Horn Institute for Peace and Development

Debt Relief for Somalia

Policy Brief

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Introduction

Somalia is a post-conflict state showing steady economic growth. The country is facing pressing macroeconomic challenges, including: a high unemployment rate; massive inflation and price instability; exchange-rate volatility; and external shock, such as deficit in trade balance and heavy external debt. External debt has been a pressing matter in recent years and the Federal Government of Somalia has been cooperating effectively with the International Monetary Fund (IMF) and the World Bank Group to at least get rid of the debt burden. The debt-relief process was started by former finance minister Mohamed Aden Ibrahim (Farketi) under Hassan Sheikh Mohamud's administration. The current government is struggling to find ways of tackling these massive debts. The debt is currently US$5.3, equivalent to 93% of the GDP, which is a sum that the current government, and even by future governments, will have difficulty in paying off. The Minister of Finance and the Governor of the Central Bank meet with the IMF several times a year seeking debt relief. However, some economists around the world have criticized the IMF and the World Bank for being doing fair enough in this case and only offering debt relief if a debtor country fulfills several harsh conditions and is backed by its biggest stakeholders. The Federal Government of Somalia began to implement some of the IMF's reform conditions in 2015. These conditions were met and the government earned international trusted and has since received an increasing number of grants. However, the principle of there being no such thing as a free lunch can be applied to this case; we will soon see whether all debts will be written off freely or whether there will be a price to be paid.

The International Monetary Fund (IMF) and Somalia

The IMF was established in 1945. It is an international economic organization and one of the United Nations' main organizations aimed at fostering global monetary partnership, developing financial stability, facilitating trade, promoting high employment and sustainable economic growth, and reducing poverty globally. A total of 189 countries are members of the IMF, including Somalia, which joined on August 31, 1962 under the presidency of Adan Abdulle Osman. Recently, following Siyad Barre's regime, Somalia failed to cooperate with the IMF to a satisfactory level (a situation that has recently been rectified), with the last direct communication between the IMF and Somalia occurring on November 13, 1989 and Somalia ceasing to be an active member following the outbreak of civil war in 1991. The IMF, however, recognized the Federal Government of Somalia on April 12, 2013 following the continuous reform efforts and strong foreign policy delivered by the government of His Excellency, President Hassan Sheikh Mohamud. Finally, in 2015, Somalia activated its membership in IMF and agreed to start the consultation regarding Article IV.

Article IV is one the IMF's articles of agreements. It generally concerns the obligations of member countries, exchange arrangements, and some other regulations (including economic policies) that serve overall to achieve the IMF's objectives.

Although some scholars doubt whether the IMF's original objectives are truly and fairly achieved, it is nevertheless, together with the World Bank, the world's leading institution for decisions regarding economic issues. Somalia has requested debt relief from the IMF and both sides agreed that Somalia, before debt relief, needs massive economic reforms so that the country will have a strong economy and can avoid falling back into other debt traps. In 2015, the IMF nominated a Resident Representative for Somalia to boost cooperation between the IMF and Somalia.

The IMF is currently providing huge capacity-building support to the Somali authorities. Almost all the capacity-building areas concern economics, including taxation, budgeting, public finance, monetary policy, commercial-bank regulations, and statistical training. This training is intended to build the staff's capacity and skills to bridge the knowledge and skills gap of the country's economic institutions.

Somalia's Debt

At the end of 2017, Somalia's external debt was estimated at US$5.3 billion (see Table 1), equivalent to 93% of the GDP. The external debt data at that time excluded the commercial debt. The US$5.3 total includes: multilaterals (US$1.5 billion); Paris Club (US$2.5 billion); and non-Paris Club (US$1.3 billion). Based on this assessment, combined with debt-sustainability analysis, Somalia lacks the ability to repay its debt in the medium term. The Debt Management Unit under the Ministry of Finance of the Federal Government of Somalia is in broad range efforts for collecting and validating the external debt data through seeking any evidence against claims.

