THE EUROPEAN EMERGENCY TRUST FUND FOR STABILITY AND ADDRESSING THE ROOT CAUSES OF IRREGULAR MIGRATION AND DISPLACED PERSONS IN AFRICA

Addendum 5 to Action Document for the implementation of the Horn of Africa Window

T05-EUTF-HOA-SO-59

1. IDENTIFICATION

Title	Somalia State and Resilience Building Contract and support to debt relief
Total cost	Total estimated cost: EUR 107 400 000 Total amount drawn from the Trust Fund: EUR 107 400 000 of which EUR 92 900 000 for budget support and EUR 14 500 000 for complementary measures.
Aid method/method of implementation	Budget Support - Direct management: State and Resilience Building Contract (SRBC) and support to debt relief Complementary Measures: direct management (services) and indirect management with an international organisation or a member state agency
DAC code(s)	21010- General Budget Support 15111- Public Finance Management 60030 – Relief of multilateral debt
Derogations, prior approvals, exceptions authorised	None

2. RATIONALE AND CONTEXT

2.1 Summary of the action and its objectives

The action directly responds to **objectives 2 and 4 of the Trust Fund**, **priority domains 1** of the Valletta Action Plan, and **Sustainable Development Goals 1, 16 and 17**.

The intervention logic of this action is that if the Somali federal state is increasingly legitimate and capacitated, and that the Somali federal project is consolidated, the government of Somalia will be able to continue on its path of reforms, and thus build a strong track record for international financial institutions (IFIs)' arrears clearance and Highly Indebted Poor Countries Initiative (HIPC)[1] Decision point, as well as be in a position to deliver more services to its population.

The overall objective of the Somalia State and Resilience Building Contract is to increase the legitimacy and capacity of the Somali federal state, further the federal project, and create the conditions for inclusive growth. The specific objectives of the action are the reinforcement of trust in the Federal Government of Somalia at three levels: (i) with the Federal Member States (FMS) by reinforcing political and policy links through increased and improved inter-governmental fiscal transfers, (ii) towards the international creditors and partners in view of building a strong reform track record for HIPC Decision point and supporting IFIs arrears clearance, (iii) towards the Somali population by gradually increasing the role of the Somali authorities in the provision of basic services. As such, in the framework of the overall EU

[1] This first stage under the HIPC Initiative is referred to as the decision point. Once a country reaches its decision point, it may immediately begin receiving interim relief on its debt service falling due

response to the COVID-19 pandemic[2], it will help to provide urgent support to the Somali government in bridging the revenue gap resulting from the crisis.

The **geographical coverage** is Somalia.

The **target beneficiaries** of the action will be (1) the young women and men of Somalia who will benefit from a more legitimate and capacitated government, both at federal and member state level; (2) the federal government of Somalia and the Somalia federal member states, who will be incentivised in their path of reforms.

Somalia is at a critical juncture. Years into the state- and nation-building process, the current administration faces a daunting range of state building challenges, including combating insecurity, developing a viable system of federal government, adequately resourcing the core functions of the state, reducing corruption, fostering growth and investing in longer term recovery. Yet its chances of addressing these challenges are effectively hindered by its lack of resources, which could undermine the progress made during the time when the stakes on political, security and economic fronts are higher. On the political front, political and policy links between the Federal Government of Somalia and the federal Member States have to be significantly stepped up and improved to achieve key state building milestones and invigorate overall reform dynamics. On the economic front, the track record of economic and financial reforms has to be further consolidated and accelerated to enter on the path of debt relief. On the security front, both the pace and scope of the security sector reform have to be increased in the preparation for the anticipated AMISOM drawdown and rebalancing towards the Somali security forces.

During this critical time, in order to support Somalia and enable it to meet these challenges, the EU's strategic objective is not only to increase its support, as demonstrated by the important increase of funding resulting from the 2017 Mid-Term Review, but also to improve the quality of aid provided, by stepping up the use of country systems through a budget support operation – State and Resilience Building Contract (SRBC), and to directly contribute to the clearance of IFI arrears, a key precondition for HIPC Decision Point (the first step toward Debt relief) to be met.

In October 2019, a Roundtable on Somalia and IFI-re-engagement was organised at the margins of the World Bank and IMF Annual Meetings to confirm Somalia’s positive progress towards HIPC “decision point” and affirm the international community's support to Somalia reaching this milestone, including by taking all the necessary steps towards clearing arrears. Somalia's eligibility for debt relief under the HIPC initiative will have a transformative effect on the state-building process, driving forward further reforms to promote economic growth and stability and allowing Somalia to access concessional financing for its development needs. In addition, it will help Somalia unlock investment in the private sector, reintegrate financial markets and, on the political front, should help to foster relations between the Federal Government and the Federal Member States.

The SRBC foresees a disbursement of EUR 82.9 million over 3 years with an additional amount of EUR 10 million dedicated to the clearance of Somalia’s arrears with the IMF and the African Development Bank (AfDB), and EUR 14.5 million for complementary measures such as TA, verification, audit and evaluation.

The SRBC is built on several considerations:

1) **The SRBC aims to incentivise reforms** - whereas other aid modalities are disbursed against eligible expenditures, SRBC **budget support is disbursed according to the results achieved**. The design of this SRBC is underlining the importance of both the quality as well as the pace of reforms by setting the safeguard measures before the 1st disbursement, greater frequency of disbursements– and therefore frequency of regular reviews, and importantly greater ratio of variable against fixed tranches - which will be disbursed upon reaching pre- agreed performance indicators, besides from meeting general eligibility

[2] As framed by the Joint Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Global EU response to COVID-19.

criteria;

2) **The SRBC is built on strong coordination with partners** – notably with the IMF, WB, the EU Member States and the contributors to the EUTF more generally. It provides further incentives towards an agreed reform framework. The performance indicators for the variable tranches will be fully aligned with the reforms targeted by the 3rd SMP, as well through the WB Recurrent Cost and Reform Financing Programme (RCRF) programme.

3) **The SRBC supports the federal agenda**. Variable tranche indicators will target improved policy and technical aspects of the fiscal transfers – targeting more rule based, transparent and predictable transfers to the FMS and greater progress on the fiscal federalism, including revenue sharing arrangements.

The initial financing agreement for this action has been signed after agreement was reached on a set of pre- conditions for the 1st disbursement and set of performance indicators for the variable tranches. These aspects were discussed in coordination the FGS, FMS, IMF, WB, EU MS and EUTF contributors more generally. The detailed mechanism for the disbursement of grant financing to the IMF and AfDB for the purpose of filling the remaining gap in Somalia's arrears clearance will be established separately.

1. CONTEXT

1.1 Sector/Country/Regional context/Thematic area

Over the last years, Somalia has been making steady progress towards peace, stability and prosperity, yet the country remains deeply fragile. As demonstrated over the last years, any progress achieved, without sustained support, could be easily reversed.

From the political perspective, lack of dialogue and persisting tensions between the Federal Government of Somalia (FGS) and the Federal Member States (FMS) have been undermining efforts in state-building and stabilisation and causing delays in federal elections which were to take place in late 2020. After the outbreak of violence in Mogadishu in 2021 followed by a mix of internal and external pressures, on 27 May 2021 key stakeholders agreed on the electoral process and subsequently the dialogue and communication between FGS, GMS and the political opposition groups have been showing signs of improvement. The implementation of inclusive elections and an orderly and peaceful transition of power will be key for stability and for invigorating overall reform dynamics.

From the state building perspective, the 27 May 2021 Electoral Agreement includes reiteration of the commitment to address the more systemic issues in Somalia's state building and democratic transition, including the finalisation of the constitution, to one-person-one-vote elections and support to reconciliation processes. The agreement and the improved dialogue between the stakeholders represents a renewed momentum and opportunity to move forward on Somalia's peacebuilding and state-building priorities. These include resolving federalism issues including natural resource revenue sharing and finalisation of the Constitution, political agreement between the Federal Government of Somalia (FGS) and the Federal Member States (FMS) on the creation of a viable federated security sector, and readiness for universal elections. Despite these recent positive developments, the relationship between the FGS and FMS remains volatile, in part because of the lack of financial resources from the Federal Government to steer the political engagement with the Federal Member States, and enhancing the dialogue between the FGS and FMS to achieve long-term political settlements remains a key priority.

From the economic perspective, solid progress has been made in restoring key economic and financial institutions, confirmed by the satisfactory performance under the successive IMF Staff Monitored Programmes (SMP). For the first time since WB/IMF re-engaged with Somalia, 2018-2019 has presented a real and unprecedented window of opportunity to accelerate the process towards the IFI arrears clearance and potentially reach the HIPC Decision Point.

Since 2017, Somalia has made important strides in fulfilling its ambition to normalise its relationship with the IFIs and benefit from debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. The EU has been at the forefront of the international community efforts in support of Somalia's aim to normalise its relationships with the International Financial Institutions (IFIs), benefit from debt relief under the HIPC initiative, and become eligible for concessional finance to fund its development needs and accelerate the state-building process.

To reach decision point, Somalia needs to demonstrate a good track-record of performance against successive SMPs and approve a National Development Plan that meets the requirements for a Poverty Reduction Strategy under the Highly Indebted Poor Countries (HIPC) initiative. The latter has already been achieved, and with the successful completion of three successive SMPs, the FGS has demonstrated its ability to achieve significant policy and reform milestones. A fourth – UCT quality – SMP, is currently being implemented and contains a set of more demanding benchmarks. A first review of this SMP was conducted in September 2019 and concluded that Somalia is on-track. Therefore, Somalia could reach Decision Point by early 2020 if it demonstrates a track-record of progress against the latest SMP and a continued commitment to poverty reduction.

On the multilateral institutions side, prerequisites for decision point include ensuring that there is clarity on the amount of arrears owed by Somalia, on the procedures for clearing them (including securing assurances for bridge financing and for arrears clearance), and on completing a full debt reconciliation and sustainability analysis to inform debt relief decisions. Somalia will also need to agree on conditionality to be implemented during the interim period leading up to completion point (known as floating triggers), which will eventually unlock the debt relief.

Somalia's arrears with the International Financing Institutions (IFIs) must be cleared before HIPC decision point can be met. These, amount to approximately 800 million USD.

For the World Bank Group and the African Development Bank, arrears can be cleared via the mobilisation of internal resources and short-term bridge loans (USD 470 million of total arrears). However, the AfDB requires a grant contribution of EUR 1 million to be made by, or on behalf of, Somalia to trigger the process and respect its internal rules on burden-sharing.

With regards to the IMF, a financing package is being prepared that would rely on a combination of IMF internal resources, distributed to 183 member countries, and additional cash grants by donors. It is estimated that around EUR 125 million / USD 138 million would need to be covered through additional grant financing to clear IMF arrears.

From the security perspective, despite limited resources, government efforts in reforming the security sector and combatting terrorism have been commendable. However, significant challenges persist. Gains that have been made are fragile and reversible and the country remains in a state of insecurity due to several factors, including the presence of Al-Shabaab and inter-clan violence. Notwithstanding a series of setbacks, Al Shabaab remains the most important existential threat to Somalia. At this crucial time, more reforms need to be incentivised in the security sector and more support is needed.

With regards to migration, the political context in Somalia, compounded by environmental challenges such as droughts and desertification, has led large numbers of people to leave to neighbouring countries and displaced millions internally.

