unicef for every child

Somalia

Investing in Social Development in the Federal Republic of Somalia

Budget Brief

November 2022

Preface

This budget brief is one in a series that explores the extent to which the government of the Federal Republic of Somalia addresses the needs of children under 18 years. The briefs analyze the macro-economic situation as well as the size and composition of budget allocations to sectors that affect children in fiscal year 2022/23. It also offers insights into the efficiency, effectiveness, equity and adequacy of past spending. The main objectives are to synthesize complex budget information so that it is easily understood by stakeholders and to put forth practical recommendations to improve social spending which benefits children.

Key Messages and Recommendations

- Despite recent economic and institutional developments, Somalia is going through a severe drought that is worsening poverty and acute malnutrition. Economic growth lags population growth and Somalia remains one of the poorest countries worldwide with a per capita GDP of US$ 425. **Somalia remains in critical need of external humanitarian support to weather the impact of the multivariate shocks that are now putting almost 50 per cent of the population at risk of famine.**

- Somalia is on a steady reform path as part of its national development strategies and commitments to international donor support and debt relief, with the latter expected to be finalized in 2023. **A tight balance needs to be maintained to address emergency conditions without derailing the strong momentum towards debt relief and long-term development.**

- The Somali Budget has almost doubled to US$ 918.7 million in 2022 namely due to a surge in donor spending, particularly in project support, accounting to two-thirds of the budget. Domestic revenues remain low at 3 per cent of GDP and 27 per cent of total revenues as informality and poverty make it difficult to impose and enforce new taxes. More than half of the budget is allocated to recurrent operational spending, whereas capital and social spending remain relatively low compared to peers. **It is vital for Somalia to improve domestic revenues and limit wasteful spending against structural difficulties in widening the tax-base to expand fiscal space for financing socioeconomic development.**

- Despite improvements in transparency and oversight, Somalia still lags regional peers with a score of 20. **FGS and FMSs should continue to strive in improving the collection and dissemination of public information and key budget documents, and the inclusion of citizens in the decision-making process.**

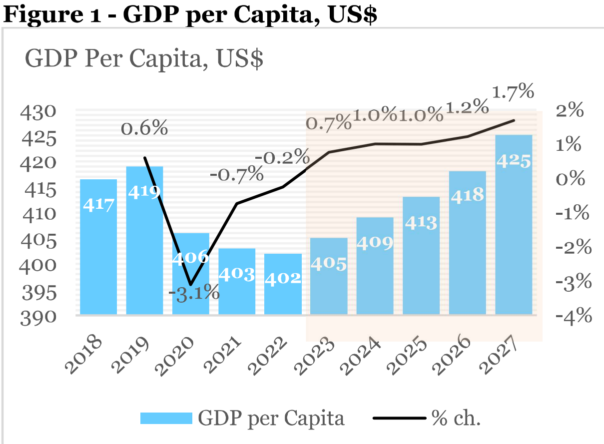
- The lack of consensus on the form and pace of decentralization and fiscal federalism continue to present major hurdles in the socioeconomic development of Somalia. **It is essential for Somalia to reach consensus on the regulation on power and resource sharing and to clearly mark the exclusive functions of FGS and devolved functions of FMSs, particularly in the administration and financing of social sectors. This would entail clearly defining responsibilities for different levels of government in revenue mobilization, rules for resource sharing, national and international borrowing, and intergovernmental transfers.**

The Economic, Social, and Institutional Context

1.1 Poverty, Vulnerability and Human Capital Development

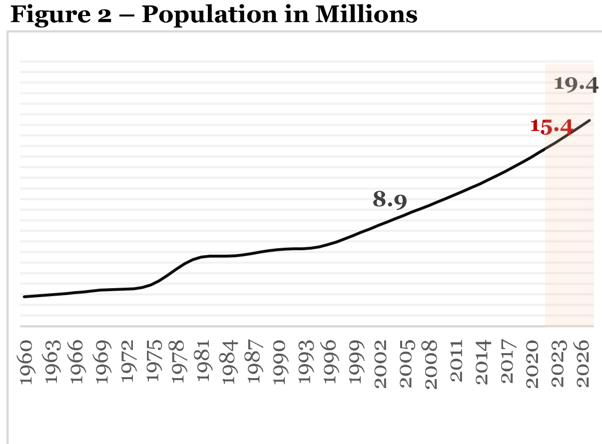
Somalia is experiencing multivariate climatic shocks, including a severe drought following four consecutive failed rainy seasons in 2020 and 2021 and a locust infestation in 2021, in addition to COVID-19 and consistent security challenges. As a mostly agropastoral economy, the acute drought has significantly reduced food output and livestock exports, a key source of income[1], which along with spikes in international food prices[2], have led to a worsening of poverty and malnutrition across large parts of the country[3]. Those factors have left Somalia highly reliant on external support, from diaspora in the form of remittances, humanitarian aid directly to communities through NGOs, and budget and development support to the government.

