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Somalia

Industrial Policies and Public Enterprise Reform

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Industry and Energy Operations Division
Eastern Africa Department

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CURRENCY EQUIVALENTS

Currency Unit

Somalian Shilling (So. Sh.)

Exchange Rates

Official Rate (September 17, 1987)	Same as Auction Rate
Last Auction Rate: (September 17, 1987)	So. Sh. 157.0 = US\$1
Parallel Market Rate (September 17, 1987)	So. Sh. 195.0 = US\$1
Official Rate (October 26, 1987)	So. Sh. 100.0 = US\$1
Free Market Rate (October 26, 1987)	So. Sh. 180.0 = US\$1
Parallel Market Rate (October 26, 1987)	So. Sh. 210.0 = US\$1

Fiscal Year

January 1 - December 31

GLOSSARY OF ABBREVIATIONS

AA	- Autonomous Agencies
A&S	- Administrative and Statistical
ADC	- Agricultural Development Corporation
CBS	- Central Bank of Somalia
CEO	- Chief Executive Officer
CG	- Consultative Group
CIP	- Commodity Import Program
CSBS	- Commercial and Savings Bank of Somalia
GOS	- Government of Somalia
GRP	- Glass Reinforced Plastic Products
HASA	- Hides and Skins Agency
HIID	- Harvard Institute for International Development
IMF	- International Monetary Fund
IPE	- Industrial Public Enterprises
IPS	- Industrial Production Surveys
MA	- Magistrate of Accounts
MI	- Ministry of Industry
MF	- Ministry of Finance
PE	- Public Enterprises
SDB	- Somalia Development Bank
SICOS	- State Insurance Company

SOMALIA
INDUSTRIAL POLICIES AND PUBLIC ENTERPRISE REFORM
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This report is based on the findings of an industrial sector mission that visited Somalia during June-July 1986. Mission members were Messrs. Ashok Khanna and Sanjaya Lall (Sr. Economists, co-mission leaders), Henry Laurant (consultant), Ivan Bergeron (consultant). Ms. Hilda L. Scioville typed the report.

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Elmwood Park
Illinois

SOMALIA
INDUSTRIAL POLICIES AND PUBLIC ENTERPRISE REFORM
EXECUTIVE SUMMARY

Introduction

i. Somalia, a large but sparsely populated (5.8 million)^{1/} country, is one of the world's poorest economies, with a per capita GDP of US\$260 in 1984. Since 1977-78 it has been afflicted by a serious economic crisis, characterized by large budgetary and balance of payments deficits, high inflation rates, near zero domestic savings and stagnating production. In 1981 the Government of Somalia (GOS) launched a stabilization program and implemented measures to improve economic incentives. After two successful years the program suffered a reversal in 1983 because of drought and declining exports, as well as a slackening of stabilization efforts. The economic situation worsened in 1984, and a new stabilization program was launched in early 1985 with a fresh IMF standby agreement. Some policy improvements resulted, but the trade gap and budget deficit remain substantial, and inflation is around 40 percent per annum. While policies giving greater operating autonomy to public enterprises have been promulgated, there has been little effective progress in their reform. Successive episodes of exchange rate reform have moved the existing rates towards unification but have not yet accomplished it. Also, some export products remain Government monopolies.

Structure, Performance and Efficiency

ii. Somalia started at independence in 1960 with a tiny industrial base (9 formal sector units). The GOS took the lead in industrialization after 1963, and since 1969 nationalized most of industrial production, distribution and finance. By 1978, the Government was responsible for 80 percent of industrial value added and employment, and 97 percent of gross capital formation. Industry's contribution to GDP remained small, reaching a peak of 3.8 percent in 1978, with consumer goods accounting for 84 percent of value added. After the late 1970s, industrial performance deteriorated. By 1984, capacity utilization in public enterprises was down to 26 percent, industry's share of GDP to 1.6 percent,^{2/} and its value added to 39 percent

^{1/} According to the Government of Somalia's latest estimates, the population is 8.5 million.

^{2/} This estimate is made from Industrial Production Surveys. However, the National Accounts show industry's share as about twice as much. This issue is discussed in para. 2.01 below.

of its real value in 1978. The number of formal manufacturing establishments had fallen by 44 percent, mainly in the private sector; however, total industrial employment rose because of the public sector's policy of recruitment despite declining output. The immediate cause of falling production was shortage of foreign exchange, but there were deeper underlying problems of managerial and technical inefficiency.

iii. To start with, Somalia's industrial activities were largely concentrated in simple consumer goods, a few based on local agricultural resources and the remainder on final assembly or packaging of imported intermediates. Even these activities made excessive demands on the scarce managerial and technological resources available to the public sector; they remain entirely inward-looking and high cost, and have been unable to improve their productivity over time. The private sector has been confined to a marginal role in even "easier" activities (final assembly and traditional products like apparel, footwear and furniture); however, it too displays widespread inefficiency. Somalia's attempted entry into more complex activities (petroleum refining, urea manufacture and cement) has encountered severe problems of declining input availability and shortages of operating skills. Infrastructural deficiencies, especially power shortages, have worsened these problems.

iv. Somali industry is dominated by 23 large (100 or more employees) plants, predominantly in the public sector, which account for 13 percent of the number of units but over 82 percent of employment, output and wages. The structure of industrial output has altered markedly since 1971. Food processing has dropped in share of output sharply (from 81 percent to 19 percent in 1971-84) because of the decline in food production. Consumer goods as a whole declined from 95 percent to 50 percent of total output. Intermediate products rose with the launching of the refinery and urea plants. Leather and tanning, potentially a major activity based on Somalia's most important resource (hides and skins), never exceeded 4 percent of total output. Total manufacturing value added declined by 26.5 percent in real terms between 1975-82, with the public sector declining by 18.2 percent and the private sector by 52.6 percent. The private sector was able to reduce employment (by shutting plants or retrenchment) by 48 percent during 1975-82, along with falling activity, while the public sector increased its employment by 60 percent in this period. Consequently, the private sector was able to maintain productivity and real wages much better than the public sector. However, the prolonged economic crisis has affected industrial remuneration adversely. Real wages had fallen below subsistence levels by 1984, with skilled labor receiving around US\$20 per month, and engineers around US\$40-50 (at free market exchange rates). This has led to absenteeism, low morale and poor performance by the workforce, as well as a massive outflow of the best trained workers to local private sector and the Gulf.

v. Inefficiency is widespread in Somali industry. A study of effective rates of protection for 27 enterprises by the Harvard Institute for International Development shows that some of these enterprises are not economically viable in Somalia and would not have existed in a less distorted incentive environment. It would save Somalia foreign exchange to close down some of them. Others should continue in operation, but under an incen-

tive structure that demands efficiency. However, any further investment needed to rehabilitate these enterprises should be evaluated carefully. The broad spread of inefficiency reflects several factors: poor choice of investments, shortages of managerial and technical skills, poor labor performance, infrastructural gaps and insufficient maintenance of facilities, high and variable levels of protection resulting from quantitative restrictions and an ad hoc tariff structure. Exogenous factors such as the decline in foreign exchange availability have led to severe production problems, but, in addition, Somali industry suffers from underlying structural problems which require long-term solutions.

vi. The private sector is too small and inexperienced to take over and operate efficiently most of the large public enterprises, though it has shown dynamism in the past, especially in trading activities. The climate for private enterprise has improved slightly since 1980, but there are still cumbersome controls and financial constraints and confidence is still weak. However, the private sector is capable of developing small-scale industries, especially those based on domestic livestock and agricultural resources. They could cater for domestic demand from the livestock and agricultural sectors and, perhaps, some of the production could be exported. Small-scale industries could also provide considerable employment.

vii. The financial system comprises the Central Bank of Somalia (CBS), the Commercial and Savings Bank of Somalia (CSBS), the Somali Development Bank (SDB), a postal savings system and the State Insurance Company, all state owned. Foreign banks were nationalized and reorganized in 1970. In 1983 competition in banking was legally allowed, but by 1986 no new financial institution had been granted a charter. Despite upward revisions in recent years, real interest rates remain negative. This diminishes the supply of savings and encourages capital flight or investment in unproductive real assets. Since 1980, the authorities have attempted to curtail credit to public enterprises in favor of the private sector, but the share of Government in total credit is still very large. The share of private sector credit rose from 11 percent in 1980 to 39 percent in 1984, but connections continue to play a role in the allocation of private credit. Industry only took 13 percent of total credit in 1984, about half its share in 1980-82, while trade increased its share because of import liberalization.

Policies

viii. Exchange Rate. Somalia undertook a major reform of the exchange rate regime in 1985 after a period of high inflation, plummeting exports and a highly overvalued exchange rate. The official rate was devalued by 38.5 percent and a free foreign exchange market was set up for most private transactions. Quantitative restrictions on trade were lifted, along with most price controls on private enterprise. There was a third market, handled by the Commercial Bank, for tourist receipts, travel and aid-financed Commodity Import Programs. The unification of all three rates at a market-determined rate was not achieved in 1985 because of unforeseen shortfalls in export earnings and higher-than-anticipated inflation levels, and a new program was launched in 1986 with IMF support. Slippages occurred again by mid-1986: the official rate (So.Sh. 74.5 to the dollar) remained at 46 percent of the free rate and the commercial rate remained unchanged at So.Sh. 84 per

dollar. Under a World Bank initiative, most of the Agricultural Sector Adjustment Program Credit of, US\$70 million is being channelled through an exchange auction. The commercial bank rate has been eliminated but the free market rate continues to function. The first auction was on September 1, 1986, followed by others at 15-day intervals. The auction was temporarily suspended in mid-January 1987 for a short period while the foreign exchange pool was replenished.^{3/} In the event, the exchange rate was not unified by the end of 1986 although the trend was in that direction.

ix. The incomplete liberalization of the foreign exchange market has had undesirable consequences. Exporters continue to be required to surrender half their earnings at the official rate. This encourages underinvoicing of exports to minimize the penalty (27 percent compared to a full repatriation at the free rate). Importers similarly underinvoiced to evade customs duties, purchasing the exchange they needed from exporters. Multiple exchange rates have distorted allocation between activities or firms with differential access to cheaper foreign exchange. Capacity utilization has worsened despite the existence of the free market (only 17 percent of free market imports in 1985 were for industrial inputs), partly because of inherent operating problems and uncompetitiveness, and partly because importers preferred to wait for inputs under CIP schemes (at the commercial bank rate). The impact of the foreign exchange auction on industrial activity is not yet known.

x. Trade Regime. Quantitative trade restrictions were almost entirely dismantled in 1985, though the Ministry of Commerce occasionally uses import licenses to protect domestic suppliers. Import duties are assessed at the official exchange rate, greatly diluting their protective impact. As noted earlier, there is also widespread evasion by underinvoicing and smuggling. The tariff structure, set up to generate revenue and implement social objectives (restrict luxury consumption), does not offer a coherent protective structure for industry. The taxation of imports is made up of: import duties ranging from 4 percent to 700 percent, with capital goods exempt and basic necessities charged least; administrative and stamp duties of 20 percent of CIF values; stamp duties of 2 percent; and supplemental charges for handling, transportation, clearance and forwarding.

xi. A study of effective rates of protection (ERP) of 27 enterprises showed high levels of ERPs in a large number of firms and a wide dispersion of ERPs, across industries as well as across firms in the same industry. This often results in serious misallocation of resources among and within

^{3/} The exchange rate system has changed twice while this report was being processed. The system described above continued until July 1987 when an enhanced auction was implemented to provide foreign exchange for all goods transactions that were previously financed through the limited auction and free market. Exporters received the auction market rate for their foreign currency earnings and importers purchased foreign exchange at that rate too. The auction rate moved rapidly from So.Sh. 134 to the US dollar in June 1987 to So.Sh. 159.8 by mid-September 1987. Because of the rapid devaluation, the Government decided to suspend the auction on October 18th, 1987 and fixed the exchange rate at So.Sh. 100 with a provision for a 40 percent retention of export earnings. This regime is still under review and may be changed in the near future.

activities; there is thus a strong case for a reform of the tariff structure to simplify it and make it more transparent and uniform. Discretionary powers over import controls and foreign exchange allocation should be minimized. Public enterprises should not be given preference over private ones. There are presently no policies to promote exports and industrial exports are nonexistent; however, the promotion of potential exports requires that appropriate measures be implemented.

xii. Domestic Trade Regulations and Price Controls. Trade regulations and price controls were pervasive in Somalia until recently. In January 1985 price controls were removed except for those on public enterprises. However, since these account for most of manufacturing activity, the effect of controls on industry are still significant. The cigarette and pasta factories, for instance, face low controlled prices and are discouraged from expanding output. The Hides and Skins Agency (HASA) offers very low prices to producers, inducing waste and smuggling to Kenya; HASA's monopoly of hides and skins export prevents more efficient private tanneries from exporting. Parallel markets have emerged in several products. It would be economically beneficial to allow market forces and competition a greater role.

xiii. Taxation. Subject to some exemptions, the private sector is taxed at 35 percent of income. Public enterprises face a high income tax (with several elements combined) of 80 percent, which creates a strong disincentive for declaring profits. In addition, they are levied a depreciation tax of 50 percent, which discourages revaluation of assets and replacement of equipment. A proposed amendment to public enterprise taxation will eliminate the depreciation tax and reduce income tax to 35 percent, though the Minister of Revenue can impose a discretionary income tax of 80 percent. The tax structure is complex and has many discretionary exemptions that can distort incentives. It should be simplified and standardized.

xiv. Licensing and Labor. The Ministry of Industry licenses private investors and is supposed to evaluate investments and guide investors to agro-based, small-scale activities. In practice, its advisory and evaluative capabilities are limited. The licensing procedures have been improved but can still be slow and arbitrary. It should ideally become only a registration procedure, allowing investors to respond freely to competitive market forces. Foreign investments are regulated by Law No. 7 of 1977, which offered incentives and guarantees which are less attractive than in other developing countries. A revised law, which offers better terms to foreign investors, has been recently approved and will be made public shortly.

xv. GOS has liberalized some of the regulations on hiring, firing and wages which in the past led to overmanning and low productivity. In 1983, the employment guarantee for school leavers was dropped. In 1984, the freedom of enterprises to fire workers and set wages was increased. Private enterprises have greater effective freedom than public enterprises, many of which still carry a full complement of staff despite low capacity utilization.

Policy Recommendations

xvi. The thrust of the policy recommendations is to move the incentive structure for industry away from being administratively determined by the Government to one that relies on automatic, across the board incentives and competitive market forces. Where it remains necessary for the Government to intervene, that intervention should be transparent, simple and not create differential incentives between activities and firms:

- there should be one market determined exchange rate and no foreign exchange retention limits imposed on exporters;
- the discretion exercised by MI in issuing import licenses should be curtailed. Import tariffs should be simplified and rationalized to provide uniform and reasonable protection for domestic production while garnering adequate revenue for the Government. The bias against exports of manufactures should be removed by implementing an export compensation scheme;
- interest rate structure and levels should be market determined or, at least, be changed towards being positive in real terms and not discriminate between borrowers. Competition in banking services should be allowed by granting charters to private sector banks;
- the remaining price controls on public enterprises should be removed and competition allowed in the distribution of commodities now monopolized by the Government;
- the tax structure should be simplified and discretionary exemption minimized; private and public enterprises should be taxed equally; and
- the industrial licensing process should be simplified and made automatic. Regulations governing foreign investment should be amended to be made the same as those for domestic investment and competitive with other countries.

Public Enterprises

xvii. There are about 45 Public Enterprises (PE) reporting to 11 ministries; about 18 of these report to the Ministry of Industry. The focus of this report is on these 21 industrial PEs. Somali PEs originated as a small number, created because the private sector was not considered capable of the relatively large investments involved. The 1969 revolution gave greater emphasis to PEs, and three waves of nationalization, in 1970, 1972 and 1975, extended their presence to the entire modern sector of the economy, including trade, manufacturing, banking and business services.

xviii. Legal and Institutional Framework. PEs are divided into three categories: autonomous agencies (AAs), financial enterprises and public companies, each subject to its own legislation and with its own management structure. AAs are headed by a management committee (including a labor committee until 1984). Public companies are headed by a general manager and a board of directors; the former appointed by Presidential decree. The

legal form of PEs has no correspondence with the sector of operation; the same management structures are utilized for a broad range of enterprises without accounting for their special needs.

xix. Nine "parent" ministers have a direct supervisory role for one or more PEs. The Ministry of Industry (MI) supervises 17 enterprises with a staff of only two. Other ministries conduct even less formal supervision, and in general few of the necessary supervisory and support functions are exercised at all. The Ministry of Finance (MF) exercises most of the supervisory functions. In late 1985, the MF established three general-directorates to deal with PEs, one to assist in budget preparation, one to do financial monitoring and one to undertake "economic reforms". MF's authority over PEs is pervasive, ranging from authorizing new investment and expansions (together with the Ministry of Planning), budget, accounting and expenditure controls, to transferring a share of profits and depreciation to the Government and (jointly with the Magistrate of Accounts) auditing. The Magistrate of Accounts has a large staff and considerable authority over PE accounts, but delays in its auditing have induced several PEs to go to private auditors and submit accounts to the Magistrate only for certification.

xx. Survey of Industrial PEs (IPEs). The mission's survey of IPEs was based on interviews, annual reports and other documents, questionnaires and relevant consultant or other studies. Fifteen IPEs were visited, and secondary data was obtained on 3 other firms. The sample is estimated to cover 80-90 percent of IPE output. Specific recommendations on action will, however, require more thorough studies.

xxi. Financial Performance The financial performance of IPEs is characterized by negative or low returns on capital, liquidity problems and an eroding capital base. About half of the 15 enterprises made losses in 1984 and 1985; where profits were made they were overstated because of inadequate depreciation allowances (unadjusted for inflation and devaluation of the S. shilling), especially in 1985. Thus, only six firms (Juba Sugar, Pasta Factory, Cigarette and Match Factory, Km. 7 Tannery, Snai-Biasa and GRP) made "real" profits in 1985, while three (Snai-Jowhar Sugar, Urea Plant and Aluminum Utensils) recorded substantial losses. Accumulated losses and indebtedness have eroded IPEs' net worth; three enterprises' equity has been completely wiped out. The debt-equity ratios are high for many IPEs: of 11 firms with information, 6 have ratios of over 3, and 4 of over 10. Initial undercapitalization has been a serious financial problem for Somali PEs and subsequent losses have exacerbated this problem. These operating results show further deterioration from the already poor record observed by Bank missions in 1975 and 1980. Thus, industrial PEs have not brought significant returns to the investments by GOS. Many firms have failed to generate cash even to conserve their initial plant and renew it. Assets have been physically degraded through improper maintenance and lack of spares. Pressing day-to-day difficulties have overshadowed significant longer-term weaknesses in operation and management. The close inter-relationship among such problems, and the lack of adequate data, make it difficult to diagnose the main causes of the problems and to prescribe appropriate remedies.

xxii. The problems observed by the mission are summarized below in order of relative importance. This also reflects the mission's view of the priority for remedial actions which could be incorporated in a rehabilitation program. The main difficulties of IPEs, other than the broader ones relating to the legal/institutional context covered in the previous section, are classified under four headings: inputs, management, employment, and management systems.

(i) Inputs

xxiii. The foremost problem of IPEs seems to be the severe difficulties experienced by all firms in securing a reliable and adequate supply of raw materials, energy and spare parts. For example:

- in 1985, Juba Sugar obtained only 37 percent of its diesel requirements for irrigation; through end-1986, supply was so inadequate as to cause anticipated sugar production for the year to be reduced by 25 percent;
- the Urea Plant, which depends partly on outside electrical supply for its process, experiences several outages per month. The plant was not in operation at the time of the mission for other reasons, but it is hard to see how it can ever operate under these conditions, because each power supply interruption requires a four-to-five day period for cleanup and restart;
- the Foundry and Mechanical Workshop is faced with power outages of such magnitude that during some weeks machines operate only one day out of six;
- the Aluminum Utensils Plant cannot procure its basic input, aluminum sheet coils, apparently because of lack of foreign exchange. Instead it has to use ingots or scrap for which it does not have the proper processing equipment; and
- In the Somaltex textile plant, spinning is less than 75 percent operative, and weaving 30 percent, due in part to lack of spare parts. Some of its electric generators are out of operation for the same reason. Dyes and chemicals are obtained very irregularly and in inadequate quantities.

xxiv. One of the main results of the lack of inputs has been a decline in capacity utilization over the last few years. Over the period 1982-1985, no enterprise exceeded a 30 percent capacity utilization level except Juba Sugar, the Refinery, and the Pasta Factory. Although many factors contribute to this low ratio, the input supply problem is the most important cause of the wasteful idleness of expensive plant and machinery.

(ii) Management

xxv. The management of Somali IPEs was found to possess insufficient training and experience to properly exercise its functions. None of the managers interviewed appear to have received specialized management training or to have much experience of industry. Only one wholly state-owned industrial firm, Juba Sugar Project, employs a foreign management team. Two

others also call upon foreign management help: Somalfruit, a mixed-ownership enterprise, and GRP Products, which is in the process of being partly privatized. In general, the management team has to rely largely on its own ingenuity to run a specialized industry, sometimes assisted by young university graduates or technicians, some of whom have spent time in training in similar industries abroad.

xxvi. Upgrading of IPE management has a priority only second to that of solving the input supply problem and improving the institutional environment. Sector-wide measures to reform the institutional framework, including identification of training needs and coordinating training programs, are expected to contribute significantly to the gradual improvement of IPE management. However, without the presence of properly trained management in plants the impact of improvements in the first two areas will be considerably blunted. These measures should be supplemented by the increased use of foreign technical expertise, major efforts in industry-specific training, setting up systems of management incentives and increased autonomy and accountability.

(iii) Employment

xxvii. Levels of Remuneration. The general level of remuneration has fallen to levels that are too low and have failed to keep up with inflation. Average IPE remuneration decreased in real terms by more than 40 percent between 1975 and 1982. Between 1982 and 1986, salaries increased in most enterprises, but by far less than the threefold increase in the cost of living. For example, salaries have increased by 140 percent over two years (1984-85) in the textile mill, by 33 percent per year for the past three years in the Snai-Jowhar complex (these two probably represent the best records in the IPE subsector) and by a range of 12 percent to 42 percent in the Juba factories in 1985. In most other enterprises, yearly annual average wage increases have been 15 percent to 20 percent. This situation contributes to the following:

- a "brain drain" of the best trained and most experienced workers, technicians and professionals to the neighboring oil-exporting countries, although some of them may be returning due to the downturn in economic activity in those countries;
- a net movement of labor from IPEs to private industry--workers leave the IPEs once they have acquired technical training in state-owned plants;
- absenteeism, "moonlighting", and pilferage and other petty illegal activities; and
- low-motivation and, as a result, very low labor productivity. Combined with frequent overstaffing, low work loads, and lack of discipline on the shop floors, this also leads to carelessness, bad workmanship, and sometimes, as reported by the textile industry, frequent breakdown of machinery.

xxviii. Inadequacy of Training. The second general problem associated with employment in IPEs is the inadequacy of training provided both outside and within the enterprises. This affects various technical levels:

- Engineers do not receive sufficient training before they are hired by enterprises; however, they are usually promoted rapidly to a supervisory level in order to justify a higher salary. This would not be a serious problem if there were more senior, experienced professionals who could train them. Such on-the-job training does take place at Juba Sugar and to some extent in the Urea plant. But in other enterprises (such as the Foundry and Mechanical Workshop operational deficiencies occur because young engineers with no more than a year or two of exposure to plants abroad (sometimes in countries where industry is still in an early process of development) are put in charge of departments, with no professional guidance to turn to;
- Technicians are trained in the German-funded vocational school in Mogadishu, in the plants, and sometimes abroad by equipment manufacturers. However, levels of proficiency are generally low as training is insufficient to keep up with turnover; and
- Semi-skilled and skilled workers are usually trained only in the plants. Except in one firm where significant resources have been devoted to a formal training program (Juba Sugar), such on-the-job training usually takes place in an environment where even the most experienced workers have not mastered their trade.

Combined with rapid turnover, this results in a fairly inexperienced workforce, with ensuing low productivity, wastage of materials and poor workmanship.

(iv) Management Systems

xxix. Most IPEs visited seem to lack the basic tools which enable management to plan firm activities, or to obtain regular feedback reports to permit performance monitoring. Major shortcomings observed were in the following areas:

xxx. Planning, Budgeting, Financial Control and Accounting. Lack of planning is quite general. In some cases, there is unrealistic planning, e.g. a recent UNIDO study cites the case of a plant whose production objectives exceeded the physical capacity of the machines by almost 100 percent, but without a sales plan. Although the preparation of an annual budget to be approved by the Ministry of Finance is obligatory, the document is often not prepared in time and does not appear to be used as a management tool. Accounting reports are crude and probably would not permit the timely reporting required for using the budget as an instrument of management control. Finally, as a rule, there is no cost accounting.

xxxi. Production Planning, Scheduling and Control. It appears that these functions are inadequate in many IPE plants. While input supply disruptions could defeat the purpose of any production planning, many enterprises would still benefit from better production scheduling, elaborating production standards, monitoring performance, and from preparing and adhering to preventive maintenance programs. Some sort of inventory control seems to be practiced in most of the places visited. However, systems for triggering timely ordering of supplies usually work poorly, and procurement procedures are long and cumbersome. Quality control is generally lacking, a situation which contributes in part to the marketing problem of some enterprises such as Somaltex and the Foundry.

xxxii. Management Information Systems. Most managers were found to lack knowledge of many aspects of their own enterprises, and to operate in an information vacuum. For example, the manager of a large IPE plant knew that a formal commitment has been made to the large labor force to raise salaries by a certain percentage over the next two years, yet was unable to tell what the percentage was, find it in his papers, or obtain it from subordinates. Similarly, the chairman of another major IPE apparently did not keep any financial statements in his office and required several days to have them sent over from the plant located outside of the capital. Yet one of the basics of managing is, to put it simply, knowing what is going on. In many cases crude and simple reporting systems, used in conjunction with some simple operation planning, would permit managers to be effectively in control, and to take immediate remedial action whenever deviations from established plans appear.

xxxiii. Investment Planning and Capital Budgeting. The whole process of public enterprise investment planning and control, including mechanisms for review and approval by Government and inclusion in the Public Investment Programs for securing required financing, appears to be ill defined, especially regarding the respective roles of enterprise management and Government agencies. This area is in need of an in-depth review, which will be best achieved in the context of redefining the sector's institutional framework and determining the roles and responsibilities of the involved parties.

