

THE DEATH KNELL FOR THE MIGHTY SOMALI SHILLING

The Causes and Effects of the Somali Shilling Depreciation and Currency Crisis in Puntland

KEY POLICY MESSAGES:

1. The Somali shilling is prone to sudden exchange rate increases and shocks. It has lost more than 30 percent of its value in a matter of three weeks between August and September 2020. The exchange rate of Somali shilling to US dollar has reached an all-time high of 46,000 SoSh per US dollar.
2. The recent jump of the exchange rate in Puntland is the result of conglomeration of factors ranging from increased supply of Somali shilling, decreased acceptance of the Somali shilling, decline in the flow of US dollars into the State, underlying fiscal and monetary problems to the economic downturn caused by Covid-19 pandemic.
3. A significant proportion of the population still uses Somali shilling. The poor and low-income families, internally displaced people (IDPs) and rural communities who live in areas that do not have telecommunication coverage rely on the shilling for trade. These particular groups are hit hardest by the depreciation of the local currency.
4. Puntland government has taken a number of measures to stabilise the value of the Somali shilling. Further government interventions might be necessary; 1) to increase the acceptance and use of Somali shilling by businesses and big companies such as the telecommunication, banking and utility companies, 2) to provide liquidity by injecting US dollars into the markets (buying Somali shilling and 3) to synchronise the dual exchange rate subsystems.
5. Somalia's international partners and international financial institutions such as the World Bank and IMF could support the FGS and Puntland State to stabilise the exchange rate, avert inflation and effectively manage fiscal and monetary policies.
6. Dollarization of the markets and the increased use of mobile e-money services pose an existential threat to the Somali shilling and will most likely hasten its demise. The FGS and FMS need to consult widely with Somali economists, academia, businesspeople, civil society groups and the wider public on the options for currency reforms and to determine whether to push for complete dollarization of the markets or issue new Somali currency to replace the current banknotes.
7. Counterfeit money printing is categorised as an organised crime and has to be dealt with accordingly. The UNODC is mandated to provide support in the fight against counterfeit money and goods.



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1. BACKGROUND

Origin:

In September 2020 the Somali shilling to US dollar exchange rate rose from 34,000 to 42,000 SoSh per US dollar, an increase of 24 percent. At the end of November 2020, it reached a record high of 46,000 SoSh per US dollar.

The Present Crisis of the Somali Shilling Depreciation

Somalia is one of the poorest and most underdeveloped countries in the world. Decades of conflict, state failure and fragility compounded by natural disasters (alternating recurrent droughts and flooding) have destroyed the social and economic infrastructure of the country, begetting - on top of the human cost of the conflict - a protracted period of displacement, economic devastation, local currency depreciation, hyperinflation and high unemployment. Today, it is estimated that nearly seven out of ten Somalis live in poverty, defined as living on less than US\$1.90 a day¹.

In September 2020 the Somali shilling to US dollar exchange rate rose from 34,000 to 42,000 SoSh per US dollar, an increase of 24 percent. At the end of November 2020, it reached a record high of 46,000 SoSh per US dollar. This unforeseen and demoralising jump of the Somali shilling to US dollar exchange rate in Puntland has caused concern and consternation among the Somali society in Puntland. Particularly it hits hardest the poor and low-income families whose earnings are paid in fixed Somali shilling and rural communities who do not have access to mobile e-money and other banking services. It could diminish their purchasing power and push them deeper into hunger and poverty as the price of the commodities traded in Somali shilling start to creep up in response to this high local currency against US dollar exchange rate.

Puntland State government has taken a number of measures to stabilise the Somali shilling / US dollar exchange rate. In a series of meetings with the business community, the government promised to support the Somali shilling, reassured the public that there is no inflationary pressure and set out plans for better financial regulations. It asked businesses to accept the Somali shilling and commercials banks to facilitate the Somali shilling to US

dollar exchange.

Historical Perspectives on Somali Shilling Depreciation (Devaluation)

Whilst the value of the Somali shilling plummeted in the aftermath of the conflict in 1991, Somalia's history of currency devaluations and higher rates of inflation dates back to early 1980s. Somalia had signed the first standby macroeconomic policy agreement with the IMF in February 1980 although the terms of that agreement were not implemented. In June 1981, Somalia signed a second standby agreement with the Fund which was completed in July 1982. These agreements had set out stabilisation and structural adjustment programmes which required Somalia to undertake economic and fiscal policy reforms and gradual privatisation such as abolishing its monopoly of grain marketing, reduce public spending and government personnel, devalue the Somali shilling and establish free market for foreign exchange among other conditions³. Following these structural adjustment programmes, the Somali shilling (SoSh) had lost 100 percent of its value from 6.2 SoSh per US dollar in 1981 to 12.6 SoSh per US dollar in 1982⁴. The sharp decline of the value of Somali shilling continued unabated and at the end of 1987 it was trading 100 SoSh per US dollar, a devaluation of more than 1,600 percent.

This period of 1980s has also seen the printing of advanced Somali shilling banknotes of 50, 500 and 1,000 SoSh. It was reported that the strict requirements of the IMF structural adjustment programme together with Somalia's meagre resources, weak revenue collection system and the dwindling foreign aid had forced Said Barre regime to resort to printing money to cover the government fiscal deficits. Somali shilling in circulation in Somalia grew from 3.8 billion SoSh in 1985 to 155.7 billion SoSh in 1990⁵.

