FEDERAL REPUBLIC OF SOMALIA
MINISTRY OF PLANNING, INVESTMENT AND ECONOMIC DEVELOPMENT

SOMALIA ECONOMIC OUTLOOK

REBUILDING SOMALIA'S ECONOMY: OVERCOMING CHALLENGES AND LEVERAGING OPPORTUNITIES FOR SUSTAINABLE GROWTH AND DEVELOPMENT

2ND

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MAY 2025

Foreword by the Minister

It is my pleasure to present the Second Edition of the Somali Economic Outlook Report, a comprehensive assessment of our country's economic status. This report offers an in-depth analysis of Somalia's economic progress over the past two decades, highlighting both opportunities and challenges that have shaped our development. It provides key insights into economic activity, labor dynamics, the investment climate, fiscal and monetary policies, food security, foreign trade, and external debt—culminating in strategic policy recommendations to guide our path toward sustainable and resilient growth.

The Somali economy has demonstrated remarkable resilience in the face of global shocks, including the COVID-19 pandemic and the growing impacts of climate change. Despite these challenges, our nation has sustained an average real GDP growth rate of 5.1% between 2004 and 2023. However, growth has not been evenly distributed, underscoring the urgent need for policies that promote inclusive and equitable economic development. The findings of this report reaffirm the government's commitment to strategic interventions that will enhance agricultural productivity, diversify economic activity, strengthen private sector participation, and build a robust human capital foundation.

A strong and inclusive labor market is central to Somalia's economic transformation. The government is fully committed to unlocking opportunities for all, particularly for women and youth. As this report highlights, increasing labor force participation is imperative, and we are taking decisive action to equip our workforce with the necessary skills and opportunities. Through strategic investments in vocational training, job creation initiatives, and aligning workforce capacity with market demand, we are fostering a more dynamic and inclusive labor market—one that empowers every Somali to contribute to and benefit from our nation's economic growth.

Investment remains the primary driver of economic expansion, and the government is dedicated to creating an enabling environment that attracts investors. While challenges persist, we view them as catalysts for transformative reforms. By advancing governance improvements, strengthening regulatory frameworks, and modernizing infrastructure, we are positioning Somalia as a competitive investment destination. Additionally, our fiscal and monetary policies are being realigned to strengthen financial institutions, stabilize our national currency, and expand financial inclusion. These efforts are critical to ensuring macroeconomic stability and unlocking new avenues for sustainable growth.

Food security remains a pressing concern due to climate shocks, declining agricultural productivity, and over-reliance on imports. The decline in the cereal self-sufficiency ratio from 66% in 2004 to 32% in 2023 signals the need for urgent action. The government is implementing targeted interventions to enhance agricultural resilience, boost productivity, and establish sustainable food systems that can withstand climate-related disruptions. In parallel, Somalia is taking decisive steps to strengthen its trade position by diversifying exports, streamlining trade processes, and deepening integration into international markets. A significant milestone in our economic journey was the successful completion of the Heavily Indebted Poor Countries (HIPC) program in December 2023, which has substantially reduced our external debt burden. Moving forward, we are committed to fiscal responsibility, institutional strengthening, and sound debt management to safeguard our economic future and drive long-term prosperity.

The insights and policy recommendations in this report serve as a crucial call to action for all stakeholders dedicated to Somalia's economic transformation. The Ministry of Planning, Investment, and Economic Development remains steadfast in advancing sound policies and fostering an environment conducive to sustainable development. I urge policymakers, investors, and development partners to leverage the findings of this report as we work together to build a more prosperous, resilient, and inclusive Somalia.

I extend my appreciation to all stakeholders, including government Ministries, Departments, and Agencies (MDAs), as well as our development partners, particularly the World Bank, for their collaboration and commitment in making this report possible. In addition, I commend the leadership of the Director General, Mr. Mohamed Shire, in steering this process and appreciate the Director of Economic Development, Mr. Abdinasir Omar Katib, along with his dedicated team, for their technical expertise and commitment in ensuring the successful completion and publication of this report.

Mohamud

H.E Hon. Mohamud A. Sheikh Farah (Beenebeene)
Minister of Planning, Investment, and Economic Development
Federal Republic of Somalia

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WASAARADDA QORSHEYNTA, MAALGASHIGA IYO HORUMARINTA DHAQAALAHA
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OFFICE OF THE MINISTER
MINISTRY OF PLANNING, INVESTMENT AND ECONOMIC DEVELOPMENT
FEDERAL REPUBLIC OF SOMALIA

PREFACE

I am pleased to present the Second Edition of the Somalia Economic Outlook Report, a crucial annual analysis of our nation's economic landscape. This initiative offers vital data on key economicindicators, labour, investment, fiscal and monetary policy,food security, trade, and debt, providing fact-based recommendations for sustainable development.

This year's report is of significant importance, as it aligns with our newly launched National Transformation Plan (NTP). The report's data-driven insights on economic resilience, investment and sectoral reformsdirectly support the NTP's goals, enabling informed policy decisionsfor inclusive growth and stability.

Despite challenges, Somalia's economy has shown resilience. However, achieving sustainable growth requires a sustained commitment to institutional strengthening, good governance, creating inducive environment that attracts foreign investments and adressing climate crisis. Addressing food security, employment, and financial access remains paramount for improving the livelihood of everyday citizen.

I commend Director Abdinasir Omar Katib for his exceptional leadership. I also acknowledge the co-authors, Prof. Dr. Mutasim Ahmed Abdelmawla and Mohamed Yusuf Abdikani, for their valuabletechnical expertise. Additionally, I thank the World Bank for its support throughout this work, and the other partners for their valuable contributions. Finally, I appreciate the support of Somali government institutions.

The Ministry remains committed to evidence-based economic analysis. I strongly encourage all stakeholders to leverage this report to drive Somalia's economic transformation and to realize the NTP's vision.

Mohamed Shire
Director General,
Ministry of Planning, Investment, and Economic Development
Federal Republic of Somalia

ACKNOWLEDGMENT

The Second Edition of the Somalia Economic Outlook Report represents a collective effort, and I am deeply grateful to all who contributed to its development.

Special thanks go to the co-authors, Prof. Dr. Mutasim Ahmed Abdelmawla of the University of Gezira, Sudan and Mohamed Yusuf Abdikani of the Ministry of Planning, Investment, and Economic Development, for their technical expertise and commitment to producing high- quality analysis,as well as to the rest of the department team,whose dedication and hard work were instrumental throughout the process.

I sincerely thank the World Bank for its valuable data contributions and unwavering support throughout this process. I also acknowledge the continued collaboration of Somali Ministries, Departments, and Agencies (MDAs).

I reaffirm the Ministry of Planning, Investment, and Economic Development's commitment to evidence-based economic analysis throughthe continued publication of the SomaliaEconomic Outlook Report. This second edition reflects our dedication to informing the national decision-making table, guiding policy choices, and supporting the objectivesof the National Transformation Plan (NTP).

Finally, I express my deep appreciation to H.E. Hon. Mohamoud Abdirahman Sheikh Farah (Beenebeene), the Minister of Planning, Investment, and Economic Development. His exceptional leadership and vision have significantly advanced our development agenda.

Abdinasir Omar Katib
Economic Development Director
Ministry of Planning, Investment, and Economic Development
Federal Republic of Somalia

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LIST OF ABBREVIATIONS

AfCFTA	African Continental Free Trade Area
AfDB	African Development Bank
AML	Anti-Money Laundering
ARIMA	Auto Regressive Integrated Moving Average
ARMA	Auto Regressive Moving Average
BLT	Build-Lease-Transfer
CBS	Central Bank of Somalia
COMESA	Common Market for Eastern and Southern Africa
COVID-19	Coronavirus disease 2019
EAC	East African Community
FDI	Foreign Direct Investment
FGS	Federal Government of Somalia
FIL	Foreign Investment Law
GDP	Gross Domestic Product
HIPCs	Heavily Indebted Poor Countries
ICT	Information and Communication Technology
IDA	International Development Assistance
IGAD	Intergovernmental Authority on Development
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
MoF	Ministry of Finance
MoLSA	Ministry of Labour and Social Affairs
MoPIED	Ministry of Planning, Investment and Economic Development
MT	Metric Ton
NBS	National Bureau of Statistics
NIPS	National Investment Promotion Strategy
ODA	Official Development Assistance
OIC	Organization of Islamic Cooperation
OLS	Ordinary Least Squares
OECD	Organization for Economic Co-operation and Development
PPP	Public-Private Partnerships
SDGs	Sustainable Development Goals
SOMINVEST	Somalia Investment Promotion Office
SOS	Somali Shilling
SRA	Somali Revenue Authority
UNCTAD	United Nations Conference on Trade and Development
UNEP	United Nations Environment Programme
UNDP	United Nations Development Programme
USDA	United States Department of Agriculture
US$	United States Dollar
WB	World Bank
WTO	World Trade Organization

SOMALIA AT A GLANCE

- GDP per Capita (USD),2023
  $ 695
- GDP Growth Rate (% annual)
  4.2% 2023
- Inflation Rate %, 2024
  5.57% in 2024
- Exchange Rate (Somali Shilling per USD), 2024
  1$=28118 shilling
- Foreign Direct Investment (FDI) (USD), 2023
  676.5 million
- Unemployment Rate (% of labor force), 2019
  21.4%
- Population Growth Rate (% annual), 2023
  3.1%
- Life Expectancy (years)
  59 years in 2023
- Literacy Rate (% of adults) 2022
  53.7%
- Poverty Rate (% living below poverty line)
  54.4% in 2022
- Access to Clean Water (% of population), 2022
  77.7%
- Human Development Index (HDI) Score 0.380, in 2022
- Remittances Received (USD), 2024
  $6.23 billion

Central Bank of Somalia (CBS) | *Somalia National Bureau Of Statistics* | *World Bank* | *UNDP*

EXECUTIVE SUMMARY

Somalia's economic landscape is characterized by a complex interplay of challenges and opportunities. Over seven chapters, this report provides a comprehensive analysis of the country's economic activity, labour force, investment profile, monetary and fiscal policies, food security, foreign trade, and external debt. The report delves into the intricacies of Somalia's economy, highlighting key trends and impacts, obstacles, and policy recommendations.

This report stands out for its use of a comprehensive time series dataset spanning 2004-2023 across most chapters, combined with a multi-method approach that utilizes both descriptive analytics and applied econometrics to derive insightful results.

Between 2004 and 2023, Somalia's economy faced significant challenges due to several global events. Key incidents include:

The Global Energy Crisis (2004-2008), which caused oil prices to soar and heavily impacted Somalia's oil-import-dependent economy.

• The Global Financial Crisis (2008), a worldwide economic downturn that reduced investments and worsened economic conditions in Somalia.

• The Yemen War (2015), which escalated regional tensions and adversely affected Somalia's trade and investment.

• The COVID-19 Pandemic (2019-2022), characterized by prolonged lockdowns and remote work, leading to reduced economic activity, increased poverty, and higher unemployment rates globally.

• The Russian-Ukrainian War (2022), which triggered a global economic shock, particularly in energy and food markets. The resulting surge in oil, gas, and wheat prices increased costs for economies worldwide, including Somalia.

The most important findings and key policy options for each chapter are outlined below, in accordance with the chapter order previously explained.

Somalia's economy is characterized by a dominant agricultural sector, a nascent industrial base, and a significant services sector driven by remittances and telecommunications. Despite challenges posed by climatic shocks, political instability, and infrastructure deficiencies, Somalia's real GDP grew at an average annual rate of 5.1% from 2004 to 2023. However, economic growth has been volatile, and the country's reliance on primary commodities and vulnerability to environmental risks hinder sustainable development. Somalia's economic growth has shown limited benefits for the poor, with only a 0.20% decrease in vulnerability for every 1% increase in economic growth. To promote economic growth, policy options should focus on enhancing agricultural productivity, diversifying the economy, promoting private sector development, investing in infrastructure, building human capital, leveraging technology and innovation, and strengthening governance and institutions.

Somalia's labour force has grown significantly over the past two decades, increasing from 5.5 million in 2004 to 8.9 million in 2023. However, labour force participation rates remain low, averaging 49% for men and 22% for women. Unemployment rates are alarmingly high, with around 20% of the labour force unemployed, disproportionately affecting women. To address these challenges, policies should focus on equipping individuals with relevant skills, supporting entrepreneurship, promoting female employment, and ensuring the use of national labour in foreign-funded projects. Additionally, developing a long-term labour force plan, fostering regional development balance, promoting agricultural industrialization, and enhancing data-driven decision-making are crucial for promoting labour force participation and reducing unemployment in Somalia.

Somalia offers significant investment opportunities in various sectors, including agriculture, manufacturing, tourism, information and communication technology, trade, education, and capacity building. Despite these opportunities, investment in Somalia faces several obstacles, such as instability, weak infrastructure, inadequate financing, bureaucracy, environmental challenges, currency devaluation, high operational costs, and high taxes. To promote investment, the government has implemented policies, including the National Investment Promotion Strategy (NIPS) and the Foreign Investment Law (FIL).

The results show that foreign direct investment (FDI) has been the primary driver of economic growth in Somalia over the past two decades. However, investments have not created significant job opportunities for the national workforce. To enhance the investment environment, policy recommendations include achieving stability and lasting peace, effective governance, creating a business-friendly environment, developing infrastructure, promoting equitable investment opportunities, fostering public-private partnerships, providing incentives for investment, increasing access to finance, and learning from international best practices.

Somalia's monetary and fiscal policies face significant challenges, including a heavily dollarized economy, limited domestic revenue mobilization, and a large budget deficit. The Central Bank of Somalia aims to promote price stability, regulate the banking system, and maintain financial stability. However, the effectiveness of monetary policy is hindered by the lack of a functioning national currency and the prevalence of counterfeit currency. Fiscal policy objectives focus on achieving economic growth and stabilization, but the government's reliance on external aid and the dominance of operational costs over development expenditure limit its impact. To enhance monetary and fiscal policies, Somalia should prioritize reintroducing the national currency, promoting financial inclusion, strengthening central bank capacity, and improving fiscal management.

Somalia faces significant food security challenges, with a declining self-sufficiency ratio for cereals, from 66% in 2004 to 11% in 2023. The country relies heavily on imports to meet local demand, with wheat and rice consumption increasing over time. Climate change has exacerbated food insecurity, with droughts causing a 23.4% decrease in food production and a 33% decrease in cultivated areas. Total cereal production declined at an average rate of 2.7% during the last two decades. Per capita food production has been declining over time, while per capita food consumption has increased. The livestock sector is central to Somalia's economy, driving exports, domestic consumption, and employment. However, droughts have caused a significant decline in the livestock production index. To improve food security, Somalia should implement policies such as designing a national agricultural development plan, developing climate resilience strategies, upgrading rural agricultural capacities, adopting fair agricultural pricing policies, safeguarding farmers' rights, and enhancing emergency response mechanisms.

Somalia's foreign trade is characterized by a significant trade deficit, driven by a reliance on imports and a lack of diversified exports. The country's trade openness has increased over the years, but its impact on economic growth is limited due to the consumptive nature of imports. The Somali shilling has consistently depreciated against the US dollar, with a significant increase in the exchange rate over the years. To improve Somalia's trade, policymakers should focus on stabilizing the exchange rate, streamlining customs procedures, providing affordable financing options, strengthening global trade ties, harnessing technology, and adopting export promotion and import substitution strategies.

Somalia's external debt has been a significant challenge, accumulating since the 1970s and 1980s. The country's inability to repay loans led to a debt trap, causing economic challenges. Analysis of Somalia's external debt from 2004 to 2022 shows a steady increase with fluctuations. Key drivers of external debt include civil war, dependence on foreign aid, corruption, and heavy external borrowing. Somalia's debt-servicing problem is exacerbated by large external debts, political instability, and corruption. The debt-to-GDP ratio has fluctuated, with an average ratio of approximately 60%. A comprehensive economic analysis reveals a strong correlation between higher debt-to-GDP ratios and lower economic growth. Somalia achieved the Heavily Indebted Poor Countries (HIPC) completion point in December 2023, reducing its external debt from 64% of GDP in 2018 to less than 6% by the end of 2023. To mitigate future external debt accumulation, Somalia should implement fiscal discipline, improve domestic revenue mobilization, and strengthen institutions, among other strategies.

CHAPTER ONE

ECONOMIC ACTIVITY: FEATURES, GDP AND GROWTH PERFORMANCE

Chapter 1

ECONOMIC ACTIVITY: FEATURES, GDP AND GROWTH PERFORMANCE

1.1 Somalia's Economic Structure and Challenges

According to the World Bank's (2023) categorization, Somalia is a low-income country and the least developed state in the Horn of Africa.
Several activities contribute to Gross Domestic Product (GDP) of Somalia, including a mix of traditional and modern sectors, as summarized below:

Agriculture, forestry and fishing: Somalia's agricultural sector is diverse, comprising crop production, animal husbandry, and fishing. Farmers cultivate crops, vegetables, and fruits using traditional rain-fed methods and irrigation systems along rivers. Nomadic pastoralism plays a significant role, with a focus on livestock rearing. Additionally, Somalia's extensive coastline offers numerous fishing opportunities, with key sites including the Gulf of Aden, Indian Ocean, Puntland coast, southwest coast, and Somaliland coast.

Industry: Somalia's industrial sector remains underdeveloped, but it does have some emerging industries. The country has a presence of food industries, including food processing such as grain milling, and fish processing. Additionally, Somalia has small-scale manufacturing industries, primarily producing traditional textiles, garments through informal production, and leather goods through tanning and crafting. However, these industries face significant challenges due to their limited capacity and obsolete technology. As part of the industrial sector, construction and real estate also contribute to Somalia’s GDP. With urbanization on the rise, there has been an increase in construction activities across major cities like Mogadishu.

Services Sector and Diaspora Support: Private investments from the Somali diaspora are the main catalyst for growth in Somalia's services sector, with a strong emphasis on telecommunications, financial services, trade, and commerce. Additionally, remittances from Somalis living abroad constitute a significant source of income for many households in Somalia, supporting their consumption and investment. Overall, the diaspora's contribution to Somalia's national economy is substantial and vital.

According to the African Development Bank/OECD/United Nations Development Programme (UNDP, 2017), Somalia’s economy remains fragile, relying mainly on agriculture and livestock, remittances, and telecommunications, with no discernible manufacturing or industrial sector. The modest industry that existed prior to the civil war has virtually vanished, with the machinery sold as scrap metal. Very little value is added to agricultural and livestock products before they are either exported or consumed. The reliance on primary commodities as a key source of export revenues is a structural bottleneck that reflects the country's limited economic base and vulnerability to market dynamics, price fluctuations, and environmental shocks.

The informal sector accounts for the majority of Somalia's economic activity. Most of the population lives below subsistence level and is involved in small-scale enterprises. The private sector has shown remarkable resilience in industries like telecommunications, financial services, construction, livestock, and fisheries. The Somali diaspora invests heavily in the country, accounting for 80% of start-up capital for small and medium firms. Returnees start businesses individually or in groups by pooling resources, and they sometimes manage their commercial interests from outside the country. Somalia committed to achieving the SDGs by endorsing them. However, achieving the SDGs will be difficult due to the country's political instability, security concerns, and lack of institutional, human, and financial resources, among other factors (African Development Bank, AfDB, 2018).

Challenges of Economic Activity in Somalia:
As extracted from the Central Bank of Somalia (CBS, 2024) and AfDB (2024), Somalia faces a multitude of challenges that significantly hinder its economic activity. These challenges stem from a combination of environmental, social, political, and economic factors that have persisted over the years. Below is a detailed examination of these challenges:

Climatic Shocks and Environmental Vulnerability
Somalia is highly susceptible to climatic shocks such as droughts and floods, which have devastating impacts on agriculture, livestock, and overall food security. The country has experienced severe droughts that have led to significant crop failures and loss of livestock, which are critical components of the Somali economy. For instance, the 2022 drought resulted in an estimated 54% of the population living below the national poverty line due to reduced agricultural output and increased food prices.

Political Instability and Security Concerns
The ongoing political instability and security issues pose substantial barriers to economic development. The presence of militant groups, internal conflicts, and weak governance structures contribute to an environment where businesses struggle to operate effectively. This instability discourages both domestic and foreign investment, as potential investors perceive high risks associated with operating in such an environment.

Low Labour Force Participation Rates
Labour force participation rates in Somalia are exceptionally low, particularly among women. This gender disparity limits the potential workforce available for economic activities and reduces overall productivity. Furthermore, many individuals who are employed work in low-productivity jobs that do not provide sufficient income to lift them above the poverty line.

Infrastructure Deficiencies
The lack of adequate infrastructure—such as roads, energy supply, ports, and communication systems—hinders trade and investment opportunities within Somalia. Poor infrastructure increases transportation costs and limits access to markets for both producers and consumers. Planned investments in energy and ports are crucial but require stable conditions for successful implementation.

Economic Volatility
Somalia's economy has shown low and volatile growth rates over recent years; for example, real GDP growth averaged only 2.1% per year from 2019 to 2023 with negative per capita growth during this period. Such volatility can be attributed to external factors like fluctuating global prices for commodities as well as internal factors such as insecurity affecting production capabilities.

High Poverty Rates
Poverty remains a pervasive issue in Somalia with significant portions of the population living below the poverty line (54.4% in 2022) due to repeated shocks that erode household assets and purchasing power (Somalia National Bureau of Statistics; NBS, 2023). The Integrated Household Budget Survey indicates that poverty rates are particularly high among nomadic populations but also prevalent in urban areas due to rapid urbanization without corresponding job creation.