Somalia continues to face one of the largest and most complex protracted displacement, and 2018 estimates suggest that the number of internally displaced people may be well above 2 million[3]. Important migration flows continue to take place along the borders with Kenya and Ethiopia. A conducive environment to ensure a sustainable return and reintegration of migrants to Somalia is not yet in place. Before any mass-scale voluntary returns can be envisaged, it is of utmost importance that the security situation is stabilised and that prospects for return, i.e. overall improvement of living conditions and job

[3] UNHCR, January 2018 and IOM displacement tracking matrix, May 2018

opportunities are in place and coordinated.

The complexity of these multiple challenges requires a comprehensive and coordinated approach by all actors to ensure they are adequately addressed. Reducing the support provided is not an option. The EU, being one of the strategic partners of Somalia is thus determined to step up its support. As a part of broader efforts, this Action Document outlines the proposed budget support through a State and Resilience Building Contract (SRBC) and an IFI arrears clearance package to secure the path to debt relief.

The EU considers that Somalia's debt relief process under the HIPC initiative has already had and will continue to have a transformative effect on the country's state-building, driving forward further reforms to promote economic growth and stability and allowing Somalia to access concessional financing for its development needs. Importantly, the fiscal space created in the short term, through access to scaled-up IFI resources post Decision Point, and in the medium-term following effective debt relief achieved at Completion Point will enable Somali Authorities to begin allocating budget resources beyond the "survival functions" of the state, and towards social sectors that are critical for poverty alleviation and economic resilience such as health, education and social protection (in line with Somalia's newly adopted NDP9). Restoring the inclusive delivery of basic services to Somali citizens will be critical to establish a viable social contract in Somalia – and weaken support for AS – by gradually shift the historical perception of the State as a vehicle for rent extraction by elites predatory as opposed to delivering public goods.

It is also important to note that Decision Point will only mark the beginning of a more ambitious reform journey that Somalia will be embarking upon over the coming years. The policy triggers that will need to be met from Decision to Completion Point mean that it will be critical for the EU to sustain the policy dialogue initiated with the SRBC operation over the coming years in core areas of economic and financial governance. In addition, it will help Somalia to unlock investment in the private sector, reintegrate financial markets and, on the political front, should help to foster relations between the Federal Government and the Federal Member States.

1.1.1 Public Policy Assessment and EU Policy Framework

The **National Development Plan 2017-2019 (NDP)** is the first NDP since 1986. It builds on the foundations laid by the New Deal Compact for Somalia, which articulated national priorities between 2014 and 2016. The overarching theme is to accelerate socio-economic transformation to achieve the stated objectives for poverty alleviation, economic revival and societal transformation, with a particular focus on increasing Somalia's resilience and capacity to resist to external and internal shocks.

The NDP is a *nationally owned* document. Recognising the importance of inclusivity and legitimacy, the NDP was drafted after extensive consultations with wide variety of stakeholders and, after varied opinions and positions among the FMS, it was eventually endorsed by all national partners. The overall *relevance* of this document is acknowledged - it identifies a number of national development priorities, outlines an approach to ensure these priorities attract the support they need and are implemented. The participatory approach also ensured to a reasonable extent the inclusion of the very varied needs as well as early stages of development of the new Federal Member States. While in many cases the underlying analysis of respective areas is hampered by the absence of solid statistics and other data, overall the document reflects the current reality of Somalia and its key priorities. The NDP has its shortcomings. Indeed, the prioritisation among identified development needs is not evident. The fact that the NDP is not costed and the absence of the budget and a credible monitoring framework are considered important weaknesses. In addition, lack of implementation capacities and the current security situation make its implementation very ambitious and at times unrealistic. The annual FGS and FMS budget is essentially covering administration and security functions with negligible expenditure remaining for economic and social development. Nevertheless, despite its shortcomings, the document is accepted in both the national and international community and remains the broad reference for strategic direction of the future development. The national – international partner coordination is supported through the **SRDF[4] - Aid Coordination**

[4] Somalia Relief and Development Forum

architecture, where the structure of Pillar Working Groups is aligned to the structure of the NDP.

An updated National Development Plan (NDP-9) (2020-2024) and is deemed credible by the IMF and the World Bank as it provides the foundation for the Government's reform programme and strategy for poverty reduction and inclusive growth and qualifies as a HIPC Initiative's Poverty Reduction Strategy (PRS). NDP-9 is organised around the four pillars of i) inclusive politics; ii) improved security and the rule of law; iii) inclusive economic growth; and iv) improved human development and resilience to shocks.

In parallel, the EU as well as the other development partners have been supporting, in cooperation with UNDP, 'the national planning process'; of which the NDP is one of the constituting parts. Its key elements are i) the establishment of **development plans at subnational level**, ii) the development of an **M&E strategy** and iii) the reinforcement of **statistical capabilities.**

Finally, in 2018, the government has led the Drought Impact Needs Assessment (DINA) and developed the Recovery and Resilience Framework (RRF) with the support of the EU, WB and UN. This is aligned with the NDP and in complementarity with the Humanitarian Response Plan. The NDP and the DINA/RRF constitute the cornerstone of Somalia's development. The SRBC will accompany the development and implementation of a Somali PRSP and strengthen its planning and monitoring framework.

The SRBC will particularly focus on two sectors of service delivery to the Somali population: education and law enforcement. It is indeed important to recognise that the role of the state structures in the provision of education services will gradually increase. Therefore it is important to ensure a gradual improvement of the existing systems. Education is one of core sectors already benefitting from the EU support, and therefore the SRBC will benefit from a number of EU financed programmes providing the necessary technical assistance while supporting greater quality and access to the education services provided. The provision of security is the key priority of all levels of administration - FGS and FMS - and spending on security forces consequently absorbs a large proportion of the budget.

The proposed budget support operation and its priority areas are fully in line with the EU cooperation strategy with Somalia, and notably with the recently approved priorities of intervention agreed by the strategic board of the EUTF: the continued stabilisation of Somalia, South Sudan and Sudan. Debt relief is already having and will continue to have a positive impact on the state-building process in Somalia. It requires reforms from the government that promote stability and will allow access to further financing for stabilisation and development.

As to the COVID-19 outbreak in Somalia, the authorities have taken immediate actions to help contain the community spread of COVID-19 (social distancing, curfew…). The FGS has issued a National Contingency Plan for Preparedness and Response to the Coronavirus Disease to address immediate needs and are seeking financing of US$7.5m to support its implementation.

The FGS has also prepared a socio-economic impact and required response for COVID-19, which serves as the basis for coordinating support from international partners. Regarding the fiscal gap, the government has already issued preliminary estimates for FGS, FMS and Somaliland amounting to USD 245.6 million. Work is ongoing, with support of the IMF and the WB, to refine these initial figures and support the preparation of a revised FGS budget, needed to reflect the fiscal impact and revised fiscal choices in response to the crisis. The EU ensures tight coordination with the IMF and the World Bank to ensure a coordinated response to bridging of the fiscal gap through the use of Somali country systems and supporting an appropriate budgetary response under the current circumstances.

With respect to the elements of response to COVID-19 included in this operation, they are framed by the Joint Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Global EU response to COVID-19, issued on 8/4/2020.

1.1.2 Stakeholder Analysis

National stakeholders: the key stakeholders of the SRBC and support to debt relief are the Somali government and oversight institutions.

At the federal level, The Office of the President and Office of the Prime Minister have key roles in coordinating development policies within the government and achieving debt relief. The Ministry of Finance's role in managing the budgetary process, public financial management reforms and domestic revenue mobilisation, makes it an essential stakeholder. The Office of the Accountant General, another key interlocutor, ensures that a proper system of account exists in every department of the Treasury and exercises general supervision over the receipts of public revenue and over the expenditure of the Government. The Office of the Auditor General and the Parliament are key oversight institutions, having a crucial role in monitoring the formulation and execution of the budget as well as auditing the government accounts.

On the sectoral level, the Federal Ministry of Internal Security is responsible for providing the overall political and civilian oversight of the various civilian security entities that fall under its responsibilities (e.g. Somali Police Force, National Intelligence and Security Agency, Border Control, Federal Coast Guard). The Ministry is responsible for ensuring inputs on annual budgetary requirements for these entities, elaborating new or updated pieces of legislation, procedures and policies. Close collaboration is maintained with the FMS Security Ministries in order to operationalise and implement the New Policing Model, which calls for inter alia, the creation of federal and state level police forces. The Federal Ministry of Education, Culture and Higher Education (MoECHE) is responsible for coordinating education activities, including the development of sector policies, plans and budgets. The ministry signed a MoU and Cooperation Agreement with state level Ministries of Education to facilitate sharing of functions, roles and responsibilities. Ministerial and technical forums provide a platform for federal-state collaboration, coordination and cooperation on provision of education services.

Federal Member States (FMS) play a key role in maintaining security and stability, providing – to the extent possible –basic services and maintaining the notion of governance in their respective areas of control. Currently, relations between the FGS and FMS are fragile, in part because of the lack of financial resources from the Federal Government to steer the political engagement with the FMS.

The ultimate beneficiaries are the people of Somalia, benefitting from the improved transparency and accountability in the management of public finances, and from increased provision of basic services by the state authorities.

International stakeholders: the EU works closely with the World Bank, IMF and other partners, notably the EU Member States and the United States.

IMF's current engagement evolves around the current SMP (fourth SMP, running from May 2019 to April 2020, and of Upper Credit Tranche quality), which is currently on track. Somalia is equally one of the largest beneficiaries of the IMF technical assistance. The IMF engagement, through four successive SMPs carries strategic importance in terms of engagement with the Somali authorities, frames the macroeconomic policy and provides clear benchmarks to be achieved, which pushes forward the reform processes.

The WB is currently managing a Multi Partner Fund (MPF) of USD 273.9 million, out of which 75% is recipient (Somali) executed. Recipient executed projects use country PFM systems, with a number of layers of WB mitigating/oversight measures, including a 3rd party Monitoring Agent. Among the 15 programmes financed by the MPF, of note is the Recurrent Cost and Reform Financing Programme (RCRF), which reimburses earmarked expenditures - financing the salaries of civil servants (in FGS and in some FMS), a small portion of non-salary recurrent costs and teacher salaries in Puntland, Jubbaland and Benadir regions. It is also through the RCRF that the Surge Programme is being delivered. The Surge

Programme was an important innovation in the nature of the support provided – making the RCRF the first programme which conditioned disbursements to the treasury (against earmarked expenditures) on the achievement of certain results[5].

Apart from what are currently donor-financed WB interventions, the WB has decided to mobilise pre-arrears clearance financing, for a total amount of USD 80 million.

International partners and the EU Member States: most important 'traditional' donors, equally engaged in the areas that the EU intends to target through the SRBC (PFM, DRM, Law Enforcement, Education) are the US and UK. A number of EU Member States are also engaged in Somalia to a lesser or greater extent (Sweden, Denmark, Netherlands, Germany, France, Italy, Finland) as well as Norway and Switzerland. Overall, most development partners currently use a 3rd party (WB MPF, UN MPTF national window) when using the country systems.

Somalia equally entertains close cultural, trade and financial links with Turkey and the Gulf countries. Currently, Turkey, Qatar and Saudi Arabia provide budget support to Somalia, expected to total USD 62,4 million in 2018. Provision of budget support from these partners is not subject to any structured form of policy dialogue or associated benchmarks. It is expected that a number of Somalia's main partners will also support IFI arrears clearance, either through bridge loan or grant financing.