Structural adjustment:

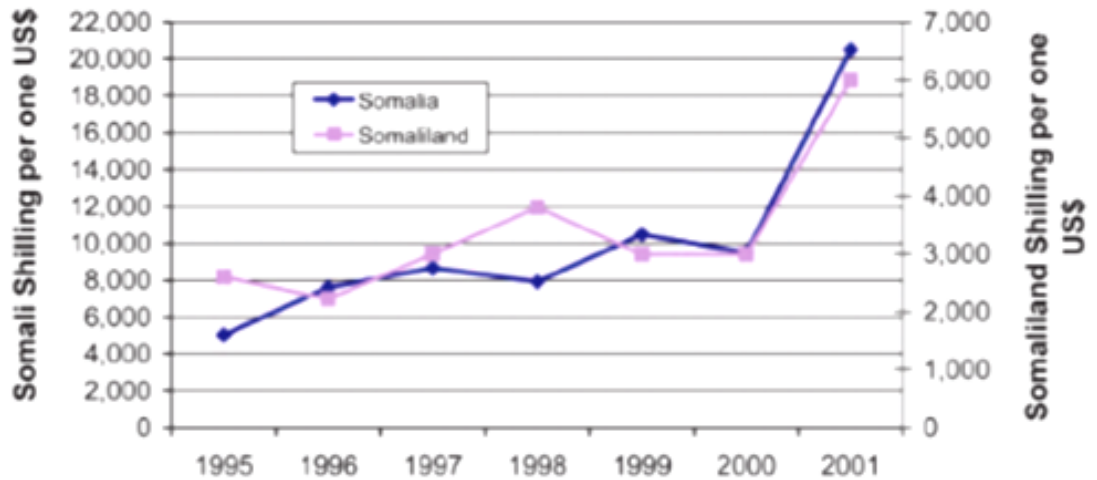
Following these structural adjustment programmes, the Somali shilling (SoSh) had lost 100 percent of its value from 6.2 SoSh per US dollar in 1981 to 12.6 SoSh per US dollar in 1982⁴.

The Value:

Although the value of Somali shilling plunged steeply against the US dollar at the collapse of the central government in 1991 but it has nonetheless kept trading and was being widely used.

Although the value of Somali shilling plunged steeply against the US dollar at the collapse of the central government in 1991 but it has nonetheless kept trading and was being widely used. The Independent newspaper rationalised the remarkable resilience of the Somali shilling without central bank in a 1994 article. It wrote “Yet in Somalia there seems to be an unwritten agreement that

shillings of one sort or another will continue to be accepted despite the fact that no agency exists to print new notes and no banks exist to distribute them.”⁶ Even though the shilling did not recover its value from the free fall, the exchange rate stabilised in the period between 1995 and 2000 where it was trading around 10,000 SoSh per US dollar.



Source: FEWS NET October 2001, Nairobi.

Depreciation of Somali and Somaliland Shilling against US Dollars 1995 – 2001.

Taken from Christian Webersik (2006); Mogadishu: An Economy without a State.

Exchange rate:

The exchange rate stabilized after 2012 as the result of an increased inflow of US dollars and the improvements in the security situation of the country.

A sharp rise of Somali shilling to US dollar exchange rate was nevertheless observed in 2001 partly due to influx of newly printed counterfeit money into the markets. The exchange rate stabilised after 2012 as the result of an increased inflow of US dollars and the improvements in the security situation of the country. Investment by returning Somali diaspora, greater re-engagement of the international community and the peace and state building programmes contributed to modest economic growth, exchange rate stabilisation and the appreciation of the Somali shilling during the period between 2012 to 2016.

shilling, hard to Kill”. The story explained how the Somali shilling has survived against the odds of lack of central bank and authority for monetary and fiscal policy in Somalia for a long time⁷.

The current Somali shilling depreciation in Puntland is significantly different from the previous depreciations and warrants not only a comprehensive assessment of its causes and effects but reliable analysis on the fate of the Somali shilling in the face of the current currency crisis, dollarization of the markets and the country’s weak monetary policies.

In 2012, the Economist, in an article to report on the durable use of the Somali shilling, titled its story “Somalia’s mighty

Exchange Rate:

Exchange rate is defined as the unit price of the domestic currency in terms of reference foreign currency (Somali shilling per US dollar).

SIDRA has conducted a research study in October – November 2020 to examine the available evidences on the causes of the current sharp decline of the value of the Somali shilling in Puntland, signs of inflation and the effects of this depreciation on the poor and low-income families, the State and the wider public. This study has not sought to analyse the expansionary or contractionary effects of the present Somali shilling depreciation on the macroeconomic stability of Puntland nor has it attempted to apply models and seek answers about the causes of the present Somali shilling depreciation in market dynamics (imports, exports, terms of trade, balance of accounts, inflation rates, interest rates, etc). This policy briefing is the product of this in-depth research and analysis and is aimed to report the key study findings and make recommendations on the possible solutions to these monetary problems.

Definitions

It is essential to explain some inherent definitional confusions between depreciation (devaluation) and inflation in Puntland State.

Exchange Rate: *Exchange rate is defined as the unit price of the domestic currency in terms of reference foreign currency (Somali shilling per US dollar).*

Depreciation and Devaluation: *Currency depreciation or devaluation denotes a decrease in the exchange value of the domestic currency (SoSh) relative to a reference foreign currency (US dollar). In other words, the exchange rate of the domestic currency increases (i.e. SoSh/US\$). Depreciation is associated with floating exchange rate or crawling peg systems whereas devaluation takes place in fixed exchange rate systems. While depreciation is largely driven by market forces, other factors such as economic and monetary policies, global markets, increase of imported goods and political events can influence the value of*

the domestic currency. On the other hand, devaluation has elements of both economic and political decisions.

