approved in the annual FGS Appropriation Act.

Table 1. Selected Economic Indicators, 2021–2027

	2021	2022	2023e	2024f	2025f	2026f	2027f
GDP, nominal (millions of US dollars)	9,839	10,420	11,680	12,807	13,897	15,070	16,324
GDP, real (millions of US dollars)	10,172	10,420	10,743	11,144	11,579	12,044	12,495
Real GDP growth	3.3	2.4	3.1	3.7	3.9	4.0	4.1
Per capita GDP, real (US dollars)	670	667	669	675	683	691	697
Poverty incidence (%, national poverty line)	..	55	..	..	..	..	..
Money and prices							
CPI inflation rate (period average)	4.6	6.8	6.1	4.8	3.9	3.6	3.4
Private credit (growth, e.o.p.)	45.7	25.3	23.8	..	..	..	..
Private credit (share of GDP)	3.2	3.8	4.6	..	..	..	..
Fiscal (percent of GDP)							
Total revenue and grants	3.8	6.9	6.3	7.1	5.9	4.8	4.4
Total expenditure	4.7	6.9	6.2	7.5	7.2	6.7	6.4
Overall balance, net	-0.9	0.0	0.2	-0.5	-1.3	-1.9	-2.0
External (percent of GDP)							
Current account balance	-7.3	-8.0	-9.6	-8.7	-8.8	-10.5	-10.8
Trade balance	-50.9	-61.2	-58.8	-58.5	-57.7	-56.9	-56.8
Exports	15.6	17.3	17.9	18.9	20.1	20.9	21.6
Imports	66.5	78.5	76.7	77.4	77.7	77.8	78.4
Remittances, private transfers	21.5	20.6	20.3	20.4	20.6	21.0	21.4
Official grants	23.0	33.0	29.3	29.8	28.6	25.9	26.4
Foreign direct investment (FDI)	5.2	5.2	5.2	5.4	5.4	5.4	5.4
External debt	39.9	36.7	5.4	5.0	5.7	7.2	8.7
Exchange rate (shilling/US dollar) (e.o.p.)	26,039	26,833	27,201				

Notes: Central government refers to the Federal Government of Somalia.
Sources: Somali authorities, International Monetary Fund (IMF), and World Bank estimates.

Declarations. The PPA on borrowing remains the same for FY24 while the revenue generation PPA refers to issuance of Revenue Administration Regulations by the Ministry of Finance.

13. **Debt relief provided upon reaching the HIPC Completion Point eliminated virtually all of Somalia's external debt.** In December 2023, the Executive Boards of the IMF and World Bank approved the HIPC Completion Point for Somalia, which provided total debt service savings for the country of US$4.5 billion. The Paris Club agreed upon a HIPC Initiative exit treatment for Somalia in March 2024, cancelling 99 percent of debt owed to its members. This reduced external debt to US$769 million from the pre-HIPC (end-2018) level of US$5.3 billion.[10] Negotiations with other official creditors are advancing.[11] Debt service payments in 2023 accounted for 0.2 percent of GDP and were mostly to multilateral creditors.[12] Although debt relief cleared debt service to IDA and African Development Bank (AfDB), Somalia still needs to pay debt service to the IMF and remaining multilaterals as well as to Russia from 2024 onwards, accounting for 0.2 percent of GDP.

Table 2. FGS Fiscal Operations. 2021–2027
(percent of GDP)

	2021	2022	2023e	2024f	2025f	2026f	2027f
Revenue and grants	**3.8**	**6.9**	**6.3**	**7.1**	**5.9**	**4.8**	**4.4**
Domestic revenue	2.3	2.5	2.8	2.8	3.0	3.3	3.7
Tax revenue	1.7	1.7	1.9	2.0	2.1	2.4	2.7
Direct taxes	0.2	0.2	0.2	0.2	0.2	0.3	0.4
Indirect taxes	1.3	1.4	1.6	1.7	1.8	2.1	2.3
Taxes on goods and services	0.2	0.3	0.3	0.4	0.4	0.5	0.6
Taxes on international trade	1.1	1.1	1.3	1.4	1.5	1.5	1.7
Other taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Non-tax revenue	0.7	0.8	0.9	0.8	0.9	0.9	0.9
Grants	1.5	4.4	3.5	4.3	2.8	1.5	0.7
Total expenditure	**4.7**	**6.9**	**6.2**	**7.5**	**7.2**	**6.7**	**6.4**
Current expenditures	4.5	6.8	6.0	7.2	6.9	6.4	6.1
Wages and salaries	2.5	2.5	2.5	2.8	2.7	2.6	2.5
Goods and services	1.1	1.4	1.2	1.7	1.6	1.5	1.5
Transfers (intergovernmental, etc.)	0.5	1.1	1.1	1.0	1.0	1.0	0.9
Social benefits	0.4	1.8	1.1	1.5	1.4	1.2	1.1
Interest and other charges	0.01	0.01	0.11	0.1	0.1	0.1	0.1
Other expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditures	0.2	0.1	0.1	0.3	0.3	0.3	0.3
Overall fiscal balance, net	**-0.9**	**0.0**	**0.2**	**-0.5**	**-1.3**	**-1.9**	**-2.0**
Financing	**0.9**	**0.0**	**-0.2**	**0.5**	**1.3**	**1.9**	**2.0**
Net accumulation of external debt	0.6	0.3	0.2	0.1	1.0	1.9	2.0
New external borrowing	0.8	0.4	0.3	0.2	1.1	2.0	2.1
Amortization of external debt	0.1	0.1	0.1	0.1	0.1	0.1	-0.1
Net change in the stock of cash	0.2	-0.3	-0.4	0.4	0.3	0.0	0.0

Sources: Somali authorities, IMF, and World Bank estimates.
Notes: New external borrowing in 2021–2024 is from the IMF.

[10] IDA and IMF, Federal Republic of Somalia: Enhanced Heavily Indebted Poor Countries Initiative Completion Point and Multilateral Debt Relief Initiative, November 2023.
[11] Remaining multilateral creditors include the Arab Fund for Economic and Social Development, Arab Monetary Fund, Islamic Development Fund, and OPEC Fund for International Development. Somalia's non-Paris Club bilateral creditors are Algeria, Bulgaria, Iraq, Libya, Romania, and the United Arab Emirates
[12] On an exceptional basis, due to its limited capacity to repay debt, debt payments to Paris Club were postponed till March 2024.

Table 3. External Financing Requirements, 2021–2027
(millions of U.S. dollars)

	2021	2022	2023e	2024f	2025f	2026f	2027
Total financing needs	**2,950**	**4,296**	**4,727**	**5,089**	**5,380**	**5,693**	**6,080**
Current account deficit[a]	2,936	4,281	4,713	5,080	5,368	5,679	6,064
Amortization	14	15	14	9	12	14	16
Total financing sources	**2,950**	**4,296**	**4,727**	**5,089**	**5,380**	**5,693**	**6,080**
FDI inflows (net)	512	542	607	691	750	813	881
Other external financing[b]	2,540	3,824	4,163	4,398	4,630	4,878	5,195
o/w World Bank DPF		100	75	125			
o/w IMF	222	28	59	20	20	20	
Use of reserves (- = increase)	-102	-70	-43	0	0	2	4

Source: Central Bank of Somalia, IMF, and World Bank estimates.
Notes: (a) excludes official grants; (b) includes official grants

Table 4. Public and Publicly Guaranteed Debt, 2024–2026
(millions of U.S. dollars)

	Debt Stock (end of period) 2024			Debt service					
				2024	2025	2026	2024	2025	2026
	million US$	Percent of Total	Percent of GDP	million US$			Percent of GDP		
Total PPG Debt	**777.5**	**100.0**	**6.1**	**21.5**	**25.5**	**27.9**	**0.2**	**0.2**	**0.2**
Domestic Debt	**67.8**	**8.7**	**0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Others	67.8	8.7	0.5	0.0	0.0	0.0	0.0	0.0	0.0
External Debt	**709.6**	**91.3**	**5.5**	**21.5**	**25.5**	**27.9**	**0.2**	**0.2**	**0.2**
Multilateral creditors	478.9	61.6	3.7	10.0	11.4	13.9	0.1	0.1	0.1
Bilateral creditors	230.7	29.7	1.8	11.5	14.1	13.9	0.1	0.1	0.1
Paris Club	0.7	0.1	0.0	0.2	0.2	0.2	0.0	0.0	0.0
Non-Paris Club	230.0	29.6	1.8	11.4	14.0	13.8	0.1	0.1	0.1

Source: Central Bank of Somalia, IMF, and World Bank estimates.
Notes: Domestic debt covers legacy government wage arrears.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

14. **Medium-term recovery is projected to be modest as risks remain significant.** Real GDP is projected to grow by 3.7 percent in 2024, accelerating to 4.1 percent by 2027. Macroeconomic and structural reforms implemented in the context of HIPC Completion Point are expected to start paying off and support sustained growth, albeit modestly due to continuing fragility. The recovery of agricultural production and exports is expected to continue in 2024 with improving weather conditions. The agriculture sector, however, is likely to remain vulnerable to climate-related shocks. Over the medium term, improved access to affordable and renewable energy supply could support the establishment of a cold chain, which can help develop new export products (e.g., lobster and other high-value seafood), as well as upgrade existing agricultural value chains. Legal reforms that improve access to finance, insurance, and electricity, and promote environmentally friendly investments—supported by this and previous DPF operations—are expected to encourage new investments to support growth and job creation over the longer term. Unanticipated shocks, however, could slow down economic growth, while on the upside, improved political conditions and intergovernmental cooperation could reduce risks for investors.

15. **The current account deficit is projected to widen as domestic demand for imports remains high while official grants gradually decline.** Limited productive capacity and high reliance on imported food and fuel contribute to the rigidity of the current account deficit, which is expected to be financed by FDIs and concessional loans. Policies to support export diversification (e.g., in fisheries), competitiveness (more affordable renewable energy and access to finance), and trade integration, including in the context of Somalia's EAC membership are expected to strengthen exports growth. However, demand for import of consumer and investment goods is likely to increase as the economy grows. This demand is likely to be increasingly financed by remittances as prices in host countries stabilize. Reliance on official grants (including from IDA), which have provided critical financing of the trade deficit, is expected to gradually decline as Somalia has access to concessional financing (Table 3). Maintaining sustainable debt outlook will require highly concessional financing and still significant official grants, most of which remain off-budget.

16. **Inflation is projected to moderate in 2024 and stabilize over the medium term.** In 2024, inflation is projected at 4.8 percent, reflecting a moderation of global commodity prices. Over the medium term, prices are projected to decline in line with historical trends and global commodity price dynamics. De facto dollarization should continue to provide relative price stability, given dependence on imports. Planned issuance of new Somali shilling notes to replace notes in circulation is likely to necessitate changes to the monetary policy to ensure rule-based issuance of Somali shillings. The CBS is continuing to strengthen its monetary policy framework, supported by IMF technical assistance.[13]