Figure 1 - GDP per Capita, US$



Source: Somali authorities, IMF estimates and Projections

Figure 2 – Population in Millions



Source: World Bank, databank 2022

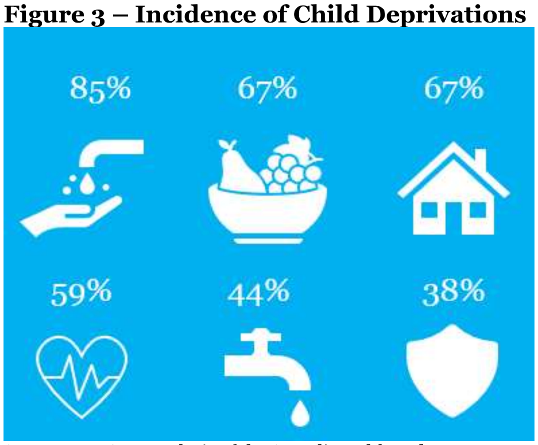
Somalia is largely agropastoral with agriculture and livestock accounting for almost 70 per cent of the economy and more than 90 per cent of exports, leaving the country highly susceptible to climate shocks. Together with other factors, including a high disease burden and security challenges, Somalia today is one of the poorest countries worldwide, with a per-capita GDP of US$ 425[4]. In addition to the impact of vulnerability, Somalia's low GDP per Capita highlights its high fertility rate – estimated at 5.7 births per woman - and population growth that consistently exceeds economic growth. The incidence of poverty is estimated at 69 per cent, and among children at 73 per cent. This had been the most recent estimate prior to the drought in 2020, with poverty and extreme poverty estimated to have significantly increased due to the various economic shocks since then. A more recent MODA analysis of the 2020 Social and Health demographic survey that was conducted by UNICEF in 2022[5] puts more than 90 per cent of the Somali population in multidimensional poverty, with severe deprivations in water, health and nutrition. Nutrition has been a particular concern in conflict affected areas, and there are now indications of an imminent famine, with almost 4.3 million people facing acute

[1] Livestock represents Around 20 per cent of Somalia's Exports are Livestock.
[2] The Food Security and Nutrition Analysis Analysis Unit estimates an average 26 per cent annualized inflation in the minimum expenditure basket across the country in September 2022, reaching more than 40 per cent in some of the hardest hit regions.
[3] The Food Security and Nutrition Analysis Unit – Somalia, 2022.
[4] World Bank (2019). Somali Poverty and Vulnerability Assessment: Findings from Wave 2 of the Somali High Frequency Survey (SHFS)
[5] The results of the UNICEF MODA analysis are expected to be published in 2022.

food insecurity, of which more than 50 per cent of the child population[6]. As Somalia is also highly import reliant, with food accounting for around 40 per cent of its imports, or US$ 3 billion - around one-third of its GDP - the recent spike in international food prices has further worsened food security.

Extreme poverty combined with weak public services since the civil war era have had a severe impact on the country's human capital development, and Somalia is particularly prone to infectious and increasingly non-infectious disease burdens. Despite substantial progress in reducing the maternal mortality rates from 732 in 2015 to 672/100,000, and the under-five mortality rate from 132 (2015) to 115 deaths (2020) per thousand live births, they are still among the world's highest. According to World Health Organization Global Estimates[7], communicable diseases and maternal, prenatal and nutrition conditions are responsible for 61 per cent of the total death in Somalia.

Figure 3 – Incidence of Child Deprivations



Source: UNICEF Analysis of the Somali Health and Demographic Survey 2020

Impact of Drought

Drought related displacement has exceeded 1.1 million since 2021 - Somalia Drought Displacement Monitoring Dashboard (August 2022)

1.8 million children are expected to face acute malnutrition in the year to June 2023 (IPC, June-December 2022)

An estimated 3 million livestock have died since mid-2021 due to lack of water, starvation and disease - FAO

1.2 Policy Reforms and Institutional Developments

Somalia continues to make strides in administrative and policy reforms on numerous fronts, crucial for attracting much needed budget and developmental support, including through internal strategic frameworks, such as the National Development Plan, and international agreements such as the Extended Credit Facility by the International Monetary Fund and the Highly Indebted Poor Countries (HIPC) agreement that would guarantee debt relief from bilateral and multilateral partners, and lead to an almost 87 per cent debt reduction from US$4.38 billion to US$ 557 million[8].Despite that, the relatively new federated country, with its five federal member states (FMS), and the self-governing Somaliland, continues to struggle on finding consensus for a unified constitution. To date, the constitution of the Federal Government of Somalia (FGS) remains provisional and unaligned with FMS constitutions[9], therefore, lacking clarity on the distribution of power and resources across different levels of government.