Appreciation and Revaluation: *Revaluation or appreciation increases the value of the domestic currency (SoSh) with respect to the foreign currency (US dollar). It refers to an upward adjustment to the country's official exchange rate relative to the price of the reference foreign currency. Revaluation is a feature of the fixed exchange rate regime, whereas the exchange rate is determined by the central bank or the government. In contrast, appreciation of a currency is associated with a floating or managed floating exchange rate system.*

Inflation rate: *In economics, inflation or price inflation is a general rise in price level relative to available goods & services resulting in a substantial and continuing drop in purchasing power in an economy over a period of time. The inflation rate is most widely used by calculating the percentage movement or change in a price index, typically the consumer price index (CPI) over time. Puntland Statistics Department (PSD) is responsible for collecting, analysing and reporting the inflation rate as consumer price index in Puntland.*

The Statistics:

Puntland Statistics Department (PSD) is responsible for collecting, analysing and reporting the inflation rate as consumer price index in Puntland..

Informants:

The key informants were drawn from the government officials, economists and financial sector experts; Puntland Ministry of Finance, Puntland State Bank, Department of Statistics, academia, private banks and foreign exchange sellers/buyer (vendors).

Literature:

A brief desk review was conducted on the literature and reports of the current exchange rate rise, historical Somali shilling depreciation (devaluation) events, currency crisis and the fiscal and monetary environment in Puntland and Somalia.

2. RESEARCH STUDY QUESTIONS

1. What are the causes of the current Somali shilling depreciation in Puntland?
2. Is there an inflationary pressure in Puntland?
3. What impact does the depreciation of the Somali shilling have on the poor and low-income families, Internally Displaced People (IDPs) and rural communities?
4. What will be the consequences if the Somali shilling becomes unacceptable in Puntland? What will happen to the billions of Somali shilling 1,000 banknotes in the market and Puntland government coffers?
5. Are the necessary fiscal and monetary regulations and policies in place in Puntland?
6. How is counterfeit money printing viewed in Puntland?
7. Are the appropriate communication channels used to promote fiscal and monetary policies?

3. RESEARCH METHODOLOGY

SIDRA uses a variety of research tools and methodologies to collect, analyse and report research findings. This study used key informant interviews, selected commodities price survey questionnaire, on-street interview survey questionnaire and observational visits to the markets. A brief desk review was conducted on the literature and reports of the current exchange rate rise, historical Somali shilling depreciation (devaluation) events, currency crisis and the fiscal and monetary environment in Puntland and Somalia.

The key informants were drawn from the government officials, economists and financial sector experts; Puntland Ministry of Finance, Puntland State Bank, Department of Statistics, academia, private banks and foreign exchange sellers/buyer (vendors).

Separate Key Informant interviews were conducted with 10 people from at risk-population (people who receive their earning in Somali shilling). Observational visits were made to the foreign exchange agents and three main food markets and the prices of selected commodities were surveyed four times in October and November 2020.

One hundred and twenty-eight people (128) were interviewed in the on-street interview survey and were asked the following three questions.

In what currency do you get paid?

- US dollar
- Somali shilling
- Both

In what currency do you use to buy things?

- US dollar
- Somali shilling
- Both

In your opinion what percentage of the population use Somali Shilling?

_____ %

The shocks:

The market driven floating exchange rate mechanism in Puntland is prone to shocks and unexpected and irrecoverable overnight depreciation of the Somali shilling.

The new shilling:

A liberal financial system operates in Puntland, with a dual exchange rate subsystem that uses market rates for private transactions but usually overvalued rate for government transactions.

4. KEY RESEARCH FINDINGS

a) The causes of the current Somali shilling depreciation

Puntland State is the only place in Somalia where the new Somali shilling is used. A liberal financial system operates in Puntland, with a dual exchange rate subsystem that uses market rates for private transactions but usually overvalued rate for government transactions⁸.

The market driven floating exchange rate mechanism in Puntland is prone to shocks and unexpected and irrecoverable overnight depreciation of the Somali shilling. This shock is exemplified by the recent increase in Somali shilling / US dollar exchange rate in the span of four weeks from 34,000 SoSh per US dollar in August 2020 to 42, 000 SoSh in September 2020.

The data from the study has shown that 80 percent of the respondents agree that there was an increase in the supply of Somali shillings in Puntland in the months leading to the exchange rate hike. Although counterfeit money printing has been blamed for this jump, whether this alleged counterfeit money printing is taking place inside or outside of Puntland could not be verified.

There is also evidence of a decrease in the supply of US dollars in recent months.

The global economic disruptions and the international travel restrictions imposed in response to Covid-19 pandemic have affected the three main sources of hard currency for Somalia; foreign development aid, remittances from Somali diaspora and the export of livestock and frankincense to the gulf countries. The cancellation of 2020 Hajj due to the pandemic has led to a ban on livestock exports to Saudi Arabia. There is some evidence of US dollar outflow from Puntland to trading partners to purchase more import goods. Speculation of further depreciation could have prompted some traders to buy US dollars, pushing the value of Somali shillings further down against the dollar. The decreased acceptance and use of the Somali shilling have eroded public confidence in the local currency.

