

Federal Government of Somalia

Financial Governance Report

Financial
Governance
Committee

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About the Financial Governance Committee

The Financial Governance Committee (FGC) was established in early 2014 by mutual agreement between the Federal Government of Somalia (FGS), donors and International Financial Institutions (IFIs) to provide a forum for dialogue and advice on strategic financial governance issues. Members of the FGC are drawn from Somali institutions and international partners. The FGC is chaired by the Minister of Finance, and other FGS members include the Governor of the Central Bank of Somalia, representatives from the President's Office and the Prime Minister's Office, the Chair of the Parliamentary Finance Committee and the State Attorney General. The FGC has four international members, who sit as delegates on behalf of the International Monetary Fund, the World Bank, the African Development Bank and donor partners.

The FGC's advisory scope encompasses Central Bank governance, asset recovery, public procurement and concessions, public financial management reforms and fiscal federalism. Since its inception, the FGC has published periodic progress reports and produced advisory notes on specific financial governance issues such as security sector expenditures, natural resource revenue management, property and asset management and use of country systems.

This report sets out the financial governance priorities the FGC believes need to be addressed in the coming year to strengthen state-building efforts going forward. Appropriate financial governance arrangements are central to the development of a viable federal system of government in Somalia, while sound financial governance is essential to successful economic development and the equitable and inclusive distribution of resources.

Executive Summary

The International Monetary Fund (IMF) recently commended the Federal Government of Somalia's efforts towards restoring its key economic and financial institutions in a very difficult political and security environment. In a context where functional central government systems have been absent for over two decades, corruption is still considered to be endemic and insecurity remains widespread, these efforts have constituted tangible positive steps towards the development of a sounder financial governance system that can limit scope for the misappropriation of public resources and enable economic development.

The incoming administration faces a daunting range of statebuilding challenges, including combating insecurity, developing a viable system of federal government, adequately resourcing the core functions of the state, reducing corruption, fostering inclusive growth and investing in longer term recovery and development. Its chances of addressing these challenges effectively are significantly hindered by its lack of resources; at present, Government cannot even finance its existing recurrent expenditures in full. The Government's financial constraints could have very real consequences for its ability to build a functional, secure federal state that enjoys the support of its citizens and increasingly provides services to them. Delays in salary payments to the security services, inability to support the finances of Federal Member States (FMS), lack of resources for infrastructure and service delivery could all undermine the credibility of the state in the eyes of its federal members and its citizens.

While more revenues and financing are needed, the way in which they are mobilised and managed is important. At present, public trust in Government's utilisation of its resources is limited. This in turn limits public and corporate willingness to consider and adhere to further revenue mobilisation by Government, creating a potential vicious circle. It also weakens donor willingness to channel aid resources through the State. While donor funding channelled through non-government entities benefits individual Somali citizens, it does little to promote trust and the social contract between the state and its citizens.

Agreeing a coherent way forward on Fiscal Federalism

In the absence of any detailed negotiations or agreement, a de facto set of intergovernmental arrangements have started to emerge. FMSs collect and spend all revenues pertaining to their geographic area of responsibility, leaving FGS to finance federal expenditures from revenues collected in Banadir region. These arrangements run contrary to the principle of fair distribution of resources established in the Provisional Constitution and potentially weaken the political and policy bond between the federal government and FMSs. They give a significant advantage to FMSs that have access to port revenues and limit the scope of the Federal Government to play its role in setting strategic direction and managing revenue redistribution.

The new Government needs to move swiftly to initiate discussions with FMSs on revenue authority, expenditure responsibility and mechanisms for resource equalisation. The FGC does not advocate that the FGS should try to reach agreement on these issues in the context of a Constitutional settlement in the first instance. An initial agreement should be developed on an interim basis and adjusted over time in line with changes in the fiscal circumstances and emerging agreements on the principles of decentralisation, including whether it should take a symmetric or asymmetric form. The principles underpinning the interim agreement need to be agreed at the highest political levels. The technical details

can then be jointly developed by the Federal Ministry of Finance and its State counterparts.

The FGC recommends that Ministry of Finance makes an immediate start by agreeing a harmonised customs tariff with the FMSs. From there, discussions should move to assignment of revenue responsibilities, mechanisms for inter-state equalisation and responsibility for service delivery, in line with the principles agreed at political level. These discussions should be accompanied by efforts to align national and subnational fiscal arrangements and reporting. The FGC recommends that the FGS starts to 'build' the inter-governmental fiscal system by making small transfers to the FMSs on a regular basis.

The FGC recommends that an office responsible for co-ordinating the federalism agenda is established in either the Presidency or the Prime Minister's Office. The way in which donors provide support to the different levels of Government in Somalia will also be an important factor in determining the progress made on fiscal federalism. As fiscal federalism principles are progressively agreed between the FGS and FMSs, it will be incumbent on donors to ensure that their support is aligned to these principles. FGS also needs to be informed of the financing donors are providing to FMSs, and as far as possible, be involved in the design of supporting projects and underlying research.

Transparent and equitable management of natural resources

Somalia has significant natural resource potential across a wide range of sectors. Access to natural resources revenues could potentially have a transformational impact on the state's finances. However, unless managed transparently and equitably, natural resource revenues also carry a substantial degree of risk. They have the potential to generate conflict between communities and their governments, and between levels of government within the federal system. Depending on how they are spent, they also have the potential to undermine rather than strengthen fiscal sustainability, disrupt economic management and generate inflation.

The FGC welcomed the recent opportunity to review the Model Oil and Gas Production Sharing Agreement (PSA) developed by the Ministry of Petroleum, and made a number of recommendations as to how the PSA's fiscal terms could be strengthened to ensure value to FGS, while still being sufficiently attractive to investors. Going forward, it is essential that the terms of the finalized model PSA provide the basis for discussions of specific PSAs. All contractors for PSAs should be selected transparently and competitively.

The FGC also recommends that the FGS finalizes the revisions to its legal framework for petroleum and establishes the necessary regulatory institutions before production sharing agreements are concluded. Otherwise there is a substantial risk that the government will lack the ability to protect to Somalia's interests effectively, which in turn can exacerbate the risks of conflict and corruption.

The FGC has noted with concern that foreign fishing vessels have recently been reported as being in negotiations with the Government of Puntland to receive licenses to fish in Somali waters. Unregulated licensing of foreign trawlers for short term gain by individual FMSs undermines the livelihoods of local fishermen, damaging the sustainability of marine resources and discouraging legitimate investors from engaging in Somalia's fisheries sector. The FGC recommends that the Ministry of Fisheries agrees a framework for sharing 2017 federal offshore fishing license revenues with FMSs, and uses the inter-governmental fiscal transfer system to provide FMSs with their shares in a way that creates incentives for licensing compliance.

The FGC is concerned about the sustainable management of natural resource revenues. There are no overall legal requirements in place governing the extent to which revenues can be spent or saved in any given year. The FGC recommends that the FGS moves rapidly to insert clauses in the draft Public Financial Management (PFM) Bill that set out the principles governing natural resource revenue management as relates to fiscal policy. The FGC also recommends that the Ministry of Finance works with the Ministry of Petroleum to review the proposed revenue sharing formula for petroleum and ensure that it is equitable within the context of the broader fiscal federalism framework.

Enhancing revenue mobilisation

The FGS has made some progress in increasing its revenue from sources other than customs duties since 2014. To a large extent, this progress has been made through the agreement of concessions for the collection of non-tax revenues. The two largest of these concessions relate to the management of Mogadishu Port and Mogadishu Airport, but FGS has also entered into concessions for the collection of road tax, vehicle licenses and property transfer tax. The FGS has made comparatively little progress in collecting private sector income taxes and indirect domestic taxes.

The FGC agrees that in a context of low capacity for revenue administration, contracting private sector entities to manage or support the collection of non-tax revenues may be an efficient way of increasing these revenues. In aggregate, the FGS's experience since 2014 demonstrates this. However, the five existing contracts were largely directly negotiated without significant technical appraisal, therefore calling into question their value for money. The FGC recommends that the new Government concludes renegotiations of all five contracts before the end of 2017, establishing clearer contract terms and ensuring stronger oversight of their revenue streams going forward.

The FGC has noticed that the individual contracts have proposed varying tax exemptions. If individual line ministries have the discretion to offer or negotiate tax exemptions, the FGS will lose control over its revenue base. Power to grant tax exemptions should be vested solely in the Minister of Finance; the FGC recommends that FGS inserts a clause into the PFM Bill to this effect. The FGC also recommends that the FGS should seek to minimise the tax exemptions that it offers in its contracts and concessions, given the negative precedent these exemptions set for future tax and contract negotiations and development of the revenue base.

There are a number of reasons for the FGS's lack of progress in increasing its revenues from sources such as income tax, sales tax and excise duty, as well as sector-specific fees and licenses. The legal framework for domestic revenues is outdated, relying on legacy laws from the 1960s to 1980s that are not well adapted to the modern economy, while the legal frameworks regulating sectors such as telecoms and money transfer are lacking. After more than two decades without domestic tax collection by central government, the compliance culture amongst taxpayers is limited, while Government systems and capacity for collection are relatively weak. Enhancing domestic revenue mobilisation requires systematic work across a range of dimensions and co-ordination across a range of stakeholders. Political level commitment to tax compliance is needed, followed by dialogue with key taxpayers in key sectors to establish mechanisms for payment of their legal dues. This needs to be backed by appropriate legislation, and supported at a technical level with capacity for collection and compliance. The FGC recommends that the new Government initiates a round table dialogue with the leading members of private sector, in order to secure their

commitment to meeting their legal tax obligations, whilst also gaining a clearer understanding of the services that the private sector expects to receive from government in return.