1.2 Other Areas of Assessment

1.2.1 Fundamental Values

Respect for fundamental values remains a structural issue in Somalia. Lack of security and access to justice, direct involvement by Somali security forces in human rights abuses and high number of civilian casualties by all sides of the conflict, impunity and corruption (Somalia ranking last on Transparency International index) are recurrent issues that together make a considerable portion of the grievances of the population. Women are frequently victims of sexual and gender based violence and 98% of girls are subject to Female Genital Mutilation (FGM). More than two million internally displaced persons (IDPs) are marginalised and their rights violated, including through recurrent forced evictions. The space for freedom of expression and opinion is very limited and under constant attack. Journalists and those who speak their opinion publicly are subject to intimidation and often arbitrary arrest. The death penalty remains in place in the country, although executions have recently been suspended (but without any formal moratorium).

The Somali institutions have very limited capacity to address this dire situation, although they have shown some commitment including through the ratification of a number of human rights instruments. There is a National Human Rights Action Plan which was developed in response to a genuine engagement in the Universal Periodic Review (UPR) process. However, resources to back the Action Plan are scarce. A bill establishing the Human Rights Commission was passed in 2017 and the process of appointment of the Commissioners has been recognised as outstanding for its transparency and fairness, although it is not yet finalised. While the initial capacity of the HRC will be minimal, the HRC Act is considered to be good and with a promising role/space for the Commission to advance respect, protection and promotion of human rights. The Ministry for Women and Human Rights Development is committed to pass a sexual offences bill as well as legislation banning FGM, although strong resistance from sectors of the population, especially religious and traditional leaders, is slowing down the process. The electoral process in 2016 demonstrated a commitment to achieve a greater representation of women, accounting for an overall 24.3% of the total number of members of parliament.

However, the same process was marred with corruption, intimidation and involved a very limited portion of the society. The next 2020/2021 federal parliamentary election would require a concerted effort by

[5] While limited in volume (USD6million in 2017 delivered though 'Surge', USD13million are envisaged to be disbursed in 2018), it provided important lessons learned for the proposed SRBC programme, further elaborated in section 3.1. As of 2018/19, the 'Surge approach' - that is conditioning part of disbursements on achievement of certain results – will be a standard part of the RCRF, which warrants a need for a strong alignment with the SRBC.

political stakeholders to agree on a system of political representation and set up the necessary legal electoral framework through an inclusive and transparent process. The National independent electoral commission, NIEC, would need to be given the necessary space, political confidence and financial means to fulfil its mandate including the registration of political parties. The SRBC and support to debt relief will provide a vehicle to enhance EU's political and policy dialogue on some of the core human rights issues and consolidate Somali commitment behind it.

1.2.2 Macroeconomic Policy

Stability-oriented macro-economic policies are nascent and subject to important security and political risks and recurrent droughts. Growth is thus presumed to remain subdued at 1.8% and inflation to pick up to 3.7% in 2017, compared to 2.4% and 1.3%, respectively in 2016. The trade deficit has been and remains high - reflecting high food imports and lower exports—largely financed by grants and remittances. Somalia's fiscal situation has greatly improved since 2014, but nevertheless remains challenging. Domestic revenue as a share of GDP remains low, at just 4 % of GDP in 2017. While this is an important improvement compared to the previous years (increase from 2.7% in 2016), it remains one of the lowest worldwide, compared to an average of 13% in low income countries. These revenue levels are inadequate to allow the FGS to guarantee appropriate security/ act decisively against Al-Shabaab or deliver services to citizens. Poor revenue collection capacity, a narrow tax base, and political disputes continue to hinder full revenue mobilisation both at FGS/FMS level. Despite progress in formalising the budget process, fiscal operations struggle with basic challenges. On the expenditure side, recurrent expenditures (currently accounting for almost all expenditure) crowd-out provision for the economic and social services sectors or capital expenditures. As a consequence, social services are generally underfunded - in 2016, the FGS spent less than US$2.5 million - 1.4% of the overall expenditure - on education and health, a pattern observed across Somalia (Somaliland being the exception). The basic monetary and financial sector has been a binding constraint to business expansion but with a growing donor support it is now on the verge of a rapid transition.

Despite what may seem as a bleak picture, the macroeconomic policies are on the improving path. The overall fiscal framework has improved, as testified by an increase in domestic revenue mobilisation to 4% of the GDP. The authorities have equally taken steps to reform the national currency, lay the basis for the regulation of the financial sector, while addressing the significant shortcomings in economic data. In parallel, although Somalia was confronted with a severe drought and sporadic terrorist attacks in 2017, it avoided, with the support of the international community, a significant economic slowdown and famine.

Macro - economic policies are currently anchored and benchmarked in the ongoing IMF SMP. It is based on three pillars: 1) fiscal policy and reforms, 2) monetary and financial sector reforms (incl. currency reform), and 3) governance and capacity development. The performance so far is assessed as broadly satisfactory. As the 2nd SMP was successfully completed, a 3rd SMP has been agreed. This suit of SMPs is designed to establish a 'track record' of policy and reform implementation, paving the way for the IFIs arrears clearance and the HIPC decision point. Equally, the WB has adopted a pre-arrears clearance financing package of 80mUSD, which is aimed at further strengthening the track record.

Overall, macroeconomic policy is stability oriented – although at a nascent stage. Risks to the macro-economic policy /SMP and the outlook are nevertheless high, chiefly due to a fragile security situation, very weak institutional capacity, and recurrent major refugee and humanitarian crises. So far, there has been a good progress in introducing policy reforms, and the international partners observed a positive momentum and increased commitment by the authorities, which should help mitigate existing risks.

As for the impact of the COVID-19 outbreak, preliminary assessments conducted by the World Bank indicate that 1) there will be a significant reduction of the (formal) economic activity, with direct impact on the (formal) employment rate; 2) remittances will reduce, 3) overall imports will reduce due to the shutdown of the airport and slowdown of the global and Somali economic activity; 4) export of livestock (main export) is likely to strongly reduce; 5) Domestic revenue collection will suffer from the closing of the airport and airspace (in particular khat tax, visa and overflight fees) and from overall reduced economic activity.

1.2.3 Public Finance Management (PFM)

Somalia's fiduciary systems are, as might be expected given Somalia's fragility, improving from a very low base. As demonstrated in the PEFA self–assessment in 2016, Somalia has important deficiencies in all assessed areas, both compared to other fragile states as well as to the East Africa Region. At the FGS level, the main challenges are to increase the oversight the Ministry of Finance over payments made by the federal government; to create an interface between federal and state-level Financial Management Information Systems; and to develop an effective external audit. Other challenges include the need for more internal controls for non-salary expenditure, and increased controls for parts of the payroll taking into account positive developments with respect to Somali National Army and Somali Police - and reinforcing procurement procedures. Despite an undeniable progress in last years, these areas need further strengthening. Some of these challenges will be specifically targeted through the specific indicators for variable tranche disbursement.

When it comes to differences between FGS/FMS, there is no single PFM system of unvarying quality in Somalia. Existing capacity capacities as well as challenges vary tremendously across federal and state levels and between respective federal member states. More established member states (e.g. Puntland) have more PFM experience on which to draw than newly emerging member states. Great disparity between the PFM systems across the FGS/FMS, and the need to harmonise – currently disconnected - state and federal PFM systems adds complexity to the overall PFM reform effort.

However, despite a number of challenges, it is important to recognise that over recent years Somalia has made significant strides in improving its PFM systems. According to the IMF, Somalia's PFM systems are getting stronger and if the reforms are sustained, the systems would be ready to handle a greater share of development assistance. Under the first IMF Staff Monitored Program with Somalia (May 2016-April 2017), the FGS met all but one of its six PFM structural benchmarks. As of 2016, an electronic system for paying civil servant salaries was introduced, ensuring an automated and controlled monthly payroll processing. Significant efforts were made to lay the path ahead – the FGS has approved a PFM Reform Action Plan and an arrears clearance plan, while the Central Bank of Somalia has developed a Currency Reform Roadmap (and met the pre-conditions for the completion of its first phase) as well as Commercial Bank and Money Transfer Business regulations. Facing the outdated legislation, a new Procurement Act and Anti-Money Laundering Act were passed and a new PFM law has been approved by Cabinet and submitted to Parliament. Taken together, while deficiencies remain, the progress against the odds has been very good and the overall trend is on the improving side.

The FGS recently agreed a fourth SMP (of Upper Credit Tranche - UCT quality), the satisfactory implementation of which, forms another HIPC "decision point" prerequisite. In September, the first SMP IV Review was completed, indicating a positive assessment. Starting from a very low base, progress has continued in developing critical elements of the PFM framework, as confirmed by recent reporting by the IMF and Financial Governance Committee (FGC). Progress has been made in the areas of customs modernisation, macro-fiscal planning; budget execution and arrears management; Treasury Single Account; expenditure and cash management (including control of advances). Gains in payroll management have also been consolidated, as the timely (electronic) payment of civil servants salaries has been sustained. Technical progress has also continued in terms of harmonising FGS-FMS fiscal reporting to ensure consistency and enable consolidation of national accounts (a key IMF benchmark). A significant milestone in financial accountability was also attained with the submission of 2018 accounts (using cash-basis IPSAS) to the Office of Auditor General (OAG), and public dissemination of the audit reports (which for the first time adopted international standards). Financial and compliance audits of the security sector and of 25 MDAs were also completed.

Equally, while the fiduciary risks of using country systems are a substantial issue of concern in Somalia, the fiduciary risks associated with not using Somalia's PFM systems cannot be ignored either. Fiduciary risk and the efficiency of spending are real concerns for the EU in Somalia, whatever the implementation modality. In average, EU/donor non-programmatic costs – that is, the costs of monitoring, overheads, security, logistics, etc. other than the costs associated with paying those actually directly delivering the services – are at between 30-60% of project budgets[6], significantly more than in many other countries. Using country systems can deliver more "cents on the euro" than when alternative delivery channels are employed, even after considering the fiduciary challenges of Somalia's PFM systems.

Given the commitment of the Somali government, the positive trends in improving national PFM systems and the enhanced dialogue space, PFM eligibility is considered to be met. With a view to the high risks involved, the budget support operation foresees a set of safeguards and mitigation measures.

1.2.4 Transparency and oversight of the budget

The entry point – publication of the budget– is met. Overall, while Somalia has made good progress since 2014, and the budget is publicly available, its overall current scores in terms of budget oversight and transparency remain below average. In most cases, while relevant processes for external scrutiny and audit exist, existing scrutiny is limited or not well evidenced. Given important weakness in the budget transparency, gradual improvements will be targeted through the enhanced policy dialogue, general conditions assessed for the disbursement of all tranches, as well as specific indicators assessed for the disbursements of the variable tranches.

In terms of Budget Transparency in 2017, Somalia provides the public with scant budget information. It scored 8 out 100, compared to the global average of 42. In terms of public participation, Somalia provides few opportunities for the public to engage in the budget process, scoring 2 out of 100, against a global average of 12. In terms of budget oversight, Somalia scored 22 out of 100 in 2017, meaning that legislature and supreme audit institution provide weak oversight of the budget.

According to the 2016 PEFA (self-assessment) score, Somalia scores D: while relevant processes for external scrutiny and audit exist, existing scrutiny is limited or not well evidenced. There is no effective internal audit function. Three levels of external scrutiny could be distinguished: (1) NGOs/CSO: very small capacity of oversight, (2) Legislature: provides weak oversight during the planning stage of the budget cycle and no oversight during the implementation stage of the budget cycle. As a sign of progress, 1st public hearing of the budget took place in 2017. When it comes to the legislative scrutiny of audit findings, the procedures exist, but committee reports are not published in a manner accessible to the public. (3) Supreme Audit Institution: Office of the Auditor General (OAG) has a very weak capacity and its current mandate is based on an outdated legislation from 1972 which does not support the independence of the OAG. In practice, this mandate has not been carried out and the last finalised financial audit of the FGS annual public accounts is that of 2014. Lastly, functional assignments between the Federal Government and the Federal Member States are under discussion, but currently the powers of the OAG cover only the Federal Government, excluding the FGS transfers to the FMS. However, there is positive momentum since September 2017 when a new OAG was appointed and the international support to the OAG was reinstated. As a result of collective efforts, a new draft Federal Audit Act, in line with international standards and supporting an independence of the OAG, is being finalised and should be submitted for parliamentary consideration in the 1st half of 2018.