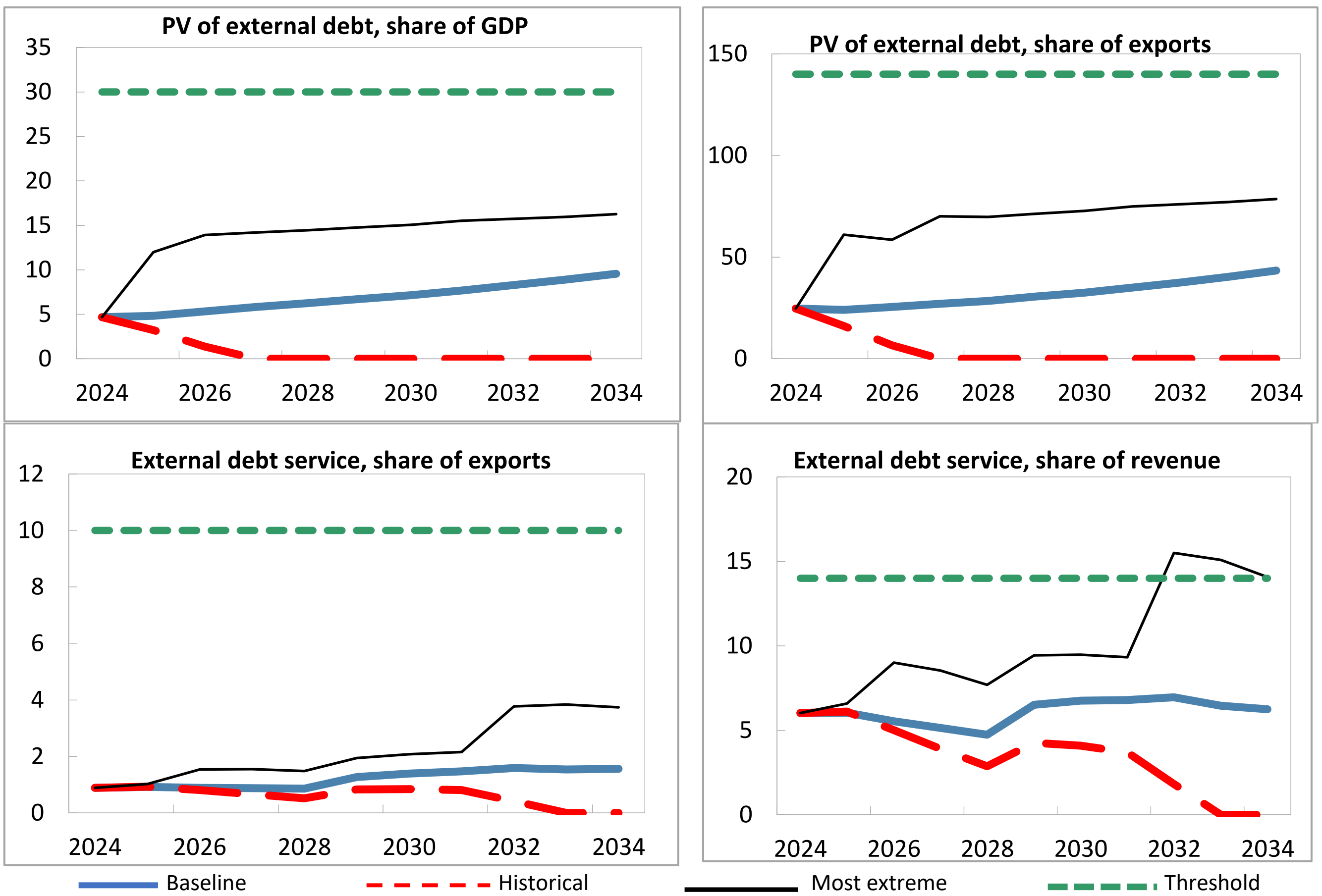
17. **Financial sector reforms and related institutional capacity building are expected to continue in the coming years, increasing confidence in the system, integrity, and financial deepening.** Financial sector oversight is expected to be significantly improved and opportunities for introduction of new products and services are expected to increase with the upcoming enactment of several new laws and regulations (Financial Institutions Law, Takaful Insurance Law, National Payment Systems Law, and Central Banking Act). Implementation of these laws will build confidence in the market and render the financial sector more robust and better aligned with international standards. Enhancements to financial infrastructure, continued payment systems strengthening, and building on the strong permeation of digital wallets provide significant opportunities for promoting financial inclusion. The introduction of digital identification will enable electronic "know your customer" (eKYC) and support financial inclusion of under- and un-banked population. Introduction of Takaful drought index insurance will help strengthen financial resilience, especially in the face of climate-related risks. The ongoing Financial Action Task Force mutual evaluation will clarify anti-money laundering (AML)/combatting the financing of terrorism (CFT)-related risks and help Somalia develop an action plan to address them, thereby bringing Somalia closer to global standards and requirements needed to promote cross-border investments and money transfers.

18. **The FGS is planning to raise more domestic revenue to expand provision of public services throughout the country.** The FGS is making numerous efforts to strengthen revenue collection from both inland and trade-related taxes, including through harmonizing federal and state tax policy and administration. A Medium-term Revenue Policy and Administration Roadmap, expected to be approved in 2024, includes new income tax legislation, continuing modernization and harmonization of customs, implementation of revenue administration reforms, and digitalization of tax payments. These revenue mobilization measures are expected to contribute an additional 0.9 percentage points of GDP of revenue between 2024 and 2027. Nevertheless, this fiscal effort will not be sufficient to offset official grants, which have been critical in financing basic public services, or support productivity

[13] Most notes in circulation are counterfeits issued since 1990. The issuance of new, legal Somali shilling notes is expected to be supported by a World Bank-financed project. The project is under preparation and its approval is linked to securing co-financing, among other requirements.

enhancing public investments. Incorporating more security spending in the budget in 2024, following the withdrawal of the African Union Transition Mission in Somalia, is expected to increase overall spending in the medium term. Improved expenditure control, transparency, and accountability (supported by IMF and World Bank technical assistance) are expected to keep overall deficit levels manageable.

Figure 1. Debt Sustainability Indicators, 2024–2034



Source: First Review Under the Extended Credit Facility Arrangement—Debt Sustainability Analysis, April 2024.
Notes: Assumes Somalia starts borrowing from IDA from July 2025 onwards. The most extreme shock for all four indicators above is the Combination shock.

19. **Debt relief has reduced the risk of debt distress to "moderate**."[14] The present value (PV) of Somalia's total public debt has been reduced well below the benchmark for countries with weak debt carrying capacity (Figure 1). However, under a combination of shocks, the external debt service-to-revenue ratio breaches the benchmark as grace periods on post-HIPC loans expire. The country remains vulnerable to security, international commodity price, and climate shocks. The FGS remains highly dependent on external concessional financing and needs to manage the transition to loans from grant financing.[15] It is expected that, from July 2025, Somalia will start

[14] IMF and World Bank. Somalia: Joint World Bank-IMF Debt Sustainability Analysis, April 2024.
[15] Under conventional IDA20 financing terms, Somalia would have experienced a change in financing terms from grants to concessional loans starting in July 2024. In February 2024, however, the World Bank Executive Board approved a moratorium

borrowing from IDA at highly concessional terms. Somalia has successfully maintained a zero non-concessional borrowing ceiling since FY21 and has been on track with its SDFP performance and policy actions focused on strengthening domestic revenue mobilization in FY23 and FY24. Preserving debt sustainability hinges on continuous improvements in debt management and effective measures to mobilize domestic revenues.

20. **Risks to the economic outlook are high but mitigation mechanisms exist.** An escalation of political instability could adversely affect activities of the private sector and downsize expected revenue gains. Unfinished intergovernmental agenda and weak control over corruption limit the effectiveness of policy measures aimed at boosting economic growth and job creation, while undermining prudent fiscal management and accumulation of contingent liabilities (e.g., that could arise from future public-private partnerships). The worsening of drought conditions, the possibility of other extreme climate events, and the absence of humanitarian support due to competing demands in donor countries could lead to a deterioration of the growth outlook. A further slowdown in global growth could contribute to a stagnation in remittance inflows from Somalia's large diaspora. However, the policy reform program supported by this operation, as well as broader World Bank engagement and support provided by other development partners, will help mitigate some of these risks. Actions in Pillar A of the DPF support improved economic governance and macroeconomic stability, critical for economic growth and improved ability to manage shocks, while actions in Pillar B strengthen economic resilience by advancement of structural reforms to support economic growth and job creation. These actions are supported by capacity building implemented in the context of IDA investment project financing (IPF), TAA milestones, IMF's Extended Credit Facility, FGC oversight, and governance reforms supported by Foreign, Commercial and Development Office (FCDO), United States Agency for International Development (USAID), and other development partners.

2.3. IMF RELATIONS

21. **Somalia entered into a three-year arrangement under the Extended Credit Facility (ECF) with the IMF upon reaching the HIPC Completion Point.** The ECF program supports reforms to enhance domestic revenue mobilization, public finance and debt management, and the financial sector (see Annex 2). There are important synergies between the ECF and this DPF. For example, the ECF supports the submission of the Income Tax Bill to the parliament, while the DPF supports the issuance of income tax regulations, thus incentivizing timely approval of the Bill and its enactment. The institutional improvements in debt management targeted under the DPF are complemented by changes to the legal framework for debt management under the IMF ECF. The IMF disbursed SDR 30 million upon approval, which the authorities used to support the CBS' foreign reserves, and will make available SDR 7.5 million upon each successful review. The IMF concluded the first review in May 2024.

3. GOVERNMENT PROGRAM

22. **Somalia's poverty reduction strategy, the ninth National Development Plan (NDP), was approved in September 2019.** The NDP9 is a nationally owned strategy for poverty reduction and inclusive growth. It builds on the progress made and lessons learned from the 2017–2019 NDP, Somalia's eight development plan, and is the first to be crafted by the central government since 1986. Underpinning the NDP9 is an in-depth analysis of the drivers of poverty, fragility, insecurity, and how resilience can be strengthened. The NDP9 was developed through consultations with civil society, private sector representatives, FGS and FMS line ministries, national and state parliamentarians, members of the judiciary, and development partners. A summary of the consultative process is included in the NDP9 document.

on hardening of IDA20 financing terms for IDA countries in good standing with the SDFP, such as Somalia, until end-June 2025.

23. **The NDP9 presents a comprehensive strategy for development that emphasizes inclusive growth and poverty reduction.** There are four pillars. Pillar 1 is *Inclusive Politics* which focuses on deepening the federal system, ratifying the constitution, building trust, and the delivery of fair and credible elections. Pillar 2 is *Improved Security and the Rule of Law,* which aims to establish a unified, capable, accountable, and rights-based Somali federal security institutions, as well as securing and improving access to justice. Pillar 3 is *Economic Development,* which aims to create an enabling environment for economic growth through regulatory changes, strengthening economic infrastructure, diversifying the private sector, and sustainably developing natural resources. Pillar 4 is *Social and Human Development,* which seeks to improve health and education outcomes to strengthen resilience and reduce poverty. The implementation of the NDP proceeds with important milestones achieved as detailed in the Letter of Development Policy (Annex 3). Annual progress reports show continuing strides in strengthening fiscal federalism with the National Consultative Council's agreement on issues like security structures and election procedures as well as advancements in economic governance in the context of HIPC Completion Point triggers.

24. **FGS is developing its National Transformation Plan (NTP), to be implemented in 2025–2029.** As the successor to NDP9, the NTP will articulate a post-HIPC development strategy for the country, focusing on strengthening the role of state and fiscal federalism, supporting private-sector-led growth, and investing in human capital with the long-term goal of transitioning out of fragility. The NTP will be aligned with Somalia's Vision 2060, an overarching strategic document that is under preparation, which charts a pathway that will lead the country to become a middle-income economy by 2060, supported by successive NTPs towards 2060.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

25. The development objective of the programmatic series is to promote economic resilience through more sustainable public finances and resilient private sector development. Pillar A aims to ensure sustainable public finances. This will contribute to the macroeconomic stability and will expand fiscal space required to meet Somalia's large development needs in the context of high volatility to climate change and fragility, conflict, and violence. Pillar B aims to enable resilient private sector development. This pillar supports structural reforms that enhance the environment for private-sector-led growth and create conditions for job creation, increasing the resilience of households. The reforms supported by this operation build on the reforms anchored in the HIPC initiative and supported by DPFs approved in 2020–2023.[16]

26. **The DPF-supported program is aligned with NDP9, which presents a comprehensive strategy for development that emphasizes inclusive growth and poverty reduction.**[17] The operation supports reforms that contribute to Pillar 3 "Economic Development," which aims to create an enabling environment for economic growth through regulatory changes, strengthening economic infrastructure, diversifying the private sector, and sustainably developing natural resources. DPF's prior actions support achievement of a number of NDP's intermediate outcomes, such as improved fiscal management, strengthened institutional capacities for domestic resource mobilization (DRM) and public service delivery, effective institutions supporting the economy, and improved regulation of private sector for fair, safe, and transparent marketplace. This operation aligns with the mitigation and adaptation and resilience goals of the Paris Agreement. Taking into consideration the analysis in the Somalia Climate Risk Review, the DPF-supported reform program is consistent with the country's climate

[16] These are the Somalia Reform and Reengagement DPF (P171570) and Supplemental Financing (P174064), and the Somalia Inclusive Growth and Development DPF series (P174089 and P179307).
[17] Ministry of Planning, Investment and Economic Development, Somalia National Development Plan 2020 to 2024: The Path to a Just, Stable, and Prosperous Somalia, October 2019.

commitments, such as Somalia's Nationally Determined Contribution (NDC), and supports the country's goals for adaptation and resilience as outlined in the Paris Agreement.[18]

27. ***Regarding mitigation goals:*** The prior actions supported by the DPF are not likely to cause a significant increase in greenhouse gas (GHG) emissions. In contrast, many actions are expected to contribute to the reduction of carbon intensity. Somalia aims for a 20 percent reduction in emissions by 2030 compared to the baseline scenario (projected to be 50 $MtCO_2eq$). The program supports initiatives that address emissions from changes in agriculture, forestry, and land use, which are the primary sources of emissions in Somalia. Enhanced tax revenue mobilization overcomes a binding constraint to achieving key targets in the NDC. A sound financial sector facilitates access to finance for renewable energy projects and other mitigation activities, supporting the NDC's goal of mobilizing private sector investment in low-carbon technologies. This indirectly supports the NDC's mitigation goals by reducing emissions. The tariff-setting regulation encourages investment in renewable energy and energy-efficient technologies, thus contributing to NDC target for expanding renewable energy capacity by 2030. In terms of institutional strengthening for mitigation goals, the prior action 8 supports the Ministry of Environment and Climate Change (MECC) in enhancing its capacity to manage climate action and oversee environment and social impact assessments (ESIAs). Strengthening institutional frameworks and regulatory capacities is critical for effective implementation of mitigation strategies outlined in the NDC.

28. ***Regarding adaptation and resilience goals:*** By strengthening tax and customs revenue and ensuring effective debt management, Somalia would generate more domestic resources, which can be allocated to fund adaptation projects, such as infrastructure development and climate-resilient agricultural practices. This aligns with the NDC's goal of enhancing financial resources for adaptation initiatives. A robust audit function ensures transparency and accountability in the use of funds for adaptation projects, aligning with the NDC's emphasis on governance and institutional capacity building. In addition, a strong financial sector would provide better access to finance for adaptation projects, including climate-resilient infrastructure and agriculture. This supports the NDC's goal of enhancing financial inclusion and mobilizing private sector investment for adaptation. Introducing Takaful insurance products helps mitigate risks associated with climate impacts, particularly in the agricultural sector, which is highly exposed to climate change. This aligns with the NDC's focus on risk management and enhancing the resilience of vulnerable communities. Strengthening fisheries management enhances food security and livelihood diversification, which are crucial adaptation measures identified in the NDC. This also includes the adoption of climate-smart practices in the fisheries sector. Enacting comprehensive environmental legislation supports the sustainable management of natural resources and strengthens resilience to climate impacts, directly supporting the NDC's environmental management goals. Renewable energy projects also enhance energy security and resilience to climate variability.