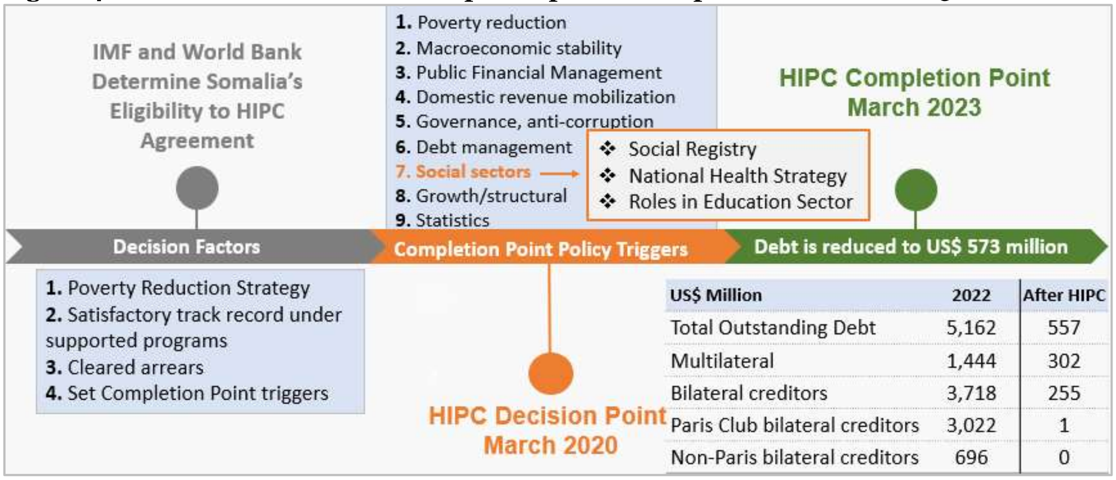
[6] Integrated Food Security Classification (IPC), Somalia: Acute food insecurity situation July-September 2022

[7] Global Health Estimates 2020: Deaths by Cause, Age, Sex, by Country and by Region, 2000-2019. Geneva, World Health Organization; 2020. who.int/data/gho/data/themes/mortality-and-global-health-estimates/ghe-leading-causes-of-death

[8] FGS Ministry of Finance, Q3 2022 Quarterly Debt Bulletin; International Monetary Fund. Somalia: Enhanced Heavily Indebted Poor Countries (HIPC) Initiative-Decision Point Document

[9] On Revewing Somalia's Provisional Constitution, Heritage Institute, 2022.

Figure 4 – HIPC Process Since 2018 up to Expected Completion Point in 2023



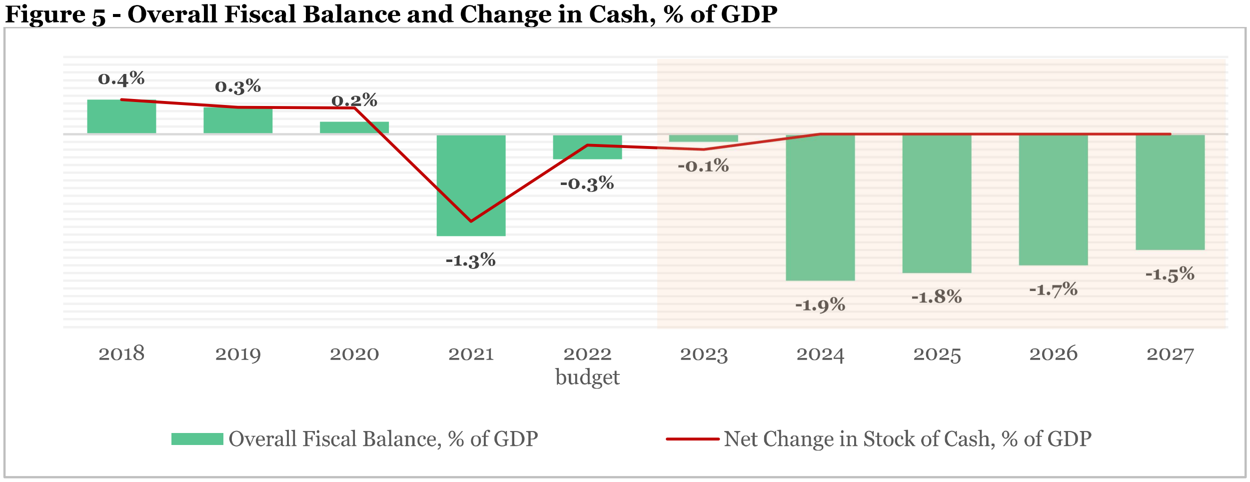
Source: IMF HIPC Decision Point

Revenue and Spending Trends

2.1 Overall Fiscal Performance

Through the regularization of fiscal policy as one of the key requirements of external support programs, Somalia had already been achieving a positive fiscal balance prior to 2020. The IMF expects the country to reach a zero balance after the 2023 debt relief, barring some outstanding arrears. However, even at its the record 2022 value of US$ 907 million, the overall budget remains one of the lowest globally at less than 11 per cent of GDP, while the IMF estimates projects a significantly lower execution rate of 7 per cent of GDP.