In order to strengthen the Office of the Auditor General (OAG) in Somalia and allow its mandate to be carried out (especially audits of government's accounts and the transfers to the FMS), additional support to the OAG will be made available under this and /or relevant decisions. Additional need for support will be assessed on the basis of complementarity with other ongoing programmes, especially foreseen increased PFM related support under the WB Pre-arrears clearance financing (PACF).

1.2.5 Intergovernmental fiscal transfers

Relations between the FGS and FMS are still fragile. In 2016, only 5% of the FGS expenditures were transferred to the FMS, undermining political and policy links between the FGS and FMS.

[6] Strengthening Somalia's systems smartly, page 18; https://openknowledge.worldbank.org/handle/10986/29441

While the systems enabling electronic inter-governmental transfers between the respective treasury single accounts exist, there were several occurrences in the past of off- treasury transfers to the FMS, undermining good financial governance and transparency, and reinforcing the perception of discretionary allocations by the FGS. Further, due to the overall fiscal stress at the level of the FGS, fiscal transfers to the FMS were made irregularly, making it hard for the FMS to manage their budget execution effectively and undermining the transfers as a tool for building inter-governmental trust and goodwill. In Somalia, shattered after decades of conflict, this issue of distrust and suspicion, fuelled by the shortcomings of the current inter-governmental relations, is of particular concern. Despite important shortcomings, over the last 3 years, there have been increased efforts to both increase the fiscal transfers to the FMS as well as to improve the framework in which they are provided. A treasury single account (TSA) has been created at FGS and FMS levels and is being increasingly strengthened. Introduction of electronic payment systems and phasing out of cash payments increases accountability. Equally, there has been an increased pace of discussions on greater resource-sharing agreements between the FGS and the FMS. There are encouraging first signs such as an agreement on harmonisation of selected tax rates between the FMS and FGS and provisional fisheries agreement.

Against this context, advancing on the resource-sharing agreements and improving the current framework for fiscal transfers, by increasing their transparency, predictability as well as regularity, are therefore key underlying objectives of the SRBC. The SRBC could therefore indicatively target: i) the level of execution of the FGS transfers to the FMS, as compared to the budget allocation, ii) improved PFM standards and service delivery systems at the FMS level and iii) quarterly FMS reporting on utilisation of fiscal transfers. In the framework of the COVID-19 response, the SRBC support to bridging the fiscal gap should be instrumental in protecting to the maximum extent possible budgeted fiscal transfers to FMS.

1.2.6 Service delivery

In general, Government's efficiency (At both FGS and FMS levels) in delivering towards the well-being of the Somalis is hampered by a number of factors (see risk assessment in chapter 2).

Delivery of Education services

In practical terms, due to the lack of administrative structures, capacities and funding, as well as the situation of insecurity, there is an extremely limited provision of basic social service (education, heath) by Somali authorities, relying essentially on private operators/ NGOs. As a consequence of the above mentioned factors, coupled with extremely constrained fiscal space, social services are generally underfunded - in 2016, the FGS spent less than USD 2.5 million - 1.4% of the overall expenditure - on education and health, a pattern observed across Somalia. However, when it comes to education, the FGS as well as the FMS are making initial attempts to enhance the role of the state structures (FGS and FMS), act on the level of policy setting, coordination of multitude of education providers, but also in the actual service delivery. The role of the state structures in the provision of education services will gradually increase, even though in the long term it will probably co-exist with private / community/ religious providers. This SRBC will thus target gradual improvement of the existing systems - both financial and non - financial (e.g. payroll, human resources systems) aspects. This will also contribute to the reduction of the transaction costs for aid, which are particularly high in Somalia where 30-60% of project funds are consumed by additional overheads related to project monitoring and delivery.

Delivery of Law enforcement

The provision of security is the key priority of all levels of administration - FGS and FMS - and spending on security forces consequently absorbs large proportions of the budget. The current situation in the security sector is that, along with the Somali National Army and Somali National Police, security is being provided by a multitude of private actors/clan militias. Due to this, it is imperative that structurally and sustainably sound policing functions start being delivered across the country in order to meet the plethora of law and order, security challenges and threats. The major milestone for law enforcement was the agreement on a New Policing Model which calls for the creation of a two-tier police structure consisting of a Federal Police and Federal Member State Police and delineates the respective responsibilities between Federal and State police services. Whilst the Federal Police (SPF) operates within a modicum of inherited procedures and legislation and has a basic functional structure in place, it remains very weak in projecting itself as an efficient law enforcement entity and will require significant change management and transformational reform. The vast bulk of manpower is deployed in and around Mogadishu. The FMS police forces on the other hand, are still nascent stage, with significant variations across FMS. The international community and Somali authorities need to focus on the following inputs: i) Increase the overall policing presence and visibility in targeted locations, ii) Provide training & development support, including assistance and advice, to the Somali Police Services, iii) Provide support to legal framework and policy development for Somali Police Services, iv) Support effective oversight and governance of policing.

A basic underlying factor for enabling this is to ensure regular payment to police personnel. This is critical to ensure loyalty, commitment, morale, performance and retention of skilled police officers. The efforts by the Somali government (Federal and State) in ensuring that salaries are paid on time are crucial and essential. The SRBC and support to debt relief, by increasing the fiscal space, will thus directly help to ensure that the salaries are paid on time, while improving both financial and non-financial aspects of the systems in use.

2. RISKS AND ASSUMPTIONS TO THE BUDGET SUPPORT OPERATION

Risks	Risk level (H/M/L)	Mitigating measures
Political and security Overall risks related to the political and security environment are high: i) volatile relationship between the FGS/FMS. Risk of FMS disengaging from federal processes leading to further internal fragmentation and further delays in the implementation of parliamentary and presidential elections, ii) risk of delayed reforms due to vested interests both within parliament as well as within the private sector. Risk of moving too fast without proper consultation and international backing leading to a backlash and iii) risk of dysfunctional Parliament unable to play a constructive role in furthering the state-building process, regularly taken up by impeachment processes against both the Prime Minister and the President, iv) provision of security largely dependent on the AMISOM, and possibility of security vacuum if AMISOM planned drawdown is not met with appropriate replacement by Somali security forces SNA/SPF. Risk of potential security gaps filled by Al-Shabaab leaving government control to even smaller territory and impairing provision of services and increasing the basis costs of running government operations. External risks: i) climate induced shocks with recurrent drought, prompting refugee flows and internal displacement, ii) the Arabian Peninsula political dynamics and quest for political	H	Political risks will be mitigated through a concerted international political and policy dialogue including via: i) enhanced political dialogue with the FMS/FGS & design of the SRBC aiming at improved framework of inter-governmental fiscal transfers; ii) continued outreach to the private sector, through respective sector programmes; iii) continued support and political dialogue with the Parliament; iv) reinforced international support to the Somali security forces, political and policy dialogue, enhanced support both to the design and implementation of the AMISOM Transition plan. External risks will be mitigated by: i) coordinated international diagnostics - Drought Impact and Needs Assessment 2018 and coordinated implementation of resilience + safety net programmes; ii) constant outreach to the Arab countries and Turkey. Further, the provisions described in section 5.3.2 apply in the case of a significant deterioration of the political and security situation. In its political and policy dialogue, the EU – in coordination with other International partners, particularly the WB and IMF - will continue to encourage constructive discussions between the FGS and FMS to resolve and agree on key constitutional issues of power and resource sharing (such as agreeing a viable framework for fiscal federalism); and emphasise the need to ensure a

domination having fragmenting impacts on Somali politics In the absence of agreement on equitable resource sharing in a nascent federal context, there is a risk that the achievement of the HIPC decision point will exacerbate existing political tensions between FGS and FMS.		transparent, accountable and equitable distribution of the benefits of debt relief to all Somalis.
Corruption / Fraud Corruption and fraud risks are high because of a lack of legal and regulatory frameworks and lack of functional implementing institutions. In the Transparency International's corruption perception 2017, Somalia ranked 180th out of 180 countries assessed. Very bottom or near bottom ranking by other worldwide governance indicators. Both petty and grand forms of corruption, permeating key sectors of the economy. Corruption manifested through various practices, including public financial mismanagement, large scale misappropriation of public and donor funds, unethical and professional negligence or concealment of actual resource flows.	H	Corruption risks are being addressed through a combination of: i) continued PFM support by the donor community through strengthening of the external oversight institutions; ii) reduction /elimination of key 'enablers' of corruption including cash payments in salary and non-salary recurrent costs: all government payments are due to be done through electronic payments to bank accounts; iii) consolidation of TSA and reduction of Ministerial sub-accounts, strengthening of procurement procedures; iv) support to Interim National Procurement Board which oversees contracts and concessions over $2m; v) support to Financial Governance Committee (FGC), which is acting as an advisory and oversight mechanism, overviewing all FGS contracts and procurements above $5m and securing a commitment from the FGS that the FGC mandate is extended for the duration of the SRBC – with continued compliance with the FGC's recommendations, particularly as regards concessions and contracts[7]; vi) support the regulatory framework – Federal Audit Act and PFM bill being finalised/ subject to parliamentary readings; vii) support to the enforcement institutions – a spectrum of support to the justice sector (further specific measures are included below in the section on PFM). Apart from the above, the risks will be mitigated through: i) enhanced policy dialogue; ii) measures framed in the

[7] FGC's current role in reviewing high-value contracts is indeed a major risk mitigation measure for the SRBC. Both ii) and iii) are mitigating the procurement related risks.