Credible public procurement and concessions

Since 2014, at the request of the FGS, the FGC has played a lead role in reviewing FGS concessions and contracts above \$5m in value. Since August 2016, it has been working closely with the Interim National Procurement Board (INPB), which has been mandated by FGS to oversee the contracting of all FGS concessions and any contracts above \$2m in value until such a time as the Procurement Act is fully implemented. The majority of the contracts that the FGC has reviewed did not result from any competitive tender process. Instead, they resulted from direct negotiations between FGS agencies and contractors, often instigated by the contractors themselves. In many instances FGS line ministries have been responsive to the feedback provided by the FGC, which is encouraging. However, the FGC notes with concern that some FGS agencies have ignored FGC advice, or bypassed the FGC altogether, and have not faced any penalties for doing so.

There have been other encouraging signs over the past year; more contracts are starting to be submitted to the FGC/INPB in draft form, and FGS has demonstrated its commitment to the competitive tendering of rations contracts for the security sector. In addition, in line with FGC advice, FGS is moving to strip out the cash component that is included in the rations contracts, and is instead pushing to pay rations cash directly to personnel through the salary payment system. Less encouragingly, some contracts are still being signed without following any evident due process. A lack of transparency around the disposal of public assets is also an increasing concern to the FGC, as such disposals serve to generate public mistrust in the motivations of the Government, and sustain perceptions of corruption.

The FGC recommends that the incoming administration makes a clear, public statement on its commitment to due process in contracting, concessions and asset leasing. The statement should explain the steps that all draft contracts, concessions and leases must follow prior to signature and set out the consequences of non-compliance. The FGC also recommends that the incoming administration supports the continuation of the recently established Commission to Protect Public Properties, working to a clear, expanded terms of reference.

Given the very low levels of procurement capacity within FGS, the FGC recommends that the FGS extends the procurement transition period until such a time as there is adequate capacity for implementation of the Procurement Act. Specifically, this should involve extending the mandate of the INPB and specifying interim procurement roles and responsibilities within FGS prior to full implementation of the Procurement Act. The FGC recommends that the FGS consider assigning responsibility for contracting all FGS goods and services above a certain threshold to the Ministry of Finance's Procurement Unit as an interim measure until procurement units in line ministries have the necessary capabilities. The Ministry of Finance's Procurement Unit will require significant interim capacity support to carry out this role.

Strengthened expenditure management

Recent expenditure management reforms have gone some way towards strengthening the expenditure management system and reducing the scope for the misappropriation of funds, particularly payment of civil service and police salary direct to individuals' accounts and payment of up to a third of non-wage expenditures direct to suppliers' accounts. FGS needs to go further in reducing the proportion of the non-wage payments that are paid out in cash, and to require all advances to be fully accounted for before new ones are made. The Cabinet and the Presidency need to give full backing to this reform. FGS also needs to place much stronger controls on the payroll, otherwise gains made in increasing revenue and reducing funds leakage will be fully absorbed by a rising wage bill.

Significant effort also needs to be put into verifying the delivery of goods and services. From the FGC's perspective, the gains made in improving the tendering and transparency of rations contracts will count for little if there is limited visibility on whether goods and services are delivered. Given the public mistrust of FGS's financial management, it may not be sufficient at this stage to rely solely on inspection reports from the receiving spending agency as proof of delivery. The FGC recommends that the Ministry of Finance establishes an Inspection Function responsible for verifying the delivery of goods and services above a certain value prior to the payment of invoices.

FGS has commenced the process of cleaning and consolidating the Somali National Army (SNA) payroll and undertaking biometric registration of personnel, in order to make salary payments direct to individuals' accounts. The FGC considers it extremely important that FGS completes this reform, which will help reduce scope for misappropriation of salary funds and payment of ghost personnel. It is also important that the donors providing stipends to the sector become part of the reform, so that all SNA salary and stipend payments are made through the FGS system against a single, commonly agreed payroll, as already occurs with the Police. This convergence and system strengthening is an important first step in the broader and longer-term process of security sector reform, which is needed to bring the SNA to a troop size that is affordable, to enable better remuneration of soldiers, and adequate provisioning of supplies and professionalization of the force.

Financial sector development

Reforms to the regulation and supervision of Somalia's financing system are already underway, and it is critical that they continue to be supported, politically, financially and technically. They will enable the re-establishment of correspondent banking relationships with international banks, thus safeguarding the flow of remittances into Somalia. They will also improve the FGS's prospects for accessing external financing and support economic development by enabling the private sector to access credit through the banking system, rather than relying on informal credit networks. Currency reform is likely to be the highest-profile financial sector issue for the incoming Government. With technical assistance from the IMF, the Central Bank of Somalia (CBS) is making all the necessary preliminary arrangements for reissuing the new Somali Shilling. Successful completion of the currency reform will require substantial donor financing for printing and distributing the new currency, plus any costs related to converting old notes for new ones.

The introduction of a new currency is a major undertaking and requires political and socio-economic commitment from all stakeholders. The FGC recommends that the incoming Government holds early discussions with CBS so that it understands the key choices and risks associated with currency reform, and initiates discussions with the FMSs. One of the most important issues requiring political input is the issue of conversion; most old Somali shilling notes in circulation are considered to be counterfeit. The question therefore is whether the people who hold these notes, particularly people with low incomes, should be entitled to full, partial or no compensation for the notes they hold. Broad acceptance of the conversion approach adopted will be critical to the acceptance of the new currency. A contested currency reform, as recently occurred in India, would severely damage the credibility of FGS and CBS, and destabilize the country more generally.

Access to external financing

Given its fiscal constraints, FGS needs increased access to external financing in order to consolidate the process of state-building and extend the development agenda. Overall aid flows to Somalia, including humanitarian aid, peacekeeping and development assistance, are estimated to have amounted to \$5.4bn over the past three years. However, direct flows to the FGS have amounted to just \$158m, equivalent to just 3% of overall aid flows to Somalia, and less than 10% of development aid. In the absence of additional financing to FGS, early stabilization gains are likely to be jeopardized. In 2015, FGS and Development Partners agreed that 15% of development assistance should be channeled through the FGS. The FGC supports this target, and suggests it should be more ambitious.

Qualifying for debt relief will be one way of unlocking additional external financing, as FGS will be able to access concessional loans from multilateral and bilateral lenders. The FGC recommends that the FGS and its creditors develop a milestones-based debt relief roadmap setting out how Somalia can qualify for the Heavily Indebted Poor Countries (HIPC) debt relief process, with arrears clearance to International Financial Institutions (IFIs) as a first step. It also recommends the FGS and the IFIs reach agreement on the adjustments needed to the National Development Plan (NDP) so it can qualify as an Interim Poverty Reduction Strategy Paper.

FGS also needs to increase its access to grant financing. The FGC recommends that the new administration uses the London conference as an opportunity to make the case to the international community of the benefits of increasing direct government financing, and the risks of not doing so, including the risk of undermining the state-building efforts they have invested so much in to date. The FGC also hopes that the forthcoming joint 'risk-benefit analysis' of the use of country systems will identify concrete risk-mitigation actions that FGS and donors can implement to support the scale-up of aid through FGS.

Blended financing offers an opportunity to use donor funds to leverage private sector financing for infrastructure and other development. The FGC recommends that the FGS holds discussions with interested IFIs about the potential scale and role of blended financing in Somalia, including its scope to create jobs and reduce poverty.

The FGC recommends that the international community helps expand government engagement with the Humanitarian Response Plan (HRP) by strengthening reporting to FGS on how HRP funds are spent, both sectorally and geographically, and by whom. The 2017 HRP should focus on core humanitarian life-saving and protection issues, freeing up external financing to focus on development activities which are better rooted in an understanding of resilience activities.

Fiscal Federalism

- 1 The FGS and the Federal Members States should establish an initial agreement on revenue authority, expenditure responsibility and mechanisms for resource equalisation, in advance of any final Constitutional Settlement. The principles underpinning the interim agreement should be agreed at the highest political levels. Technical details should then be jointly developed by the Federal Ministry of Finance and its counterparts at FMS level.
- 2 An office responsible for co-ordinating the federalism agenda should be established in either the Presidency or the Prime Minister's Office.
- 3 The Ministry of Finance should make an immediate start by agreeing a harmonised customs tariff with the FMSs while awaiting political agreement on the broader principles.
- 4 The FGS should start to 'build' the inter-governmental fiscal system by aligning national and subnational fiscal arrangements and making small transfers to the FMSs on a regular basis.
- 5 Donors need to inform FGS of the support they are providing to FMSs and involve FGS in project design to ensure it aligns to the agreed fiscal federalism principles.

Transparent and Equitable Management of Natural Resources

- 1 FGS should finalize the revisions to the legal framework for petroleum and establish the necessary regulatory institutions before entering into any production sharing agreements.
- 2 Cabinet should approve the finalised model Oil and Gas PSA in line with FGC recommendations. The terms of the finalized model PSA should provide the basis for discussions of specific PSAs, which should also be approved by the INPB and by Cabinet.
- 3 FGS should insert clauses in the draft PFM Bill that set out the principles governing natural resource revenue management as relates to fiscal policy.
- 4 The Ministry of Fisheries should agree a framework for sharing 2017 federal offshore fishing license revenues with FMSs, and use the inter-governmental fiscal transfer system to provide FMSs with their shares in a way that creates incentives for licensing compliance.
- 5 The Ministry of Finance should work with the Ministry of Petroleum to review the revenue sharing formula proposed in the petroleum agreement, and initiate new negotiations with all FMSs.

Enhanced Revenue Mobilization

- 1** FGS should conclude renegotiations of all five existing revenue collection contracts before the end of 2017, establishing clearer contract terms and ensuring stronger oversight of their revenue streams going forward.
- 2** The Ministry of Finance should provide guidance to its counterparts in the FMSs on how to develop and manage revenue collection contracts based on its own experience.
- 3** FGS should insert a clause into the PFM Bill stating that the power to grant tax exemptions will be vested solely in the Minister of Finance. FGS should seek to minimise the tax exemptions that it offers in its contracts and concessions, given the negative precedent such an approach sets for future tax and contract negotiations.
- 4** Political level commitment is needed to tax compliance and passage of relevant legislation (e.g. Communications Act).
- 5** FGS should initiate a round table dialogue with the leading members of private sector to secure their commitment to meeting their legal tax obligations and gain an understanding of the services they need to provide in return.