29. **This operation incorporates lessons learned from previous DPF operations in its design.**[19] These lessons include: a simple but robust design targeting critical constraints to state building in an FCV context; results targets calibrated to Somalia's nascent public sector capacity; lengthier reform process supported by continuous World Bank Group engagement through multiple instruments and through sequences of more than one DPF series; need for closer policy dialogue on how the DPF and other external resources will be used to benefit all Somalis, including through agreed intergovernmental fiscal arrangements.

[18] Federal Republic of Somalia, Updated Nationally Determined Contribution, July 2021. World Bank, Somalia Climate Risk Review, 2023.
[19] World Bank, Implementation Completion and Results Report: Somalia Reengagement and Reform Development Policy Financing, Report No: ICR00005635, June 30, 2023.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar A: Ensuring sustainable public finances

30. **Sustainable public finances support economic resilience by increasing fiscal space to respond to shocks and provide more basic services to the poor while ensuring accountable public spending**. Low domestic revenues limit government's ability to address recurrent shocks, such as droughts and commodity price volatility, which create food insecurity in the country. Moreover, basic public services critical for human capital development are mostly financed through foreign aid, which is likely to decline over time. Debt relief reduced sharply the cost of servicing external debt, but Somalia will need to prudently manage new borrowing to avoid falling back in debt distress. Access to new concessional loans will provide opportunities for investing in growth enhancing public services and infrastructure. At the same time, public spending needs to be managed prudently and transparently. Increased accountability over government financial operation and stronger administrative capacity will encourage greater use of country systems to implement externally financed projects. These reforms will enhance the legitimacy of the state. This pillar supports actions that create the building blocks for adequate funding for development, contain the costs and risks of public debt, and enhance accountability of public spending.

Policy Area: Adequate funding for development

31. **Despite experiencing steady growth, revenue collected by the FGS is among the lowest in the world at 2.8 percent of GDP in 2023, with tax collection only at 1.95 percent of GDP** (Table 2).[20] This is insufficient to cover basic government services, provide public goods, and support economic resilience: only 45 percent of FGS public spending was financed by domestic revenue in 2023, while the rest was covered by external grants from international financial institutions and bilateral donors. Customs revenues made up 64 percent of tax revenues, but their efficiency remains low.[21]

32. **The revenues generated are subject to volatility and with marked differences across FGS and FMS.** Somalia depends on a few sources of revenue due to the low diversification of its economy, limiting robust and sustained levels of tax revenues. Furthermore, revenue generation is characterized by geographical fragmentation with FGS generating 79 percent of all tax revenues collected in the Federal Republic of Somalia, followed by Jubaland and Puntland States. FMSs collect taxes only in large ports and cities. The almost exclusive reliance on informal institutions for more than two decades, marked by total absence of tax culture, makes the task of reinforcing the federal state's legitimacy very delicate, particularly with respect to taxation and consensual revenue mobilization.[22]

33. **Somalia has taken important strides to improve revenue legislation and administration, although revenue harmonization and revenue sharing is at the nascent stage**. The FGS adopted a modern Revenue Administration Act and Customs Act in 2019. A modern income tax law is being drafted and expected to be submitted to Parliament in 2024. The act will provide an aligned income tax framework across the federation. Tax administration reforms include issuance of taxpayer identification numbers using the Financial Management

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[20] Domestic revenue includes inland taxes, taxes on international trade, and non-tax revenue. Domestic revenue increased from US$113 million in 2016 to US$329.5 million in 2023 demonstrating annual growth of 25 percent except for the COVID years.

[21] Somalia's customs revenue efficiency rate (customs revenue as a percent of imports of goods and services) at 2.2 percent in 2022 is well below the efficiency rates of its comparator countries (5.5 percent). As a conservative estimate, if the efficiency gap were closed by half of the value, annual customs revenues might yield an additional US$120 million.

[22] Dom, Khan, Lomme and Fiebelkorn. 2021. Somalia Customs Compliance Study. Assessing Enforcement, Facilitation, and Trust. Washington, DC: World Bank; Raballand and Knebelmann. 2020. Domestic Resource Mobilization in Somalia. Washington, DC: World Bank.

Information System (FMIS), establishment of large and medium taxpayer offices across FGS and FMS, the development of a tax audit strategy, and the continuous training of tax officials. The Somali Customs Automated System (SOMCAS) went live in Mogadishu and Kismayo ports in December 2023. Development of an Integrated Tax Administration System (ITAS) is underway. Other initiatives to enhance tax collection include broadening the tax base, enhancing enforcement and voluntary compliance in international trade and indirect taxation (particularly for telecommunications), and harmonizing income taxes. The ongoing harmonization of customs duties is a top priority, both for revenue collection and for Somalia's participation in international trade agreements. The FGS has developed a Medium-term Revenue Policy and Administration Roadmap, which is expected to be approved in 2024.

Prior action #1. To improve inland revenue mobilization, the Recipient's Minister of Finance has issued the Revenue Administration Regulation, which (a) clarifies procedures for tax payments, (b) provides for tax consultants, and (c) establishes electronic tax administration system.

34. **Rationale**. Tax revenue collected in Somalia falls well short of amounts required to finance public spending needed to foster economic growth and poverty reduction. The previous DPF series and ongoing IPF operations have, therefore, been supporting the inland revenue reforms to broaden the tax base and strengthen tax administration. For instance, the Somalia Reengagement and Reform DPF (P171570) included a prior action on the enactment of the Revenue Administration Act, 2019, which, coupled with tax policy reforms, helped the FGS quadruple inland tax revenue from US$38.6 million in 2018 to US$158 million in 2023.[23] The 2019 Revenue Administration Act provided the FGS with a framework for compliance with revenue obligations, but its full implementation requires further clarifications of provisions that were not fully provided in the law.

35. **Policy content.** The Ministry of Finance issued the Revenue Administration Regulation in April 2024.[24] The regulation establishes an electronic tax administration system and mandates the use of specialized electronic devices by businesses to apply sales tax to transactions. It introduces procedures for withholding sales tax by contract-awarding entities. It creates rules to govern tax consultants and tax brokers. This regulation clarifies tax collection and administration aspects to ensure that taxpayers have the information and support they need to meet their obligations and claim their tax liabilities. It also establishes the order and timing of payment of taxes, record keeping, appeals processes, and mandates of tax advisors. A trigger for DPF2 is the issuance of regulations to implement the Income Tax Act, which will harmonize income tax policies across FGS and FMSs and is expected to be enacted by the end of 2024.[25] The estimated contribution of implementing the Income Tax Act and Regulations to the FGS tax-to-GDP ratio is 0.1 percentage points of GDP by December 2026.

Prior action #2. To enhance customs revenue mobilization, the Recipient's Minister of Finance has issued the General Customs Regulation, which (a) establishes a comprehensive framework for customs revenue collection, (b) defines the process for licensing of customs brokers, and (c) enhances the enforcement provisions of the Customs Act.

36. **Rationale.** The FGS depends critically on customs duties, which generated 68 percent of FGS revenue in 2023. The FGS has been steadily investing in customs automation to both improve revenue collection and reduce

[23] The Reengagement and Reform DPF result target was a 38 percent increase in inland revenue between 2018 and 2022, which was surpassed.
[24] The regulations were developed with the support of the Second Public Financial Management Capacity Strengthening Project (P151492).
[25] Submission of the draft Income Tax Bill to the parliament is a structural benchmark in the IMF ECF program.

compliance costs. Still, the revenue capacity of customs duties is not yet fully maximized. The Somalia Inclusive Growth DPF series (P174889 and P179307) supported the harmonization of tariff schedules and the adoption of regulations on the Customs Reference Values and Customs Declarations. The implementation of SOMCAS, which was financed by FCDO and became operational in 2023, necessitates clarification of a number of customs procedures.

37. **Policy content.** The Ministry of Finance issued the General Customs Regulation in May 2024.[26] This regulation establishes comprehensive rules for the Customs Department's collection of duties, taxes, fees, and charges. It also introduces a regime for licensing customs brokers (including establishing the Institute of Customs Brokers), delineates enforcement powers of customs officers, and sets rules on customs refunds.

38. **Expected results of prior actions #1 and #2 and trigger #1.** Adoption of the revenue administration and customs regulations will increase the FGS's ability to increase domestic revenue. Provisions of the Revenue Administration Regulation will expand the tax base through the increased number of registered taxpayers (goods and services), strengthened enforcement, and improved voluntary compliance leading to a 0.2 percentage point increase in the tax-to-GDP ratio by 2026. The reforms contribute to achieving results in Outcome Area 4 of the World Bank Group Corporate Scorecard (FY24–30). Results will be measured by an increase in tax revenue as a share of GDP, from 1.95 percent in 2023 (baseline) to 2.4 percent in 2026 (target). The Somalia Enhancing Public Resource Management Project (SERP, P177298) will contribute to achieving these results. The Somalia-wide implementation of the Income Tax Act and Regulation will be further incentivized through the Somalia Recurrent Cost and Reform Financing–Phase III (P173731) performance-based condition requiring FGS and FMS to prepare their FY2026 budgets using the new harmonized tax rates.

Policy area: Debt costs

Prior action #3. To improve management of the risks and cost of public debt, the Recipient through its Minister of Finance has issued a Decree that establishes the middle office within the Debt Management Unit and provides the core functions of the front office, middle office, and back office.

39. **Rationale.** Setting the institutional and legislative foundations for debt management have been supported by previous DPF operations and IMF ECF programs. The regulations to implement the Public Financial Management (PFM) Act with provisions on debt, public investment, and natural resource revenue management were a HIPC Completion Point Trigger, supported by the First Inclusive Growth DPF. Post-HIPC, improvements in the legal framework are being implemented under the IMF ECF program, aiming to strengthen the procedures for issuing debt guarantees. Further improvements in institutional arrangements are also required to ensure the Debt Management Unit (DMU) is well structured and staffed, capable of assessing the risks and costs of new public borrowing, managing the stock of debt, and ensuring transparency of all debt-related activities. The DMU currently consists of four externally financed staff who perform a mix of front- and back-office functions. A joint IMF-World Bank technical assistance mission recommended bringing DMU staff into the civil service and separating functions into front, middle, and back offices to provide a sound institutional framework for debt management.[27] The technical assistance mission also recommended establishing a high-level Public Debt

[26] The General Customs Regulation was prepared with the support of FCDO-financed PREMIS II project.

[27] World Bank and International Monetary Fund, "Debt Management Reform Plan," February 2021. Specific responsibilities of front, middle, and back offices vary across jurisdictions, but the general division of functions is as follows. The front office engages potential creditors and is responsible for loan negotiation and contracting. The middle office covers legal compliance, monitors risks, and assesses performance. The back office manages debt recording, monitoring, financial execution

Management Committee to ensure that debt management policies and procedures are aligned with sound practices and consistent with other policy objectives.

40. **Policy content.** The Ministry of Finance (MOF) issued a Ministerial Decree on June 18, 2024, that establishes the middle office of the DMU and specifies the core functions of front-, middle-, and back-office staff, in line with sound international practices. MOF will hire at least two additional staff, who will be civil servants, to perform middle office functions.[28] Expanding the role of the Treasury Committee to include oversight of the DMU's policies and procedures and serve as Public Debt Management Committee, a trigger for DPF2, will further strengthen the institutional arrangements for debt management by promoting coordination among MOF directorates (economic, budget, revenue, and expenditure) and CBS.

41. **Expected results.** These institutional reforms will enhance the FGS's ability to contain the costs and risks of public debt and contingent liabilities. This result will be assessed by measuring the increase in debt service costs, from US$17.7 million cap on growth of debt service costs in 2023 (baseline) to US$25 million in 2026 (target). Continued World Bank and IMF technical assistance, as well as discipline provided by limits on non-concessional borrowing under the SDFP and the IMF ECF program will contribute to realizing this result.

Policy Area: Accountability

Prior action #4. To strengthen the independent oversight over expenditure, the Recipient's Council of Ministers has issued the Public Audit Regulation, which inter alia: (a) establishes national auditing standards and procedures, (b) provides the code of conduct for the Office of the Auditor General (OAG), (c) provides for OAG relationship with other governmental and international entities, and (d) spells out the procedures for the dismissal of the Auditor General.

42. **Rationale**. The 2023 Audit Act replaced an outdated legislative framework that had governed audits since 1972. Supported by the previous DPF (P179307), the law strengthened the independence of the Office of the Auditor General of the Federal Republic of Somalia (OAG) by removing the unilateral power of the executive to appoint and dismiss the Auditor General. Implementing regulation is now required and is the logical continuation of the reforms supported by the previous DPF operations.