Figure 5 - Overall Fiscal Balance and Change in Cash, % of GDP



Source: Somali authorities, World Bank, IMF estimates and Projections

***After HIPC Completion Point, net change in cash goes to zero, due to differed arrears**

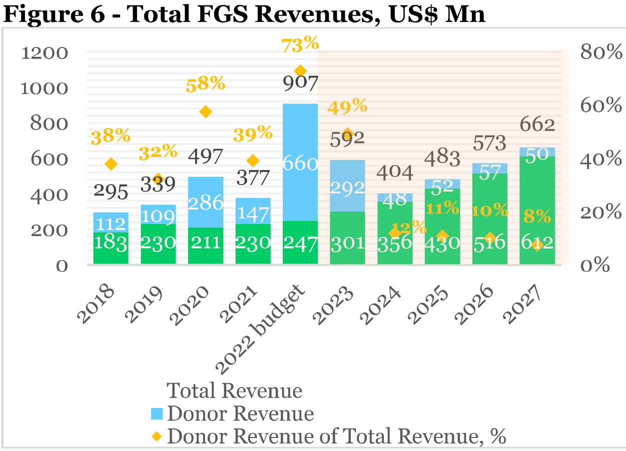
Outside Donor Funded Projects, Fiscal Space Remains Tight on Account of the Relatively Large Recurrent Spending. Government expenditures are expected to increase with donor financing for budgeted project support. Outside those, increases in prices of consumer goods will likely exert pressure on recurrent costs, forcing the government to make difficult decisions in the allocation of resources and risking heightened tensions between different levels of government. In 2022, ministries of finance in FMSs issued a joint statement announcing their suspension of ties with the FGS Ministry of

Finance on account dissatisfaction with the allocation of ODA[10]. Knowing that much of the poorer FMS largely depend on a system of transfers from the federal government – which fall under "Grants" in the Federal Budget, such dynamics risk further politicization of intergovernmental transfers and inequality between FMSs at the expense of social development and progress made in devolving certain service delivery functions (See evolution of Grants in Figure 12).

2.2 Revenue Mobilization

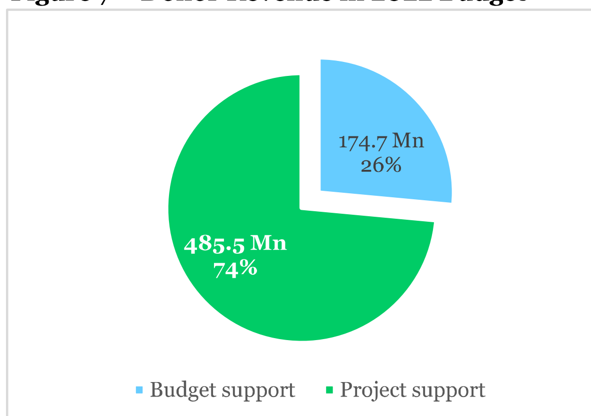
Budgeted revenues in 2022 were boosted by external project support but domestic resource mobilization remains structurally weak. Total Revenues for the Federal Government are expected at a record US$ 907 million, almost triple their 2021 value of US$ 377 million on account of new budgeted funding for social protection projects by development agencies and IFIs, mainly including the Social Safety Net Project (Baxnaano). In total, donor revenue accounts for 73% of the budget although the IMF estimates a considerably more conservative level of disbursements, almost half the budgeted amount.

Figure 6 - Total FGS Revenues, US$ Mn



Source: 2022 Budget

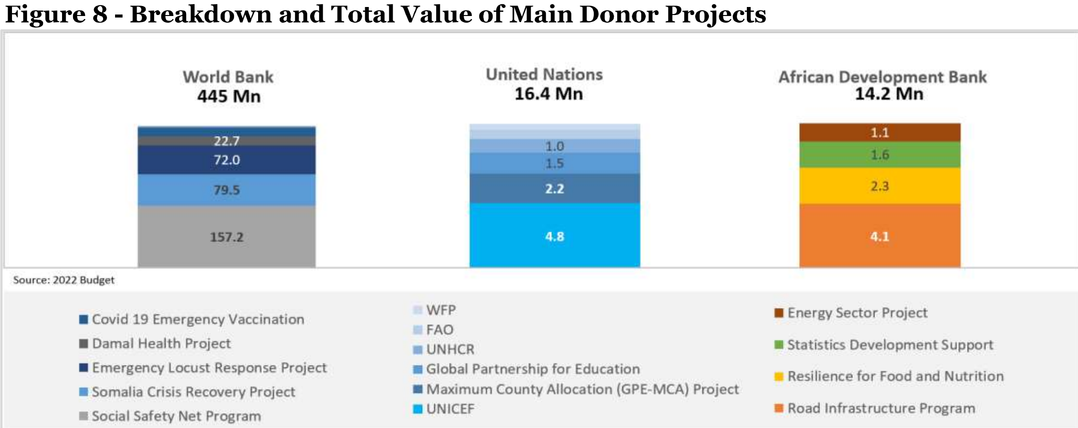
Figure 7 – Donor Revenue in 2022 Budget



Source: 2022 Budget

Budgeted Donor revenue is largely attributed to World Bank programs with around 94 per cent of total spending, followed by UN agencies with 3.4 per cent, led by UNICEF with US$ 4.8 million, and the African Development Bank with 2.9%. World Bank projects are largely aimed at social protection, drought and Covid-19 crisis response, whereas UN projects are in large part developmental in nature and support recurrent expenditures in social sectors. Budgeted support by the African Development Bank is largely aimed at sector development and infrastructure.