Credible Public Procurement and Concessions

- 1** FGS should issue a Prime Ministerial Decree re-affirming its commitment to due process in contracting, concessions and asset leasing. The Decree should: specify procurement roles and responsibilities within FGS until such a time as the Procurement Act can be adequately implemented; extend the mandate of the INPB for the duration of the transition period; set out the steps all draft agreements must follow prior to signature; and, state the consequences of non-compliance.
- 2** FGS should consider assigning responsibility for contracting all FGS goods and services above a certain threshold to the Ministry of Finance's Procurement Unit as an interim measure until procurement units in line ministries have the necessary capabilities.
- 3** Donors need to step up their support to FGS procurement; significant levels of operational support and capacity building are required both within the Ministry of Finance and across line ministries.
- 4** The incoming administration should support the continuation of the recently established Commission to Protect Public Properties, working to a clear, expanded terms of reference.

Strengthened Expenditure Management

- 1** Cabinet should provide explicit backing to the Ministry of Finance to further reduce the proportion of the non-wage payments that are paid out in cash, and to require all advances to be fully accounted for before new ones are made.
- 2** FGS needs to place much stronger controls on the payroll, as otherwise gains made in increasing revenue and reducing funds leakage will be fully absorbed by a rising wage bill.
- 3** The Ministry of Finance should establish an Inspection Function responsible for verifying the delivery of goods and services above a certain value prior to the payment of invoices.
- 4** The Ministry of Finance and SNA should FGS complete the process of cleaning and consolidating the SNA payroll and undertaking biometric registration of personnel, and commence payment of salaries (and rations cash) direct to individuals' accounts.
- 5** Donors providing stipends to the security sector should commit to becoming part of the SNA payroll and payment reform; the objective should be that all SNA salary and stipend payments are made against a single, commonly agreed payroll and paid direct to individuals' accounts through the FGS system, as already occurs with the Police.

Financial Sector Development

- 1** FGS should hold discussions with the FMSs to come to a clear, common understanding of the role of the CBS in the regions in the context of the broader fiscal federalism discussions, and with respect to currency reform.
- 2** The FGC recommends that the incoming Government holds early discussions with CBS so that it understands the key choices and risks associated with currency reform, and initiates discussions with the FMSs.
- 3** Particular attention needs to be paid to the issue of currency conversion, to ensure that currency reform does not have a negative impact on people with low incomes who currently hold old Somali shilling notes.
- 4** Successful completion of the currency reform will require substantial donor financing, for printing and distributing the new currency, plus any costs of converting old notes for new ones.

Access to External Financing

- 1** The FGC recommends that FGS and its creditors should develop a milestones-based debt relief roadmap setting out how Somalia can qualify for the HIPC debt relief process. As a part of this, FGS and the IFIs should reach an agreement on the adjustments they need to make to the NDP so it can qualify as a poverty reduction strategy paper (PRSP).
- 2** FGS should use the London conference as an opportunity to make the case to the international community of the benefits of increasing direct grant financing, and the risks of not doing so.
- 3** FGS and donor partners should revise the current 15% target for development aid on budget and make it more ambitious.
- 4** FGS and donors should use their forthcoming joint 'risk-benefit analysis' of the use of country systems to identify concrete risk-mitigation actions that they can implement to support the scale-up of aid through FGS.
- 5** FGS should hold discussions with interested IFIs on the potential scale and role of blended finance in Somalia.
- 6** The international community should help expand government engagement with the HRP, by strengthening reporting to FGS on how HRP funds are spent, both sectorally and geographically, and by whom.



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Acronyms

AfDB	African Development Bank
ALSF	Africa Legal Support Facility
CBS	Central Bank of Somalia
EU	European Union
FGC	Financial Governance Committee
FGS	Federal Government of Somalia
FMS	Federal Member States
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
HRP	Humanitarian Response Plan
IFI	International Financial Institutions
IMF	International Monetary Fund
INPB	Interim National Procurement Board
MTB	Money Transfer Business
NDP	National Development Plan
NISA	National Intelligence and Security Agency
PFM	Public Financial Management
PRSP	Poverty Reduction Strategy Paper
PSA	Production Sharing Agreement
SFMIS	Somalia Financial Management Information System
SMP	Staff Monitored Program
SNA	Somali National Army
STAR	Stolen Asset Recovery Initiative
UCS	Use of Country Systems
UCT	Upper Credit Tranche
UK	United Kingdom
US	United States

1. Introduction

The Financial Governance Committee (FGC) was established in early 2014 by mutual agreement between the Federal Government of Somalia (FGS), donors and International Financial Institutions (IFIs) to provide a forum for dialogue and advice on strategic financial governance issues. Members of the FGC are drawn from Somali institutions and international partners. The FGC is chaired by the Minister of Finance, and other FGS members include the Governor of the Central Bank of Somalia (CBS), representatives from the President's Office and the Prime Minister's Office, the Chair of the Parliamentary Finance Committee and the State Attorney General. The FGC has four international members, who sit as delegates on behalf of the International Monetary Fund (IMF), the World Bank¹, the African Development Bank (AfDB)² and donor partners³.

The FGC was established in the aftermath of the resignation of the Governor of the Central Bank of Somalia, Yusur Abrar, in late 2013, amid concerns over the management of recovered assets and the nature of a contract FGS had entered into with a US law firm to assist the asset recovery process. As a result, the FGC's initial focus was on strengthening Central Bank Governance, enabling a transparent process for asset recovery and reviewing public procurement and concessions. Over time, alongside these initial core issues, the FGC has progressively taken on a role in reviewing FGS progress in implementing public financial management (PFM) reforms in the context of the PFM Action Plan and IMF Staff Monitored Program (SMP), and promoting dialogue on fiscal federalism. In addition, in response to emerging demand, it has provided guidance on specific financial governance issues that impact on overall governance such as security sector expenditures, natural resource revenue management, property and asset management and use of country systems.

Consistent with its composition as a hybrid Somali-international body, the FGC plays a mixture of advisory, monitoring and catalytic roles. It does not have executive powers. However, until such a time as the Procurement Act is under full implementation, it has been mandated to review all Government contracts and concessions above \$5m in value. It also supports the work of the Interim National Procurement Board (INPB), an FGS committee mandated to approve all concessions and contracts above \$2m. The FGC's current mandate runs to the end of April 2017. Its renewal will be subject to discussion between the incoming Government and the international community.

This report sets out the strategic priorities the FGC believes the Government and its partners need to address in the coming year to strengthen financial governance and state-building efforts going forward. Appropriate financial governance arrangements are central to the development of a viable federal system of government in Somalia, while sound financial governance is essential to successful economic development and the equitable and inclusive distribution of resources. Poor financial governance reinforces inequality and encourages incentives and opportunities for corruption. Corruption ultimately undermines the public's trust in its government and can become a conflict driver, undermining state building efforts. Success in building financial governance should help reinforce the legitimacy of the government, promote stability in Somalia, open the door to debt relief and enable access to the financial flows essential to rebuilding the country.

¹ Funded through the World Bank Multi Partner Fund. The fund has ten contributing donors – for further details see: <http://somaliampf.org/development-partners>

² The FGC is awaiting the appointment of a new AfDB delegate

³ Funded on behalf of donors by the European Union

2. Main Financial Governance challenges

The IMF recently commended FGS's efforts towards restoring its key economic and financial institutions⁴ in a very difficult political and security environment. These efforts have encompassed a range of financial governance dimensions, from policy and legal frameworks to system strengthening and institutional development.

In a context where functional central government systems have been absent for over two decades, corruption is still considered to be endemic⁵, and insecurity remains widespread, these efforts constitute tangible positive steps towards the development of a sounder financial governance system that can limit scope for the misappropriation of public resources and enable economic development. Nonetheless, the overall context remains highly fragile; as the IMF has noted, the Somali economy is expected to continue to be sustained by donor grants, remittances and foreign direct investment, mainly from the Somali diaspora, and growth is expected to decline in 2017, due to the impact of the drought on the agriculture sector. Transition finance will be needed to maintain stability for some years to come.

Good financial governance is essential for good governance overall; the consequences of failure would be very serious for the new government. Financial governance is more than just ensuring a functioning public revenue and budget system and the observance of public accountability that is increasingly transparent, rules-based and effective. In a post-conflict situation like Somalia, it also concerns the flow of resources; it affects the architecture of aid, the behaviour, priorities, influence and power of different groups; and the development of longer term capacity in the government.

The incoming administration faces a daunting range of statebuilding challenges, including combating insecurity, developing a viable system of federal government, adequately resourcing the core functions of the state, reducing corruption, fostering inclusive growth and investing in longer-term recovery and development. Its chances of addressing these challenges effectively are significantly hindered by its lack of resources; at present, Government cannot even finance its existing recurrent expenditures in full. If left unaddressed, the Government's financial constraints could have very real consequences for its ability to build a functional, secure federal state that enjoys the support of its citizens and increasingly provides services to them.

Progress towards stronger Financial Governance since 2014

Legal and regulatory: The Procurement Act and Anti Money Laundering Act have been passed, a draft PFM Bill has been submitted to Parliament, CBS has established its by-laws, developed key Commercial Bank and Money Transfer Business (MTB) regulations and issued licenses.

Policy: FGS has approved a five year PFM Reform Action Plan and an Arrears Clearance Plan and drafted the NDP. CBS has prepared a Currency Reform Road Map. Successful completion of two Article IV consultations with the IMF for the first time in twenty-five years and agreement of an SMP are also significant milestones, enhanc-

⁴IMF Press Release No. 17/40: <http://www.imf.org/en/News/Articles/2017/02/08/pr1740-IMF-Executive-Board-Concludes-2016-Article-IV-Consultation-with-Somalia>

⁵Transparency International Corruption Perceptions Index 2016: http://www.transparency.org/news/feature/corruption_perceptions_index_2016

ing FGS's financial management credibility and providing a pathway towards debt relief and new lending from international financial institutions.