43. **Policy content**. The Council of Ministers adopted the Public Audit Regulation of the Office of the Auditor General on June 13, 2024. The regulation includes important provisions for staff discipline and remuneration, a code of conduct for OAG, independence, and dismissal procedures for the Auditor General. The regulation represents a critical step forward towards aligning OAG's functions with international standards.[29] Provisions on staff discipline and remuneration will reinforce OAG's autonomy in critical areas of staffing, operational management, and financial resourcing. Somalia Governance and Institutions Programmatic ASA (P179174) will further support OAG in adopting an audit framework with clearly defined quality criteria in line with the 2023 Audit Act and implementing regulations. To ensure the implementation of the Federal Audit Act across Somalia, a proposed agreement to be signed between FGS and FMS auditors general, a DPF2 trigger, would delineate

(payments and revenues) and reporting. The clear segregation of debt management duties reduces the risk of errors, policy breaches, and fraudulent behavior.

[28] The transitioning of the rest of the DMU staff to civil servants, including hiring an in-house legal adviser, will be completed by the end of 2025.

[29] These include INTOSAI-P1—Lima Declaration, and INTOSAI-P10—Mexico Declaration on Supreme Audit Institutions Independence.

responsibilities between OAG and FMS auditors general, thus supporting nationwide improvements in accountability.

44. **Expected results.** The regulation and the intergovernmental agreement will contribute to sustainable public finances by increasing public expenditure transparency and facilitating the containment of spending growth. Results will be measured by the number of additional audits on top of the OAG's annual audit of the government's accounts conducted in line with the quality criteria set out in the new audit framework, with a target of two additional audits in 2026.[30] Technical assistance provided through the Somalia Governance and Institutions Programmatic ASA (P179174) will contribute to achieving these results.

Pillar B: Enabling resilient private sector development

45. **Pillar B focuses on structural reforms that enhance conditions for private sector growth and job creation and thus strengthen the resilience of the private sector against adverse shock.** These reforms provide the building blocks for developing non-bank financial institutions and improving access to microfinance and insurance so that micro firms can invest in expanding and diversifying economic activity, while pastoralists are better prepared to withstand climate shocks. Tapping into new sources of growth will require joint FGS-FMS effort in strengthening governance of the fisheries, a sector with substantial potential for higher value exports. At the same time, Pillar B includes reforms to ensure that new investments are made in a responsible manner and do not exacerbate already high climate challenges. And finally, economic resilience of private sector will be supported by improved access to electricity as Somalia shifts to cleaner and cheaper renewable energy sources.

Policy Area: Access to financial services

Prior action #5. To expand access to finance, the Recipient's Council of Ministers has submitted to Parliament the Financial Institutions Bill, which provides the framework for regulation and supervision of financial institutions, including microfinance institutions.

46. **Rationale.** Somalia's financial intermediation is one of the lowest in the region, with private credit continuing to remain below 5 percent of GDP. Loans are concentrated in a few sectors, large firms, and in urban areas. Although banks dominate the financial sector, the forthcoming Somalia Country Private Sector Diagnostic finds a growing demand for microfinance services and other non-bank services in Somalia. For example, the microfinance institutions (MFIs) in Somalia operate with limited coverage and with few options to access funds. These institutions serve the lower income groups that operate mostly in climate-vulnerable segments of the economy (e.g., agriculture, fisheries, micro businesses, etc.). Existing laws do not provide for supervision of the non-bank financial sector (e.g., MFIs, mobile money operators, etc.) and the related regulation remains deficient compared to global standards on several aspects. This constrains the ability of these institutions to raise resources for providing financial services to this underserved and vulnerable segment.

47. **Policy content.** CBS has drafted the Financial Institutions Bill to expand the oversight framework to cover non-bank financial institutions. The draft bill was submitted to Parliament in April 2024. The bill extends CBS's supervisory authority to MFIs and other non-bank financial sector institutions (excluding insurance, which is

[30] Two audit reports (e.g., special, performance, or compliance audits) in addition to OAG's annual audit of the government's accounts in line with Article 5 of the Law of the Office of the Auditor General of the Federal Republic of Somalia (Law No. 14, September 10, 2023).

covered by its own legislation), bringing them for the first time under a regulatory and supervisory framework.[31] Issuing Regulations to the Financial Institutions Act, a DPF2 trigger, would help implement the new law.

48. **Expected results.** Bringing all MFIs and other non-bank institutions of Somalia under regulatory supervision would strengthen oversight, build confidence in these institutions (as formally regulated and supervised) and thus, improve their ability to raise funds enabling them to expand provision of financial services, especially to the underserved and unserved segments of the population across the whole of Somalia—not only in Banadir but those living in all FMSs and Somaliland. Because of lack of data on MFIs' operations, results will be measured by the increase in the number of financial institutions under formal supervision in all of Somalia, from 29 in 2023 (baseline) to 42 in 2026 (target), with most of the increase expected to be due to MFIs. The Somalia Capacity Advancement, Livelihoods and Entrepreneurship, through Digital Uplift Project (SCALED-UP, P168115) will support strengthening of CBS capacity and achievement of these results.

Prior action #6. To strengthen the insurance sector and support financial resilience of pastoralists against drought and climate-related risks, the Recipient's Council of Ministers has submitted to Parliament the Takaful Bill, which inter alia: (a) establishes a system of regulation and supervision of all **Takaful** ***affairs, and (b) supports a sound competitive environment among takaful operators.***

49. **Rationale.** A feasibility study on drought index insurance for livestock in Somalia conducted by the World Bank in 2019 identified the lack of a legal and supervision framework for insurance as a significant constraint to the insurance sector in Somalia. During droughts, insufficient animal feed and fodder causes pastoralists to sell livestock—their primary economic asset—when prices are lowest. Insurance and other financial services could help pastoralists spread risks from such climatic shocks, but formal financial service providers tend to operate primarily in urban areas. Laws governing insurance in Somalia date to the 1970s and presume state provision of insurance. Consequently, few insurance companies operate officially in Somalia. The market for *takaful* is nascent, comprising six operators and one broker, each with two to nine years of existence.[32]

50. **Policy content.** CBS has drafted the Takaful Bill, which Cabinet submitted to Parliament in October 2023. The Bill establishes the institutional and regulatory framework for the national insurance market that will adhere to Shariah guidelines. The primary reason for supporting this policy is to enable the drought index insurance to be sold to pastoralists according to Shariah regulations and be Shariah compliant. Its provisions protect the rights and interests of takaful customers and promote the professional development of the takaful market throughout Somalia. After the law is enacted, all insurance entities will need to be licensed and supervised by CBS. The Takaful regulations, a DPF2 trigger, will continue to enhance the regulatory framework and strengthen CBS to supervise the insurance sector.

51. **The reform also contributes to addressing gender gaps in access to finance.** There are stark gender disparities in bank account ownership and access to financial services across Somalia, which are partly underpinned by large distance to bank branches for women pastoralists who are nomads, as well as lack of product offerings and distribution and outreach channels. The reform aims to ensure that at least 50 percent of the pastoralists covered by drought index insurance are women. The drought index insurance is being introduced and

[31] It repeals the Financial Institutions Law, 2012, whose scope was limited to banks.

[32] *Takaful* is an Arabic word that means guaranteeing each other. It is a mutual insurance concept that operates in accordance with Islamic principles and is based on fairness, transparency, and social responsibility. Participants share risk by making specific contributions into a fund that is used to pay for losses suffered by its members. The fund can be used for projects aimed at climate adaptation, such as the construction of water reservoirs, fodder banks, and other infrastructure that reduces vulnerability to drought and other climate risks. See World Bank, "Horn of Africa DRIVE Takaful FAQ," December 2023.

sold for the first time in Somalia and delivered as part of a financial package, including a saving account and digital account that will allow women to access other financial products. As only 6.4 percent of women own a formal banking account (compared to 11.5 percent of men), the reform is expected to reduce the gender gap in financial inclusion and enable women to access financial services for the first time.[33]

52. **Expected results.** Implementation of the Takaful legislation, once approved and enacted, is expected to expand financial services and facilitate the adoption of Shariah-compliant drought index insurance to pastoralists and thereby enable them to better adapt to climate change. The regulations will enhance the ability of Takaful insurance companies to operate efficiently and serve pastoralists throughout Somalia (including Somaliland). This reform will have a nationwide impact since it will benefit the entire country where Shariah products are the preferred and accepted form of insurance. Results will be measured by the increased number of pastoralists and their dependents covered by drought index insurance, from zero in 2023 (baseline) to 180,000 in 2026 (target), of which 50 percent are women. Activities financed by the De-risking, Inclusion and Value Enhancement of Pastoral Economies in the Horn of Africa (P176517) project, including a livestock value chain fund targeted to women and pastoralists, and the SCALED-UP IPF will contribute to achieving these results.

Policy Area: FGS-FMS fisheries

Prior action #7. To improve fisheries governance and investment, the Recipient through its Ministry of Fisheries and Blue Economy has issued Regulations for the Fisheries Management and Development Council Rules and Procedures for coordinated federal-state management of Somalia's fisheries.

53. **Rationale**. Somalia has significant potential to turn fisheries into key source of growth, jobs, food security, and diversification of exports.[34] Strong seasonal upwelling off Somalia's Indian Ocean coast provides one of the most productive marine ecosystems in the world. Since 2018, revenue is being generated—and shared between the FGS and FMSs—through offshore licensing of foreign fishing vessels. In addition, the vibrant domestic private sector is investing in fishing, cold chain, and processing. However, realizing the potential to create jobs and boost exports requires sustainable management of the fisheries, as well as integration of the Somali fisheries sector into world markets, supported by a governance framework based on strong FGS-FMS cooperation. The 2023 Federal Fisheries Law, supported by previous DPF series, sets the basis for shared FGS-FMS responsibilities and coordination by creating a high-level platform for FGS-FMS policy dialogue—the Fisheries Management and Development Council (FMDC).[35] Operationalization of the FMDC requires adoption of framework that governs how the FGS and FMS will function for policy decision making on governance, management, and development of the sector in a sustainable way. Development of an internationally integrated fisheries sector will also require establishing the appropriate legal, regulatory, and institutional framework for assuring that fisheries products meet health, safety, and hygiene standards required for the domestic market and exports.

54. **Policy conten**t. On June 1, 2024, the Ministry of Fisheries and Blue Economy of the FGS (MFBE) issued a regulation that mandates the FMDC to oversee the sustainable development and management of the fisheries by providing strategic direction, policy formulation, and monitor implementation of policies and strategies. This regulation establishes a formal structure for governance of the sector that is coordinated and collaborative

[33] National Bureau of Statistics. 2023. Somalia Integrated Household Budget Survey. Federal Republic of Somalia: Mogadishu.
[34] Fisheries' economic development potential is analyzed in World Bank and Food and Agriculture Organization, Country Economic Memorandum Volume 1: Rebuilding Sustainable Agriculture in Somalia, 2018.
[35] The FMDC comprises the Fisheries Minister of the FGS (chair) and all fisheries ministers from the FMS and meets on a quarterly basis. The meetings of the FMDC will be supported by the Somali Sustainable Fisheries Development (Badmaal) Project (P178302).

between the FGS and FMS governments and that supports sustainable exploitation and conservation of Somalia's marine resources. Technical regulations that harmonize standards for imported and exported seafood are a trigger for DPF2.

55. **Expected results**. Operationalization of the FMDC will enable coordinated FGS-FMS policy decisions and promotion of Somalia's fisheries sector. This is expected to facilitate new private investment in fisheries needed to increase production for both domestic and external markets, in particular of high-value products, and thereby improve livelihoods for Somalis along the country's 3,300 km coastline (the longest in Africa). Results will be measured by the increased value of seafood exports, from US$15 million in 2023 (baseline) to US$18 million in 2026 (target). Activities financed by the Somali Sustainable Fisheries Development (Badmaal, P178302) and Somalia–Horn of Africa Infrastructure Integration (SHIIP, P173119) projects will contribute to achieving these results.[36]

Policy Area: Environmentally friendly investment

Prior action #8. To ensure that investments incorporate environmental and climate considerations, (a) the Recipient has enacted the Environment Protection and Management Act, which mandates environment and social impact assessments (ESIAs) of projects and installations and establishes the core functions of the Ministry of Environment and Climate Change (MECC) for management of climate action and oversight of ESIAs, and (b) the Recipient's MECC has issued the supporting ESIA Regulation that designate the types of installations and projects that are subject to ESIAs and mandates the incorporation of climate risk management and identification of priority climate actions into ESIAs.

56. **Rationale**. Deforestation, soil degradation, and pollution remain unchecked due to the lack of enforcement mechanisms and institutional capacity. Somalia already records some of the highest mean annual temperatures worldwide. Central Somalia will be particularly affected. Established only in 2022, the MECC is still an untested institutional anchor for climate and environmental risks management. The World Bank's Somalia Country Environmental Analysis identified legislative, policy, and institutional reforms, including the need to provide clear guidance for management of environmental and social risks in investment projects in the country.[37]

57. **Policy content**. Somalia enacted the Environment Protection and Management Act on February 24, 2024, marking a significant step towards addressing the country's environmental challenges. The Act requires environment and social impact assessments (ESIAs) of investment projects and establishes the core functions of MECC for leading initiatives aimed at climate resilience and natural resource management. On May 24, 2024, the supporting regulations were issued, clarifying the types of installations and projects that are subject to ESIAs and incorporating climate risk management into ESIAs. The Act also creates the National Environmental Fund to help attract and use climate finance. The Act and the Regulations will work best under circumstances of intergovernmental cooperation between the FGS and FMS. The operationalization of the National Environmental Council, a DPF2 trigger, will ensure collaboration of FGS and FMS in designing and implementing environmental policies across the country. The World Bank is already technically supporting the establishment of an intergovernmental cooperative framework that serves to not only strengthen collaboration in management of environmental and social risks in the country but goes further to deepen the federal agenda in a critical sector.