Figure 8 - Breakdown and Total Value of Main Donor Projects

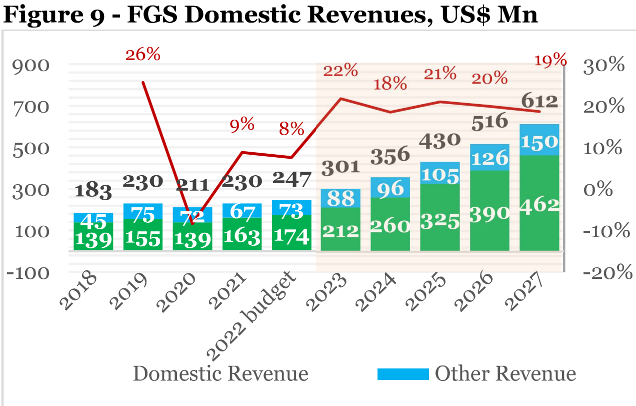


Source: 2022 Budget

[10] https://goobjoog.com/english/fms-govt-finance-ministers-suspend-cooperation-with-federal-treasury-cite-failed-promises/

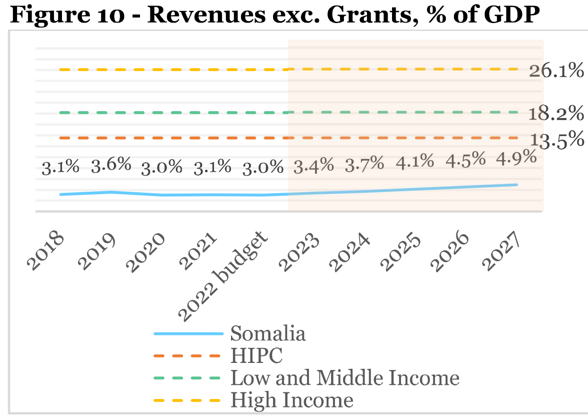
Domestic revenue collection remains weak even in comparison to other highly indebted poor countries. Domestic revenues in Somalia present a complex dynamic of lacking institutional capacity and structural weaknesses that prevent collection of direct taxes. Primarily, as an agropastoral society, much of the labor force in Somalia is informal, making it extremely difficult to regularize and impose direct taxes. Moreover, lacking clarity in the delineation of responsibilities between FGS and FMS and a failure to set consistent tax collection cycles reduces the willingness of tax compliance, particularly when service delivery to justify taxation is low. This leads to most taxes being levied indirectly on international trade and consumption, often to the benefit of FMSs that have access to air- and seaports where the bulk of trade taxes are collected. Finally, security challenges and lacking service delivery across the country, create room for informal taxation, whereby in some regions, up to 70% of the population pay informal taxes to community leaders for service delivery[11].