A Recommended Approach to PE Reform

xxxiv. Background and Purpose: The poor performance of public enterprises has taxed the resources of the Treasury and banking system over the years. Reform of the sector is urgently needed to stem the flow of further resources into loss-making enterprises, many of which are of dubious economic viability. At the same time, in recent years GOS policy has moved towards "opening up" the economy, giving greater scope to private enterprise and to economic incentives. Reform of the sector is, therefore, possible at present. The 1985 Committee on Public Enterprise Reform prepared, on grounds of viability, "essentiality" and strategic importance, a provisional list of PEs which should be retained in the public sector (in their existing condition or substantially improved to render them viable) and those that should be divested through privatization or liquidation. This list was reviewed and modified by a high-level working group. The necessary reform program of the PE sector, including improvements, privatization and liquidation, should be based on the understanding that it will have to be a long-term process, and that enterprises retained in the PE sector must function efficiently. The reform process proposed below would include improvements in the PE sector overall institutional environment, and enterprise-specific improvements and actions.

xxxv. Institutional Reform: The operation of PEs as autonomous decentralized bodies requires that a balance be sought between managerial autonomy to enable enterprises to run efficiently and Government supervision to safeguard its ownership interest and to ensure that its objectives are being attained. To achieve this balance, a reformed system must be instituted, to perform certain functions which are necessary to PE-Government relations and successful PE operations; such functions are currently not being performed

at all or are performed unsatisfactorily (irregularly, partially or with arbitrariness). These functions include setting PE objectives, planning and budgeting to attain these objectives, monitoring of operations by the Government, and ex post, performance evaluation. Fulfilling these functions should serve as the basis of institutional reform of the PE sector. PEs supervision should stay within their present parent ministries and current supervisory functions exercised by the Ministries of Finance and Planning and the Magistrate of Accounts should be retained. However, these functions should be more rationally distributed and better performed, and greater managerial autonomy should be given to PEs. It will be a difficult task to build up such institutional capabilities. It may be advisable to use the existing small PE unit in MI as a pilot operation, to develop its ability to first monitor a few enterprises in Mogadishu, and then gradually expand its supervision to the remaining IPEs.

xxxvi. The Ministry of Finance (MF) should take the lead in designing and coordinating the reform program for all PEs. MF should be endowed with the kind of persuasive and implementation authority required, and the unit dealing with reform upgraded. The inter-ministerial task force on PEs, or the more recent high-level working group on PEs should be made into a ministerial level steering group on reform. The legal framework, which presently suffers from having been repeatedly patched-up rather than thoroughly revised, needs comprehensive review. Legal and regulatory instruments must give the proposed institutional framework authority and link it to operating principles.

xxxvii. Framework for IPE Reform Enterprise specific measures should emphasize those in greatest difficulty. To start with, IPEs can be classified into (a) those of uncertain economic viability, (b) those which can be made viable with urgent rehabilitation, (c) those not in serious difficulty at present. The mission made a tentative classification along these lines. Work on privatization can proceed concurrently with rehabilitation.

xxxviii. IPEs in category (a) could include the petroleum refinery, the urea plant and the Kismayo meat factory. The refinery, due to small size and obsolet. design, loses significant amounts of foreign exchange compared to importing the finished product. The urea plant is also too small and uses the untested process, and is affected by severe and prolonged "teething" problems. The Kismayo meat factory faces a depressed market, problems of local supply and general disrepair of systems and machinery. These enterprises should be carefully examined for basic economic soundness, and unviable ones should be closed down, or used for some other purpose.

xxxix. IPEs in category (b) have shown poor performance recently, yet seem to be worth rehabilitating if they can be run more efficiently. These may include: Foundry and Mechanical Workshop; Cigarette and Match Factory; Somaltex; Aluminum Utensils; Snai-Jowhar Sugar; HASA Km. 7 Tannery and Shoe Factory. Rehabilitation may involve changes in ownership status in some cases.

x1. The third category of IPEs are operating relatively satisfactorily, though some suffer from weaknesses and all need improvements of various types. The scarcity of resources deems that these IPEs should be

provided only with the sector-wide improvements noted above and a general liberalized environment. This category includes: Pasta and Flour Mill, Juba Sugar, Snai-Biasa and the State Printing Agency.

xli. Among the enterprises mentioned above, GOS has classified the following for privatization: Somaltex, HASA Km. 7 Tannery and Shoe factory, Foundry and Mechanical workshop, Aluminum Utensils factory and Snai-Biasa. Preparatory work for privatization of ownership or management can commence concurrently with rehabilitation, especially for Snai-Biasa and the Pasta and Flour factory which are not in need of major attention. Studies to estimate the sales value of all these enterprises can be commissioned and a search for potential buyers or managers begun.

Summary of Recommendations

xlii. Public enterprise reform is the most urgent area of concern in the industrial sector. Without immediate attention the drain on the Treasury or the banking system to support IPE losses, will continue and the physical plant of IPEs will deteriorate rapidly. At the same time policies to develop the private sector, on which the future growth of industry in Somalia depends, should be implemented. The PE reforms and policy changes should include:

- Public Enterprises:
 - o diagnostic studies for liquidation of non-viable IPEs followed by action;
 - o valuation studies for IPEs to be privatized followed by action;
 - o rehabilitation of remaining IPEs accompanied by (i) training for managers and technicians in IPEs and supervision staff at MI; (ii) price decontrol; (iii) adjustment of real wages and salaries; (iv) adjustment of IPE taxation to equalize it with the private sector; and (v) change of the institutional and legal structure for IPE supervision.
- Policies:
 - o allowing private sector banking and liberalizing interest rates;
 - o rationalizing and simplifying tariffs and other import duties;
 - o delicensing investment and review of the tax code and foreign investment regulations to facilitate investment; and
 - o improvement of price policies in agriculture and livestock; decontrol of export monopolies and distribution of imports; and improvement of power supply and transportation.

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CHAPTER I

INTRODUCTION

A. Economy

1.01 Somalia is a fairly large but sparsely populated country with a population of 5.8 million. It is among the poorest countries in the world with a per capita income of US\$260 in 1984. During the 1970s Somalia's real GDP fluctuated considerably, but it was no larger in 1980 than in 1972, while population increased by 2.6 percent p.a. It has been in a critical economic situation for a number of years, with large budgetary and balance of payments deficits, high rates of inflation, near zero domestic savings and large external debt and service arrears. As the crisis deepened, the Somali Government made a major shift in policy beginning mid-1981. It launched a stabilization program to curtail demand expansion and provide incentives to the productive sectors by exchange rate adjustments, fiscal and monetary restraint, increased interest rates and substantial increases in producer prices. Real GDP rose by 6.4 percent p.a. in 1981 and 1982; the overall budget deficit decreased from 17 percent of GDP in 1978-80 to less than 10 percent in 1981-83; and the inflation rate fell from 59 percent in 1980 to 23 percent in 1982.

1.02 Real GDP growth fell to 4 percent and inflation increased to 36 percent in 1983 as drought conditions adversely affected agricultural production and a Saudi ban on cattle imports from Somalia, its main export, led to a severe shortage of foreign exchange. The Government decided not to implement additional policy measures, including devaluation, liberalization of trade and price controls and financial restraint. As a result, the financial crisis worsened in 1984; the budget deficit grew to 23 percent of GDP, the external position deteriorated and inflation reached a record 92 percent. Faced with this declining economic situation, the Government adopted a major adjustment program for 1985 under a new IMF Stand-by Arrangement, which came to an end in September 1986. The official exchange rate was devalued by 28 percent in foreign currency terms and a free foreign exchange market was established for most non-Government transactions; the two rates were to be unified by the end of 1986. Quantitative export and import restrictions were virtually eliminated, most price controls were dismantled and fiscal and monetary measures to constrain demand were implemented.

1.03 Despite these improvements, serious weaknesses remain in the Government's financial management and control. Fiscal and monetary policies have not succeeded in stabilizing the economy. The trade gap and budget deficit are quite substantial, while inflation is running at 40 percent p.a. The exchange rate has not yet been unified and little progress has been made in public enterprise reform. While most trade and price controls have been dismantled, there are still some products, including hides and skins, frankincense and myrrh, that remain under Government control.

B. Industry

1.04 At independence in 1960, Somalia inherited a very small industrial base. There was only one large industrial establishment, the sugar mill at Jowhar, and a few medium-sized plants--three fish processing factories, a printing and publishing house, a furniture making unit, a tannery and shoe factory, an edible oil mill and an electric power station. In the early 1960s, the economy was run on free market system, with little Government intervention of any kind. However, the First Development Plan, covering 1963-67, sought to expand the industrial base by establishing state-owned and operated medium- and large-scale industries while not discouraging the private sector; eleven new industrial enterprises were established, in the public and private sectors, before the 1969 revolution. In 1970, the new Government formally announced its adherence to "scientific socialism" which relies on development through public sector ownership of the commanding heights of the economy. Three waves of nationalization followed between 1970 and 1972, leaving most of industrial production, distribution, banking and insurance under the Government's purview. In addition, the Government made several new investments in industry, largely based on the processing of agricultural products (fruits, vegetables, sugar and cotton), livestock and fish to substitute for imports and create export possibilities. By 1978, the public sector was responsible for about 80 percent of both value added and employment and 95 percent of gross capital formation in industry.

1.05 During the 1970s Somalia's industrial sector drew heavily on the Government's development funds and resources of the financial sector. From 1974 to 1978, industry accounted for 27 percent of public investment expenditure, and between 1976 and 1980, industry received 21 percent of total loans and advances. About 60 percent of the loans provided by the Somali Development Bank, the primary source of long-term finance, went to industry during the 1971 to 1982 period. Manufacturing value added of the formal sector (over five employees) grew in real terms through most of the 1970s, reaching a peak contribution of 3.8 percent to GDP in 1978, still remaining a very small sector. The number of establishments rose to a peak of 375 in 1974, with about 10 percent being large, publicly-owned companies and the rest small private sector enterprises. About 84 percent of manufacturing value added in 1978 was in the production of consumer goods, mostly food (39 percent), beverages and tobacco (12 percent) and textiles (17 percent).

1.06 Since the late 1970s, however, the performance of the industrial sector, especially public enterprises, has been dismal. By 1984, capacity utilization in public enterprises was down to an average of 26 percent and the sector's contribution to GDP dropped to about 1.6 percent, only 39 percent of its value in 1978. In per capita terms this amounts to US\$0.8 (at the parallel market rate), one of the lowest in the world. The number of establishments declined steadily, reaching 161 in 1982 (27 public and 134 private). The decline was borne largely by the private sector, which lost 60 percent of its establishments in 1978-82, while the public sector lost only 20 percent. The private sector also cut back on employment, but the public sector took on more employees despite falling production. Total employment in formal manufacturing rose by 18 percent in 1975-82.

1.07 These developments in Somalia illustrate clearly the problems of industrialization in a small poor country with few natural resources, a very narrow capital base, direct Government involvement in industry, substantial Government policy intervention and an economy in disequilibrium for many years. The small population and low per capita income provide too small a market to achieve economies of scale in many products. Furthermore, the market is fragmented, with 50 percent of the population being nomadic and another 20 percent living on scattered agricultural holdings. Somalia's resource endowment is poor. Livestock, the main resource, accounts for 80 percent of total exports and provides 60 percent of the population with a living. Cattle, goats and camels are exported on the hoof to the Gulf states where cultural traditions limit the market for processed meats. Hides and skins are exported in a wet or dry salted state, but distribution and price controls have limited the development of this industry. Some aromatic gums are also exported. Apart from this, Somalia does not grow or extract anything in quantities that can meet domestic consumption or find foreign markets. Scarcity of technical and managerial skills and experience is a major constraint which has been accentuated by migration to the Gulf states. Shortage of capital is endemic with the domestic savings rate at below 2 percent of GDP. The core public investment program is financed entirely by foreign grants and loans.

1.08 The Government's direct involvement in industry through the 1970s was in relatively simple technologies, intended to exploit local agricultural and other resources. It was in the early 1980s that some sophisticated, capital-intensive projects were undertaken. However, even the early investments were too demanding of managerial and technical resources for the public sector to handle, especially in an environment of economic disequilibrium. As a consequence, these industries have fared badly, sustaining huge losses. They have utilized low levels of their capacity and their products are expensive and of poor quality. The Government protected industry by restricting and taxing imports and by compelling public enterprises to sell and buy from each other. Government intervention in management, pricing, distribution and employment and so on, worsened matters. Finally, the economic imbalances of the past six or seven years, with large budget and balance of payments deficits, high inflation and foreign exchange shortages, have made it difficult for industry to survive in spite of some liberalization implemented by the Government. Future prospects for industry in Somalia depend on stabilizing the economy and implementing policies that will provide stable incentives for a competitive and efficient industrial sector to grow as well as ensure a supply of skilled managerial and technical manpower. Meanwhile, public enterprises will have to be reformed to become more efficient, privatized or liquidated, and the private sector prepared to respond to the new incentives based on market forces.

CHAPTER II

STRUCTURE, PERFORMANCE AND EFFICIENCY

A. Size and Growth

2.01 There are two sources of estimates for manufacturing contribution to GDP: Industrial Production Surveys (IPS) and GDP Statistics, both from the Ministry of Planning. The IPS data show a considerably lower manufacturing contribution to GDP than the GDP Statistics data. The difference exceeds the estimated amount of informal sector activity, which is included in GDP Statistics but not in IPS data. The IPS data appear to be the more reliable because they are based on actual returns filed by all formal sector enterprises; these are used in Table II.1. The share of formal manufacturing in GDP reached a peak of 3.8 percent in 1976 and 1978, and declined sharply thereafter to 1.7 percent by 1982. If the informal manufacturing sector produced another 0.8 percent of GDP (using other low income countries in the region as a guide, its contribution to GDP is around 20 percent of the formal sector), the total share of manufacturing would reach 4.6 percent in the peak years. By this reckoning, it declined to 2 percent by 1982.

Table II.1: SOMALIA - CONTRIBUTION OF MANUFACTURING SECTOR TO GDP (1975-82)
(So.Sh. m.)

	1975	1976	1977	1978	1979	1980	1981	1982
GDP (Factor Cost, Current)	3,943	4,578	5,373	6,356	6,730	12,421	17,622	24,808
Formal Sector Value-added (current)	118	174	118	241	234	417	335	423
As % of GDP	3.0	3.8	2.2	3.8	3.5	3.4	1.9	1.7
Formal Sector V.A. (1977 prices)	150	193	118	220	172	192	107	110
Growth of Formal Sector (%) (constant terms)	-	29.2	-39.0	86.0	-21.6	11.5	-44.3	-3.0
Share of Public Sector (%) in V.A.	78.0	82.3	78.0	78.4	77.8	85.6	76.0	84.6
No. of Ests. (of which, public)	288 (84)	255 (37)	257 (33)	262 (38)	242 (32)	152 (22)	140 (28)	161 (27)

Source: Ministry of National Planning and Industrial Production Survey (various).

B. Capacity Utilization

2.05 Capacity utilization, calculated on a one shift basis, is officially estimated at 26 percent for 23 public sector firms in 1984, down from 33 percent in 1983. Of these firms, 6 had no production in 1984 (4 operating plants closed down and 2 have yet to go into production after prolonged teething problems); 6 had utilization rates of 10-20 percent, nine between 21 percent and 40 percent, and only two of 41 percent to 60 percent (none were over 60 percent). Comparable data on the private sector are not available, but examples suggest only a slightly better performance.

2.06 The situation had not improved much in 1986, despite the ongoing partial liberalization of the foreign exchange market. This may be so for three reasons. First, most intermediate input imports are currently provided under aid-financed Commodity Import Programs (CIPs), which the Government sells at a significantly lower foreign exchange rate than the free market rate. This policy induces manufacturers to wait for cheap imported inputs even at the cost of idle capacity. Second, to the extent that public enterprises have a captive market in each other, they may be reluctant or unable to raise selling prices sufficiently to buy inputs at the free market rate. Third, inputs purchased at the free market rate, about twice as expensive as CIP inputs, appear to render much of Somali industry unable to compete with imports. Recent trade liberalization removed most quantitative restrictions on imports, and evasion and smuggling tend to dilute the effects of import duties. All these factors contribute to capacity underutilization, in turn further raising costs and reducing competitiveness.

C. Investment Patterns

2.07 The industrial censuses in Somalia do not provide any data on the stock of fixed capital in manufacturing. They do, however, show yearly additions to fixed capital. The subsectoral and ownership distribution of additions during 1975-82, in total (current prices) and per employee (employment in 1982) are shown in Appendix I, Table 6. In these eight years, the total current value of additions to fixed assets in the formal sector came to So. Sh. 910 million, of which 87.4 percent was accounted for by the public sector. The largest investment in this period was made in the food industry (Juba Sugar in 1981-82), followed by textiles (Somaltex). The tobacco firm comes next, followed by the cement plant, the Government printing press and the tanneries. In the private sector, furniture, chemicals, metal products and beverages received the largest additions to fixed assets. In terms of investment per employee, and bearing in mind that the public sector greatly expanded its employment while private sector contracted, the former's investment was much higher than the latter's. The most capital-intensive activity in the public sector was textiles, while in the private sector it was furniture.

D. Structure of Output and Value Added

2.08 The structure of formal sector manufacturing output has changed noticeably since the early 1970s (Appendix I, Table 2). However, because of large falls in the real value of activities, it is difficult to discern any clear pattern. In 1971, food processing accounted for 81 percent of the

2.02 For 1983-84, production data are only available for the 27 public sector manufacturing units (Performance of the Somali Economy in 1984, Ministry of National Planning, 1985). Their value added rose by 4.3 percent in 1983, then declined by 19 percent in 1984. If these trends are extrapolated to the entire formal sector, which is predominantly public, total manufacturing value added in 1977 prices comes to So. Sh. 93 m. in 1984, 1.6 percent of GDP, and only 39 percent of its peak value in 1978 (Appendix I, Table 1). The GDP statistics, by contrast, show the manufacturing contribution at a peak of 6.9 percent in 1980, down to 6 percent in 1982, and 5.1 percent in 1984. In per capita terms, manufacturing value added in 1984 lay between US\$2.7 (at the official exchange rate) and US\$0.8 (at the parallel market rate), one of the lowest in the world.

2.03 The share of the public sector in industrial value added fluctuated between 76 percent and 86 percent during 1975-82. In the same period, its share of employment rose from 62 percent to 82 percent, and it accounted for 87 percent of total additions to fixed assets in industry. While Somalia did not, for the most part, go for large, capital-intensive, sophisticated industrial projects until the 1980s, even its early investments, intended to exploit local agricultural and other resources, were too demanding of managerial and technical resources for its public sector to handle. As a consequence, they never developed beyond the technologically simple, first-stage assembly or packaging phases. These industries stayed high cost and uncompetitive, and were unable to raise their productivity over time. The private sector was confined to a marginal role, and chose even "easier" activities (essentially mixing, assembling, packaging and selling imported components, or making traditional products like apparel, footwear and furniture); however, it too suffered from widespread inefficiency.

2.04 High levels of protection against imports were needed to sustain this structure, which was unable to produce any manufactured exports. Protection was given partly by restricting and taxing imports, partly by compelling public enterprises to sell to and buy from each other. The country's major resource, hides and skins, was exported predominantly in non-manufactured form; as such, it did not provide a basis for industrial growth. Until 1984, unrealistic exchange rates also held back potential export activities. Government intervention in management, pricing, wages and employment, worsened matters. Infrastructure was weak, and power supply failed to keep up with industrial needs. In the 1980s, Somalia entered more demanding activities (petroleum refinery, urea plant, and in the near future cement and pharmaceutical plants). Projects already completed ran into problems very quickly, partly because of import and infrastructural constraints, and partly because of inherent operating difficulties and skill shortages. Thus, the combination of some poorly chosen projects, policy interventions, high dependence on imported inputs, poor management and unreliable infrastructure led both to sharp fluctuations in industrial activity as well as to its rapid decline in the 1980s. The foreign exchange problem was the most immediate cause of declining production, but the other factors played a major underlying role.

total, and consumer goods were 95 percent of the total while producer goods were only 5 percent. By 1974, the share of food had dropped sharply to 55 percent, while producer goods rose to 19 percent (though some of the items classified here, like toiletries under chemicals and some "others," could be consumer goods). The decline in the share of food continued until 1982, when, because of very low production, it contributed only 19 percent of total output. Beverages and tobacco showed a large increase after 1977, mainly because the public sector cigarette factory boosted its turnover by selling imported cigarettes. Textiles showed a healthy expansion until 1977, then lost their share as the main producer (Somaltex) ran into operating difficulties. Leather and footwear never exceeded 4 percent of total output despite Somalia's large supply of hides and skins; their share declined steadily as the state agency in sole charge of collecting hides and skins (HASA) paid progressively lower real prices to producers, and so provided less raw material to HASA's own tanneries and to other tanneries, while encouraging smuggling.

2.09 The share of chemical output shot up after 1980 as the public sector refinery came on stream. By 1984, however, this share had declined dramatically as a shortage of crude petroleum reduced the refinery's output to 12 percent of its 1981 figure. Plastics production practically disappeared in the 1980s. The metal products industry in Somalia reached 2 percent of the total by 1982. It is small and engaged in very simple assembly or fabrication activities. There is no mechanical engineering sector to speak of. The lack of basic mechanical engineering skills is a major weakness of Somali industry. It means, not only that the country remains entirely dependent on imports for the simplest tools, parts, replacements or technical "trouble shooting" services, but also that routine operation or maintenance of plant is often deficient. The Government did set up a plant, the Foundry and Mechanical Workshop, to serve as the hub of development of mechanical engineering activities in Somalia, but it has turned in a dismal performance.

2.10 The structure of value added by ownership in 1975 and 1982 is shown in Appendix I, Table 3 and Table II.2 below. The public sector accounted for 76 percent and 85 percent of total industrial value added in those two years. Its predominance increased considerably in consumer goods, mainly because of the large trading profits made by the Cigarette and Match Factory in 1982, while the private sector suffered a loss in this same sub-sector. The public sector also dominated in food, textiles, printing and publishing and, in 1982, in chemicals. It accounted for less than half of total value added in 7 subsectors in 1982. Of these, its share has increased during 1975-82 in 3 (apparel, leather and footwear, metal products) and decreased in 3 (furniture, pottery, china, etc., and "others"); it never undertook jewelry manufacture. With this last exception, however, the spread of public sector activities is striking. In 1982, the most important sources of value added in the public sector were tobacco, printing, food (mainly sugar), chemicals (refined petroleum) and textiles, while in the private sector they were china etc. (mainly structural clay), food (mainly bakeries), wooden furniture, metal products (again mainly furniture), chemicals (mainly soaps and toiletries) and apparel. Overall, the private sector appears to show a transformation from consumer to producer goods over the 1975-82 period, but this is mostly due to the negative value added in domestic prices for beverages in the latter year.

**Table II.2: SOMALIA - VALUE ADDED IN ORGANIZED MANUFACTURING ^{a/}
BY OWNERSHIP, 1976-82
(So.Sh. million)**

	1975	1976	1977	1978	1979	1980	1981	1982	% change 1976-82
Total V.A. (current)	118.3	174.1	118.0	241.4	243.1	416.5	334.5	422.6	257.2
Total V.A. (1977 prices) ^{b/}	149.7	193.4	118.0	219.5	172.1	191.9	106.9	110.1	-28.6
Public Sector (current)	89.9	143.8	89.7	189.2	182.1	356.5	264.1	357.6	297.8
Public Sector (1977 prices) ^{b/}	113.8	159.2	89.7	172.0	183.9	164.3	81.2	98.1	-18.2
Private Sector (current)	28.4	30.8	28.3	52.2	52.0	60.0	80.4	65.0	128.9
Private Sector (1977 prices) ^{b/}	35.9	34.2	28.3	47.5	38.2	27.8	25.7	17.0	-52.6
Share of Public Sector (current)	76.0	82.3	76.0	78.4	77.8	85.6	76.0	84.6	

Source: General Directorate of Statistics, "Industrial Production Survey" (various).

Notes: a/ All establishments with 5 or more employees.

b/ The price deflator used is the manufacturing GDP deflator of the Ministry of National Planning.

2.11 Table II.3 shows subsectoral changes in value added in the public and private sectors during 1975-82, furnishing detail to the growth figures presented earlier. The public sector declined more in producer goods than consumer goods, while the private sector did the reverse (because of negative value added in beverages). Overall, six sectors showed increases in value added, and eight showed declines. The public sector had six instances of decline (including two of complete demise, plastics and china). The private sector also had six cases of decline (but no deaths). The erratic distribution of growth or decline is evidence of the unsettled and shallow nature of the Somali industrialization process, with widespread Government intervention and exogenous shocks exerting very large impacts.

**Table II.3: SOMALIA - CHANGE IN MANUFACTURING VALUE ADDED, 1975-82
BY SUBSECTOR AND OWNERSHIP
(Percentage)**

Subsector	Public	Private	Total	Subsector	Public	Private	Total
Consumer Goods	-12.7	-72.8	-25.5	Producer Goods	-41.7	-6.4	-29.8
Food	-68.8	-58.4	-67.2	Paper	Infinite	-	Infinite
Beverage, Tobacco	473.5	-195.2	151.9	Chemicals	1700.0	-28.1	205.4
Textiles	5.0	-58.5	-8.7	Plastics	-100.0	Infinite	-99.2
Apparel	400.0	10.0	28.6	China, Clay etc.	-100.0	23.5	-44.7
Leather, Footwear	38.4	-52.6	-32.7	Metal Prods.	Infinite	52.6	110.5
Furniture	-71.4	20.0	-12.8	Other	-95.8	-70.8	-87.0
Printing, Publishing	-44.3	-	-44.3				
Jewellery	-	50.0	50.0				
Total Manufacturing					-18.2	-62.6	-26.5

Source: Appendix Table 3.

Note: Value added at 1977 prices.

E. Size Distribution

2.12 The size distribution of formal sector industrial establishment in 1982 is shown in Appendix I, Table 4. Establishments are grouped into 6 sizes by employment, and various characteristics of each group are shown. Table II.4 below summarizes some features of these groups. It shows a heavy bias towards the largest plants (100 plus employees): these 23 units account for only 13 percent of the total number of establishments, but for 82-89 percent of total employment, wages and output. Of these large establishments, 19 (83 percent) are in the public sector, in which the dominance of the largest plants is even greater (93-96 percent of employment, wages and output). In the private sector, both ends of the size distribution are important, accounting for the largest shares of employment, wages and output. Average wages per employee show an unusual profile by size of establishment (Appendix I, Table 4). The smallest units, which would normally be expected to pay least, in fact pay the second highest wages, after the largest plants. The six smallest public sector plants (all of which are in water supply or power generation, which could not be separated from manufacturing activity for the analysis of size) pay over twice the average industrial wage. In the private sector, wages tend to rise with size, except for the group with 50-99 employees which shows an inexplicable dip. Employment and wages are described further below.

