# SOMALIA DEBT RELIEF
## *Growth on the Horizon*

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*Analysis*

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On February 12, 2020, under the Initiative of the Enhanced Heavily Indebted Poor Countries (HIPC), the Executive Boards of the International Monetary Fund (IMF) and the World Bank met to consider Somalia's eligibility for debt relief. The board agreed that Somalia is eligible for the forgiveness of most of its debt, which measured US$5.3 billion. On 24thof March, the UK and the EU paid the loans owed by Somalia to the African Development Bank. The next day, March 25th, 2020 was the historic day for Somalia to be officially announced that she successfully reached to the decision point. The World Bank also aims a program of giving money to Somalia to create employment for the youth and reduce poverty. This is a major milestone for the war-torn horn of African nation. The country has been lacking a central bank that can initiate and implement macroeconomic policies to manage the country's business circles. This debt relief was a subsequent to a consistent hard work of solid institutional reforms obligated by the IMF and the World Bank on Somalia to be eligible for the debt relief. Despite this, still, there is an uncertainty of what will happen after the debt relief or whether that forward step will be followed by another simultaneous set back of being deeply in debt again or whether the IMF obligatory requirements will further worsen the already deteriorating economic downfalls the country have been going through since the fall of Barre regime.

### Positive Prospects

The debt relief may attract an inflow of international official finance and receiving programs aimed at boosting the local living standards and eliminating poverty. The debt relief is a milestone for Somalia to deal with the international financial markets, investors and creditors. That will enable the nation to increase employment, reduce poverty, collect increased sums of taxes, an increase in government financial account surplus, build and improve the quality of productive public institutions, build infrastructure and eventually improve the overall standard of living of the people. Of course, that is when responsible, capable, reliable, accountable and transparent institutions are on hand. Otherwise, vice versa is going to be inevitable. So, as we can observe in what we will explain later, borrowing is not always a bad idea, but what matters is that of how you are going to manage and prioritize your goals. You can boost economic growth and reduce poverty by borrowing. Somalia's debt relief is not only going to help Somalia borrow money but also attract foreign investors to invest in the country, extract its natural resources and connect with international banks and other financial institutions.

If we just dive deep into the effects of the debt relief would have on Somalia's overall economy, we can closely notice that the debt relief haven't the direct effect, but it does have the indirect one as the debt relief opens several doors and opportunities which could contribute to economic growth. One of those opportunities is financial inflow, whether it is borrowed or direct capital investment depending on the interest rate which Somalia is willing to offer to its international lenders or investors, the bigger the interest rate the larger the financial inflow.

## Effects on Domestic Forex Market

If Somalia experiences an inbound flow of financial capital, the value of the dollar will decrease in response to the increased supply of the dollar in the domestic foreign exchange market and that will allow the deeply depreciated Somali Shilling to regain some value over the dollar as explained in figure 1.

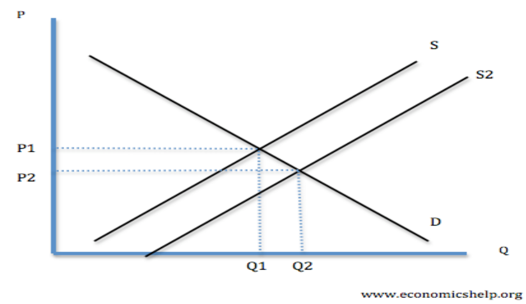


*Figure 1*

In figure 1, Q is the quantity of dollar in the market, P is the price of the dollar, S is the supply of the dollar and D stands for the demand of the dollar. As the quantity of the dollar increases from Q1 to Q2, the supply curve shifts to the right from S to S2 causing the price of the dollar in terms of shilling to decrease a little bit from P1 to P2. However, the amount of dollar inflow into the market and the government policies will determine how far the dollar will decrease. In here, we are assuming the demand is not changing (short run) and ceteris paribus holds.

On the other hand, the shilling may regain its value through the demand side. Although dollarization affected the shilling badly, decreasing the demand for the shilling, there still some hope that it would regain some of its lost value when the country opens up to the rest of the world as shown in figure 2.

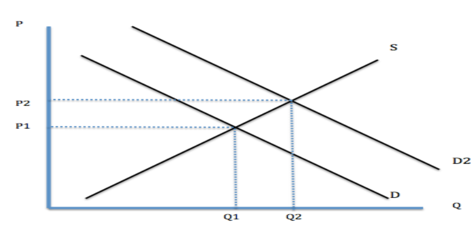


*Figure 2*

In figure 2, we assume that the supply of shilling is not changing meaning that the government is not printing extra shilling and pouring it into the market. Despite dollarization effects in the country, still, some of the inbound capital will be exchanged into shilling, making the demand of the shilling to move from D to D2 causing its value against the dollar to increase from P1 to P2.