		pre-conditions for the 1st disbursement; iii) concrete set of indicators for variable tranche disbursement.
Macroeconomic Macroeconomic risks remain high due to important vulnerabilities in relation to political situation, security, recurrent droughts and aid dependency. Key risks include: high reliance on development support and inflow of remittances, weak domestic revenue mobilisation, weak expenditure management, fluctuating political commitment, limited institutional capacities, weak CBS governance and failed currency reform, lack of credible financial sector supervision.	H	Macroeconomic risks can be only addressed in close cooperation with other actors, notably the IMF, the WB and the EU MS. Risks will be mitigated through i) political dialogue and messaging to keep the policy commitment to the SMP and reform momentum; ii) strengthened political and technical support, including variable tranche indicators, to improve domestic revenue mobilisation and strengthening PFM though the respective support programmes (including through the EU-UK-US financed on-going programme to strengthen domestic revenue generation with a focus on strengthening customs operations, in addition to the ongoing PFM support programmes both and FGS and FMS level); iii) completion of the preparatory work for the launch of the new national currency; enhanced implementation of the financial sector development roadmap and improvement of compliance with the Anti-Money Laundering and Combating the Financing of Terrorism framework; continue supporting the CBS and iv) renewed intensity and scope of overall donor support notably through the WB pre-arrears financing (as of 2019)
Developmental Developmental risks are very high and the Governments' efficiency (at both FGS and FMS levels) in delivering towards the well-being of the Somalis is hampered by: i) ongoing conflict with Al-Shabaab effectively limiting the areas controlled by the government (whether FGS or FMS) to their capitals/or other main cities, ii) very fragile security situation forcing the FGS/FMS to spend whatever resources it has on the security actors as a key priority, iii) lack of inter-governmental arrangements on service delivery and revenue sharing leaving undefined mandates and responsibilities across FGS/FMS, iv) poor	H	Developmental risks are mitigated though an array of international support and government actions, most of which have been mentioned in the sections above. Apart from these already listed they will include: i) political dialogue and technical support aimed at finalising the new Constitution, which would among others provide a better anchor for inter-governmental division of labour and revenue sharing; ii) vast development support aimed at either reforming the civil service (WB, UNDP) or targeting specific institutions or ministries. Apart from these this budget support equally will; iii) provide greater fiscal space in the short and long term (including through unlocking additional grant financing from IFIs) enabling better execution of the budget and increased transfers to the

governance and very limited technical capacity in general, v) scare fiscal resources available and vi) inexistent or very nascent administrations for social services given the decades of war.		FMS; iv) improve the framework for intergovernmental fiscal transfers as benchmarked through variable tranche indicators; v) lay the ground stones or strengthen the existing systems for service delivery, especially education and law enforcement
Public Finance Management Somalia's fiduciary systems are, as might be expected given Somalia's fragility and given a relatively short period of extended international support, improving from a very low base. Somalia lags behind in all dimensions compared to other fragile states. However, it is important to recognise the continued improvements of the PFM systems. Many reform efforts are ongoing and the results are manifested in improvements of practices and performance.	H	PFM risks are mitigated at political, policy and technical level support: i) participation of the EU to the Cash Management Committee of the FGS; ii) agreement between the FGS and the partners on a short term PFM action plan. PFM is equally one of the result areas of the SRBC where success will be tracked on the basis of a) pre-conditions for budget support, b) general conditions for all disbursements and c) concrete set of performance indicators for variable tranche disbursement – all aiming for constant improvement; iii) enhanced political dialogue encompassing key deficiencies in the PFM, stimulating commitment to the SMP and the pace of the reforms, iv) policy level, by cooperating on the key legislative bills (audit, PFM) and ensuring policy coordination between the FGS/FMS through inter-governmental fiscal forum; v) extensive EU co-financed technical programmes (WB PFM programme, PREMIS – supporting PFM in the new FMS, IMF Trust Fund), and new programmes – new programme in support of the domestic revenue mobilisation, and continued support to the Recurrent Cost Financing and PFM through the WB pre-arrears clearance financing; v) external assistance to be recruited under this decision for additional Monitoring and Verification; vi) external support to be recruited under this decision to support the OAG – Supreme Audit Institution to carry out financial audits as well as the audits of the fiscal transfers to the FMS Finally, with respect to the COVID-19 response, the EU will tighten its political and policy dialogue with FGS (in close coordination with IMF and WB) with respect to the

		preparation, adoption and implementation of the related revised FGS budget. The external experts supporting the Ministry of Finance and OAG will continue to be instrumental in further strengthening the PFM framework for the implementation and monitoring of the (COVID-19 crisis) revised budget.

Assumptions

- The overall security and political situation does not deteriorate and the FGS and FMS are able to retain / or extend control of the respective territories, and the FMS continue to engage in the federalist agenda.
- The Government remains committed to pursue its reform agenda by formulating and implementing credible policies, in particular in implementing successive Staff Monitored Programmes and WB pre-arrears clearance financing package;
- The international community remains engaged in Somalia and maintains relevant complementary measures (IMF, WB MPF; WB pre-arrears clearance financing, AMISOM and support to the Transition Plan; policy dialogue) and contributes to IFI arrears clearance and, where relevant, bilateral debt relief

The final list of mitigation measures have been agreed with the authorities. Mitigation measures agreed for this SRBC are the following:

- EU observer status in the Cash Management Committee
- External assistance to be recruited under this decision for additional monitoring and verification
- Support with TA the Office of the Auditor General to ensure enhanced oversight capacity, with particular focus on the delivery of annual compliance audit of the National Budget and including facilitated implementation of the new legal framework
- Further support to the Financial Governance Committee (FGC) and securing a commitment from the FGS that the FGC mandate is extended for the entire duration of the SRBC – and re-affirmed commitment to the compliance with the FGC's recommendations, particularly as regards concessions and contracts
- Development of the short-term PFM action plan and alignment to it by all relevant partners

3. LESSONS LEARNT, COMPLEMENTARITY AND CROSS-CUTTING ISSUES

3.1 Lessons learnt

The proposed EU budget support (BS) is the first of its kind in Somalia. However it is designed on the basis of the lessons learnt from other budget support programmes managed by the European Union in other fragile countries, as well as from other EU programmes implemented in Somalia.

The EU as well as the other partners have a number of lessons learnt from the use of country systems (UCS), notably through the WB MPF – which is largely implemented through the country systems - as well as parallel programmes such as the EU support to the police stipends (via UNOPS). These have provided valuable insights into the design of the budget support operation as well as envisaged mitigation measures.

Key lessons are:

- The risks of UCS must be balanced against the potential benefits. Donors' use of country systems in Somalia have helped focus both donor and government attention on strengthening those systems as well as incentivising dialogue and reform (example: WB RCRF). Government-executed projects have equally helped build government legitimacy and public support, strengthening accountability between the state and its citizens – the EU police stipends programme being one the examples;
- UCS has helped maximise the effectiveness of aid, directly benefitting the EU and other donors by providing better value for money. This is a critical consideration in a high cost environment like the one of Somalia where 30-60% of project funds are consumed by additional overheads related to project monitoring and delivery. In contrast, bypassing country systems have in certain cases undermined the legitimacy of the state, led to greater fragmentation and created mistaken loyalties (police becoming accountable to a number of supporting donors as opposed to Somali hierarchy);
- Short-term benefits have to be balanced against long term considerations. In the short-term, making full use of Somalia's systems to implement projects may result in delayed and lower quality implementation than could be achieved through other implementation modalities. Yet, balanced against it is the obvious argument that parallel delivery systems are not a sustainable solution for sectors and activities that will be provided by the state in the long-term. For the SRBC, this is the case for law enforcement - where the state aims to be the sole provider of law enforcement (monopoly of violence) and education, where state provided education will probably co-exist with private / community providers. From an operational standpoint, the question in these selected sectors is not whether to transition towards country systems, but when and how to do so. The budget support, through its design aims to improve the systems for service delivery, providing the basis for greater share of development support being channelled through the country systems in the future;
- As an example, in the case of the security sector, the Somalia Security and Justice Public Expenditure Review[8] highlights that payroll reform is urgently needed for both the Somali National Army (SNA)

[8] http://documents.worldbank.org/curated/en/644671486531571103/pdf/Somalia-SJPER-01302017-Final-Version.pdf

and Somali Police Force (SPF). It stresses that, "the maintenance of parallel government and donor payroll systems and under-investment in the former reduces the efficiency, effectiveness and accountability of public spending in Somalia."[9] As a consequence, donors, including the EU, currently spend substantial time working to verify "their" payroll lists, but this effort does not in any way strengthen the government systems that pay the very same individuals their salaries;

- UCS can thus strengthen medium-term capacity by focusing donor and government attention on the quality of government systems, both financial and non-financial (e.g. payroll, human resources systems). Where used – like in the case of EU police stipends - international attention and resources have shifted from the operational challenges of a parallel system towards those of government, creating "positive spill-overs" for country systems. This approach strengthened the country systems as a result of their use;
- As shown by the SMP and the WB RCRF Project (especially 'Surge' support), in the context where sector priorities are often ill defined (macro-economic policy, PFM), political support fluctuates and the leadership is often changing (recurrent attempts for impeachment of the PM, reshuffles of the government) - defining simple and time-bound benchmarks helps concentrate both political attention as well as technical efforts. Benchmarks create a sense of urgency, which help to bring together diverging interests within a government and single out the spoilers;
- As the above-mentioned programmes showed, incentive-based approaches work - penalising non-adherence by suspension of the SMP or non –payment of tranche, and vice versa – rewarding reforms by additional financial support have helped to achieve more reforms in a shorter time horizon than what the technical assistance programmes have been striving to achieve for past years;
- As state-building is the true goal of the international support in Somalia - there are not too many ways around it - support delivered through NGOs / UN programmes can help deliver short term results but achieves little in terms of building a state with its own financial mechanisms and system of fiscal transfers.

Overall, provision of support to Somalia through the general non – earmarked budget support –will provide a comprehensive platform for dialogue on the totality of the budget – as opposed to against certain earmarked expenditures. This approach will also further reinforce the totality of country systems - including the expenditure areas which did not yet benefit from international support. Equally, the SRBC will provide further incentives for reform – by defining clear and time bound performance indicators whilst aligning with the WB and the IMF. The SRBC will further reinforce the state building efforts within a federal context by not only reinforcing the country systems at the level of the FGS but also reinforcing the system of fiscal transfers, creating thus stronger links between the FGS and the FMS. In a context where cash management and resulting cash rationing are serious concerns, the budget support will provide a greater fiscal space, enabling regular payments to the civil service and the security forces, and enabling basic functioning of the government. Last, the budget support will maximise the effectiveness of aid, directly benefitting EU by providing better value for money.

3.2 Complementarity, synergy and donor coordination

The proposed budget support can be a powerful instrument and accelerate progress towards the arrears clearance as long as the messages are clear and unified. The argument of donor coordination is even more valid in Somalia – with extremely limited capacity and only a handful of valid interlocutors with whom to engage in a policy dialogue. This budget support is thus not designed to establish parallel or competing policy dialogue mechanisms - instead it will be aligned with existing ones, in coordination with partners. In this regard, the Financial Governance Committee offers a natural landing place for the discussions and coordination of all relevant partners. It is therefore expected that its soon-to-be-renewed mandate will be expanded to entrust it with such coordination.

A key aspect for consideration is that the budget support will be one of the three key instruments which will be put in place under the common goal to accelerate the progress towards the IFI arrears clearance. These instruments are the successive Staff Monitored Programmes and the WB PACF, with its

[9] Same as above, p.102

corresponding programmes. This SRBC will thus align both **in terms of process, timing and in terms of substance with the IMF and the WB** and the instruments mentioned. Detailed alignment with both the IMF and the WB is outlined in the section 5.3.2.

Close coordination with partners will be established through***:***
High level policy dialogue: to regularly review the progress on Public Policy, as outlined by the National Development Plan, and further specified in the respective Sector Development Plans (The Federal Ministry of Education, Culture and Higher Education- Education Sector Strategic Plan 2018-20, Federal Government of Somalia and Federal States –Somali Federal and State Police Plan 2017-2022) with particular attention to the result areas covered by the programme. This dialogue will be equally informed by progress on the Mutual Accountability Framework, regular progress on fundamental values, progress against next elections, notably progress on the Constitution review and preparations towards the next electoral process, human rights situation, fight against corruption and progress in security sector reform.

In its political and policy dialogue with Authorities, the EU will continue to emphasise the need to ensure a transparent, accountable and equitable distribution of the benefits of debt relief to all Somalis. As a follow-up to the successful October 2019 SPF, the EU has continued to encourage constructive discussions between the FGS and FMS to resolve and agree on key constitutional issues of power and resource sharing (such as agreeing a viable framework for fiscal federalism); and to ensure sustained technical dialogue and collaboration required to make progress against IMF SMP IV benchmarks and reform priorities (in order to reach Decision Point, as well as between Decision Point and Completion Point).
Sector working groups /dialogues: at sector level, the EU is an active development partner in all of its focal sectors. Currently, the EU chairs bi-monthly pillar working group on Effective and Efficient Institutions, and equally chairs one of its sub-working groups on PFM, which serves as a forum for a continued dialogue between the FGS/FMS, information sharing and as a 1st step platform in the process of the approval of new projects, ensuring close coordination and complementarity with other interventions in the sector.