Table II.4: SOMALIA - FEATURES OF MANUFACTURING ESTABLISHMENTS BY SIZE, 1982
(Percentages)

	Size Distribution by Employment						
	5-9	10-19	20-29	30-49	50-99	100+	Total
No. of Establishments: Total	55.4	9.6	7.3	9.6	5.1	13.0	100.0
Public	14.0	4.7	4.7	20.9	11.6	44.2	100.0
Private	68.7	11.2	8.2	6.0	3.0	3.0	100.0
Employment: Total	4.4	1.7	2.3	4.9	4.9	81.8	100.0
Public	0.3	0.3	0.5	3.0	3.5	92.5	100.0
Private	26.5	9.6	12.1	15.2	12.2	24.3	100.0
Total Wages: Total	3.0	1.0	1.7	3.0	2.5	88.8	100.0
Public	0.7	0.2	0.3	1.2	2.2	95.4	100.0
Private	20.8	7.3	12.9	18.5	4.1	38.4	100.0
Output: Total	4.5	2.1	1.8	3.9	2.5	85.2	100.0
Public	-						
Private	0.5	1.5	1.8	96.1	100.0		
	27.0	12.4	8.7	15.8	6.0	32.0	100.0

Sources: 1982 Industrial Production Survey, Ministry of National Planning, 1986.
Note : These data include 16 public sector water supply and power generating plants.

F. Employment and Wages

2.13 While value added declined by over one-quarter in 1975-82, total employment in the formal manufacturing sector increased by 18 percent. The public achieved by shutting down loss-making establishments and firing employees in operating plants, while public enterprises expanded employment even when making losses. Appendix I, Table 5 shows the subsectoral breakdown of employment and wages in the two years for public and private firms. The largest employer in the public sector is the food industry, which nearly doubled its labor force when its value added fell by 69 percent. This is followed by textiles, printing and publishing, tobacco and chemicals. In the private sector, the largest employers are chemicals, food, beverages, furniture and leather and footwear.

2.14 Public sector wages were on average 1.8 times higher than private wages in 1975, and exceeded them in every subsector except for furniture. By 1982, public sector wages were 21 percent higher than private wages, and private wages were higher in six activities. However, the Somali economy had suffered a large decline in real wages during this period, and the average total industrial wage had fallen (in 1977 prices) from So. Sh. 6.2 thousand per annum to So. Sh. 3.9 thousand, a decline of 37 percent. Public sector wages had fallen by 49 percent and private sector by 20 percent. Thus, by cutting total employment more or less in line with production, the private sector had succeeded in preserving real wages better than the public sector. After 1984 it appears that the public sector was permitted to shed some labor and raise wages, but in 1986 there still appears to be gross overmanning, and real wages were still abysmally low. Skilled labor received around US\$20 per month while a top Somali engineer got around US\$40-50 (converted at the free market exchange rate of So. Sh. 150 to the dollar). Private sector wages had reportedly exceeded public sector wages by 1986, but were still very low by international standards (for instance, skilled labor in India receives over US\$120 per month and engineers around US\$300 per month in organized industry, and India is reckoned to be a very low-wage country).

2.15 While the availability of labor at such low wages constitutes a potential source of competitive advantage to Somali manufacturing--if it had the other attributes needed to set up and run efficient industries--there are several offsetting factors. First, labor morale is extremely low, absenteeism is rampant, and there is tremendous slack in work practices. Second, the quality of the work force is poor. Formal education levels are low, in quantity and quality, in-house training by enterprises is weak and the low wage levels are a major disincentive to the accumulation of skills, both at educational establishments and in the workplace. Finally, there is a massive outflow of qualified labor to the Gulf. This deprives Somali industry of the best trained and most enterprising of its workers and professionals. It is evident that any reform of Somali industry would have to simultaneously raise salary levels significantly and cut a substantial part of the public sector labor force. Over the longer term, the quality of employees would have to be raised at all levels, not just by providing higher remuneration, but by training, education and tighter discipline.

3. Productivity and Efficiency

Productivity

2.16 The low degree of capacity utilization and widespread Government controls and intervention make it difficult to gauge the real productivity of Somalia's industry. The normal measure, value added per employee, does not correctly show underlying relative productivities under these conditions. Nevertheless, no better measure is readily available. Appendix I, Table 7 shows total value added and non-wage value added per employee, by ownership and subsector, for 1975 and 1982. Both measures declined by about 40 percent between 1975 and 1982, and the decline is entirely accounted for by the public sector. Indeed, if the anomalous negative value added in private sector beverages and tobacco in 1982 is removed, then the private sector would actually show an increase in both measures. This corroborates both the better adjustment of the private sector to difficult economic circumstances and the ability of the public sector to continue operations in spite of declining profitability and productivity. Only three subsectors out of twelve for which data exist for 1975 and 1982 show an increase in both total value added and nonwage value added per employee; these were apparel, furniture and jewellery. However, these subsectors represented a mere 4 percent of manufacturing output in 1982.

Efficiency

2.17 The data and reports on Somalia's industries suggest widespread inefficiency in the industrial sector. Visits to plants and lack of manufactured exports corroborate this view. The only concrete evidence, however, is contained in a Harvard Institute for International Development (HIID) study¹ of Somalia's industrial sector, commissioned by USAID, and completed in 1985. The study team conducted a firm level survey, collected adequate data from 27 firms to calculate effective rates of protection (ERP) for all, and domestic resource cost (DRC) ratios for 15. The sample, which covered a wide spectrum of activities² in the public and private sectors, and about 10-15 percent of sectoral output, was not scientifically designed. While no definite conclusions can be drawn from the results, they are nevertheless indicative of the state of the sector.

¹/ "Quantitative Analysis of Incentives and Disincentives for Expansion of Industrial Output and Employment in Somalia", Cambridge (Ma.), July 1985 (mimeo).

²/ Food & beverages (6), textiles & apparel (3), leather and footwear (3), furniture (2), chemicals (4), plastics (3), clay products (1), metal products (3), other (2).

2.18 ERP results will be discussed in an appropriate section below. Before reporting the DRC results, however, some general insights into the efficiency of the sector can be gained from the measurement of value added at world prices, the denominator for the ERP ratios, for all 27 enterprises. When an activity has negative value added at world prices, it means that it would cost Somalia less foreign exchange to import the final product than to import the inputs (or to use domestically produced tradeable inputs) and process them domestically. Value added can be estimated in two ways: not counting depreciation, thereby treating capital as a sunk cost, and including depreciation. Five out of 27 enterprises (see Appendix I, Table 8), close to 25 percent of the sample, show negative value added at world prices without taking depreciation into account. In other words, even if invested capital is treated as a sunk cost, these enterprises consume more foreign exchange in their current operation than they save by substituting for imports. It can be shown that the economy would be better off if these enterprises were closed. When depreciation is included in value added, another 7 enterprises acquire negative value added, making 12 in total, or about 40 percent of the sample.

2.19 DRC ratios are a measure of the economic efficiency of firms. They compare domestic factor costs at economic prices with value added, also at economic prices. A DRC less than one indicates that an activity is economically profitable--in the absence of Government policy this activity would produce more than enough value added to remunerate labor and capital. Alternatively, it would suggest that Somalia has a comparative advantage in a product because factor costs incurred in its manufacture are less than the direct foreign exchange earnings or savings. Summary results are presented in Table II.5 below.

Table II.5: SOMALIA - SUMMARY RESULTS OF DRC ANALYSIS
OF 15 ENTERPRISES
(No. of Firms)

DRCs	Infinite	10.0	5-10	1-5	0.5-0.9	0.1-0.5	Total
L/Term	11	1	-	2	-	1	15
S/Term	2	-	-	1	6	6	15

Source: HIID, op. cit. See Appendix I, Table 8 for details.

2.20 When the full opportunity cost of capital is taken into account (long-term DRC), 11 of the 15 enterprises show negative value added at world prices and therefore infinite DRC ratios. Three of the remaining four show DRC ratios of about three or more, meaning that it costs Somalia at least three shilling's worth of domestic resources to save a shilling's worth of

foreign exchange. Only one enterprise (construction) appears highly efficient, costing the economy only 14 cents in domestic resources per shillings worth of foreign exchange saved (but the HIID study suspects under-reporting of capital costs in this case). When invested capital is treated as a sunk cost (short-term DRC), two enterprises (leather and metal products) still display infinite DRC ratios. An additional enterprise (metal products) still appears inefficient. The remaining twelve appear quite efficient and there is a case for keeping them operating in the short-run, as long as no new investment is needed. Whether they merit remaining in operation over the long-run depends on the Government pursuing policies that encourage enterprises to make efficient use of capital invested in future replacement and expansion.

2.21 In summary, the survey results indicate widespread inefficiency in a sector that has been officially promoted (although still very small) and allowed to exist by virtue of a long standing policy of high protection for domestic production. Some of these investments are not economically viable in Somalia at present and would not have been made in a less distorted incentive environment. Now that they have been made, it would save Somalia foreign exchange to close a few down. Others should continue in operation, but under an incentive structure that demands efficiency. Any further investment needed to rehabilitate these enterprises should be evaluated carefully against the use of those funds elsewhere in the economy.

2.22 What accounts for this dismal state of Somali Industry? The Somali Government's own assessment mentions most of the relevant factors: inappropriate investments; shortages caused by foreign exchange scarcity (fuel oil, spares, raw materials and intermediate inputs); migration to the Gulf of skilled manpower; poor training and overemployment; poor technical and operational management; inadequate preventive and normal maintenance; low wages, lack of productivity-based incentives; lack of autonomy in management of public sector establishments; and a taxation system which does not provide public enterprises with sufficient retained earnings for equipment balancing, replacement or modernization.³

H. Technology

2.23 The technological factors affecting the performance of Somali industry include, not only the choice of techniques which are overly capital intensive in relation to Somalia's given factor endowments (because of wrong prices attached to capital in relation to labor and to imports versus domestic goods), but also the general shortage of technological capabilities to assess and implement industrial investments, operate them efficiently, improve them over time and link them to the rest of the economy. As far as the choice of production technique was concerned, all the equipment was imported as was the process technology for all except the very simple or small-scale activities. While this may have led to some deployment of relatively modern capital-intensive techniques (e.g. the use of shuttleless looms in Somaltex), in most activities the techniques were not obviously inappropriate. Leather processing, metal working, furniture making, construction materials manufacture or garment making employed simple,

^{3/} Ministry of National Planning, Performance of the Somalia Economy in 1984, Mogadishu, 1985, pp. 136-37.

relatively unsophisticated techniques. Where more mechanization was employed (some food processing like large-scale bread or pasta manufacture, printing, cigarette making, chemicals), it is likely that scale and quality considerations made the use of more capital-intensive techniques necessary.

2.24 If the choice of industry and technique was not too unsuitable for a country starting to industrialize, why does the evidence suggest such gross inefficiency? Apart from the shortage of imported inputs, spare parts and power supplies, two sets of technological factors are responsible. First, the lack of scale economies in some activities (petroleum refining, urea, textile spinning and possibly the cement plant). Second, and more fundamental, the widespread lack of technological and managerial capabilities at all stages of the industrial process. In the setting up of new plants, the absence of local project design and implementation capabilities led to several cases of expensive delays, the use of obsolete technologies and prolonged running-in problems. In the operation of received technologies, there existed inadequacies in the capabilities required for maintenance, quality control, production and process knowhow, training, etc. These represented the most serious single handicap to efficient industrial operation in Somalia. Over time, Somali enterprises also failed to adapt and improve their facilities, further reducing their competitiveness as raw materials, market demands, technologies and equipment performance changed. The industrial structure remained shallow and import-dependent as the original manufacturers did not develop the ability to transfer technology to potential local suppliers and subcontractors.

2.25 These different technological capabilities are the basis of long-term efficient industrialization in any country. Their tremendous scarcity in Somalia, and the absence of evidence that two decades of industrialization have led to their accumulation, have far-reaching implications of industrial strategy. The existing industrial structure is inefficient and costly, not just because of exogenous events or infrastructural deficiencies, but also, perhaps mainly, because of inherent shortages of the requisite kinds of technical and managerial skills. The shortages are traceable to the initial socioeconomic conditions and historical background of the country. They afflict the private sector as well as the public, though the former is perhaps better placed in managerial terms since it enjoys greater autonomy and faces more market discipline. Privatization and liberalization in general will not of themselves provide a solution to the fundamental problem of technological incapacity: what they will provide is a more competitive setting where the incentives to accumulate the capabilities are present, and the direction in which technical effort is directed is a healthy one.

2.26 As it stands, however, the needs of the Somali industrial sector vastly exceed the supply of technical and managerial manpower required to run it with some degree of efficiency. Expatriates can fill a part of the gap. But expatriates are expensive. They cannot provide the large middle-ground of expertise between shop-floor workers and top managers, and they are necessarily temporary. The only viable industry Somalia can support over the long term is that which Somalis themselves can operate effectively, given realistic estimates of the additional trained manpower which can be produced or attracted back in the time horizon set. However, increasing the supply of technological skills may be worth little unless macroeconomic, ownership and financial sector policies are geared to efficient growth.

I. The Private Sector

2.27 The private sector played a very marginal role in manufacturing for the past 15 years but, since the move towards liberalization, it has become the hope for future development of industry. Somalia has a tradition of commerce, and a reasonable stock of experienced traders who could have formed a viable entrepreneurial class in industry. Many may have been daunted by the waves of nationalization, lack of financing available, cumbersome controls, including investment licensing, foreign exchange allocation procedures, price controls, labor codes and finally, poor banking and insurance services and infrastructure. Others may have been pre-empted from investing because of direct Government involvement in industry during the 1970s.

2.28 In spite of these difficulties, a sizeable number of entrepreneurs did take the initiative over the years to set up first-stage manufacturing activities. Some learned to prosper within the regulatory system but substantial numbers have been driven out of business. Thus, during 1974-82, the private sector lost 60 percent of its establishments, when the public sector lost only 20 percent. The fall in value added was similarly disproportionate, with the private sector losing 53 percent in 1975-82 and public sector 18 percent. At the same time, the private sector was able to adjust to adverse circumstances better than the public sector precisely because enterprises could be shut down. By so doing, the private sector was able to maintain real wages and productivity relatively more than public enterprises, which carried more unproductive labor and could continue making a loss because they were supported by subsidies and other privileges.

2.29 Since 1980, when Government policies began to move away from socialism towards a market economy, the climate for the private sector has improved. Short-term and long-term financing was more readily available and many controls, including those on product and labor prices, were lifted. However, virtually all private industrialists interviewed said that they did not feel that the Government fully supported the private sector. The economy is in disequilibrium, inflation is high and access to foreign exchange is limited. Doing business in Somalia is still difficult. It still takes 2-3 years to start an enterprise. Licensing procedures, obtaining financing and foreign exchange are time consuming. There is no comprehensive national company law that governs business transactions: the North operates on Indian company law introduced by the British and the South on Italian. Once a business gets started, after the initial tax holiday, taxation exacts a heavy burden. Government monopolies in banking, insurance and transportation provide poor services and infrastructure is deplorable.

2.30 Until the present, the private sector has not responded to the new policy environment with increased activity. For instance, it has not taken advantage of the free foreign exchange market to increase capacity utilization, preferring to wait for foreign exchange allocation at the commercial rate of exchange. It is heavily protected through subsidized foreign exchange, import licensing that limits competitive imports and tariffs and other charges levied on imports, although this protection is vitiated where products can be smuggled in. The inefficiency of private manufacturers is corroborated by the HIID study, and it also faces the skill shortages that

confront public enterprises. However, this is still a transition period from Government intervention in every aspect of the economy to one that is more market based and liberal. Only when a market-based incentive structure and an open competitive economy have been in place for a few years, and supporting measures are undertaken to provide managerial and technological skills, will increased efficient private sector activity be forthcoming. In the meantime, expectations that the private sector will expand rapidly, especially if protection is lowered, are probably not realistic.

2.31 There has been some discussion of privatizing industrial public enterprises, partly to reduce direct Government involvement in industry, and partly to stem the drain on the exchequer caused by subsidies given to keep these enterprises operating. At the moment the capability of private business to take over existing public enterprises is limited. They do not have the management experience, technical expertise or finances to buy and operate the larger and more complex operations, except perhaps in one or two cases. Over time, as some entrepreneurs accumulate capital, expand their operations and acquire knowhow, they may be able to purchase some public enterprises and operate them efficiently.

2.32 Private foreign direct investment is largely absent in Somalia: in 1986, one German firm invested US\$500,000 and another Egyptian firm US\$200,000. Somalia is not a very attractive country to invest in, especially if protection is reduced and kept at moderate levels. However, whatever potential exists has not been properly exploited. Private foreign investment could fulfill a very useful function in providing a package of capital, technology, management and marketing. There are a couple of successful joint ventures between foreign investors and the Government--Somalfruit and GRP Products. This example could be followed by Somalia's private sector to their benefit.

J. Financial Sector

2.33 The Somali financial system comprises the Central Bank of Somalia (CBS), the Commercial and Savings Bank of Somalia (CSBS), the Somalia Development Bank (SDB), a postal savings system and State Insurance Company (SICOS), all Government owned. In 1970, all branches of foreign banks operating in the country were nationalized and reorganized over the years to provide for areas of credit specialization, and ensure compatibility of banking activities with economic policy objectives. Day-to-day banking operations are controlled by CBS, commercial banking activities by CSBS and term lending by SDB. In 1983, the law was amended to permit competition in commercial banking services, but no domestic or foreign institutions have yet been granted a charter.

Credit

2.34 While there have been changes in the level of interest rates in the past few years, they remain significantly negative in real terms. This diminishes the supply of savings for credit creation and encourages capital flight or conversion into real assets that appreciate with inflation. Indeed, as Table II.6 shows, between 1980 and 1984, total credit claims outstanding decreased by 47 percent in real terms.

2.35 Since 1980, as part of a strategy to promote private sector activity, a deliberate effort has been made by the authorities to curtail credit to public enterprises and make it available to the private sector. Between 1980 and 1984, the private sector increased its share of total credit outstanding from 11 percent to 39 percent, whereas parastatals decreased their share from 40 percent to 16 percent: the private sector received about two-thirds of all new credit while parastatals received virtually nothing. This is a welcome development after many years during which the Government crowded out the private sector from access to credit. Even now the Government still retains a total of 61 percent of credit outstanding, considerably higher than the 40 percent in neighboring Kenya. This share has to decrease further to facilitate long-term sustained development of the private sector. Furthermore, allocation of credit to the private sector continues to be based on connections rather than intrinsic creditworthiness of the borrower or the project and banking services are generally slow and poor. Allowing competition in the banking sector would help the private sector get access to credit and improved services, and result in a better allocation of resources.

2.36 As Table II.6 shows, most of the banking system credit goes to trade and this share has increased from about 50 percent during 1980-82 to 60 percent in 1983-84 because of import liberalization policies. Both industry and agriculture's shares declined as a consequence. Indeed, industry's share declined to 13 percent, about half of the earlier period, probably because demand also declined with decreasing investment and capacity utilization. Industry's share of long-term loans from SDB were just over 50 percent of total loan approvals between 1980-84. In the past two years virtually all of these loans have been for the private sector.

2.37 Negative real interest rates appear to be resulting in declining resource mobilization, inefficient allocation of capital, capital flight and perhaps currency speculation. This is a direct consequence of liberal import and foreign exchange policies with inappropriate interest rate policies and a monopoly in banking services. Interest rates, like the foreign exchange rate, should be determined by competitive market forces. The Government should move towards positive real interest rates and grant charters to encourage competition in commercial banking services. While the private sector has increased its share of credit considerably, it is still low for sustained long-term development. In any case, in the present economic environment, most of the private sector credit is used for trade rather than agriculture or industry. Breaking the Government's banking monopoly and changing interest rate policy will go a long way in promoting private sector activity in agriculture and industry, if supported by measures to rationalize tariff protection and enhance the supply of managerial and technical skills.

Table II.6: SOMALIA - FINANCIAL INDICATORS (1980-84)

	1980	(S)	1981	(S)	1982	(S)	1983	(S)	1984	(S)
Total Credit Claims Outstanding: a/ (So. Sh. millions, Current Prices)										
Private Sector	426	(11.0)	575	(12.6)	1,624	(32.3)	2,293	(43.5)	3,727	(38.8)
Public Entities	1,551	(40.0)	1,721	(37.9)	1,300	(25.9)	1,163	(22.1)	1,511	(15.7)
Government (Net)	1,903	(49.0)	2,250	(49.5)	2,100	(41.8)	1,805	(34.3)	4,378	(45.5)
Total	3,880	(100.0)	4,546	(100.0)	5,024	(100.0)	5,261	(100.0)	9,816	(100.0)
Total Credit Claims Outstanding (So. Sh. million Constant 1977 Prices)	1,790		1,450		1,308		1,004		955	
Commercial & Savings Bank Lending Lending Interest Rates: /	7.5-12.5		10.0-12.5		12.0-14.5		12.0-14.5		12.0-14.5	
Annual percent Increase in Mogadishu Consumer Price Index	59		45		23		36		82	
Distribution of Banking System b/ Credit by Activity (Percentages):										
Agriculture	15.6		21.9		23.2		18.5		14.3	
Industry	25.1		25.6		24.6		19.6		13.4	
Trade	53.0		47.8		48.8		64.1		59.3	
Other	6.3		4.7		3.4		3.8		13.0	
Somalia Development Bank, Share of Loan Approvals for Industry (Percentages)	52.0		52.0		73.0		56.0		57.0	

a/ Central Bank of Somalia.

b/ IMF, Recent Economic Developments (various issues).

CHAPTER III

POLICIES

A. Exchange Rate

1. Background

3.01 Somalia undertook a major reform of the exchange rate system at the start of 1985. The previous year had been one of severe hardship. Exports had plummeted as a consequence of a Saudi ban on livestock imports from Somalia, and foreign aid had declined while debt arrears had mounted. The Government had eased on its earlier stabilization efforts, leading to a trebling of the budget deficit, rapid monetary growth and an inflation rate of 92 percent per annum. The official exchange rate (So. Sh. 26 to the dollar in 1984) had become highly overvalued, and the parallel market rate had reached So. Sh. 80-100 to the dollar by the end of 1984.

3.02 A major adjustment program was adopted in 1985 under a new IMF Stand-by Agreement, in the formulation of which Bank staff had been closely involved. The official exchange rate was devalued by 38.5 percent to So. Sh. 36 to the dollar on January 1, 1985, and a free foreign exchange market was set up to handle most private transactions. A franco valutal¹ system, which had been re-introduced in 1984 as a means of easing the severe shortage of imports, was abolished. This was accompanied by the lifting of most quantitative controls on exports and imports and a virtual dismantling of the pervasive apparatus of price controls on private sector activity. Measures to control monetary growth, raise interest rates to positive real levels, reform public enterprises and reduce the budget deficit were anticipated.

3.03 It was also anticipated that the exchange rates would be unified at a market-determined rate by end-1985, following a progressive monthly devaluation of the official rate and a gradual transfer of items from the official to the free market rate. The official market handled all aid and debt transactions, military imports, petroleum imports and diplomatic expenditures, while the private market handled all private imports, some public enterprise imports and capital transfers. There was also a third market for foreign exchange administered by the Commercial and Savings Bank, used mainly for tourist receipts, overseas travel and educational expenditures and imports brought in under aid-financed Commodity Import Programs (CIPs). The commercial bank rate, set initially at So. Sh. 84 to the dollar (when the free market rate was So. Sh. 89), was supposed to change in line with the free market rate until the unification of all rates was achieved.

3.04 In the event, only some elements of this policy package were implemented in 1985. Monetary and fiscal targets could not be met and inflation was higher than expected. Foreign receipts fell far short of projections, causing external arrears to increase; the Standby was suspended as Somalia also fell into arrears with the IMF. Interest rates continued to be negative. The devaluation of the official exchange rate was slowed down, retarding the unification of the foreign exchange market as the free market rate depreciated. The commercial bank rate was not adjusted, and was still

1/ Imports purchased with the buyers own foreign currency resources.

at So. Sh. 84 per dollar until mid-1986. No transactions were transferred from the official to the free market. Tariff duties were charged at an artificially low rate rather than, as agreed, at the free market rate. Reform of public enterprises and the banking system was also delayed.

3.05 The IMF renewed its Agreement in early-1986 under a revised timetable. The official rate was devalued by 22 percent, from So. Sh. 42.5 to the dollar in December 1985 to So. Sh. 54.5 in January 1986, and was depreciated by So. Sh. 4 per month so as to reach parity with the free market rate by end-1986. The commercial bank rate was to be adjusted every 10 days in line with the free market rate. Private exporters had to surrender 50 percent of their export receipts at the official exchange rate (raised from 35 percent in 1985), with the remainder sold at the free market rate. By mid-1986, slippages had again occurred. The rate of inflation continued to exceed projections, and the official rate (at So. Sh. 91/US dollar by October) was still only 68 percent of the free market rate. The commercial bank rate remains unchanged. The interest rate remains negative in real terms--the commercial bank overdraft rate was 15-20 percent while prices were rising at around 40 percent per annum.

3.06 Under a World Bank initiative, most of the Agricultural Sector Adjustment Program (ASAP) credit of US\$70 million is being channelled through an exchange auction, which acts as a "wholesale" market for foreign exchange, usable for essential imports only. The commercial bank rate has been eliminated and the free market continues to function rather like a retail foreign exchange market. Bids at the auction can range from a minimum of US\$5,000 to a maximum of US\$200,000. Private and public enterprises (except Somalpetrol) and individuals can participate in the auction to purchase any imports except military equipment and luxury goods. The first auction was held on September 1, 1986, followed by others at 15-day intervals. The auction was temporarily suspended in mid-January 1987 until the foreign exchange pool could be replenished.² In the event, the exchange rate was not unified by the end of 1986. The official rate was So. Sh. 90.5 to the dollar; the auction rate was So. Sh. 113 to the dollar and the free market rate So. Sh. 140 to the dollar. The trend was, however, towards unification and a broadening of the auction market with additional funds as well as an enlargement of allowed importables will provide an improved basis for unifying the exchange rate in the future.

²/ The exchange rate system has changed twice while this report was being processed. The system described above continued until July 1987 when an enhanced auction was implemented to provide foreign exchange for all goods transactions that were previously financed through the limited auction and free market. Exporters received the auction market rate for their foreign currency earnings and importers purchased foreign exchange at that rate too. The auction rate moved rapidly from So. Sh. 134 to the USdollar in June 1987 to So. Sh. 159.8 by mid-September 1987. Because of the rapid devaluation, the Government decided to suspend the auction on October 18th, 1987 and fixed the exchange rate at So. Sh. 100 with a provision for a 40 percent retention of export earnings. This regime is still under review and may be changed in the near future.

3.07 Table III.1 shows the evolution of the various exchange rates in Somalia. The parallel market rate at end-1984 is also shown for comparison; this market almost disappeared when the free market was introduced, since the latter fulfilled all its functions more conveniently and legally. According to Somali authorities, a tiny parallel market still exists for illegal (contraband) transactions and for people who do not have the required US\$1,000 to open an external account, but its rates are practically the same as the free market rate. The free market rate started squarely in the middle of the parallel market range in January 1985. During the first six months (January-June), it depreciated by 9.9 percent, the next six months by 17.3 percent and, by 31.4 percent in the first six months of 1986. Over the period, while the rate of fall was fairly steady,³ it decelerated around the third quarter of 1985, then speeded up in 1986 (the greatest acceleration took place around April-May 1986). For the whole of 1985, the depreciation of 29 percent was more or less equal to the rate of inflation (around 30 percent). In 1986, the rate of inflation was around 37 percent p.a. but the rate of depreciation was only 22 percent, resulting in an appreciation in real terms.