Systems: The Ministry of Finance has consolidated government's bank accounts, automated its financial management system and established electronic payment of civil service and police salaries direct to individuals, while CBS is implementing its core banking system. The two institutions have also recently established a Memorandum of Understanding to enable taxpayers to pay revenues into accounts held in commercial banks.

Institutional development: The INPB has been established to review all concessions contracts and all contracts for goods and services above \$2m in value until such a time as the Procurement Act is fully implemented. CBS has reconstituted its Board and is in the process of implementing a workforce realignment plan.

Accountability: FGS's 2015 financial statements have been submitted to the auditor general, while external auditors have recently concluded an audit of CBS's 2014 accounts. 2016 accounts...

Asset recovery: USD 9million of assets were recovered in 2013 and distributed transparently in line with FGS procedures; \$5m went towards financing the 2014 Budget, \$0.9m to Puntland and Jubaland administrations, \$2m to CBS reserves, \$1m to CBS cash management operations, \$0.1m to drought relief. The process of asset recovery is still ongoing, supported by the World Bank Stolen Asset Recovery (StAR) initiative.

Delays in salary payments to the security services can reduce their motivation to combat insecurity and create incentives for predatory behaviour that, while generating alternative income, undermines citizens' trust in the State⁶. Inability to support the finances of Federal Member States (FMS) potentially weakens the political and policy bond between the Federal Government and its Federal Members, reduces scope for redistribution of resources to address geographic inequalities and can create perverse incentives at regional level for revenue raising measures that undermine economic development and effective administrative arrangements. A lack of resources for infrastructure and service delivery, whether delivered by the national government or at regional level, risks undermining the credibility of the state in the eyes of its citizens.

There are a number of reasons for the low level of FGS revenues, which amount to less than 3% of Gross Domestic Product (GDP)⁷. First, FGS revenues are generated from a limited geographic area (Banadir), with a heavy concentration on one revenue source (customs duties) that uses an outdated tariff schedule (based on volumes rather than values). FGS has no access to revenues collected in other regions beyond Banadir, including customs duties collected through ports such as Kismayo and Bosasso. Second, the legal framework for domestic revenues is outdated, relying on legacy laws from the 1960s to 1980s that are not well adapted to the modern economy. After more than two decades without domestic tax collection by central government, the compliance culture amongst taxpayers is limited, compounded by Government systems and capacity for collection that are rela-

⁶ Marqaati: Somalia State of Accountability 2016

⁷ Latest IMF data indicates tax and non-tax revenues amounted to 2.6% of GDP in 2016

tively weak. Third, FGS has been able to access direct grant financing from some donors (Turkey, Saudi Arabia, Norway, World Bank, European Union [EU]), but the amounts remain relatively small, and their disbursement has been unpredictable. In general, perceptions of fiduciary and political risk have meant that most major donors prefer to channel their funding through non-government entities. While this funding continues to be of benefit to individual Somali citizens, its delivery through non-Government channels means that it does little to promote trust and the social contract between the state and its citizens.

While more revenues are needed, the way in which they are mobilised and managed is also important. At present, public trust in Government's utilisation of its resources and assets is limited⁸. This in turn limits public and corporate willingness to accept further revenue mobilisation by Government, creating a potential vicious circle. It also reduces donor willingness to channel aid resources through the State. Measures to increase the transparency of Government revenue mobilisation and its expenditures, align state activities to citizens' priorities and demonstrate that funds are reaching their intended destination will all continue to be important elements in FGS's efforts to strengthen financial governance.

The remainder of this report sets out the strategic priorities that the FGC believes the new Government and its partners need to address in the coming year in order to strengthen its financial governance and associated state-building efforts going forward. The FGC recommends that the incoming Cabinet and Parliament are briefed on these issues, and that all incoming Ministers receive a financial governance induction which explains their roles, responsibilities and powers with respect to financial management.

2.1. Agreeing a coherent way forward on Fiscal Federalism

Fiscal federalism concerns the division and allocation of public sector functions and finances among different tiers of government. Article 50 of Provisional Constitution of Somalia establishes the principles of federalism in the Federal Republic. These principles are general in nature, and provide limited guidance on the form that fiscal federalism is expected to take. They establish that power will be given to the level of government where it is most likely to be exercised, resources will be distributed fairly and that the responsibility for raising revenues will be given to the level government where it is most likely to be exercised. Article 54 leaves the allocation of powers and resources to be negotiated and agreed upon by the Federal Government and the FMSs. The only powers and responsibilities that are explicitly reserved for the Federal Government relate to Foreign Affairs, National Defence, Citizenship and Immigration and Monetary Policy⁹.

In the absence of any detailed negotiations or agreement between the Federal Government and the FMSs pursuant to the principles established in the Constitution, a de facto set of intergovernmental arrangements have started to emerge. Principle amongst these are that RMSs collect and spend all revenues pertaining to their geographic area of responsibility, leaving FGS to finance federal expenditures from revenues collected only in Banadir region. As already noted, these arrangements mean that at present FGS has a revenue base which is insufficient to finance its current expenditures, let alone enable any meaningful transfer of resources to FMSs. These arrangements also give a significant revenue advantage to FMSs which have access to ports (Puntland, Jubaland) relative to landlocked FMSs that are unable to collect customs duties. Effectively, these ad hoc arrangements limit the scope of the Federal Government to play its role in setting strategic direction and managing revenue redistribution.

At present, there is no mechanism in place to equalise revenues between FMSs; FGS has no resources with which to make transfers to FMSs, and there is no horizontal agreement on revenue sharing between member states. Thus the de facto arrangements run contrary to the principle of fair distribution of resources established in the Provisional Constitution. The longer these de facto arrangements persist, the more difficult it is likely to become for advantaged FMSs to give up their revenue bases. In addition, the arrangements create the risk that disadvantaged FMSs look for other means raising revenue, for example by erecting tariff barriers on goods entering their territory in order to be able to extract a proxy form of customs duty. While such a response might be logical for the affected FMS, it would be a suboptimal response to unequal distribution of resources, increasing costs to the consumer in the FMS, undermining the growth of Somalia's fragile economy and eroding the premise of trust and goodwill upon which a successful federal system is built.

A further consequence of the current de facto arrangements is that they complicate attempts by FGS to increase its revenues, by moving from a customs tariff based on the volume of goods being imported to one based on their value. If FGS tries to adjust the customs rates applied at Mogadishu port and airport without first agreeing the approach with FMSs that manage their own ports, the likelihood is that it will face pressure for reversal from importers, or a reduction in the volume of goods passing through Mogadishu in the event that importers find it cost-effective to use an alternative port of entry with lower duty rates.

⁹ Article 123 (3) establishes producing currency as one of the main functions of the Central Bank of Somalia

Clarity is first needed on responsibility for setting tax policy - which level of Government has the right to establish tax rates, and for which taxes – and agreement on the tariffs to be used.

The new Government needs to move swiftly to initiate discussions with FMSs on revenue authority, expenditure responsibility and mechanisms for resource equalisation. Discussions on these three aspects of fiscal federalism need to go hand in hand, in order to avoid a situation where a level of government is assigned an expenditure responsibility but lacks the means with which to finance and exercise it, weakening public trust in the ability of the government as a whole to deliver against its assigned functions. Establishing the division of labour between the FGS and the FMSs, agreeing on revenue authority and establishing the mechanisms for resource redistribution are critical to developing a coherent governance system, preserving a strong economic space across the country, addressing spatial inequities, improving service delivery and building stability.

It may be appropriate to consider in applying some type of 'asymmetric decentralisation'¹⁰ in Somalia. Asymmetric decentralization is an approach where the level of autonomy granted to subnational governments varies according to negotiations and agreed criteria. Given that Puntland and Somaliland are well ahead of other emerging FMSs in development and administrative terms, this approach may have value in Somalia, enabling the federal union to accommodate different levels of subnational autonomy while safeguarding the FGS's key fiscal and monetary powers and its authority over natural resource management.

The FGC does not advocate that the FGS should try to reach agreement on these issues in the context of a Constitutional settlement in the first instance. Revising the Constitution is likely to be a lengthy process. Instead, an initial agreement should be developed on an interim basis and adjusted over time in line with changes in the fiscal circumstances of the FGS and the FMS. The principles underpinning the interim agreement should be agreed at the highest political levels. Technical details should then be jointly developed by the Federal Ministry of Finance and its counterparts at FMS level.

The FGC recommends that Ministry of Finance makes an immediate start by agreeing a harmonised customs tariff with the FMSs. From there, discussions should move to assignment of revenue responsibilities, mechanisms for inter-state equalisation and responsibility for service delivery, in line with the principles agreed at political level. These discussions should be accompanied by efforts to align national and subnational fiscal arrangements and reporting. The FGC recommends that the FGS starts to 'build' the inter-governmental fiscal system by making small transfers to the FMSs on a regular basis, and accessing donor resources to finance delivery of small-scale projects at community level.

Making progress on fiscal federalism, and federalism more generally, requires significant co-ordination at both political and technical levels, and across levels of Government. At present, responsibility for leadership on federalism issues is not clearly assigned within FGS. The FGC recommends that an office responsible for co-ordinating the federalism agenda is established in either the Presidency or the Prime Minister's Office.

The way in which donors provide support to the different levels of Government in Somalia will also be an important factor in determining the progress made on fiscal federalism. Donors already provide support in individual regions. In many cases, this support is co-ordinated with regional administrations, and in some cases, the administrations themselves receive

¹⁰ Asymmetric decentralization is now being discussed in the context of Iraq. It has been used in many situations to recognize diversity and manage internal conflict, for example, in the cases of Quebec in Canada, and Banda Aceh in Indonesia. In Europe, Spain has applied asymmetrical arrangements to help prevent wider conflict by granting cultural and administrative autonomy to the Basque and Catalan communities.

direct support. However, FGS is largely unsighted on the details of this support, and the way in which it is provided. As fiscal federalism principles are progressively agreed between the FGS and FMSs, it will be incumbent on donors to ensure that their support is aligned to these principles. FGS also needs to be informed of the financing donors are providing to FMSs, and as far as possible, involved in its design.

