FEDERAL GOVERNMENT OF SOMALIA

MINISTRY OF FINANCE

BUDGET STRATEGY PAPER (BSP)

SEP 2018

ACRONYMS

FGS	Federal Government of Somalia
WB	World Bank
AFDB	African Development Bank
MOF	Ministry of Finance
IMF	International Monetary Fund
SMP	Staff Monitoring Program
BSP	Budget Strategy Paper
BSC	Budget Strategy Committee
MDA	Ministry Departments Agencies
MFTT	Medium Term Fiscal Framework
NDP	National Development Plan
FMS	Federal Member of States
PFM	Public Finance Management
IFI	International Financial Institutions

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INTRODUCTION

The Ministry of Finance introduced the Budget Strategy Paper (BSP) in 2016 which national annual budgeting process as an effort to improve transparency in the preparation of the national budget. To this end, the BSP serves as a consultation document to facilitate discussions of the national budget at various budget consultation forums, where by stakeholders includes the FGS, Federal Member of States, private sector, non-governmental organizations and representatives of the Local Authorities. The budget consultation forums provide an opportunity for these key stakeholders to review suggested national priorities, strategies, and budget allocations in year basis.

The BSP also adds to the Summary national budget documentation which is produced as part of the public disclosure to improve fiscal projection and transparency in addition to that BSP, provides a snapshot of key issues of consideration during a given year, the subsequent annual Budget provides more elaborate details of current situations.

The publication of the National Budget Strategy Paper is a part of requirements to comply of public finance management Act 2017 which not yet promulgated PFM act into Somali parliament. The PFM is a main context of the Government's Budget Reform agenda, which aims to improve the preparation of budgets, provides full efficient management of public finances and further promotes transparency and accountability. The Budget Strategy Paper offers the public with an overview of the fiscal landscape of the country while the Government's fiscal policy responses to these prevailing conditions. It also provides the public with an opportunity to device the Government's record on delivering on its promises.

BACKGROUND

The result of this document comes from Budget Strategy Committee (BSC) formed under the authority of the Minister of Finance to provide advice on the appropriate strategy to adopt in producing a realistic and affordable budget for the Federal Government of Somalia (FGS) for fiscal year 2019.

The financial year 2017 and 2018, Budget framed relatively with consideration of world economic conditions, which influenced by efficient generation of revenue collection as international financial institutions requirement of achieving140 million USD in 2017, IMF requires FGS to achieve, tax collection approximately 165 million in 2018. The World Bank and IMF were expects to recover self-sufficient in 2017 and 2018 that will lead a positive domestic economic growth reflecting an increase in revenue taxation.

EXECUTIVE SUMMARY

The federal budget is extremely small by international comparison, at about 3% of GDP, and is largely being used to the recurrent costs mainly based on public sector expenditure and security operations costs, which consequently dominates to the national budget. The budget characterized by in efficient revenue collection which have in recent years resulted un-excepted arrears. In this case, there are no virtually systematical locations of national budget strategic in sense of the general public services to the people such as free health care, development of public education, and poverty reduction policies.

The Somali government is committed to sustain its efforts to rebuild the economy, improve social conditions, and move forward to normalize coordination with international financial institutions. In this regard, it has formulated a reform program, which commenced on May 2016 to April 2019 that focuses on implementing prudent macroeconomic policies, while strengthening institutional capacity for macroeconomic management. The program outlined in the nation's Staff Monitored Program (SMP) with the International Monetary Fund. The SMP has a number of indicative fiscal targets for the above-mentioned period, which determines the FGS Budget needs to be zero cash balanced, with which no further entertainment of borrowing requirements in addition to that there will not be any indicative of arrears to generate.

Therefore, the 2018 Budget should balanced on policy of a cash basis, and the revenue forecasting needs to be conservative to ensure that the budget is realistic and able to be executed without generating new expenditure arrears. Only resources that are under the control of the Government are to be included in the Appropriation Bill. However to achieve the level of fiscal discipline required to produce a balanced budget for the Ministries, Departments and Agencies to base their 2018 budget requests on the amount of resources allocated to them in the 2019 Budget.

PRIORITIES OF THE FGS

The budget is the key instrument through which the Government implements its policies, and the Budget Strategy Paper is a key link between Government's overall policies and the annual budget. The purpose of this document is to set out how the Government intends to achieve its policy objectives over short to medium terms through the budget. In doing so the basic macroeconomic framework presented in this paper forms the basis of resource projections and indicative expenditure allocations.