It will be too simplistic to attribute this depreciation and the volatility in the exchange market to increased supply of Somali shilling in Puntland alone and overlook the existing monetary and fiscal problems in Somalia. The results of the study have indicated that free market forces, the dollarization of the markets and the innovative modern financial services such as the mobile e-money and private banking services which are denominated in US dollars are playing a role in whittling away at the Somali shilling.

Causes of the current Somali shilling depreciation

Nasra Abdirahman, a money exchange seller, commented on the causes of the current jump in the exchange rate of Somali shilling to US dollar. She said, “Everyone is blaming large quantity of new Somali shillings which entered into Puntland markets for the exchange rate and inflation troubles. We do not know when and where they were printed and who printed them, but I guess it does not matter. I think that this is just one of many causes. The use of Somali shilling is declining. The government does not want to collect taxes in Somali shilling. Big companies do not accept Somali shilling and consider them worthless paper.

What the data shows:

during the peak of the depreciation of SoSh against the US\$, the monthly change of September 2020 recorded an increase of 0.09 percent compared with the increase for previous month of August 2020 which was -0.75 percent. Consequently, the all-items CPI increased 0.20 percent in the month of October 2020.

b) Inflationary pressure in Puntland

The monthly Puntland Statistics Department Consumer Price Index (PSD CPI) data below between August 2020 and October 2020 shows no significant increase in majority of indices in US dollar terms. The data shows that, during the peak of the depreciation of SoSh against the US\$, the monthly change of September 2020 recorded an increase of 0.09 percent compared with the increase for previous

month of August 2020 which was -0.75 percent. Consequently, the all-items CPI increased 0.20 percent in the month of October 2020. The official CPI statistics confirm that there is NO inflationary pressure in Puntland as the result of the Somali shilling depreciation. The effects of the depreciation have been minimized by the dollarization of the markets and the extensive use of mobile e-money which is denominated in US dollars.

Table 1: Key Figures, August – October 2020 by main COICOP groups (Index = 100 at 2015)

COICOP Classification Group	Aug 2020	Sept 2020	Oct 2020	% change Aug – Sept 20	% change Sept – Oct 20
Total consumption expenditure all items	88.97	89.05	89.23	0.09	0.20
Food and beverages	87.26	86.51	86.52	-0.85	0.01
Tobacco and Khat	98.68	99.42	98.00	0.75	-1.43
Clothing and footwear	90.09	91.85	91.95	1.95	0.12
Housing, water, electricity, gas	87.21	86.97	87.42	-0.28	0.51
Furnishings, and Households maintenance	87.54	88.12	87.62	0.66	-0.56
Health	91.10	94.51	96.33	3.75	1.92
Transport	97.73	98.11	99.53	0.39	1.44
Communication	87.72	87.61	87.49	-0.13	-0.13
Recreation and culture	107.87	107.58	107.25	-0.27	-0.31
Education	90.61	90.61	90.61	0.00	0.00
Restaurants and hotels	84.43	85.76	84.93	1.58	-0.97
Miscellaneous goods and services	121.88	125.98	126.06	3.37	0.06

Evidence:

The price of 1 kg of potatoes was 20,000 SoSh before the exchange rate hike in August 2020 and rose to 34,000 SoSh in October, an increase of 70 percent. Similarly, the cost of ½ Waslad of meat increased 35 percent to 105,000 SoSh.

Source: Puntland MoPEDIC, Statistics Department, October 2020

However, there is some evidence from our selected commodity price surveys which points to a rise in the commodity prices when traded in Somali shilling. For example; the price of 1 kg of potatoes was 20,000 SoSh before the exchange rate hike in August 2020 and rose to 34,000 SoSh in October, an increase of 70 percent. Similarly, the cost of ½ Waslad of meat increased 35 percent to 105,000 SoSh.

Table 1: The prices of selected commodities paid in Somali shilling

Item	Previous Price in Somali shilling (August 2020)	Current Price in Somali Shillings (October 2020)
Meat (1/2 Waslad)	78,000	105,000
Tomatoes (1kg)	43,000	46,000
Potatoes (1kg)	20,000	34,000
Banana (One Piece)	5,000	11,000
Onion (1kg)	27,000	42,000
Rice (25kg)	442,000	588,000
Oil (10 ltr)	323,000	420,000
Flour (25kg)	349,000	452,000
Sugar (25kg)	425,000	546,000
Milk (HILWA for children - 1 tin)	442,000	609,000

Source: Primary data of the commodity price surveys, SIDRA, October 2020

The Official Statistics: Consumer Price Index (CPI) from PSD

Abdifatah M Abdullahi, Director of Puntland Statistics Department said, “We conduct consumer price index surveys on a sample of representative goods and services. We analyze the data using robust economic analytical tools and formulas. We subject our data to rigorous verification and validation processes. We produce the statistics, share them with the respective government departments, the financial sector and the wide public. We also publish up-to-date statistics in the department website”.

He continued, “An increased supply of Somali shilling in Puntland is most likely the cause of this exchange rate rise. Decreased supply of US dollars due to the effects of Covid-19 is probably another factor. The CPI and other monthly surveillance data of the markets do not indicate any increase in the inflation rate in US dollar terms, so the Somali shilling / US dollar exchange rate upshift has not affected the inflation in Puntland. In short, there is no inflationary pressure in Puntland”.

The Tale of Two Currencies

SIDRA Researchers commented on the effects of the Somali shilling depreciation on the inflation.