FGC Recommendations: Fiscal Federalism

- 1** The FGS and the Federal Members States should establish an initial agreement on revenue authority, expenditure responsibility and mechanisms for resource equalisation, in advance of any final Constitutional Settlement. The principles underpinning the interim agreement should be agreed at the highest political levels. Technical details should then be jointly developed by the Federal Ministry of Finance and its counterparts at FMS level.
- 2** An office responsible for co-ordinating the federalism agenda should be established in either the Presidency or the Prime Minister's Office
- 3** The Ministry of Finance should make an immediate start by agreeing a harmonised customs tariff with the FMSs while awaiting political agreement on the broader principles.
- 4** The FGS should start to 'build' the inter-governmental fiscal system by aligning national and subnational fiscal arrangements and making small transfers to the FMSs on a regular basis.
- 5** Donors need to inform FGS of the support they are providing to FMSs and involve FGS in project design to ensure it aligns to the agreed fiscal federalism principles.

2.2. Transparent and equitable management of natural resources

Somalia has significant natural resource potential across a wide range of sectors; petroleum, minerals and fisheries. Depending on their scale, access to revenues arising from these natural resources could potentially have a transformational impact on the State's finances. However, unless managed transparently and equitably, natural resource revenues also carry a substantial degree of risk. They have the potential to generate conflict between communities and their governments, and between levels of government within the federal system. To the extent that they are finite, and depending on how they are spent, they also have the potential to complicate economic management, and undermine rather than strengthen fiscal sustainability; if finite natural resource revenues are used to increase near-term recurrent costs (particularly the public wage bill), they can reduce economic competitiveness ('Dutch Disease') and leave Government exposed to a fiscal crisis in the event of a revenue downturn. Given the scale of the potential revenues involved, they also provide fertile ground for corruption.

To date, FGS has been most active in the petroleum and fisheries sectors. On the petroleum side, it has issued a number of contracts for seismic exploration, is preparing revisions to its legal framework, has developed a Model Production Sharing Agreement (PSA), has commenced bilateral production sharing negotiations with Soma Oil and Gas, and has announced plans for a licensing round in 2017. It has also developed an Interim Revenue Sharing Agreement, which sets out how government revenues from petroleum and minerals would be shared between the Federal Government and FMSs. On the fisheries side, it has updated its Fisheries legislation and developed a revenue sharing proposal setting out how fisheries revenues could be shared between levels of government. However, the FGS has not yet reached a consensus with FMSs on fisheries licensing.

The FGC has a number of concerns and recommendations relating to natural resource revenue management. It welcomed the recent opportunity to review the Model Oil and Gas PSA developed by the Ministry of Petroleum, and made recommendations as to how the PSA's fiscal terms could be strengthened to ensure value to FGS, while still being sufficiently attractive to investors¹¹. Going forward, it is essential that the terms of the finalized model PSA provide the basis for discussions of specific PSAs. Any proposed PSA and associated tender or licensing documents should be submitted to the INPB for scrutiny (and to the FGC for final review if the FGC continues to play this role in future), prior to approval by Cabinet. All contractors for PSAs should be selected transparently and competitively.

The FGC has noted that the FGS has already commenced PSA negotiations with Soma Oil and Gas based on the rights granted in their 2013 Seismic Option Agreement. If these negotiations are continued by the new Government, the PSA terms should be adjusted to reflect the provisions of the model PSA and Soma should be required to demonstrate its technical and financial capacity to undertake the works. Any material deviation between the proposed Soma PSA and the model PSA will need to be clearly explained and justified to the INPB.

The FGC also recommends that the FGS finalizes the revisions to its legal framework for petroleum and establishes the necessary regulatory institutions before production sharing agreements are concluded. The risks of moving ahead with exploration before the legal framework is finalized and regulatory institutions are in place are substantial; the govern-

¹¹ <http://mof.gov.so/financial-governance-committee-seeks-improvements-in-oil-and-gas-terms/>

ment will lack the ability to protect Somalia's interests, and the interests of the communities directly affected by exploration, effectively. As noted above, this in turn is likely to exacerbate the risks of conflict and corruption.

The FGC has noted with concern that foreign fishing vessels have recently been reported as being in negotiations with the Government of Puntland to receive licenses to fish in Somali waters. Illegal licensing of foreign trawlers by individual FMSs undermines the livelihoods of local fishermen and damaging the sustainability of marine resources. Unregulated licensing also gives rise to suspicions of corruption, and discourages legitimate investors from engaging in Somalia's fisheries sector. The FGC recommends that the Ministry of Fisheries agrees a framework for sharing 2017 federal offshore fishing license revenues with FMSs, and uses the inter-governmental fiscal transfer system to provide FMSs with their shares in a way that creates incentives for licensing compliance. The FGC has offered to provide advice to the Ministry of Fisheries on how best to do this.

The FGC's comments on the proposed mechanisms for natural resource revenue sharing are on two levels. First, individual initiatives at sector level to establish revenue sharing formulae between levels of government must be placed within the context of the fiscal federalism agenda. Otherwise, individual sector decisions on resource allocations may cumulatively lead to a set of resource allocations between FGS and the FMSs, and across FMSs, that are not equitable and do not match the decisions taken at the political level on the functional responsibilities of the different levels of government. The FGC further notes with concern that in the case of Petroleum, the Interim Revenue Sharing Agreement has been signed with individual states, rather than being negotiated with all states simultaneously. The FGC recommends that the Ministry of Finance works with the Ministry of Petroleum to review the revenue sharing formula proposed in the petroleum agreement, and initiate new negotiations with all FMSs.

Second, the FGC is concerned about the sustainable management of natural resource revenues. At present the agreements drafted at sector level assume that the sector is at liberty to dispose of 100% of the revenue accruing to government from that sector. This stems from the fact that there are no overall legal requirements in place governing the management of natural resource revenues, including the extent to which they can be spent or saved in any given year. Such provisions are usually established in law at a national level, either in a PFM Act or in legislation specific to natural resource revenue management, and are a key part of national fiscal diversification and avoiding dependency on finite resources. The FGC recommends that the FGS moves rapidly to insert clauses in the draft PFM Bill that set out the principles governing natural resource revenue management as relates to fiscal policy.

The background image shows a busy port or market area. On the left, a large orange crane is visible. In the foreground, there are several vehicles: a green truck, a white truck, and a white car with red stripes. A person in camouflage clothing is standing near the white car. The sky is blue with some clouds.

FGC Recommendations: Transparent and equitable management of natural resources

- 1 FGS should finalize the revisions to the legal framework for petroleum and establish the necessary regulatory institutions before entering into any production sharing agreements.
- 2 Cabinet should approve the finalised model Oil and Gas PSA in line with FGC recommendations. The terms of the finalized model PSA should provide the basis for discussions of specific PSAs, which should also be approved by the INPB and by Cabinet.
- 3 FGS should insert clauses in the draft PFM Bill that set out the principles governing natural resource revenue management as relates to fiscal policy.
- 4 The Ministry of Fisheries should agree a framework for sharing 2017 federal offshore fishing license revenues with FMSs, and use the inter-governmental fiscal transfer system to provide FMSs with their shares in a way that creates incentives for licensing compliance.
- 5 The Ministry of Finance should work with the Ministry of Petroleum to review the revenue sharing formula proposed in the petroleum agreement, and initiate new negotiations with all FMSs.

2.3. Enhanced revenue mobilisation

The FGS has made some progress in increasing its revenue from sources other than customs duties since 2014. As at end December 2016, non-trade revenues stood at \$44m, as compared to \$20m in 2014. To a large extent, this progress has been made through the agreement of concessions for the collection of non-tax revenues. The two largest of these concessions relate to the management of Mogadishu Port and Mogadishu Airport, but FGS has also entered into contracts related to the collection of road tax, vehicle licenses and property transfer tax. The FGS has made comparatively little progress in collecting private sector income taxes (personal income tax from employees and corporate tax) and indirect domestic taxes (sales tax and excise duties).

The FGC agrees that in a context of low capacity for revenue administration, contracting private sector entities to manage or support the collection of non-tax revenues may be an efficient way of increasing these revenues. In aggregate, the FGS's experience since 2014 demonstrates this. However, the contracts were largely directly negotiated without significant technical appraisal, therefore calling into question their value for money. The FGC subsequently played a lead role in reviewing the port and airport concessions, and identified a number of areas in which they required strengthening to deliver value to FGS. The Africa Legal Support Facility (ALSF) has since supported the FGS to re-draft the terms of the airport concession, and renegotiations with the contractor are expected to commence in 2017. Less progress has been made to date with the port concession. The FGC has also supported the INPB in its review of the road tax, vehicle license and property transfer tax contracts, and all three are expected to be revised in 2017. Overall, the FGC recommends that the new Government concludes renegotiations of all five contracts before the end of 2017, establishing clearer contract terms and ensuring stronger oversight of their revenue streams going forward. The FGC also recommends that the Federal Ministry of Finance provides guidance to its counterparts in the FMSs on how to develop and manage revenue collection contracts based on its own experience. The Ministry of Finance has already indicated that the INPB would be available to review any draft agreements that FMSs develop, and provide feedback.

In the process of reviewing the revenue concessions and the Oil and Gas Model PSA, the FGC has noticed that the individual agreements have proposed varying tax exemptions for the relevant contractors, including exemption from corporate tax. The FGC has two recommendations to make in this regard. The first is that power to grant tax exemptions should be vested solely in the Minister of Finance; the FGC recommends that FGS inserts a clause into the PFM Bill to this effect. If individual line ministries have the discretion to offer or negotiate tax exemptions, the FGS will lose control over its revenue base. The second recommendation is that the FGS should seek to minimise the tax exemptions that it offers in its contracts and concessions, given the negative precedent such an approach sets for future tax and contract negotiations. It is for this reason that one of the FGC's main recommendations on the Model PSA was that the contractor should be obliged to pay corporate income tax on its share of profit petroleum¹².