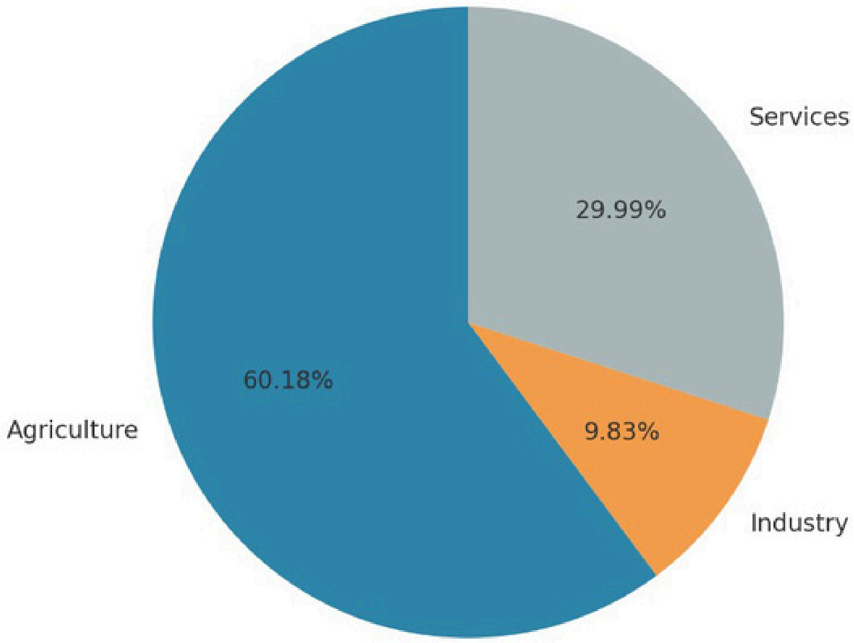
In summary, Somalia's economic activity is challenged by climatic shocks, political instability, low labour participation rates, dependence on humanitarian aid, infrastructure deficiencies, economic volatility, and high poverty rates—all contributing factors that require comprehensive strategies for improvement.

1.2 Somalia's Economic Performance: Trends and Insights

Somalia's GDP at current prices has increased gradually from (3.86) billion dollars in 2004 to (5.84) billion dollars in 2013, then to (11.68) billion dollars in 2023. The average GDP at current prices during the period (2004-2023) was estimated at about (6.57) billion dollars. The coefficient of variation for nominal GDP over the previous two decades amounted to 41%, indicating a degree of convergence and homogeneity in the development of national income over time. In 2020, the Corona pandemic lost the Somali economy about (216.3) million dollars of its GDP compared to 2019.

The agricultural sector is the backbone of the Somali economy, contributing about three-fifths of the economy's gross value added on average during the period (2004-2023), while the industrial and service sectors contribute about one-tenth and three tenths, respectively. Livestock contributes about 60% of agricultural output, outperforming the crop sector, which contributes about 40%. The low contribution of the industrial sector highlights that there are significant challenges facing the sector. The following figure shows the sectors' contribution to GDP.

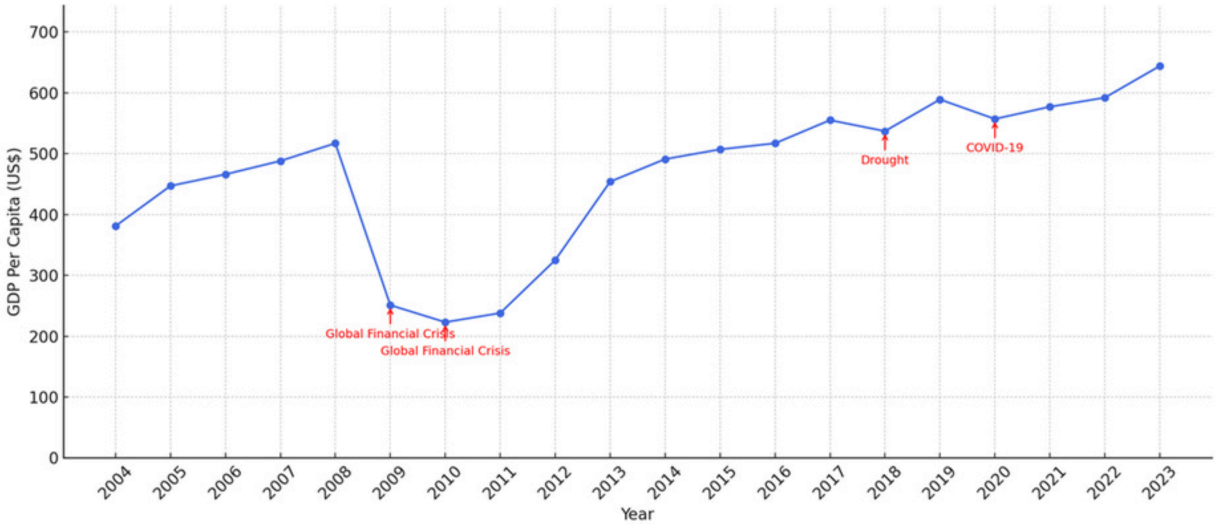
Figure (1.1) Sectoral Average Shares in Total Value Added (Current Prices), 2004 – 2023



Source: *Based on Data Collected from the Organization of Islamic Cooperation (OIC, 2024).*

One way to gauge a society's level of development is to look at its GDP per capita. In any nation, rising per capita income is a sign of prosperity. It is important to remember that GDP per capita, which is dependent on both GDP and population size, is a prerequisite for attaining economic growth. Somalia's nominal GDP per capita increased from 381 dollars in 2004 to 644 dollars in 2023, a total rise of 68.7% over the course of two decades. The mean GDP per capita (current US$) over the period (2004 – 2023) is estimated at (459 US$). There was a 27% disparity in the growth of nominal per capita income. Figure (1) illustrates the development of GDP per capita in Somalia over the past two decades. A number of factors might have contributed to the decline of GDP per capita in four years during the time span; international financial crisis (2009, 2010), drought (2018) and Covid 19 (2020).

Figure (1.2) GDP Per Capita in Somalia (Current US$), 2004 – 2023



Source: *Based on Data Collected from the World Bank (2024)*

1.3 Period Average Growth Rate of Real GDP and GDP Per Capita

An analysis of Somalia's economic growth over two decades (2004-2023) using the Ordinary Least Squares (OLS) technique, reveals significant trends. The OLS estimation of a trend equation for real GDP and real GDP per capita shows that the average annual growth rate of real GDP was 5.1% over the entire period, with 6.2% from 2004-2013 and 3.8% from 2014-2023. However, the last decade saw a 39% decline in economic growth due to climate-related challenges and the COVID-19 pandemic. Real GDP per capita grew at an average rate of 2.1% over the entire period, with 3.6% from 2004-2013 and 0.6% from 2014-2023, implying a population growth rate of 3% per annum over the past two decades. These findings provide valuable insights into Somalia's economic growth and development from 2004 to 2023.

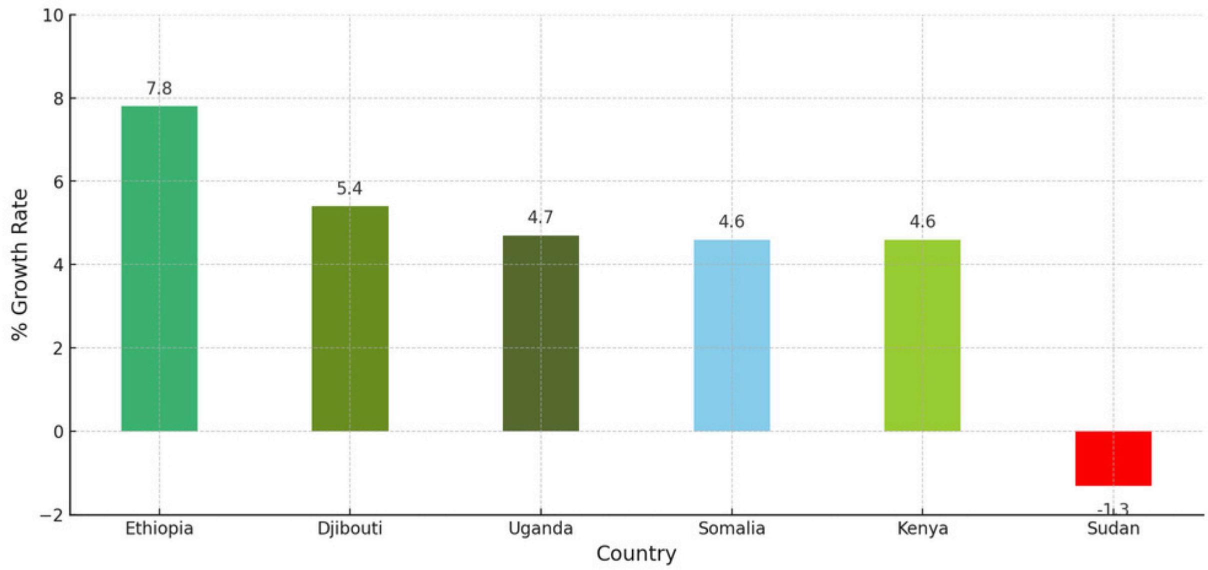
1.4 Regional Economic Growth Comparison: Somalia and Its Neighbors

A comparative analysis of economic growth performance among IGAD countries over the last decade, based on World Bank data, shows that Somalia's economic growth record is:

- Comparable to Kenya's average growth performance.
- Superior to Sudan's, which faced instability for nearly half of the decade.
- Lagging behind that of other IGAD nations.

This comparative analysis provides valuable insights into Somalia's economic growth performance relative to its regional peers.

Figure (1.3) Economic Growth in Some IGAD Courtiers, Average Period of 2014 - 2023



Source: *Based on Data from the World Bank.*

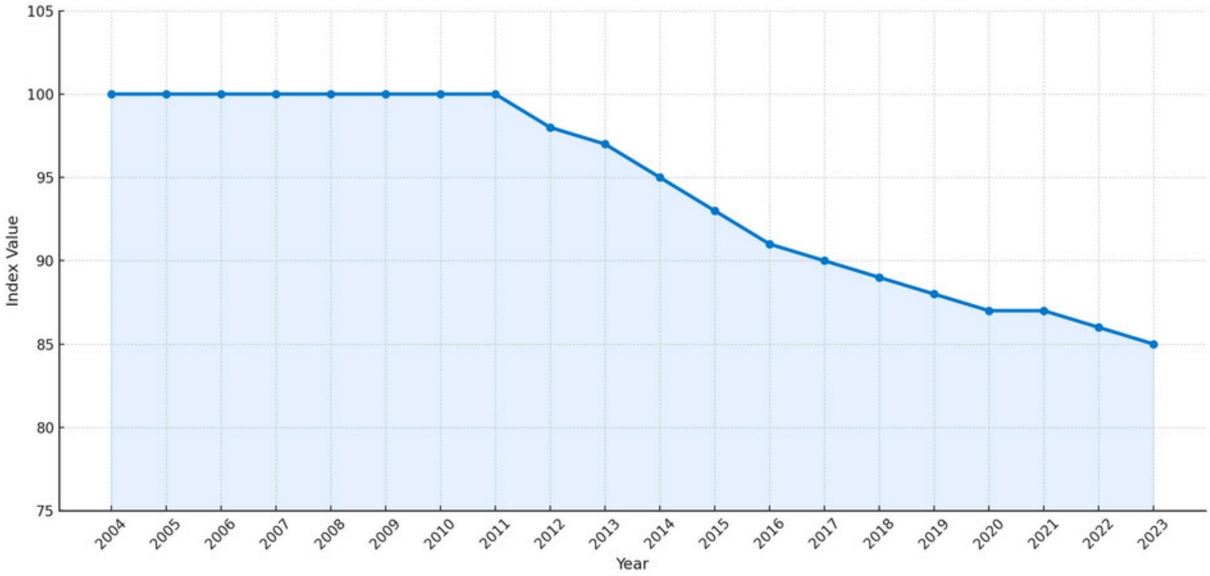
1.5 Impacts of Global Economic Trends and Environmental Risks on Economic Growth

For investigating the impacts of global economic trends and environmental risks on economic growth in Somalia during the period (2004 – 2023), world inflation, a dummy variable expressing climate change and a trend variable were used as regressors. The average economic growth rate in Somalia over the period, influenced by international events and environmental factors, reached 5.6% and was statistically significant at 1%. The results illustrated that both world inflation and environmental risks deter economic growth in Somalia. In particular, a 1% increase in world inflation reduces economic growth by 0.03%. The estimated sensitivity coefficient is significant at 10%. It is worth noting that world inflation is estimated at 3.72% on average over the past two decades, with 4.30% and 3.14% for the periods (2004 – 2013) and (2014 – 2023), respectively. On the other hand, shocks represented in climate change in the years 2013, 2020 – 2023, significantly lowered economic growth in Somalia by an estimated magnitude of coefficient reached (0.10). The P-Value of the t statistic is found to be (0.0002), expressing a very high significance level. These results assert that economic growth in Somalia is more responsive to climate change than global economic trends, a result which is natural since the economy depends largely on agricultural activity. Thus, building resilient capacities matter for sustaining economic growth in the country.

1.6 Extent to Which Economic Growth in Somalia is Pro Poor

Robust economic growth is the capital accumulation that benefits the poor people in the country (pro poor growth). To investigate this argument, this section tests the impact of economic growth in Somalia on vulnerability index using data collected for the Radboud University Global Surveys (2024). Data are available for the period (2004 – 2020). The analysis extends the data to 2023 by applying a trend equation. The OLS method serves as the regression approach. The findings reveal that economic growth in Somalia is insensitive in reducing vulnerability in the country. In particular, the increase in economic growth by 1% reduces vulnerability index by only 0.20%. The estimated elasticity is significant at 1%. It is worth noting that vulnerability index for Somalia has reduced from 100% in 2004 to 92% in 2013, then to 85% in 2023. This analysis signifies a simple correlation coefficient of (-0.977) between economic growth and vulnerability index.

Figure (1.4) Vulnerability Index for Somalia (2004 - 2023)

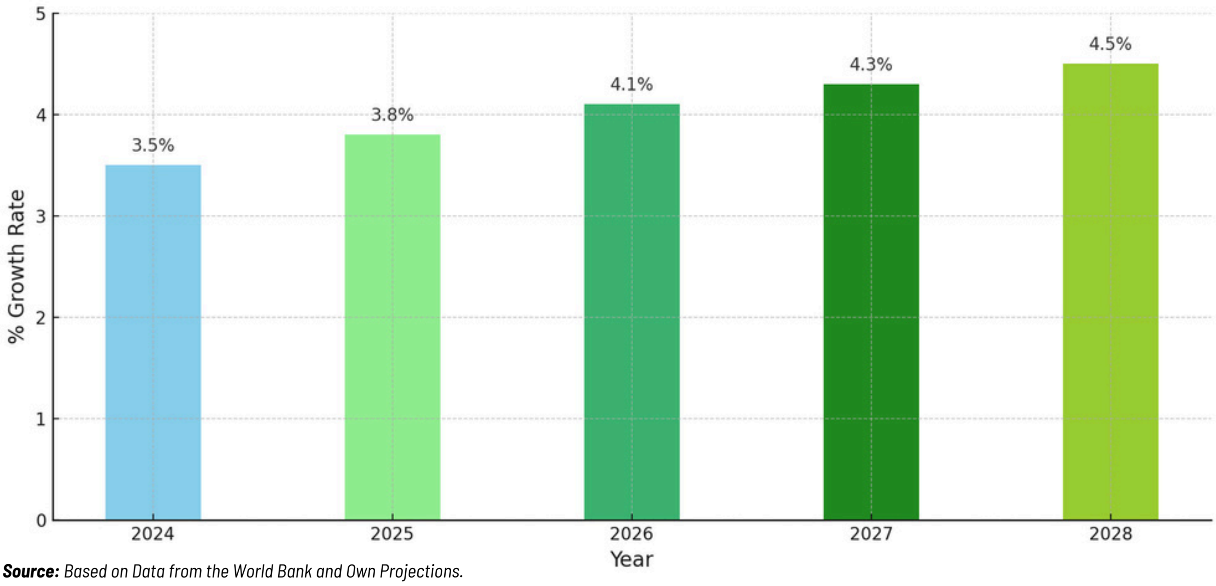


Source: *Based on Data from Radboud University Global Surveys (2024).*

1.7 Somalia's Economic Growth Forecast: 2024 -2028

Based on a simple ARIMA model and historical data on real GDP from 2004 to 2023, a forecast of Somalia's economic growth is presented, extending up to 2028, as illustrated in the following figure.

Figure (1.5) Projected Economic Growth Rate for Somalia (2024 – 2028)



Source: *Based on Data from the World Bank and Own Projections.*

1.8 Policy Options for Enhancing Economic Growth in Somalia:

To promote economic growth in Somalia, a multifaceted approach is required, focusing on various sectors and addressing underlying challenges. Here are several key policy options:

Enhancing Agricultural Productivity

Since agriculture remains a cornerstone of the Somali economy, policy options to increase productivity include:

- Implementing climate-smart practices.
- Training farmers in sustainable agricultural techniques and technologies.
- Improving irrigation systems via investing in irrigation infrastructure.
- Providing improved seeds.
- Facilitating agricultural financing conditions, and attracting support for farmers from international organizations.

Diversification of the Economy

To reduce dependence on a single sector and create a more resilient economy, Somalia should diversify its economy by expanding into new areas, such as industry, tourism, and renewable energy. This strategy will help reduce risks, create more job opportunities, increase economic stability, and enhance government revenue.

Promoting Private Sector Development

The private sector is quite important for job creation and economic diversification. Policies include:

- Supporting Micro, Small, and Medium Enterprises.
- Facilitating access to finance.
- Providing training and promoting market information systems.
- Encouraging investment in key sectors.

Investing in Infrastructure

Infrastructure development is vital for connecting people and markets, and facilitates trade both domestically and internationally. Key areas of focus should include:

- Improving roads, ports, and airports for enhancing logistics efficiency.
- Boosting energy supply particularly from renewable sources.
- Expanding access to electricity specially for productive activities (agriculture and industry).

Building Human Capital

Investing in social capital and skills development is fundamental for guaranteeing long-term economic growth. In this regard, the following recommendations are crucial:

- Ensuring quality education to create more skilled workforce.
- Providing vocational training programs to meet labour market demands.
- Facilitating technology transfer and access to technology.
- Encouraging technical and technological education.
- Establishing and supporting educational platforms.

Leveraging Technology and Innovation

Adoption of embracing digital technologies can drive efficiency across various sectors:

- Promoting digital finance via expanding mobile banking services in order to increase financial inclusion.
- Encouraging and sponsoring innovation by supporting tech startups.
- Providing digital extension services for farmers and manufacturers.

Strengthening Governance and Institutions

Institutions are the foundation of a stable and prosperous economy. To achieve this, Somalia should prioritize strengthening its governance and institutions, focusing on:

- Building capacities of public sector employees through qualification and training.
- Improving transparency and accountability for public finance management.
- Fighting corruption and all sorts of underground economy activities.
- Enhancing Legal Frameworks and setting clear regulations that protect property rights and facilitate business operations..

CHAPTER TWO

LABOUR FORCE AND UNEMPLOYMENT

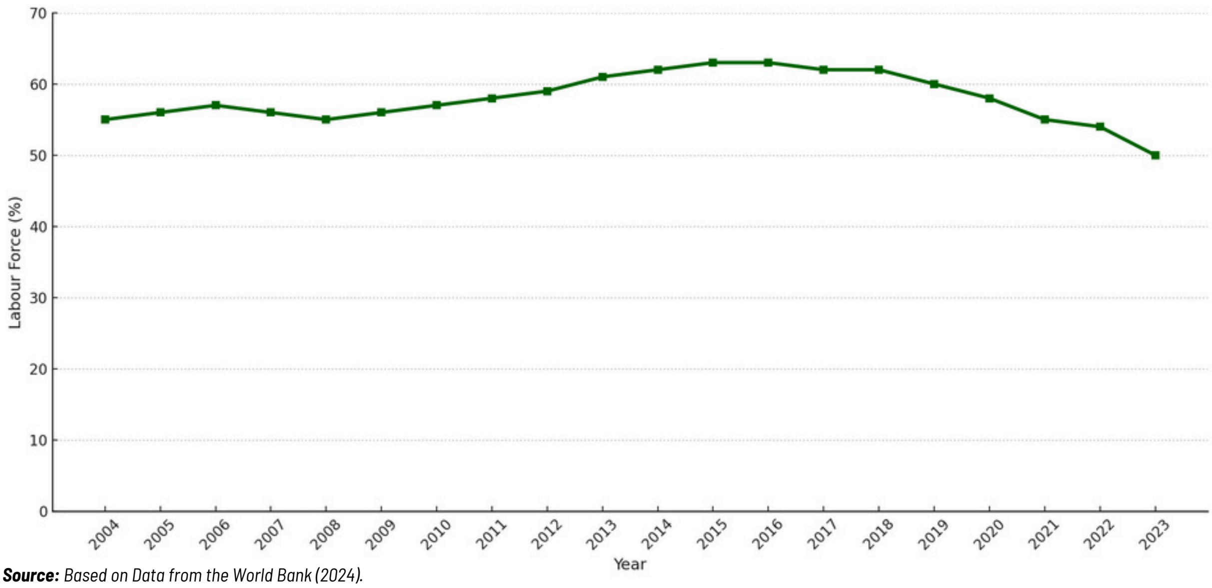
Chapter 2

LABOUR FORCE AND UNEMPLOYMENT

2.1 Somalia's Labour Force: Size, Participation, and Gender Dynamics

Somalia's labour force has experienced significant growth over the past twenty years, increasing from 5.5 million in 2004 to 7.9 million in 2013 and 8.9 million in 2023. Based on the average compound growth rate, which is calculated according to the estimate of the general trend function, the average labour force growth rate over the past two decades was 2.6% (with an average growth rate of 3.8% during the period 2004-2013, and an average growth rate of 1.4% during the period 2014-2023). The evolution of labour force in Somalia is relatively homogeneous, with a 17.7% coefficient of variation. On average, women make up approximately one-third of the labour force (31%), while men comprise slightly more than two-thirds. The labour force accounts for 57% of the population, indicating a high dependency ratio of 43%. This situation necessitates substantial efforts from government authorities, national and international organizations to address the needs of children and the elderly.