Professor Mohamed Said Samantar, Senior Economist and Executive Director of SIDRA said, “Commodity prices are pegged to the US dollar in Somalia. We have not seen changes in the commodity prices in US dollars terms. It is safe to say that there is no inflationary pressure in Puntland at the moment and this assertion is supported by the monthly consumer price index (CPI) from Puntland Statistics Department and World Bank Somalia economic projections”.

Abdukadir Mohamed Musse, Programme Coordinator and Researcher at SIDRA said, “There is an incongruence between the official figures of inflation (CPI) and the perception of the general population on the streets especially the poor and low-income families, the labourers who get paid in Somali shilling and the market stall vendors and small businesses who accept Somali shilling. Anyone paying in Somali shilling would tell you that there is a price rise in some of the essential commodities. This price rise in Somali shilling affects a portion of the population and should be considered when calculating inflationary pressure indices”.

The other factor:

In Puntland is most likely the cause of this exchange rate rise. Decreased supply of US dollars due to the effects of Covid-19 is probably another factor.

The incongruence:

There is an incongruence between the official figures of inflation (CPI) and the perception of the general population on the streets especially the poor and low-income families, the labourers who get paid in Somali shilling and the market stall vendors and small businesses who accept Somali shilling..

An important distinction:

The report makes the important distinction between the prices in the two trading currencies. It reports that “In USD, prices are stable at USD 40 compared to the previous year (USD 41) but seven percent below the five-year average, reflecting a low supply of saleable animals and depreciation of the local SOS”¹⁰.

The World Bank, in its Somalia Economic Update (June 2020), projected the inflation to remain low in Somalia in 2020. The reports stated that “domestic inflation is linked to US inflation, given dollarization and the large import component of the consumption basket. De facto dollarization continues to provide relative price stability, particularly given Somalia’s dependence on imports”⁹.

Famine Early Warning System (FEWS NET) reported in its latest report in October 2020 a price rise in Somali shilling. The report states that “the high-level devaluation of the Shilling due to illegal printing of the Shilling in Puntland has also affected price dynamics”. It continued to cite price references “in Ceerigabo, a key reference market, where the price of a local goat in SoSh in October was 31-37 percent higher than last year and the five-year average”. The report makes the important distinction between the prices in the two trading currencies. It reports that “In USD, prices are stable at USD 40 compared to the previous year (USD 41) but seven percent below the five-year average, reflecting a low supply of saleable animals and depreciation of the local SOS”¹⁰.

It is reasonable to argue, according to official CPI data and given the dollarization of the markets, that the Somali shilling to US dollar exchange rise and consequential increase in commodity prices in Somali shilling, do not have an effect on the real commodity prices in US dollar terms and, in essence, could not be construed as representing inflationary pressure in the State.

c) Currency crisis

In IMF paper, Kaminsky et al (1997) defined currency crisis “as a situation in which an attack on the currency leads to a sharp depreciation of the currency, a large decline in international reserves, or a combination of the two”¹¹. They outlined several indicators to define currency crisis; percentage change in the exchange rate,

deviations of the real exchange rate from trend, imports, exports, international reserves and the terms of trade among others. It is apparent, by looking at the percentage change of the exchange rate since 1991 despite the absence of data on other indicators, that there has been a real currency crisis in Somalia for a long time.

d) The impact of the Somali shilling depreciation on the poor and low-income families, internally displaced people (IDPs) and rural communities.

A 2017 paper by Altai Consulting for the World Bank estimated mobile money penetration rate to be around “73% (83% in urban areas, 72% in IDP camps and 55% in rural areas)”¹². This analysis indicated that at least 17% of the urban population, 28% of IDPs and 45% of rural population had relied on the use of Somali shilling.

Our on-street interview survey revealed that the wider public perceive the Somali shilling as an essential currency for the country. It showed that around 31 percent (39 out of 128) of those interviewed reported to get paid in Somali shilling, while around 35 percent (45) of them reported using both US dollar and Somali shilling to buy things. Forty-nine percent (63 out of 128) of the respondents thought that between 20 and 30 percent of the population use Somali shilling.

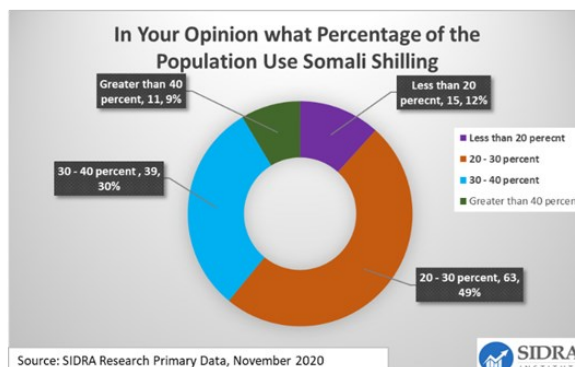
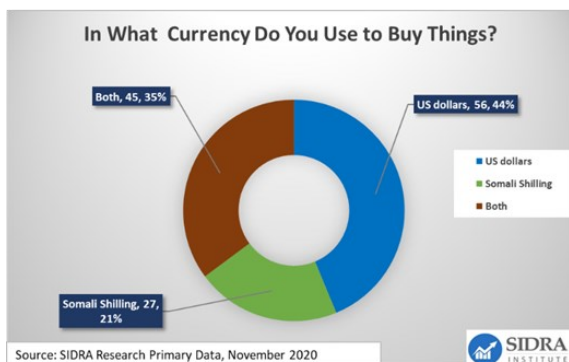
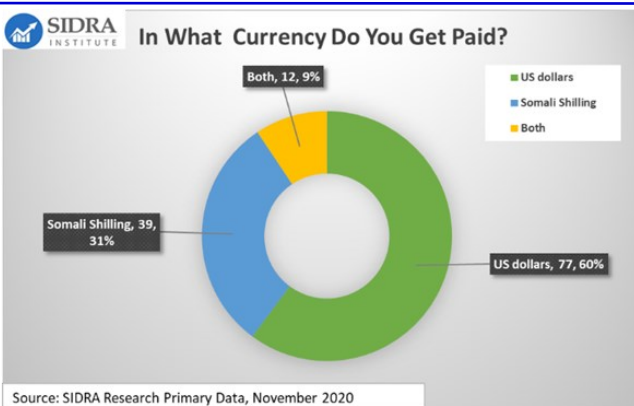
The price of some goods and services paid in Somali shilling has significantly gone up in recent weeks, making many essential commodities such as food and clothing more expensive for the poor and low-income families, IDPs and rural communities. Many manual labourers such as constructions workers, small business workers, general hand, farmworkers, cleaners, drivers and fruit and vegetable sellers who get paid in Somali shillings have experienced a substantial reduction of their earnings in real terms, adversely affecting their ability to buy basic necessities.