There are a number of reasons for the FGS's lack of progress in increasing its revenues from sources such as income tax, sales tax and excise duty, as well as fees and licenses from high value sectors such as telecoms and money transfers. The legal framework for domestic revenues is outdated, relying on legacy laws from the 1960s to 1980s that are not well adapted to the modern economy, while the legal frameworks regulating sectors such

¹²However, the FGC also recommended that the contractor's share of profit petroleum should be increased at higher profitability levels, so that the overall fiscal terms of the PSA remained broadly balanced.

as telecoms and money transfer are lacking. In addition, after more than two decades without domestic tax collection by central government, the compliance culture amongst taxpayers is limited, while Government systems and capacity for collection are relatively weak.

The FGC recently analysed the existing options for raising revenue from the Telecoms sector. The analysis indicated that it is possible for FGS to raise revenue from the Telecoms sector on the basis of existing legacy domestic tax laws and telecom-specific decrees from the Council of Ministers, but that the revenue potential from the sector would increase significantly with the passage of a modern Telecommunications law and revision of domestic tax laws. The analysis also indicated that deficiencies in the legal framework are not the only constraint to effective revenue collection from Telecoms. The FGS faces practical challenges in calculating and collecting revenues and ensuring compliance. Political support for taxation of telecoms is also required, and even with this support, extensive discussions with the operators are also necessary.

This analysis provides a useful insight into the continuing efforts FGS will need to undertake in order to enhance domestic revenue mobilisation. Political level commitment to tax compliance is needed, followed by dialogue with key taxpayers in key sectors to establish mechanisms for payment of their legal dues. This needs to be backed by appropriate legislation, and supported at a technical level with capacity for collection and compliance. There are no quick fixes to enhancing domestic revenue mobilisation; enhancing the tax base requires systematic work across a range of dimensions and co-ordination across a range of stakeholders. The FGC is of the view that the process will make limited headway without political support. It recommends that the new Government initiates a round table dialogue with the leading members of private sector, in order to secure their commitment to meeting their tax obligations, whilst also gaining a clearer understanding of the services that the private sector expects to receive from government in return.



FGC Recommendations: Enhanced revenue mobilization

- 1 FGS should conclude renegotiations of all five existing revenue collection contracts before the end of 2017, establishing clearer contract terms and ensuring stronger oversight of their revenue streams going forward.
- 2 The Ministry of Finance should provide guidance to its counterparts in the FMSs on how to develop and manage revenue collection contracts based on its own experience
- 3 FGS should insert a clause into the PFM Bill stating that the power to grant tax exemptions will be vested solely in the Minister of Finance. FGS should seek to minimise the tax exemptions that it offers in its contracts and concessions, given the negative precedent such an approach sets for future tax and contract negotiations.
- 4 Political level commitment is needed to tax compliance and passage of relevant legislation (e.g. Communications Act).
- 5 FGS should initiate a round table dialogue with the leading members of private sector to secure their commitment to meeting their legal tax obligations and gain an understanding of the services they need to provide in return.

2.4. Credible public procurement and concessions

Since 2014, at the request of the FGS, the FGC has played a lead role in reviewing all FGS concessions and contracts above \$5m. Since August 2016, it has been working closely with the INPB, which has been mandated by FGS to oversee the contracting of all FGS concessions and any contracts above \$2m in value until such a time as the Procurement Act is fully implemented. At this point, the INPB¹³ will be transitioned into the Inter-Ministerial Concessions Committee as provided for in the Act, and will have sole responsibility for the award of FGS concessions. Contracts will become the responsibility of procuring entities established within FGS Spending Agencies, overseen by regulatory entities created in the Act.

The FGC has reviewed 19 FGS contracts since 2014, and one contract submitted by a FMS¹⁴. Of these, 14 were already signed by the time of FGC review, while 5 were received in draft form. Of the contracts reviewed by the FGC, six¹⁵ were subsequently revised to incorporate FGC recommendations, four¹⁶ were not adjusted, while the FGC is yet to receive feedback on one of them¹⁷. The remainder did not proceed. The FGC has also supported the INPB to review three revenue collection concessions and make recommendations on their renegotiation, as well as to oversee the competitive tendering process for the Somali National Army (SNA) rations contract and review a draft telecoms contract.

In general, the majority of the contracts that the FGC has reviewed did not result from any competitive tender process. Instead, they resulted from direct negotiations between FGS agencies and contractors, often instigated by the contractors themselves. From a financial governance perspective, this kind of approach to contracting gives significant cause for concern; it lacks transparency, which inevitably gives rise to suspicions of corruption, and carries a substantial risk that the contract terms will not offer value for money for FGS. This risk is amplified by the fact that in general, FGS agencies have very limited experience and capacity in contract negotiation and management. The fact that in many instances FGS line ministries have been responsive to the feedback provided by the FGC is encouraging. However, the FGC notes with concern that FGS agencies that have ignored FGC advice, or bypassed the FGC altogether, have not faced any penalties for doing so.

There have been some encouraging signs over the past year; more contracts are starting to be submitted to the FGC/INPB in draft form, and FGS has demonstrated its commitment to the competitive tendering of rations contracts for the security sector (SNA, Police, National Intelligence and Security Agency [NISA]), as announced by the former President H.E. Hassan Sheikh in September 2015. In addition, in line with FGC advice, FGS is moving to strip out the cash component that is included in these contracts, and is committed to paying rations cash directly to personnel through the salary payment system.

Less encouragingly, some contracts continue to be entered into without following due process. These include the airport taxi contract between the Somalia Aviation Authority and Sahel, whose terms are still unknown to the FGC, and the dry port contract between Simat-

¹³The INPB was established by the Council of Ministers in March 2015, but did not become fully operational until August 2016. Its membership comprises the Minister of Finance, Minister of Planning, Minister of Foreign Affairs, Minister of Justice and the State Attorney General.

¹⁴Galmudug

¹⁵Contracts with CGG Robertson and Spectrum ASA for seismic data collection and analysis, contract with PGM Projet for import/export quality assurance, contracts with Perkins and Horn for food supply to Police and NISA, Model Production Sharing Agreement for Oil and Gas

¹⁶Contract with Soma Oil and Gas for seismic exploration, ADCO contract for Khat collection, Favori concession for Mogadishu airport, Al Bayrak concession for Mogadishu port

¹⁷Contract with M&T for port scanning equipment

ech and the Ministry of Ports. The Simatech contract, which the FGC received through unofficial channels and has not yet formally reviewed, is a good example of the risks of sole-source contracting without full diligence. The contract provides Simatech with a long-term, exclusive concession for storage and customs clearance of goods entering the port of Mogadishu, and carries substantial financial penalties should FGS decide to terminate it. At the same time, the services that are granted exclusively to Simatech are currently being provided by Al Bayrak under its port management concession. FGS will need to find a way of unscrambling the potential conflict between the two contracts in the context of the renegotiation of the Al Bayrak concession.

Finally, FGS disposal of public assets is of increasing concern to the FGC. There have been a number of recent reports of disposal of public lands and assets in Mogadishu to private individuals and enterprises on unclear terms¹⁸. Such reports serve to generate public mistrust in the motivations of the Government, and sustain perceptions of corruption. Some of the assets being referred to (e.g. former Government hotels) appear to have been leased (or sold) without submission of the contract to the FGC for review, while some of the public lands have been assigned to contractors whose contracts are known to have bypassed the FGC (Sahel, Simatech). The FGC was encouraged when former Prime Minister Sharmaarke established a Commission to Protect Public Properties, ordered a stoppage to the sale of public lands, and required the lease of public lands to follow legal process¹⁹. The FGC provided advice to FGS on the role and detailed terms of reference of the Commission, and has outlined the technical support it would require in order to do its job effectively.

The FGC recommends that the incoming administration makes a clear, public statement on its commitment to due process in contracting, concessions and asset leasing. The statement should explain the steps that all new contracts, concessions and leases must follow prior to signature and set out the consequences of non-compliance. The statement could take the form of a Prime Ministerial Circular or Decree. The FGC also recommends that the incoming administration supports the continuation of the recently-established Commission to Protect Public Properties, working to a clear, expanded terms of reference.

Given the very low levels of procurement capacity within FGS, the FGC is of the view that adequate implementation of the Procurement Act will take considerable time and require significant capacity support. Early implementation of the Act in the absence of the requisite capacity to follow its provisions and provide the necessary oversight to Government contracts creates the risk that the fragile gains that have been made in procurement to date will be reversed. The FGC recommends that the FGS extends the procurement transition period until such a time as there is adequate capacity for implementation of the Procurement Act. Specifically, this should involve extending the mandate of the INPB and specifying procurement roles and responsibilities within FGS until such a time as the Procurement Act can be adequately implemented. The FGC recommends that the FGS consider assigning responsibility for contracting all FGS goods and services above a certain threshold to the Ministry of Finance's Procurement Unit as an interim measure until procurement units in line ministries have the necessary capabilities. However, the FGC notes that the Ministry of Finance's Procurement Unit will also require additional capacity support to carry out this role.

¹⁸ See: Somalia and Eritrea Monitoring Group report to the UN Security Council, October 2016, and Marqaafi: State of Somalia Accountability, 2016

¹⁹ Prime Ministerial Decree dated 28th July 2016



FGC Recommendations: Credible public procurement and concessions

- 1** FGS should issue a Prime Ministerial Decree re-affirming its commitment to due process in contracting, concessions and asset leasing. The Decree should: specify procurement roles and responsibilities within FGS until such a time as the Procurement Act can be adequately implemented; extend the mandate of the INPB for the duration of the transition period; set out the steps all draft agreements must follow prior to signature; and, state the consequences of non-compliance.
- 2** FGS should consider assigning responsibility for contracting all FGS goods and services above a certain threshold to the Ministry of Finance's Procurement Unit as an interim measure until procurement units in line ministries have the necessary capabilities.
- 3** Donors need to step up their support to FGS procurement; significant levels of operational support and capacity building are required both within the Ministry of Finance and across line ministries.
- 4** The incoming administration should support the continuation of the recently-established Commission to Protect Public Properties, working to a clear, expanded terms of reference.