Figure 9 - FGS Domestic Revenues, US$ Mn



Source: 2022 Budget

Figure 10 - Revenues exc. Grants, % of GDP

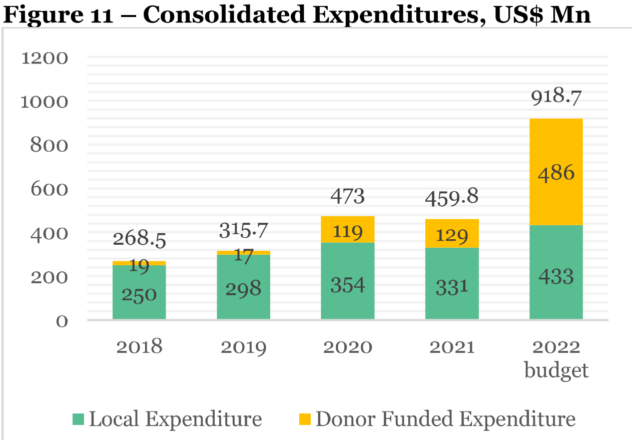


Source: 2022 Budget, World Bank

2.3 Resource Allocation Trends

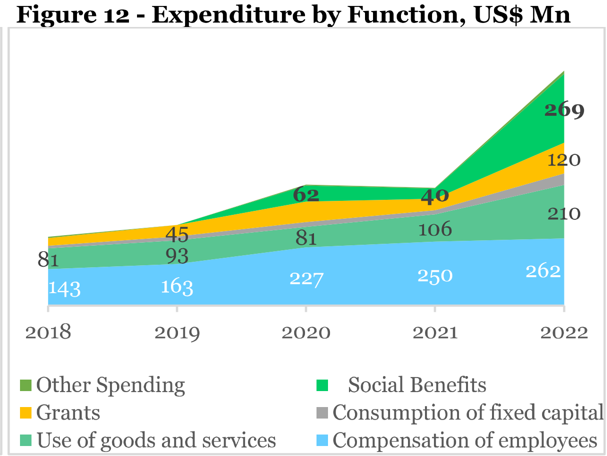
Donor funded special projects exceed domestic spending in 2022 budget, contrary to actual spending in the previous five years, indicating a rise in donor commitments with the exacerbation of the drought, as well as the increased budgeting of ODA. This is evident by the distribution of spending across functions, with social benefits showing an almost 7-fold increase to US$ 269 million. Other notable increases include grants, or allocations from FGS to FMSs, which are also in part a function of ODA allocations.

Figure 11 – Consolidated Expenditures, US$ Mn



Source: 2022 Budget

Figure 12 - Expenditure by Function, US$ Mn

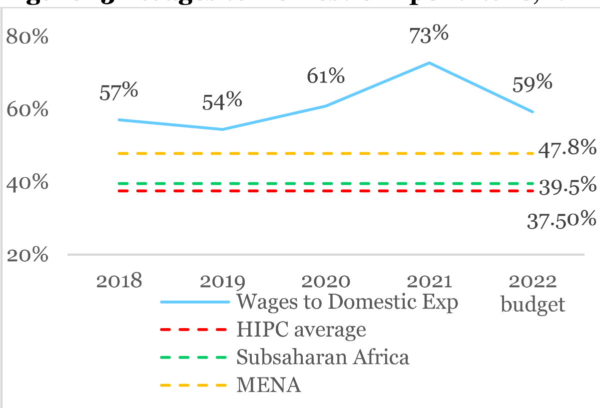


Source: 2022 Budget

[11] Institute of Development Studies, Explaining Informal Taxation and Revenue Generation. Evidence from South-Central Somalia 2021

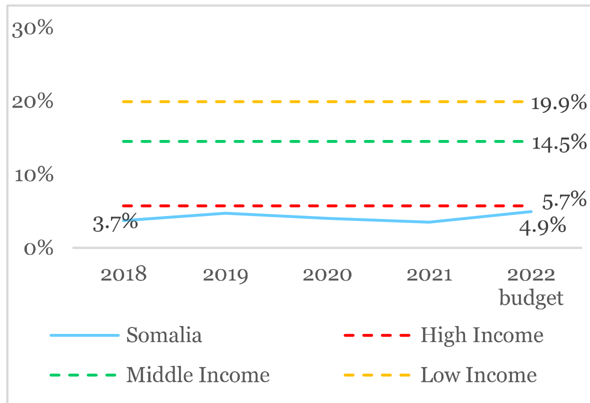
Recurrent expenditures, particularly relating to compensation of employees and use of goods and services continue to account for more than 50 per cent of total spending, leaving limited space for the expansion of the domestic budget. Wages to domestic expenditure remain around 60 per cent of domestic spending, considerably higher than average highly indebted poor countries, and averages in Sub-Saharan Africa and the Middle East ad North Africa region. Likewise, capital investments of total spending remain under 5 per cent, significantly lower than low-income countries that are in particular need of high levels of capital formation.

Figure 13 - Wages to Domestic Expenditure, %



Source: 2022 Budget, World Bank

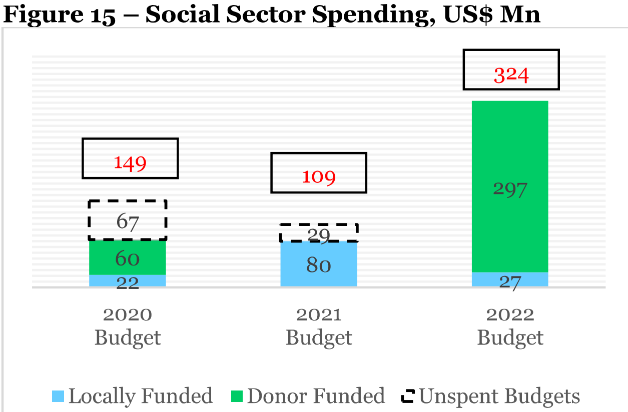
Figure 14 - Capital to Total Expenditure, %