Table III.1: SOMALIA - EXCHANGE RATES, DEC. 1984 - JUNE 1986
(So. Sh. per US\$ at end-period)

	Official Central Bank	Commercial Bank	Free Market Rate	Auction Market	Parallel Market Rate	Ratio of Free to Official Rates
1984 Dec.	26.0	-	-	-	80-100	3.1 - 3.8
1985 Jan.	36.0	80.4	89.0	-	-	2.5
" March	37.0	82.0	91.4	-	-	2.5
" June	40.6	84.4	97.8	-	-	2.4
" Sept.	40.6	84.4	100.7	-	-	2.5
" Dec	42.5	84.4	114.7	-	-	2.7
1986 Jan.	54.5	84.3	114.8	-	-	2.1
" Feb.	54.5	84.3	122.9	-	-	2.3
" March	58.5	84.3	138.6	-	-	2.4
" April	62.5	84.3	148.1	-	-	2.4
" May	66.5	84.3	152.9	-	-	2.3
" June	70.5	84.3	154.0	-	-	2.2
" July	74.5	84.3	150.8	-	-	2.0
" August	78.5	84.3	138.9	-	-	1.8
" Sept.	82.5	84.3	138.4	105	-	1.7
" Oct.	86.5	86.5	139.7	96	-	1.6

Source: Commercial Bank.

^{3/} A regression line fitted to 50 observations of 10-day average rates from January 1, 1985 to end-May, 1986, "explains" 86 percent of the variation in the rate. The mean value of the rate is 110.4, with a standard deviation of 20.

3.08 The free market rate differs by So. Sh. 2-3 from buyer to buyer, depending on the amount involved, with larger buyers getting better rates. The daily fluctuations can be quite substantial: in ten days of early June 1986, for instance, they ranged from 0.5 percent to 4.2 percent. Nevertheless, the month-by-month stability of the rate during 1985 was remarkable, in view of the fact that the free market was so new and relatively thin (about US\$2.6 m. per month in early 1985, US\$4.8 m. per month in late 1985 and the same in early 1986). It is also subject to seasonal fluctuation in the supply of foreign currency because livestock exports are affected by the "pilgrimage season", and demand also varies, depending on need to import food privately as food aid disbursements fluctuate. The main transactors, some 100 large livestock exporters and an unknown number of overseas remitters on the supply side, and some 30 large private traders on the demand side, thus showed an impressive ability (a) to smooth out cycles in supply and demand, and (b) to match the decline in the domestic purchasing power of the shilling. The thinness of the market did not appear to hamper the flow of information or the formation of expectations of the main actors.

2. Structure of the Free Foreign Exchange Market

3.09 The free market is fed by the retained portion of private export receipts and remittances from abroad: these are channelled through two separate accounts--export accounts and external accounts. The same person may have both accounts, but foreign exchange earned by exporting cannot be transferred to an external account. Export accounts can only be used, by the exporter or anyone else, for payments for legitimate imports of goods and services, by transferring the money to an import account. External accounts are supplied, on a "no questions asked" basis, with foreign exchange from overseas residents or Somali traders. These holdings can be used either for imports of commodities or for transfer of capital overseas.

3.10 The external account market serves three functions besides transferring remittances to Somalia. First, since exporters have to surrender half their foreign exchange at the official rate, they face an implicit tax of 27 percent compared to a unified free rate, and have an incentive to underinvoice their exports and bring the money via external accounts, so evading the penalty. Second, since capital can be transferred abroad freely by anyone holding an external account who buys exchange from another external account holder, this submarket has taken over the capital flight function of the parallel market. The fact that the free market rate did not start off above the parallel rate in January 1985 suggests either that the parallel market was relatively riskless and efficient, or that the desired portfolio adjustment of wealthy Somalis between domestic and foreign currency had largely been accomplished by then, or both. Third, real interest rates continue to be negative in Somalia while they have been positive and relatively high in the Middle East and developed countries, making it attractive to borrow in Somalia for investment overseas.

3.11 The depreciation of the shilling has been led by the external-account submarket, where rates tend to be slightly higher (i.e., more shillings to the dollar) than the export/import-account market. In January-

May 1986, of the total of US\$21.7 m. worth of transactions in the free market, US\$11.9 m. or 55 percent was sold from the external account market, US\$2.6 m. or 12 percent from export accounts and US\$7.1 m. or 33 percent from import accounts (the last two being usable only for imports). It is reasonable to believe that the recent pressures on the value of the local currency have been fuelled by a change in the underlying fundamentals, that is, an increased budget deficit and credit expansion.

3.12 In 1985, the imports of commodities financed by the free market came to US\$42.9 m. Of this, food, beverages and tobacco accounted for 40.1 percent, construction materials for 33.8 percent, and transport equipment (largely passenger cars) for 12 percent. Industrial inputs (raw materials, machinery and spares) accounted for only 17 percent of imports (US\$7.4 m.), a large part of which (around US\$5 m.) was imported directly by the Government. Thus, the liberalization of imports and foreign exchange has predominantly led to the meeting of affluent consumer and urban construction demands rather than to increasing the use of installed industrial capacity. Industrial enterprises prefer to wait for much cheaper allocations of imports under CIPs (at the commercial bank rate). This appears to be the more profitable alternative even though it leaves a lot of unutilized capacity. The reluctance to resort to the free market implies the inability to compete or sell at those prices. The evidence adduced towards the end of Chapter II supports this interpretation.

3. Effects of Exchange Rate System

3.13 The complex system of exchange rates in Somalia during 1985-86 has had a mixture of beneficial and harmful effects. The beneficial effects are that the move towards a market-determined exchange rate, however halting, has helped exporters (except producers of hides and skins, frankincense and myrrh, whose prices are controlled), reduced administrative control over a section of the import market and virtually eliminated the parallel market.

3.14 The harmful effects stem from the complicated way in which liberalization is taking place, including the existence of multiple exchange rates. First, the penalty imposed on exporters has induced underinvoicing⁴ of exports and has enabled underinvoicing of imports. The free market has made this circuit easier because importers no longer have to obtain exchange illegally. As a result, the Government loses tariff revenue and local producers have their protection diluted. Second, multiple exchange rates have created competitive distortions between firms with differential access to imports at the lower rates. Multiple exchange rates have also had a negative impact on production: the greater the perceived probability of future allocations at the cheaper rate, the greater the expected loss from purchasing now at the free market rate. This encourages intermittent production and low levels of capacity utilization. Third, the external account system, in combination with domestic inflation and negative real interest rates, has encouraged capital flight.

⁴/ A calculation by the IMF from partner country trade data shows that in 1984 Somali exports were valued at US\$62 m. by Somalia and US\$123 m. by the importers. The difference of US\$61 m., as large as declared exports, was presumably kept abroad for capital flight or remittance via the parallel market.

B. Trade Regime

3.15 1. Imports. Until the end of 1984, Somalia had the usual mixture of quantitative restrictions and tariffs on imports that characterizes early import-substituting industrialization efforts. Import tariffs had been set up for revenue purposes rather than as a coherent protective device, and contributed nearly half of total Government revenue. As part of its Stand-by Agreement with the IMF, Somalia dismantled practically all its quantitative restrictions on trade in early 1985. However, the export of ivory and hides and skins required prior approval. The import of military equipment and items related to its manufacture, narcotic drugs and morally offensive literature was banned, while the import of alcohol, tobacco, petroleum, medicines, explosives, precious metals and minerals was subject to prior approval.

3.16 The taxation of imports is made up of three main elements:⁵

(i) Import duties: These are comprised of customs and fiscal duties. Together they range from 4 percent to 700 percent of CIF values. The structure is roughly in accordance with an equity principle and an import-substituting trade strategy. Capital goods are wholly exempt and some recurrent inputs are also exempt, but this depends on administrative discretion, and neither the criteria employed nor the incidence of exemptions is clear. Goods that an average urban consumer needs are charged duties of 30-50 percent, though some items (soft drinks, soaps, garments) are in higher brackets to protect domestic production. Luxury goods like toiletries, alcohol, durable consumer goods are charged the highest duties (large cars 123 percent, audio and video equipment 147 percent, soaps 171 percent and spirits 700 percent).

(ii) Administrative and Statistical (A&S) Duty: 20 percent of CIF value.

(iii) Stamp tax: 2 percent of all other taxes and harbour dues (but not CIF value).

3.17 The weight of all these additional charges varies with the level of import duty. At the extreme import duty values of zero and 700 percent, the extra charges add 24.1 percent and 59.6 percent respectively to C.I.F. value. As a proportion of total official costs to the importer, additional charges vary from 100 percent when import duty is zero to 7.8 percent when import duty is 700 percent.

3.18 Apart from the various official duties and charges noted above, the Somali importer has to bear the following supplemental charges: (1) port handling and transportation; (2) freight forwarding and insurance; and (3) "rents" collected by persons who can accelerate customs clearance and influence the level of charges collected. The first two charges are for services provided by state monopolies and are regarded as expensive. A USAID audit of 2 shipments under their CIP revealed that the sum of port-related and extra-port direct costs fell between 10 percent and 20 percent of C.I.F. cost for 6 out of 12 shipments, and between 25 percent and 50

^{5/} These data are drawn from the HIID report (op. cit.).

percent for the remaining 6. The weight of these costs varies erratically between different products, further distorting the impact of the tariff structure.

3.19 The protective effect of tariffs and other charges is, however, diluted by three factors: (1) the Government uses an artificially low rate of exchange (So. Sh. 60 to the dollar) for tariff purposes, even if an import is transacted at the market exchange rate (see para. 3.13). Thus, at present, the impact of all ad valorem duties is diluted by about 55 percent; (2) there appears to be widespread evasion of import duties by underinvoicing imports and by assigning them to categories with lower duties. The customs authorities try to check declared prices against a price list, but this list is not comprehensive and tends to become outdated quickly because it is denominated in shillings; and (3) there is a considerable amount of smuggling of consumer goods, for instance, garments, pots and pans, cigarettes, etc.

3.20 The net protective impact of import duties and supplemental charges, together with other Government policies can be measured by the effective rate of protection (ERP) received by each firm or product. This ratio focuses on the protection an enterprise receives for its value added (revenue from sales of tradeable outputs minus costs of tradeable inputs). In other words, it takes into account not only the effects of policy on protecting final output, but also the effects of protecting inputs to production. The ERP is the ratio of value added at market prices to value added at economic (world) prices. Divergence between domestic market and world prices of tradeable inputs occur when taxes, customs duties and charges and price control affect the prices received for the output or paid for the inputs of the firm. A positive ERP indicates that the firm is receiving a net positive protection from the combination of policies influencing the costs of material inputs and sales revenue; a negative value indicates that the firm is receiving a net disincentive. An infinite ERP means that the value added at world prices is negative. In other words, the foreign exchange cost of manufacturing a product domestically exceeds the foreign exchange cost of importing the finished product: the country is giving up more foreign exchange to manufacture a product than it would to import it as a finished good.

3.21 The results of the HIID survey mentioned earlier are summarized in Table III.2 below and presented in detail in Table 8 in Appendix I.

Table III.2: SOMALIA - SUMMARY RESULTS OF ERP ANALYSIS
OF 27 ENTERPRISES
(Number of Firms)

ERP	Infinite	100 %	50-100 %	25-50 %	0-25 %	Negative	Total
Gross	5	6	6	4	2	4	27
Net	9	3	1	2	2	2	20

Source: HIID (op. cit.)

3.22 Value added at world prices was measured in two ways: by not including depreciation as an input (gross value added), and by including depreciation as an input (net value added). Data were available to calculate ERPs on gross value added for all 27 firms but for only 20 firms on net value added. Apart from activities with infinite protection, which have negative value added at world prices and lose foreign exchange (discussed earlier), two other aspects of the protection structure are notable. First, there is a wide dispersion of ERPs across enterprises, resulting from the patchwork combination of protective tariffs, sporadic access to subsidized foreign exchange, undervaluation of imported inputs, partial exemptions from tariffs on inputs and price controls on output. Second, firms in the same subsector receive widely differing rates of protection. Seven of the eleven subsectors surveyed are represented by at least three enterprises. ERPs observed for 6 of the 7 subsectors span at least 3 of the ranges in Table III.2; coefficients for 4 subsectors--food products, textiles and apparel, leather and tanning and construction materials--span at least 5 ranges; and firms in textiles and apparel and construction material span all 6 ranges, i.e., from negative to infinite ERPs. Such a diverse range of protection, among and within subsectors, provides widely different incentives for different activities and firms, resulting in a substantial misallocation of resources. Incentives should be equal among activities and for individual firms to ensure that investments are attracted into lines of production that earn or save the maximum amount of foreign exchange.

3.23 There is a strong case for a thorough reform of the import regime in Somalia. The present structure is largely geared to generating revenue. It is complicated, allows for arbitrary use of discretionary powers and does not encourage efficient resource allocation. The regime needs to be simplified and made more transparent to minimize or eliminate the use of discretionary powers. Protection should be more uniform among activities (except for luxuries and undesirable items) to ensure that resources are allocated to the most efficient uses and there is no differential in incentives. These changes can probably be made with little loss in revenue to the exchequer and also minimal dislocation because the industrial sector, especially the private sector, is very small. There is an opportunity to lay the foundation for the future development of an efficient private industrial sector.

3.24 2. Exports. Somali industry hardly exports anything at present, but it is possible that it may develop exports in local-resource based products like processed fruit, vegetables, meat or fish and leather products. Exports of wet blue hides and skins and finished leather have been prevented by the monopoly power exercised by the Hides and Skins Agency (HASA): as a monopsonist buyer it offers low prices for hides and skins thereby encouraging smuggling to Kenya and creating a shortage for processing; it has a monopoly in exports of processed hides and skins which has prevented some private tanneries from exporting wet blue hides and finished leather of better quality than HASA's. There appear to be no existing policies to promote manufactured exports. However, the main barrier is less the

absence of export incentives than the backwardness of the productive structure. The present incentive structure, by protecting industry, makes production for the domestic market much more profitable than exports. This bias is reinforced by the foreign exchange retention scheme which penalizes exporters, and the lack of duty drawback or excise tax rebate schemes for exports. It is important to establish incentives that do not discriminate against exports, to lay the foundations for the growth of export-oriented industries.

C. Trade Regulation and Price Controls

3.25 Trade regulation and price controls are often linked: trade regulation, that limits competing imports, can create monopolies and monopsonies which are powerful enough to charge uneconomic prices; in many instances, Governments impose price controls to regulate their domestic market power. In either case, the prices are not determined by competitive market forces and may impose a cost to society. When the prices of outputs are controlled they act as a disincentive to production and can result in lower production or investment, or in a growing parallel market. When prices of inputs are controlled they are an inducement to production, but shortages of inputs result, thereby disrupting production and raising costs.

3.26 Trade regulation and price controls were pervasive in Somalia through the 1970s and early 1980s. By 1982 it was becoming clear that these measures were having little effect other than to compound shortages and divert goods to the parallel market. Implementation of price control was eased and, from January 1985, dismantled, except for public enterprises. These enterprises are, however, a large part of the economy, especially of the industrial sector. Of the 15 public industrial enterprises surveyed by the mission, at least 7 had to sell their production at Government-set prices. In several cases, for instance cigarettes and pasta, they are below CIF levels. The Cigarette and Match Factory, the only enterprise legally entitled to import or produce cigarettes and matches in Somalia, is discouraged from expanding output by buying additional inputs at the free market rate because of its low sales prices. As a result, capacity utilization is very low and 70 percent of domestic demand is supplied by smuggled imports even though many consumers apparently prefer the domestic product. The state Wheat Flour and Pasta factory enjoys a privileged position in the distribution of wheat, imported under food aid arrangements, at a price based on the official exchange rate. However, this advantage is outweighed by the controlled low sales price. As a result, the pasta factory is discouraged from expanding output.

3.27 Other industrial enterprises, according to officials of the Ministry of Industry, are supposed to set output prices to cover costs and provide for a suitable (about 8-10 percent) return on investment. It is not known what level of capacity utilization is assumed in calculating unit costs or whether assets are revalued in accordance with devaluation and/or

inflation to calculate depreciation. Administered prices could be an incentive if they provide a return on investment at very low capacity utilization, or a disincentive if they deprive enterprises of resources needed to maintain and replace their fixed assets.

3.28 Virtually all industrial enterprises consume petroleum, either directly or indirectly. The National Petroleum Agency and the Petroleum Refinery have monopolies in the procurement, distribution and refining of petroleum. The authorized sale price of petroleum products is based on the official exchange rate, resulting in an implicit subsidy, due to the considerable difference between the official and free market exchange rate. The subsidy this provides to Somali industry is offset by the shortages that result from excess demand at the official price. While manufacturers who obtain petroleum at the official price gain, many others, that have to pay an artificially high parallel market price, suffer. Such differences in prices among enterprises for the same product make for an inefficient allocation of resources.

3.29 Trade regulation and price controls are costly to administer, cumbersome and have a damaging impact on business activity in Somalia. Production has suffered in several industries and there has been a loss in foreign exchange from potential exports of hides and skins, wet blue hides and finished leather. Parallel markets have been created resulting in differential incentives between activities and firms depending on access to the official or parallel markets. Such interventions should be lifted to allow competition in production and trade, and prices should be based on market forces. There will undoubtedly be a net gain in efficiency and foreign exchange, and an opportunity to develop the leather industry, one in which Somalia probably has a comparative advantage.

D. Taxation

3.30 In the Somali tax system, private and public enterprises are taxed differently. Private companies are taxed at a flat 35 percent of their income. The income tax rate, even without exemptions, is within normal limits, and probably at the lower end of corporate income tax rates worldwide. The Minister of Revenue is entitled to exempt from taxation (1) domestic private enterprise net income up to 10 percent return on investment for a period not exceeding ten years; and (2) foreign private enterprise net income for a period not exceeding five years. No list of exempted companies was available. In addition, the Minister can also exempt industrial companies from income tax up to 40 percent of undistributed profit or 25 percent of chargeable income, whichever is lower, provided that amount is set aside for reinvestment. It is not known whether this exemption has ever been applied.

3.31 According to Law No. 58 of 1972, all public enterprises are subjected to three main taxes: (1) a turnover tax of 50 percent on profits; (2) an income tax of 30 percent; and (3) a depreciation tax of 50 percent.

It was the intent of the law that the turnover tax would be assessed on gross sales but, in practice, it is applied to income, making the total income tax rate 80 percent (the law is in the process of being changed to reflect actual practice). Such a high rate of income tax is a strong disincentive for declaring profits. Similarly, the 50 percent tax on depreciation is a disincentive to revaluation of enterprise assets in line with devaluation and inflation, to make adequate provisions for replacement. A proposed amendment to the tax law will eliminate the depreciation tax and reduce income tax to 35 percent, in line with the tax rate for private enterprise. However, the Minister of Revenue will be able, at his discretion, to require payment of up to 80 percent of income--the present rate for public enterprises.

3.32 In addition to income tax there is a sales tax of 5 percent levied on most items and an ad valorem excise tax applied to a large range of products. Rates of excise tax vary from 100 percent for cigarettes and alcoholic beverages, to 80 percent for matches and wine, 60 percent for sugar and 5-20 percent for other consumer goods. There are also local taxes and a stamp tax. These taxes add to the price of products, thereby lowering domestic sales and profits, and rendering manufactured goods uncompetitive with goods that escape taxation--smuggled goods and household produced goods--further lowering their profitability.

3.33 The tax structure is complex and includes too many discretionary exemptions that can create differentials in incentives. It should be simplified and standardized. The private sector income tax rate is within reasonable limits but public enterprises are taxed too heavily; they should be treated equally with private enterprises, especially in view of potential privatization or autonomous operation of public enterprises as suggested in the reform program (see below). The Government has to balance its short-term revenue needs with long-term growth objectives. Finally, there is no scheme for rebating excise and other taxes, or indeed customs duties, for exporters of manufactured goods. While there are no sizeable exporters at present, this could deter new entrants.

E. Labor

3.34 Until recently, hiring and firing of labor was controlled by the Ministry of Labor. Wages were set according to a Government grading system which was applied to industrial public enterprises regardless of the scarcity value of skills needed for particular jobs. All secondary school leavers were guaranteed employment and 90 percent of industrial public enterprises employees were permanent staff who had to be paid even if the factory was idle. This led to overmanning, poor morale, absenteeism and very low productivity.

3.35 In 1983 the employment guarantee for school leavers was dropped and, in 1984, Law No. 26 increased the freedom of private and public enterprises to hire and fire, set wage rates and implement incentive programs.

According to the Ministry of Commerce and Industry, Law No. 26 requires enterprises to obtain permission from the Ministry of Labor when they hire or fire but, in practice, this is never denied. Private sector businessmen interviewed by the mission agreed with this assessment. They basically keep the Ministry of Labor informed of their actions and are occasionally asked to justify lay-offs and wage rates at the low end. The evidence is that the private sector has been able to retrench and maintain productivity to adjust to the difficult economic circumstances of the past few years.

3.36 In theory industrial public enterprises also enjoy the same freedom. Each factory is supposed to negotiate with its employees three-year collective contracts that include incentive programs. In practice, however, only a few public enterprises have taken advantage of the new law. Most enterprises still retain a full complement of staff even though their capacity utilization is below 25 percent. In some cases this may be justified because wage rates are very low and capacity utilization is expected to increase. In other cases unjustified overmanning continues and could adversely affect prospects for privatization or improvement in efficiency.

F. Licensing

3.37 The Ministry of Industry is empowered to issue industrial licenses to private investors. There are no regulations which prescribe the sectors which private industrialists can enter, though certain activities (alcohol) are totally forbidden. The Ministry is supposed to advise potential investors on the economic feasibility of their proposals and to review their studies. In theory, it guides entrepreneurs towards agro-based and small-scale labor intensive activities. In practice, the advisory and evaluative capabilities of the Ministry are limited. In 1985, about 150 applications were received and 40 were approved. Many applications were not adequately formulated and some were rejected because the projects were too import-intensive.

3.38 The process of obtaining licenses used to be lengthy and cumbersome. The recent reforms are supposed to have changed that but there are complaints that the process is still slow and arbitrary. After an industrial license is granted, the Ministry helps the investor get free land from the local Government. The Somali Development Bank provides up to 75 percent of the investment as long-term credit for local resource based industries, and up to 50 percent for other projects. The import of capital goods is authorized by the Ministry of Commerce.

3.39 As the economy moves towards liberalization, industrial licensing should become simply a registration procedure, rather than a selection process through which the Government gives guidance or entitlement to special benefits. The private sector should be allowed to respond to competitive market forces, assess the risks involved in starting a business and proceed when it sees an opportunity. The entrepreneur then bears the entire responsibility for the success or failure of the venture. This will get the Government out of the business of picking winners and avoid kickbacks and

influence as important determinants of business success. However, the most important constraint on the growth of the private sector is not the licensing system, but the entrenched state monopolies that control distribution of hides and skins, transportation, banking and insurance.

3.40 Regulations affecting foreign private investment are specified in Law No. 7 of January 29, 1977 on Foreign Investments. Under this law, the Ministry of Finance is authorized to grant total or partial exemption from import and export duties, excise and income taxes and municipal levies for up to five years for "productive enterprises". Licensing decisions must be conveyed to the foreign investor within 60 days of the receipt of the application. For "productive enterprises", interest, profit and loan repayments are transferable abroad up to the amount of 30 percent per annum of the original capital invested plus reinvested profits and interest. Unused transfer rights can be carried forward for the next three years. Capital brought in is transferable abroad in the same currency after five years (in exceptional cases, three years) from the date of registration. For "non-productive enterprises", transferred profits cannot exceed 10 percent of capital invested in shares or loans.

3.41 There has been very little foreign industrial investment since this law was enacted, largely because of the overall economic situation. However, the incentives and guarantees offered are less favorable than some other countries (e.g., Mauritius) which have been more successful in attracting foreign capital. A revised law, which offers better terms to foreign investors, has been approved and will be made public shortly.

G. Recommendations

3.42 The main recommendations made in this chapter are summarized below. The thrust of the recommendations is to move the incentive structure for industry away from being administratively determined by the Government to one that relies on automatic, across the board incentives and competitive market forces. Where it remains necessary for the Government to intervene, that intervention should be transparent, simple and not create differential incentives between activities and firms:

- there should be one market determined exchange rate and no foreign exchange retention limits imposed on exporters;
- the discretion exercised by the Ministry in issuing import licenses should be curtailed. Import tariffs should be simplified and rationalized to provide uniform and reasonable protection for domestic production while garnering adequate revenue for the Government. The bias against exports of manufactures should be removed by implementing an export compensation scheme;
- interest rate structure and levels should be market determined or, at least, be changed towards being positive in real terms and not discriminate between borrowers. Competition in banking services should be allowed by granting charters to private sector banks;

- the remaining price controls on public enterprises should be removed and competition allowed in the distribution of commodities now monopolized by the Government;
- the tax structure should be simplified and discretionary exemption minimized. Private and public enterprises should be taxed equally; and
- the industrial licensing process should be simplified and made automatic. Regulations governing foreign investment should be amended to be made the same as those for domestic investment and competitive with other countries.

CHAPTER IV
PUBLIC ENTERPRISES

A. Introduction

4.01 There are about 45 public enterprises (PE) in Somalia that report to 11 ministries (Table IV.1) and play a paramount role in each of their sectors. About eighteen of these PEs, representing a sizeable proportion of the total assets in the PE sector, report to the Ministry of Industry (MI). This chapter's main emphasis is on the performance, present condition and need for reform of these industrial PEs. However, the institutional and legal structure that governs their operations also affects that of other PEs so it is difficult to restrict the discussion to industrial public enterprises. It is important to review the institutional and legal arrangements governing PE operations at present because the Somali economy is in transition from an economy with considerable direct Government involvement, to a market based economy with much less intervention. The situation of all PEs, especially industrial PEs, has to change to allow competitive market forces and the private sector to play a larger role in production and distribution. This chapter presents a: (1) brief overview of the evolution, performance and recommended reform of the PE sector; (2) description of the legal and institutional arrangements governing PE operations and their supervision by the Government; (3) report of the survey of industrial PEs conducted by the mission--their financial performance and main problems; (4) proposal for the reform of the legal and institutional structure governing PEs; and (5) proposal for the reform of industrial PEs.

B. Overview of Somalia's Public Enterprise Sector

1. Evolution of PEs in Somalia

4.02 Public enterprises in Somalia originally included a small number of entities created by the Government largely because the private sector was not considered capable of the relatively large investments required. This includes companies such as Somaltex and the Los Koreh fish factory which were set up in the 1960s. The 1961 constitution (Article 86) envisaged PEs as agents of decentralized state activity, along with bodies established for social purposes (e.g., Social Security Fund, CASS) and cultural-educational purposes (e.g., National Theater, National University). There were also a number of mixed companies in which the Government had a partial ownership, such as National Banana Board, Jowhar Sugar Factory (with Italian interests), Somali Airlines (with Alitalia owning 49 percent), and others. Although considered PEs, these enterprises operated as independent companies and were managed accordingly. This situation continued through the 1960s.