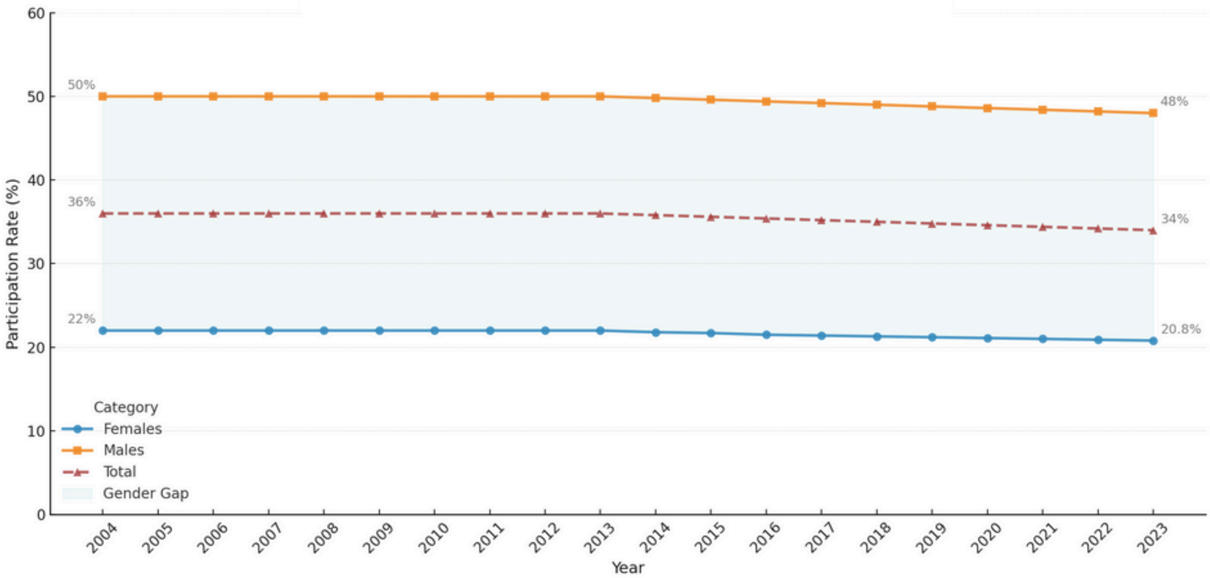
Figure (1.2) Labour Force in Somalia as % of Total Population, 2004 – 2023



Source: *Based on Data from the World Bank (2024).*

Labour force participation rate in Somalia remains low, averaging 49% for men and 22% for women between 2004 and 2023. At the national level, the overall participation rate stands at 35%. Notably, male participation has been declining at an annual rate of 0.30%, while female participation has been increasing at 0.08% per year. Consequently, the national participation rate has been decreasing by 0.17% annually. The following figure depicts the trend of labour force participation in Somalia over time.

Figure (2.2) Labour Force Participation Rate in Somalia, 2004 - 2023



Source: *Based on Data from the World Bank (WB, 2024).*

2.2 Government Initiatives for Job Creation in Somalia

The Somali government has finalized a National Employment Policy (2019) aimed at providing sustainable employment opportunities. This policy focuses on three priority areas: strengthening the private sector, job creation through promotion of micro, small, and medium enterprises, and enhancing labour market governance. By actively engaging the private sector, the government can create an environment conducive to job creation, which is essential given that over 60% of the population is below 25 years of age (Somalia Ministry of Labour and Social Affairs; MoLSA, 2019).

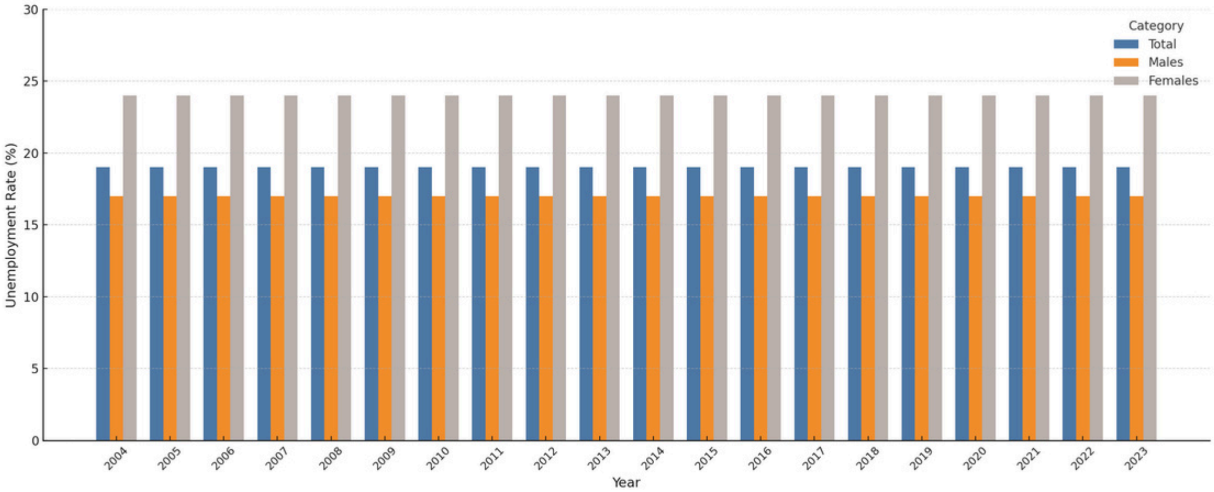
Somalia's Youth Engagement Initiatives were launched in 2019, with the National Youth Development Initiative being a key program aimed at promoting job creation and economic recovery among young people. This initiative recognizes the critical role youth play in nation-building and seeks to foster a sense of ownership among younger generations.

The initiative aligns with the Somali national strategy for preventing and countering violent extremism, emphasizing community engagement and youth resilience. Additionally, the program focuses on empowering youth to participate in decision-making processes and promoting social cohesion. By engaging youth in nation-building activities, Somalia aims to harness the energy and creativity of its young population to drive economic growth and stability.

2.3 Analysis of Unemployment Rate (Total, Males, and Females):

At the national level, about a fifth of the labour force is unemployed. This alarmingly high rate, which is 4-5 times the natural unemployment rate, has a debilitating impact on the country's economic performance and social well-being. A breakdown by gender reveals that unemployment disproportionately affects women, with around 25% of the female labour force unable to find employment, compared to 17% of men. Notably, societal barriers in Somalia, including customs and traditions, restrict women's participation in the workforce.

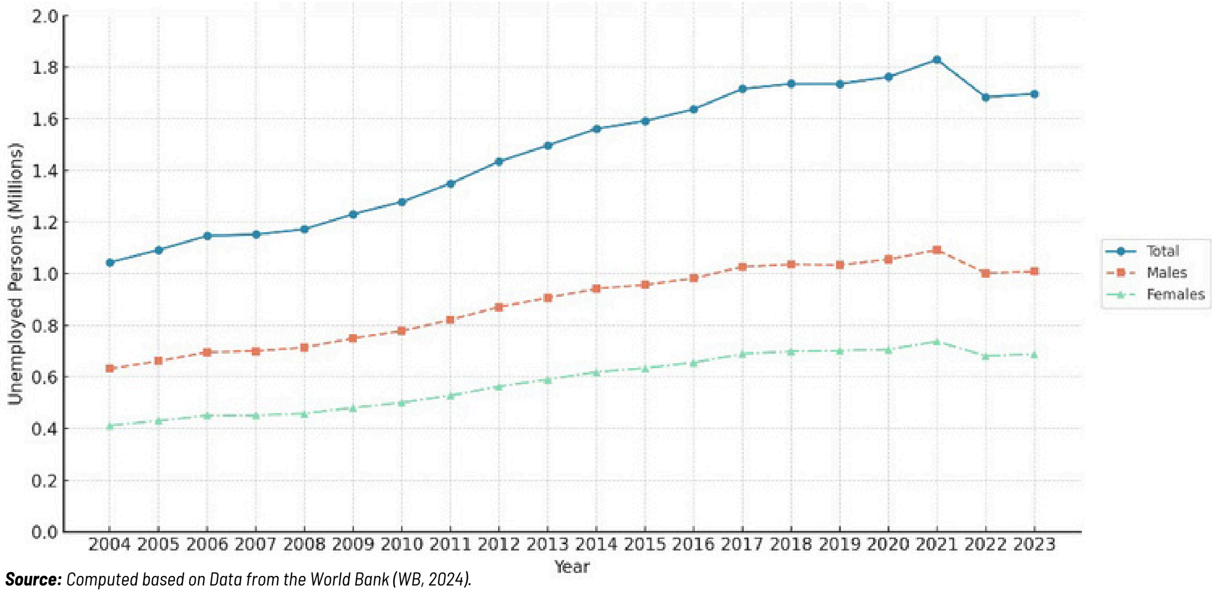
Figure (2.3) Unemployment Rate in Somalia, 2004 - 2023



Source: *Based on Data from the World Bank (WB, 2024).*

Remarkably, the number of unemployed individuals is increasing at a rate comparable to the population growth rate (3.1%). As a result, the unemployment rate has remained relatively stable over time. The unemployed population has grown steadily, from approximately 1.04 million in 2003 to 1.5 million in 2013 and 1.7 million in 2023. The following figure provides a visual representation of the estimated number of unemployed individuals in Somalia over the past two decades.

Figure (2.4) Number of Unemployed Persons in Somalia, 2004 – 2023



Source: *Computed based on Data from the World Bank (WB, 2024).*

2.4 Impact of Unemployment on GDP Growth

To test Arthur Okun's hypothesis that unemployment influences negatively on economic growth, simple regression analysis is adopted, utilizing data for twenty years (2004 – 2023). The results reveal that unemployment in Somalia has a significant detrimental effect on economic growth. Specifically, a 1% increase in unemployment leads to an 11% decrease in economic growth. Unemployment alone accounts for 31% of the variations in economic growth, with an estimated elasticity that is statistically significant at 1%. Furthermore, the correlation between unemployment and economic growth is (-0.58), indicating a strong negative relationship. Conversely, economic growth has a limited impact on reducing unemployment, as a 1% increase in economic growth only decreases the unemployment rate by 0.03%. These findings, combined with the results from the previous chapter, suggest that economic growth in Somalia is not being effectively utilized for social protection or addressing vulnerability.

2.5 Unemployment in Somalia: Links to Social and Climate Change Factors

This section investigates the impact of adult illiteracy, drought-related shocks, and previous unemployment on current unemployment in Somalia between 2004 and 2023.

An ARMA model with maximum likelihood estimation was employed to analyze the relationships.

The results reveal:

- A statistically significant positive correlation between adult illiteracy and unemployment, with a 1% increase in illiteracy associated with a 0.46% rise in unemployment. Notably, Somalia's average adult literacy rate over the past two decades is approximately 40%.
- Shocks, such as droughts, significantly exacerbate unemployment.
- Previous unemployment has a statistically significant positive relationship with current unemployment.
- The model's independent variables explain around 73% of the variation in unemployment.
- The estimated model is statistically robust (free of regression problems).

In conclusion, the ARMA model demonstrates that adult illiteracy, climate-related shocks, and lagged unemployment all have significant relationships with current unemployment. These findings can inform policymakers and stakeholders in developing targeted strategies to address adult illiteracy and mitigate the impact of shocks, ultimately reducing unemployment in Somalia.

2.6 Policies for Promoting Labour Force Participation and Reducing Unemployment in Somalia

To address the challenges of labour force participation and unemployment in Somalia, the following policies should be implemented to promote labour force participation, particularly among youth and women, while also reducing overall unemployment rates:

Equipping Individuals with Relevant Skills for Improving Employability:
This includes:

- Mentorship initiatives.
- Occupation-specific skills training.
- Apprenticeship opportunities that cater to the needs of both youth and women.

Supporting Entrepreneurship:
As self-employment accounts for more than two-thirds of Somalia's workforce, supporting entrepreneurship is critical for economic development via:

- Facilitating access to finance via grants or microfinancing options tailored for young entrepreneurs and women.
- Partnerships with local private sector.
- Building Networks and Community Hubs for sharing resources, knowledge, and opportunities among creative professionals in Somalia.
- Integration with regional and international institutions such as African Development Bank (AfDB), IGAD, World Bank, and the IMF.

Promoting Female Employment:
To address the disproportionately high unemployment rates among women, future employment policies should prioritize female job seekers. One potential strategy is to leverage the success of remote work arrangements and working-from-home models, applying them across various sectors to create more flexible and accessible job opportunities for women.

Ensuring the Use of National Labour in the Projects Financed by Foreign Investors:
To promote local economic development and maximize the benefits of foreign investment, it is essential to ensure that projects financed by foreign investors prioritize the use of national labour. This can be achieved through:

- Implementing localization policies that require foreign investors to hire a minimum percentage of local workers.
- Providing training and capacity-building programs for national labour to enhance their skills and competitiveness.

- Encouraging foreign investors to partner with local businesses and enterprises to promote knowledge transfer and technology diffusion.
- Establishing a database of national labour to facilitate matchmaking between local workers and foreign investors.
- Offering incentives, such as tax breaks or subsidies, to foreign investors who prioritize the use of national labour.
- Strengthening labour laws and regulations to protect the rights of national labour and prevent exploitation.

Fostering Regional Development Balance:
To drive equitable growth, job creation, and socioeconomic development, a balanced approach to regional development is crucial. Key strategies to achieve this include:

- Distributing productive and service activities across different regions of Somalia.
- Encouraging investments in rural areas and less developed regions.
- Creating economic opportunities and jobs in underserved areas.

Promotion of Agricultural Industrialization:
Since Somalia is an agrarian economy, agricultural value addition is highly important for job creation in the country.

Access to External Markets
Facilitating access to broader regional and international markets via commercial agreements can significantly enhance employment opportunities for Somali entrepreneurs, and will help local businesses thrive.

Enhancing Data-Driven Decision Making:
To inform evidence-based policy decisions and optimize human resource utilization, Somalia should:

- Conduct regular population censuses (e.g., every 10 years).
- Carry out periodic labour market surveys (e.g., every 3 or 5 years).
- Update and refine data collection methods to ensure accuracy and relevance.

Harnessing the Potential of Remittances:
To unlock the development potential of remittances, Somalia can:

- Channel diaspora remittances towards financing productive projects.
- Implement initiatives to encourage diaspora investment.

CHAPTER THREE

DOMESTIC AND FOREIGN INVESTMENT PROFILE

Photo Credit: REUTERS

Chapter 3

DOMESTIC AND FOREIGN INVESTMENT PROFILE

3.1 Background on Investment Acts

Investment is the change in stock of capital, and plays key roles to realize economic growth, creation of job opportunities and for achieving sustainable development objectives. Realizing these objectives requires integrated efforts from multiple parties, including the government, domestic private sector, donor agencies, regional and international financial institutions, academia, foreign investors, and many others.

According to the United Nations Conference on Trade and Development (UNCTAD, 2020), the Somalia Foreign Investment Law (2015) summarized the forms of foreign investment as follows:

Foreign investment: This can be made in any of the following:

- Convertible currency specified by the Central Bank of Somalia and duly transferred to Somalia.
- Machinery, equipment, spare parts, installations and current production inputs, whose importation is permitted under the prevailing import legislation.
- Intellectual property duly registered in Somalia, provided it is necessary for the activities to be pursued under the Approved Investment.
- The amount of foreign currency spent on studies and technical documentation, prepared in connection with the foreign Approved Investment.
- Profit reinvested, originating from foreign investment approved in accordance with this law.

Said investment: This shall be made for the purpose of the establishment or the expansion of an enterprise incorporated and registered in Somalia.

The investment map gives priority to foreign investment in those areas where it:

- Puts Somalia’s human and natural resources to productive use.
- Introduces innovative technology suited to the country's conditions.
- Generates new earnings or savings of foreign exchange through exports, resource-based import substitution or service activities.
- Contributes to responsible, sustainable development and regionally balanced socioeconomic development.

The following points highlight recent efforts put in place regarding investment in Somalia:

- In November 2022, the government of Somalia held the first ever International Investment Conference as an opportunity to showcase investment opportunities, sectoral studies and the general business investment climate in Somalia.
- Formation of the Somalia Investment Promotion Office under the Ministry of Planning, Investment and Economic Development as a statutory body to promote foreign investment, rebrand Somalia, facilitate investment entry and retain, and to continuously advocate for improvised investment policies.
- To ease doing business, the Ministry of Commerce and Industry has already implemented key aspects of the Economic Development Roadmap. This includes drafting and enacting legislation related to licensing and business trademarks, protecting intellectual property rights, company law and one-stop shop for businesses and company registration. Supported by the establishment of the Somalia Bureau of Standards, key products and services will begin to inherit both national and international standards. The execution of NIPS will require considerable efforts to be made in the improvement of the following key areas;

Somalia Government represented in the Ministry of Planning, Investment and Economic Development (MoPIED), launched the National Investment Promotion Strategy (NIPS) in 2017 to be executed over a period of five years. The NIPS is underpinned by a set of activities aimed at creating a favorable environment for accelerating both foreign and domestic investment. The basic principles upon which the national strategy has been established in relation to investment protocols and approaches of cooperation and coordination are as follows:

Non-Discrimination, Protection of Property, Investor Grievances, Simplification of Somalia National Investment Promotion Codes, Public Private Dialogue, National Treatment, Foreign Direct Investment, Diaspora Investment, Business Process Simplification through E-governance, Knowledge Economy to Promote Human Capital, Business Process Simplification and Implementation of Social and Environmental Standards.

The institutions responsible for implementation framework and organizational structure of the NIPS included the Investment Promotion Office, SOMINVEST with a hands-on approach supported by the MoPIED, and of the Foreign Investment Board. The Office of the Prime Minister provides the overall oversight of the NIPS.

Regarding the overall approach of the NIPS, the Government aimed to accelerate investment by improving the investment eco-system while pursuing investment promotion through building positive attributes, improving Somalia's image abroad and targeting specific priority investment sectors. Reform decisions have been established on the following:

Evidence-based Formulation – Somalia has been going through somewhat a resurgence in terms of data availability, allowing more optimal development pathways to be identified. This strategy built on existing evidence and allowed a sharper focus on removing the primary constraints to the expansion of private capital. Data on different sectors of the economy have been assessed to determine the most optimal investment strategy.

Commitment to Ongoing Reforms – The Government remained committed to a number of ongoing reforms, including: the IMF Staff Monitored Program (SMP), Public Finance Management (PFM), Public Administration Reform (PAR), revenue collection, treasury management, domestic arrears and cash management, reaching debt relief under the Heavily Indebted Poor Countries (HIPC), improving statistics, and enhancing the business environment in key productive sectors.

Clear Set of Investment Priorities – The NIPS focused on overcoming the most critical constraints to expansion in private investment. Through a wide consultations' process accommodating inputs from all stakeholders at Federal and State levels, a clear set of investment priorities have been identified.

Improving Investor Protection – The Federal Government of Somalia put in place a comprehensive investor protection framework that guarantees, among other things, national treatment in investment administrative processes, provide physical protection to investors' lives and property, governance safeguards and corporate transparency requirements that reduce the risk of abuse. The framework tried to ease the possibility of operating a business in Somalia, and to attract domestic and foreign trade opportunities.

Accelerating Revenue Collection – Instruments in this regard included among others, building citizen's trust in the government, strengthening security institutions, reinforcing human resource capacities by recruiting tax experts , and establishing an independent national revenue authority; the Somali Revenue Authority (SRA).

Improving Regional Cooperation – Recognizing the fact that regional economic cooperation is essential for market integration, for lowering transaction costs and for opening up markets to both imports and exports, the Federal Government of Somalia continued to participate in on-going Horn of Africa economic cooperation and other regional/global initiatives.

A Regulatory Guillotine Approach – Given the build-up of regulations spanning many decades, a regulatory guillotine approach is adopted to eliminate outdated laws and regulations, replacing them with modern, unified and simplified regulations that promote Enterprise Driven Economic Development.

Attracting Foreign Direct Investment – Foreign Direct Investment (FDI) is essential to bridge finance gaps in key sectors, and though FDI volumes have increased in recent years in Somalia, the Government targeted attracting more funds particularly that considered strategic investments.

Blended Finance – Because of diminishing international assistance, the Government aimed at establishing a national Public Private Partnerships (PPP) policy framework and regulations to support modalities including Build – Operate – Transfer (BOT) and its variants, Build – Lease – Transfer (BLT), Design – Build – Operate – Transfer (DBFOT) and Operate – Maintain – Transfer (OMT) options.

Investment Promotion Zones – To complement the process of regulatory reforms internally, the government, through SOMINVEST, intended to roll out extensive investment promotion roadshows and sectoral events in order to enhance targeted investment flow to Somalia. This included creating investment promotion zones based on investment relations with Somalia for traditional and new investment sources. The promotion aspect of the NIPS ensured the right investment is attracted to the country, including the diaspora investment.

The Federal Parliament approved the Foreign Investment Law (FIL) in 2015 to regulate all foreign investment in Somalia. The law promotes and protects foreign investments. It aims to offer favourable incentives to foreign investors, such as tax advantages, and guarantees against expropriations. It also guarantees that an investor can settle any dispute through international arbitration.