[36] The Somali Sustainable Fisheries Development (Badmaal) Project (P178302) will build the capacity of the FMDC and finance the strengthening and harmonization of the policy, legal, and regulatory frameworks at both federal and state levels.
[37] World Bank. 2020. Somalia Country Environmental Analysis: Diagnostic Study on Trends and Threats for Environmental and Natural Resources Challenges. World Bank, Washington, DC.

58. **Expected results**. The new legal and regulatory framework, supported by institutional arrangements for improved intergovernmental collaboration, will make the economy more resilient to climate change and reduce environmental costs. The number of development projects processed under the Regulations will measure progress towards this long-term outcome, with a target of five development projects in 2026.

Policy Area: Access to electricity

Prior action #9. To increase private sector provision of electricity, including from renewable sources, the Recipient through the National Electricity Authority has issued the Tariff Methodology and Tariff Adjustment Formulae, which applies principles of full cost-recovery.

59. **Rationale.** Somalia electricity sector is underdeveloped, carbon-intensive, priced in an ad hoc manner (i.e., whatever the market will bear), and costly—the average tariff is estimated at about US₵60/kWh.[38] The private sector supplies more than 90 percent of power in urban and peri-urban areas using unregulated local mini-grids, powered by diesel (despite substantial solar and wind energy potential). Meanwhile, without the certainty and transparency of formal regulation, large-scale investments in electricity have not taken place. To lower costs, expand access to electricity, and facilitate investment in renewable energy, the FGS is creating the enabling legal, regulatory, and institutional framework for the sector. Enactment of the Electricity Law and the licensing and tariff regulations in 2023 were supported as prior actions in the previous DPF series and as a HIPC Completion Point. In 2024, the regulator—the National Electricity Authority (NEA) was established.

60. **Policy content.** In June 2024, NEA issued the Tariff Setting Methodology Regulation, which establishes parameters for the costs that electricity service provider can pass along to customers and for the allowable profit margin. This will operationalize the principles embedded in the 2023 regulations to reflect the electricity service costs and incentives for improving operating efficiency. The regulation also initiates the institutionalization of a regular tariff review process that will permit licensed electricity service providers (ESP) to transparently cover their annual revenue requirements, which is crucial to the financial health and sustainable investments of the sector. The tariff setting methodology represents significant improvement from the past where the service providers were charging consumers nontransparent tariffs—one contributor to the exceptionally high prices in Somalia. A trigger for DPF2 is Cabinet approval of the Energy Sector Generation and Transmission Network Optimized Development Plan as a mechanism to guide investment in the electricity sector, especially renewable energy-based generation.

61. **Expected results.** The reform is expected to facilitate private sector investments in the energy sector, particularly in renewable energy generation, thus contributing to Outcome Area 9 of the World Bank Group Corporate Scorecard. The transparent alignment of tariffs to true costs is expected to increase investor confidence in the sector. Because the methodology constrains ESPs from charging tariffs in excess of allowable costs, the regulation is expected to encourage the transition away from fossil fuel-based generation, which has persisted to date in the absence of tariff regulation.[39] The results will be measured by the amount of renewable generation capacity whose costs are approved based on the tariff setting methodology, with a target of 50 MW in 2026. Further, the methodology requirements related to efficiency improvements and service quality are expected to lead to positive environmental and climate co-benefits in addition to cost of service reductions.

[38] National electricity access is estimated at about 50 percent (70 percent in urban areas and 32 percent in rural areas).
[39] It is more costly to use imported diesel for electricity generation compared to solar photovoltaic with battery storage. Results from recent projects have demonstrated the potential to reduce the electricity generation cost by 50 percent by hybridization of existing thermal based generation with solar photovoltaic and battery energy storage systems.

Table 5. Analytical Underpinnings of the Proposed Operation

Prior Action	Analytical Underpinnings
Pillar A: Ensuring Sustainable Public Finances	
Prior action #1: Tax revenue	"Towards Building Somalia's Social Contract" - Somalia Enhancing Governance Dialogue Analytical Program (P171974) highlights the importance of improved tax administration for stronger compliance, automation, and income tax harmonization for increased inland revenue.
Prior action #2: Customs revenue	"Towards Building Somalia's Social Contract" - Somalia Enhancing Governance Dialogue Analytical Program (P171974) provides the analysis of the efficiency of customs collections and highlights the importance of customs harmonization and strengthening of administration procedures.
Prior action #3: Debt management office structure	World Bank and International Monetary Fund, "Debt Management Reform Plan," February 2021, highlights the importance of incorporating the DMU staff in the civil service while clarifying its role and establishing a high-level Public Debt Management Committee.
Prior action #4: Audit function	The World Bank's Somalia Public Expenditure Management Assessment (June 2020) highlights the need for a strong regulatory framework for the independence and integrity of the OAGs. Somalia Financial Management Capacity Building and Risk Management (P179174) Programmatic ASA review of the Audit Act 2023 recommends clarifying the procedures for the dismissal of the Auditor General through regulations.
Pillar B: Enabling Resilient Private Sector Development	
Prior action #5: Financial Institutions Bill	The World Bank Group's "Somalia: Country Private Sector Diagnostics" (June 2024) highlights the importance of upgrading of the legal and regulatory framework for strengthening the soundness of the financial system as well as improving financial inclusion. The IMF-WB "Somalia Enhanced HIPC Initiative Completion Point Document" (December 2023) also notes the role of the Financial Institutions Law in supporting financial market development.
Prior action #6: Takaful insurance	The feasibility study on drought index insurance for livestock in Somalia conducted by the World Bank in 2019 identified the lack of an insurance law and associated regulatory and supervision framework as a significant constraint to the insurance sector. In addition, the report also noted the need for Shariah products.
Prior action #7: Fisheries	The World Bank 2022 Policy Notes "Unlocking Somalia's Potential to Stabilize, Grow and Prosper" stress on the need to improve coordination between the federal and regional fisheries ministries to support reaching the potential of the sector to diversify exports and sources of nutrition, upgrade climate smart agricultural practices, and ensure sharing of revenues from fisheries licenses.
Prior action #8: Environmental Protection and Management Act and ESIA Regulation	The World Bank's Somalia Country Environmental Analysis (CEA, 2020) reviewed the national legislative setup for managing environmental risks in the country and noted that the necessary national organic legislation had not yet been formulated. The CEA, therefore, strongly recommended the enactment of a basic environmental law, which covers the management and coordination of Somalia's environment, and which needs to be developed and ratified by the FGS and the respective FMS in tandem.
Prior action #9: Tariff-setting methodology	The Somalia Power Sector Master Plan (2019) highlights the need for having in place an enabling legal, regulatory, and institutional framework to support the increased private sector investments. UKAID Energy Security and Resource Efficiency in Somaliland Project (2019–2021) results have demonstrated the significant benefits reducing the electricity generation cost by 50 percent through hybridization of existing thermal based generation with Solar Photovoltaic and Battery Energy Storage Systems. Ministry of Energy and Water Resources Somalia Electricity Supply Industry Institutional Structure Study (May 2021) assessment highlights the required regulatory and institutional reforms to ensure an efficient electricity supply industry.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WORLD BANK GROUP STRATEGY

62. **The operation supports the objectives of the World Bank's Country Partnership Framework (CPF) for Somalia (FY24–28, Report number 187254-SO) and incentivizes progress in reaching IDA's TAA milestones.** The

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 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." Two of the result indicators of the operation are directly linked to the World Bank Group Scorecard Indicators (tax revenue and access to electricity).

63. **The reforms supported by this operation complement the World Bank Group's engagement in Somalia.** The SERP (P177298) and the Recurrent Cost and Reform Financing (RCRF) Project–Phase 3 (P173731) support domestic revenue mobilization, expenditure management, and intergovernmental fiscal cooperation. Support to financial inclusion is being provided under the SCALED-UP IPF (P168115). The Sustainable Fisheries Development (Badmaal) Project (P178032) supports the fisheries sector. The Electricity Sector Recovery Project (P173088) is supporting new investments in the electricity sector. Somalia's response to climate-related crises is being strengthened through the Crisis Recovery Project (P173315) and the upcoming Country Climate and Development Report (P501734).

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

64. **The reforms supported by this operation support the NDP9, as well as sector guidelines and policies, which were all prepared in a consultative manner.** The NDP9 was prepared through an extensive consultative process, which involved civil society, the private sector, FGS or FMS line ministries, and representatives of the National Parliament and of FMS Assemblies. Reforms to advance domestic revenue mobilization, access to finance and insurance have benefitted from consultations with stakeholders at the federal and FMS levels, as well as the private sector. The Tariff Setting Methodology and the Environment Protection and Management Act were also approved following consultations with government and private sector stakeholders, as required by law. Similarly, before its approval, the FMDC regulation was endorsed by the FMDC, ensuring FMS collaboration.

65. **The operation has been developed in close collaboration with development partners.** There has been close collaboration with the IMF to agree on common priority reform areas (DRM, PFM, and debt management) and assessment of the macroeconomic policy framework. The European Union has also been a close partner for budget support, with complementary reforms in PFM and intergovernmental relations. There has been close collaboration with the AfDB in areas of PFM and debt management. In addition, there has been continuous collaboration with bilateral partners through the MPF, including dissemination of analytical work that informed the design of the operation and updates on the assessment of the macroeconomic policy framework. The collaborative efforts to prepare this operation build on the ongoing partnerships with development partners to support Somalia in reaching the HIPC Completion Point. FCDO supports the implementation of SOMCAS in the FGS and the Jubaland and Puntland FMSs and provided technical assistance to the development of Customs Act Regulations. The World Bank is closely coordinating with USAID on the support to the OAGs and with FCDO and AfDB on PFM and revenue reforms.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

66. **No prior actions are likely to have significant negative poverty and social impacts.** Prior Actions 1 and 2 are not expected to have distributional impacts as they do not envision any changes in tax or tariff rates. However, these reforms are expected to generate positive impact in the medium and long run as higher revenues will

support expanded basic service delivery. The improved supervision of MFIs and non-banks (Prior Action 5) is expected to help expand outreach to small and micro borrowers and open new opportunities, including for the underserved and unserved economic segments as poorer households tend to own small and micro enterprises. The reform may help expand microfinance and other services that have more women customers, such as women-owned micro and small businesses, reducing the gender gap in access to finance. Only 6 percent of women (among population aged 15 and above) have a bank account, compared to 12 percent of men.[40] Pastoral nomads, who suffer heavily from droughts, are the poorest group in Somalia, with poverty rate of 78 percent, compared to the national average of 54 percent (SIHBS 2022).[41] Prior Action 6 is expected to enable them to better adapt to climate change, which would result in poverty reduction. The adoption of an electricity tariff-setting framework (Prior Action 9) is designed to constrain ESPs from charging tariffs in excess of allowable costs and to encourage more efficient electricity generation away from expensive diesel and thus reduce prices faced by end-users, supporting poverty reduction. However, levels of tariff rates approved in the future are uncertain and make it difficult to determine the distributional impacts at this point. An analysis will be conducted using the existing SIHBS 2022 to examine the impact of electricity prices on consumption and poverty.

5.2. ENVIRONMENTAL ASPECTS

67. **No prior actions are likely to have significant adverse environmental costs.** Although the construction of new electricity generation facilities expected to be enabled by Prior Action 9 could pose some marginal risks to the environment (such as possible carbon dioxide and sulfur and nitrous oxide emissions from power plants that may contribute to climate change), the new requirement for investors to conduct ESIAs under Prior Action 8 mitigates these risks significantly. In addition, the regulation is likely to impose higher tariffs on power generated from diesel, which is typically more expensive due to the costs of importing fuel, maintenance, and environmental considerations. By setting higher tariffs for diesel-generated electricity, the regulation makes it less economically attractive for energy producers and consumers, meaning limited GHG emissions possibility. The operation is consistent with Somalia’s Nationally Determined Contribution (NDC) and supports the country's goals for adaptation and resilience as outlined in the Paris Agreement. 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 GHG emissions and are unlikely to prevent Somalia from achieving its GHG emission targets.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

68. **PFM environment.** The FGS has been progressively rebuilding its core PFM systems, including procurement, with the support of the World Bank and other development partners.[42] Implementation of the financial management information system is strengthening expenditure controls and supports production of International

[40] World Bank, Somalia Poverty Assessment, forthcoming.

[41] Somalia Integrated Household Budget Survey (SIHBS), 2022.

[42] The Public Procurement and Concessions Act 2016, Public Financial Management (PFM) Act 2019, Audit Act 2023, and associated regulations form key building blocks of the legal framework.