The Shilling usage:

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The burden:

While the currency depreciation places a heavy burden on the poor and low-income families, the study has shown that the current trend of dollarization coupled with the high Somali shilling/ US dollar exchange rate could undermine public confidence in accepting and using Somali shilling for trade purposes.



e) The long-term nation-wide consequences of the Somali shilling depreciation

While the currency depreciation places a heavy burden on the poor and low-income families, the study has shown that the current trend of dollarization coupled with the high Somali shilling/ US dollar exchange rate could undermine public confidence in accepting and using Somali shilling for trade purposes.

As explained by Mohamed Dalmar in one of his articles on monetary policies in Somalia, “The foreign exchange market operated by money-changers grew bigger and more vibrant as it benefited from the absence of government controls and the sizeable inflow of remittances from the Somali diaspora”¹³. These remittances are paid in US dollars and recently into mobile money accounts which are denominated in US dollars.

Evidence shows that the following factors are driving the dollarization of Somali markets;

- The pegging of import commodity prices to the US dollars.
- The adaption of and increasing use of unregulated mobile e-money which is seen as a convenient and reliable alternative to the Somali shilling.
- The big telecommunications, remittance and utility companies which accept payments in US dollars only. It is worth mentioning that the mobile money service providers are owned or affiliated to banks, telecommunication and remittance companies.

At present the SoSh in use in Puntland is NOT used in others parts of Somalia as a legal tender whereas the US\$ is a legal tender throughout Somalia. This fact divides Somalia into three distinct areas of local currencies as legal tenders: newly printed Somali shilling in Puntland, Somaliland shilling in Somaliland and old worn-out Somali shilling in South-Central. The great majority of the population in all parts of the country prefer to keep their assets and savings in US dollars.

At present:

The SoSh in use in Puntland is NOT used in others parts of Somalia as a legal tender whereas the US\$ is a legal tender throughout Somalia.

A bleak future:

The long-term economic prospects of the poor and low-income families look bleak as the worsening depreciation could lead to hysteresis, where other socio-economic aspects are affected.

Considering the accelerating dollarization of the markets, this unsustainable high exchange rate could seal the fate of Somali shilling and signal its death-knell. If the Somali shilling becomes unacceptable in Puntland, it could have undesirable consequences for the economic stability and growth in Puntland as billions of Somali shillings are in circulation in the State and there is a large reserve of the currency held in government coffers.

The long-term economic prospects of the poor and low-income families look bleak as the worsening depreciation could lead to hysteresis, where other socio-economic aspects are affected. For instance; these poor and low-income families might not be able to have access to basic social services such as clean water, education, health and electricity. There is also the risk of the depreciation of Somali shilling to impact on import of goods where it could lead to persisting high and rising inflation rate .

f) Macroeconomic policy framework

Somali National Development Plan (NDP 9 2020 - 2024) outlined macroeconomic policy framework as one of the country's priority goals. It supports the "building of the capacity of Central Bank of Somalia to carry out its mandate by strengthening its operational capabilities to (1) develop and implement independent monetary policy instruments and reserve management guidelines, and (2) regulate and supervise financial institutions within its jurisdiction". However, it is recognized that "monetary policy in Somalia is weak because the economy is dollarized due to the lack of

credibility of the Somali Shilling (SOS). The Shilling has not been issued since 1991, so the likelihood that the notes in circulation are counterfeits is high"14.

As part of its reengagement with Somalia, the World Bank signed Country Partnership Framework (CPF) FY2019-2022 with Somali Federal government in 2018. One of the main objectives of the framework is to strength "greater licensing and supervision capacity of the Central Bank, resulting in more secure financial services"15.

This study has revealed that while both FGS and Puntland have fiscal and monetary regulations and policies in place, the existing policies are not adequate to respond to the present economic and financial challenges without the necessary fiscal and monetary tools and assets such as healthy foreign exchange reserves.

Nationally, the Federal Government of Somalia through the Central Bank of Somalia is constitutionally responsible for monetary policies as per article 54 of the Provisional Federal Constitution. Somalia re-established its central bank in 2011 but the institution does not have sufficient technical and financial capacity to set monetary policies and regulatory mechanisms to influence the currency exchange rate markets. World Bank Somalia Economic Update (June 2020) referred to Central Bank of Somalia, citing its lack of assets and its limited monetary capability, as an instrument for "prudential supervision"9.