3.2 Highlight of Investment Opportunities and Impediments

3.2.1 Highlights of investment opportunities

Environmental diversity, arable land, abundant unexploited natural resources, and a long coastline characterize Somalia, providing vast investment opportunities in various sectors for both national and foreign investors. The most important of these opportunities can be summarized as follows:

Agricultural Production: This includes food production, export crops, livestock (camels, cattle, sheep, goats), and fisheries.

Manufacturing Industries: Agricultural products can serve as inputs for various industries, such as sugar production, textiles, food oils, tomato paste, fish canning, and more.

Tourism: The long coastline and the presence of a large number of foreign investors and Somali diaspora represent latent opportunities for further investment in the hotel and tourism sectors.

Information and Communication Technology (ICT): The electronic and mobile banking system adopted by Somalia offers opportunities for investment in areas such as financial applications, networks, information systems, computer and mobile device maintenance, technical education and training, cyber security, and more. Somalia leads Africa in mobile money, mainly transacted in US dollars, with billions exchanged annually.

Trade: The significant agricultural activity, combined with the presence of coastline and ports, presents excellent opportunities to activate both domestic and foreign trade.

Education and Capacity Building: A large proportion of the labour force lacks formal education, presenting an opportunity for investment in private education to cater to the children of Somali diaspora and foreigners residing in Somalia. This is in addition to investing in capacity building and vocational training.

3.2.2 Impediments to investment

Despite the promising investment opportunities in Somalia, there are several obstacles facing investors, including:

Instability and Armed Conflicts: Extremist groups perpetuate instability and armed conflicts.

Weak Infrastructure: Poor roads, bridges, and other infrastructure hinder development.

Inadequate Financing: Insufficient funding and unfavorable financing conditions are major impediments.

Bureaucracy and Complexity: these include among others, lengthy procedures besides lack of transparency and accountability.

Environmental Challenges: Drought, desertification, and other environmental issues negatively influence economic activity.

Currency Devaluation: The decline in the value of the national currency against foreign currencies leads to high inflation rates.

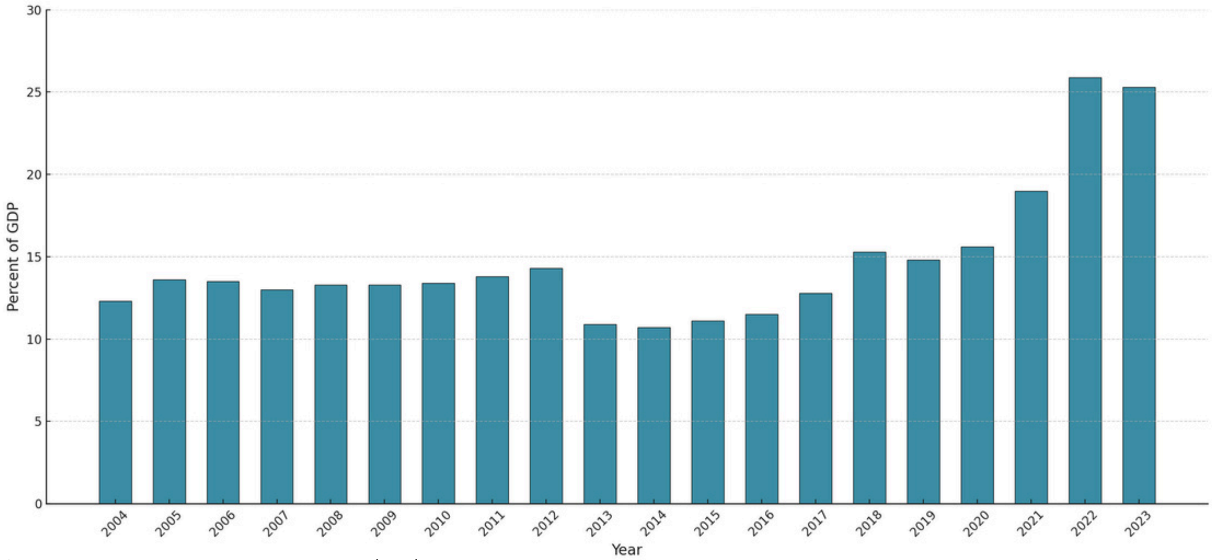
High Operational Costs: Elevated costs reduce returns on investment for entrepreneurs.

High Taxes: Taxes on profits, wages, and foreign trade are significant sources of government revenue, but they hinder investment.

3.3 Domestic Investment: Assessing Investment Rate

The local investment rate in Somalia more than doubled between 2004 and 2023, increasing from 12.3% to 25.3%. The average gross fixed capital formation as a percentage of GDP during the period (2004-2023) was 15%, with a coefficient of variation of 29%. Using a first-difference model based on regression analysis, the results indicated that the national investment promotion strategy adopted since 2017 played a crucial role in improving the local investment rate, which increased by approximately 36% compared to the pre-strategy period average. The difference is significant at a 5% significance level. The results also showed that about 67% of the positive change in the local investment rate was due to the adoption of this strategy. The following figure illustrates the development of gross fixed capital formation as a percentage of GDP over time.

Figure (3.1) Gross Fixed Capital Formation (% of GDP) in Somalia, 2004 - 2023

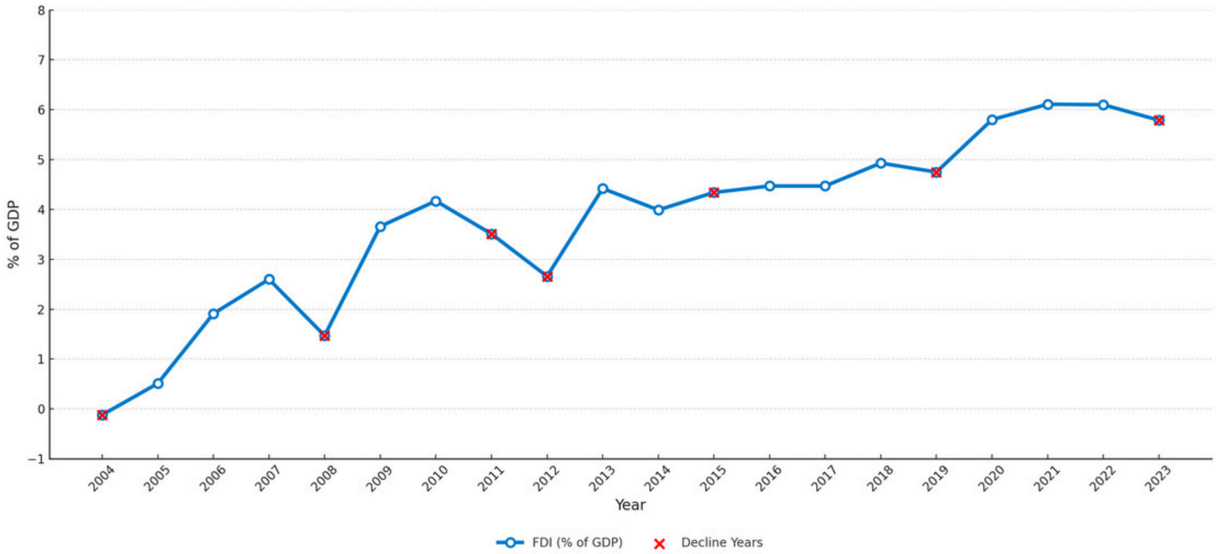


Source: *Based on Data from the OIC and World Bank (2024).*

3.4 Foreign Direct Investment (FDI): Analysis of Net Inflows

The average net inflow of foreign direct investment (FDI) as a percentage of GDP during the period (2004-2023) was 3.8%, with a coefficient of variation of 47%. The net FDI inflow transitioned from a negative rate in 2004 to a positive rate in 2005, with subsequent increases in net inflows before declining in 2008 due to the global financial crisis. FDI net inflows recovered in 2009 and 2010, then declined in 2011 and 2012 due to terrorist attacks on the World Trade Center. FDI net inflows increased significantly since 2015, driven by Somalia's Foreign Investment Law and its accompanying incentives, resulting in an average net FDI inflow rate of 5.2% of GDP during the period (2015-2023). These results show that global events and the investment environment in the country both shape FDI inflows. Notably, consecutive droughts over the last four years of the analysis did not influence FDI in Somalia, since most foreign investments focus on infrastructure. The estimated average compound annual growth rate of net FDI inflows as a percentage of GDP was 4% during the period (2004-2023). The following figure illustrates the developments in net FDI inflows in Somalia over two decades.

Figure (3.2) Foreign Direct Investment, Net Inflows (% of GDP), 2004 – 2023



Source: *Based on Data from the OIC and World Bank (2024).*

3.5 Roles of Domestic Investment and FDI in Inducing Economic Growth and Creating Job Opportunities

Through multiple regression analysis using data covering the period (2004-2023), it was found that local and foreign direct investment explain 78% of the variation in Somalia's economic growth rate. The economic growth rate responds more significantly to changes in FDI than to local investment. Specifically, a 1% increase in FDI as a percentage of GDP leads to a 0.83% increase in the economic growth rate, while a 1% increase in national investment as a percentage of GDP leads to a 0.32% increase in the economic growth rate. The degree of response of economic growth to changes in the rate of local investment is significant at 5%, while the degree of response of economic growth to changes in the rate of foreign investment is significant at 1% (99% confidence level). The simple correlation coefficient between the rate of local investment and economic growth was (0.58), while the simple correlation coefficient between the rate of foreign investment and economic growth was estimated at (0.90). These results confirm that foreign investment was the primary driver of economic growth in Somalia over the past two decades – particularly foreign investments in infrastructure, construction, port and airport development, and tourism sectors.

Regarding the impact of investments on employment and reducing overall unemployment rates, the results indicated that foreign investments did not play a significant role in employment. Specifically, a 1% increase in the foreign direct investment rate leads to a 0.03% decrease in the number of unemployed; however, the estimated coefficient is not statistically significant. On the other hand, national investments contributed significantly to reducing unemployment (the estimated coefficient was statistically significant with a p-value of 0.0162), but the response rate was also weak (a 1% increase in national investment as a percentage of GDP reduced unemployment by only 0.07%). This means that despite the increase in investments in Somalia over the past twenty years, these investments did not create significant job opportunities for the national workforce, but rather focused on utilizing previous local workforce experiences or brought in foreign labour.

To ensure maximum benefit from foreign investments, there should be a focus on re-investing, particularly in productive sectors, with the employment of large numbers of national workers. This would help reduce unemployment rates while promoting economic growth. On the other hand, policies should also work to remove all obstacles hindering national investments, enabling them to play a significant role in accelerating economic growth and creating job opportunities. Most importantly, the capital accumulations resulting from national and foreign investments should benefit the poor and vulnerable segments of society. Investors should allocate a significant proportion of capital profits to social responsibility.

3.6 Strategic Recommendations for Promoting Investment in Somalia

Promoting investment in Somalia requires the adoption of critical foundations, key enablers, and supporting factors.

Achieving Stability and Lasting Peace throughout the Country

- Building a strong and stable state.
- Enhancing security and stability.
- Resolving conflicts and promoting national reconciliation.
- Promoting economic and social development.
- Strengthening governance, transparency, and accountability.

Effective Governance: A Foundation for Progress

Good governance plays a crucial role in promoting investment by improving the investment environment, strengthening confidence in state institutions, and enhancing international cooperation.

Creating a Business-Friendly Environment

Establishing a favorable business climate is vital for attracting investors. This requires streamlining regulations, removing bureaucratic obstacles, strengthen legal frameworks and promoting transparency in government procedures. By setting clear guidelines for business operations and offering supportive services, the government of Somalia can bolster investor trust and confidence.

Developing Infrastructure through Intelligent Partnerships

Improved infrastructure reduces operational costs and increases efficiency, making the country more attractive to investors. Somalia can accelerate its infrastructure development by forming strategic partnerships with international organizations, foreign investors, and local stakeholders.

Promoting Equitable Investment Opportunities

Ensuring fair access to investment opportunities across the country can boost local investment, attract foreign investors, reduce market risks, drive inclusive development, and strengthen political stability by building trust in the government.

Fostering Public-Private Partnerships (PPPs)
Encouraging partnerships between the government and private sector can mobilize resources for large-scale projects. PPPs can help enhance private investment while sharing risks associated with infrastructure development and service delivery.

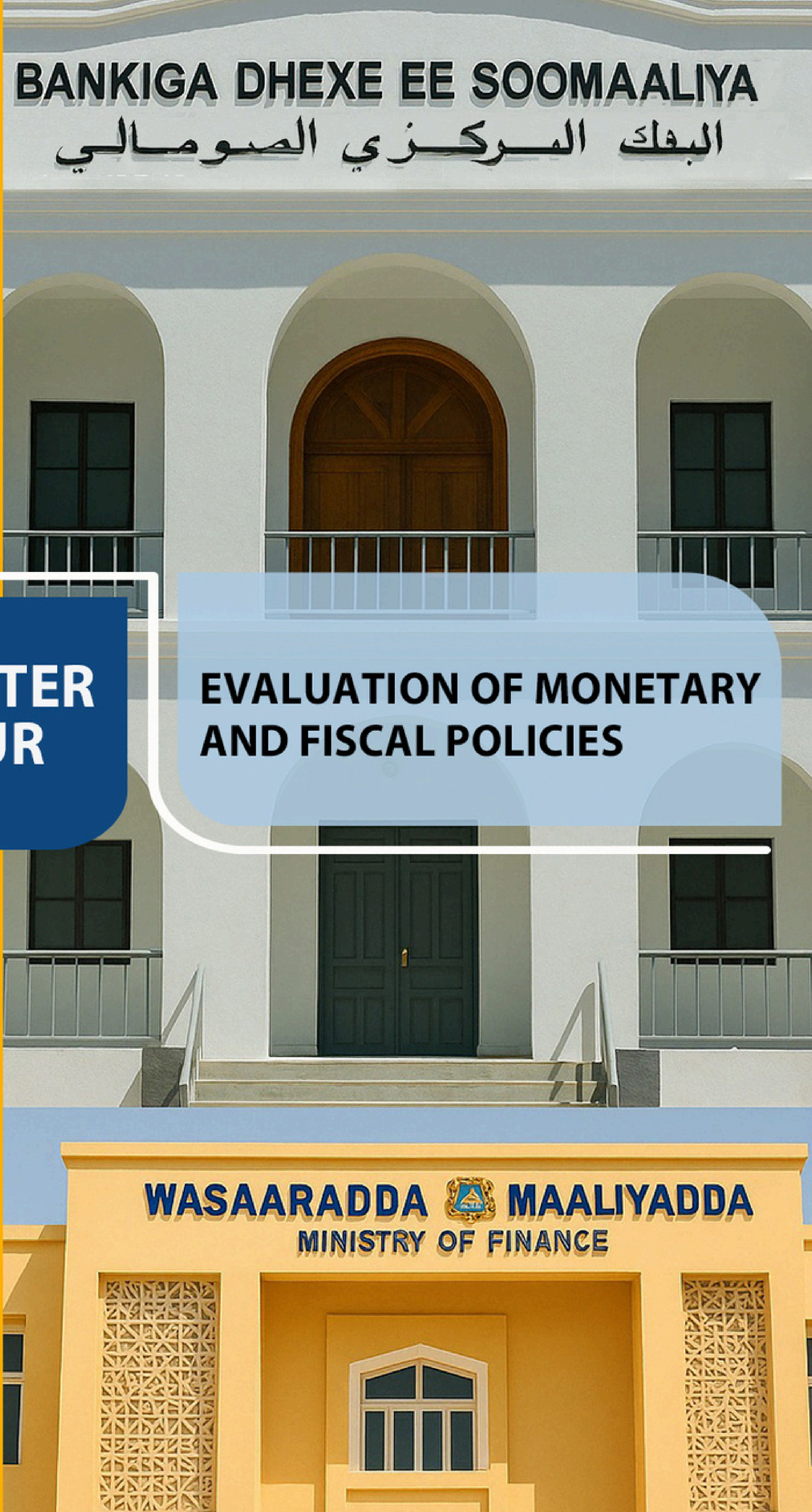
Providing Incentives for Investment
Offering tax incentives, grants, or subsidies can attract both domestic and foreign investors. The governments should design these incentives to encourage investment in priority sectors that align with national development goals.

Increasing Access to Finance
Improving access to finance through local banks or international financial institutions can facilitate investment by providing necessary capital for startups and expanding businesses.

Learning from International Best Practices
Somalia can greatly benefit from the successful experiences of countries like South Korea and Malaysia in mobilizing savings and financing investments.

CHAPTER FOUR

EVALUATION OF MONETARY AND FISCAL POLICIES



Chapter 4

EVALUATION OF MONETARY AND FISCAL POLICIES

4.1 Monetary and Fiscal Policy Framework in Somalia

Macroeconomic policies in any country include monetary and fiscal policies. The Central Bank of Somalia (CBS) is responsible for taking full charge of formulating and implementing monetary policy in the country. The CBS was established in 1960, but its processes stopped in 1991 because of civil war. The Bank was reestablished in 2009 to realize medium and long-term monetary policy objectives, which include:

- Price stability.
- Formulating and implementing monetary and exchange rate policies.
- Maintaining and enhancing the value of local currency.
- Regulating the banking and credit system.
- Maintaining financial stability.
- Managing the external reserves of the Republic.
- Harmonization and coordination with Government fiscal policy.

A number of challenges face proper implementation of the monetary policy in Somalia. These include lack of adequate resources both financial and material, weak confidence in the local currency and the resulting deep Dollarization even for local trade exchanges, and the large issuance of the Somali shilling by the private sector, which fuels the general price level leading to inflation and depreciation of the Somali shilling.

The African Development Bank Group (AfDB, 2024) argued that Somalia's economy remains heavily dollarized since the currency board last issued the Somalia shilling notes in 1991, before the outbreak of the civil war. The IMF estimates that 90 percent of the country uses the US dollars as a medium of exchange alongside the Somalia shilling. Very old and counterfeit Somali shilling notes are frequently used for small value transactions in urban areas and remain the primary medium of exchange in rural areas, especially in the nomadic communities. Due to rampant dollarization and currency counterfeiting, Somalia lacks an apparent monetary policy.

In anticipation of the implementation of a monetary policy and exchange rate system, the CBS is strengthening its regulatory and supervisory capabilities. The delayed implementation of the currency reform program commenced in 2021 is underway. Along with the monetary policy and exchange rate regime, the government plans to replace the US dollar and counterfeit Somali Shillings with the new Somali Shillings by 2026.

Fiscal policy objectives in Somalia are similar to those in other countries, focusing on achieving economic growth and stabilization. The primary goals include:

- Promoting sustainable economic growth by stimulating investment, consumption, and job creation.
- Preserving the purchasing power of citizens by keeping inflation rates low.
- Achieving full employment by creating an environment conducive to job creation and economic development.
- Managing the balance of payments to ensure a stable exchange rate and adequate foreign exchange reserves.

To achieve these objectives, the government of Somalia uses various fiscal policy tools, including government spending, taxation and Public-Private Partnerships with the private sector to finance and deliver public services and infrastructure projects.

According to Somalia Ministry of Finance (MoF, 2022), fiscal policy implementation in Somalia encounters significant challenges, including:

- Revenue Mobilization: Somalia's government needs to diversify its revenue streams and increase tax collection to reduce dependence on external aid.
- Fiscal Federalism: The country is transitioning to a federal system, which requires significant changes to its fiscal policy framework, including the allocation of resources between the federal government and regional states.
- Dollarization: Somalia's economy is highly dollarized, which limits the effectiveness of monetary policy and makes fiscal policy the primary tool for regulating the economy.
- Instability: The country's fragile security situation and instability pose significant challenges to fiscal policy implementation and economic development.
- Poor execution of donor-funded projects and lower absorption due to weak project management, hinder fiscal policy performance.
- Weakness of integrity and corruption risks: These are among the top of challenges in the country.

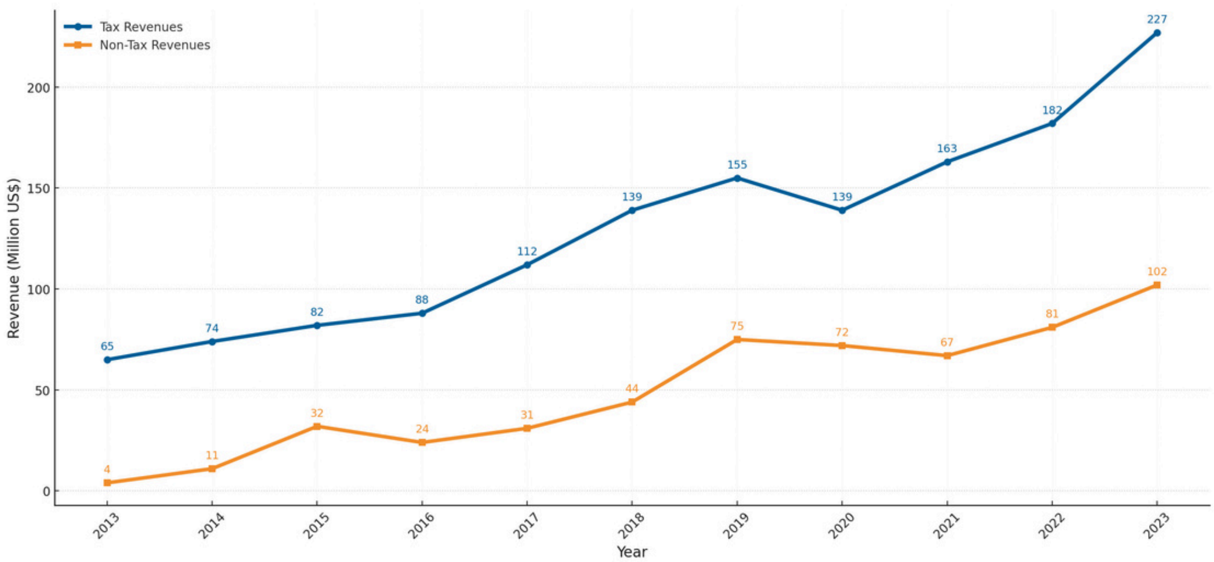
4.2 Assessing the Effectiveness of Monetary Policy in Somalia

It is worth noting that there is no updated data on the money supply in Somalia as a time series. Therefore, this report relied on a previous series of World Bank data, and by equating the trend over time, data was provided for the period covered by the analysis. There are a number of techniques (descriptive and economic modeling) for examining the effectiveness of monetary policy. One of the econometric methods is to investigate causality between economic growth and money supply, using Granger test. Monetary policy is said to be effective, only if there is one-way relationship running from money supply to economic growth. For the case of Somalia economy, causality between money supply to GDP ratio is tested against economic growth. The results showed that money supply to GDP ratio is statistically significant at 5% in inducing economic growth after differencing twice. It is worth noting that money supply in Somalia is growing at a period average of 4.7%, while current GDP grows at a period average of 6% over the period (2004 – 2024). This implies that money supply to GDP ratio is decreasing at an average of 1.3% over the mentioned period.