2.5. Strengthened expenditure management

In 2013, FGS's expenditure management system created significant opportunity for leakage of funds. The payment process was entirely manual, while payments (including salaries) were made almost entirely in cash and often on the basis of very minimal documentation. Large cash withdrawals by spending agencies from the Central Bank were commonplace. The Ministry of Finance had no real oversight over the payments being made, limited control over cash balances, and very limited capacity for reporting. Progress has been made against this low base in the past four years. Salary payments to civil servants and to the police are paid electronically, direct to individuals' accounts. All FGS bank accounts in the CBS have been consolidated into a Single Treasury Account, managed by the Ministry of Finance. Payment requests are logged into the Somalia Financial Management Information System (SFMIS) prior to approval by the Accountant General's office. Approximately a third of non-wage payments were made direct to suppliers' bank accounts in 2016, as compared to almost none in 2015.

These reforms have gone some way towards strengthening the expenditure management system and reducing the scope for the misappropriation of funds. However, the Auditor General's audit report for 2015 highlighted a number of continuing weaknesses, including continuing use of cash payments, travel advances made without supporting documentation, inadequate regulation of advances and weak cash management. Under the auspices of the PFM Reform Action plan, and with the technical support the IMF, the World Bank, the AfDB and others, the Ministry of Finance is working to address these challenges.

From the FGC's perspective, in order to reduce the scope for leakage of funds, FGS needs to further reduce the proportion of the non-wage payments that are paid out in cash, and to require all advances to be fully accounted for before new ones are made. The Ministry of Finance will require the full backing of the Cabinet and the Presidency in completing this reform. FGS also needs to place much stronger controls on the payroll, as otherwise gains made in increasing revenue and reducing funds leakage will be fully absorbed by a rising wage bill.

Significant effort also needs to be put into verifying the delivery of goods and services. At present, the draft PFM Bill and PFM Reform Action plan pay relatively little attention to strengthening inspection and internal audit. However, from the FGC's perspective, the gains made in improving the tendering and transparency of rations contracts will count for little if there is limited visibility on whether goods and services are actually delivered. Given the public mistrust of FGS's financial management, it may not be sufficient at this stage to rely solely on inspection reports from the receiving spending agency as proof of delivery; some kind of verification by another entity in FGS is also required. The FGC recommends that the Ministry of Finance establishes an Inspection Function responsible for verifying the delivery of goods and services above a certain value prior to the payment of invoices.

Finally, and by far the largest issue, is security sector expenditure reform. Security sector salary payments (SNA, Police, NISA) take up a third of the FGS wage budget, yet salaries are extremely low (\$50 for the lowest ranks), and due to FGS's revenue constraints and cash flow problems, are rarely paid on time. These salaries are topped up by an equivalent of \$60 per person in rations, of which \$30 is delivered in the form of dry goods through rations contracts, and the other \$30 is paid in cash; from now on the rations cash will be paid

through the FGS salary payment system rather than by the contractors delivering the rations contracts. In addition, donors have pledged a \$100 stipend. However, these stipends are also paid irregularly. The police stipends, which are funded by the EU, are paid through the FGS salary payment system, direct to individuals' accounts, and are paid against the same payroll of police officers held by the Ministry of Interior. The SNA stipends, which are funded by the United Kingdom (UK) and the United States (US), are paid in parallel to the FGS salary payment system, and are not paid against the same set of payrolls held by the Ministry of Defence. The variation is up to 40%; this means that there are some personnel considered by the UK and the US to be members of the SNA, but who only receive a stipend, and there are other personnel considered by the SNA to be members of the SNA, who only receive a salary.

In line with its commitments under the IMF SMP, FGS has commenced the process of cleaning and consolidating the SNA payroll and undertaking biometric registration of personnel, to establish a single, biometrically verified payment list against which salary payments (and rations cash) can be paid direct to individuals' accounts. The FGC considers it extremely important that FGS completes this reform, which will help reduce scope for misappropriation of salary funds and payment of ghost personnel. It is also important that donors providing stipends to the sector become part of the reform, so that all SNA salary and stipend payments are made against a single, commonly agreed payroll and paid direct to individuals' accounts through the FGS system, as already occurs with the Police. Donors need to work towards full Government ownership and strengthened institutional capacity from the outset²⁰. This convergence and system strengthening is an important first step in ensuring security sector stabilisation before the broader process of longer-term security sector reform commences. The latter is needed to bring the SNA to a troop size that is affordable, to enable better remuneration of soldiers and adequate provisioning of supplies and professionalization of the force.

²⁰The problems with supporting security sector expenditure in the long term can be illustrated amply by reference to Afghanistan where a lack of attention to institutional development has led to donors supporting payment infrastructure for more than 15 years through the LOTFA programme.

A man in a light blue shirt is standing in a warehouse or store, surrounded by shelves filled with various goods. The background is slightly blurred, showing more shelves and products. The overall scene is brightly lit.

FGC Recommendations: Strengthened expenditure management

- 1** Cabinet should provide explicit backing to the Ministry of Finance to further reduce the proportion of the non-wage payments that are paid out in cash, and to require all advances to be fully accounted for before new ones are made.
- 2** FGS needs to place much stronger controls on the payroll, as otherwise gains made in increasing revenue and reducing funds leakage will be fully absorbed by a rising wage bill.
- 3** The Ministry of Finance should establish an Inspection Function responsible for verifying the delivery of goods and services above a certain value prior to the payment of invoices.
- 4** The Ministry of Finance and SNA should FGS complete the process of cleaning and consolidating the SNA payroll and undertaking biometric registration of personnel, and commence payment of salaries (and rations cash) direct to individuals' accounts.
- 5** Donors providing stipends to the security sector should commit to becoming part of the SNA payroll and payment reform; the objective should be that all SNA salary and stipend payments are made against a single, commonly agreed payroll and paid direct to individuals' accounts through the FGS system, as already occurs with the Police.

2.6. Financial sector development

Considerable effort has been made since 2013 to resuscitate the CBS, and to position it at the centre of Somalia's financial sector and the economy. Significant technical support has been directed towards strengthening capacity and governance of the CBS. Going forward, increased resources will be needed to carry on with the reform process, which includes both financial sector reforms and the currency reform process.

Improving the regulation and supervision of Somalia's financing system is critical on many levels. It will enable the re-establishment of correspondent banking relationships with international banks, thus safeguarding the flow of remittances into Somalia, which amount to almost 25% of GDP. It will also improve the FGS's prospects for accessing external financing and support economic development by enabling businesses to access credit through the banking system, rather than relying on informal credit networks.

Efforts are underway to improve the regulatory environment. The passage of the Anti-Money Laundering Law in 2015 was an important milestone. Its implementation is expected to help reduce risk concerns amongst international banks, and enable them to restore their correspondent banking relationships with Somalia. The Central Bank is committed to improving financial sector accounting and reporting in line with international standards and to strengthening its oversight of commercial banks. The implementation of the national payment system is expected to support commercial bank lending and enable CBS to establish banking relationships with FMSs.

The CBS is at an advanced stage of opening branches in the FMS²¹s. Having operational branches in the FMSs is essential for currency reform, as well as the establishment of a functioning inter-governmental fiscal transfers system. At present, FGS has to rely on MTBs to make transfers to FMSs. FMSs appear to hold differing views on the role of the CBS and their relationship to it. Puntland has established its own national bank, and has been reported to be printing currency²². It will be important to come up with a clear, common understanding on the role of the CBS in the regions in the context of the broader fiscal federalism discussions, and with respect to currency reform.

Currency reform is likely to be the highest-profile financial sector issue for the incoming Government. With technical assistance from the IMF, CBS is making all the necessary preliminary arrangements for reissuing the new Somali Shilling. The roadmap for the currency reform focuses on finalizing the counterfeit strategy, deciding on the scope of exchange and conversion factors, properly phasing in the legal framework, and preparatory work for currency storage, distribution, and collection. Successful completion of the currency reform will require substantial donor financing, for printing and distributing the new currency, plus any costs of converting old notes for new ones.

The introduction of a new currency is a major undertaking and requires political and socio-economic commitment from all stakeholders. The FGC recommends that the incoming Government holds early discussions with CBS so that it understands the key choices and risks associated with currency reform, and initiates discussions with the FMSs. One of the most important issues requiring political input is the issue of conversion; most old Somali shilling notes in circulation are considered to be counterfeit. The question therefore is whether

²¹ Branches have been opened in Kismaayo (Jubbaland) and Baidoa (Southwest), and CBS plans to open in Garowe (Puntland), Jowhar (HirShabelle), and Dhusamareb (Galmudug).

²² See: Somalia and Eritrea Monitoring Group report to the UN Security Council, October 2016

the people who hold these notes, particularly people with low incomes, should be entitled to full, partial or no compensation for the notes they hold. A contested currency reform, as recently occurred in India, would severely damage the credibility of FGS and CBS, and destabilize the country more generally.



FGC Recommendations: Financial sector development

- 1** FGS should hold discussions with the FMSs to come to a clear, common understanding of the role of the CBS in the regions in the context of the broader fiscal federalism discussions, and with respect to currency reform.
- 2** The FGC recommends that the incoming Government holds early discussions with CBS so that it understands the key choices and risks associated with currency reform, and initiates discussions with the FMSs.
- 3** Particular attention needs to be paid to the issue of currency conversion, to ensure that currency reform does not have a negative impact on people with low incomes who currently hold old Somali shilling notes.
- 4** Successful completion of the currency reform will require substantial donor financing, for printing and distributing the new currency, plus any costs of converting old notes for new ones.

2.7. Access to external financing

Given its fiscal constraints, FGS needs increased access to external financing in order to consolidate the process of state-building, finance service delivery, promote federalism and be seen to deliver tangible benefits to its people. In the absence of additional financing to FGS, early stabilization gains are likely to be jeopardized.