The government of the priority areas for attention in 2019 has informed the BSC.

These priority areas are:

- Construct Administration and Security Sectors Costs.
- Provide Excellence Social Services Delivery, e.g: Education, Health, Sports etc.
- Development Projects, e.g: Fishery, Irrigation, Energy, Sanitation and Transportation.
- Other Infrastructure through Public Private Partnership.

The Ministries, Departments, and Agencies (MDAs) are required to consider these priority areas when approving the detailed budgets for 2019.

PRINCIPLES

The budget is prepared in accordance with a set of principles endorsed by the BSC and considered appropriate for sensible and sustainable fiscal management in Somalia at this time, the principles developed in consultation with the International Monetary Fund and other key international partners.

The principles are:

1. The budget is prepared on a cash basis.
2. The budget managed within a medium term fiscal framework.
3. The budget is limited to the funds that are under the control of the government.
4. Rules for cash rationing expenditures are included in the appropriations law passed by Parliament.
5. The urgent priority needs for budget repair in FGS includes implementing an emergency revenue mobilization plan and implementing a strategy to eliminate expenditure arrears.

Overarching these principles is to firstly identify what resources are available, rather than as in the past, to add-up the assessed needs of ministries. By this method, usually referred to as a top-down approach, the assessed resource envelope is calculated, and this establishes the amount of funds available for spending. From that envelope, ministries provided guiding expenditure ceilings against which they are required to develop their detailed estimates. This approach will require further development over the coming years, and for 2019, the intention is to use the 2019 Budget allocations as the initial expenditure ceiling. Details of the expenditure ceilings are contained in the 2019 Budget Call Circular.

FISCAL RULES

To assist adherence to the budget principles, a set of fiscal rules have endorsed by the BSC. These rules are:

1. Debt limit, the budget makes no addition to government debt.
2. Budget balance, the budget has a zero cash balance.
3. Expenditure, fiscal discipline is aides by expenditure ceilings limited to the 2019 Budget.
4. Revenue, all windfall revenues are where possible to allocate to reducing expenditure arrears.

ECONOMIC DEVELOPMENT

Somalia is a country located at Eastern Africa, it has an area of 637,660 Km2, Somalia, with a population of 14,317,996 people, is ranked at 74 positions by population of 196 countries, and it has a moderate population density, 22 people per km. The capital is Mogadishu and its currency is Somali shillings Somalia is holding the 147 position by nominal GDP .In terms of the human development index (HDI) which is the index used by the United Nations to measure the progress of a country.

Implementation of fiscal policy has significantly improved, but challenges remain. Domestic revenue grew by 26.5%, from $112.7 million in 2016 to $142.6 million in 2017 driven by trade taxes. Donor grants almost doubled to $103.6 million in 2017 from $55.3 million in 2016 a remarkable performance of the commitments been realized.

Over the past four years, real GDP growth has been moderate, averaging about 3.4%. Real GDP growth slowed to an estimated 2.4% in 2017, due mainly to the ongoing drought, and projected to recover to 3.5% in 2018 and 2019. The main drivers in 2017 were construction, telecommunications, and financial services. The rise in GDP growth in 2018 and 2019 expected to driven by a recovery in the agriculture, higher private-sector investment, and improved security. Inflation, which has contained by dollarization and the sharp decline in oil prices predicted to remain around 2.7% in 2018 and 2019.

MEDIUM TERM FISCAL FRAMEWORK (MTFF)

The Medium Term Fiscal Framework provides for the major objective details of revenues and expenditure over the medium and long-term perspective with the consideration of historically the actual receipts and expenditures accrued in recent years, which resulted to reach the budget estimates for Current Financial Year and projections over next coming years.

The implementation of efficient tax revenue and generation of introducing sales tax is a key to building both a sustainable state and a durable peace. This revenue strategy will synchronized with the budget cycle. Some of the outcomes of the diagnostic work for the domestic revenue strategy have integrated in the budget strategy as part of the policy measures and administrative measures for F/Y 2018/19.

Table 1 shows The Figures of Medium Terms Fiscal Framework for Revenue.