Public Sector Accounting Standards-compliant annual financial statements from the system. The FGS continues to strengthen cash management and is operationalizing a Treasury Single Account. To strengthen public procurement, which has faced challenges from persistent conflict, fragility, and weak capacity, the FGS developed a series of guidelines and manuals as well as launched the Somali Public Procurement website. Reviews and temporary oversight over large public procurement contracts conducted by the FGC provide a measure of transparency and accountability. The World Bank is working to enhance procurement integrity through increased procurement operations support and is using third-party monitoring agencies during project implementation.

69. **Budget transparency.** The FGS publishes the annual budget, annual financial statements, quarterly in-year implementation reports, and detailed monthly revenue and spending outturn data.[43] Starting in 2021, the FGS began publishing consolidated FGS-FMS budget reports.

70. **Foreign exchange control environment of the central bank.** Somalia's economy is de facto dollarized (as are FGS fiscal operations), and CBS does not buy or sell Somali shilling notes. The IMF concluded a Safeguards Assessment of the CBS in 2024. The CBS legal framework and the internal audit function provide important safeguards to ensure that World Bank financing is credited to an FGS account to finance budgeted expenditure. The internal auditor produces relevant reports and follows up on the recommendations. In July 2023, external auditors provided a clean audit opinion of the 2022 CBS financial statements.[44]

71. **Funds flow arrangement and auditing aspects.** Disbursement will follow the "General Conditions for IDA Financing, Development Policy Financing," dated July 14, 2023. Upon effectiveness, IDA will disburse the proceeds of the grant in the amount of US$125 million equivalent as a single tranche into dedicated accounts acceptable to IDA. Upon receipt, the FGS will provide notice to IDA that the funds have been received in dedicated accounts mapped to the treasury single account (TSA), and the equivalent amount will be reflected in the FGS's fiscal reports. The FGS confirmation will be provided to IDA within 30 days after the funds disbursement.[45] The World Bank reserves the right to have specific audits conducted to confirm the funds flow and movement of funds from the World Bank to the dedicated accounts and from the accounts to the TSA. If the control environment ceases to be effective at any time during implementation, the government will provide full details of the bank accounts to which the DPF funds are disbursed and related transactions. The audit report will be submitted to the World Bank not later than four months after the World Bank's request for the audit.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

72. **Monitoring and evaluation.** The Ministry of Finance has the lead responsibility for the coordination, monitoring, and ensuring ultimate completion of the prior actions. Monitoring of the DPF results will build on mechanisms that the ministry has developed for managing the IMF ECF program and the HIPC Completion Point commitments. Recognizing the government's capacity constraints, the DPF prior actions were selected to complement the ongoing support provided under World Bank-financed operations, IMF programs, and EU projects to minimize the additional workload associated with monitoring the actions in this operation.

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[43] Proposed and final budgets are available at https://mof.gov.so/index.php/publications/annual-budget. Monthly outturn data are posted in machine-readable format at https://mof.gov.so/fiscal/.

[44] The audited 2022 financial statement is available at https://centralbank.gov.so/wp-content/uploads/2023/07/CBS-Audited-Financial-Statement-2022.pdf.

[45] This confirmation will state that: (a) the DPF proceeds were received into an account of the government that is part of the country's foreign exchange reserves (including the date and the name/number of the government's bank account in which the amount has been deposited); and (b) an equivalent amount has been recorded in the country's budget management system (including the chart of accounts name/account number, the date, and the exchange rate used).

73. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Project affected communities and individuals may submit their complaint to the World Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of World Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and World Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank's Accountability Mechanism, please visit https://accountability.worldbank.org.

6. SUMMARY OF RISKS AND MITIGATION

74. Overall residual risk for the operation is **high**.

75. **Political and governance risks to the PDO are rated high**. These risks are inherently high due to the legacy of state fragmentation and civil war, the unfinished political settlement and nascent federal systems, incomplete constitution (especially on allocation of powers between federal and state governments), continued insurgency, and perceptions of pervasive corruption. Achievement of the country-wide results require strong commitment by FGS and FMSs, which can be disrupted by the ongoing political disagreements about the constitution.[46] Measures to promote federal-state cooperation through this DPF, through institutionalized intergovernmental technical discussions and World Bank-financed investment projects (through the Finance Ministers Fiscal Forum, supported by RCRF; the FMDC, supported by the Badmaal Project; projects supporting DRM, PFM, and civil service reforms in FGS, FMSs, and Somaliland), and through the adoption of several pieces of legislation by the federal parliament will mitigate the risks. Strengthening of the external audit function, supported by Prior Action 4, SERP, and PFM programmatic ASA as well as leveraging FGC, a high-level oversight mechanism supported by the World Bank through the MPF, contributed to improvements in government accountability and would mitigate governance risks. Nevertheless, residual risks remain high, including the risk of politization of resources as resources risk changing the balance in the political marketplace given the fragile and unsettled context. Elections are expected to take place in 2026.

76. **Macroeconomic risks are rated high**. Low revenue mobilization, absence of discretion over spending, the absence of monetary policy tools, and other gaps in macroeconomic policy capacity limit the ability to respond to economic shocks, making risks inherently high. Reforms supported as prior actions in Pillar A and the discipline of the IMF ECF program tend to mitigate macroeconomic risks, but residual risks remain high.

77. **Institutional capacity for implementation and sustainability risks are rated substantial**. The inherent risk is high. Public sector institutions in Somalia remain underdeveloped—a legacy of state fragmentation and conflict, as well as due to political divisions and minimal revenue mobilization. A shortage of managerial and professional staff to implement economic policy reforms also contributes to inherently high risk. Public sector capacity

[46] Tensions between the FGS and the Puntland State of Somalia in respect to the constitutional process and power sharing arrangements have reached its peak in March 2024 with the recent constitutional amendments passed by the Parliament and Puntland's declared withdrawal from the federation.

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 RCRF III and SERP. Ongoing assistance provided by the World Bank-financed IPFs, ASAs, and International Finance Corporation (IFC) Advisory Services will reduce residual risks to substantial.

78. **Fiduciary risks to the PDO are rated substantial**. Somalia's PFM environment is characterized by inadequate and nascent legal, policy, and institutional framework, making the inherent fiduciary risks high. PFM procedures, and operational systems remain new and incomplete, capacity to implement them is still being developed, keeping weak fiscal transparency and accountability systems at the federal and state levels low. Prior Action 4 and the broader World Bank, IMF, and other development partners' support for wide-ranging PFM, transparency, and accountability reforms at both federal and state levels reduce the residual risk to substantial.

79. **Stakeholders' risks are rated substantial.** Reforms supported in this operation require cooperation and agreement of stakeholders across the country, from different ministries, and the private sector in a context of competing interests and political fragmentation. Frequent cabinet reshufflings pose the risk to the ownership and sustainability of reforms. Substantial consultations with, and engagement of, multiple categories of stakeholders beyond politically appointed leaders and establishment of a consultative process with the support from ongoing IPFs and ASAs will help mitigate the risk, ensure visibility, and generate expectations for the operation's outcomes.

Table 6. Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Substantial
9. Other	
Overall	High

ANNEX 1: POLICY AND RESULTS MATRIX

DETAILED RESULTS FRAMEWORK

	Prior actions and Triggers		Results		
Policy area	**Prior Actions under DPF 1**	**Triggers for DPF 2**	**Indicator Name**	**Baseline (end-2023)**	**Target (end-2026)**
	Pillar A: Ensuring sustainable public finances				
Adequate funding for development	Prior Action #1: To improve inland revenue mobilization, the Recipient's Minister of Finance has issued the Revenue Administration Regulation, which (a) clarifies procedures for tax payments, (b) provides for tax consultants, and (c) establishes electronic tax administration system. Prior Action #2: To enhance customs revenue mobilization, the Recipient's Minister of Finance has issued the General Customs Regulation, which (a) establishes a comprehensive framework for customs revenue collection, (b) defines the process for licensing of customs brokers, and c) enhances the enforcement provisions of the Customs Act.	Trigger #1: To expand the tax base, the Minister of Finance issues Regulations under the Income Tax Law that harmonize personal income tax, corporate income tax, rental income tax, and capital gain tax across FGS and FMS.	Results Indicator #1: Increase in inland tax and customs revenue collected as share of GDP (aligned with the Corporate Scorecard)	1.95 percent	2.40 percent
Debt costs	Prior Action #3: To improve management of the risks and cost of public debt, the Recipient through its Minister of Finance has issued a Decree that establishes the middle office within the Debt Management Unit and provides the core functions of the front office, middle office, and back office.	Trigger #2: To strengthen debt management, the Minister of Finance amends the Public Finance Management Regulations to expand the role of the Treasury Committee to include oversight of the Debt Management Unit's policies and procedures.	Results Indicator #2: Cap on growth of debt service costs, US$ million	US$17.7 million	US$25 million

	Prior actions and Triggers		Results		
Policy area	**Prior Actions under DPF 1**	**Triggers for DPF 2**	**Indicator Name**	**Baseline (end-2023)**	**Target (end-2026)**
Accountability	Prior Action #4: To strengthen independent oversight over expenditure, the Recipient's Council of Ministers has issued the Public Audit Regulation which, inter alia: (a) establishes national auditing standards and procedures; (b) provides for the code of conduct for the Office of the Auditor General (OAG), (c) provides for OAG relationship with other governmental and international entities, and (d) spells out the procedures for the dismissal of the Auditor General.	Trigger #3: FGS and FMS OAGs sign an agreement that delineates the FGS' and FMS' roles and responsibilities in conducting the audits across the country.	Results Indicator #3: Increased number of audits conducted in line with the quality criteria set out in the new audit framework and published online	0	2
	Pillar B: Enabling resilient private sector development				
Access to financial services	Prior Action #5. To expand access to finance, the Recipient's Council of Ministers has submitted to Parliament the Financial Institutions Bill, which provides the framework for the regulation and supervision of financial institutions, including microfinance institutions.	Trigger #4: To safeguard access to finance, the CBS issues regulations under the Financial Institutions Act to license and supervise microfinance institutions.	Results Indicator #4: Increased number of financial institutions under formal supervision	29	42
Access to financial services	Prior Action #6: To strengthen the insurance sector and support financial resilience of pastoralists against drought and climate-related risks, the Recipient's Council of Ministers has submitted to Parliament the Takaful Bill, which inter alia: (a) establishes the system of regulation and supervision of all *Takaful* affairs, and (b) supports a sound competitive environment among *takaful* operators.	Trigger #5: To ensure financial stability of takaful operators, the Central Bank of Somalia issues regulations under the Takaful Act to license and supervise takaful operators.	Results Indicator #5: Increased number of pastoralists and their dependents covered by drought index insurance	0 of which 0 women	180,000 of which 90,000 women
FGS-FMS fisheries	Prior Action #7: To improve fisheries governance and investment, the Recipient through its Ministry of Fisheries and Blue Economy has issued Regulations for the Fisheries Management and Development Council Rules and Procedures for coordinated federal-state management of Somalia's fisheries.	Trigger #6: To improve exports, the Ministry of Fisheries and Blue Economy issues Regulations for standards on exports and imports of fish.	Results Indicator #6: Increased value of seafood export	US$15 million	US$18 million

	Prior actions and Triggers		Results		
Policy area	Prior Actions under DPF 1	Triggers for DPF 2	Indicator Name	Baseline (end-2023)	Target (end-2026)
Environmentally friendly investment	Prior Action #8: To ensure that investments incorporate environmental and climate considerations, (a) the Recipient has enacted the National Environment Protection and Management Act, which mandates environment and social impact assessments (ESIAs) of projects and installations and establishes the core functions of the Ministry of Environment and Climate Change (MECC) for management of climate action and oversight of ESIAs, and (b) the Recipient's MECC has issued the supporting ESIA Regulation that designate the types of installations and projects that are subject to ESIAs and mandates the incorporation of climate risk management and identification of priority climate actions into ESIAs.	Trigger #7: To ensure collaboration of FGS and FMS in implementing environmental policies across the country, the MECC issues regulations to establish the roles and responsibilities of the National Environmental Council.	Results Indicator #7: Number of new development projects processed under the Regulations.	0	5
Access to electricity	Prior Action #9: To increase private sector provision of electricity, including from renewable sources, the Recipient through the National Electricity Authority has issued the Tariff Methodology and Tariff Adjustment Formulae, which applies principles of full cost-recovery.	Trigger #8: To increase investment in the supply of electricity, the Cabinet approves the Energy Sector Generation and Transmission Network Optimized Development Plan.	Results Indicator #8: Renewable energy capacity enabled (MW)	0 MW	50 MW

Note to Result Indicator #3: Two audit reports (e.g., special, performance, or compliance audits) in addition to OAG's annual audit of the government's accounts in line with Article 5 of the Law of the Office of the Auditor General of the Federal Republic of Somalia (Law No. 14, September 10, 2023).