Table IV.1: SOMALIA - PUBLIC ENTERPRISES GROUPED BY SUPERVISING (PARENT) MINISTRY

Parent Ministry	Enterprise
Agriculture	Agricultural Development Corporation (ADC) Farm Machinery and Agricultural Services (ONAT) Somalfruit (formerly National Banana Board)
Industry	Somaltex Sail Jowhar Complex Cigarette and Match Factory Juba Sugar Kismayo Meat Factory Aluminum Utensils Factory Sopral Meat Plant Berbera Cement Asbestos Sheet Roofing Gypsum Plant Somali Pharmaceutical Industry Mogadishu Urea Plant Foundry and Mechanical Workshop Edible Oil Mill Hides and Skins Agency (HASA) Mogadishu Petroleum Refinery Mogadishu Milk Factory
Commerce	National Petroleum Agency (distribution) National Trading Agency (ENCE)
Somalia Development Bank	WBB Wheat, Flour and Pasta Factory
Information	Somali Film Agency State Printing Agency
Public Works	National Electric Energy Authority (ENEE) Public Construction Agency (PCA) Somali Consulting and Engineering Agency
Health	Agency for Production and Distribution of Drugs (ASPIMA)
Air and Land Transport	Trading Agency for Vehicles and Spare Parts (WAGAD) Somali Airlines Somali Transport Agency
Fisheries and Marine Transport	Somali Marine Products (Kismayo Fish Factory) Lee-Qoreh Fish Factory Somali GRP Products Co. (boat building) Somali Shipping Line Somali Shipping Agency Somali Port Authority Canda'a (Fish Canning) Haba (Cold Storage)
Water and Mineral Resources	Kismayo Water Agency Hargeisa Water Agency Mogadishu Water Agency
Tourism	Various hotels
Cooperatives	ITOP Brick Factory

4.03 The 1969 revolution provided a new ideological underpinning for the PE sector by adopting scientific socialism as the guiding development doctrine. The Government embarked on a program of reorganizing the economy on a socialist model; PEs were regarded primary as "engines of growth", intended to help in achieving that goal. Their number was greatly increased through several successive waves of nationalization: one in 1970 which covered the banking system, electric power, the sugar industry, banana exports and petroleum products distribution; a second in 1972 covering retail sugar distribution, the printing industry and publishing companies; and a third in 1975 covering the import and distribution of motor vehicles, agricultural machinery, building materials, textiles and appliances, electric and electronic products, and others. These nationalizations, as well as new investments, increased the PE sector during the 1970s to well over 50 enterprises. The new 1979 Constitution (Article 41) defined the public sector of the economy as the "vanguard of the country's economic development", to be given special priority over the other sectors which are cooperative, private, and mixed state-private. Public enterprises have come to dominate the modern sector of the economy, totally controlling the banking, insurance and wholesale trade sectors, and accounting for the major portions of the business services, tourism, export, and manufacturing.

IPE Financial Performance in the 1970s

4.04 PEs' operating performance has been mixed. Their objectives are not clearly spelt out, but include that they (i) be self-financing; (ii) produce for domestic consumption and export; (iii) contribute to foreign exchange earnings through import substitution and export promotion; (iv) create employment; and (v) contribute to Government revenues. There is no clear indication as to how the Government of Somalia (GOS) ranks these objectives and what trade-offs it is willing to make when objectives conflict. This fact, and the lack of proper financial and operating records, make the evaluation of public enterprise performance difficult.

4.05 Enterprise profitability is the key to PEs' ability to be self-financing and to contribute to Government revenues. A 1976 Bank study found that most manufacturing enterprises were consistently losing money while trading enterprises were on a declining trend. Reasons cited for this disappointing performance included high tax and interest burdens, detrimental pricing policies and practices, low capacity utilization and weak management. Only the financial sector, benefiting from high levels of short-term borrowing by the trading and manufacturing enterprises, showed a good profit performance. Later data collected during the 1980 Bank mission indicate little change in, and perhaps a worsening of, the profit situation. Accounts available for 1977 and 1978 showed continuing losses for a number of firms, and eroding profits or a reversal of a previously profitable position in other firms. The only really profitable enterprise outside the financial sector was the flour and pasta factory. Major problems affecting the manufacturing enterprises were loss of markets; declining supplies of domestic agricultural raw materials; lack of managerial and technical skills; and lack of spare parts and obsolescence of equipment, both due in part to foreign exchange constraints. Since the 1970s, financial performance appears to have worsened even further. This is borne out by the data presented in Chapter II earlier and the June 1986 survey of industrial PEs conducted by the mission.

The Beginnings of Reform

4.06 The need for, and commitment to, PE reform was initiated in the 1985 Stand-By Agreement with the IMF. This served as an impetus for GOS to set up a high-level committee to look at various aspects of PE operation and strategy. Its report was not published but appears to have led to active consideration of the possibilities of divestiture and other means of rationalizing the PE sector. The report was followed up with a survey in 1985 which classified PEs into those to be retained in the public sector and those that could undergo some degree of divestiture, (this classification is summarized on Table IV.5). Also, a few joint-venture arrangements were made starting in 1983, among them Somalfruit, which was formed from the former wholly GOS-owned National Banana Company, as a joint venture with private Italian interests.

C. Legal and Institutional Framework

4.07 PEs in Somalia are officially divided into three categories: autonomous agencies, financial enterprises and public companies. Each is subject to its own legislation although the instruments of that legislation present certain gaps in some respects while overlapping in others.

Autonomous Agencies

4.08 Autonomous agencies (AA) is the term used by Law No. 16 to designate wholly Government-owned non-financial public enterprises. This is the basic law issued by the new revolutionary Government of Somalia in April 1970 to govern such agencies. It provides inter alia that each AA: (i) should be established through a separate law which would lay down its objectives; (ii) shall function under the supervision of a competent Ministry; (iii) shall be subject to having its accounts audited by the Magistrate of Accounts; and (iv) may appoint the personnel it needs subject to Government directives.

4.09 Law No. 16 also provided for each AA to be headed either by a General Manager who would be both Chief Executive Officer and Chairman of the Board of Directors, or by a General Manager who would operate without a Board. A few months later (September 1970) this provision was cancelled by Law No. 56 which ruled instead that AAs would only be headed by General Managers reporting directly to their supervising Ministry.

4.10 Three weeks after Law No. 16 was promulgated, Decree 74 obliged each PE to establish a management committee, chaired by the General Manager, with the Personnel Manager as ex-officio member, but otherwise heavily weighted towards representation of lower-level workers, and a labor committee consisting of elected staff members. The former was to participate in preparing and executing the PEs' programs while the latter, as further provided by Law No. 19 (February 1977), is entitled to "fully participate" in decisions on production and administration including contracts, procurement, labor relations and other staff matters, and the annual budget. In 1984 Law No. 65 decreed that labor committees should no longer participate in annual budget preparation. While the actual degree of active participation in these matters by the committees has varied widely among

PEs, their overall impact on management does not seem to have been substantial. Further important legal instruments include Law No. 58 (July 1972), "Finance of Public Enterprises and Agencies" and Law No. 17 (April 1974) which defines the substantial powers of each supervising Minister concerning the operations of PEs placed under his supervision.

Financial Enterprises

4.11 Financial enterprises include the State banks and insurance company. They are excluded from Law No. 16 and are subject to their own regulations on management structure and authority, and on staffing. They are not further discussed here.

Public Companies

4.12 Public companies include (i) PEs which constitute a joint venture between GOS and private or foreign capital (e.g., Somalfruit, now 60 percent private Italian capital) or (ii) wholly GOS-owned PEs for which special separate laws have been promulgated (e.g., GRP Products). There is no unified legislation that applies to all public companies. Joint ventures are subject to the commercial section of the Civil Code. Other than that, there is still no company law for joint stock companies;¹ the North is reported to use a code similar to Indian (based on British) commercial law, and the South, one based on Italian commercial law. However, both types of public companies are subject to audit by the Magistrate of Accounts. They are also subject to general ministerial supervision but are excluded from the specific powers of the supervising Minister decreed in Law No. 17. They are not subject to the profit distribution authority of GOS as established in Law No. 58. Most importantly, from the point of view of management structure, public companies are headed by a General Manager as Chief Executive Officer (CEO) and a Board of Directors. The former is appointed by Presidential decree and members of the latter are appointed by decree of the supervising Minister. The board of directors has the responsibility for formulating company policy and to approve the budget and annual accounts. There is thus a clear and very real difference between the management pattern of public companies and that of AA-type PEs.

4.13 There are now three wholly GOS-owned public companies: Somali Airlines, Somali Marine Products (SMP) and Glass Reinforced Plastic Products (GRP). Somali Airlines shares are available to private shareholders, "in a manner to be effected by Presidential decree", provided the GOS share remains at no less than 51 percent; it is thus potentially a joint-venture, leaving SMP and GRP for the moment as the only definite wholly GOS-owned public companies. However, the expected liberalizing effect of the 1983 legislation giving this status to SMP and GRP, must be viewed as limited by the fact that the supervising Minister of Fisheries is chairman of both Boards.

4.14 There is no apparent correlation between the classification of PEs as Autonomous Agencies or Public Companies, and the sector they belong to; both AAs and joint-venture Public Companies include PEs from practically all sectors. This indicates that the legal form used has little relationship to

1/ A draft law is currently under consideration.

the type of PE for which it is used: for example, AAs include such public service monopolies as the Electricity and Water Agencies, as well as industrial enterprises such as Jowhar and Juba Sugar Factories, Somaltex and the Pasta and Flour Factory. This means that the same management structures and degrees of autonomy are attributed by law to a broad range of enterprises of widely varying types, without taking account of their different needs.

Legal Constraints on PE Autonomy

4.15 In the case of AA-type PEs, which are the great majority, and which have no board of directors between their management and supervising ministry, the situation leaves inadequate autonomy to PE managements. The most serious legal constraints to autonomy include the following:

- Law No. 17 assigns full or final responsibility to supervising ministers regarding planning, accounts, procurement, sale of goods, and contracts of PEs under their supervision. By contrast, Law No. 17 does not detail the specific responsibilities and powers of a General Manager but limits itself to generalities;
- Law No. 58 disposes that out of PE profits (after paying turnover and profit taxes) and depreciation funds, a share unilaterally decided by the Minister of Finance, shall be contributed to GOS; the share actually taken is reported to average 80 percent of profits plus 50 percent of depreciation;
- The spending authority of PE managements is weak. In one case (ASPIMA) the law setting it up limits such authority to So. Sh. 15,000 (about US\$180); any contract above this amount has to be approved by the supervising Minister. Most other PEs are reported to be in a similar situation;
- Prices charged by PEs for many goods and services produced by them are still controlled by the Ministry of Industry and Commerce, making it impossible for PE managements to actively pursue profit maximization;
- Most PE investments, including all expansion, are decided by the Ministry of Planning with respect to compatibility with national and sectoral plans, and by the Ministry of Finance with regard to availability of funds;
- All foreign exchange allocations for PE inputs (raw materials, fuel, supplies, etc.) are controlled and centrally allocated by MI;
- The appointment of PE executives is highly centralized. The general managers of AA-type PEs are typically appointed by the President on the recommendation of the supervising minister. In the case of SNAI (Jowhar Sugar Factory) the founding law stipulates that not only the general manager but also the department

directors are appointed by the President. However, there are exceptions as in ASPIMA (pharmaceuticals) whose founding law specifies that the general manager be appointed by the supervising minister; and

- Until recently an employment guarantee was given to secondary school leavers and most staff appointments were on a permanent civil service pay scale, where workers were paid even when plants were idle. Legislation in 1983 and 1984 dropped the guarantee and provided managers with greater freedom to hire and fire and to influence wage structures.

4.16 These and other constraints necessarily have a negative impact on the scope and quality of PE management as was amply corroborated during the PE industry survey reported on below. However, in addition to weakening management, the system also puts a substantially larger decision-making burden on many Government departments than they are in fact able to handle efficiently.

D. Government Supervision and Control

4.17 The actual situation of PEs vis-a-vis the GOS is the result not only of powers prescribed by laws but also of the ability of the principal actors to implement them. The laws give broad powers to various GOS agencies, but the deficiencies of organization and of human and financial resources result in practices that are somewhat different from case to case.

Sector Ministries

4.18 At the sectoral level, nine "parent" ministries have a direct supervisory role over from 1 to 17 PEs each as shown on Table IV.1. Only MI, the one with most PEs to supervise, has a separate unit with full-time personnel assigned to this function. Even there, that unit has only two people (one being the Director), insufficient to monitor and support the 17 PEs which constitute the bulk of the country's industrial sector.

4.19 The MI is supposed to review the PEs' annual draft budget and make recommendations to the Ministry of Finance (MF) which has approval authority; to give policy guidelines and instructions to PE managements; to monitor PE operations through receipt and analysis of quarterly reports; and to evaluate performance. In reality, the unit's lack of staff and resources enables them to do only one or two of these tasks, and then only in a rudimentary fashion. The budget is not analyzed by the unit but once it is approved by MF the unit tries to use budget parameters for PE monitoring; it was also stated that the PEs' quarterly reports to MI usually did not arrive at all, or are too late for effective monitoring. The only quasi-evaluation work done by the unit is an annual sector report, covering all PEs coming under MI with fairly rudimentary comments on salient points, prepared as an internal document for the Minister.

4.20 Other parent Ministries do even less supervision. Lacking a monitoring organization, contacts with PEs are informal, and often only at the level of the Minister and his advisors. Nobody has the time to devise or

follow standard procedures or formats or to keep adequate records of matters dealt with. Most PEs receive guidelines from their supervising ministries verbally at the ministerial level, and at best irregularly.

Other GOS Agencies

4.21 The Ministry of Finance, in late 1985, upgraded its PE-related activities within a general reorganization which established three Directorates. There are two departments working exclusively with PEs (Figure 1): one under the Director General of the Budget which has a staff of two and assists PEs in budget preparation² and one under the Accountant General, which has about 12 people and in principle does financial monitoring. The latter also oversees a staff of outside accounting officers (one assigned full-time to each PE) who exercise certain direct controls in accordance with MF instructions. Among other duties, they must countersign all checks issued by the PEs.

4.22 Apart from the functions carried out by these two departments, a new set of functions has been assigned to the Research Department under the Director General of the Treasury and its newly set up Economic Reforms Division: the analysis and definition of PE-related reforms, their coordination throughout the Government, and support to PEs' efforts at forward planning. While these functions are not fully staffed, their inclusion is a positive sign of GOS's intention to improve the situation of PEs and PE-GOS relations.

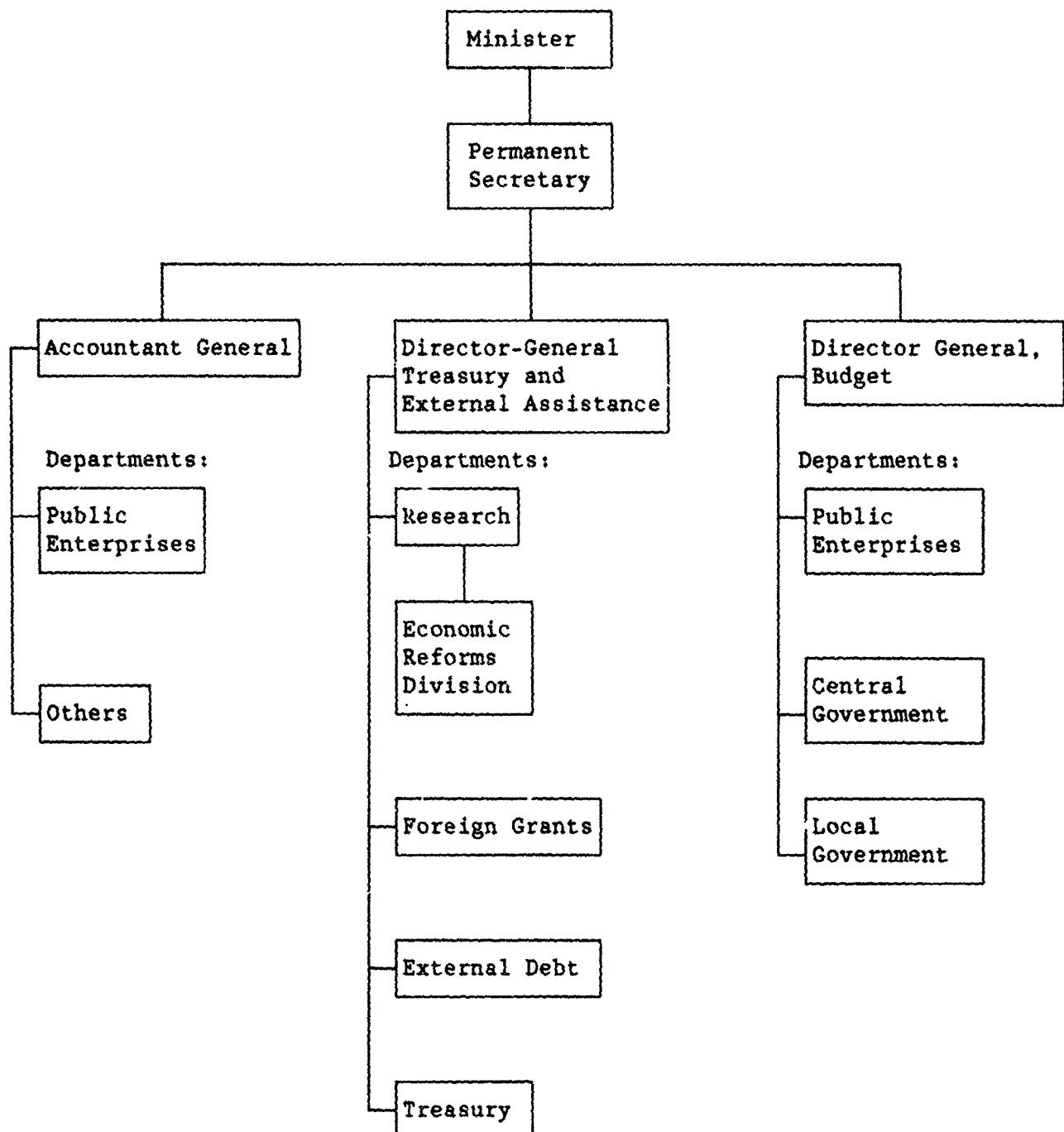
4.23 MF's authority over PEs is pervasive in several respects. Ex ante control is exercised mainly through annual budget approval and current accounting and expenditure control. Financial monitoring of current operations, though nominally done by the Accountant General, is reportedly not carried out effectively due to staff constraints and the pressure of other work. MF exercises ex post control over PE liquidity through its authority to decide the share of profits and depreciation to be transferred to the Central Government. As to audit control, MF shares this function with the Magistrate of Accounts, who exercises most of it.

4.24 The Ministry of Planning has jurisdiction to determine the "centralized" PE investments, defined in Law No. 58 as financing of new enterprises or expansion of existing ones. The law leaves each PE free to finance non-centralized investments such as equipment replacement, modernization of production methods, and "provision of dwelling and recreation facilities" (Article 8) by bank or other credit or from profits; from the depreciation, social facilities and housing funds; and through sale of excess equipment. In practice, this freedom is largely inoperative since the MF may, and usually does, take charge of most of these funds.

2/ This used to be a division which verified PEs' taxable income, to have a basis for collection of taxes from PEs. This function is now carried out in the Ministry of Revenue, which was established as part of the reorganization.

Figure 1

SOMALIA: Organization of Ministry of Finance



4.25 The Magistrate of Accounts (MA) functions under Law No. 34 of 1972 which gives him broad control authority over the financial and accounting processes of the entire Public Administration. Appointed by the President, the MA also reports solely to him, thus enjoying considerable autonomy. He has a large staff of about 200 auditors (120 work on PEs) and examiners; a new proposal would raise this to 500. The bulk of the MA's PE-related control takes the form of audits of cash transactions, profit-and-loss statements and balance sheets. It includes prior verification of compliance with laws and regulations, for which the MA's staff have adequate legal powers. In addition, all PE expenditures between So. Sh. 200,000 (the limit of the supervising ministry's authority) and So. Sh. 2 m. (above which the approval of the Council of Ministers is needed) must come to MA for registration and procedural approval.

4.26 Despite the MA's relatively large manpower resources there are many complaints about long delays in processing, presumably caused by the heavy work load. As a result, and despite the fact that Law No. 16 obliges PEs to have MA audit them (Article 18), a number of PEs have recourse to private audit firms and go to the MA only to obtain the certification required by law. The quality of the MA's audit activities is limited because (except for expatriates) there is at present no professionally qualified accountant working in the country, including in the MA's office.

4.27 A number of comments can be made about the current supervision and control system. First, it is strongly overcentralized in that non-sectoral agencies carry out almost all of the formal functions while sectoral parent ministries have limited participation (with the sole exception of MI). Second, only some of the functions generally considered to be necessary to effective guidance, support, supervision and control of PEs are carried out. Third, functions that are now exercised suffer from lack of uniformity and consistency, and from little discipline to ensure that they are carried out punctually and correctly; this is particularly noticeable in accounting and financial reporting.

E. Survey of Industrial Public Enterprises (IPE)

(a) Methodology and Coverage

4.28 The survey of the Somali IPE subsector consisted of the following main activities:

- interviews with enterprise managements and plant visits;
- examination of annual reports, financial statements and other pertinent documents that were available; and
- study of consultant reports and feasibility and other studies as could be obtained.

4.29 The interviews consisted of informal conversations with the firm's general manager, financial director and/or chief accountant, and, where possible, senior technical staff to elicit the following types of information:

- (i) General Information:
Short history of the firm, main activities, plant capacity, recent production, ownership, licensing and/or management contracts, etc.;
- (ii) Financial Data:
Examination and clarification of the firm's accounts, balance sheet, P&L statement, statement of sources and application of funds (if available). Main items of interest: Government grants and transfers, borrowings and debt service, methods of accounting, revaluation of assets, taxation, liquidity and cashflow, dividends, factors underlying financial performance etc.; and
- (iii) Operational Data:
Input supply, process and technology used, human resources, training, sales and marketing, institutional framework and relationships with Government.

4.30 Fifteen enterprises were visited (see Table IV.2). Also, reports and secondary data were obtained on three additional firms. It is estimated that the sample covers 80 percent to 90 percent of the IPE subsector's output, which is ample to obtain a picture of its situation and problems. However, the quality of the data was unreliable due to rudimentary accounting practices. Thus, specific courses of action for each enterprise will have to be based on additional and more thorough feasibility and/or diagnostic studies. Detailed reports on each enterprise are in Appendix II and their overall financial performance and main problems are discussed in the following sections.

Table IV.2: SOMALIA - LIST OF IPES VISITED DURING THE SURVEY

- 1. Petroleum Refinery, Mogadishu
- 2. Urea Plant, Mogadishu
- 3. Somaltex, Balad
- 4. Snai Jowhar Sugar Factory, Jowhar
- 5. Juba Sugar Project (Head Office), Mogadishu
- 6. HASA, Km. 7 Tannery & Shoe Factory, Mogadishu
- 7. Foundry & Mechanical Workshop, Mogadishu
- 8. Wheat, Flour & Pasta Factory, Mogadishu
- 9. Cigarette & Match Factory, Mogadishu
- 10. Aluminum Utensils Factory, Mogadishu
- 11. Snai-Biasa Factory, Jowhar
- 12. State Printing Agency, Mogadishu
- 13. Somali Pharmaceutical Industry, Mogadishu
- 14. Somal GRP Products Company, Mogadishu
- 15. Somalfruit, Mogadishu

(b) Financial Performance

(i) Operating Results

4.31 The financial performance of IPEs in the last few years has been characterized by low or negative returns on capital, inadequate cashflow, liquidity problems, and an eroding capital base. This situation is illustrated by Table IV.3 which shows three indicators of financial performance for 1984 and 1985. Profit as a percent of turnover³ is negative for about half of the 15 enterprises surveyed in both years. For those firms that realized a profit, figures are somewhat misleading as the assets are not revalued in keeping with inflation or devaluation of the currency, thus making depreciation allowances inadequate. Some firms did revalue their assets in 1984, following instructions from the Ministry of Finance. None have done so in 1985 even though inflation was at least 30 percent. Thus it is estimated that real profits were only realized by six firms in 1985 (Juba Sugar, Pasta Factory, Cigarette and Match Factory, Km. 7 Tannery, Snai-Biisa and GRP Products). Losses were quite significant in both years for Snai-Jowhar Sugar, the Urea Plant and Aluminum Utensils, essentially due to low output and sales.

(ii) Financial Structure

Liquidity Situation

4.32 The figures shown for net working capital do not seem to indicate any liquidity problem, as most of the firms show working capital to be at least equivalent to three months of sales. These figures are, however, misleading for the following two reasons:

- in several cases turnover is abnormally low, and working capital would be inadequate to sustain a return to sales volume approaching a reasonable utilization of capacity; and
- inventories are included in the definition of working capital; for some firms (Somaltex, Juba, Km. 7. Tannery, Aluminum Utensils, Pasta Factory) inventories are a large percentage of current assets, representing more than 50 percent of net working capital. When such inventories are fast-moving finished products, they are truly liquid assets. However, stocks of a few of these firms are either finished products that are unsold due to a price/quality problem (Somaltex, Foundry and Workshop) or raw materials that will take varying periods of time to convert (Juba: standing cane; Aluminum Utensils: scrap and metal ingots). For these firms, cash flow represents a real obstacle to future improvement of performance, although it may, at this time, be overshadowed by more pressing problems.

³/ This indicator is used in preference to return on investment or return on equity, as available accounting data do not usually permit making meaningful estimates of these ratios.

Table IV.3: SOMALIA - FINANCIAL PERFORMANCE: SELECTED INDUSTRIAL ENTERPRISES (1984-1985)
(Millions So. Sh)

Enterprise	1985				1984			
	Profit	Profit/(Loss) as % Turnover	Net Wkg. Cap. as % Turnover	Net Worth	Profit	Profit/(Loss) as % Turnover	Net Wkg. Cap. as % Turnover	Net Worth
Juba Sugar Project	111.1	13.2	17.0	-88.5	-23.3	-7.3	21.4	-232.2
Shai-Jowhar Sugar	-79.9	-525.3	842.8	15.3(1)	-93.1	-831.3	1731.3	41.4 (1)
Edible Oil Mill, Mogadishu	n.a.	n.a.	n.a.	n.a.	Loss	Loss	n.a.	n.a.
Wheat Flour & Pasta Factory	26.0	9.9	0.9	37.9	16.4	10.9	12.1	33.9
Meat Factory, Kismayo	n.a.	n.a.	n.a.	n.a.	-3.7	-28.5	n.a.	n.a.
Milk Factory, Mogadishu	n.a.	n.a.	n.a.	n.a.	0.0	-inf.	n.a.	n.a.
Urea Plant	Major Loss	Major Loss	-	-	Major Loss	Major Loss	-	-
Cigarette & Match Factory	36.4	7.4	23.4	200.8	25.8	11.3	40.1	163.2
Somaltex	1.3	0.8	132.2	185.8	-6.6	-6.3	189.1	208.0
Foundry & Mechanical Workshop	Loss	Loss	n.a.	n.a.	0.5	5.7	198.9	23.0
Aluminum Utensils	-6.3	-153.7	58.5	17.6	-0.8	-6.6	61.2	22.3
Kn. 7 Tannery & Shoe Factory	4.0	7.7	43.6	32.0	Profit	Profit	n.a.	n.a.
Petroleum Refinery	-7.2	-0.5	23.7	1514.5	31.1	5.3	49.9	974.8
Printing Agency	1.1	1.0	68.4	n.a.	Profit	Profit	n.a.	n.a.
Shai-Klasa	56.8	80.8	140.2	(1)	3.8	26.2	319.3	(1)
GRP Products	39.9	39.9	24.7	n.a.	1.8	7.2	49.6	n.a.