		<Actual	Budget	Projection >		
In US$ Million	Actual 2016	Actual 2017	Revised Budget 2018	Projection 2019	Change on Budget $	Change on Budget %
Total Revenue	**167.98**	**248.26**	**297.07**	**340.07**	**43.0**	**12.6%**
Domestic Revenue	**112.68**	**142.64**	**172.51**	**189.85**	**17.3**	**9.1%**
Tax Revenue	**88.57**	**112.03**	**127.86**	**135.20**	**7.3**	**5.4%**
Tax on Income, Profit and Capital Gains	2.37	3.45	7.16	9.10	1.9	21.3%
Taxes on goods and services	9.89	15.80	26.20	29.10	2.9	10.0%
Taxes on international trade and transactions	76.31	92.79	94.50	97.00	2.5	2.6%
Non-Tax Revenue	**24.11**	**30.61**	**44.65**	**54.65**	**10.0**	**18.3%**
Grants	**55.30**	**105.61**	**124.56**	**150.22**	**25.7**	**17.1%**
Bilateral	**24.04**	**43.79**	**81.11**	**30.00**	**-51.1**	**-170.4%**
Multilateral	**31.26**	**61.82**	**43.46**	**120.22**	**76.8**	**63.9%**

Table 2 Shows The Figures of Medium Terms Fiscal Framework for Revenue as percentage.

In US$ Million	Actual 2016	Actual 2017	Revised Budget 2018	Projection 2019	Change on Budget $	Change on Budget %
Total Revenue	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Domestic Revenue	67.1%	57.5%	58.1%	55.8%	40.3%	72.2%
Tax Revenue	52.7%	45.1%	43.0%	39.8%	17.1%	42.9%
Tax on Income, Profit and Capital Gains	1.4%	1.4%	2.4%	2.7%	4.5%	168.6%
Taxes on goods and services	5.9%	6.4%	8.8%	8.6%	6.7%	78.8%
Taxes on international trade and transactions	45.4%	37.4%	31.8%	28.5%	5.8%	20.4%
Non-Tax Revenue	14.4%	12.3%	15.0%	16.1%	23.3%	144.7%
Grants	32.9%	42.5%	41.9%	44.2%	59.7%	135.1%
Bilateral	14.3%	17.6%	27.3%	8.8%	-118.9%	-1347.4%
Multilateral	18.6%	24.9%	14.6%	35.4%	178.5%	505.0%

The vertical analysis of the revenue for revised budget 2018 and budget 2019 trend for Total revenue is positive high where the variance of 43 USD (in millions) 297.07 to 340.07, reasoned by the introducing the imposition of sales tax and an increased of international grants. but must continue in this vein for a number of years to permit resources to be directed comprehensively to the usual range of goods and services a government is expected to provide to its citizens, compositional issues are readily apparent, The comparisons of analyses for 2018 and 2019 of estimated Grants USD (in millions) 124.56 to 150.22 which indicated an increase of more grants in 2019.

The dominance of Trade Taxes as a proportion of domestic revenues underscores the weakness in corporate taxes, sales tax, income and, and in consumption taxes. Each of these categories requires major efforts to improve the legal and administrative basis for collecting these taxes.

Finally, the large increases in non-tax revenue (primarily Airport and Harbor fees and visa charges) indicate from improved and efficient management of the airport and port operations.

As far as detailed revenue forecasts for 2019 are underway to expected the total resource envelope will be approximately for 2019is about 340.7 million, and achievement depends critically on continued international support.

The Table 3 Shows the Figures of Medium Terms Fiscal Framework for Expenditure.

In US$ Million	Actual 2016	<Actual Actual 2017	Budget Revised Budget 2018	Projection > Projection 2019	Change on Budget $	Change on Budget %
Expenditure	**171.07**	**245.57**	**297.07**	**340.06**	**43.0**	**29.5%**
Compensation of Employees	79.31	128.87	145.68	154.42	**8.7**	**5.7%**
Purchase of Goods and Services	70.25	82.94	96.68	117.06	**20.4**	**17.4%**
Capital	5.94	6.35	15.52	26.61	**11.1**	**41.7%**
Transfers (Grants)	9.42	23.40	33.26	37.95	**4.7**	**12.3%**
Other expenses	2.06	4.01	5.94	4.02	**-1.9**	**-47.6%**
Net lending and repayments	4.09	0.00	0.00	0.00	**0.0**	**0.0%**
Gross Operating Balance	**-3.08**	**2.69**	**0.00**	**0.01**	**0.01**	**-0.17**

Table 4 Shows the Figures of Medium Terms Fiscal Framework for Expenditure as percentage.