RESULTS INDICATORS BY PILLAR

Baseline	Closing Period
Ensuring sustainable public finances	

Increase in inland tax and customs revenue collected (share of GDP) (Percentage)	
Dec/2023	Dec/2026
1.95	2.4
Cap on growth of debt service costs (Amount(USD))	
Dec/2023	Dec/2026
17,700,000	25,000,000
Increased number of audits conducted in line with the quality criteria set out in the new audit framework and published online (Number)	
Dec/2023	Dec/2026
0	2
Enabling resilient private sector development	
Increased number of financial institutions under formal supervision (Number)	
Dec/2023	Dec/2026
29	42
Increased number of pastoralists and their dependents covered by drought index insurance (Number)	
Dec/2023	Dec/2026
0	180,000
➢Of which women (Number)	
Dec/2023	Dec/2026
0	90,000
Increased value of seafood export (Amount(USD))	
Dec/2023	Dec/2026
15,000,000	18,000,000
Number of new development projects processed under the Regulations. (Number) (Number)	
Dec/2023	Dec/2026
0	5
Renewable energy capacity enabled (Megawatt)	
Dec/2023	Dec/2026
0	50

ANNEX 2: FUND RELATIONS ANNEX

IMF Executive Board Concludes the First Review of the Extended Credit Facility for Somalia

May 29, 2024

- The IMF Executive Board completed the first review under Somalia's Extended Credit Facility (ECF) arrangement. The decision allows for an immediate disbursement of about US$10 million to Somalia to support its economic policies and reforms.
- Real GDP growth is expected to rise to 3.7 percent in 2024 compared to 2.8 percent in 2023, supported by continued recovery in agriculture, greater remittances, and higher investment.
- Somalia has continued to advance its reform agenda and program performance has been strong. Policy priorities are to maintain fiscal sustainability, strengthen revenues and public financial management, promote financial deepening, improve governance, and enhance statistics.

Washington, DC: The Executive Board of the International Monetary Fund (IMF) today completed the first review of the Extended Credit Facility (ECF) arrangement for Somalia. The Board's decision enables the immediate disbursement of SDR 7.5 million (about US$10 million), which will be channeled for budget support, bringing Somalia's total disbursement under the Extended Credit Facility (ECF) to SDR 37.5 million (about US$50 million).

Somalia's ECF arrangement was originally approved by the Executive Board on December 19, 2023 (see Press Release No. 23/463). The program supports the authorities' reform strategy, after achieving the completion point under the Heavily Indebted Poor Countries (HIPC) initiative, to further strengthen key economic institutions and promote macroeconomic stability and growth. This is in line with Somalia's national development plan and the government's long-term vision to maintain economic stability, strengthen revenues and public financial management, promote financial deepening, improve governance, and enhance statistics.

Following the Executive Board discussion, Ms. Antoinette Sayeh, Deputy Managing Director and Acting Chair, made the following statement:

"The Somali authorities have maintained strong reform momentum, after reaching the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in December 2023. Somalia's performance under the Fund-supported Extended Credit Facility Arrangement has been strong. The authorities' continued strong ownership of the reform agenda will be important to build resilience, promote inclusive growth, and reduce poverty. Continued and timely support from development partners is also critical for the successful implementation of the reform strategy.

"The authorities' strong revenue performance and steadfast implementation of revenue-enhancing reforms are welcome. Sustained efforts on domestic revenue mobilization would help to make room for priority spending. Key reforms include customs modernization and the new income tax law. Further strengthening of public financial management is also important, including continued progress on payroll integration, enhancing expenditure controls, as well as developing debt management capacity.

"Ongoing reforms to strengthen central bank institutional capacity are commendable. Careful formulation of the monetary and exchange rate policy frameworks is important in the context of the planned currency reform. Efforts should continue to promote financial deepening and financial inclusion and to advance reforms to improve the AML/CFT framework and governance.

"Measures to bolster inclusive growth and strengthen resilience are important. The authorities are focused on building capacity in the petroleum sector and implementing its legal framework. Addressing food insecurity, building climate resilience, and enhancing trade integration are central to ensuring Somalia's long-term development."

ANNEX 3: LETTER OF DEVELOPMENT POLICY

Jamhuuriyadda Federaalka Soomaaliya
Wasaaradda Maaliyadda
Xafiiska Wasiirka

Federal Republic of Somalia
Ministry of Finance
Office of the Minister

جمهورية الصومال الفيدرالية
وزارة المالية
مكتب الوزير

Ref: MOF/OM/0506/2024 **June 23rd, 2024**

Mr. Ajay Banga
President
World Bank
1818 H Street, NW Washington, D.C. 20433
Washington DC

Dear Mr. Banga,

Somalia Letter of Development Policy

I am writing to formally request the Economic Resilience Development Policy Financing operation (DPO) on behalf of the Federal Republic of Somalia. The DPO program will support the advancement of vital reforms in Somalia which will enable our post HIPC macroeconomic stability and growth aspirations.

The DPO will focus on supporting the Somali government reduce poverty and the implementation of Somalia's 9th National Development Plan which is our national development blueprint and is firmly in line with the new Country Partnership Framework. This letter outlines some of the key achievements of the administration, the challenges going forward, and the overall commitment to the reform process which the DPO will be an integral part of assisting.

The Federal Government of Somalia is proud to have achieved the HIPC Completion Point and secured debt relief from most of its major creditors, including the Paris Club, starting from December 13th, 2023. This is a huge milestone which the government is truly committed to building on and deepen the reform implementation successes with a new 3-year IMF Extended Credit Facility successor program.

Somalia is making strong progress in its state building journey and in the fight against the international terrorist group Al-Shabaab. A genuine process of consultations and Parliamentary discussions are in progress to finalise the Provisional Constitution and to enhance democratic and inclusive governance going forward. This is a fundamental enabler of Somalia's wide ranging economic objectives.

Since the last DPO was granted in 2023, the Somali government has passed key pieces of legislation to support our state building efforts, advance macroeconomic stability, and strengthen transparency and accountability. Some of our key measures include abiding by the budget priorities specified in the Appropriation Bill, the continued efforts to work towards implementing the Pay and Grade Policy and the ongoing security sector expenditure review process. To enhance the implementation of the 2023 Audit Act, we issued Public Audit Regulations in June 2024. These Regulations improve the independent auditing process in Somalia and provide confidence through greater transparency and accountability. Furthermore,

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the successful implementation of Audit Act, supplemented by the Regulation, will hopefully increase the confidence of international partners in the use of Somalia's public financial management systems.

Alongside the Audit Regulations, the government has enacted the Revenue Administration Regulation (April 2024) and the General Customs Regulation (May 2024). These are now in force and already assisting to raise domestic revenue as they provide the necessary clarifications and comprehensive framework on procedures for tax payments, operations of tax consultants, the use of electronic tax administration system, duties, fees, and charges. Furthermore, both regulations strengthen tax payment enforcement which has enhanced the legal awareness of taxpayers and empowered tax officials.

Domestic revenue mobilization remains the overwhelming key priority for enhancing effectiveness of the state in supporting Somalia's economic growth. In this regard, we continue to invest in tax administration by expanding automation and public awareness raising campaigns to encourage increased compliance. Customs modernization and harmonization is also going very well with the operationalisation of the Somalia Customs Automated System (SOMCAS). In addition to this, the earlier mentioned revenue regulations have contributed to strengthening the legal framework and now there is greater operational clarity and efficiency, key for improving compliance. We anticipate that the Income Tax Bill, once enacted , will help clarify citizens' understanding and obligations and thereby increase domestic revenue to finance vital public investments like education and health. Additionally, greater emphasis has been placed in systemically and effectively collecting more domestic revenue from inland sources like property and transportation and reducing the heavy dependence on customs revenue. Overall, the government's domestic revenue strategy is now streamlined, focused and realistically guided by the Medium-Term Revenue Roadmap for 2024-27.

As result of the above sustained efforts, domestic revenue has risen by 41 percent year-on-year in Q1-2024. Today, the Somali Federal Government can cover the cost of employee compensation from domestic resources with an aim to achieve full operational cost sufficiency by 2027 in line with the new IMF ECF 3-year program.

Transparency and accountability are a core part of building strong and trusted systems that advance economic reforms in Somalia. Accordingly, we are actively strengthening procurement and concessions operations as well as oversight alongside all the other good governance focused legislations, policies and strategies I have stated in this letter. A key notable success is also the institutionalization of the Tax Exemption operations which is supported by high level oversight including reporting to the Office of the Auditor General, the Council of Ministers and Parliament. All these measures together will help our government raise more revenue transparently and increase public trust in our systems.

Debt Management is more crucial than ever with Somalia achieving the HIPC Completion Point. The agreement with the Paris Club Creditors has provided an opportunity for Somalia to be receive over USD4 billion as Somalia owed two thirds of its arrears to the Paris Club. Currently, following the successful Paris Club negotiations in March this year, we are engaging each Paris Club member to sign the bilateral agreements to finalize the process. In addition, we are also positively and actively engaging all other Non-Paris Club creditors and have successfully concluded agreements with the Kuwait Fund for Development and the Saudi Fund for Development.

The Ministry of Finance is committed to continually increasing the capacity of its staff and improving the management of debt in Somalia. Improving the management of the risks and cost of public debt is fundamental to not return to the unsustainable crippling debt levels of the past. Accordingly, I issued a Ministerial Decree in June 2024 that establishes a middle office in the Debt Management Unit (DMU) at the Ministry of Finance and finetuned the roles and responsibilities of the front and back offices of the DMU.

Going forward, the Somali government is firmly focused on expanding the tax base, enhancing tax compliance, advancing Inter-governmental Fiscal Federalism agenda further, growing the economy through diversification and trade, as well as raising more domestic revenue to finance its running costs and basic public services like education and health. Based on an agreed formula for fiscal transfers, the Federal Government of Somalia has mobilized external budget support (including proceeds of the Inclusive Growth DPF series, EU budgetary support, and other RCRF allocations) to support intergovernmental grants aimed at building a robust federal system.

Somalia's accession to the East African Community in 2024 is an opportunity which the government is also seeking to benefit from through regional trade. The government is also working towards joining the World Trade Organization, and actively participating in the Horn of Africa Initiative supported by the World Bank alongside other key international partners. This is in line with the national priority of nurturing a strong private sector led economic model to support our entrepreneurial population and investors alike.

To improve the environment for doing business, the Federal Council of Ministers has passed the amendment to the AML/CFT Act and the Financial Institutions Bill. These are assisted by the Cabinet passing and forwarding to Parliament for debate and approval the National Payment Systems Bill and Takaful Insurance Bill. These bills promote financial inclusion and resilience for the most vulnerable in Somali society through microfinance regulations and access to insurance for pastoralists to safeguard against the adverse effects of climate change. Furthermore, the government is actively working on finalising the Income Tax Bill and Public Private Partnership Bill. These legislative efforts are the anchor for strengthening the key pillars of economic growth by creating a conducive environment for private sector growth, investment and jobs by strengthening government operations and institutional capacity.

Somalia's economic growth depends heavily on developing new sectors for investment and job creation. In this regard, the government is focused on promoting investment in the blue economy, digital enterprises, energy, and the modernisation of livestock and agriculture exports with better adherence to global standards and innovative supply chain linked additions. In support of this, we are working tirelessly to continually review and improve the investment environment to ensure the most conductive conditions to facilitate opportunities and growth. As evidence, the Ministry of Fisheries and Blue Economy has issued Regulations for the Rules and Procedures of the Fisheries Management and Development Council for coordinated federal-state management of Somalia's fisheries. This will improve fisheries governance and investment and help to become a larger source of domestic revenue, exports, as well as address food security challenges at home and in the East African region.

New investments, however, will need to consider climate and social impacts. In February 2024, the Environmental Protection and Management Act was enacted, requiring environment and social impact assessments (ESIAs) of investment projects, and defining the core functions of the Ministry of Environment and Climate Change (MOECC). In May 2024, the MOECC issued the ESIA regulations, clarifying the guidance for management of environmental and social risks in investment projects in the country. Climate change considerations are critical for Somalia given Somalia's high exposure to climate change risks and substantial impacts on economic growth and poverty reduction.

Energy is critical to grow Somalia's economy and realise our national development potential. In this regard, Somalia's National Electricity Authority has issued the Tariff-setting Methodology Regulation, which applies principles of full cost-recovery. This will assist in increasing private sector provision of electricity, including from renewable sources which will support Somalia's private sector development and growth.

Challenges

Despite all the clear gains from Somalia's economic reform journey and successes, our fiscal space remains extremely tight. We are facing huge fiscal pressures and remain very concerned about the economic impact of the tense and prolonged geopolitical situation in our region. Alongside the continuing effects of the painful COVID 19 pandemic, Ukraine conflict, and recurrent and cyclical climate change which continue to destroy lives and livelihoods in Somalia, we are also dealing with the prolonged Red Sea crisis. This crisis is directly hampering international supply chains and Somalia's customs revenue as the transit volumes are still down on last year by around 40 percent. Despite working tirelessly to increase the percentage of inland revenue in the overall national revenue collection to balance against the dominance of customs generated income, the Somali economy is still very dependent on shipping and customs as we are a nation of traders and importers.

The Red Sea crisis is also having other profound effects on Somalia's economy as it is raising the cost of doing business as well as cost of living. This is directly impacting our population, especially the most vulnerable. As a government, we do not have many policy instruments or options to respond to the deep, prolonged and costly external climate, security and economic challenges we are facing today, including access to external financing. Accordingly, this DPO will play a valuable role in strengthening our government's immediate fiscal capacity to respond to all these challenges and creating resilience through the economic reform process.