1/ Shai-Klasa and Shai Jowhar Sugar consolidated under the latter.

Source: Enterprise financial statements, and Ministry of National Planning: Performance of the Somali Economy in 1984, Mogadishu, June 1985.

4.33 In general, due to past and continuing inflation, the inability (in some cases) to raise prices in keeping with rising costs and failure to generate adequate sales volumes, has resulted in the cash position of all IPEs steadily eroding to a point where it is difficult to sustain a normal throughput, let alone make equipment renewals or finance major repairs or expansions.

Net Worth

4.34 The net worth of IPEs, equivalent to the net value of the Government's equity in these firms, has also been eroding through accumulated deficits and increased indebtedness. The unfavorable development from 1984 to 1985, as shown on Table IV.3, is the continuation of a trend which dates back several years. The equity of three enterprises has been all but wiped out by repeated losses: Juba Sugar, Aluminum Utensils and Snai Jowhar Sugar. For the latter, this took place in spite of a So. Sh. 300 m. injection of funds from GOS in 1984. For Juba Sugar, the trend towards negative net worth seems to have been reversed, or at least interrupted, by a return to profitability in 1985. Of perhaps greater long-term significance is the fact that plant and machinery have not been properly maintained: adequate preventive maintenance is not carried out as a rule; lack of spare parts prevents timely essential repairs; and machines are run in faulty condition (e.g., inadequate lubrication, broken or worn-out parts) thus increasing wear and tear and reducing useful life. As a result, the physical assets of the enterprises are subject to a rapid rate of degradation (with a few exceptions, as pointed out in the descriptions of the individual enterprises - see Appendix II).

Debt-to-Equity Relationships

4.35 The balance between debt and equity is inadequate for many IPEs, with heavy indebtedness and a very small equity base being frequent. Out of 11 firms for which financial statements were obtained, 6 have debt-to-equity ratios higher than 3, and 4 higher than 10. Indeed, for two enterprises, Juba Sugar and the State Printing Agency, it is not clear that they have any equity at all, their books showing only debt to Government under "capital."

4.36 A small or non-existent equity base is particularly critical in the start-up period of an enterprise when assets are not yet fully productive and losses are normally occurring. Heavy borrowing at that time for covering such losses contributes to preventing the generation of retained earnings, and jeopardizes the early attainment of financial equilibrium. Previous studies show that initial undercapitalization has historically been a problem in Somali PEs. This trend appears to continue for at least one recently created industry, Juba Sugar. This major project (US\$200 m. investment) is reaching the end of its start-up phase (agricultural development is still being carried out), with either very small (less than 1 percent of initial investment) or no equity. It seems that prudence should have dictated creation of a much stronger equity base at the outset so as to lessen the risk of failure of this important project.

(c) Summary of Main Problems

4.37 The major investment made by GOS in building up the IPE subsector has not brought any significant return so far. Furthermore, the operation of the plants have failed to generate sufficient cash to ensure the conservation of the initially invested capital and essential renewals. Finally, the physical state of the assets has been unduly degraded through external constraints and improper internal practices, thus accelerating the process of decapitalization of Somali IPEs. This complex situation makes the task of diagnosis and eventual rehabilitation difficult. Pressing day-to-day difficulties tend to overshadow long-term weaknesses, which will make themselves felt as soon as the former are removed or attenuated. Also, problems tend to be closely interrelated, and causal relationships become difficult to unravel when sources of dysfunction are too numerous. Finally, lack of proper operating records and reliable financial data makes the evaluation of performance difficult.

4.38 The problems observed by the mission are summarized below in the order of their relative importance. This also reflects the mission's view of the priority for remedial actions which could be incorporated in a rehabilitation program. The main difficulties of IPEs, other than the broader ones relating to the legal/institutional context covered in the previous section, are classified under four headings: inputs, management, employment and management systems.

(i) Inputs

4.39 The first and foremost problem of IPEs seems to be the severe difficulties experienced by all firms in securing a reliable and adequate supply of raw materials, energy and spare parts. Unfortunately, data are inadequate to derive a comprehensive picture of this basic problem as Somali IPEs do not prepare annual business plans which would permit comparing actual satisfaction of needs with pre-established requirements. Nevertheless, the following examples will serve to illustrate the present supply crisis of Somali IPEs:

- in 1985, Juba Sugar obtained only 37 percent of its diesel requirements for irrigation; so far in 1986, supply has been so inadequate as to cause anticipated sugar production for the year to be reduced by 25 percent;
- the Urea Plant, which depends partly on outside electrical supply for its process, reportedly experiences several outages per month. The plant is not in operation at present for other reasons, but it is hard to see how it can ever operate under these conditions, taking into account the fact that each power supply interruption has to be followed by a four- to five-day period for clean-up and restart;
- the Foundry and Mechanical Workshop is faced with power outages of such magnitude that during some weeks machines operate only one day out of six;

- the Aluminum Utensils plant cannot procure its basic input, aluminum sheet coils, apparently because of lack of foreign exchange. Instead it has to use ingots or scrap for which it does not have the proper processing equipment; and
- in the Somaltex textile plant, spinning is less than 75 percent operative, and weaving 30 percent, due to lack of spare parts. Part of the electric generators are out of operation for the same reason. Dyes and chemicals are obtained irregularly and in inadequate quantities.

4.40 One of the main results of this situation is the decline in capacity utilization over the last few years. This is illustrated by Table IV.4 which shows the percentage of single-shift capacity⁴ achieved by the main IPEs over the period 1982-1985. No enterprise exceeded a 30 percent capacity utilization level except Juba Sugar, the Refinery, and the Pasta Factory. Although many factors contribute to this low ratio, the raw material/energy/spare part supply problem is the most important cause of this wasteful idleness of expensive plant and machinery.

Table IV.4: SOMALIA - UTILIZATION OF INSTALLED CAPACITY:
SELECTED INDUSTRIAL PUBLIC ENTERPRISES (1982-1986)
(Percent)

Enterprise	1982	1983	1984	1985	1986 (proj.)
Juba Sugar Project	35	42	40	56	44
Snai-Jowhar Sugar	30	7	2	1	0
Edible Oil Mill, Mogadishu	2	1	0	-	n.a.
Wheat Flour & Pasta Factory	10	33	68	55	n.a.
Meat Factory, Kisimayo	3	2	3	6	n.a.
Milk Factory, Mogadishu	16	2	0	0	n.a.
Urea Plant	-	-	3	6	15
Cigarette & Match Factory	46	39	18	21	n.a.
Somaltex	48	33	23	18	n.a.
Foundry & Mechanical Workshop	45	22	18	6	n.a.
Aluminum Utensils	45	21	34	8	n.a.
Km. 7 Tannery & Shoe Factory	10	30	29	n.a.	n.a.
Petroleum Refinery	38	43	31	33	n.a.

Note: Full capacity is defined as single shift operation, except for Somaltex where it is three-shift.

Source: Enterprise interviews, and Ministry of National Planning:
Performance of the Somali Economy in 1984, Mogadishu, June 1985.

4/ Except for the textile mill where capacity utilization is based on three-shifts.

(ii) Management

4.41 The management of Somali IPEs was generally found to possess insufficient training and experience to properly exercise their functions. Such shortcomings, to some extent unavoidable in developing countries, are usually compensated elsewhere by the presence of foreign technical assistants operating in tandem with national counterparts. In Somalia only one wholly state-owned industrial firm, Juba Sugar, employs a foreign management team. Two others also call upon foreign management help: Somalfruit, a mixed-ownership enterprise, and GRP Products, which is in the process of being partly privatized. In addition, some firms employ foreign professionals in lower level technical positions; a typical case is the position of accountant which is often held by an expatriate from the Indian sub-continent. Thus the management team has to rely largely on its own ingenuity to run a specialized industry, assisted as it may be by young university graduates or technicians, some of whom have spent some time in training in similar industries abroad.

4.42 Principles and techniques of management can only be acquired through specialized training, which none of the managers interviewed appear to have had. Not a few are former army officers and most others come from the ranks of Government officials. In both cases, their formal training and previous career experience are insufficient preparation for the task of managing industrial concerns. In the mission's view, the upgrading of IPE management has a priority only second to that of solving the input supply problem and improving the institutional environment. Regarding the latter, sector-wide measures to reform the institutional framework, including a function to identify training needs and coordinate training programs, are expected to contribute significantly to the gradual improvement of IPE management. However, without the presence of properly trained management teams in the plants the impact of improvements in the first two areas will be considerably blunted. These, as well as other steps, such as increased use of foreign technical expertise, major efforts in industry-specific training, setting up systems of management incentives and increased autonomy and accountability, are covered in a later section of this chapter.

(iii) Employment

Levels of Remuneration

4.43 An important problem connected with employment is that the general level of remuneration is much too low and has failed to keep up with inflation. Average IPE remuneration has decreased in real terms by more than 40 percent between 1975 and 1982. Between 1982 and 1986, salaries increased in most enterprises, but by amounts far less than the threefold increase in the cost of living. For example, salaries have increased by 140 percent over two years (1984-85) in the textile mill, by 33 percent per year for the past three years in the Snai-Jowhar complex (these two probably represent the best record in the IPE subsector), and in the Juba factory, wage increases ranging from 12 percent to 42 percent were effected in 1985. But in most enterprises, yearly annual average wage increases have been 15 percent to 20 percent. This situation contributes to the following:

- a "brain drain" of the best trained and most experienced workers, technicians and professionals to the neighboring oil-exporting countries;
- a net movement of labor from IPEs to private industry--workers leave the IPEs once they have acquired technical training in state-owned plants;
- absenteeism is reported to be a major problem. As a rule, unskilled and even skilled workers earn less than the bare minimum cost of living, so that there is much "moonlighting", and it is suspected that pilferage and other petty illegal activities are going on in the plants; and
- motivation is in general very low and, as a result, labor productivity is minimal. Combined with frequent overstaffing, low work loads, and lack of discipline on the shop floors, this also leads to carelessness, bad workmanship, and sometimes, as reported by the textile industry, frequent breakdown of machinery.

Inadequacy of Training

4.44 The second general problem associated with employment in IPEs is the inadequacy of training provided both outside and within the enterprises. This affects all technical levels:

- Engineers do not receive sufficient training before they are hired by enterprises but are usually promoted rapidly to a supervisory level in order to justify a sufficient salary to entice them in. This in itself would not be too serious if there were more senior, experienced professionals who could train them. Such on-the-job training does take place at Juba Sugar and to some extent in the Urea Plant. But in other enterprises such as the Foundry and Workshop, young engineers with no more than one year, or at most two, of exposure to a real work situation in plants abroad are put in charge of departments, with no professional guidance to turn to;
- Technicians are trained in the German-funded vocational school in Mogadishu, in the plants and sometimes abroad by equipment manufacturers. Levels of proficiency are generally low as training is insufficient to keep up with turnover; and
- Semi-skilled and skilled workers are usually trained only in the plants. Except in one firm where significant resources have been devoted to a formal training program (Juba Sugar), such on-the-job training usually takes place in an environment where even the most experienced workers have not mastered their trade. Combined with the turnover problem alluded to earlier, this results in a fairly inexperienced workforce, with ensuing low productivity, wastage of materials and poor workmanship.

(iv) Management Systems

4.45 Most if not all of the IPEs visited seemed to be lacking in the basic tools which enable management to plan the activities of the firm and

its various departments, and to obtain regular feedback reports permitting the monitoring of performance. Major shortcomings observed were in the following areas:

Planning, Budgeting, Financial Control and Accounting

4.46 Lack of planning is quite general. Managers are not asked to prepare a business plan (beyond a basic expense budget) and do not prepare one nor request department managers to develop targets and operational plans and submit them for approval. Planning is likely to be a frustrating exercise in the present environment, especially because of the input supply constraint and external limits on management autonomy. Nevertheless, it remains an essential exercise, if only to provide factual evidence as to the effects of external constraints on performance. In some cases planning is carried out, but without due reference to reality. A recent UNIDO study cites the case of a particular plant establishing production objectives which exceed the physical capacity of the machines by almost 100 percent, but without a sales plan which would make timely ordering of imported materials and supplies possible.

4.47 Although the preparation of an annual budget to be approved by the Ministry of Finance is obligatory, the document does not appear to be used as a management tool. Accounting systems are usually elementary and do not permit the timely reporting required for using the budget as an instrument of management control. Although the deadline for preparing the yearly accounts is March 31 of the following year, some firms did not have their 1985 accounts ready at the time of the mission, i.e., late June to early July. As a rule, there is no cost accounting.

Production Planning, Scheduling and Control

4.48 Although the time available for visiting each enterprise did not permit detailed examination of the procedures used for production planning and control, it is apparent that this function is lacking or inadequate in many IPE plants. As input supply disruptions would partly defeat the purpose of any production planning, initial sound practices may in some cases have been abandoned. Nonetheless, many enterprises would benefit from better production scheduling, from elaborating production standards and monitoring actual performance with respect to them and from preparing and adhering to preventive maintenance programs, etc. In enterprises where production is on a batch or order basis, the establishment of a proper job scheduling and follow-up system is essential. In keeping with the small size of the plants, and the general simplicity of the processes used, such systems should be kept simple and easy to use.

4.49 Inventory control seems to be practiced in most of the places visited. However, systems for triggering timely ordering of supplies usually work poorly, and procurement procedures are long and cumbersome. Quality control is generally lacking, a situation which contributes in part to the marketing problem of some enterprises such as Somaltex and the Foundry.

Management Information Systems

4.50 Most managers were found to have limited knowledge of many aspects of their enterprises and to operate in an information vacuum: during interviews, reports, statistics or internal memos were only rarely referred to for information. Most often, memory was relied upon, not always successfully. For example:

- the manager of a large IPE plant knew that a formal commitment had been made to the large labor force to raise salaries by a certain percentage over the next two years, yet was unable to tell what the percentage was, find it in his papers, or obtain it from subordinates;
- the chairman of another major IPE apparently did not keep any financial statements in his office and required several days to have them sent over from the plant, located outside of the capital; and
- another manager was unable to provide details on the agricultural operations of his enterprise started in the last few years in an effort to replace raw material imports.

4.51 In many cases, crude and simple reporting systems, used in conjunction with some simple operation planning, would permit managers to be effectively in control, and to take immediate remedial action whenever deviations from established plans appear.

Investment Planning and Capital Budgeting

4.52 Little investment activity seems to have taken place over the last few years (except for new plants being built such as the Urea facility, the Berbera cement plant and the Pharmaceuticals industry, and at Jowhar Sugar, where a major plant overhaul program is underway). Yet in the future, these firms will not be able to continue operating without some essential renewals, and in some cases some expansions or additions to remove bottlenecks. The process of public enterprise investment planning and control, including mechanisms for review and approval by Government and inclusion in the Public Investment Programs for securing required financing, is not properly defined, especially regarding the roles of enterprise management and Central Government agencies. This area is in need of an in-depth review, which will be best achieved in the context of redefining the sector's institutional framework and determining the roles and responsibilities of the involved parties.

F. A Recommended Approach to Public Enterprise Reform

1. The Background and Purpose of Reform

4.53 The principal element of GOS policy since the early 1970s has been to retain strategic sovereignty over national resources. However, there has been no overt hostility to private enterprise which was at times challenged to invest capital in the productive sectors of the economy. More recently, GOS policy has gone still further in that direction. Official statements

now speak of making PEs more efficient within the framework of a more balanced distribution of economic resources and activity between the public and private sectors. This is to be achieved by "opening up the economy" and giving freer rein to the interplay of economic incentives and rewards.

4.54 The medium-term recovery program prepared for the March 1983 Consultative Group (CG) meeting explicitly recognized the need for an incentive framework for development of the economy and the private sector. Progress in laying the groundwork led the November 1985 CG meeting to commend GOS for its reform efforts aimed at improving public sector efficiency and promoting the private sector. Specific measures included expanded credit to the private sector, a free foreign exchange market instituted in 1985 and easing of licensing procedures. Also, GOS started to work on rationalizing the PE sector.

4.55 The GOS set up a Committee on Public Enterprise Reform in March 1985 for the purpose of (i) collecting information leading to a judgment on the degree of strategic importance of each PE, and (ii) preparing on that basis a preliminary classification as to which PEs should be retained in the public sector and which should be divested through total or partial privatization or through liquidation. The Committee conducted a survey of 45 PEs (not all responded) and arrived at the classification in Table IV.5. This list is still provisional and does not represent GOS decisions. The list has been recently reviewed and modified by a high-level working group which has made confidential recommendations to the Council of Ministers for decision.

4.56 The planning for rationalization of the PE sector to emerge from the deliberations just described, will determine which PEs will remain in the public sector and which will not. However, it is essential to realize that the design and implementation of such a plan will be a continuous and long-term process, and that while the process is important, it should not delay the adoption of reforms that are critical to attaining improved efficiency in the PEs. This recognition should be used as the basis for three component and parallel parts of an overall PE sector reform program as follows:

- (a) rationalization, resulting in a more efficient PE sector (continuous, long-term);
- (b) functional and institutional reform measures, resulting in more efficient management, operation and supervision of those PEs that remain in the public sector at any phase of the rationalization process (short- and medium-term); and
- (c) prepare for privatization of enterprises by conducting valuation studies and searching for potential purchasers (short- and medium-term).

4.57 The recommendations for a reform program that follow will concentrate on the specific content of B and C, both in terms of what needs to be done and by whom it can best be done. Proposals for functional institutional and personnel-related reforms are divided into those affecting all PEs and those that only concern industrial PEs. Proposals for preparing for privatization are outlined subsequently.

Table IV.5: SOMALIA LISTING OF PUBLIC ENTERPRISES ACCORDING TO FIRST PROVISIONAL RESULT OF CLASSIFICATION EXERCISE

<u>Category a/</u>		
A	Cigarette and Match Factory National Petroleum Agency ADC ONAT Somali GRP Products	High revenue producer Amalgamate with refinery Discontinue some functions Keep in A "for a while" SIDA (Sweden) provides technical assistance and part of input materials
	Berbera Cement Somali Port Authority Somali Marine Products State Printing Agency	Allow competition and divest some functions
	Public Construction SCA Somali Construction & Engineering Somali Airlines Mogadishu Water Agency Kismayo Water Agency Hargeisa Water Agency	Keep in A "for some time"
B	Snaï Jowhar Complex Juba Sugar Mogadishu Petroleum Refinery	Rehabilitate Explore joint venture prospect Consider private management contract
	Mogadishu Urea Plant Somali Pharmaceutical Industry National Electric Energy Authority Somali Transport Agency Foundry & Mechanical Workshop	Undecided between B and C UNDP experts are available
C	Somaltex HASA Tanneries and Shoe Factory Pasta and Flour Factory Aluminum Utensils Factory Somalfruit Somali Shipping Agency SSA Edible Oil Mill Asbestos Sheet Roofing Plant Gypsum Plant Kismayo Meat Factory Sopral Meat Plant Somali Trading Agency ASPIMA Somali Films Agency WAGAD Somali Transport Agency Hotels	Already 60% private Should be divested gradually Divest except drug testing May be more suitable for D
D	Somali Shipping Line SSL	Undecided between B and C Unless divestable under C

a/ A - Should remain in the public sector, being (i) actually or potentially viable and (ii) essential and/or strategic.
 B - Being essential and/or strategic but not viable, effort - should be made to make the PEs in this category viable, if need be with private domestic or foreign participation.
 C - Not considered essential and/or strategic, but viable. These PEs would be candidates for privatization.
 D - Being neither essential or viable, should be sold off, or if this fails, liquidated.

b/ Remarks by the Committee.

2. Institutional Reform

PE Management and Supervision Functions

4.58 In Somalia, as in most countries, the creation of PEs as decentralized autonomous bodies reflects a desire to enable PEs to be run with managerial and business acumen that is not necessarily present in the Government structure itself; to relieve Central Government of a burden it would not be capable of carrying effectively; and to endow PEs with both separate capital and the obligation to account for its use separately from Government accounts. The operation of PEs following the above motivation implies that a balance should be sought between management autonomy to enable PEs to be run efficiently, with enough Government supervision to safeguard the state's ownership interest and to ensure that the objectives are being attained.

4.59 In order to bring about this balance, adoption of the functions listed below, should be the key content of a reformed system of PE operation and of Government-PE relations. Brief comments in parentheses summarize the extent to which these functions are currently followed in Somalia.

- (a) Central strategy formulation by the Government to decide which PEs are used and for what purpose; whether to set up new PEs or to expand, divest or otherwise modify existing ones; in short, what the Government's PE portfolio should consist of and how it should be managed. (Although it is assumed that this function is carried out in Somalia, no agency appears to be formally charged with it.)
- (b) PE investment project appraisal to ensure feasibility and to prioritize projects in accordance with sectoral and national development aims. (Ministry of Planning (MP) and MF have responsibilities for different aspects of this function but the level of economic analysis utilized is not consistently adequate.)
- (c) Setting of PEs' objectives by Government, including quantitative targets and performance indicators mutually agreed between PE management and the supervising ministry. (No formal setting of objectives and targets is currently done.)
- (d) Planning and budgeting by PEs is intended to indicate how the PE plans to attain its objectives. (Somali PEs prepare annual budgets, assisted by MF, which are then submitted through the sectoral supervising ministry to MF for approval. No PE-level multi-year corporate planning exists except for "centralized" investment programs over which the MP has jurisdiction, nor is it provided for in law.) Such plans provide the framework within which PE management can operate with whatever degree of autonomy it is allowed.
- (e) Controls, divided into ex ante (e.g., approval of annual budget) and ex post (e.g., various forms of audits of annual results). (As practiced by MF and MA, this is at present the least vulnerable aspect of PE-Government relations, but it still needs considerable improvement.)

- (f) Monitoring of PE operations by Government, to supply the supervising authority with a current check on how the PE is doing in attaining its targets, and also to act as a means for providing timely warning of potential future problems. (The weakness of monitoring by sectoral ministries in Somalia has been summarized earlier.)
- (g) Evaluation of the PE's actual performance as compared with objectives established by the Government. (This function is not being exercised at all.)
- (h) Coordination of the sector's strategy, operation and supervision to ensure that execution of all activities listed above is not hampered by overlaps, misunderstandings and omissions, and to resolve questions and disputes that may arise. (A division in one of the departments in MF's Directorate-General/Treasury is charged with coordination.) This function becomes more crucial during the preparation and implementation phases of a reform program which adds substantially to its tasks.

4.60 At this time, some of these functions are neither provided for by law nor being performed. Others, which present legislation explicitly assigns to certain agencies, are either not carried out, or carried out only partially or irregularly, or carried out in a manner that leaves matters up to the personal judgment of the officials involved. It is therefore recommended that all of the above functions be used as the basis for institutional reform of the PE sector, with the purpose of improving the efficiency of the sector as a whole and of its component enterprises.

Institutional

4.61 The distribution of the functions should be made as far as possible within the existing system. This means that the present assignment of each PE to a parent ministry should remain in effect, and also that parent ministries, and those non-sectoral agencies now exercising certain supervisory and control functions (Ministries of Finance and Planning, Magistrate of Accounts), should retain important functions in the reformed system.

4.62 The principal points of difference between the existing and reformed systems would be:

- to institute a more rational distribution of PE-related functions between parent ministries and non-sectoral agencies;
- to endow the ministries and other agencies concerned with enough system support (i.e., formats and know-how) and resources to enable them to exercise their functions and powers correctly and within known parameters, rather than irregularly or not at all;
- to base the reformed system on the principle that PEs should be operated with the maximum autonomy that is considered compatible with currently acceptable political thinking; and

- to disseminate the principles to be followed in the reformed system to the people who will be the principal actors so that they are clear about its basic philosophy.

4.63 The first point--distribution of functions--is crucial; failure to do this right might endanger the success of the whole reform process. It would not be appropriate here to propose detailed functional assignments to specific GOS agencies which must come out of a full and frank consideration of each agency's technical and political suitability for carrying out the various functions. However, as a general guideline, it is suggested that it would be advisable to (i) assign those functions to sectoral ministries that involve direct and frequent contact with the PEs under their supervision (e.g., working out PE objectives and targets, supporting PEs' planning and budgeting activities, and performance monitoring and evaluation); and (ii) to assign broader oversight and control functions to non-sectoral agencies (e.g., Government PE strategy, investment project appraisal, design of formats and guidelines for use by PEs and parent ministries, auditing, and coordination).

4.64 A note of caution may be inserted here. It has been mentioned that most sectoral ministries at present lack institutional capability for carrying out PE-related functions on a regular basis. To install such functions in these ministries from scratch is a task that should not be underestimated. A possible approach may be to strengthen the existing small PE unit in MI so that it can be used as a pilot operation for the gradual introduction of the new functions (see para. 4.59) that are to be assigned to sectoral supervising ministries; similar units can then be gradually set up in other ministries on the basis of MI's pilot experience, with MF and MI providing technical assistance and support.

Reform Coordination

4.65 The GOS already has asked the Ministry of Finance to coordinate the PE reform program. It is recommended that MF also take the lead in designing it. These roles are complex and require considerable political acumen as well as technical capability. The agency which carries them out will have high visibility in the Government, PE communities and the country as a whole. To explain, promote and "sell" the concept and specifics of PE reform, it should be endowed with the kind of persuasive authority and "clout" that will facilitate its task. The MF unit now entrusted with reform coordination is at division level, two reporting levels removed from the Director-General. In line with the preceding argument, it is believed that this is an inappropriately low level, considering the importance and difficulty of the tasks to be performed. It is therefore suggested that either this unit be upgraded, or that it be abolished and then recreated at a level within MF that would satisfy the requirements summarized above.

4.66 It is also suggested that either the 1984 inter-ministerial task force on PEs or the more recent high-level working group which reviewed the preliminary rationalization proposals made by the Committee be made into a ministerial-level steering group on PE reform. This would provide (i) a forum for discussing the reform concepts on an intersectoral basis; (ii) a screening process for the political feasibility of the proposed reforms; and (iii) a powerful ally in promoting the acceptance and implementation of

those reform ideas and measures which could gain its endorsement. The Steering Group's principal responsibility would be to oversee the introduction of all of the functions listed under para. 4.59; to assist in the decision-making process regarding the PE sector's rationalization, as well as regarding other pertinent policies that may be adopted. It would serve only until the PE reform program is complete.