On the Education front, the EU serves in the executive organ of the Education Sector Committee which is the main education sector coordination mechanism. The EU has equally taken over the coordinating role of the Global Partnership for Education (GPE) Fund preparing ground for the development and implementation new complementary GPE funding totalling to USD 33.1 million. The EU also continues to facilitate annual Joint Reviews of the Education Sector (JRES), a platform for reviewing the performance of all education initiatives and dialogue on education financing issues in Somalia.

On the Security front, the EU is co-Chair of the Internal Security Strand (part of the Comprehensive Approach to Security) and is thus very well placed to ensure enhanced information exchange, coordination and collaboration amongst international and Somali civilian security providers. Moreover, the EU co-chairs the Rule of Law Working Group and actively participates in the police sub-working group. All these venues will be crucial for cooperation other actors under the SRBC, notably in discussions about the performance of the respective sectors, performance indicators for variable tranches as well as additional capacity development support that might be necessary during the implementation of SRBC.

Internal EU coordination mechanisms: The EU chairs regular meetings of the Human rights and Gender Working Group and has bi-weekly internal coordination mechanisms that bring together EUDEL, EU CSDP, ECHO and HQ services (the so-called CAB-meetings). Through the regular meetings at Head of Missions, Political and Development counsellors, the EU activities are closely coordinated with EU Member State interventions.

This engagement will also be used to galvanise additional grant support for IMF arrears clearance, with a view to minimise the amount of resources that would have to be redirected from the SRBC.

3.3 Cross-cutting issues

The political and policy dialogue will be informed by progress on the democratic agenda, notably progress against next elections and Constitution review, human rights situation, fight against corruption, progress in security sector reform. Migration will also remain an important area of dialogue within this context.

Considering the prevalent gender inequities in service delivery, the education component of the SRBC will integrate special measures to promote girls' and women's participation in education at all levels. Wherever possible, sex-disaggregated indicators and targets will be included in the performance indicators for the variable tranches. The sub/working groups on gender at the National Development Plan (NDP) and sector levels will increase gender-sensitivity of the sector and SRBC. Gender dimension in national policies and systems will be promoted in the policy dialogue engagements, notably through the annual Joint Reviews of the Education Sector (JRES) and accompanying EU financed programmes in the education sector. Overall, gender mainstreaming will remain an integral part of all planning and decision making processes.

Women's participation in law enforcement (both as practitioners and as beneficiaries) is weak. Throughout the implementation of the SRBC special attention will be put on ensuring a greater role for women. The sub/working group on police (part of Strand 2b - Internal Security of the Comprehensive Approach, currently co-chaired by the EU) as well as the Rule of Law Working Group (currently co-chaired by the EU/NL) will be appropriate fora in which increasing the role of women across law enforcement is and can continue to be tabled and discussed. The gender dimension will also need to be internalised into state and federal legislations and policies pertaining to police Acts, for instance. Gender mainstreaming as well as identifying targets/indicators will also part of the EU co-financed new UN Justice Programme and new Joint Police Programme.

4. Description of the action

4.1 Objectives/results

The **general objective** is to increase the legitimacy and capacity of the Somali federal state, further the federal project, and create the conditions for inclusive growth.

The **specific objectives** are the reinforcement of trust in the Federal Government of Somalia at three levels: (i) with the Federal Member States (FMS) by reinforcing political and policy links through increased inter-governmental fiscal transfers, (ii) towards the international creditors and partners in view of building a strong reform track record for HIPC Decision point, and supporting IFI arrears clearance (iii) towards the Somali population by gradually increasing the role of the Somali authorities in the provision of basic services.

The **expected results** are:

1. Additional fiscal space for priority national development spending, for intergovernmental fiscal transfers - reinforcing links between the FGS and the FMS - and for enhanced macroeconomic stabilisation through both the direct provision of budget support (including as part of the EU response to the COVID-19 crisis) and the unlocking of IFI grant and concessional financing;

2. Accelerated reform process and improved Public Finance Management and Payment processes for both salary and non-salary recurrent costs and improved budget transparency and accountability;

3. Enhanced Domestic Revenue Mobilisation (DRM) and greater accountability and transparency in the collection of revenues;

4. Accelerated engagement between the FGS and FMS leading to tangible progress on intergovernmental fiscal arrangements;

5. Gradual increase of the role and capacity of the Somali authorities in the service provision, with a focus on law enforcement/policing and education.

6. Enable Somalia to reach HIPC Decision Point by facilitating the clearance of IFI arrears through the provision of grant financing to cover residual gaps.

7. Enhanced inclusive governance that facilitates the implementation of inclusive elections through supporting measures. An orderly electoral process and transition of power between administrations would send a political signal, to the IFIs, creditors and other international partners to accelerate their support for Somalia's reengagement process with the IFIs.

4.2 Main activities

4.2.1 Budget Support

Overall, the main activities envisaged by the budget support include policy dialogue with the Somali Government in coordination with development partners, financial transfers, performance assessments in relation to the general and specific conditions, and coordination with complementary measures in support of the budget support objectives and in reducing the associated risks.

The activities will include:
- Transfer of 82.9 million over 3 years (spread across minimum 4 payments to the Treasury Single Account);
- High level policy dialogue on the Public Policy, as outlined by the National Development Plan, and further specified in the respective Sector Development Plans (The Federal Ministry of Education, Culture and Higher Education- Education Sector Strategic Plan 2018-20, Federal Government of Somalia and Federal States –Somali Federal and State Police Plan 2017-2022) with particular attention to the result areas covered by the programme. This dialogue will be equally informed by progress on the Mutual Accountability Framework of the New Partnership for Somalia;
- Dialogue between the EU Delegation, IMF, WB and the national authorities with the objective to consolidate and reduce the reporting obligations by the FGS, while at same time reinforce the national coordination capacities;
- Regular monitoring / evaluation of the general eligibility criteria for budget support (see criteria in 5.3.2.);
- Assessment of performance indicators under all the variable tranches will be based on the disbursement report prepared by the relevant departments of the national administration under the authority of the Ministry of Finance and transmitted by the Ministry of Planning as the National Authorizing Officer. The EU will work together with the WB and with the IMF - with the objective to hold common assessments, common policy reviews with the FGS and common verification of performance indicators.

4.2.2 Debt Relief

An amount of EUR 10 million dedicated for IMF and AfDB arrears clearance. The EU's planned contribution to IMF arrears clearance is intended to serve as complementary funding to fill any outstanding gap that remains following IMF members' own contributions. Mechanisms will be put in place in the disbursement of these funds to ensure that any un-used funds can be utilised in the framework of the SRBC.

4.2.3 Complementary Measures

Complementary support will be delivered under the present programme with the objective to cover any outstanding gaps within the PFM, budget transparency and other areas covered by the budget support, provide where required additional technical assistance, enable participation to the Cash Management Committee and enable additional monitoring and verification of the performance indicators by the EU Delegation.

To ensure that the eligibility criteria on satisfactory progress in the implementation of the National Development Plan will be met and to support the political and policy dialogue of the programme which will be informed on the progress of the democratic agenda, complementary measures will support the key areas under the inclusive politics pillar of the NDP-9. Focus areas will include supporting inclusive governance to support inclusive elections as per the Electoral Agreement of 27 May 2021 as well as the post-electoral period, and supporting political and policy dialogue, including in the area of fiscal federalism and deepening linkages between economic and inclusive governance.

Assessment of the outstanding gaps will be based on the scope of support which will be provided through the upcoming PFM support package through the WB PACF and future IMF Technical Assistance support.

It is expected that further support might be required to i) strengthen the internal audit function, ii) strengthen the capacity of the Office of the Auditor General, iii) strengthen the capacity of the Accountant General and the Cash management committee, iv) implement the security forces payroll reform, v) strengthen domestic revenue mobilisation, vi) strengthen FMS PFM systems, etc.

Complementary measures will be implemented through service contracts and through delegation agreements with international organisations or a member state agency following the EU rules and procedures.

The above mentioned support will be provided in complementarity with programmes already supported by the EU, i.e.:

- Support the Financial Governance Committee (support provided in parallel to the WB and the IMF support) while securing a commitment from the FGS that the FGC mandate is extended for the duration of the SRBC and ensuring continued compliance with the FGC's recommendations, particularly as regards concessions and contracts;
- Support to the Establishment of Public Management Systems in the Emerging Federal States of Somalia ('PREMIS' DFID and EU co-financed programme);
- Support to the FGS to strengthen domestic revenue generation and macroeconomic management (DFID, USAID and EU co-financed programme);
- Support to the Somalia Trust Fund for Capacity Development in Macroeconomic Policies and Statistics (IMF Trust Fund);
- Support to the WB MPF – with its corresponding programmes, notably: Recurrent Cost and Reform Financing Program II, Public Finance Management programme II and Capacity Injection Programme.

The EU will seek to continue delivering much needed financial and technical support to Somali institutions responsible for economic governance throughout the HIPC process, so as to leverage the reforms required to get to Completion Point in the shortest possible timeframe. Whilst the Completion Point policy triggers will not be time-bound, a realistic scenario – provided the reform momentum is sustained - is that they will be achieved within 2-3 years from decision point.

5. IMPLEMENTATION

5.1 Financing agreement

To implement the budget support component of this action, it is foreseen to conclude a financing agreement with the partner country, referred to in Article 17, Annex IV of the Cotonou Agreement. The complementary measures will be contracted separately from the financing agreement.

5.2 Indicative implementation period

The indicative operational implementation period of this action, during which the activities described in section 4.2 will be carried out and the corresponding contracts and agreements implemented, is 72 months from the date of entry into force of the financing agreement.

Extensions to the implementation period may be agreed by the Commission’s authorising officer responsible by amending this decision and the relevant contracts and agreements. Such amendments to this decision constitute technical – non substantial amendments in the sense of Article 9 of Regulation (EU) No 322/2015.

5.3 Implementation of the budget support component

5.3.1 Rationale for the amounts allocated to budget support

The amount allocated for the budget support component is EUR 92.9 million. This amount takes into account the financing needs and the absorption capacity of the public administration and the estimated financing needs for arrears clearance. In the fiscal year 2018, annual budget of the FGS amounts to USD 274.6 million, with minimal monthly expenditures representing USD 20 million to guarantee a basic functioning of the administration and payment of the monthly wage bill. However, only USD 13 million are collected in average through domestic revenues, with the remaining USD 7 million that have to be raised externally, though external grants.

5.3.2 Criteria for disbursement of budget support

This SRBC envisages A) general conditions applicable for disbursement of all tranches; B) a safeguard measure for the 1st disbursement, C) specific conditions applicable for the disbursement of variable tranches. Under all these dimensions, the SRBC will be closely aligned with the IFM SMP and the WB PACF, both in terms of substance as well as in terms of process.