4.3 Public Finance: Evolution of Government Budget over Time

The state's total revenue gradually increased from $69 million in 2013 to $183 million in 2018, and then to $329 million in 2023, with a compound average growth rate of 15% during the period (2013-2023). Tax revenues during the mentioned period increased by about 3.5 times, while non-tax revenues increased by about 25.5 times. This significant increase is because non-tax revenues were very modest in the past, and the state has recently started to develop them. The following figure illustrates the development of tax and non-tax revenues over the past 11 years, for which data is available.

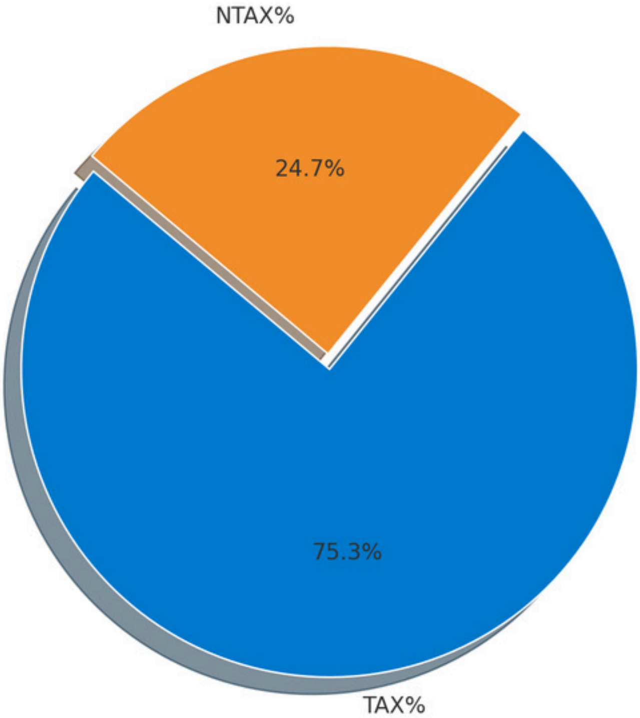
Figure (4.1) Tax and Non Tax Revenues in Somalia, 2013 - 2023 (Million US$)



Source: *Based on Data Collected from Somalia Ministry of Finance*

Somalia's total revenue is primarily based on taxes of various types. Despite the gradual increase in the contribution of non-tax revenues from 5.8% in 2013 to 31% in 2023, tax revenues accounted for approximately three-quarters of total revenue on average for the period (2013-2023), while other state revenue items contributed around a quarter. The following figure illustrates the average contribution of tax and non-tax revenues to total revenue.

Figure (4.2) Average Contribution of Taxes and Non-Tax Items to Total Revenues (2013 - 2023)



Source: *Based on Data Collected from Somalia Ministry of Finance (2024)*

Government spending in Somalia has increased significantly over the past decade, driven by increases in wages and salaries, as well as the impact of the COVID-19 pandemic. According to statistics, the average annual growth rate of government spending was 18.5% between 2013 and 2023, rising from $117.4 million in 2013 to $720.3 million in 2023. However, development spending accounted for a small proportion of total government spending, averaging 14.5% over the period, while current spending (operating costs) accounted for 85.5% on average. Government spending declined in 2016 due to a decline in total revenue caused by climate change, and in 2021 due to large expenditures on COVID-19-related consequences in the previous year. However, the prolonged drought from 2020 to 2023 did not lead to a decline in government spending, as the government worked to increase public revenues through expansion of non-tax sources. Finally, the decline in development spending, which exceeded the increase in current spending, led to a decline in total government spending in 2023, despite a 25% increase in total revenue compared to the previous year. The following table reviews the development of government spending in Somalia over a previous annual series.

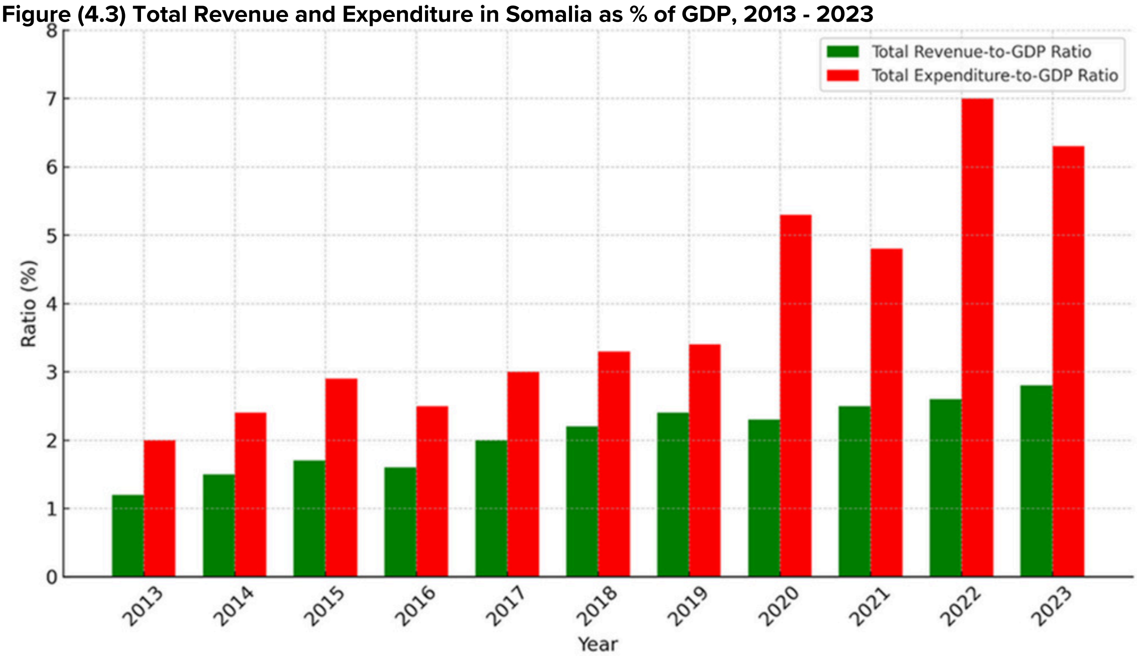
Table (4.1) Government Expenditure in Somalia (Million US$), 2013 – 2023

Years	Operational Costs	Development Expenditure	Total Expenditure
2013	117.4	0	117.4
2014	150.9	0.2	151.1
2015	184.5	14.5	199
2016	160	11	171
2017	228	17.6	245.6
2018	250	18.5	268.5
2019	298	17.7	315.7
2020	354	131.3	485.3
2021	355	118.9	473.9
2022	445	286.4	731.4
2023	468	252.3	720.3

Source: *Somalia Ministry of Finance (2024).*

The state budget has continued to record a continuous deficit over the past eleven years (see the following figure), leading to an increase in reliance on external aid. It is expected that the budget deficit will continue in the coming years, as long as the average growth rate of total revenue (15%) is less than the average growth rate of total public expenditure (18.5%). Total revenue as a percentage of GDP averaged 2% for the period (2013-2023), while the average government spending as a percentage of GDP was 3.8% during the same period. This situation calls for diversifying public revenue sources, while working to reduce current government spending in favor of real development.

Figure (4.3) Total Revenue and Expenditure in Somalia as % of GDP, 2013 - 2023



Source: *Based on Data Collected from Somalia Ministry of Finance (2024)*

The findings in this report tally with previous research. For example, Volz et al. (2020) argued that Somalia's domestic revenue is notably the lowest in Africa, particularly among East African economies, with a tax revenue-to-GDP ratio of less than 3 percent, contrasting sharply with Africa's average of 15 percent. Along the same lines, the MoF (2023) indicated that despite significant reforms implemented by the FGS since 2013 to enhance revenue, it remains insufficient to cover the government's recurrent expenditures. The operational costs of the FGS have escalated significantly, outpacing the growth in domestic revenues, largely due to a fivefold increase in salary payments over the past decade. This imbalance between high expenditures and inadequate domestic revenue has forced the FGS to heavily rely on external grants to finance its operations.

According to the MoF (2022), the fiscal profile of the FGS has remained fragile for many decades, and government revenue and expenditure as a percent of GDP have increased at modest rates since 2018, reflecting efforts by the government to improve its public financial management and public administration. However, the simultaneous impact of COVID-19, locust swarms, and erratic weather patterns contributed to a major decline.

4.4 Effectiveness Extent of Fiscal Policy: Response of Economic Growth to Changes in Government Expenditure

Government expenditure is a crucial fiscal policy tool that can stimulate economic growth, particularly in developing economies. However, for government expenditure to have a significant impact on economic growth, certain conditions need to be satisfied. These include:

- Allocating a sufficient share of government expenditure towards development projects, such as infrastructure development, education, and healthcare.
- Ensuring efficient use of resources to minimize waste and corruption.

  Maintaining a stable macroeconomic environment, including low inflation and a sustainable fiscal deficit.
- Encouraging private sector participation and investment to complement government expenditure.

In the case of Somalia, the relationship between government expenditure and economic growth is examined, with a focus on the responsiveness of economic growth to changes in government expenditure. Based on regression analysis, total government expenditure to GDP ratio is found to be significant at 1% in inducing economic growth in Somalia over the period 2013 – 2023. However, the responsiveness of economic growth to changes in government expenditure is inelastic. In particular, economic growth increases by only 0.27% for an increase in government expenditure by 1%. This suggests that government expenditure is not being utilized efficiently to drive economic growth. The main reason behind this inelastic response is that operational costs dominate governmentexpenditure in Somalia, rather than development expenditure.

The main reason behind this inelastic response is that operational costs dominate government expenditure in Somalia, rather than development expenditure. In other words, a large chunk of government spending goes towards maintaining existing operations, such as salaries and administrative costs, rather than investing in development projects that could drive economic growth. Overall, while government expenditure does have a significant impact on economic growth in Somalia, the inelastic response suggests that there is a need for more efficient allocation of resources towards development expenditure to drive economic growth.

4.5 Impacts of Money Supply and Public Debt on Inflation

This section of the report aims to highlight the problem of inflation in Somalia, which has a significant impact on overall economic performance, and leads to a reduction in purchasing power, especially for low-income individuals, resulting in increased rates of deprivation and poverty. The average inflation rate during the period (2013-2023) was around 8%. The inflation rate in Somalia is characterized by large fluctuations, with a coefficient of variation of 93%. Using econometric analysis, the impact of monetary and fiscal policy performance in Somalia on the inflation rate based on GDP deflator was examined. The results showed that changes in money supply and budget deficit are among the main causes of inflation in Somalia, explaining about 54% of the changes in the inflation rate. Both variables are significant at 1% level of significance in affecting local inflation. A 1% rise in the money supply leads to a 12% surge in inflation, whereas a 1% increase in the budget deficit results in a relatively modest 1.4% rise in inflation. This means that inflation responds more strongly to weaknesses in monetary policy performance compared to fiscal policy. It is worth noting that many economic analysts consider that monetary policy is not present in the true sense in Somalia, due to high dollarization rates. On the other hand, the spread of counterfeit currency in Somalia is a major problem affecting the Somali economy. Several other factors contribute to the high inflation rate in Somalia. One key factor is the country's limited domestic production capacity, particularly for essential food grains. This shortage leads to increased reliance on imports, which in turn fuels demand for foreign currency and exacerbates inflationary pressures. In addition, factors such as instability, corruption, and climate change - along with global inflation (imported inflation) - play a role in the high local inflation rates in Somalia.

4.6 Policies for Enhancing Monetary and Fiscal Policies in Somalia

Effective macroeconomic policies matter for achieving economic stability, promoting growth, and improving the living standards the citizens. To enhance monetary and fiscal policies effectively, it is essential to adopt a comprehensive approach that addresses both immediate needs and long-term sustainability.

- **Fiscal Policy Considerations**
  The economy of Somalia relies heavily on the US dollar due to past currency devaluations, making fiscal policy the main tool for economic regulation, with the Federal Ministry of Finance playing a key role. Promoting fiscal policy performance include strengthening fiscal management.

- **Capacity Building for the Ministry of Finance:** It is imperative to ensure that the MoF possesses adequate capacity and resources to manage fiscal policies effectively. This includes investing in human capital through training programs focused on macroeconomic analysis, public financial management, and data analytics.

- **Adopting Robust Macro-Fiscal Analysis:** Implementing a comprehensive macro-fiscal framework will enable policymakers to assess performance-oriented indicators such as tax-to-GDP ratios. This analysis can guide decision-making processes and improve transparency in fiscal management.

- Enhancing Revenue Mobilization: The government should tackle Somalia's low public revenues by strengthening tax systems, broadening the tax base, and improving compliance to increase revenues and reduce dependence on external grants.

Developing a Fiscal Risk Framework: Establishing a robust fiscal risk framework will enhance resilience against economic shocks by allowing policymakers to identify and mitigate potential risks, including revenue volatility, expenditure pressures, and external funding dependencies, and take proactive steps to ensure a more stable economic environment.

- **Building Credibility:** Policymakers can foster public trust by issuing regular technical reports throughout all phases of fiscal policy implementation. They should also ensure consistency among fiscal policies, macroeconomic frameworks, and development goals to maintain credibility with stakeholders and demonstrate a commitment to transparency and good governance.

Monetary Policy Implications

- **Reintroducing the National Currency:** A gradual reintroduction of the Somali shilling can help stabilize the economy by reducing dependence on foreign currencies. To ensure a successful implementation, this process should be carefully managed with support from international financial institutions, such as the IMF and World Bank.

- **Promoting Financial Inclusion:** Enhancing access to financial services for all segments of society will contribute to economic growth and stability. Initiatives aimed at promoting microfinance institutions and digital banking can facilitate greater participation in the formal economy.

- **Strengthening Central Bank Capacity:** The central bank should enhance its institutional capacity to implement effective monetary policies that complement fiscal measures. This includes developing frameworks for inflation targeting and interest rate management.

Boosting Financial Governance: Improving governance structures within financial institutions is critical for fostering an environment conducive to economic growth. Measures should be taken to enhance transparency in financial transactions and strengthen anti-money laundering (AML) frameworks.

- **Monitoring External Risks:** Ongoing evaluation of external risks, including commodity price volatility and regional security concerns, informs proactive adjustments to monetary policy, enabling timely and effective responses.

CHAPTER FIVE

FOOD SECURITY: SITUATION ANALYSIS AND RESPONSE TO CLIMATE CHANGE

Chapter 5

FOOD SECURITY: SITUATION ANALYSIS AND RESPONSE TO CLIMATE CHANGE

5.1 Contribution of Food Sub Sector to Agricultural Value Added

Agriculture plays a vital role in Somalia's economy, serving as its mainstay and contributing significantly to the country's economic output, employment opportunities, and export earnings. The sector is the primary source of livelihood for a vast majority of Somalis, supporting countless families and communities across the country. Somalia's agricultural landscape is characterized by a dominant presence of smallholder farmers, who own and manage approximately three-quarters of the country's agricultural land. In contrast, large-scale farmers account for around one-quarter of land ownership and management. The agricultural sector is a significant source of employment, with the majority of the workforce engaged in primary production. Geographically, agricultural production is concentrated in the southern region, where fertile land and abundant riverine water irrigation create favorable conditions for farming. Primary agricultural produce includes coarse grains, pulses, oil seed crops, and horticultural crops (i.e. fruits and vegetables). Somalia possesses significant productive resources, presenting a tremendous opportunity for rapid economic growth and transformation. Harnessing these resources could have a profound impact on the livelihoods of the Somali people, promising improved prosperity and a brighter economic future. These resources include 8.9 million hectares of arable land (with 25 percent of crop production grown through irrigation systems), more than 50 million livestock and about 1.8 million tons of fish annually for export. It has two main rivers, Juba and Shabelle Rivers with a total length of 2,300 km, and has the longest coastline in mainland Africa of 3,333 km. These natural features present myriad opportunities for growth across all sectors, and especially in the agriculture sector (African Union, 2022).

Somalia’s four main staple foods are maize, sorghum, rice, and wheat. While maize and sorghum are produced locally, rice and wheat are almost entirely imported. There are two main harvests in Somalia: the January to March *Deyr* and the July to September *Gu*. The lean season peaks in June before the start of the *Gu* harvest. At the national level, the *Deyr* harvest contributes, on average, approximately 60 percent of annual coarse grain (maize and sorghum) production, and the *Gu* harvest contributes the remaining 40 percent. On average, local sorghum and maize production (approximately 166,000 MT and 139,000 MT, respectively, cover domestic requirements, making Somalia self-sufficient for maize and sorghum.

Production is largely rainfed, with rainfall patterns driving the large inter-annual variations in production. The Southern region (including Lower Shabelle, Gedo, Lower Juba, Bay, Bakool, and Hiraan) is the surplus-producing area of Somalia. Production in the Northern and Central regions do not satisfy local needs, except for a small surplus-producing area around Hargeisa. Somalia's domestic production of rice and wheat is negligible, forcing the country to rely heavily on international markets to meet its local demand for these essential commodities. To bridge this gap, Somalia imports substantial quantities of rice and wheat flour every year. The country's annual import average stands at around 201,000 metric tons of rice and 208,000 metric tons of wheat flour. Notably, wheat flour imports have consistently risen since 2008, whereas rice import trends have fluctuated over the years. There are four major ports in Somalia: Berbera and Bossaso in the north, and Mogadishu and Kismayo in the south with varying capacity. A closer look at subnational patterns reveals distinct regional preferences for staple foods in Somalia. The Northern and Central regions exhibit a strong affinity for rice, which is the most consumed staple in these areas. In contrast, the Southern region is dominated by maize and sorghum consumption. Furthermore, wheat consumption is largely concentrated among urban, affluent households, highlighting socioeconomic disparities in food preferences (Famine Early Warning Systems Network, 2017).

The agricultural sector in Somalia has a significant role in various aspects and is the largest sector in terms of contribution to the country's GDP. It has a crucial role in income generation, job creation, ensuring food security and foreign exchange earnings. The sector is diverse, comprising primary products such as coarse grains, pulses, oilseed crops, and horticultural crops, including fruits and vegetables. The agricultural sector is further divided into three major subsectors: crops, livestock, and fishing. Among these, the livestock sector stands out as a critical driver of economic growth, providing employment, consumption, and export opportunities. Historically, livestock exports have been a key factor in Somalia's economic growth, underscoring the sector's vital role in the country's economic development. Crop production activities provide job opportunities.

and a source of income for people living in the agricultural regions of Somalia. The fishery sector is a lifeline source of income and food for coastal communities. Agricultural production is estimated to decline in 2022 mainly due to climate change cycle including floods and droughts. These factors have led to the failure of five consecutive rainfall seasons and the high cost of farm inputs (CBS, 2022).
The agriculture sector is still characterized by low productivity due to the use of antiquated methods, such as inappropriate crop spacing, furrow planting and crop rotation. In addition, low productivity is attributed to inadequate access to finance, overdependence on rain-fed agriculture despite recurring droughts, dilapidated irrigation infrastructure, poor or non-existent transport infrastructure, and disputed property rights. The general insecurity, especially in the southern parts of the country where crop production is the main economic activity, also remains a major challenge (AfDB, 2017).

5.2 Self Sufficiency of Main Food Crops (Individual Crops and Total): Features and Trends

This section reviews an analysis of Somalia's self-sufficiency levels for major staple cereals (maize, sorghum, wheat, and rice). Self-sufficiency is based on production levels compared to consumption. The analysis will start with an overview of the supply side, followed by the demand side, leading to a clarification of the level of self-sufficiency.

Somalia's cereal production faces several challenges, resulting in fluctuating crop production over the years. The average maize production was 103.6 thousand metric tons during the last twenty years, declining from 202 thousand metric tons in 2004 to 119 thousand metric tons in 2013 and then to 75 thousand metric tons in 2023. The lowest maize production was in 2019 (57 thousand metric tons), while the highest production level was in 2004 (202 thousand metric tons). The time trend coefficient for maize is negative and significant at 1% significance level, and the average compound growth rate was (-4.2%).

Sorghum production is more stable compared to maize, but production is also decreasing. Sorghum production declined to 100 thousand metric tons in 2023 from 145 thousand metric tons in 2004 and 113 thousand metric tons in 2013. The average decline rate is about 1% during the last two decades, but the estimated time trend coefficient is not statistically significant.

Rice production is almost constant at around 1 thousand metric tons per year, except for 2009, which reached a production level of 2 thousand metric tons. Wheat production is also constant at around 1 thousand metric tons per year. It is worth noting that wheat production data is not available for the entire time series, so various sources indicating that annual production is around 1 thousand metric tons were used. Other cereal data were obtained from the United States Department of Agriculture.