In US$ Million	Actual 2016	<Actual Actual 2017	Budget Revised Budget 2018	Projection > Projection 2019	Change on Budget $	Change on Budget %
Expenditure	**100%**	**100%**	**100%**	**100%**	**0.0%**	**0.0%**
Compensation of Employees	46.4%	52.5%	49.0%	45.4%	**0.0%**	**0.0%**
Purchase of Goods and Services	41.1%	33.8%	32.5%	34.4%	**0.0%**	**0.0%**
Capital	3.5%	2.6%	5.2%	7.8%	**0.0%**	**0.0%**
Transfers (Grants)	5.5%	9.5%	11.2%	11.2%	**0.0%**	**0.0%**
Other expenses	1.2%	1.6%	2.0%	1.2%	**0.0%**	**0.0%**
Net lending and repayments	2.4%	0.0%	0.0%	0.0%	**0.0%**	**0.0%**
Gross Operating Balance	**-1.8%**	**1.1%**	**0.0%**	**0.0%**	**0.0%**	**-57.1%**

The increase of the expenditure of the budget is mainly salary centric, which more than 45.5% of spending allocated to staff salary support whereas the proportion of security sector spending is more of the 2018 Budget. These large shares of spending crowd-out opportunities for funding other spending areas, such as interest payments on debt, transfers and subsidies to government business enterprises and for other sector development; spending on health and education, which is vitally needed to improve social and economic development, with fostering infrastructure capital spending; and a social safety net. Additionally any failure of allocated spending of these sectors can also give rise to arrears to government budgets.

Spending as a proportion of GDP is extremely low at about 3%. This proportion can only grow once revenue expands and provided staff numbers and wage rates are kept under tight control.

Although comprehensive revenue forecasts for 2019 are still ongoing, propositions are that the total resource envelope will be approximately to that for 2019 about 340 million and accomplishment be contingent censoriously on continued global support.

EXTERNAL AND INTERNAL DEBTS ON SOMALIA

Most of Somalia's external debts linked to ousted republic of Somali lead by former respected president M Siad Barre, who in the 1970s and 1980s went borrowing spree for infrastructure and development projects. Therefore nearly 30 years, with the war economy lingering, Somalia is one of the three last nations in the world, alongside Sudan and Eritrea, to still not meet conditions for debt relief under a World Bank and IMF initiative known as Heavily Indebted Poor Countries (HIPC), which aims to ensure no poor country faces a debt burden it cannot manage and can address its development needs. It is a several steps process requiring specific criteria and benchmarks to be met before the debt is cancelled and new development focused lending is permitted.

Somalia, among the poorest countries in the world, is one of three remaining countries that are eligible for comprehensive debt relief under the HIPC Initiative (the other two are Sudan and Eritrea). Somalia is estimated to have over USD 4.6 billion in external debt, with Paris Club creditors and Non-Paris Club bilateral creditors representing the largest multiple blocs (roughly $3.1 billion), Under the heavily Indebted Poor Countries (HIPC) Initiative and the complementary Multilateral Debt Relief Initiative, virtually all of Somalia's multilateral debt and the vast majority of its bilateral debt would be eliminated, Somalia received unsanctioned debt engagement since the collapse central government of Somalia in 1991.

Somalia's debt relief process started in April 2013, once the IMF officially recognized the federal government, which had formally established less than a year before, after an extended transitional period. It has slowly developed over time in February 2017 significant progress had made with identifying Somalia's external debt statistics. The federal government and IMF have agreed upon a third more ambitious staff-monitored program that aims to help Somalia's economic reconstruction efforts and focuses on reforms to strengthen macroeconomic policy management, economic governance, and institutional capacity.

Somalia debts contained four major different constellations, World Financial Institutions, Paris Club, Non Paris Club, Payroll arrears.

Table 5 shows Local Arrears by MDA's Predominantly Payroll Arrears.