Nationally:

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The Impact of the Exchange Rate rise: Commodity Prices rise in Somali shilling

Mohamed Ali commented on the commodity price rise in Somali shilling. He said, "Three months ago, I used to buy 1kg of potatoes, 1kg of tomatoes and 1kg of onions every two days. Now the same amount of Somali shilling can only buy half a kg. I still earn the same amount in Somali shilling but the food prices have gone up. Meat has become very expensive and unaffordable. Previously we were buying meat once a week, now we are lucky if we manage to buy it once a month. Import commodities such sugar, flour and rice are getting more expensive in Somali shilling than one month ago".

Puntland State Bank:

The role of the bank in setting the value of the local banknotes on foreign exchange rate, formulating monetary policies and safeguarding the economy from counterfeit money.

Puntland Ministry of Finance is responsible for the fiscal policies of the State. Puntland State Bank is entrusted with powers in Puntland Constitution to oversee and regulate the financial and monetary system in Puntland. The Director of Puntland State Bank emphasised the role of the bank in setting the value of the local banknotes on foreign exchange rate, formulating monetary policies and safeguarding the economy from counterfeit money.

A combination of fiscal and monetary interventions is needed to rein in this uncontrolled exchange rate rise and stabilise the value of the Somali shilling. Government measures might be required to revalue the Somali shilling;

- Promoting and enforcing the exchange of Somali shilling to US dollars and synchronising the dual exchange rate subsystems
- Increasing the acceptability and use of the Somali shilling (through revenue collection, public spending and payments)
- Improving financial and banking sector regulations (mobile e-money)
- Creating conditions to build and retain the confidence of the private sector to uptake the use of Somali shilling.

Fiscal and monetary policies are inherently interlinked. With the support of the World Bank, Puntland MoF is carrying out

financial management reforms and envisions to set up robust long-term fiscal policies. The effective management of fiscal instruments will provide a space for Puntland State Bank to build its institutional, technical and financial capacity, improve its reserves and acquire the appropriate tools and resources to affect its monetary policies. Stable and sustainable exchange and inflation regimes are as crucial as market friendly regulatory environment to stimulate the economy. Skilled labour, reliable and cheap water, electricity and gas supplies, telecommunication services and better transportation networks such as roads, ports and airports are vital for spurring economic growth

g) Dollarization or a New Currency

In reference to the inability of the Central Bank of Somalia to affect the money supply, the World Bank CPF asserted that “With IMF support, the CBS is now preparing a phased currency reform to exchange existing Somali shilling in circulation with a new currency issued by CBS in small-denominations (i.e., 1,000; 2,000; 5,000; and 10,000). Phase two of the reform will inject new Somali shilling banknotes, including larger denominations, after strengthening the CBS’s institutional capacity and developing independent monetary policy instruments and reserve management guidelines”. That said, the role of the World Bank and IMF to provide support to CBS to stabilise the current Somali shilling is not clear.

Phase two:

The reform will inject new Somali shilling banknotes, including larger denominations, after strengthening the CBS’s institutional capacity and developing independent monetary policy instruments and reserve management guidelines.

The Role of Puntland State Bank

Mr. Mohamed Farah Mohamoud, Director of Puntland State Bank, commented on the role of the bank that “We have the necessary monetary laws and policies in place. We have developed a number of plans to affect these monetary policies, including stabilization of the exchange rate in the near future. Exchange rate and price stability are some of our highest priorities. Puntland State Bank’s role is clear; we safeguard the economy of the State, set the value of the local currency on foreign exchange rate and supervise the financial markets in the State”.

Building trust:

One of the monetary tools to influence exchange and inflation rates is to use information, guidance and economic plans to build the trust and confidence of the markets.

The debate on currency reforms and issuing a new Somali currency has been deferred for the last two years. The turbulent relationship and disagreements between the FGS and FMS over a raft of issues from the ongoing constitutional review processes, resource and revenue sharing, and 2020-21 Federal electoral models have eclipsed many important debates on peace and state building such as currency reforms in Somalia. The decision of whether to allow the accelerating dollarization of the markets or promote the campaign for a new currency to replace the old Somali shilling deserves a broader public debate, not one confined to small group of government officials and international financial institutions.

h) Communicating CPI, Exchange and Inflation Rate Information and Guidance

One of the monetary tools to influence exchange and inflation rates is to use information, guidance and economic plans to build the trust and confidence of the markets. The public want stability and certainty which could be attained by providing accurate information on the markets, financial and economic reports such as the consumer price index, price stabilisation initiatives, government commitments in spending and investment, reforms and stimuli to strengthen and improve the functioning of the markets and the financial sector.

The Department of Statistics, in collaboration with the Ministry of Finance and Puntland State Bank, need to establish communications channels to report this vital information. The Ministry of Finance and Puntland State Bank need to issue regular guidance on exchange and inflation rates and communicate its budgetary plans and commitments to promote economic growth.

i. Counterfeit money printing.

The access to cheap digital equipment such as advanced colour scanners, photocopiers, printers and powerful PCs have made possible the printing of low quality 1,000

Somali shilling banknotes in many towns and cities in the country. The commonality of this illicit activity derives partly from the fact that counterfeiting is a lucrative business in Somalia (currency, food, pharmaceuticals, travel documents, land ownership documents, etc) and moreover, counterfeit money is not perceived as a crime, let alone the more serious category of organized crime in Somalia.