A) The **general conditions** for disbursement of all tranches (disbursement expected for fiscal years 2019 and 2020 and potentially 2021) are as follows:

- Satisfactory progress in the implementation of development policy, specifically the new National Development Plan (NDP) and Mutual Accountability Framework,[10] and their continued relevance and credibility thereof;

- Maintenance of a credible and relevant stability-oriented macroeconomic policy or progress made towards restoring key balances, as evidenced by the satisfactory performance under the IMF SMP, the adoption of the third SMP and the SMP program remaining on-track;

- Satisfactory progress in the implementation of reforms to improve public financial management, including domestic revenue mobilisation, and continued relevance and credibility of the reform programme, as defined in the respective policy instruments – notably 3rd SMP as well the WB PACF and its corresponding programmes (notably RCRF and PFM). This assessment will also require the adoption of a focused short term PFM action plan, which is envisaged to be agreed between the FGS and relevant partners;

- Satisfactory progress with regard to the public availability of timely, comprehensive and sound budgetary information. Minimum required publicly available budgetary information will be defined in the Financing Agreement.

B) **A safeguard measure that was put in place before the 1st disbursement** is the agreement on the participation of the EU as an observer to the Cash management Committee of the FGS. Typical reporting requirements expected from this committee before any assessment of variable tranche include:

- Monthly Revenue Reports: These should indicate revenue type at 4 and 6 digit code level and include the description. Reports shall include original budget amount, supplementary budget, approved budget, and revenue by month. This is equivalent of the IMF SMP 1A Monthly Revenue Trend report. Reports have to be delivered within 30 days of month-end in both PDF and EXCEL format.
- Monthly Expense Reports: These should indicate object code (cost centers) at 5 digit code level, and expense type at 4 digit code level and include the description. Reports shall include original budget amount, supplementary budget, approved budget, and expenses by month. This will be equivalent of the IMF SMP 1B Monthly Expense Trend report. Reports have to be delivered within 30 days of month-end in both PDF and EXCEL format.

C) The **specific conditions** for disbursement of all variable tranches will be further detailed in the financing agreement. In duly justified circumstances, the National Authorising Officer (Ministry of

[10] The assessment might take into account performance against relevant sector plans including: The Federal Ministry of Education, Culture and Higher Education- Education Sector Strategic Plan 2018-20, Federal Government of Somalia and Federal States –Somali Federal and State Police Plan 2017-2022

Planning and International Cooperation) may submit a request to the Commission for the targets and indicators to be modified. The changes agreed to the targets and indicators may be authorised by exchange of letters between the two parties.

The specific conditions for disbursement of variable tranches will be aligned – and some cases identical - to the WB and IMF benchmarks. With respect to the SMP, the SRBC variable tranche performance indicators will aim to reinforce the SMP indicators, but in some cases will be more granular. In terms of areas covered, the EU indicators will be expanded beyond the scope of the SMP and cover to a greater extent the inter-governmental fiscal relations and will include in addition areas of service delivery - education and law enforcement. The EU, IMF and the WB will be closely aligned in the PFM and payment processes, DRM and Inter-governmental fiscal relations.

D) The abovementioned conditions A-C do not apply for the disbursement of arrears clearance grant financing. The disbursement of these funds will be made once the IFIs have endorsed (at Board level) the process towards HIPC decision point and the financing needs for arrears clearance. The detailed mechanism for the disbursement of this grant financing will be subject to separate arrangements with the IFIs.

In addition to the above mentioned elements, which outline strong coordination in terms of *substance*, the EU through this SRBC will fully align in terms of *process:*

Process alignment: As mentioned above, the safeguard measure for the 1st disbursement as well as variable tranche indicators for 2019 have been finalised over the summer 2018, to enable full alignment with the WB RCRF 'Surge' 2018, as well as 3rd SMP. The contributors to the EUTF have been closely associated to this process.

Variable tranche indicators for 2020 are proposed to be finalised at the latest by Q1 of 2020, based on the progress made against SMP/RCRF and the SRBC during 2019. This will enable full alignment with the IMF - and successor to the 3rd SMP - as well as the WB.

An assessment of unallocated/undisbursed amounts for arrears clearance, SRBC and support measures components will be made in the course of 2020, leading to their potential reallocation into disbursements in 2020 and 2021. Finalisation of variable tranche indicators and additional potential disbursements (in case they include a variable portion) will be formalised with the FGS through an exchange of letters.

Further, apart from the policy level, the EU and the WB (where possible IMF) will coordinate on the operational level and hold common assessments, common policy reviews with the FGS and common verification of the selected indicators.

In case of a significant deterioration of fundamental values, budget support disbursements may be formally suspended, temporarily suspended, reduced or cancelled, in accordance with the relevant provisions of the financing agreement.

5.3.3 Budget support details

Budget support is provided as general budget support to the national treasury. The crediting of the EUR transfers disbursed into USD will be undertaken at the appropriate exchange rates in line with the relevant provisions of the financing agreement.

The budget support consists of EUR 92.9 million split over a four-year period combining fixed tranches based on satisfaction of eligibility conditions and pre-conditions, variable tranches linked to the satisfaction of performance/trigger indicators, and grant financing for the IMF and AfDB (see next paragraph for more details on this last point). Apart from the first fixed tranche, presented for disbursement immediately following signature of the Financing Agreement in 2018, it is anticipated that there will be minimum two disbursements per year split between fixed and/or variable tranches and possible payments directly to the IFIs mentioned above. The fixed tranche disbursement foreseen for Q2 2020 will help to provide urgent support to the Somali government in bridging the revenue gap resulting from the COVID-19 crisis.

Of the amount available for budget support, a maximum of EUR 10 million in grant financing is foreseen for the IMF and AfDB in order to contribute to the clearing of Somalia's arrears with those institutions. This is a pre-condition for Somalia to reach decision point of the HIPC initiative. An assessment of unallocated/undisbursed amounts will be made in the course of 2020, leading to their potential reallocation into disbursements of tranches in 2020 and 2021. The need for further disbursements to alleviate the negative impact of the COVID-19 crisis will also be assessed as the situation evolves. Any modifications to the disbursement timetable initially included in the Financing Agreement will be agreed between the two parties via a rider to the said Financing Agreement. To note that Disbursement linked to these grant financing are not included in the number of tranches mentioned in the previous paragraph.

	Total (in million EUR)
Fixed Tranche	63
Variable Tranche	19.9
Debt Relief	10
Total	92.9

5.4 Implementation modalities

Following implementation modalities are defined for the complementary measures, following section 4.2.2.

Subject in generic terms, if possible	Management Mode	Type	Indicative nº of contracts	Indicative trimester of launch of the procedure
Complementary support to the implementation of the SRBC	direct	services	2	Q4 2018
	indirect	Indirect management with an international organisation or a member state agency	3	Q4 2021
Evaluation Audit	direct	services	2	Q1 2021 Q1 2019
Communication and visibility	direct	services	1	Q2 2019

d) Exception to the non-retroactivity of costs
The Commission authorises that the costs incurred may be recognised as eligible as of 15 July 2021 because of the necessity to start implementing the action as urgently as possible. This due to the necessity to provide timely support and avoid the risk of further delays to the electoral process, which could ultimately trigger violence in Somalia.

5.4.1. Scope of geographical eligibility for procurement and grants

The geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act and set out in the relevant contractual documents shall apply.

5.5 Indicative Budget

	EU Contribution (EUR)
4.2.1. – Budget Support : State Building and Resilience Contract and support to debt relief	92.900.000 (*of which 10.000.000 for debt relief*)
4.2.2. – Complementary Support – Procurement (direct management) or Indirect management with an International organisation or a Member state agency)	14.000.000
5.8 – Evaluation, 5.9 – Audit	400.000
5.10 – Communication and visibility	100.000
Total	107.400.000

5.6 Organisational set up and responsibilities

The budget support will be provided in the framework of broader international support –provided notably in the framework of 3rd SMP and WB PACF. In addition to what is described in chapter 3.2., the SRBC will contribute to the establishment of a coordination group for budget support, co-chaired by the Ministry of Finance and a representative of the development partners. It will be kept informed by the Somali government about the progress, challenges and any possible issues and obstacles in the implementation of the SRBC. In the meantime, an SRBC Committee will be established, co-chaired by the EU Delegation and the Ministry of Finance, with the participation of relevant line ministries.

Final decisions concerning the disbursement of general and variable tranches will be taken by the EU, based on a review of the information provided and progress made, and informed by the discussions of the SRBC Committee. The interested contributors to the EUTF will be associated.

5.7 Performance monitoring and reporting

The day-to-day technical and financial monitoring of the implementation of this action will be a continuous process and part of the implementing partners' responsibilities. To this aim, the implementing partners shall establish a permanent internal, technical and financial monitoring system for the action and elaborate annual progress reports and a final report.

Every report shall provide an accurate account of implementation of the action, difficulties encountered, changes introduced, as well as the degree of achievement of its results (outputs and direct outcomes) as measured by corresponding indicators, using as reference the list of result indicators which will be part of the financing agreement. The report shall be laid out in such a way as to allow monitoring of the means envisaged and employed and of the budget details for the action. The final report, narrative and financial, will cover the entire period of the action implementation.

The Commission may undertake additional monitoring both through its own staff and through independent consultants recruited directly by the Commission for independent monitoring reviews (or recruited by the responsible agent contracted by the Commission for implementing such reviews).

5.8 Evaluation

Having regard to the importance of the Action, a final evaluation will be carried out for this action, preferably jointly with other budget support providers, with funds made available under this decision via independent consultants contracted by the Commission. It will be carried out for accountability and learning purposes at various levels (including for policy revision), also taking into account in particular that this budget support operation is the first EU or EU MS budget support operation in Somalia. This evaluation will, among other highlight any lessons learned that can be instrumental for future budget support programmes.

The Commission shall inform the implementing partner at least 2 months in advance of the dates foreseen for the evaluation missions. The implementing partner shall collaborate efficiently and effectively with the evaluation experts, and inter alia provide them with all necessary information and documentation, as well as access to the project premises and activities.

Indicatively, one contract for evaluation services shall be concluded in Q1 2021.

5.9 Audit

Without prejudice to the obligations applicable to contracts concluded for the implementation of this action, the Commission may, on the basis of a risk assessment, contract independent audits or expenditure verification assignments for one or several contracts or agreements.

In order to strengthen the Office of the Auditor General (OAG) in Somalia - FGS, support to the financial audits of the government accounts and the fiscal transfers to the Federal Member States will be conducted by the OAG with additional support made available under this and/or other relevant decisions. Indicatively, one contract for audit services shall be concluded in Q1 2019.

5.10 Communication and visibility

Communication and visibility of the EU is a legal obligation for all external actions funded by the EU.

This action shall contain communication and visibility measures which shall be based on a specific Communication and Visibility Plan of the Action, to be elaborated at the start of implementation and supported with the budget indicated in section 5.5 above.

In terms of legal obligations on communication and visibility, the measures shall be implemented by the Commission, the partner country, contractors, grant beneficiaries and/or entrusted entities. Appropriate contractual obligations shall be included in, respectively, the financing agreement, procurement and grant contracts, and delegation agreements.

The Communication and Visibility Manual for European Union External Action shall be used to establish the Communication and Visibility Plan of the Action and the appropriate contractual obligations.