Source: 2022 Budget, World Bank

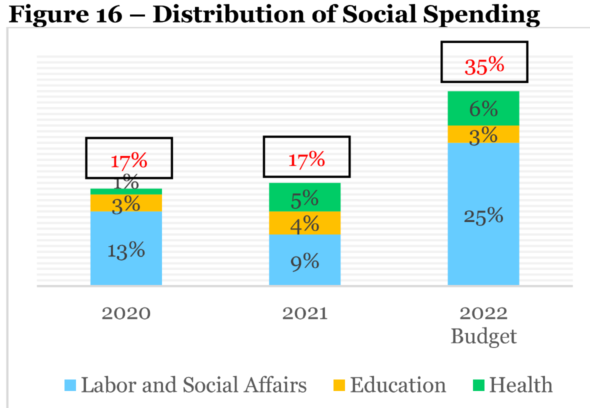
Social Sector Spending Remains Highly Reliant on Donor Support. Social sector spending is largely donor funded and the 2022 budget for social spending is significantly larger than actual spending in the previous two years on account of the budgeted Social Protection and Locust Emergency Response programs, as well as the Covid-19 response among others. The 2022 social sector budget accounts for almost 35 per cent of the total year's budget, surpassing the one-third HIPC completion point policy trigger. Having said so, social sector spending in previous years had fallen significantly shorter than budgeted amounts, whereby in 2020 and 2021, disbursements were respectively 45 per cent and 26 per cent lower than budgeted amounts.

Figure 15 – Social Sector Spending, US$ Mn



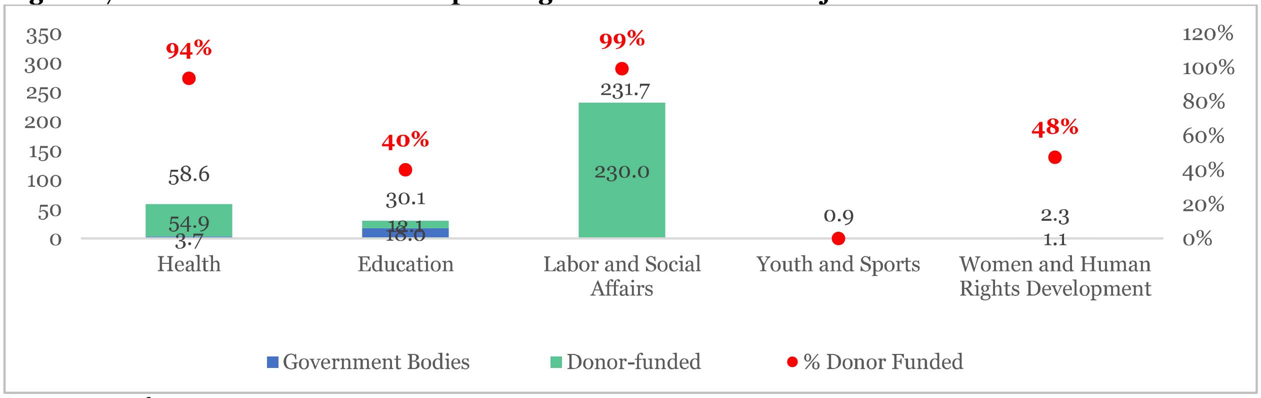
Source: 2022 Budget, Ministry of Finance

Figure 16 – Distribution of Social Spending



Source: 2022 Budget, Ministry of Finance

Figure 17 – Social Sector Domestic Spending vs Donor Funded Projects



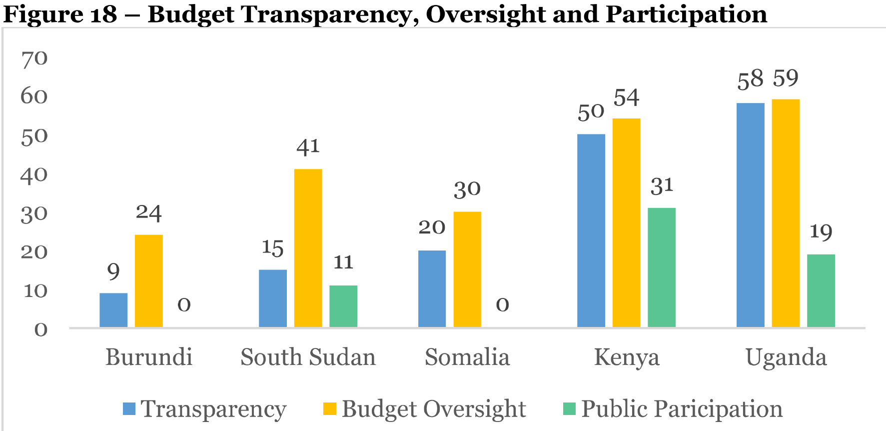
Source: 2022 Budget

Reforms in Public Financial Management

Efforts to improve public financial management are a high priority for the government, as those present a key requirement for meeting HIPC completion point policy triggers and other international agreements. Marked improvements have been made in recent years in the reporting and auditing of financial statements, the legislation of acts in revenue mobilization, natural resource management and investment[12], and despite implementation challenges, a continued mounting of internal pressure on improving procurement processes and the prioritization of projects at the level of decision makers[13].

Budget transparency indicators have palpably improved since 2017, with scores on budget reporting and accessibility increasing from 8 to 20 in 2021 and from 22 to 30 on budget oversight.[14] Transparent PFM processes help build trust for more effective and efficient revenue mobilization urgently needed to face the humanitarian emergency and support long-term development. To do so, the FGS and FMSs should continue to strive for increased collection and collation of data and the timely dissemination of public information and key budget documents, as well as the inclusion of local communities in decision making processes.