	2013	2014	2015	2016	2017	Total
Members of Parlement, People's House	$ -	$ -	$ -	$ 4,593,000.00	$ -	$ 4,593,000.00
Civil Servant Staff	$ 904,301.70	$ -	$ 4,235,356.00	$ 10,293,288.00	$ -	$ 15,432,945.70
Non-Civil Servant Staff	$ -	$ -	$ 2,062,134.00	$ 3,915,284.60	$ -	$ 5,977,418.60
Somali Custodian Corp	$ -	$ -	$ 866,000.00	$ 1,082,500.00	$ -	$ 1,948,500.00
Somali National Army	$ -	$ -	$ 7,116,400.00	$ 15,708,500.00	$ -	$ 22,824,900.00
Somali National Police	$ -	$ -	$ -	$ 2,798,100.00	$ -	$ 2,798,100.00
National Intelegency and Security Agency	$ -	$ -	$ 457,333.33	$ 914,666.66	$ -	$ 1,371,999.99
Total by Year	$ 904,301.70	$ -	$ 14,737,223.33	$ 39,305,339.26	$ -	$ 54,946,864.29

The above figure indicates only salaries and allowances arrears from different MDA's, Somalia government faces crisis for local arrears from previous administrations, and it's mandatory to pay back and clear for next future, the total internal debt from government agencies is mainly based on salaries, allowances and operation costs which approximately 55 million .

Somalia previous administration failed to pay recurrent costs debts on time due shortage of revenue collection and scarcity of international grants in 2016. International communities have pledged billions to Somali government, but not mostly as direct budget support. Somali government backed by the international community since collapse of central government 1991, but has become a source grumbling for Somalis, as changes come in a very slow pace.

RISK ASSESSMENT

The budget strategy is subject to financial risks, which include unexpected financial pressures the government may encounter in the future; the probability that the projected revenues may not be achieved and that spending may exceed the estimates listed in the budget. The following risk matrix identifies the main risks, provides an estimate of likelihood, impact, and steps that can be taken to mitigate the risk.

Risk	Likelihood	Impact	Mitigation or Management strategy
Overall security situation deteriorate	Medium	• Poor revenue performance, delay in disbursements and economic decline. • Worsening humanitarian situation • Reduce prospects for economic growth • Increase costs in service delivery	• Improve security situation through reconciliation and inclusive approach • Strengthen security personnel • Provide security needed equipment • Improve certainty of security compensation
Arrears to security force	Medium	Exacerbate insecurity and contribute to poor revenue performance	Implement improved SNA identification and secure funding for timely payment of salary

Collection of corporate taxes (Telecommunication and remittances companies)	Low	• Delay in the introduction of corporate taxes would put expected revenue at risk	Ministry of Finance submit corporate tax bill to the Parliament and implement it on time
Budget income: 44.1% consists of grants from donors	Medium	• Donor delay or cancel of disbursements could collapse the budget	Include in the budget only firm commitments backed with funds made available to the budget
Increase compensation of employees as a share of total expenditure	Medium	• The increase in compensation of employees risk crowding out in investment and other priority areas	Keep compensation of employees to a level that is acceptable or feasible to available revenues
Weak enforcement of rule of law		• Slow development of integrity institutions which are necessary to facilitate private sector development and promote growth and development	Create awareness on the need for the government to raise taxes and build integrity institutions.

CONCLUSION

This Budget Strategy Paper is prepared under continued difficult domestic economic conditions, with moderate growth expected due to weak recovery in the global economy. Expected growth in the real GDP of 3.0 percent in 2019 is insufficient in addressing the development challenges of unemployment, poverty, and income inequality. Hence, there is a need to use the 2019 budget, which will be one of financial year following the adoption of NDP and, to align the implementation of the two documents, with a view to promoting growth, economic diversification, and employment creation.

The preparation of the 2019 Budget Strategy Paper therefore drew from the national priorities identified in the draft NDP, while taking into account the country`s fiscal policy parameters. However, there was also need to ensure that the implementation of the ongoing staff monitoring Program (SMP) continued during 2019 financial year, despite the budgetary pressures.

Amongst the major upgrading fragments to the 2019 budget outlook includes the continued to fulfill all benchmarks from IMF and World Bank in order to relief the global debts. Despite the exiting challenges, 2019 budget outlook, Government remains committed to maintaining fiscal sustainability in the medium term. Thus, additional measures to raise domestic revenues or trim the planned expenditure during the implementation of the NDP will considered, if necessary, to restore fiscal sustainability.