Legal Instruments

4.67 To be effective, a reformed institutional system must be backed by a set of legal and regulatory instruments that give it authority and link it to prevailing policy principles. Due to changes in economic policy which have not always been reflected by corresponding changes in the legislation, and because legally provided functions have not always been institutionalized, there is now a lack of cohesion between PE-related institutions and functions and the body of laws governing them. Once the details of the proposed institutional reform have become clear, it is recommended that the resulting obligations, responsibilities and powers be reflected in the legal framework, which will first require a review and then appropriate measures as recommended by the review.

4.68 The existing legal framework has been repeatedly patched up rather than thoroughly revised, resulting in piecemeal and partial changes. This is reflected in occasional contradictions and even in inconsistent terminology; for example, the terms "autonomous agency" and "public enterprise" are often used interchangeably, while in fact "public enterprise" is initially defined as the generic grouping and "autonomous agency", "financial enterprise", and "public company" as its constituent categories. There is no official listing of entities that fall into these categories, yet the categories are named throughout the legislation as if it were clear what they include. For both substantive and nomenclature reasons, a thorough review of all PE-related legal instruments now in force would be desirable; the fact that broad-based PE reforms must be given legal standing means that the review must be followed by the reform of the legal framework affecting PEs. The review should result in specific recommendations on consistent use of terminology and nomenclature, and in model texts for the organization, establishment and functioning of PEs in the existing PE categories (autonomous agencies, financial enterprises, public companies) or in whatever different categorization may be adopted. These models should be easily useable to revise the existing statutes establishing individual PEs, or to write new statutes for PEs that do not have one.

4.69 In addition to model statutes, a new general law should be drafted that defines the reformed relations between PEs and the Government. It is here that the principles and details of the reform should be expressed as simply as possible by prescribing specific attributes of autonomy, supervisory powers and the distribution of decision-making authority to PEs and Government agencies respectively, so that all concerned have a clear mandate for what they can and cannot do. Later instruments could deal with specific aspects such as personnel, procurement, investment and others that may not have been included in the general law.

The Role of Boards of Directors

4.70 A matter which should receive priority attention in both legal and institutional aspects of PE reform is the need to separate management and supervisory functions. The extent of real autonomy in the making and implementation of PE policy and day-to-day management decisions may legitimately vary depending on whether the PE is run as a monopoly or in a competitive market setting or whether it is financially dependent on the Government budget or not. But a great deal of experience has shown that arbitrary and/or frequent Government intervention cannot help confusing both the functions and the players, with negative effects on management efficiency. The place in which the balance between the relative needs for autonomy and accountability is best reflected is the Board of Directors. It is therefore suggested that serious consideration be given to extending the current trend of instituting boards of directors in public companies (see *st 10*) to AA-type PEs. Furthermore, where boards already exist, as well as where they may be newly instituted, it will be useful to review how appropriate it is for a PE's top management body (the Board of Directors) to be headed by the supervising Minister.

3. Personnel Reforms

4.71 Any PE sector reform program would not be realistic if it did not confront the problems of personnel. These problems are well-known and have been studied with some frequency. Inefficiencies frequently found in PE management and operations and in the exercise of GOS supervisory and support functions can often be traced to inadequate training and motivation. On the one hand, this is partly responsible for overstaffing: out-of-date or inefficient techniques and procedures require more manpower than efficient ones (e.g., in accounting and auditing) and unmotivated and underpaid personnel work less well than others. Also, the lack of suitably qualified personnel means that the functions will be carried out in a rudimentary fashion (e.g., corporate budgeting and planning in PEs, monitoring in supervising ministries).

Measures to Improve Motivation

4.72 As indicated by the IPE survey findings, the general level of remuneration is so low in industrial PEs that employee morale is undermined, absenteeism is high, pilferage is known to occur and turnover is very high as skilled employees move to better employment in the private sector or abroad. Thus it is recommended that the reform program should review possible ways to raise remuneration, both pecuniary and other. The presently unclear rules set out in several prior instruments, culminating in the new Civil Service Law (No. 5) and Law No. 26 on Government-owned factory employees, should be reviewed and recommendations made in regard to establishing separate sets of pay schedules and other terms of employment for PE employees, or modifying those already existing, that would promote stronger worker motivation but without infringing on management prerogatives. This might be done in two ways:

- through suitable salary increases to compensate for current inflation and also to catch up gradually on past major advances of the cost of living; and

- through the implementation of suitable incentive schemes, relating employee remuneration to their own performance and perhaps also to the overall performance of the firm.

4.73 It is also recommended that any significant improvement in the remuneration package of PE employees be accompanied by a tightening of employee discipline: full shifts should be worked, persistent and extreme lateness or absenteeism should be disciplined and managers should be in a position to discharge employees when justified. It should become both more rewarding and more challenging to work in the public enterprise sector. Consequently, it should be expected that increased personnel costs resulting from better pay and incentive packages would be more than compensated by higher productivity.

Training Requirements

4.74 The reform program should include skills training programs, giving priority to the areas of major weakness. The priority training needs include accounting and finance (all levels), general management, functional management such as marketing, production and administration, and supervisory functions.⁵ In addition, the mission's survey of industrial PEs found major inadequacies in training of managers as well as of technical personnel at all levels: engineers, technicians and skilled and semi-skilled workers. Finally, adoption of the functions recommended above as part of the PE reform program would create further needs for more specialized training of PE personnel and GOS personnel engaged in PE supervisory, control and support activities so that they can eventually carry out improved corporate budgeting and planning, setting of mutually agreed objectives as well as operational and financial targets, monitoring, various types of controls, and performance evaluation.

4.75 The extent and pervasiveness of observed training deficiencies in the sector, and the corresponding urgency and magnitude of the tasks aiming at correcting these deficiencies over time, suggest that the problem be approached through the inclusion of a training coordination and supervision function as part of the reformed institutional framework. Such a function might include the following elements:

- conduct extensive reviews of training needs at all levels of PE enterprises: managers, accounting and financial staff, technical managers, technical staff;
- elaborate and propose suitable training programs;
- identify suitable sources of training in Somalia and abroad, and eventually make recommendations regarding the strengthening of Somali training institutions and programs that would contribute to the satisfaction PE needs and those of the private sector;

⁵/ This was the finding of a 1984 survey sponsored by UNIDO and the Ministry of Industry which confirms the conclusions of previous surveys.

- identify and recommend additional technology and know-how transfer schemes such as management contracts, twinning with foreign enterprises, sectoral seminars, training in foreign firms, etc.; and
- ensure the overall coordination of the training effort, monitor its results with respect to pre-established objectives and constantly develop the required new programs in response to the evolution of needs and the gradual efficiency improvement of the sector.

4.76 Such an ambitious but essential effort should begin by a review of the most urgent training needs to establish what skills are required, even at a relatively simple level, for getting the reform program off to a reasonably early and successful start. This preliminary effort would be followed by a more comprehensive approach as outlined above.

G. Proposals Concerning the Industrial Public Enterprise Subsector

Framework for Reform of IPEs

4.77 The results of the survey indicate that most IPEs have some important problems in common in the key areas of logistics of supply, management and management systems, technical skills proficiency, levels of remuneration and price controls. These and other deficiencies have been outlined in the previous sections describing the IPE survey. In addition, as shown in Appendix II, each enterprise suffers from specific shortcomings or difficulties which range from questionable economic soundness to relatively minor weaknesses in some areas such as quality control or accounting.

4.78 Privatization. MI should commission studies to establish sales values for a few of the most likely candidates among those classified for privatization (Aluminum Utensils and HASA tanneries) to expedite the sale process. Simultaneously, MI should begin to canvass potential domestic or foreign private sector purchases through the commercial and development banks and commercial attachés in embassies.

4.79 Rehabilitation. The rehabilitation of enterprises to be retained in the public sector, temporarily while awaiting sale or permanently, will be best carried out by a two-pronged attack:

- (i) Sector-wide measures which will make their impact felt on the whole PE sector including IPEs. These are the institutional, legal and personnel-related reforms discussed in the previous section; and
- (ii) Enterprise-specific measures, with emphasis on some that are aimed at establishments which are presently in the most difficult situation.

4.80 The approach suggested is (i) to categorize IPEs according to some suitable criteria involving seriousness of enterprise problems and corresponding urgency of remedial actions; (ii) to define specific programs of action for each category of enterprise; and (iii) to implement the programs within the reformed institutional context.

4.81 The findings of the survey suggest that Somali IPEs could be classified in the following three categories:

- (a) enterprises of uncertain intrinsic economic viability;
- (b) enterprises requiring urgent rehabilitation and/or reorganization measures in order to become or remain economically and financially viable; and
- (c) other enterprises, i.e., those that are not at present experiencing grave financial difficulties but would greatly benefit from the implementation of the sector-wide institutional, legal and personnel-related reforms discussed earlier.

4.82 The main issue raised for firms of category (a) is the question of their basic economic soundness. It is probable that the resources they consume in terms of capital costs and current operating expenditures may be more than the value of their output. If this is the case, the best course of action for GOS would be to discontinue operation of these enterprises. Thus it is urgent that the economics of continued operation of IPEs in this category be carefully analyzed. If the analysis determines that continuation of operation in the present configuration is not economically feasible, it should also identify the alternative courses of action which are open to GOS, including the financial and social implications of each one. The enterprises recommended to be placed in this category are the following:

- Petroleum Refinery;
- Urea Plant;
- Kismayo Meat Factory.

4.83 Feasibility studies should be conducted for these enterprises to decide the best alternative available for continued use or disposal of existing assets, be it rehabilitation and continued operations under the present structural configuration, continued operations in a different configuration, mothballing of the facilities in the expectation of future change in the economic environment, or outright closure of the facilities and liquidation of the assets.

4.84 The feasibility studies should consist of:

- An analysis of the basic technical and economic viability of the plant in present and foreseeable circumstances regarding input supply, process technology, size of plant, markets, price trends, etc. The result of this phase would provide an answer to whether or not the plant should continue to be operated in the present structural configuration.
- In the event that the finding of the first phase is negative, a systematic exploration of other alternatives should be made, showing the costs and benefits associated with each possible course of action. A recommendation should then be made on which is considered preferable.

- The third phase should develop the best rehabilitation plan covering restructuring if any, sequence and timing of operations, nature and role of the intervening parties, (Government agencies, consultants and outside experts, donors, etc.), and detailed costs.

4.85 The specific issues that arise in connection with each of the three enterprises for which such an approach is recommended are discussed in Appendix II and may be briefly summarized as follows.

4.86 Due to its small size and obsolete design, the Petroleum Refinery (Appendix II, page 79) has a finished product cost which is higher than import parity prices under present conditions of world refining overcapacity and weak demand for hydrocarbons. This means that Somalia loses a significant amount of foreign exchange by refining some of its petroleum product requirements rather than purchasing them directly on the international market. The purpose of the feasibility study would be to ascertain whether this existing situation is likely to change significantly in the near future, and if not, what options are available to correct the present situation of intrinsic unviability. These options may include expanding and upgrading the refinery so as to change its product mix, mothballing the facility while ensuring its basic maintenance, converting some of the refinery's equipment to other uses, or closing it outright.

4.87 The Urea Plant (Appendix II, page 83) faces the same type of problem: it is too small and uses the wrong process to compete effectively with large efficient producers which are presently facing a very slack demand for nitrogenous fertilizers. In addition, the plant is affected by very severe "teething" problems which have delayed the start of production by three years. In this case, the technical aspects of the feasibility study would provide an objective assessment of the soundness of the process selected by the plant designer and builder. Because of its proximity to and close relationship with the refinery (the Urea Plant uses heavy distillates produced by the refinery as feedstock), the feasibility studies for the two plants might be usefully combined. If this is done, some of the possible solutions may also imply a joint plan of action for the two facilities.

4.88 The Kismayo Meat Factory (Appendix II, page 118), a producer of canned meat products, is facing a depressed market, problems of local supply, and generalized disrepair of systems and machinery. The reconversion of the plant to the production of more economically attractive products such as frozen meat is one possible option. However, that option entails major changes in the process of cattle raising and marketing as traditionally practiced in Somalia. Expected resistance to change increases the risk of failure in attempting to bring about such a conversion. Yet it is one of the few possible avenues open for upgrading the local value added derived from the most abundant and valuable natural resource of Somalia. The feasibility study in this case would have to be of broad enough scope to integrate agricultural, industrial and marketing considerations, including by-product.

4.89 IPEs in the second category (b) are beset by numerous and grave problems; as a result, their recent performance has been dismal as characterized by their low capacity utilization rates and precarious financial situations. Yet, on the basis of the information gathered during the survey, they seem to be worth rehabilitating since they are probably economically viable provided they can somehow be made to run more efficiently. In these cases, it is recommended to conduct diagnostic studies to prepare and cost a suitable rehabilitation plan for each IPE studied. This would be followed by implementation of the plan and careful monitoring of their results. It is recommended that the following IPEs be included in this category:

- Foundry and Mechanical Workshop;
- Cigarette and Match Factory;
- Somaltex;
- Aluminum Utensils;
- Snaï-Jowhar Sugar;
- HASA Km. 7 Tannery and Shoe Factory.

The rehabilitation of these enterprises involves four main steps:

Diagnostic Studies:

In-depth examination of the firm's functioning in all main areas: management, process and technology, marketing and pricing, management systems, salary structure, skills and training etc. This inquiry would more or less cover the same ground as the survey described in this report, but in much more detail. For each establishment this should typically involve an industry specialist in addition to general management consultants. The objective is to identify areas of weakness and major problems, sort out the relationships between them, and rank them by order of priority.

Preparation of a Rehabilitation Plan:

Description and sequence of the specific measures recommended for bringing the enterprise up to a satisfactory level of efficiency. This would include identifying the role of the proposed actors in the plan (enterprise management, outside technical assistance, concerned Government agencies), preparing cost estimates for the recommended actions and proposing a detailed schedule with performance targets. Once approved jointly by the management of the enterprise and the Government, the rehabilitation plan could become a contractual document which defines the reciprocal obligations of the enterprise and the Government over the plan period.

Implementation of the Plan:

Typical rehabilitation actions may include the following:

- Essential physical rehabilitation;
- Limited physical expansion if indicated, which might be required to remove bottlenecks or process imbalances;
- Technical assistance and/or management contracts, with compulsory associated training of counterparts and program of phased re-nationalization;
- Industry-specific training programs; and
- Design and gradual implementation of management system improvements (with the help of either the TA/management team, outside consultants or an eventual central management assistance/troubleshooting organization set up for this purpose).

Most of the six enterprises identified for rehabilitation are in such a financially critical situation that it is expected that most if not all of the above actions will be part of the individual plans.

4.90 While modification to the ownership status of the enterprise may be considered as part of the rehabilitation package, in no case should an eventual search for a private partner hold up the process of rehabilitation. Three main reasons to support this view:

- The present underutilization of the capital assets of the firms earmarked for rehabilitation is wasteful and should cease as soon as practically possible;
- It is easier to find a private partner for an efficient, smoothly-running facility, showing positive financial results, than for an ill-maintained, partly idle, money-losing firm; and
- One of the basic tenets of public sector creation in Somalia is still extant, and that is the lack of sophistication of the private sector. As a result, prospects for rapid privatization of IPEs are slim, and it would be prudent not to adopt a policy which would place high stakes on this occurring in the near term.

Monitoring of the Plan:

This is an essential element of the whole rehabilitation process as it is most important that the actual results in terms of improved performance be carefully monitored with respect to the pre-established targets. Potential causes of deviation should be carefully analyzed and timely corrective action taken. As cautioned in earlier recommendations, suitable institutional arrangements for monitoring the execution of rehabilitation plans will have to be provided.

4.91 The third category (c) of enterprises includes those firms that were found by the survey to have a satisfactory financial performance, although some of them suffer from significant weaknesses and all are in

great need of improvements in many areas. No specific measures are recommended for these firms at this time. From a practical point of view, the limited availability of resources dictates that enterprise-specific actions be concentrated on those establishments which constitute the most severe drain on national resources, namely the firms of the two previous categories. For the enterprises of category (c) it is tentatively deemed sufficient to provide an improved operating environment through the implementation of general liberalization policies, and through the implementation of the sector-wide institutional, legal and personnel reforms recommended earlier. At a later time, when most of the more severely deficient firms have been taken care of, it may be found useful to turn to these better performers, and to design specific improvement programs to upgrade their efficiency.

4.92 The firms whose inclusion in category (c) is recommended are the following:

- Pasta and Flour Mill
- Juba Sugar;
- Snai-Biasa;
- State Printing Agency.

4.93 In addition, three IPEs were surveyed which do not require any specific attention at this stage. One of them, Somalfruit, has mixed ownership status with private majority; another, GRP products, is in the process of acquiring this status with GOS retaining control; the third one, Pharmaceutical Industries, is only just starting operations under the aegis of foreign-led management.

APPENDIX I

TABLES

Table 1

SOMALIA - VALUE ADDED IN ORGANIZED MANUFACTURING^{a/} BY OWNERSHIP 1975-82
(So. Sh. million)

	1975	1976	1977	1978	1979	1980	1981	1982	% change 1975-82
Total V.A. (current)	118.3	174.1	118.0	241.4	243.1	416.5	334.5	422.6	257.2
Total V.A. (1977 prices) ^{b/}	149.7	193.4	118.0	219.5	172.1	191.9	106.9	110.1	-26.5
Public Sector (current)	89.9	143.3	89.7	189.2	182.1	356.5	254.1	357.6	297.8
Public Sector (1977 prices) ^{b/}	113.8	159.2	89.7	172.0	133.9	164.3	81.2	93.1	-18.2
Private Sector (current)	28.4	30.8	28.3	52.2	52.0	60.0	80.4	65.0	128.9
Private Sector (1977 prices) ^{b/}	35.9	34.2	28.3	47.5	38.2	27.6	25.7	17.0	-52.6
Share of Public Sector (current)	76.0	82.3	76.0	78.4	77.8	85.6	76.0	84.6	

Source: General Directorate of Statistics, "Industrial Production Survey" (various).

Notes: a/ All establishments with 5 or more employees.

b/ The price deflator used is the manufacturing GDP deflator of the Ministry of National Planning.

Table 2

SOMALIA - STRUCTURE OF MANUFACTURING OUTPUT 1971-82, CURRENT PRICES
(So. Sh. m.)

Subsector	1971 Value (%)	1974 Value (%)	1977 Value (%)	1980 Value (%)	1982 Value (%)
Food	165.8 (80.6)	178.9 (55.2)	201.5 (38.5)	320.2 (41.6)	321.3 (18.9)
Beverages, Tobacco	5.2 (2.5)	9.2 (2.9)	61.0 (11.7)	132.1 (17.1)	228.1 (13.4)
Textiles	1.2 (5.0)	19.7 (6.1)	77.1 (14.7)	94.3 (12.2)	119.8 (7.0)
Apparel	N.A. -	9.5 (2.9)	9.6 (2.5)	19.6 (1.8)	22.0 (1.3)
Leather, Footwear	2.8 (1.4)	12.8 (4.0)	19.3 (3.7)	18.0 (2.3)	32.7 (1.9)
Furniture	3.7 (1.8)	8.5 (2.6)	8.5 (1.6)	27.9 (3.6)	32.8 (1.9)
Printing, Publishing	7.0 (3.4)	21.0 (6.5)	57.9 (11.1)	43.6 (5.7)	78.5 (4.6)
Jewellery	0.7 (0.3)	1.7 (0.5)	2.4 (0.5)	6.4 (0.8)	10.8 (0.6)
Total Consumer Goods	195.4 (94.9)	260.4 (80.5)	437.3 (83.5)	662.1 (85.9)	846.0 (49.7)
Paper	- -	- -	- -	24.5 (3.2)	29.8 (1.7)
Chemicals	5.8 (2.8)	12.1 (3.8)	20.8 (4.0)	52.0 (6.7)	753.3 (44.2)
Plastics	- -	30.0 (9.3)	28.3 (5.4)	- -	1.9 (0.1)
Pottery, China, Clay, Lime	2.2 (1.1)	10.5 (3.3)	16.6 (3.2)	23.2 (3.0)	31.3 (1.8)
Metal Products	0.7 (0.3)	4.8 (1.5)	2.8 (0.5)	6.7 (0.9)	34.1 (2.0)
Others	1.7 (0.8)	4.7 (1.5)	17.8 (3.4)	1.9 (0.2)	6.6 (0.4)
Total Producer Goods	10.4 (5.1)	62.1 (19.3)	86.3 (16.5)	108.3 (14.1)	857.0 (50.3)
Total	205.8 (100)	332.5 (100)	523.6 (100)	770.4 (100)	1703.0 (100)

Source: See Table 1.

Table 3
 SOMALIA - VALUE-ADDED AND ESTABLISHMENTS IN ORGANIZED MANUFACTURING,
 BY SUBSECTOR AND OWNERSHIP, 1975-82
 (So. Sh. million, 1977 prices)

Sub-Sector	1975					1982				
	Public		Private		% V. A. Public	Public		Private		% V. A. Public
	No.	V.A.	No.	V.A.		No.	V.A.	No.	V.A.	
Consumer Goods										
Food	12	44.8	59	7.7	85.3	11	14.0	27	3.2	81.4
Beverage & Tobacco	1	6.8	3	6.3	51.9	1	39.0	4	-6.0	118.2
Textiles	1	8.0	23	2.3	77.7	1	8.4	2	1.0	89.4
Apparel	2	0.1	32	2.0	5.0	1	0.5	13	2.2	18.5
Leather, Footwear	1	1.1	18	3.8	22.4	3	1.5	9	1.8	45.5
Furniture	8	1.4	26	2.5	35.9	2	0.4	21	3.0	11.8
Printing, Publishing	1	30.0	-	-	100.0	1	16.7	1	1.0	94.4
Jewellery	-	-	5	0.4	-	-	-	9	0.6	-
Sub-Total	26	92.2	166	25.0	78.7	20	80.5	86	6.8	92.2
Producer Goods										
Paper	-	-	-	-	-	1	2.3	1	N11	100.0
Chemicals ^{a/}	2	0.5	8	3.2	13.5	3	9.0	8	2.3	79.6
Plastics	1	12.4	-	-	100.0	-	-	1	0.1	-
Pottery, China, Clay, Lime	3	4.2	56	4.3	55.3	-	-	18	4.2	-
Metal Products	-	-	9	1.9	-	2	1.1	18	2.9	27.5
Others	2	4.5	15	2.4	64.7	1	0.2	2	0.7	22.2
Sub-Total	8	21.6	88	10.9	66.5	7	12.6	48	10.2	55.3
Total	34	113.8	254	35.9	76.0	27	93.1	134	17.0	84.6

Source and Note: See Table 1.

^{a/} "Chemicals" includes various consumer products like soap, cosmetics, toiletries and pharmaceuticals. These predominate in private sector chemical production.

Table 4

SOMALIA - SIZE DISTRIBUTION OF ORGANIZED MANUFACTURING ESTABLISHMENTS,
BY OWNERSHIP, 1982^{a/}

	Establishment Size Distribution by Employment						Total
	5-9	10-19	20-29	30-49	50-99	100+	
No. of Establishments							
Total	98	17	13	17	9	23	117
Public	6	2	2	9	5	19	43
Private	92	15	11	8	4	4	134
Employment: Total ^{b/}	595	232	305	656	650	10,948	13,386
Public	36	29	51	335	393	10,436	11,280
Private	559	203	254	321	257	512	2,106
Average Wage ^{c/} : Total (So. Sh. thousand current)	13.4	10.8	12.0	9.1	8.2	15.8	14.9
Public	31.6	9.0	10.5	6.3	9.8	15.7	15.2
Private	11.7	11.2	12.3	12.4	4.9	16.8	12.6
Average Output (So .Sh. million current)							
Total	0.9	2.3	2.6	4.2	5.2	69.3	10.6
Public	0.1	0.3	3.6	2.6	5.7	79.1	36.3
Private	0.9	2.5	2.4	6.0	4.6	23.1	2.3

Source: See Table 1.

Notes: ^{a/} Includes 16 public sector water supply and electric power generating establishments which could not be separated from this table.

^{b/} Including self-employment.

^{c/} Excluding self-employment.

Table 5

SOMALIA - EMPLOYMENT AND WAGES^a IN FORMAL SECTOR MANUFACTURING
1975-82

Subsector	1975						1982					
	Public		Private		Total		Public		Private		Total	
	Emp.	Wages	Emp.	Wages	Emp.	Wages	Emp.	Wages	Emp.	Wages	Emp.	Wages
Food	3,399	6.9	1,076	4.0	4,475	6.3	6,280	4.2	270	3.3	6,550	4.1
Beverage, Tobacco	580	5.7	231	4.9	811	5.5	572	3.1	264	4.7	835	3.6
Textile	864	10.5	429	2.3	1,293	9.2	1,204	4.1	77	2.0	1,281	4.0
Apparel	77	6.6	211	3.1	288	3.5	152	1.9	97	2.8	249	2.2
Leather, Footwear	141	6.0	321	7.1	462	6.7	322	2.2	211	4.4	533	3.0
Furniture	180	5.1	286	6.0	466	5.6	52	0.9	261	2.4	313	2.1
Printing, Publishing	677	7.3	-	-	677	7.3	861	3.3	39	6.8	900	3.3
Jewellery	-	-	39	4.1	39	4.1	-	-	48	3.7	48	3.7
Total Cons. Goods	5,918	7.2	2,584	4.6	8,502	6.6	9,443	3.9	1,266	3.5	10,699	3.2
Paper	-	-	-	-	-	-	187	2.8	15	1.9	202	2.7
Chemicals	42	9.6	127	7.1	169	7.9	487	6.6	391	3.5	878	5.3
Plastics	250	7.3	-	-	250	7.3	-	-	10	2.6	10	2.6
China, Clay etc.	110	5.7	260	2.9	370	3.4	-	-	160	3.1	160	3.1
Metal Products	-	-	279	6.4	279	6.4	199	1.6	175	2.1	374	1.8
Others	266	5.9	638	2.1	904	3.0	43	3.3	89	2.0	132	2.8
Total Prod. Goods	568	6.7	1,460	3.0	2,028	4.1	916	4.6	840	2.3	1,756	3.9
Total	6,486	7.2	4,044	4.1	10,530	6.2	10,359	4.0	2,106	3.3	12,465	3.9

Source and Notes: As Table 1.

Notes: a/ Annual Wages in So. Sh. '000 at 1977 prices.

Table 6

SOMALIA - ADDITIONS TO FIXED ASSETS 1975- 82
(Current So. Sh.)