Figure 18 – Budget Transparency, Oversight and Participation



Source: International Budget Partnership 2021

[12] Federal Republic of Somalia Office of the Auditor General, 2021 Annual Compiance Audi Report.
[13] Ibid.
[14] Internationalbudget.org (2021)

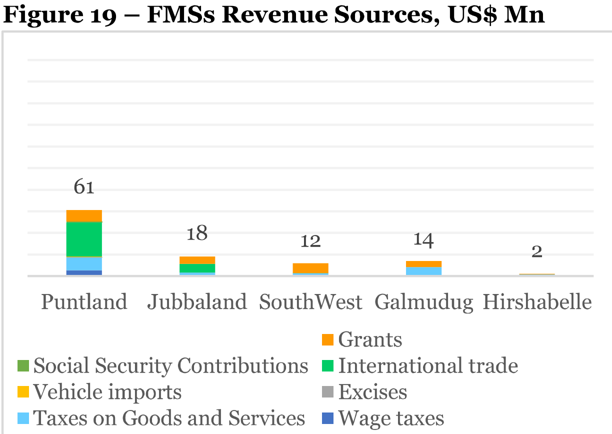
Decentralization and Fiscal Federalism

Power and resource sharing are intricately connected in Somalia but remain loosely defined by the provisional constitution that sets general guidelines for relations between the FGS and FMS, without clearly delineating operational functions and resource sharing. "Article 54 in the provisional constitution designates foreign affairs, national defense, citizenship and immigration, and monetary policy as the exclusive jurisdictions of the federal government"[15] but leaves the principals of public finance – Article 121 - administration of land and water resources, health and education – Article 52 - for discussion among different levels of government.

To carry out those discussions, the Finance Ministers' Fiscal Forum (FMFF) and a Technical Intergovernmental Fiscal Federalism Committee (IGFFC) were formed starting 2016. While some standard practices have been established since, such as the US$ 150,000 fiscal transfer from FGS to each of Southwest, Galmudug, and HirShabelle, other coordination efforts are rarely enforced, which along with unclarity in operational responsibilities lead to contentious results, often to the detriment of service delivery in social sectors. This is particularly true as much of donor support is aimed at emergency response and social service delivery. For example, in 2019 the FGS Ministry of Finance signed an agreement with FMSs Ministries of finance that 60 per cent of donor grants would go to the FGS and Benadir Regional Administration while 40 percent would be earmarked to the FMSs, however there is no arrangement on how the 40 per cent is distributed among FMSs. In reality "there is no clear objective criteria or agreed-upon framework through which the FGS distributes these transfers, for instance based on the size of the population, level of development, poverty, etc."[16]

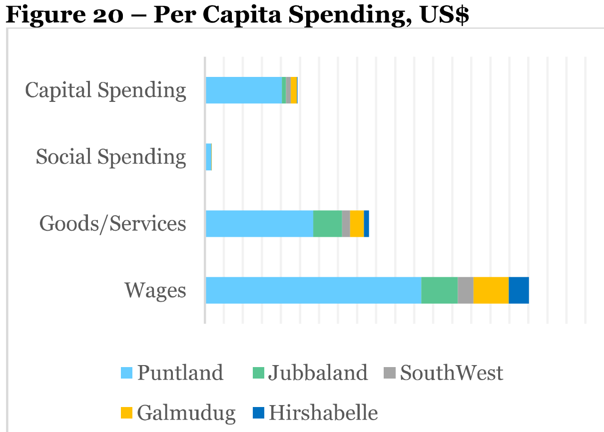
FMSs widely differ in their climate vulnerabilities, security conditions, levels of institutional development, access to resources and income generating capacities, a key factor necessitating redistributive policies for inclusive growth. Mogadishu, Puntland, and Jubaland all have seaports that generate taxes from international trade, which for FGS represent more than 50 per cent of total revenues and for Jubaland around 25 per cent of revenues. As a result of the relative disparities in institutional capacities and security, tax and non-tax revenues are similarly highly unequal across FMSs. For example, Puntland boasts Social Security Contributions[17] as part of its revenue sources, which while low, suggest developed institutional capacities in revenue mobilization and contributory social protection systems. Despite the attempted redistributive allocation of transfers from the FGS budget to FMSs, by increasing allocations for poorer states, inequalities between FMSs remain high, reflecting stark disparities in per-capita spending on economic and social development.

Figure 19 – FMSs Revenue Sources, US$ Mn



Source: FMS Ministries of Finance, Author's estimates from 2022

Figure 20 – Per Capita Spending, US$



Source: FMS Ministries of Finance, Author's estimates from 2022

[15] Ibid.
[16] Isak & Ali, Fiscal Federalism Policy in Somalia: Emerging Challenges and Agenda for Reform, Perspectives on Federalism, 2019.
[17] World Bank (2021) Domestic Resource Mobilization in Somalia

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