Total cereal production is declining at an average rate of 2.7% during the last two decades, where total production declined to 177 thousand metric tons in 2023 compared to 349 thousand metric tons and 234 thousand metric tons in 2004 and 2013, respectively. The average total cereal production in Somalia during the last twenty years was 221.3 thousand metric tons with a coefficient of variation of 25.4%. The following table illustrates Somalia's cereal production during the time series.

Table (5.1) Cereal Production in Somalia (000 Metric Ton; MT), 2004 - 2023

Years	Corn	Sorghum	Wheat	Rice	Total
2004	202	145	1	1	349
2005	200	140	1	1	342
2006	97	145	1	1	244
2007	99	80	1	1	181
2008	100	75	1	1	177
2009	107	84	1	1	194
2010	120	115	1	1	237
2011	114	142	1	1	258
2012	96	184	1	1	282
2013	119	113	1	1	234
2014	111	132	1	1	245
2015	107	130	1	1	239
2016	63	77	1	1	142
2017	77	95	1	1	174
2018	102	132	1	1	263
2019	57	125	1	1	184
2020	75	100	1	1	177
2021	75	100	1	1	177
2022	75	100	1	1	177
2023	75	100	1	1	177

Source: *United States Department of Agriculture (USDA, 2024)*

The self-sufficiency ratio of cereals in Somalia decreased significantly from 66% in 2004 to 36% in 2013 and then to 32% in 2023, with an average decline rate of 10% during the period (2004-2023). This downward trend indicates a substantial increase in the country's reliance on external sources to meet local demand and ensure food security. The growing reliance on imports to fill the gap in local cereal production undermines Somalia's food sovereignty and increases vulnerability to global market fluctuations. In addition, the country's inability to produce enough cereals to meet domestic demand poses significant risks to food security, particularly for vulnerable populations such as rural communities and internally displaced persons. Furthermore, the increased reliance on imports also puts a strain on Somalia's economy, as the country spends more of its foreign exchange reserves on cereal imports.

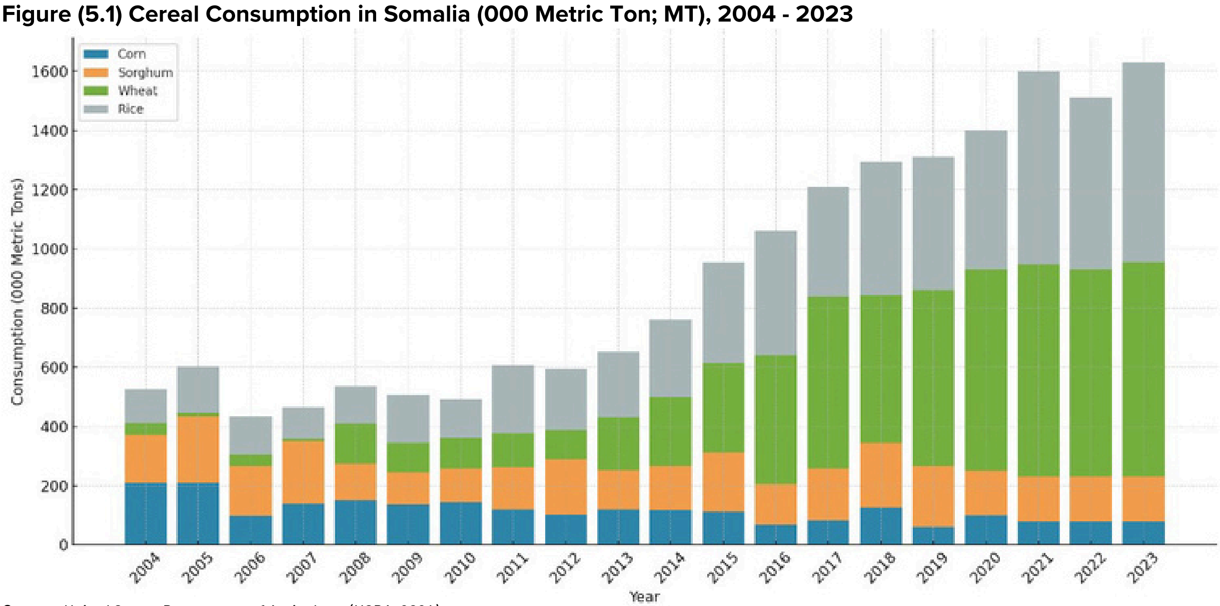
The average self-sufficiency ratio for maize and sorghum was 90.4% and 71.8%, respectively, while the self-sufficiency ratio for wheat and rice was estimated at 1.6% and0.5%, respectively, over the period 2004-2023. The following figure illustrates the development of self-sufficiency ratios for food crops in Somalia.

It is worth noting that the growth rate of sorghum consumption is the only one not statistically significant among the calculated growth rates for cereal consumption levels. The average consumption of wheat and rice during the last two decades was 315.1 thousand metric tons and 307.7 thousand metric tons, respectively, while the average consumption of maize and sorghum was 115.6 thousand metric tons and 163.9 thousand metric tons, respectively.

Notably, an examination of cereal consumption patterns reveals significant variations. Wheat consumption exhibits the highest volatility, with a coefficient of variation of 85.6%. In contrast, sorghum consumption demonstrates the most homogeneity, with a coefficient of variation of 20.6%. These findings suggest a shift in food consumption patterns in Somalia, potentially indicative of rising living standards and increasing urbanization. This transformation in consumption patterns presents opportunities for agricultural development and market growth. Understanding these shifts is crucial for policymakers and stakeholders seeking to enhance food security and promote sustainable agricultural practices in Somalia.

The figure below illustrates Somalia's cereal consumption over time.

Figure (5.1) Cereal Consumption in Somalia (000 Metric Ton; MT), 2004 - 2023



Source: *United States Department of Agriculture (USDA, 2024)*

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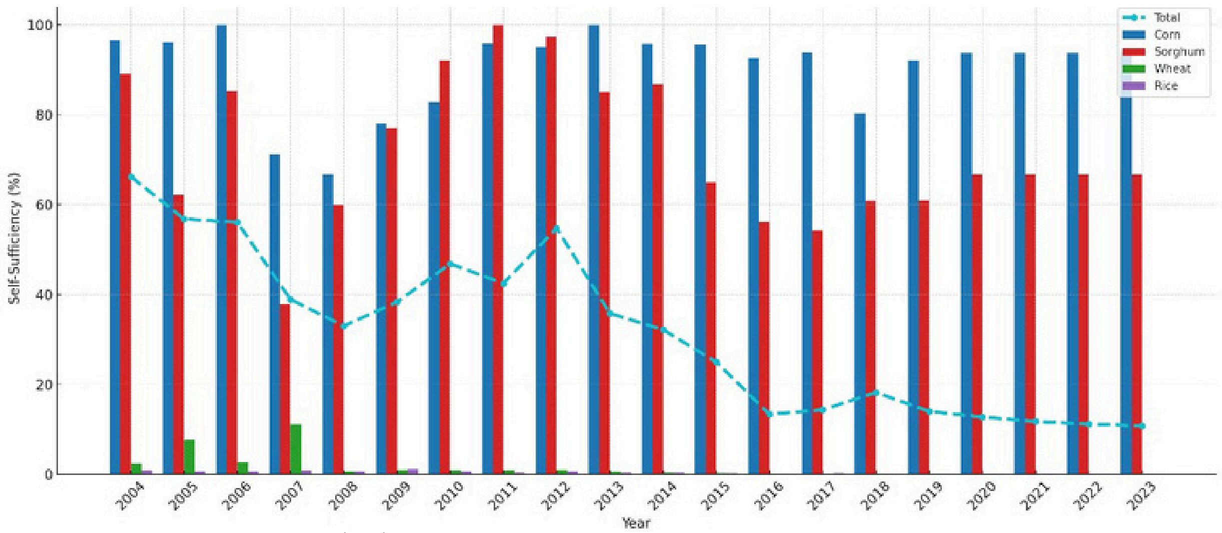
Figure (5.2) Self Sufficiency of Food Crops in Somalia, 2004 - 2023

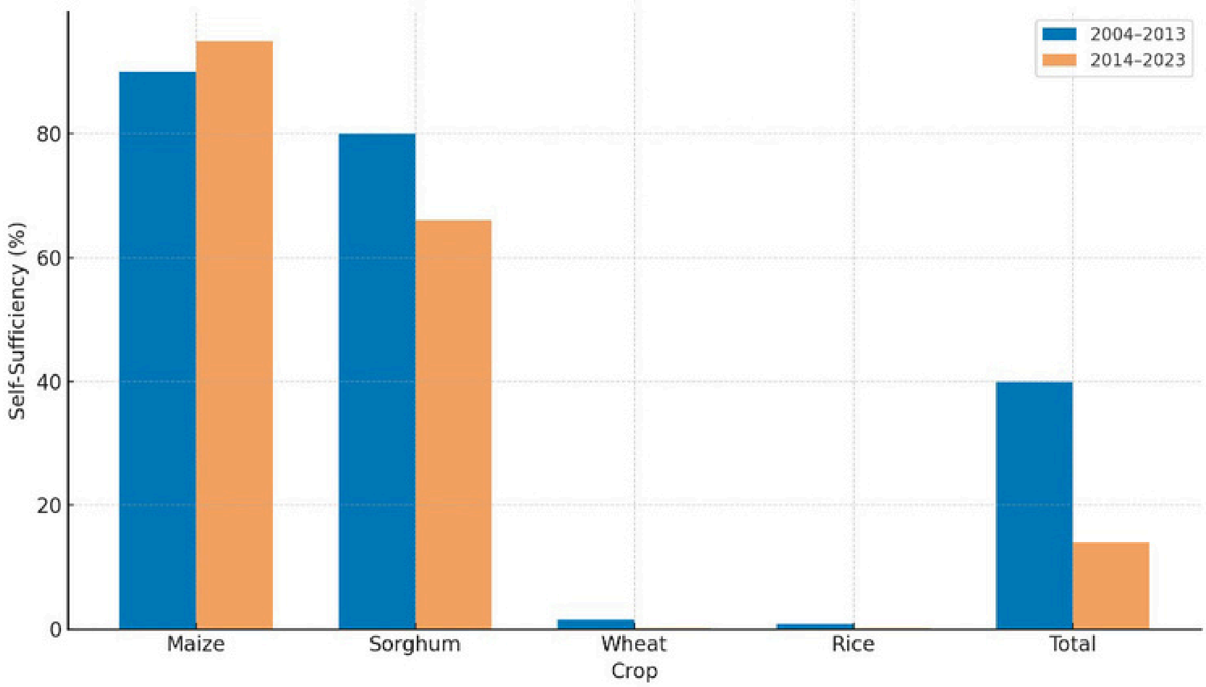


Source: *Based on Data Collected from the USDA (2024)*

Comparing the average self-sufficiency ratios for food crops during the first decade (2004-2013) with the average self-sufficiency ratios during the second decade (2014-2023) reveals the following:

- The self-sufficiency ratio for maize increased by about 5.7%, raising the average from 88% in the first decade to 93% in the second decade.
- Sorghum self-sufficiency decreased from an average of 79% to an average of 65%, with a decline rate of about 18%.
- Wheat self-sufficiency decreased from an average of 2.9% to only 0.2%, with a decline rate of about 93%.
- Rice self-sufficiency decreased from an average of 0.8% during the first decade to only 0.2% as an average for the second decade (decline rate of 75%).
- The decline in the average self-sufficiency ratio for sorghum, wheat, and rice at rates higher than the increase in the self-sufficiency ratio for maize resulted in a decline in the overall self-sufficiency ratio for food crops from 47% as an average for the first decade to only 16% as an average for the second decade (a decline of about two-thirds).

Figure (5.3) Food Self-Sufficiency Trends in Somalia: 2004-2013 vs. 2014-2023



Source: *Based on Data Collected from the USDA (2024)*

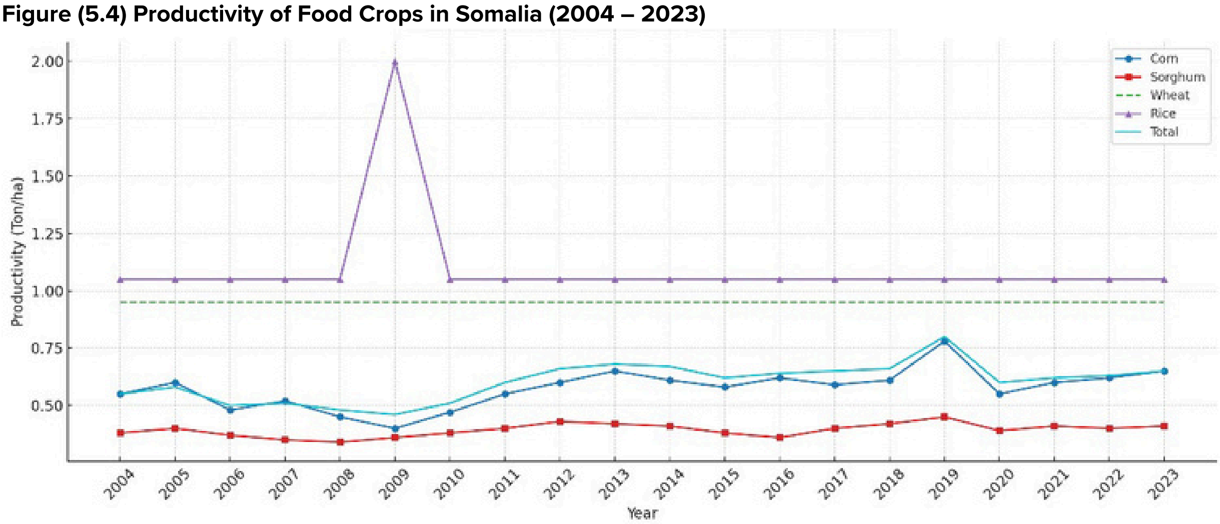
5.3 Productivity Analysis of Main Food Crops

This part of the report reviews the productivity of food crops in Somalia during the period (2004-2023). Maize productivity ranged from (0.415-1.097) metric tons per hectare, while sorghum productivity ranged from (0.220-0.564) metric tons per hectare. Wheat productivity is constant at 1 metric ton per hectare. During the last two decades, rice productivity per hectare remained constant at 1 metric ton, except for 2009, when productivity per hectare doubled to 2 metric tons.

The average productivity per hectare for key cereals in Somalia was as follows: maize (0.638 metric tons), sorghum (0.388 metric tons), rice (1.05 metric tons), and wheat (1 metric ton). Total cereal productivity averaged 0.474 metric tons per hectare, with a range of 0.312-0.717 metric tons per hectare. The coefficient of variation for productivity per hectare varied across crops, ranging from 21% for rice to 25% for maize, with a coefficient of variation of 19% for total cereal productivity.

Maize, sorghum, and total cereal productivity per hectare are increasing over time in Somalia, but this trend is not driven by the adoption of agricultural technologies or improved farming practices. Instead, productivity gains are solely due to a greater decrease in cultivated area compared to production, indicating that Somalia is experiencing horizontal contraction. The following figure illustrates the development of cereal productivity in Somalia.

Figure (5.4) Productivity of Food Crops in Somalia (2004 – 2023)



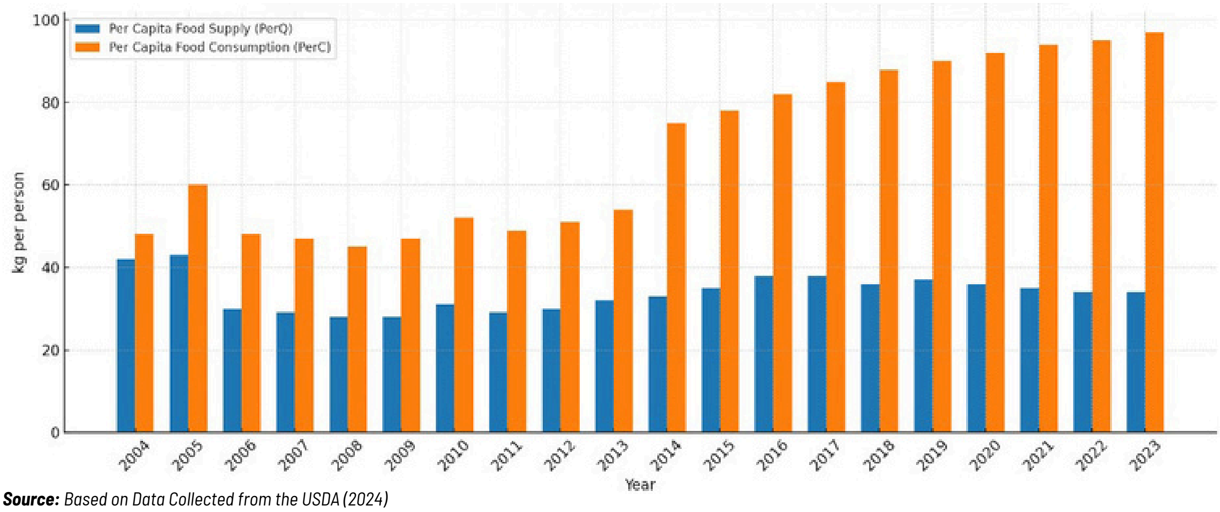
Source: *Based on Data Collected from the USDA (2024)*

5.4 Per Capita Food Supply and Consumption

Dividing total cereal production and consumption by the population yields the per capita share of these indicators. The average per capita cereal production stood at 17.2 kilograms during 2004-2023, ranging from 9.94 to 34.5 kilograms. In contrast, the average per capita cereal consumption reached 63.3 kilograms during the same period, with a range of 40.33 to 89.95 kilograms.

A comparison of the data reveals that per capita food production is more volatile, with a coefficient of variation of 41%, whereas per capita food consumption is more stable, with a coefficient of variation of 30%. Furthermore, the data shows that per capita food production has been declining over time, with an average annual growth rate of (-5.7%), as total food output is decreasing despite a growing population. In contrast, per capita food consumption has increased at an average rate of 4.4% annually, driven by rising total food consumption that outpaces population growth. Notably, the trend coefficients for both indicators are statistically significant at a 1% significance level.

Figure (5.5) Per Capita Food Supply (PerQ) and Consumption (PerC) in Somalia, kg (2004 – 2023)



Source: *Based on Data Collected from the USDA (2024)*

5.5 Analysis of Livestock Production Index

It is crucial to begin by highlighting the significance of the livestock subsector in Somalia, given its substantial contribution to the economy. The livestock sector is central to Somali economic and cultural life, accounting for 40% of the country's GDP and providing livelihoods for over 60% of the population. Notably, Saudi Arabia is the primary market for Somali livestock exports, particularly goats, sheep, and camels, with nearly 75% of these exports being destined for the kingdom, especially during the Hajj season. (Famine Early Warning Systems Network, 2017). The livestock sector plays a dominant role in Somalia's economy, driving exports, domestic consumption, and employment. Notably, it has been one of the few sectors to remain relatively unscathed by the civil war. Most livestock exports are shipped through the ports of Bossaso and Berbera, with smaller volumes handled at Kismayo and Mogadishu ports (CBS, 2022).

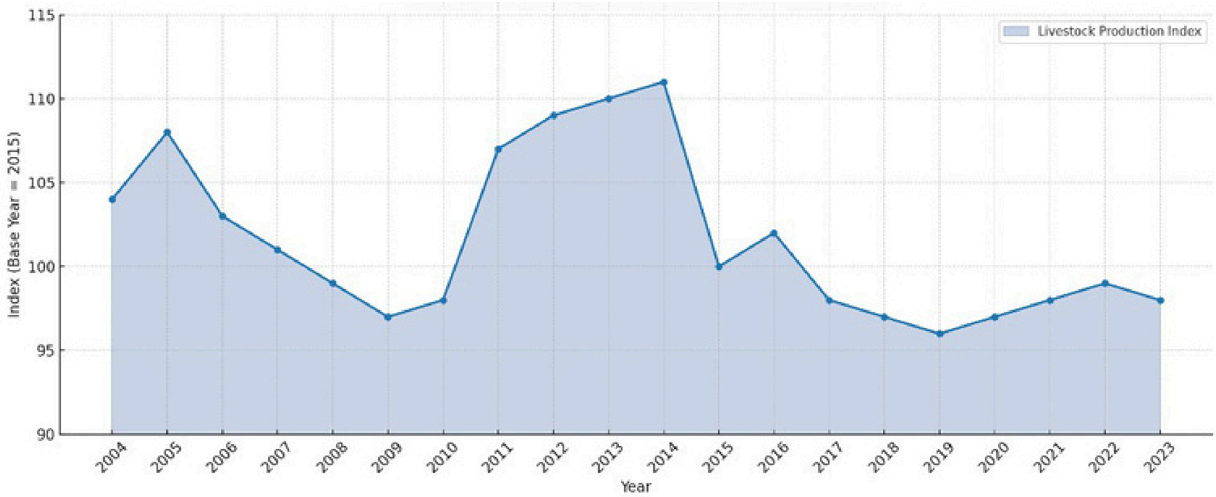
Somalia has an extensive number of livestock, estimated to be 50 million heads, with an export value of USD 500 million from USD 5.3 million heads of animals. Expectedly, livestock is the main driver of Somalia's real GDP growth with livestock exports representing over 90 percent of total exports and accounting for 25 percent of total employment. The main export destination is Saudi Arabia. Livestock exports rose by a factor of almost 10 between the 1980s and mid-2010s. Yet, it is observed that the export of unprocessed livestock products accounted for 76 percent of total exports in 2022, calling for more value addition (AfDB, 2024).

Based on data collected from the CBS (2022), it is evident that livestock exports increased by about 8% during the period (2018 – 2022). In particular, livestock export revenues increased from 404 million US$ in 2018 to 512 million dollars in 2019, and dropped to 505 million dollars in 2020 due to Corona pandemic, while sustained in 2021 and 2022 to reach 523 million dollars and 558 million dollars, respectively.