Table 1: Somalia's external public debt as of 2017 (millions of US dollars).

Total outstanding debt		**5.3 (1+2)**
	Of which is arrears (payable/relievable)	4.9
1.	*Multilateral*	***1.5***
2.	*Bilateral Creditors*	***3.8 (a+b)***
	a. Paris Club	2.5
	b. Non-Paris Club	1.3

Source: IMF.

Staff Monitoring Programs (SMPs) and the Upper Credit Tranche (UCT)

The Federal Government of Somalia agreed to start a Staff Monitoring Program (SMP) with the IMF. The SMP involves IMF staff supervising and monitoring the country's economic policy reforms and keeping them on track. Their reports to the IMF's board, the World Bank Group, and other donors are crucial to their decision making. The required reforms include all economic sectors; fiscal; monetary; external; and real.

Somalia is currently in its third SMP and has succeed in the previous two programs, with the government achieving several economic reforms, including: tax reforms followed by increased government revenues; establishing good practices for public financial management (PFM); budget reforms; developing a currency-reform roadmap; licensing and supervising commercial banks; and compiling the statistical data for the real and external sectors.

This third SMP contains tough conditions and reform packages aimed at building strong foundations for Somalia's economy to enable it to better recover from the prolonged recessions of the last three decades.

After successfully completing several SMPs, Somalia will begin a final SMP anticipated to include the Upper Credit Tranche (UCC). The UCC program refers to a system through which the IMF releases loans to the member debtor to make financial and economic reforms following guidelines and conditions established by the IMF. This process will take 18 to 36 months. If Somalia – or any other heavily indebted poor nation (HIPC) – fulfills the UCC conditions, it/they will progress to the HIPC Initiative.

Heavily Indebted Poor Nations (HIPC) Initiative

Every poor country in debt and unable to pay back its debt will have to follow the HIPC Initiative. The Heavily Indebted Poor Countries (HIPC) Initiative was launched by the IMF and the World Bank in 1996 following lobbying by international NGOs and other international bodies. The HIPC Initiative was aimed at lowering the massive debt burden on poor nations. Following this, the international financial community, including multilateral organizations and governments, has worked together to reduce to sustainable levels the external debt burdens of the most HIPCs. Countries must, however, meet certain conditions in the following two-step process:

Step 1: Decision Point

In this step, countries must fulfill the following conditions:

a. Be eligible for the World Bank's IDA grants and interest-free loans to the debtor nations as well as the IMF's Poverty Reduction and Growth Trust, which provides loans to low-income countries at a subsidized rate. These are also called pre-arrears-clearance loans/grants and they include supervision of how these funds are spent in the social sectors and the reduction of poverty.

b. Face unsustainable debt burden that cannot be addressed through traditional debt-relief mechanisms.

c. Have an established track record of reform and sound policies through IMF- and World-Bank-supported programs.

d. Have developed a Poverty Reduction Strategy Paper (PRSP), through a sophisticated participatory process in the country.

Upon Somalia's meeting of the above conditions of the decision point, the executive board of the IMF and World Bank officially confirmed Somalia's eligibility for debt relief and the possibility to pass to the completion point.

Step 2: Completion Point

To receive full and final debt relief through the HIPC Initiative, a country must perform the following actions:

a. Establish a further track record of excellent performance under programs supported by IMF and World Bank loans.
b. Satisfactorily implement key reforms established at the decision point.
c. Adopt and implement the Poverty Reduction Strategy Paper (PRSP) for at least one year.

Once the Federal Government of Somalia meets these conditions, it will reach the completion point, allowing Somalia to receive the final debt relief agreed at the decision point.

Under the current external public debt burden, Somalia cannot borrow from any bilateral or multilateral entity. After completion of the debt relief, however, Somalia will be able to borrow from any entity or country in the world, based on its liquidity and ability to make repayments. It will also be eligible for long-term loan projects through International Financial Institutions (IFIs).