Overall aid flows to Somalia, including humanitarian aid, peacekeeping and development assistance, are estimated to have amounted to \$5.4bn over the past three years²³. Just over a third of this support (\$1.9bn) has been for development assistance. However, donors have disbursed over ninety percent of their development aid through non-government systems, given the fiduciary and political risk perceived to be associated with direct financing to the Somali Government. Total direct flows to the FGS have amounted to just \$158m²⁴, equivalent to just 3% of overall aid flows to Somalia. Lead on-budget donors have included Norway (the Special Financing Facility), the World Bank (the multi-donor funded Recurrent Cost and Reform Finance project), the EU (Police stipends), Saudi Arabia and Turkey.

Qualifying for debt relief will be one way of unlocking additional external financing, as FGS will be able to access concessional loans from multilateral and bilateral lenders. Now that the FGS is fully re-engaged with the IFIs, the process of working towards obtaining debt relief is underway. In particular, debt relief will be key to increasing access to external financing for large scale infrastructure. Whilst the process of achieving debt relief will undoubtedly be slow, expectations can be regulated with a clear roadmap.

The FGC recommends that the FGS and its creditors develop a milestones-based debt relief roadmap setting out how Somalia can qualify for the Heavily Indebted Poor Countries (HIPC) debt relief process, with arrears clearance to IFIs as a first step. Measures are likely to include: establishing a further track record of good performance with the IMF through successful completion of the current SMP with the IMF and successor SMPs of a quality equivalent to those under a Fund upper credit tranche (UCT) arrangement; reconciling external debt and confirming that debt sustainability indicators are above the relevant HIPC initiative thresholds; normalizing relations with creditors, including to mobilize donor agreement and resources to finance debt relief; and preparing a poverty reduction strategy paper (PRSP).

The recently drafted National Development Plan (NDP) provides a first step towards the preparation of a poverty reduction strategy, but the IMF's 2016 Article IV report has recommended that the NDP is strengthened in a number of areas before it is finalized. In particular, the Fund recommends that the vision and mission is clearly articulated and co-ordinated between FGS and RMSs, the overall medium term strategy is be consistent with sectoral strategies, and there is further discussion on costing and sources of funding. The FGC recommends the government and the IFIs reach agreement on the adjustments needed to the NDP so it can qualify as an Interim PRSP.

FGS also needs to increase its access to grant financing. FGS and its donor partners have initiated a dialogue on the Use of Country Systems (UCS), in order to identify various fiduciary safeguards that can be put in place to enable a scale-up of aid disbursed through Government systems. In 2015, FGS and Development Partners agreed that 15% of devel-

²³ IMF Article IV, 2016

²⁴ IMF Article IV, 2016

opment assistance should be channeled through the FGS²⁵. Currently use stands at 10%²⁶. The FGC supports this target, and suggests it should be far more ambitious, given the state-building needs of FGS. The FGC recommends that the new administration uses the London conference as an opportunity to make the case to the international community of the benefits of increasing direct government financing, and the risks of not doing so, including the risk of undermining the state-building efforts they have invested so much in to date.

The FGC recognizes that donors will also be encouraged to increase their financing to Government where there is agreement on priorities and ways of working, and robust fiduciary safeguards are in place. Progress has been made in setting common goals, targets and milestones in a number of documents including the NDP, sector strategies and the PFM Action Plan, but further joint work needs to be done between FGS and its partners to identify and overcome a number implementation challenges. The FGC hopes that the forthcoming joint 'risk-benefit analysis' of the use of country systems²⁷ will identify concrete risk-mitigation actions that FGS and donors can implement to support the scale-up of aid through FGS.

Blended financing offers an opportunity to use donor funds to leverage private sector financing for infrastructure and other development²⁸. The FGC recommends that the FGC meets interested IFIs such as the ADB and IFC to discuss the potential scale and role of blended financing in Somalia, including its scope to create jobs and reduce poverty. Government involvement in blended finance is essential; while this type of finance can have a substantial developmental impact especially on infrastructure and the productive sectors, it can also damage the government's credibility and legitimacy if there are problems in delivery or a perceived lack of value for money. The FGS need to be confident that investments from donors that are pursuing blended finance options can meet adequate levels of transparency and accountability²⁹.

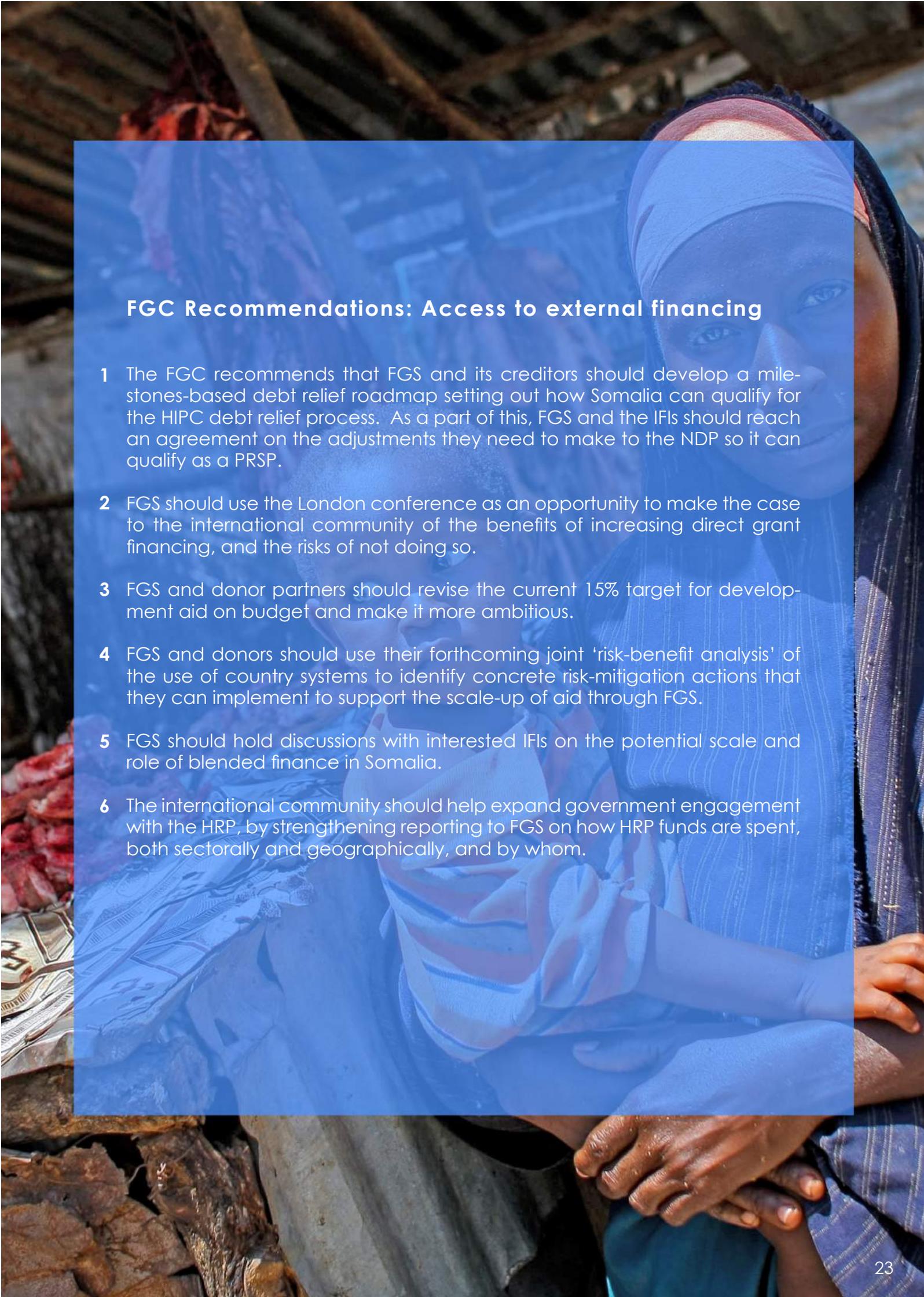
Finally, the FGC is concerned about the lack of oversight and accountability in the humanitarian sector. These concerns include the overlapping nature of some funding mechanisms, the lack of alignment of humanitarian funding with the NDP, the continued use of humanitarian mechanisms to fund interventions that are really development activities, and the extent to which FGS is unsighted on humanitarian funding. The FGC recommends that the 2017 HRP focuses on core humanitarian life-saving and protection issues, freeing up external financing to focus on development activities which are better rooted in an understanding of resilience activities. It also recommends strengthened reporting to FGS on how Humanitarian Response Plan (HRP) funds are spent, both sectorally and geographically, and by whom. Now that the political process has run its course, we expect a renewed effort from the international community to help expand government engagement with the 2017 HRP and onwards. The FGC would also like to see humanitarian programmes that push more power from the 'providers' to the 'beneficiaries', such as cash programming.

²⁵ Government and Development Partners 2015 Benchmarks & Indicators: "15% of external development spending channeled through treasury, including SDRF national windows which use treasury". HLPF Use of Country Systems: Mid-Year Progress Report, 2015

²⁶ IMF Article IV, 2016

²⁷ The study will be commissioned through the joint donor-FGS UCS Working Group.

²⁸ Although the potential for 'blended finance' can be extended to support SMEs, Agribusiness, and climate change initiatives



FGC Recommendations: Access to external financing

- 1 The FGC recommends that FGS and its creditors should develop a milestones-based debt relief roadmap setting out how Somalia can qualify for the HIPC debt relief process. As a part of this, FGS and the IFIs should reach an agreement on the adjustments they need to make to the NDP so it can qualify as a PRSP.
- 2 FGS should use the London conference as an opportunity to make the case to the international community of the benefits of increasing direct grant financing, and the risks of not doing so.
- 3 FGS and donor partners should revise the current 15% target for development aid on budget and make it more ambitious.
- 4 FGS and donors should use their forthcoming joint 'risk-benefit analysis' of the use of country systems to identify concrete risk-mitigation actions that they can implement to support the scale-up of aid through FGS.
- 5 FGS should hold discussions with interested IFIs on the potential scale and role of blended finance in Somalia.
- 6 The international community should help expand government engagement with the HRP, by strengthening reporting to FGS on how HRP funds are spent, both sectorally and geographically, and by whom.