Over the past twenty years, the average livestock production index stood at 102, with a relatively stable fluctuation rate of 4.2%. This index is decreasing over time at a rate of 0.31%, but the time trend coefficient is not statistically significant. The results also indicated that droughts, especially during the last decade, caused a significant decline in the livestock production index by about 4.3%. Drought alone explains about 50% of the changes in the livestock production index, due to its direct impact on fodder production. This result is consistent with the findings of the Islamic Relief Organization (2023), which highlighted that drought waves in Somalia have devastated the agricultural sector, which is a major source of income for Somalis. About half of Somali households are supported by women, who face severe challenges in the country, including climate change and food insecurity.

Agriculture and livestock provide livelihoods for many Somalis, including women. However, for many herders of sheep and cattle, recent poor rainy seasons have destroyed their only source of income. The organization recommended increasing resilience through climate-smart agriculture through the "SARIA" project, which is designed to address the challenges of recurring droughts and food insecurity in Somalia by providing farmers with climate-resilient livestock and implementing climate-smart agricultural techniques to protect them from the impacts of climate change. The following table illustrates the trend of the livestock production index in Somalia.

Figure (5.6) Livestock Production Index for Somalia (2004 – 2023)



Source: *Based on Data Collected from the World Bank (2024)*

5.6 Impact of Climate Change on Food Security

Using linear regression analysis and applying the difference model, the impact of climate change (drought) on the cultivated areas of food crops and total food production in Somalia during the period (2004-2023) was examined. The results showed that drought in Somalia has led to a decrease in the cultivated areas of food crops by about one-third, as well as a significant decrease in food production, estimated at about 23.4%. Climate change explains about 65% of the change in cultivated areas of food crops and about 69% of the change in total food production. The estimated models demonstrate statistical robustness, indicating their reliability. Therefore, mitigating environmental issues requires adopting effective policies that create a favorable environment for agricultural production in general and food production in particular. On the other hand, these results are consistent with several studies that have indicated that drought in Somalia has caused a reduction in agricultural areas and an increase in desertification, forcing hundreds of thousands of people dependent on agriculture to internally displace or seek refuge in neighboring countries. All this increases the prevalence of poverty, causing people to lose the ability to provide adequate food.

The United Nations Environment Programme (UNEP, 2018) noted that Somalia has witnessed a cycle of prolonged droughts over the past twenty-five years, peaking in 2016 and 2017 when there was a scarcity of rainfall for three consecutive seasons. Drought has caused food shortages, malnutrition, cholera, and other diseases, forcing people to migrate from rural to urban areas, and increasing the number of school dropouts.

5.7 Policies for Improving Food Security in Somalia

Ensuring access to sufficient, safe, and nutritious food is a critical development priority. In Somalia, food insecurity remains a significant challenge, affecting the well-being and livelihoods of many citizens. This section outlines key policies and strategies to improve food security:

- **Designing a National Agricultural Development Plan**

Implementing a comprehensive national agricultural development plan is crucial. This plan should focus on increasing agricultural productivity through sustainable practices, enhancing crop yields, and diversifying agricultural outputs. It should also prioritize agricultural financing besides investment in research and development to introduce drought-resistant crop varieties and innovative farming techniques.

- **Climate Resilience Strategies**

Given Somalia's vulnerability to climate change impacts such as droughts and flooding, developing strategies that enhance climate resilience is essential. This includes implementing early warning systems for extreme weather events, optimizing water resources and improving irrigation systems, and investing in sustainable land use.

- **Upgrading Rural Agricultural Capacities**

Improving agricultural infrastructure is vital for enhancing market accessibility and reducing post-harvest losses. Investments should focus on building roads, storage facilities, irrigation systems, and marketplaces that facilitate the movement of goods from rural areas to urban centers.

Adoption of Fair Agricultural Pricing Policies

Pricing mechanisms should balance both supply and demand sides. In this regard, implementing farmer-supporting policies, in addition to targeted food subsidies particularly for poor segments of the society, is crucial for enhancing the food security situation in the country.

Safeguarding Farmers' Rights

Protecting the rights of farmers is essential for fostering an environment where they can thrive. This includes ensuring access to land, fair pricing for their products, and legal protections against exploitation. Empowering farmers through education about their rights can help them advocate for better conditions and support.

Enhancing Emergency Response Mechanisms

Establishing robust emergency response mechanisms is necessary to address acute food shortages when they arise. This includes creating contingency plans that outline how resources will be mobilized quickly during crises, ensuring that vulnerable populations receive timely assistance.

CHAPTER SIX

FOREIGN TRADE AND EXCHANGE RATE

Chapter 6

FOREIGN TRADE AND EXCHANGE RATE

6.1 Somalia's International Trade Framework and Agreements

Somalia's unique geography, boasting the Horn of Africa's longest coastline along the Red Sea and Indian Ocean, positions it as a prime regional hub for international trade. However, the country's undiversified export base poses a significant external vulnerability. Over 80% of Somalia's export earnings stem from unprocessed agricultural products, primarily livestock shipped to the Gulf and Saudi Arabia, as well as oilseeds and bananas. This heavy reliance exposes Somalia to the unpredictable nature of global commodity markets. Furthermore, livestock exports to the Middle East, predominantly to Saudi Arabia, account for over 70% of the country's total exports. Somalia's export value has recently taken a hit, primarily due to the challenging global economic and financial landscape, exacerbated by the 2022 Russia-Ukraine conflict, and compounded by the country's fragile domestic business environment. Other structural problems, such as poor macroeconomic policies and heavy reliance on unprocessed livestock exports of a narrow range of primary products, amidst low and falling primary commodity prices, have also played a role in the achievement of the low rate of transformation (AfDB, 2024).

On the import side, Somalia relies heavily on foreign goods to meet its domestic consumption needs. The country's import bill is substantial, driven primarily by demand for essential commodities such as food, fuel, and manufactured goods. Somalia's imports are largely sourced from the Middle East, Asia, and Europe, with key trading partners including the United Arab Emirates, China, and Turkey.

According to the CBS (2022), the top exports of Somalia are livestock, crops & vegetable oil, and forest products. The United Arab Emirates (UAE), Oman, Saudi Arabia, Turkey, India, and China have emerged as the country’s largest trading partners. In terms of exports, UAE (24 % share), Oman (23 % share), and Saudi Arabia (20 % share) were the top three export destinations for Somali products. In terms of imports, China (17 % share), India (15 % share), and Turkey (6 % share) remain the largest import partners. The top import categories in 2022 were fuel, food, construction materials, cars & spare parts, and clothes & footwear.

Somalia is a member of several regional and international trade blocs and has bilateral trade agreements with some countries. Here are some key trade agreements that Somalia.

is a part of:

Multilateral Agreements

- World Trade Organization (WTO): Somalia has been a member of the WTO since 2012.
- African Continental Free Trade Area (AfCFTA): Somalia is a signatory to the AfCFTA, which aims to create a single market for goods and services across Africa. Trading under the AfCFTA officially began on January 1, 2021.
- Common Market for Eastern and Southern Africa (COMESA): Somalia joined the Preferential Trade Area (PTA) in 1981 and later became a member of the Common Market for Eastern and Southern Africa (COMESA) in 2018, specifically on July 19, 2018.

Bilateral Agreements

- Turkey-Somalia Free Trade Agreement: Somalia and Turkey signed a free trade agreement in 2019, which aims to increase trade and investment between the two countries.
- United Arab Emirates (UAE)-Somalia Trade Agreement: Somalia and the UAE signed a trade agreement in 2018, which aims to increase trade and investment between the two countries.
- China-Somalia Economic and Trade Cooperation Agreement: Somalia and China signed an economic and trade cooperation agreement in 2018, which aims to increase trade and investment between the two countries.

Regional Agreements

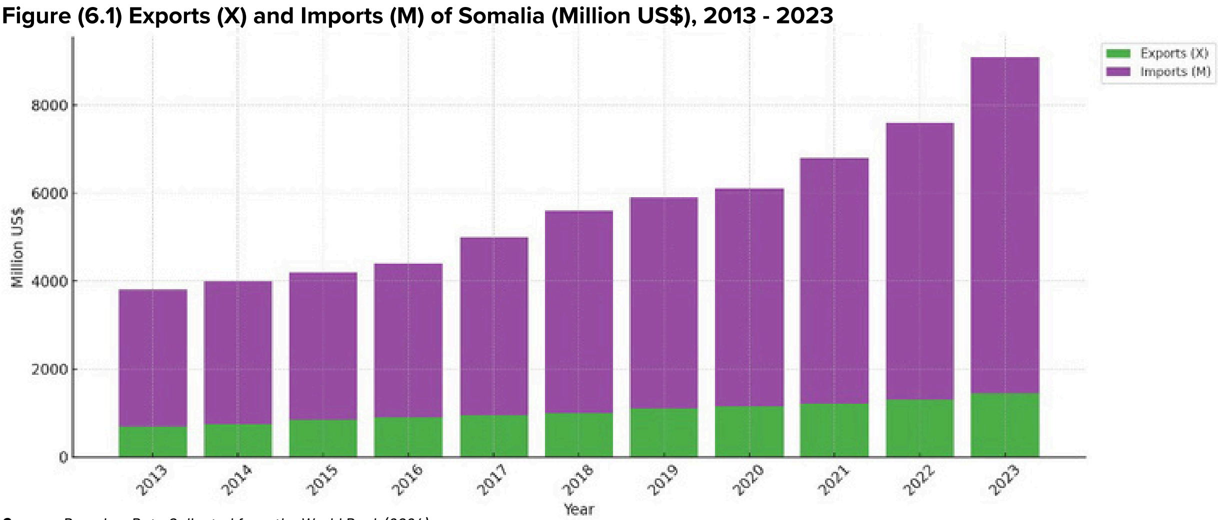
- East African Community (EAC) Treaty: As of March 4, 2024, Somalia became the eighth Partner State of the EAC, which aims to promote economic integration and cooperation among its member states.
- Intergovernmental Authority on Development (IGAD) Treaty: Somalia is a founding member of IGAD, which was initially established as the Intergovernmental Authority on Drought and Development (IGADD) in 1986 and later renamed IGAD in 1996.

6.2 Balance of Trade: Situation Analysis and the Share in GDP

The foreign trade sector is one of the main components of any economy. This part of the report aims to analyze Somalia's foreign trade indicators during the period (2013-2023), for which data was available. The results of analyzing the data shown in the following figure indicate that export earnings ranged from $942.6 million in 2013 to $2089.5 million in 2023, and the average export earnings during the mentioned period were estimated at approximately $1272.1 million with a coefficient of variation of 29%. Export earnings are increasing at an average growth rate of 7.3% (the probability value of the estimated trend coefficient is 0.000). Regarding imports, Somalia's imports are continuously increasing at an average growth rate estimated at around 9% during the period (2013-2023), where the import bill increased to $8956.6 million in 2023 from $3560.9 million in 2013.

The average value of imports during the relevant period was $5483.2 million, with a coefficient of variation of 32%. This means that the import bill for Somalia is more volatile than export earnings. Somalia's imports have increased remarkably since 2020 due to the COVID-19 pandemic and successive drought periods that the country has faced. It is worth noting that most of Somalia's imports are food and strategic manufactured goods that are indispensable, while its exports are characterized by low value-added.

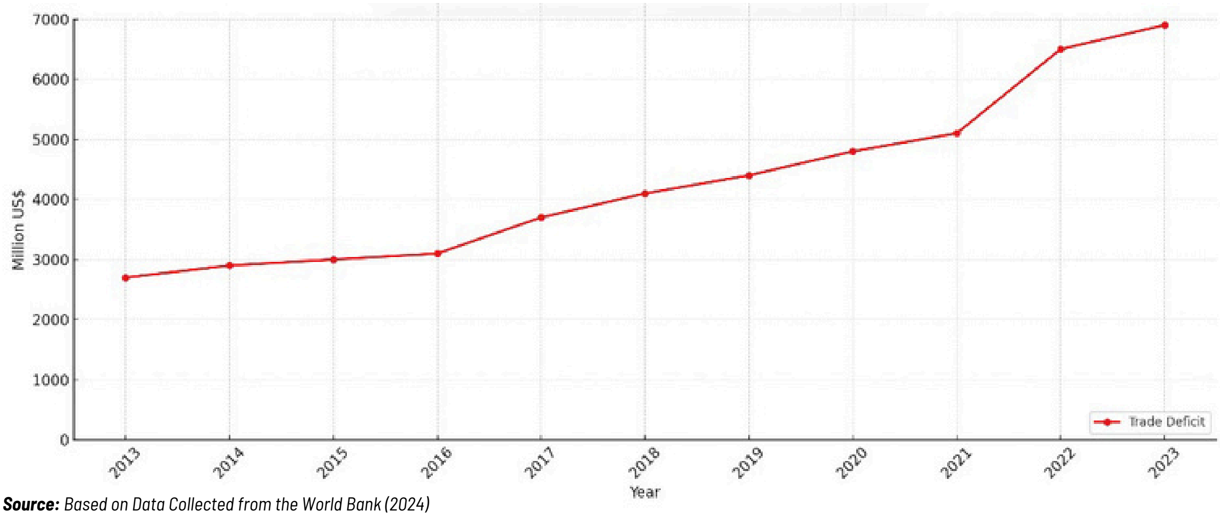
Figure (6.1) Exports (X) and Imports (M) of Somalia (Million US$), 2013 - 2023



Source: *Based on Data Collected from the World Bank (2024)*

Somalia's trade balance has consistently been in deficit over the past eleven years (2013-2023), with an average annual deficit of $4.2 billion and a moderate variation of 34%. Notably, the trade deficit more than doubled during this period, increasing by 2.6 times from $2.6 billion in 2013 to $6.9 billion in 2023. Unless measures are taken to promote exports and substitute imports, the trade deficit is expected to persist, driven by the faster growth of imports compared to exports. The following figure illustrates the trend of Somalia's trade deficit over time.

Figure (6.2) Somalia's Balance of Trade Deficit (Million US$), 2013 - 2023



Source: *Based on Data Collected from the World Bank (2024)*

Understanding the trade balance as a percentage of GDP is crucial. During 2013-2023, Somalia's average export ratio was 15% of GDP, while the average import ratio was 63%. This translates to an average trade deficit equivalent to approximately 48% of GDP. Alarmingly, since 2020, the trade deficit has surpassed half of the country's income generated from economic activities (Table 6.1). These findings underscore the fragility of the Somali economy, highlighting its vulnerability to health and environmental shocks.

Table (6.1) Somalia's Balance of Trade Situation as Percentage of GDP, 2013 - 2023

Years	Export to GDP Ratio	Import to GDP Ratio	BOT Deficit (% of GDP)
2013	16.15	61.02	44.87
2014	16.79	59.72	42.93
2015	14.86	57.08	42.22
2016	14.44	56.75	42.31
2017	12.05	56.03	43.98
2018	13.52	61.87	48.36
2019	12.01	57.57	45.56
2020	12.80	63.21	50.41
2021	15.57	66.51	50.94
2022	17.31	78.53	61.21
2023	17.89	76.69	58.79

Source: *Based on Data Collected from the World Bank (2024)*

6.3 Trade Openness and Its Causal Relationship with Economic Growth

Trade openness measures the sum of a country's exports and imports as a percentage of GDP, indicating the extent of international trade integration. Somalia's trade openness was 77% in 2013, decreasing to 75% in 2018 due to drought-related export capacity disruptions. However, over the last five years, trade openness has surged to 95% in 2023, driven by increased imports to address COVID-19 pandemic needs and compensate for domestic production gaps caused by consecutive droughts. The average trade openness for Somalia during 2013-2023 was approximately 78%, with a low coefficient of variation (12%), indicating minimal variation around the mean. An ordinary least squares regression analysis revealed a positive and significant time trend coefficient (1% significance level), with an average compound growth rate of 2.2% over the period. The following table illustrates Somalia's trade openness trend over time:

Table (6.2) Somalia's Degree of Trade Openness, 2013 - 2023

Years	Total Trade as Percentage of GDP
2013	77.17
2014	76.51
2015	71.94
2016	71.19
2017	68.08
2018	75.39
2019	69.57
2020	76.01
2021	82.08
2022	95.84
2023	94.58

Source: *Based on Data Collected from the World Bank (2024)*

The causal relationship between trade openness and economic growth in Somalia was examined using the Granger causality test. The results indicated a significant one-way causal relationship from economic growth to trade openness, at the third difference of the data (F-test significant at 5%). External trade openness did not have a significant impact on economic growth during the period (2013-2023) because it was more consumptive than productive. It is worth noting that trade openness enhances economic growth levels in a country when accompanied by an increase in the total productivity of production elements (land, labour, capital, organization) and job creation - this is provided with political stability, a healthy economic environment, and continuous development of infrastructure and technologies in the country. All these conditions are challenges facing the Somali economy. Therefore, the trade openness that Somalia witnessed during the period did not have a significant impact on economic growth despite its positive effect. The results also indicated that the simple correlation coefficient between trade openness and economic growth in Somalia was 0.38. To reap real benefits from trade openness, Somalia should adopt export promotion methods and prioritize imports by focusing on capital goods.

6.4 Somalia's Exchange Rate Trend

This section of the report examines the fluctuations in the exchange rate between the Somali Shilling (SOS) and the US Dollar (USD) from 2013 to 2023. Despite widespread dollarization in local transactions, analyzing the exchange rate is crucial for understanding the economy. The annual average exchange rate; calculated from the midpoint of buying and selling prices, was used as a time series. Data from the Central Bank of Somalia (CBS) reveals a significant increase in the exchange rate over time. The SOS/USD exchange rate rose from 19,283.8 SOS in 2013 to 23,954.2 SOS in 2018 and 27,225.3 SOS in 2023, with an average of 23,891.3 SOS per USD. A rising exchange rate indicates a decline in the national currency's value and an appreciation of the foreign currency. The Somali Shilling's value depreciated by approximately 3.3% annually during the mentioned period. This steady decline will likely have a negative impact on citizens' standard of living, as imports become more expensive due to the weakened national currency. Furthermore, this depreciation may exacerbate poverty and inflation, undermining the country's economic stability. To mitigate these effects, policymakers must consider strategies to stabilize the exchange rate and promote economic growth. Potential measures include diversifying exports, encouraging foreign investment, and implementing monetary policies to manage inflation.

The following table provides detailed data on the SOS/USD exchange rate:

Table (6.3) Yearly Average Somalia Shillings per US$ (Mid-Rate), 2013 – 2023

Years	Exchange Rate
2013	19283.80
2014	20229.97
2015	22254.24
2016	23061.78
2017	23097.99
2018	23954.18
2019	25064.63
2020	25761.17
2021	26039.01
2022	26832.52
2023	27225.31

Source: *CBS (2024)*

6.5 Factors Influencing Somalia's Exchange Rate Devaluation

Despite the fact that there are several factors that can affect changes in the exchange rate of a country's national currency against foreign currencies, the focus in this report will be on considering the trade balance deficit and net FDI inflows as a percentage of GDP. This is because the time series data covering only eleven years does not enable the conduct of a reliable multiple regression analysis that includes several independent variables in the model. By applying the ordinary least squares method to the logarithmic form of the model, it was found that changes in the exchange rate of the Somali shilling against the dollar respond more to changes in the trade balance deficit compared to net FDI inflows as a percentage of GDP. These two variables explain about 82% of the changes in the exchange rate. The trade balance deficit causes further deterioration in the value of the national currency, while foreign investment inflows into the country improve the value of the national currency. Specifically, a 1% increase in the trade balance deficit leads to a 0.47% deterioration in the exchange rate, while a 1% increase in net FDI inflows leads to a 0.26% improvement in the national currency's exchange rate. The coefficient (elasticity) of the trade balance deficit is statistically significant at 1%, while the coefficient of net FDI inflows is statistically significant at 10%.

6.6 Policy Recommendations for Improving Somalia's Trade

Somalia's economic growth and development depend on engaging in foreign trade. Despite its strategic location and natural resources, the trade sector faces challenges. The following recommendations address these challenges to unlock Somalia's trade potential.

Stabilize Exchange Rates for Stronger Trade

A stable exchange rate is vital for international trade:

- **Central Bank Guidance:** The Central Bank should implement policies to stabilize the Somali shilling against major currencies, protecting traders from currency fluctuations.
- **Foreign Reserve Management:** Building robust foreign currency reserves will provide a safety net against external economic shocks, shielding the exchange rate.

Streamline Customs for Easier Trade

- **Make customs easier and faster:** Simplify procedures to reduce delays and costs for traders.
- **Lower tariffs on key export goods:** Reduce customs duties on essential export products to make them more competitive in global markets.
- **A Lifeline to the needy:** Eliminate tariffs on life-sustaining imports.
- **Combat customs evasion:** Enforce strict measures to prevent smuggling and customs evasion, in order to protect the economy and ensure fair trade.

Boost Foreign Trade through Affordable Financing

Recommended initiatives:

- Encourage commercial banks to offer competitive financing options for foreign trade.
- Provide easy and affordable financing costs to support importers and exporters.

Strengthen Global Trade Ties

- **Forge stronger trade partnerships:** Negotiate and activate more trade agreements that benefit all parties.
- **Simplify trade processes:** Rationalize procedures and reduce unnecessary paperwork to facilitate smoother trade.
- **Attract foreign investment:** Offer incentives, enhance partnerships between local and foreign companies, and develop free zones.
- **Share technology and expertise:** Collaborate with other countries to improve trade efficiency and stay competitive.
- **Develop trade skills and knowledge:** Cooperate on education and training initiatives to enhance the capabilities of merchants and companies.