Intervention Logic for the Somalia State Building and Resilience Contract (SBRC)					
Note: For performance indicators which will trigger performance-tranche disbursements, the mention "joint" expresses the fact that the exact same indicator is being used by the World Bank in the context of the IDA Pre-Arrears Clearance grants					
Note: the EU performance indicators for 2020 and 2021 are indicative and will be subject to revision in the quarter preceeding each year					
Note: in addition to the performance indicators, the Financing Agreement will include the following safeguard measures, which will need to be fulfilled before the first disbursement planned for Q4 2018 takes place (there are no performance indicators for that first payment)					
Safeguard measures to be put in place prior to first disbursement of the SBRC:					
1. **Cash Management Committee**: EU to receive observer status in the cash management committee, chaired by the Accountant General					
2.**PFM Action Plan**: Submission of the updated 2016-20 PFM reform action plan , stating what was accomplished and framing new objectives for 2019-20. The submitted Plan must be endorsed by the Ministry of Finance					
3.**Financial Governance Committee (FGC)**: i) extension of the FGC mandate by one additional year and commitment by the FGS to further extend FGC over the whole duration of the EU Budget Support. ii) Re-affirmation by FGS of the commitment to observe the recommendations made by the FGC					
4.**Federal Member States (FMS) Reporting**: Commitment by all FMS to report on a bi-annual basis to FGS on the utilisation of FGS fiscal transfers					

	Results chain	Indicators (tbc)	Baselines	Targets	Sources and means of verification	Assumptions
Overall objective: Impa	To increase the legitimacy and capacity of the Somali federal state, further the federal project, and create the conditions for inclusive growth					The overall security and political situation does not deteriorate and the FGS and FMS are able to retain / or extend control of the respective territories, and the FMS continue to engage in the federalist agenda.
Specific objective(s): Outcome(s)	The specific objectives of the action are the reinforcement of trust in the Federal Government of Somalia at three levels:					The Government remains committed to pursue its reform agenda by formulating and implementing credible policies, in particular by negotiating a strong 3rd Staff Monitored Programme and WB pre-arrears clearance financing package; The international community remains engaged in Somalia and maintains relevant complementary measures (IMF, WB MPF; WB pre-arrears clearance financing, AMISOM and support to the Transition Plan; policy dialogue)
	(i) with the Federal Member States (FMS) by reinforcing political and policy links through increased and improved inter - governmental fiscal transfers	(i) more rule based, transparent and predictable transfers to the FMS and greater progress on the fiscal federalism, including revenue sharing arrangements	Only 5% of FGS expenditure transferred to FMS, in un-predictable and not sufficiently transparent terms	i) increased level of execution of the FGS transfers to the FMS, as compared to the budget allocation ii) improved PFM standards and service delivery systems at the FMS level and iii) quarterly FMS reporting on utilisation of fiscal transfers.	FGS and FMS budget documentation	
	(ii) towards the international creditors and partners in view of building a strong reform track record for IFI arrears clearance and HIPC Decision point and supporting IFI arrears clearance	(ii) benchmarks and measures approved with the IMF, WB and under this SRBC are met (ii bis) IFIs have endorsed (at board level) the process towards HIPC decision point and the financing needs for arrears clearance	Under the first IMF Staff Monitored Program with Somalia (May 2016-April 2017), the FGS met all but one of its six PFM structural benchmarks In October 2019, the World Bank and IMF confirmed Somalia's positive progress towards HIPC "decision point" as well as the possibility to reach it in early 2020	A similar track record is maintained EU contribution to arrears clearance is channeled to relevant IFIs	IMF reviews, WB RCRF reports, SRBC reports Proof of endorsement by IFIs boards of the process towards HIPC decision point and of the financing needs for arrears clearance	
	(iii) towards the Somali population by gradually increasing the role of the Somali authorities in the provision of basic services	(iii) enhanced role of the state structures (FGS and FMS) on the level of policy setting, coordination of service providers, and in the actual service delivery	Delivery of education and law enforcement now essentially in the hands of private sector/clan militias	Improvements of the existing systems, both financial and non-financial (payroll, human resource systems), etc.	Policies, regulations, budget documentation	

Induced outputs	1. Additional fiscal space for priority national development spending, for intergovernmental fiscal transfers- reinforcing links between the FGS and the FMS- and for enhanced mac-roeconomic stabilisation;	1.1 - Improved framework for intergovernmental transfers	Lack of a rule-based approach to the distribution of funds between FGS and FMS/BRA, with limited assurance that Article 50 (e) of the Constitution ('fair distribution of resources') is being adhered to.	a. By March 2019, Policy paper outlining policy framework for Intergovernmental Fiscal Transfers agreed at Finance Ministers Fiscal Forum covering: Budget timetable, reporting, accountability and disbursement conditions. [Joint] b. By August 2020, Policy paper including: (i) principles to guide FGS transfer allocations to FMS/Benadir Region Administration; (ii) comparative analysis, reflecting regional context, and; (iii) long-term views, tabled and adopted at Finance Ministers Fiscal Forum [Joint] c. By August 2021, Incorporation - and publication - in the 2022 Pre Budget Statement Framework Paper of a) specification of the indicative financial envelope for fiscal transfers b) transparent criteria for horizontal allocation
		1.2 - Increased, more rule based, transparent and predictable transfers to the FMS	Very limited portion of FGS expenditure transferred to FMS, in un-predictable and not sufficiently transparent terms	d. By March 2019, the total budget proposed for FMS transfer, as contained in the MoF/Council of Ministers proposal of the Appropriation Act in 2019, remains at least in the same proportion of the overall budget of Somalia as compared to 2018 and increases at least by 40% compared to the FMS allocation within 2018 budget e. By August 2020, FGS fiscal transfers execution rate to FMS equal to or greater than the outturn rate for domestic revenues (Year 2) [Joint] f. By August 2021, FGS fiscal transfers execution rate to FMS equal to or greater than the outturn rate for domestic revenues (Year 3) [Joint]
	2. Accelerated reform process and improved Public Finance Manage-ment and Payment processes for both salary and non-salary recurrent costs and improved budget transparency and accountability;	2- Payment processes are managed more effectively and in a more transparent manner, leading to more effective use of resources	**Cash Management & Treasury single account (TSA)**: Limited ability for Treasury to effectively manage cash; limited view of all liquid assets, limited view of commitments, and of revenue accrued but not booked.	Cash Management & Treasury single account (TSA): g. By March 2019, Somalia Finance Management Information System (SFMIS) incorporates: (i) End-of-day balances of all TSA accounts and (ii) monthly balances of all Ministries, Departements and Agencies (MDA) accounts held at the Central Bank of Somalia (CBS). [Joint] h. By August 2021,Cash forecasting model used to inform management about allotments, available balances and expected revenues with regular monthly management reports produced by the Accountant General (joint)
			Payment process for operational expenditures: Extensive use of cash advances to finance MDA operational costs, with lack of associated financial controls and unrequited expenditures	Payment process for operational expenditures: i. By August 2020, A Cash-basis IPSAS compliant set of annual financial statements of the FGS for the financial year of 2019 is submitted to the Office of the Auditor General by 30th April 2020 j.By August 2021, A Cash-basis IPSAS compliant set of annual financial statements of the FGS for the financial year of 2019 is submitted to the Office of the Auditor General by 30th April 2021

Induced outputs	3. Enhanced Domestic Revenue Mo-bilisation (DRM) and greater ac-countability and transparency in the collection of revenues;	3.1- Key institutions (customs and tax) in leveraging domestic revenues are reinforced and collection processes are reviewed in view of increasing collected amounts and transparency of the processes	**Customs and Tax administrations**: Poor systems capacity : organizational, technology, and workflows to support effective and efficient customs management and collection. Volume-based custom tarification. IT system not standardized accross FGS and FMS	**Customs administration**: k. By August 2019 - customs modernization road map and action plan tabled, discussed and adopted at intergovernmental technical committee, including agreement on common goods classification [Joint] l. By August 2020 - Implementation of interim IT customs system at Mogadishu, Bosaso and Kismayo ports, including common goods classification, customs practices and procedures and valuation of goods. [Joint]
				Tax Administration: m. By March 2019 - Tax Identification Number (TIN) and Tax Credit Certificates (TCC) mandatory when bidding for government contracts and valid TIN required to have invoice paid. [Joint] n. By August 2020 - Targeted automation for collection of sales tax, excise duty, road tax, stamp duty, and registration fees deployed [Joint]
		3.2 - Increased revenue collection from Telecoms and Fisheries	**Telecoms revenue:** Communication Act passed but not implemented, leading to continued shortfall fo revenues compared to potential collection. Telecoms Revenue collection 2017 = USD 5.3 million	Telecoms revenue: o. By August 2021 - Enhance transparency in the regulatory process of the Telecommunications and Mobile Money Sectors (joint with IMF)
			Fisheries: continued shortfall fo revenues compared to potential collection, progress to be made to increase transparency, systems to be strengthened	Fisheries: p. By August 2019, all tuna licences issued between 1/1/2019 and 31/8/2019 have been issued in full respect of transparent licensing process based on the interim agreement between FGS, FMS and BRA of February 2018 q. By August 2021, Establishment of a formal institutional mechanism for inter-governmental policy dialogue and coordination on fisheries management and oversight r. By August 2021, Lists of all fishing vessels currently registered in Somalia and all valid fishing licenses issued and are available on the website of federal Ministry of Fisheries and Marine Resources
	4. Accelerated engagement between the FGS and FMS leading to tangible progress on intergovernmental fiscal arrangements;	4 - Progress on revenue sharing agreements	**Fisheries:** Overall principles of fisheries licensing established between FGS and FMS, but transparent and sustainable licensing process remains to be established and applied, and revenue sharing agreement to be fine-tuned, in order to unleash potential of the sector	Fisheries: s. By August 2020, Implementation of the Inter-governmental interim agreement on allocation of foreign licensing revenues adopted by FGS and FMS t. By August 2021, Implementation of the Inter-governmental interim agreement on allocation of foreign licensing revenues adopted by FGS and FMS
	5. Gradual increase of the role and capacity of the Somali authorities in the service provision, with a focus on law enforcement/policing and educa-tion.	5-1 **Law enforcement**: implementation of the State Police Development Plans and the SPF's Transformation Plan put Somali Police forces in a better position to provide law enforcement service across the country	**Law Enforcement** (police) is cost-ineffective and lacks the required professionalism, capability, efficiency, accountability and trust needed to effectively and efficiently provide law enforcement service to the Somali people.	Law enforcement: u. By March 2019, Finalize Police payroll reform by: 1) Biometric registration of all FGS SPF personnel, and Registration of SPF personnel into SFMIS and 2) Remuneration of all Federal SPF personnel via electronic means v. By August 2019, FGS authorities have issued and adopted administrative proceduresand policies governing recruitment and remuneration of Somali Federal Police personnel as well as their code of conduct w. By August 2020, Electronic human resources management system established x. By August 2021, Implementation of the Law on the Pensions and Gratuities for Members of the Armed forces and Security Services
		5.2 -**Education:** sector governance is improved, the new curriculum effectively implemented in Somali classrooms and a minimum competency level of teachers promoted	**Education governance and function assignment**: Insufficient articulation of the roles, functions and accountabilities between the federal and state level education authorities. **Curriculum Framework** adopted but requires a nation-wide rollout. Learning materials aligned to the new curriculum framework are lacking, teachers are not oriented on the new curriculum and supervision is weak **Teacher Proficiency** is not tested	Education: y. By August 2019 - Review the framework for Cooperation on Education and MoU signed between FGS and FMS to facilitate effective sharing of functions, roles and responsibilities z. By August 2019, teacher proficiency test piloted in at least one eligible FMS/BRA, establishing minimum competency level of teachers [Joint] aa. By August 2020, develop and formally approve a policy framework for private education provision (including school licensing, fees and curriculum implementation) bb. By August 2021, Review and approve content for grade 5-8 Science, Mathematics, Social Studies, Somali and English in line with the approved curriculum framework
ct outputs	Improvement of the relationship between external assistance and the national budget and policy processes.	Increased size and share of external assistance funds made available through national budget; policy dialogues and capacity		