## Macroeconomic Effects and the Phillips Curve

The economic effects of the debt relief would not only be felt in the forex market but also has much broader macroeconomic effects, from decreasing unemployment to increased growth and inflation. So, let's take a closer look at the impact of the inbound financial capital on the domestic economy. Whenever Somalia experiences those inflows of financial capital, at least the government spending on infrastructure and other areas of public priorities, for example, would increase resulting in increased public recruitment which would lead to increased GDP. Also the private sector would have the same effect on the domestic economy. Look at figure 3.

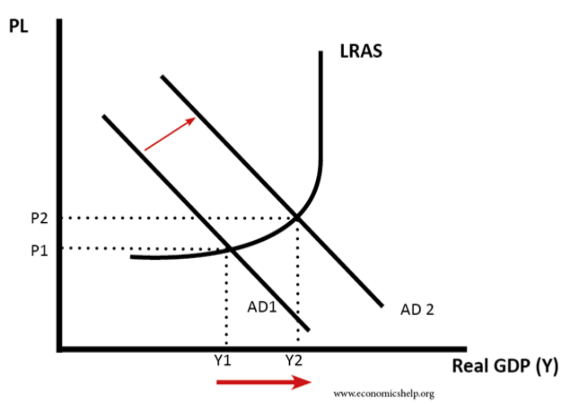


*Figure 3*

In figure 3, the inbound financial capital into Somalia results in increased employment and thus causes the aggregate demand (AD) to be increased from AD1 to AD2 which brings about a boom in real GDP (Y) from Y1 to Y2 but has its costs and consequences as the equilibrium price levels (PL) increase from P1 to P2 (where Aggregate Demand (AD) intersects the Long Run Aggregate Supply).

On the other side, the increase in employment would drive the aggregate demand to increase and shifts to the right as illustrated in figure 3, and which means more people can buy things as more people are employed. The increase in demand causes the prices to rise and rise in prices means an increase in inflation which, in turn, leads to decreased unemployment as illustrated in figure 4.

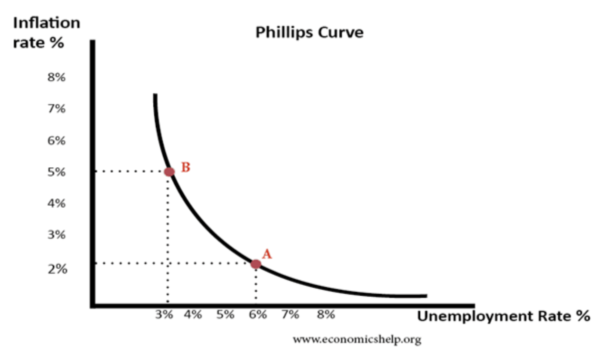


*Figure 4*

If, for example, unemployment is decreased from 6% to 3%, due to the public and private recruitments, it would eventually lead to increased inflation from 2% to 5% as the example in the Phillips Curve above. So, inflation is not always such a bad thing to worry about all the time unless it is going to be out of control and the government is needed to take counteractive measures in such bad scenario cases.

In conclusion, despite the debt relief, there are enormous challenges that Somalia is facing from security to corruption and ineffective public institutions. But if the current efforts by the government sustain in the future, slowly but surely, Somalia will take gradual steps to economic development and prosperity. To do so, it's needed to break the vicious circle of poverty by finding other ways of doing things like opening up to the international markets as the debt relief paves the way to such engagements with the rest of the world. To get an external inbound capital from the outside of the system is vital for breaking such a circle of remaining poor and it is a precondition to development. So, there are two ways you can get such inflow of capital, getting an external aid and assistance or attracting foreign investors. The latter is better and most likely to help countries grow economically as the aid has already been tested and doomed to fail in reducing poverty. So, there are two forms or ways to attract foreign investors one way is to create a condition or environment were foreign investors dare to invest in or move their capital to the country. The other way is to offer higher interest rates to foreign lenders to simply encourage them to lend you money and that money you will use for building infrastructure, public institutions, improving the system of education, increasing local production, improving country's competitiveness in the international markets by investing in what the country is good at and capable of offering to the world market and so on. Of course, all those require an increased number of employment opportunities and so that poverty is reduced. Again, despite tough challenges on the ground, the debt relief might pave the way for Somalia once again to attract foreign investors and borrow money from international lenders and so invest in the productive sectors of the nation, decrease unemployment and in the long run reduce poverty.