Harness Technology for Smarter Trade

Key initiatives:

- Develop cutting-edge commercial information systems.
- Invest in technological infrastructure to support trade operations.
- Build the skills and capacities of the workforce to effectively utilize these technologies.

Offer Incentivizing Exchange Rates

Key points:

- Provide competitive exchange rates for exporters and importers of essential goods.
- Activate monitoring and tracking mechanisms to ensure effective implementation.

Adopt Export Promotion and Import Substitution Strategies

These strategies can be highly beneficial for improving the balance of trade and stabilizing the exchange rate of the national currency. Key recommendations in this regard include:

- **Value-added agricultural exports:** Focus on manufacturing agricultural products and livestock instead of exporting raw materials to increase export earnings.
- **Diversify export products and markets:** Expand the range of exported goods and explore new markets to reduce dependence on specific products and markets.
- **Meet international standards:** Ensure that exported goods comply with global specifications, packaging, safety, and security requirements.
- **Develop import substitution industries:** Encourage local production of goods currently imported, and invest in infrastructure to support these industries.
- **Promote local consumption:** Raise awareness among citizens about the importance of consuming locally produced goods to support the national economy.

Unlocking Foreign Trade Opportunities through Tourism

Development Recommended initiatives:

- Develop the tourism sector to attract foreign visitors and increase export earnings.
- Promote tourism services as a key component of foreign trade development.

CHAPTER SEVEN

EXTERNAL DEBTS AND DEBT SERVICE

Chapter 7

EXTERNAL DEBTS AND DEBT SERVICE

7.1 Background on External Debts of Somalia

Foreign debt is one of the main sources of financing development in developing countries, where it is appropriate for the governments to borrow to meet financial necessities in the cases of deficit in order to bridge the investment - saving gap. Failure to properly manage and utilize external debt for productive development can lead to a debt trap, causing numerous economic challenges and ultimately resulting in unsustainable debt levels for the state.

Accumulation of foreign debt is a problem that bothers most developing countries, especially in the African continent, and Somalia is no exception. The problem of foreign debt in Somalia began in the 1970s and 1980s, when the Somali government started borrowing from countries and international organizations to finance development projects. At that time, Somalia was suffering from economic and political problems, including civil war and political instability, which led to the deterioration of the Somali economy and increased dependence on foreign loans.

In the 1980s, the Somali government began borrowing from countries and international organizations, including the World Bank (WB) and the International Monetary Fund (IMF). These loans were used to finance development projects and infrastructure, including road, bridge, and port projects. However, the Somali government was unable to repay these loans, leading to the accumulation of foreign debt, which in turn led to many economic and social problems, most notably the spread of poverty and increased unemployment rates.

In 1991, the Somali government collapsed, leading to civil war and political instability. These problems led to further deterioration in the Somali economy and the accumulation of foreign debt over the years, until the state was completely unable to pay. As Somalia's debt obligations became increasingly unmanageable, the government initiated talks with international creditors in the late 2010s, seeking debt relief and a path towards fiscal recovery. The subsequent discussion provided a comprehensive overview of Somalia's foreign debt challenge, supported by data-driven insights and analytical perspectives.

On the import side, Somalia relies heavily on foreign goods to meet its domestic consumption needs. The country's import bill is substantial, driven primarily by demand for essential commodities such as food, fuel, and manufactured goods. Somalia's imports are largely sourced from the Middle East, Asia, and Europe, with key trading partners including the United Arab Emirates, China, and Turkey.

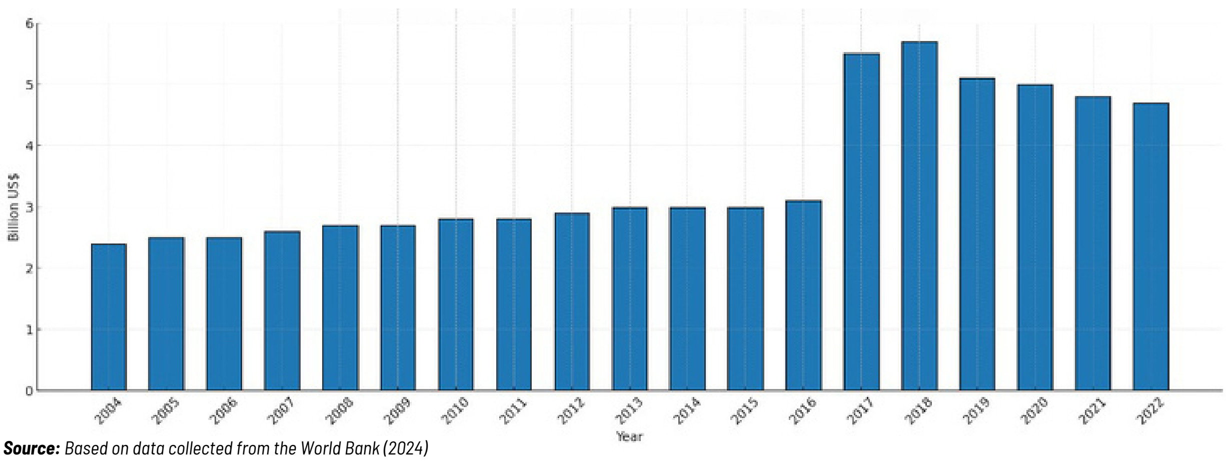
According to the CBS (2022), the top exports of Somalia are livestock, crops & vegetable oil, and forest products. The United Arab Emirates (UAE), Oman, Saudi Arabia, Turkey, India, and China have emerged as the country’s largest trading partners. In terms of exports, UAE (24 % share), Oman (23 % share), and Saudi Arabia (20 % share) were the top three export destinations for Somali products. In terms of imports, China (17 % share), India (15 % share), and Turkey (6 % share) remain the largest import partners. The top import categories in 2022 were fuel, food, construction materials, cars & spare parts, and clothes & footwear.

7.2 Analyzing Somalia's External Debt: Trends, Patterns, and Drivers

7.2.1 Trend and Patterns of External Debt

The following figure illustrates Somalia's total external debt stocks from 2004 to 2022, in current US dollars. This section examines the trends, patterns, and fluctuations in Somalia's external debt over time. Key findings indicate that Somalia's external debt has increased steadily over the past 19 years, with some fluctuations (29% coefficient of variation). The debt stock reached its peak of $5.62 billion in 2019 and its lowest point of $2.67 billion in 2005. Between 2004 and 2022, the external debt grew at an average annual rate of 3.2%.

Figure (7.1) Somalia’s External Debt Stocks, Total (Current Billion US$), 2004 – 2022



Source: *Based on data collected from the World Bank (2024)*

In what follows, the analysis by sub-period is given to provide some more details.

First Sub-Period: 2004-2013

- The country's external debt increased gradually over the period, with some fluctuations (3.4% degree of volatility).
- The average external debt stock was estimated at $ 2.86 billion.
- External debt increased with an average annual growth rate of 0.96%.
- The external debt remained relatively stable over the last three years of the period.

Second Sub-Period: 2014-2022

- This period witnessed significant increase of external debt, with more fluctuations than the first period (30.2% degree of volatility).
- The average external debt stock stood at $ 3.93 billion.
- The external debt increased with an average annual growth rate of 7.6%.
- External debt decreased significantly over the last three years of the period.

7.2.2 Key Drivers of External Debt

Several factors have significantly contributed to Somalia's external debt, including:

Civil war and political instability:

Somalia was in a situation of statelessness and civil conflicts for almost three decades, there was no functional central government to monitor and control the external debts received from foreign countries and institutions, which made Somalia fall in the debt trap.

Dependence on foreign aid:

Official Development Assistance (ODA), also known as foreign aid, involves the transfer of resources from developed to developing countries through concessional loans. Somalia has witnessed a significant surge in foreign aid over the years, emerging as a crucial financing option for the country.

Corruption and exploitation:

Widespread corruption and embezzlement have contributed significantly to Somalia's mounting external debt. Foreign loans were misused to fund non-viable projects, while public funds were embezzled, resulting in the wasteful depletion of the country's resources.

Heavy external borrowing:

Somalia's external debt is attributed to its significant reliance on loans from international financial institutions, such as the World Bank and the International Monetary Fund.

Additionally, the country has borrowed from various bilateral creditors, including Paris Club members (the United States, the United Kingdom, Russia, France, Italy, Japan, and Turkey) and non-Paris Club countries (the UAE, Saudi Arabia, and China).

Drought and natural disasters:

Somalia is one of the countries most affected by drought and natural disasters in Africa. These natural disasters have led to the destruction of infrastructure, and agriculture has been negatively affected by repeated years of drought, leading to increased economic costs. These problems have resulted in an increased need for foreign loans.

Inadequate state financial management:

Somalia's foreign debt crisis has been compounded by inadequate debt management, a depreciating national currency, excessive dollarization, and meager foreign exchange reserves, which have collectively undermined the country's financial stability.

Chronic budget deficits:

Somalia's public budget has consistently faced shortfalls, with public revenues failing to meet expenditure commitments, prompting the government to rely heavily on foreign borrowing to finance these deficits.

Interest on foreign debt:

Debt servicing has become a major driver of Somalia's external debt accumulation, as a substantial portion of the country's budget is dedicated to interest payments and debt amortization.

7.3 Analysis of Somalia’s Debt Servicing Problem

The debt-servicing problem in Somalia is a major challenge that affects the country's economic and social development. After decades of conflict and political instability, Somalia has accumulated large debts with international financial institutions and foreign investors.

Causes of the debt-servicing problem in Somalia include:

- Large external debts: Somalia has accumulated external debts of over $5 billion, which places a heavy burden on the country's economic resources.
- Political instability: Somalia's prolonged political conflicts and instability have severely impacted the economy, disrupted government services, and hindered debt-servicing capabilities.
- Corruption and mismanagement: Widespread corruption and mismanagement have exacerbated Somalia's debt servicing challenges, undermining economic development and diverting resources away from essential public services.

This section analyzes the debt service on external debt based on the following data set.

Table (7.1) Somalia's External Debt Service Payments (Current US$), 2004 - 2022

Years	Debt Service on External Debt, Total (Current US$)
2004	450640.6
2005	721702.9
2006	857783
2007	740248.2
2008	1829627.8
2009	167530.7
2010	228973.7
2011	78367
2012	220472.9
2013	585698.1
2014	34951.5
2015	32179.9
2016	54212.3
2017	34668.5
2018	62305.3
2019	638337.7
2020	820909164.3
2021	17392936.6
2022	19554763.9

Source: *World Bank (2024).*

Overall Analysis (2004-2022)

Somalia's total external debt service has exhibited substantial fluctuations between 2004 and 2022, with volatility reaching 413%. The debt service peaked at $820 million in 2020, while the lowest payment was $32,180 in 2015. Over the 19-year period, the average annual debt service was approximately $45.5 million. The data set indicates a general increasing trend in debt service over the years.

Sub-Period Analysis (2004-2013)

During this period, the debt service on external debt showed a relatively stable trend, with some fluctuations. The highest debt service during this period was recorded in 2008, with a value of approximately $1.83 million. The average debt service stood at $588,104.49, with an 87% coefficient of variation. The data suggests that the country's debt service burden was relatively manageable during this period, with no significant increases or decreases.

Sub-Period Analysis (2014-2022)

In contrast to the previous period, the debt service on external debt showed a significant increase during this period. The average debt service stood at $95.41 million, with a 285% coefficient of variation. This surge can be attributed to various factors, including changes in interest rates, exchange rates, and the country's overall economic performance. The data indicates that Somalia's debt service burden increased substantially during this period.

7.4 Debt Overhang Problem in Somalia

The debt overhang problem is a situation where a borrower, typically a corporation or a government, has taken on so much debt that it becomes difficult or impossible for them to pay back the debt, even if they generate sufficient cash flows. A number of factors cause debt overhang problem including:

- **Excessive borrowing:** Taking on too much debt, often at high interest rates, can lead to a debt overhang problem.
- **Decline in asset values:** A decline in the value of assets used as collateral for loans can make it difficult for borrowers to repay their debts.
- **Economic downturn:** An economic downturn can reduce cash flows, making it challenging for borrowers to service their debt.

The debt-to-GDP ratio is a metric that compares a country's government debt to its gross domestic product (GDP). It is a crucial indicator of a country's economic stability and its ability to pay back its debts.

Countries with high debt-to-GDP ratios may face several challenges, including reduced economic growth, increased borrowing costs and reduced credit rating.

As extracted from the following chart, over the past 19 years, the analyses of debt-to-GDP ratios for Somalia reveal the following:

The debt-to-GDP ratio has fluctuated over the years, with a few notable trends:

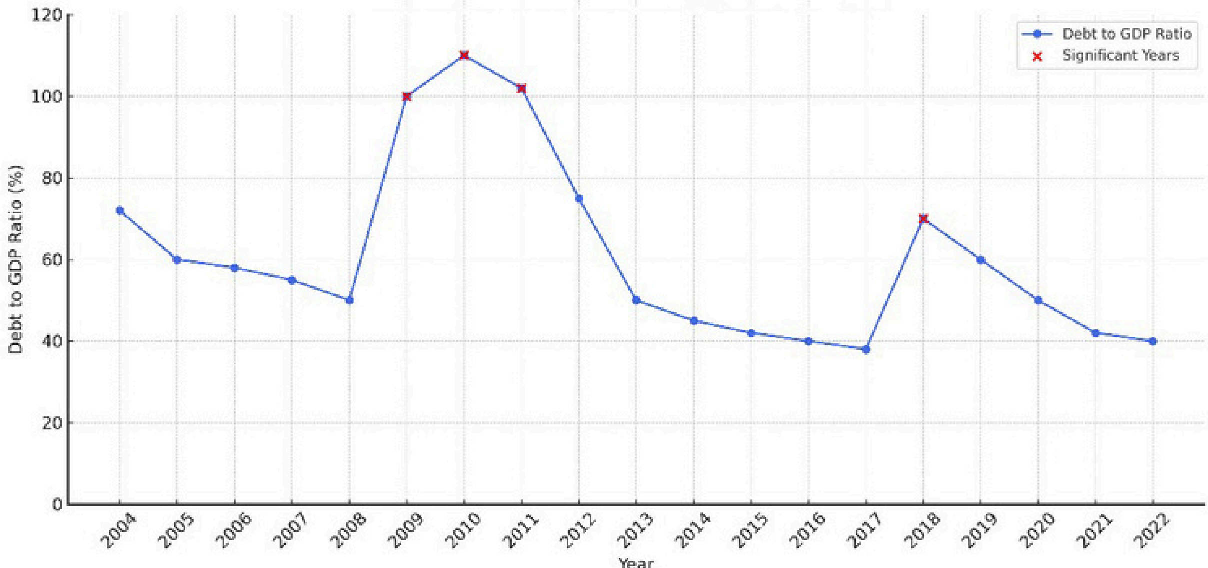
- Declining trend in most of the years; (2004-2008), (2012 – 2017), (2019 – 2022).
- Increasing trend, (2008 – 2010), 2018.
- Very high ratio (100% or above), 2009 – 2011

The average debt-to-GDP ratio over the 19-year period is approximately 60%.

The highest debt-to-GDP ratio was 109.17% in 2010, while the lowest was 34.34% in 2017.

Debt-to-GDP ratio declined at an average rate of 3.9% over the period (2004-2022).

Figure (7.2)Somalia's Debt to GDP Ratio (%), 2004 – 2022



Source: *Based on Data Collected from the World Bank (2024)*

The debt-to-export ratio is a crucial indicator of a country's ability to service its debt using its export earnings. Somalia's debt-to-export ratio is analyzed for the period (2013-2022). The choice of this period is dedicated by data availability.

The mean debt-to-export ratio is approximately 327.42, while the median is 279.93. This suggests that the distribution of the debt-to-export ratio is slightly skewed to the right. A debt-to-export ratio of 327.42% means that for every dollar earned from exports, the country owes approximately $3.27 in debt.

In other words, the country's debt burden is roughly 3.27 times its annual export earnings. This indicates a very high level of indebtedness, which could potentially pose challenges for the country's economic stability and ability to service its debt. The standard deviation of the debt-to-export ratio is approximately 99.75, indicating a moderate level of variability (31%). The debt-to-export ratio ranges between 230.81 and 497.02 as minimum and maximum values, respectively.

Table (7.2) Somalia's Debt to Export Ratio (%), 2013 - 2022

Years	Debt to Export Ratio (%)
2013	311.79
2014	258.45
2015	266.93
2016	257.19
2017	284.97
2018	496.73
2019	497.02
2020	395.45
2021	274.88
2022	230.81

Source: *Based on Data Collected from the World Bank and CBS (2024)*

7.5 Association of External Debts with Economic Growth

This section empirically investigates the impact of debt overhang problem, measured by the debt-to-GDP ratio, on economic growth in Somalia, proxied by the logarithm of real GDP. The analysis is based on a dataset spanning from 2004 to 2022, with a total of 19 observations. The analysis employs an ARMA (Auto Regressive Moving Average) model, estimated using the Maximum Likelihood method.

The key findings include the following: The coefficient of the regressor is negative and statistically significant (p-value = 0.0376), indicating that a higher debt-to-GDP ratio is associated with lower economic growth. In particular, a 1% increase in debt-to-GDP ratio reduces economic growth by 0.06%. The model exhibits a high goodness of fit, with an R-squared value of 0.978 and an adjusted R-squared value of 0.972. This analysis provides evidence that a higher debt-to-GDP ratio deters economic growth, supporting the hypothesis of debt overhang problem in Somalia. The results suggest that policymakers should be cautious when accumulating debt, as it may have negative consequences for long-term economic growth. The model's high goodness of fit and significant coefficients provide confidence in the results, making this analysis a valuable contribution to the ongoing debate on the impact of debt on economic growth.

7.6 Complying with the Heavily Indebted Poor Countries (HIPCs) Initiative

Since 2016, Somalia has embarked on a long journey of economic and financial reforms to swap external debts, particularly through the Heavily Indebted Poor Countries (HIPC) Initiative. The government emphasized the national commitment and prioritization of this agenda. The Debt Management Department within Somalia's MoF plays a crucial role in managing the country's external debt. The department is responsible for collecting, recording, managing, and reconciling external debt, as well as preparing for re-engagement with international financial institutions. These efforts demonstrate Somalia's commitment to managing its external debt and improving its economic stability (MoF, 2023).

On December 13, 2023, Somalia achieved a historic milestone by reaching the Heavily Indebted Poor Countries (HIPC) Initiative completion point, becoming the 37th country to do so. This accomplishment followed the successful implementation of crucial reforms aimed at rebuilding Somalia’s economy and institutions, which included a comprehensive poverty reduction strategy, enhancements in public financial management, improvements in governance, and effective resource management. Upon reaching the HIPC Completion Point, Somalia’s external debt has significantly reduced from 64% of GDP in 2018 to less than 6% by the end of 2023. In particular, public debt decreased from US$ 5.3 billion at the end of 2018 to US$ 0.6 billion at the end of 2023. The debt relief has not only normalized Somalia’s standing with international financial institutions but has also paved the way for new external funding to support inclusive growth and poverty reduction.

However, Somalia faces ongoing challenges in the post-HIPC era, including low domestic revenue, vulnerability to external shocks, and political instability (CBS, 2024). According to AfDB (2024), the attainment of the HIPC Completion Point qualified Somalia for the Multilateral Debt Relief Initiative (MDRI), which positioned it to benefit from the cancellation of all debt repayment claims from the African Development Bank Group and International Development Assistance (IDA), and post-HIPC assistance from the International Monetary Fund (IMF) and Paris Club creditors. The AfDB delivered its full share of HIPC debt relief with the arrears’ clearance in March 2020, estimated at UA 88.15 million (USD 122.6 million), including payments due through 30 June 2021. By March 2024, the FGS had received assurance from most bilateral and all multilateral creditors about 90 percent of the Present Value (PV) of the HIPC debt relief. The FGS should pursue a cautious fiscal policy to sustain debt sustainability, while expediting the formulation of the new revenue mobilization strategy.

7.7 Mitigating Future External Debt Accumulation

To avoid future accumulation of external debts, the Somalia government should consider the following strategies:

Fiscal Discipline and Budgeting

- Implement a transparent and accountable budgeting process
  Prioritize essential public expenditures.
- Reduce operational costs in government spending in order to improve budget performance.
- Combat corruption and confront it firmly and decisively.
  Ensure alignment with national development priorities.

Improve Domestic Revenue Mobilization

- Enhance tax administration and collection.
- Expand the tax base rather than increasing tax rate.
- Implement efficient revenue collection systems.
- Reduce reliance on foreign aid and grants.

Debt Management and Monitoring

- Establish a robust debt management framework.
- Monitor debt levels and composition.
- Ensure the effective use of borrowed funds.
- Implement debt repayment strategies.
- Maintain transparency and accountability in debt management.

Invest in Domestic Economic Growth

- Foster a conducive business environment.
- Promote private sector development.
- Invest in infrastructure, education, and healthcare.
- Encourage foreign direct investment based on win win.

Strengthen Institutions and Governance

- Enhance the capacity of institutions responsible for economic management.
- Promote good governance.
- Ensure the independence of institutions, such as the central bank and auditor general.

Diversify the Economy

- Reduce dependence on a single sector or commodity.
- Promote economic diversification through investments in agriculture, manufacturing, and services.
- Encourage entrepreneurship and innovation.
- Improve export competitiveness.
- Diversify export base to improve resilience to external shocks.

Seek Concessional Financing

- Explore concessional financing options from international financial institutions.
- Negotiate favorable loan terms, such as low interest rates and long repayment periods.
- Meet eligibility criteria, such as income level or creditworthiness.
- Ensure compliance with the financing institution's or donor's requirements.

Encourage Private Sector Participation

- Promote public-private partnerships (PPPs) in key sectors.
- Encourage private sector investment in infrastructure and other development projects.

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