During the pre-decision-point stage, Somalia may face some pressing challenges, including instability, weak governance, and lack of public goods delivery. These are key risk factors fora strong economic foundation for Somalia. The presence of these factors can hinder the practices of good governance and state building.

Another challenge is that Somalia's fiscal and monetary policies are very weak and are not under the government's full control. The possibility of self-financing, public goods delivery, and regulating the monetary system requires strong policies, both monetary and fiscal, and being weak could cause Somalia to fall again into another debt trap, even if the current debt is relieved.

The last challenge is to ensure that Somalia receives full debt relief from its creditors following eligibility.

Even if some multilateral institutions grant full debt relief, some creditors – most likely bilateral and commercial creditors– may write off only a percentage of the debt burden or require some exchange for their foregoing credit, which may lead to Somalia remaining in continuous debt trap or in a weak position with some creditors.

As well as Somalia, there are other countries that are, or have been, part of the HIPC Initiative; some were found eligible, some are potentially eligible, aiming for debt relief process (see Table 2).

Table 2: HIPC Initiative countries.

Post-completion-point countries		
Afghanistan	Burundi	Comoros
The Gambia	Guyana	Madagascar
Nicaragua	Senegal	Uganda
Benin	Cameroon	Republic of Congo
Ghana	Haiti	Malawi
Niger	Sierra Leone	Zambia
Bolivia	Central African Republic	Democratic Republic of Congo
Guinea	Honduras	Mali
Rwanda	Tanzania	Côte d'Ivoire
Burkina Faso	Chad	Mauritania
Guinea-Bissau	Liberia	Ethiopia
São Tomé & Príncipe	Togo	Mozambique
Pre-decision-point countries		
Eritrea	Somalia	Sudan

Source: IMF

Concluding Remarks and Recommendations

Somalia will, it is to be hoped, enter into a UCT arrangement and then start following the HIPC Initiative process. The debt burden is greater than the ability to pay as it is almost close the entire GDP. The Federal Government of Somalia has a high hopes of debt relief in the near future. Currently, the IMF is helping Somalia obtain debt relief under the HIPC Initiative as soon as possible, within established HIPC measures. The HIPC Initiative procedure is helping Somalia avoid slipping back into arrears while putting the country on a path to sustainable growth and poverty reduction. This process is not time-bound. It will take however long Somalia needs to achieve the target reforms and fulfill the conditions.

The study recommends, therefore, the following:

1. Since the IMF has not prohibited the Federal Government of Somalia from talking separately to any creditors, it is strongly recommended that Somalia engages in discussion with its bilateral and multilateral creditors one by one asks them if they can write off, or reduce, its debts.
2. The Federal Government of Somalia should seek the help of NGOs and membership organizations like the United Nations, the Arab League, the African Union, and other international communities, to lobby for debt relief for Somalia. Some super-power countries could also help with lobbying for Somalia's debt relief, as the US did for Liberia.
3. Somalian authorities should continue their economic and social policy reforms. This will build a strong economic base and prevent slipping back to other external arrears.
4. The Federal Government of Somalia should exercise caution when entering into any harsh agreements that may arise from some creditors when they are writing off their arrears. For example, they may ask – at the time of negotiations–for Somalia to give them a license for natural-resources extraction or an absolute tax waiver to their potential investors coming to Somalia, which would have severe revenue implications.

5. The IMF and the World Bank should provide to Somalia grants or interest-free loans since it is eligible for pre-arrears clearance grants/loans. These grants or loans will be a test examination of the country's transparency, social-sector spending, and the implementation of poverty-reduction strategies. We recommend that the government exercise caution when managing these grants/loans. If the government mismanages them, or does not satisfactorily meet the requirements, this could have negative consequences, including delaying the debt-relief process and decisions.

The process depends on how successfully the current government implements the reforms, along with international lobbying for its cause. The negotiation skills of the Somali delegates to the IMF and to other international communities cannot be ignored since this is a very important contributing factor.