Conclusion

The Somali government is very committed to achieving its security, political and socio-economic priorities which are in line with the 9th National Development Plan. Somalia's ambitious post-HIPC plans to deepen reforms, enhance domestic revenue and grow the economy is a must to address extreme poverty, unemployment, and attract investment into key sector like the Blue economy, energy and digitalisation. Despite Somalia being one of the most fragile nations in the world and facing multiple internal and external shocks, there is real reform momentum and spirit of hope for a better future. Therefore, the Somali government requests the World Bank's valuable support to strengthen national efforts to build resilience, promote stability and create real opportunities for economic growth. Without doubt, the World Bank is a valuable partner in Somalia's sustainable development journey and this DPO assistance will help to support our government deliver a better future for the Somali people.

Yours sincerely,

H.E. Bihi Iman Egeh
The Minister

JAMHUURIYADDA FEDERAALKA SOOMAALIYA
FEDERAL REPUBLIC OF SOMALIA
OFFICE OF THE MINISTER
XAFIISKA WASIIRKA
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ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant positive or negative poverty, social or distributional effects
Pillar A: Ensuring sustainable public finances		
Prior action #1	No	Positive impact in the long run – greater harmonization and efficiency and expanded fiscal space to finance basic public service delivery.
Prior action #2	No	No direct adverse effect, as no changes in custom duty rates envisioned. Positive impact in the long run – expanded fiscal space to finance basic public service delivery.
Prior action #3	No	No direct adverse effect on poverty expected.
Prior action #4	No	No direct adverse effect on poverty expected. Potentially positive indirect impact if the independent oversight resulted in improved service delivery.
Pillar B: Enabling resilient private sector development		
Prior action #5	No	No direct adverse effect on poverty expected. Potentially positive impacts in access to finance among poor household and female entrepreneurs.
Prior action #6	No	No direct adverse effect on poverty expected. Potentially positive indirect impact if it can improve resilience among pastoralists.
Prior action #7	Positive	No direct adverse effect on poverty expected.
Prior action #8	Positive	No direct adverse effect on poverty expected.
Prior action #9	Positive	Potential positive effects from lower prices as the tariff methodology constrains ESPs from charging tariffs in excess of allowable costs and encourages more efficient electricity generation away from expensive fossil fuel.

ANNEX 5: PARIS ALIGNMENT ASSESSMENT

Program Development Objective: To promote economic resilience through more sustainable public finances and resilient private sector development.	
Step 1: Considering our climate analysis, is the operation consistent with the country's climate commitments, including for instance, the NDC, NAP, LTS, and other relevant strategies?	**Answer** Yes. **Explanation**: The DPF's objectives are consistent with Somalia's policies and commitments to make the economy less carbon-intensive and more resilient to climate change.
Mitigation goals: assessing and reducing the risks	
Pillar A Objective: ***Ensuring sustainable public finances***.	
Prior Action #1: To improve inland revenue mobilization, the Recipient's Minister of Finance has issued the Revenue Administration Regulation, which (a) clarifies procedures for tax payments, (b) provides for tax consultants, and (c) establishes electronic tax administration system.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer** No. **Explanation**: Establishing the procedures and electronic systems for tax administration does not affect GHG emissions. They will improve revenue collection and reduce travel by taxpayers.
Conclusion for Prior Action 1: Aligned	
Prior Action #2: To enhance customs revenue mobilization, the Recipient's Minister of Finance has issued the General Customs Regulation, which (a) establishes a comprehensive framework for customs revenue collection, (b) defines the process for licensing of customs brokers, and (c) enhances the enforcement provisions of the Customs Act.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer** No. **Explanation**: As a public administration reform, this prior action is considered to be universally aligned. Prescribing the taxes, duties, fees, and charges which Customs collect, introduction of customs brokers, and other customs administration measures do not affect GHG emissions.
Conclusion for Prior Action 2: Aligned	
Prior Action #3: To improve management of the risks and cost of public debt, the Recipient through its Minister of Finance has issued a Decree that establishes the middle office within the Debt Management Unit, and provides the core functions of the front office, middle office, and back office.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Explanation**: As a public administration reform, this prior action is considered to be universally aligned. Enhancing the functioning of the Debt Management Unit does not affect GHG emissions.
Conclusion for Prior Action 3: Aligned	

Prior Action #4: To strengthen independent oversight over expenditure, the Recipient's Council of Ministers has issued the Public Audit Regulation which, inter alia: (a) establishes national auditing standards and procedures; (b) provides the code of conduct for the Office of the Auditor General (OAG), (c) provides for OAG relationship with other governmental and international entities, and (d) spells out the procedures for the dismissal of the Auditor General.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No **Explanation**: As a public administration reform, this prior action is considered to be universally aligned. The establishment of the national audit standards and other audit regulations does not affect GHG emissions.
Conclusion for Prior Action 4: Universally Aligned	
Pillar B Objective: Enabling resilient private sector development	
Prior Action #5: To expand access to finance, the Recipient's Council of Ministers has submitted to Parliament the Financial Institutions Bill, which provides the framework for the regulation and supervision of financial institutions, including microfinance institutions.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Explanation**: As a non-sector specific reform of financial sector regulation, this prior action is considered to be universally aligned. The improved regulation and supervision of microfinance institutions does not affect GHG emissions.
Conclusion for Prior Action 5: Aligned	
Prior Action #6: To strengthen the insurance sector and support financial resilience of pastoralists against drought and climate-related risks, the Recipient's Council of Ministers has submitted to Parliament the Takaful Bill, which inter alia: (a) establishes a system of regulation and supervision of all Takaful affairs, and (b) supports a sound competitive environment among takaful operators.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Explanation**: As a non-sector specific reform of financial sector regulation, this prior action is considered universally aligned. The introduction of takaful insurance and its regulation and supervision does not affect GHG emissions.
Conclusion for Prior Action 6: Universally Aligned	
Prior Action #7: To improve fisheries governance and investment, the Recipient through its Ministry of Fisheries and Blue Economy has issued Regulations for the Fisheries Management and Development Council Rules and Procedures for coordinated federal-state management of Somalia's fisheries.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Explanation**: Improved FGS-FMS cooperation of fisheries is expected to protect the marine ecosystem and pose low risks of GHG emissions.
Conclusion for Prior Action 7: Aligned	

Prior action #8. To ensure that investments incorporate environmental and climate considerations, (a) the Recipient has enacted the National Environment Protection and Management Act, which mandates environment and social impact assessments (ESIAs) of projects and installations and establishes the core functions of the Ministry of Environment and Climate Change (MECC) for management of climate action and oversight of ESIAs, and (b) the Recipient's MECC has issued the supporting ESIA Regulation that designate the types of installations and projects that are subject to ESIAs and mandates the incorporation of climate risk management and identification of priority climate actions into ESIAs.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Explanation:** As a public administration reform that creates institutions to reduce air, land, and water pollution, this prior action is universally aligned. The law strengthens the Ministry of Environment and Climate Change's (MECC) capacity to monitor climate change and finance climate actions.
Conclusion for Prior Action 8: Aligned	
Prior action #9. To increase private sector provision of electricity, including from renewable sources, the Recipient through the National Electricity Authority has issued the Tariff Methodology and Tariff Adjustment Formulae, which applies principles of full cost-recovery.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Explanation:** The tariff setting methodology directly supports reduction of GHG emissions by discouraging high-cost electricity generation from diesel. The regulation is likely to impose higher tariffs on power generated from diesel, which is more expensive due to the costs of importing fuel, maintenance, and environmental considerations. By setting higher tariffs for diesel-generated electricity, the regulation makes it less economically attractive for energy producers and consumers, thus discouraging the use of diesel power plants, which are more polluting and contributing significantly to greenhouse gas emissions.
Conclusion for Prior Action 9: Aligned	
Mitigation goals: Conclusion of the Paris Alignment Assessment for the Program: Aligned	
Adaptation and resilience goals: assessing and managing the risks	
Pillar A Objective: Ensuring sustainable public finances.	
Prior Action #1: To improve inland revenue mobilization, the Recipient's Minister of Finance has issued the Revenue Administration Regulation, which (a) clarifies procedures for tax payments, (b) provides for tax consultants, and (c) establishes electronic tax administration system.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** No. **Explanation**: Climate hazards are not expected to affect the establishment of procedures for tax administration. Improving domestic revenue mobilization provides more fiscal space to support Somalia's development and manage climate risks.
Conclusion for Prior Action 1: Aligned	
Prior Action #2: To enhance customs revenue mobilization, the Recipient's Minister of Finance has issued the General Customs Regulation, which (a) establishes a comprehensive framework for customs revenue collection, (b) defines the process for licensing of customs brokers, and (c) enhances the enforcement provisions of the Customs Act.	

<table>
<tr><td>Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action’s contribution to the Development Objectives?</td><td>Answer: No.
Explanation: Climate hazards are not expected to affect the issuance of Customs Regulations. Improving customs revenue mobilization provides more fiscal space to support Somalia’s development and manage climate risks.</td></tr>
<tr><td colspan="2">Conclusion for Prior Action 2: Aligned</td></tr>
<tr><td colspan="2">Prior Action #3: To improve management of the risks and cost of public debt, the Recipient through its Minister of Finance has issued a Decree that establishes the middle office within the Debt Management Unit, and provides the core functions of the front office, middle office, and back office.</td></tr>
<tr><td>Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action’s contribution to the Development Objectives?</td><td>Answer: No.
Explanation: Climate hazards are not expected to affect institutional improvements of debt management. Managing prudently debt costs and risks will provide more fiscal space to support Somalia’s development and manage climate risks.</td></tr>
<tr><td colspan="2">Conclusion for Prior Action 3: Aligned</td></tr>
<tr><td colspan="2">Prior Action #4: To strengthen independent oversight over expenditure, the Recipient’s Council of Ministers has issued the Public Audit Regulation which, inter alia: (a) establishes national auditing standards and procedures; (b) provides the code of conduct for the Office of the Auditor General (OAG), (c) provides for OAG relationship with other governmental and international entities, and (d) spells out the procedures for the dismissal of the Auditor General.</td></tr>
<tr><td>Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action’s contribution to the Development Objectives?</td><td>Answer: No.
Explanation: Climate hazards are not expected to affect measures to strengthen independent oversight over expenditure. Keeping expenditure in check will provide more fiscal space to support Somalia’s development and manage climate risks.</td></tr>
<tr><td colspan="2">Conclusion for Prior Action 4: Aligned</td></tr>
<tr><td colspan="2">Pillar B Objective: Enabling resilient private sector development</td></tr>
<tr><td colspan="2">Prior Action #5: To expand access to finance, the Recipient’s Council of Ministers has submitted to Parliament the Financial Institutions Bill, which provides the framework for the regulation and supervision of financial institutions, including microfinance institutions.</td></tr>
<tr><td>Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action’s contribution to the Development Objectives?</td><td>Answer: No.
Explanation: Climate hazards are unlikely to affect the expansion of access to finance.</td></tr>
<tr><td colspan="2">Conclusion for Prior Action 5: Aligned</td></tr>
<tr><td colspan="2">Prior Action #6: To strengthen the insurance sector and support financial resilience of pastoralists against drought and climate-related risks, the Recipient’s Council of Ministers has submitted to Parliament the Takaful Bill, which inter alia: (a) establishes a system of regulation and supervision of all Takaful affairs, and (b) supports a sound competitive environment among takaful operators.</td></tr>
<tr><td>Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action’s contribution to the Development Objectives?</td><td>Answer: No.
Explanation: Climate hazards are unlikely to affect the expansion of access to finance. It may even reduce the vulnerability of the PDO to climate change as it increases the resilience of pastoralists from drought.</td></tr>
<tr><td colspan="2">Conclusion for Prior Action 6: Aligned</td></tr>
</table>

Prior Action #7: To improve fisheries governance and investment, the Recipient through its Ministry of Fisheries and Blue Economy has issued Regulations for the Fisheries Management and Development Council Rules and Procedures for coordinated federal-state management of Somalia's fisheries.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** **Explanation**: Climate risks are not expected to have an adverse effect on the reform's contribution to the Development Objectives. It may even reduce the vulnerability of the PDO to climate change as improved FGS-FMS coordination will help protect healthy fish stock and diversify sources of income for the population.
Conclusion for Prior Action 7: Aligned	
Prior action #8. To ensure that investments incorporate environmental and climate considerations, (a) the Recipient has enacted the National Environment Protection and Management Act, which mandates environment and social impact assessments (ESIAs) of projects and installations and establishes the core functions of the Ministry of Environment and Climate Change (MECC) for management of climate action and oversight of ESIAs, and (b) the Recipient's MECC has issued the supporting ESIA Regulation that designate the types of installations and projects that are subject to ESIAs and mandates the incorporation of climate risk management and identification of priority climate actions into ESIAs.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** **Explanation**: Climate risks are not expected to have an adverse effect on the reform's contribution to the Development Objectives. It may even reduce the vulnerability of the PDO to climate change, as ESIAs require climate risk screening.
Conclusion for Prior Action 8: Aligned	
Prior action #9. To increase private sector provision of electricity, including from renewable sources, the Recipient through the National Electricity Authority has issued the Tariff Methodology and Tariff Adjustment Formulae, which applies principles of full cost-recovery.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** **Explanation**: Climate risks are not expected to have an adverse effect on the reform's contribution to the Development Objectives. It may even reduce the vulnerability of the PDO to climate change, albeit only slightly.
Conclusion for Prior Action 9: Aligned	
Adaptation and resilience: Conclusion of the Assessment for the Program: Aligned	