Puntland Police Force has a unit established to fight against organized crime such as piracy, drugs and human trafficking. But the unit does not have the technical capacity, resources and intelligence to detect, analyse and prosecute the counterfeit money printing inside and outside of Puntland. The United Nations Office on Drugs and Crime could provide such technical and financial assistance and support the police organized crime units to put an end to the forged money printing in Somalia.

j. Experiences of exchange rate and inflation control measures in other parts of the country

Somaliland government succeeded in preventing counterfeit money, ensuring the parallel use of Somaliland Shilling and US dollars in the markets and regulating the mobile e-money and the banking sector. In South-central Somalia, the use of old well-thumped Somali shilling which is unaffected by counterfeiting and the extensive use of US dollars have helped stabilise the exchange rate and control inflation.

Counterfeit money printing:

The commonality of this illicit activity derives partly from the fact that counterfeiting is a lucrative business in Somalia (currency, food, pharmaceuticals, travel documents, land ownership documents, etc) and moreover, counterfeit money is not perceived as a crime, let alone the more serious category of organized crime in Somalia.

5. CONCLUSIONS

The capability:

A predominantly floating exchange rate mechanism operates in Puntland alongside the official government fixed exchange rate system. None of the financial authorities (Puntland Ministry of Finance, Puntland State Bank and Central Bank of Somalia) have the capability to stabilize and control the exchange rate.

The Somali shilling in use in Puntland is not accepted in other parts of the country including Mogadishu where the Central Bank of Somalia is based. Several causes could be linked to the current Somali shilling depreciation, but the most obvious factors are the increased supply of Somali shilling and decreased flow of US dollars into the State. Commodities are pegged to the US dollar and the official statistics (CPI), calculated on US dollar terms, show that there has been no inflationary price change between August and October 2020.

The results of the study have demonstrated that the prices of some essential commodities such as food and clothing have gone up in Somali shilling, causing fears of inflation and the effects on the poor and low-income families. The public perception of the depreciation and inflation is different from the official interpretation on the effects of this exchange rate rise.

As mentioned before, a predominantly floating exchange rate mechanism operates in Puntland alongside the official government fixed exchange rate system. None of the financial authorities (Puntland Ministry of Finance, Puntland State Bank and Central Bank of Somalia) have the capability to stabilise and control the exchange rate.

A combination of factors on top of the present depreciation and the weak of macroeconomic policy framework may precipitate the Somali shilling to head towards the exit. The consequences will be great and the options of whether to complete the dollarization of Somalia or issue a new currency is open for debate, not a discussion for the few but one owned and led by Somali economists, businesspeople, investors, civil society groups and the wider public.

6. RECOMMENDATIONS

1. Puntland government has taken a number of measures to stabilise the value of the Somali shilling. Further government interventions might be necessary; 1) to increase the acceptance and use of Somali shilling by businesses and big companies such as the telecommunication, banking and utility companies, 2) to provide liquidity by injecting US dollars into the markets (buying Somali shilling and 3) to synchronise the dual exchange rate subsystem.
2. Private commercial banks and mobile money providers should be required to accept exchange of Somali shilling to US dollar in order to improve the acceptability and the use of Somali shilling. Similarly, the big telecommunication and utility companies must accept payments in Somali shilling.
3. International financial institutions such as the World Bank and IMF need to support the government, Central Bank of Somalia and Puntland State Bank to stabilise the currency exchange rate. The institutions can make financial assistance available to these institutions to provide liquidity and buy Somali shilling.
4. Somalia's international partners, the World Bank and IMF need to provide financial assistance to expand Puntland government public spending and investment in infrastructure projects which could create jobs, improve the US dollar flow into the State and stimulate economic growth.

International partners:

Somalia's international partners, the World Bank and IMF need to provide financial assistance to expand Puntland government public spending and investment in infrastructure projects which could create jobs, improve the US dollar flow into the State and stimulate economic growth.

Punishment:

The Somali penal codes on counterfeit money printing need to be reformed to deliver appropriate sentencing and punishment for the perpetrators.

6. RECOMMENDATIONS

5. The Ministry of Finance, Puntland State Bank and Central Bank of Somalia need to coordinate their fiscal and monetary policies under a macroeconomic policy framework with sound economic objectives and goals based on diverse macro indicators such as the import and export price indices, consumer price index, foreign exchange rate, employment indicators, financial sector regulatory mechanisms, private sector investment, government revenue collection, public spending and official reserves.
6. Puntland State need to carry out structural reforms that would improve how business is conducted in the State.
7. It is vital to restart the debate over financial and currency reforms (issuing new currency) and engage with not only the Federal Member States but to conduct broad-based consultations with the business community, academia and major private companies such as banks, telecommunication and mobile money providers about replacing this old Somali shilling with a new currency.
8. UNODC need to provide technical and financial support to police organised crime units to combat and put an end to counterfeit money and other counterfeit goods by strengthening their intelligence gathering, investigative and prosecuting capacities. The Somali penal codes on counterfeit money printing need to be reformed to deliver appropriate sentencing and punishment for the perpetrators.



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About SIDRA

SIDRA is a registered independent Research and Policy Analysis Think Tank based in Garowe, Puntland, Somalia.

Our Vision

A Somalia in which social justice prevails and inclusive economic growth benefits all and improves the well being of all people.

Our Mission

A center of development and research that generates relevant and original knowledge for dynamic policy environment support, institutional capacity development and alliance.

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