Subsector	Total Additions to F. A. (So. Sh. m.)				Total Additions per Employee ^{a/} (So. Sh. thousand)		
	Public	Private	Total	%	Public	Private	Total
Food	481.3	6.9	488.2	98.6	76.4	30.7	74.7
Beverage, Tobacco	35.9	12.8	48.7	73.7	66.3	41.1	58.3
Textiles	155.1	0.2	155.3	99.9	128.6	6.5	121.2
Apparel	5.5	0.1	5.6	98.2	30.3	10.3	22.5
Leather, Footwear	24.7	2.7	27.4	90.1	75.5	14.7	51.4
Furniture	1.0	33.8	34.8	2.8	19.2	129.5	111.2
Printing, Publishing	30.1	-	30.1	100.0	35.0	-	35.0
Jewellery	-	0.4	0.4	-	-	8.3	8.3
Total Consumer Goods	733.6	56.9	790.5	92.8	77.6	45.7	73.9
Paper	2.4	11.0	13.4	17.9	12.8	2.9	12.0
Chemicals	6.3	31.8	38.1	16.5	11.1	83.6	43.4
Plastics	1.4	-	1.4	100.0	-	-	-
China, Clay, etc.	40.2	1.3	41.5	96.9	-	8.2	8.2
Metal Products	9.7	13.3	23.0	42.2	98.5	19.4	61.5
Other	1.8	0.4	2.2	81.8	9.3	20.2	16.7
Total Producer Goods	61.8	57.8	119.6	51.7	30.3	47.9	37.0
Total	795.5	114.7	910.1	87.4	73.4	46.6	68.9

Note: ^{a/} Employment in 1982.

Table 7

SOMALIA - VALUE-ADDED PER EMPLOYEE BY SUBSECTOR AND OWNERSHIP, 1975-82
(So. Sh. '000, 1977 prices)

Subsector	Total Value-Added/ Employee						Non-Wage Value-Added/ Employee					
	Public		Private		Total		Public		Private		Total	
	1975	1982	1975	1982	1975	1982	1975	1982	1975	1982	1975	1982
Food	13.4	2.2	7.3	11.7	11.9	2.6	6.5	-2.0	3.3	8.4	5.6	-1.5
Beverages & Tobacco	11.9	68.2	27.8	-22.8	16.5	39.6	6.2	65.1	22.9	-27.5	11.0	36.0
Textiles	9.3	7.0	5.3	12.9	8.0	7.3	-1.2	2.9	3.0	10.9	-1.2	3.3
Apparel	-	3.4	9.7	22.3	7.1	10.8	-6.6	1.5	6.6	19.5	3.6	8.6
Leather & Footwear	8.2	4.6	12.0	8.6	10.8	-6.2	2.2	2.4	4.9	4.2	4.1	3.2
Furniture	7.8	7.5	9.0	11.5	8.5	10.8	2.7	6.6	3.0	9.1	2.9	8.7
Printing & Publishing	44.9	19.4	-	25.4	44.9	19.7	37.6	16.1	-	18.6	37.6	16.4
Jewellery	-	-	9.9	13.0	9.9	13.0	-	-	5.8	9.3	5.8	9.3
Total Consumer Goods	15.8	8.5	9.8	5.3	14.0	8.2	8.6	4.6	5.2	1.8	7.4	4.3
Paper	-	12.1	-	-	-	11.2	-	9.3	-	-1.9	-	8.5
Chemicals	12.2	18.5	25.2	5.9	22.0	12.9	2.6	11.9	18.1	2.4	14.1	7.6
Plastics	50.2	-	-	-	50.2	-	42.9	-	-	-	42.9	-
China, Clay, etc.	35.1	-	6.4	24.8	12.3	10.9	29.4	-	3.5	21.7	8.1	21.7
Metal Products	-	5.8	12.3	16.7	12.3	10.9	-	4.2	5.9	14.6	5.9	9.1
Other	28.2	4.2	3.8	8.2	8.7	6.9	22.3	0.9	1.7	6.2	5.7	4.1
Total Producer Goods	38.1	13.8	7.6	12.1	16.1	13.0	31.4	9.2	4.6	9.8	12.0	9.1
Total	17.7	9.0	9.0	8.0	14.4	8.8	10.5	5.0	4.9	4.7	8.2	4.9

Source and Notes: See Table 1.

Table 8

SOMALIA - EFFECTIVE RATES OF PROTECTION AND DOMESTIC RESOURCE COST
OF SELECTED ENTERPRISES

Enterprise (Ownership)	(a). ERP on Gross Value Added (excluding depreciation)	(b). ERP on Net Value Added (including depreciation)	(c) DRC Long-Term (capital costs accounted)	(d). DRC Short-Term (capital costs sunk)
1. Food Products (Public) (Wheat, Flour and Pasta Fact.)	-29%	-56%	35.2	0.13
2. Food Products (Public)	9%	21%	N.A.	N.A.
3. Food Products (Public or Private)	425%	N.A.	N.A.	N.A.
4. Beverage (Private)	38%	50%	2.94	0.65
5. Beverage (Private)	31%	Infinite	Infinite	0.70
6. Beverage (Private)	35%	37%	N.A.	N.A.
7. Tobacco (Public) (Cigarette and Match Factory)	58%	Infinite	Infinite	0.23
8. Textiles, Apparel (Public) (Somaltex)	-33%	-236%	Infinite	0.35
9. Textiles, Apparel (Public or Private)	Infinite	N.A.	N.A.	N.A.
10. Textiles, Apparel (Public or Private)	133%	N.A.	N.A.	N.A.
11. Furniture (Private)	43%	53%	2.99	0.59
12. Furniture (Private)	92%	559%	Infinite	0.16
13. Paper (Private)	61%	Infinite	Infinite	0.38
14. Chemicals (Private)	123%	Infinite	Infinite	0.70
15. Chemicals (Private)	267%	Infinite	N.A.	N.A.
16. Chemicals (Private)	Infinite	N.A.	N.A.	N.A.
17. Chemicals (Private)	86%	Infinite	N.A.	N.A.
18. Leather (Private or Public)	Infinite	Infinite	Infinite	Infinite
19. Leather (Public or Private)	18%	17%	N.A.	N.A.
20. Leather (Public or Private)	92%	N.A.	N.A.	N.A.
21. Metal Products (Public) (Foundry & Mechanical Workshop)	64%	Infinite	Infinite	0.71
22. Metal Products (Private) (Aluminum Utensils Factory)	93%	Infinite	Infinite	1.54
23. Metal Products (Private or Public)	Infinite	Infinite	Infinite	Infinite
24. Constr. Mat. (Private or Public)	118%	641%	Infinite	0.64
25. Constr. Mat. (Private or Public)	-46%	-49%	0.14	0.10
26. Constr. Mat. (Private or Public)	Infinite	N.A.	N.A.	N.A.
27. Boats (Public)	-4%	N.A.	N.A.	N.A.

Source: Harvard Institute for International Development, "Quantitative Analysis of Incentives and Disincentives for Expansion of Industrial Output and Employment in Somalia", Cambridge (Mass.), 1985, mimeo.

Note: For definitions of terms see text.

APPENDIX II
ENTERPRISE-BY-ENTERPRISE SUMMARY
OF
THE SURVEY'S FINDINGS

List of Abbreviations

t	metric tons
tpy	metric tons per year
tpd	metric tons per day
So. Sh.	Somali Shilling
MW	megawatt
kWh	kilowatt-hour
ha	hectare
DM	Deutsch Mark
ECU	European Community Unit of Account
qtl	quintal (100 kilograms)
bbl	barrel (159 liters)
m	meter

Appendix II
Enterprise-by-Enterprise Summary of the Survey's Findings

Introduction

Findings for each enterprise. The Broad outline of coverage is as follows:

- firm's profile: history, products and markets, personnel, summary financial data;
- specific problems; and
- recommended actions.

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1. PETROLEUM REFINERY, MOGADISHU

Background

1.01 The petroleum refinery was originally established as a 50/50 joint venture between the Somali and the Iraqi Government, the latter providing the necessary financing through a US\$16 million loan. The refinery came on stream in 1978 and operated until the end of 1983 under Iraqi management. At that time the Iraqi's withdrew their participation and the facility became 100 percent owned by the Somali Government. It is believed that all Iraqi experts have left since early 1985. The Government has now requested assistance from Italy for the provision of experts and spare parts.

Technical Characteristics

1.02 The rated capacity of the plant is 5,000,000 tpy of Arabian light crude. However, the figure of 3,000,000 tpy was quoted by the refinery's management as reflecting more closely the present capacity. Maximum throughput was reached in 1980, with 263,000 tons of crude processed. In 1984 and 1985 quantities of processed crude were respectively 126,400 and 164,300 tons. Some of the oil processed over the last few years has been supplied as a grant by Saudi Arabia, but it appears that free supply has been considerably reduced since 1984. According to the refinery accounting data, the cost of crude supply averaged 8,740 So. Sh. per ton in 1985 which would be US\$242 at the official exchange rate of 36 So. Sh. /US\$. This figure suggests that none of the crude oil obtained during that year was free.

1.03 The design characteristics of the refinery are such that the output mix does not correspond to the needs of the market. Gas-oil and kerosene, which account for 70 percent of domestic consumption, are 30 percent of the refinery's output, while unused surpluses of heavy fuel oil and naphta have to be exported at low prices. The timely commissioning of the urea plant would have alleviated that situation as it uses heavy distillates as feedstock. Start-up and other problems (see following section) have up to now prevented this plant from absorbing any significant quantity of the refinery's heavy fuel production.

Finances

1.04 Financial data obtained from the refinery's accounts, are of little value, as they reflect grossly unrealistic amounts for operating expenses and depreciation (assets have not been revalued since the establishment of the firm). For example the main items from the 1985 operating statement are as follows (in millions So. Sh., for a throughput of 165,000 tons of crude):

REVENUE:	Sales of products	1,412.8
EXPENDITURE:	Crude oil	1,436.4
	Wages and salaries	19.5
	Other expenses	13.1
	<u>Other materials</u>	<u>31.5</u>
	Operating expenditure	<u>1,500.5</u>
	Depreciation	51.3
	Profit (loss) before tax	(139.0)

1.05 Reported expenses other than crude oil and input chemicals can be compared with recent estimates prepared by the Ministry of Finance, which show that normal fixed and variable operating costs for the refinery amount to at least So. Sh. 290 million per year, for 120,000 tons of processed crude, including So. Sh. 84 million for maintenance. This estimate is still low, as it includes an unrealistic allowance for depreciation, derived from historical value of assets, and is based, for the foreign exchange component of the cost, on a rate of exchange much below the open market rate. Adjusting the rate of exchange to reflect the free market rate would bring the yearly operating costs of the refinery (excluding cost of chemicals), at the same throughput, to around So. Sh. 960 million, which would, if applied to the 1985 operating results, result in a loss in excess of So. Sh. 1 billion.

Major Problems

1.06 The most immediate problem faced by the refinery at present is the fact that it is operated by unqualified staff under severe foreign exchange constraints which prevent regular supply of crude feedstock, purchase of spare parts and essential chemicals. In addition, frequent power outages severely affect the operation of the plant whenever availability of crude allows it to run. Maintenance of the plant is grossly inadequate: its piping, tanks and structures are being rapidly corroded, especially as the facility is located close to the sea, unprotected from the strong, salt-spray-laden winds. Due to poor accounting practice and insufficient cash flow, inadequate provisions have been made for equipment renewals. Thus the capital of the enterprise is in the process of being dilapidated, both physically and financially, before making any allowance for repayment of the loan used to build the plant (the liability for the Iraqi loan is not carried on the refinery books and is assumed entirely by the Government of Somalia).

Intrinsic Viability

1.07 But the problem of the Mogadishu refinery is in fact more profound. Due to its small size and obsolete design, and to the mismatch between the product mix and the requirements of internal demand, it appears unlikely that it can function economically in the present context of huge world refining overcapacity and weak demand for petroleum products. A recent (August 1985) energy assessment report by the World Bank showed that

ex-refinery costs of products, even at historical (i.e. high) levels of crude throughput were about US\$3.4/bbl. Even if crude was still available on a grant basis, it would be more economical to have this crude refined for a fee in an efficient foreign refinery, or to receive petroleum products instead of crude as a grant.

Recommended Actions

1.08 The refinery not only suffers from severe operating problems but more fundamentally, from doubtful intrinsic viability. At this juncture it appears advisable to carry out an economic feasibility study which would analyse the viability of continuing the refinery's operations as compared with other possible options. Such options include:

- upgrading and expanding the refinery so as to increase production of middle distillates. This would be a costly proposition, unlikely to be attractive in present world market conditions of minimal or negative refining margins and massive refinery closures;
- closure of the refinery, and disposal of the assets;
- mothballing of the refinery, so as to keep open the option of restarting the facility once world market conditions improve markedly. This would be a costly proposition and also difficult to implement due to lack of properly trained maintenance personnel;
- converting some of the refinery's equipment to other uses in situ or elsewhere. For example it might be used for the reinforcement of the country's unloading and storage facilities for petroleum products.

1.09 If the outcome of the study shows that continuing the refinery's operations is not the most economical solution, a detailed alternative plan of action should be established, costed and recommended to the Government of Somalia.

Table 1

SOMALIA - MOGADISHU REFINERY ANALYSIS, 1986 PRICES

	Yield percent	Input Output (MT'000)	Value (US\$/MT)	Total (US\$'000)
Crude Throughput		210.0	106 (1)	22,260
<u>Products Output</u>				
LPG	1.0	2.1	293	615
Gasoline	13.0	27.3	177 (2)	4,832
Heavy Naphta	5.0	10.5	157	1,649
Kerosene	10.3	21.6	180	3,893
Gas Oil	20.0	42.0	50 (3)	2,100
Heavy Fuel Oil	48.7	102.3	112	<u>11,454</u>
T O T A L				24,543
<u>Refinery Costs</u>				
Fixed Costs (4)				6,053
Chemicals		1,050		
T O T A L			7,103	
Net Profit/(Loss)				(4,819)
per ton crude processed (US\$)				(22.95)
per bbl crude processed (US\$)				(3.17)

(1) Equivalent to US\$ 15/bbl
 (2) Recent quoted CIF price provided by Ministry of Finance, other prices calculated with reference to gasoline price, on the basis of Table 4.2 of source, except for heavy oil.
 (3) June 1986 quote in Platt's Oilgram.
 (4) As estimated by Ministry of Finance.

Source: World Bank/UNDP, Somalia: Issues and Options in the Energy Sector, August 1985, Table 4.2 updated as noted above.

2. UREA PLANT, MOGADISHU

Background

2.01 In July 1979 the Government of Somalia issued a letter of intent to the Italian consulting firm, Technipetrol, for the construction, on a turnkey basis, of an ammonia-urea plant with a daily production capacity of 150 tpd of urea (50,000 tpy), using the heavy fuel oil produced by the adjoining refinery as feedstock. The US\$70 million project was to be financed as follows:

- US\$10.5 million - Italian Government loan (9 years, 4 percent);
- US\$59.5 million - loans from various European banks (9 years, 7.75 percent).

Interest payments on the bank loans are reported to be guaranteed by the Italian Government.

2.02 Erection was completed in March 1983 and the Mechanical Completion Certificate was issued. However, start-up of the plant has been plagued by numerous problems; as a result only very small quantities of urea, corresponding to the output of test runs, have been produced so far (1,400 tons in 1984, 1,950 tons in 1985, none so far in 1986). A technical team from the Italian contractor, numbering 18 engineers and technicians, is still making final adjustments in order to fully commission the plant and finally get it into production.

Technical Characteristics

2.03 The overall process chosen for the plant is based on the integration of several proprietary sub-processes, provided by various licensors (Texaco, Snamprogetti, Allied Chemicals, Haldor Topsoe). Although each individual sub-process appears to be well proven, their combination within the same overall process, has, according to a UNIDO report, rarely, if ever, been attempted.

Markets

2.04 The domestic market for urea is currently estimated at a maximum of 10,000 tons. Any production in excess of that figure would have to be exported. International prices of urea are presently quite depressed due to the world supply exceeding demand, and to the existence of large efficient ammonia-urea plants using inexpensive natural gas as feedstock. Present international prices of urea fluctuate between US\$80 and US\$90 per ton, FOB tidewater. As will be seen below, in no way can the plant in its present configuration produce urea at such a price.

Finances

2.05 No detailed financial statements for the urea plant were made available to the mission. However, it was reported that major losses were incurred in 1984 and 1985, due to the negligible output. All losses up to January 1st, 1986 have been covered by the Government of Somalia. Sales proceeds of the small quantities produced in 1984 and 1985 were sufficient to cover salary costs.

Personnel and Training

2.06 Employment at the plant stands presently at 230 Somali nationals, of which 30 are graduate engineers from the national university. The contract between the Somali Government and the consulting engineer includes an important training component, which involves theoretical and practical training abroad (over a 6-month period for 45 engineers and technicians), and on-the-job training to be carried out by the technical assistance team on site. According to a detailed evaluation carried out by a UNIDO team, the obligations of the training contract have been so far only partially met, and the quality and depth of training have been inadequate. Furthermore, practical training abroad took place in a plant of different configuration and process, which raises questions about its relevance. Indeed, as pointed out by the UNIDO report, the innovative nature of the plant is such that its start up and operation constitute a learning experience for the consulting engineering firm itself.

Main Problems

2.07 The problems that have prevented the timely start-up and operation of the plant appear to be of two types:

- problems of plant commissioning which the technical team for Technipetrol is presently attempting to solve. According to the firm's representative on the site, all technical adjustments have now been carried out, and the plant is ready to start as soon as feedstock is available.
- sources of malfunction which are quite foreign to the process itself, and depend on exogenous factors. First and foremost is the unreliability of electricity supply which causes frequent shutdowns. Internal power generation at the plant accounts for 6MW but an additional 3MW of power has to be secured from the nearby thermal generating station. Unfortunately, this latter supply is very unreliable, and the figure of 20 to 25 power outages per month has been quoted by the plant's management as an average for the last few months. Since any interruption of the manufacturing process through power breakdown entails a washup procedure which takes up to three days, it is clear that it is practically impossible for the plant to operate normally under present circumstances, even if all process-related problems were successfully solved. Reliable supply of feedstock from the refinery, and difficulties in attracting, training and retaining suitable personnel (even unskilled labor) in a remote location without adequate transportation, housing, food and recreation facilities were also quoted as important constraints.

Economic Viability

2.08 As with the refinery, the most fundamental question concerning the urea manufacturing facility, is its intrinsic viability. As mentioned earlier, the market price for urea is around US\$90/ton FOB, which would correspond perhaps to about US\$120/ton CIF Mogadishu. Table 2 shows the estimated cost of inputs per ton of urea. Taking the cost of heavy oil feedstock at its present depressed opportunity value of US\$50/ton, and electric energy at US\$.09/kWh,¹ the unit cost of inputs at current prices excluding wages, technical assistance, maintenance, capital and other fixed costs, amounts to US\$121.75/ton of urea. Assuming a plant life of 20 years and using a discount rate of 10 percent, capital costs by themselves would amount to US\$164/ton, assuming continuous operation of the plant at full rated capacity.

2.09 The predicament of a small, heavy oil based urea plant in the present context of excessive world supply of nitrogenous fertilizers is well illustrated by data prepared by the World Bank.² The production cost of ammonia (which is the final stage before the synthesis of urea), at current world prices of heavy oil and natural gas, is about US\$125/ton in a small (200 tpd) heavy oil based ammonia/urea plant, as compared with US\$72/ton in a large (1,000 tpd) natural gas facility. This 45 percent cost advantage provided by more efficient feedstock and size of plant, is compounded by the fact that the marginal cost of natural gas is negligible in several oil-producing areas of the world.

Table 2

SOMALIA - UREA PLANT: COST OF INPUTS PER TON OF UREA, 1986

Input per Ton of Output	Qty	Unit Value (US\$)	Total Value (US\$)
Heavy fuel oil	(MT)	0.85	50.00
LPG	(MT)	0.0047	293.00
Naphta	(MT)	0.0133	157.00
Chemicals		-	-
Bags	(U)	20.00	0.75
Electricity	(kWh)	555.00	0.09
T O T A L			106.67

1/ Lowest average cost of generation, including capital cost, obtainable in present conditions in a small size thermal plant at a tidewater site.

2/ World Bank, Handbook of Fertilizers, February 1981.

Recommended Actions

2.10 A study to assess the economic viability of the urea plant should be conducted. Such a study would compare the presently contemplated course of action with other options, which would include the closure and disposal of the plant, or its mothballing. Because of its close technical relationship with, and physical proximity to the refinery, feasibility studies for the two plants might be usefully combined. Another reason for this suggestion is the distinct possibility that some options might involve joint plans of action for the two facilities, (conversion into storage, outright sales of equipment, etc.). Although the probability of obtaining attractive proposals appears remote due to the weak economics of the operation, the possibility of leasing the plants, jointly or separately might be an option that a competent expert might recommend. Such leasing arrangements may include the reconversion of the facilities for other purposes. All possible options should be carefully explored by a specialized consultant, familiar with the fast-changing economics and opportunities in the fields of hydro-carbon processing and finished product marketing.

3. SOMALTEX, BALAD

Background

3.01. Somaltex was established in 1966 as a joint venture between the Somali Government and German interests. Production started in 1969 but the enterprise suffered large losses until 1973, apparently because of low output due to outdated machinery. The firm was nationalized in 1973, following which the plant was modernized and expanded at a cost of So. Sh. 140 million. The refurbished plant, completed in 1976, is a fairly modern textile facility, comprising the following departments ginning, spinning, weaving (154 Sulzer looms), finishing (bleaching, dyeing, printing), knitting, medical cotton and bandage. Capacity of production is 20 million yards of cloth per annum on a three-shift basis. The highest level of production was reached in 1980 with 13 million yards with two shifts. Output in 1985 was 3.5 million yards, or 17.6 percent of capacity.

Products and Markets

3.02 Main products consist of low to medium quality fabric in grey, bleached, dyed and printed qualities. Distribution of sales among these products was as follows in 1985: grey - 25 percent, bleached - 11 percent, dyed - 40 percent, and printed - 24 percent. Marketing of products is carried out through 5 regional distribution centres, and a number of commission agents. The bulk of the production is sold in rural areas to low income consumers. Apparently very little volume is realized in urban areas, where consumers prefer imports of better quality, particularly synthetic or mixed fiber fabrics. Somaltex also supplies the National Police and Army with dyed drill cloth for uniforms. Sales decreased drastically from 1984 to 1985 (from 7.8 to 3.3 million yards). The ample stock of finished products at the end of 1985 (40 percent of year's turnover) suggest that the firm faces major marketing problems.

Financial Data

3.03 Financial statements for 1984 and 1985 are shown on Table 3. In spite of the major drop in sales volume, the profit situation actually improved from 1984 to 1985; showing a nominal profit in the latter year as compared with a small loss in the previous period. This is due in part to a drastic reduction of the labor force (from 894 to 635), and in part to major price increases, which probably explain the marketing problem pointed to earlier. The following points are also worthy of note:

- repair and maintenance expenses are totally inadequate to maintain plant and machinery in proper working conditions (less than 1 percent of the original purchase value);

Table 3

SOMALIA - SOMALTEX: SUMMARY FINANCIAL DATA

Operating Statement (Millions So. Sh.)	1985	1984
SALES	161.7	105.2
<u>Expenditures</u>		
Raw materials and Supplies	93.8	55.4
Wages and Salaries	26.9	27.4
Repairs and Maintenance	1.4	1.1
Depreciation	17.3	14.5
Misc. Operating Expenses	4.5	3.8
Overhead	<u>16.5</u>	<u>9.6</u>
TOTAL EXPENDITURES	160.4	111.8
PROFIT/(LOSS)	1.3	(6.6)
<hr/>		
<u>Balance Sheet</u>		
ASSETS		
Fixed Assets (Net)		
Lands and Buildings	26.8	28.1
Plant and Machinery	202.0	237.5
Other Fixed Assets	6.9	5.5
Total Fixed Assets	235.7	271.0
Current Assets		
Stock	216.7	194.8
A/C Receivables and Prepayments	14.6	24.0
Cash and Bank Balance	22.3	9.8
Total Current Assets	<u>253.6</u>	<u>228.6</u>
TOTAL ASSETS	489.3	499.6
LIABILITIES		
Long Term Debt	261.9	261.9
Bank O'Draft and Short Term Loans	1.3	1.5
A/C Payable	<u>40.3</u>	<u>28.2</u>
TOTAL LIABILITIES	303.5	291.6
NET WORTH		
Accounted for by:		
Paid-up Capital	293.1	293.1
Accum. Profit/(Loss)	(0.9)	(2.4)
Capital Reserves	14.4	14.4
Exchange Equalization	<u>(120.8)</u>	<u>(97.1)</u>
TOTAL SHAREHOLDERS' EQUITY	185.8	208.0

- assets have not been revalued in 1985 in keeping with the devaluation of the currency, thereby making allowances for depreciation inadequate;
- servicing of long-term loans is in arrears (accounts do not show by how much); and
- Somaltex does not appear to pay any taxes (except the 5 percent sales tax, which is passed on to the consumer).

Major Problems

3.04 Thus, despite false appearances of financial equilibrium, the enterprise is in fact in a very critical situation: production is falling steadily, sales are decreasing even faster and assets are not properly maintained; the firm is getting rapidly decapitalized and is neither contributing to the servicing of its debt nor to the finances of the Government.

3.05 There are a host of underlying problems contributing to this situation which can be summarized under the following headings:

- insufficient management experience and training of technical staff;
- inadequate supply of diesel oil, spare parts and raw materials. Lack of foreign exchange and long administrative and delivery delays is resulting in an acute shortage of spare parts. As a result, the spinning capacity is considerably decreased, and 70 percent of the lcoms are inoperable. As regards raw materials, it is interesting to note that Somaltex imports 60 percent of its cotton fiber requirements. Increased promotion of local cultivation of cotton appears advisable as it would save foreign exchange and contribute to the growth of the agricultural sector. A prefeasibility study carried out in 1982,³ confirmed that there exists considerable potential for cotton cultivation in Somalia. A preliminary development program aiming at producing 20,000 tpy of seedcotton was identified, which would satisfy the requirements of Somaltex (at full capacity, the mill requires 3,500 tpy of ginned cotton, equivalent to 10,000-11,000 tpy of seedcotton).
- Poor organization of production; in 1984 a technical survey of the mill was carried out by a UNIDO consultant. This study identified a great number of grave shortcomings in the organization of production at the mill, and recommended a program of improvement. The following major deficiencies were noted: (i) absence of production standards and corresponding control;

3/ Songreah, Cotton Lands Rehabilitation and Development Project, First Phase: Project Identification, July 1982.

(ii) poor state of machinery and lack of preventive maintenance; (iii) inadequacy of professional technical staff (there is only one textile engineer); (iv) incompetence of middle management; (v) overstaffing; (vi) counter productive incentive system and grave disregard for quality control; (vii) absence of a suitable cost accounting system; and (viii) unrealistic planning and budgeting.

- It is not known whether the consultant's recommendations have been acted upon, beyond the reduction of staff which took place recently. It can be safely assumed, however, that lack of funds, insufficient management experience and supply constraints have prevented any significant improvements being made to the plant's organization. The 18 percent drop in production observed between 1984 and 1985 speaks for itself.
- Apparent disregard for marketing considerations. As noted earlier, the dominant obstacle to normal, profitable operations in 1985 was not the falling production, but the lack of sales. Due to a combination of low quality and high prices, Somaltex appears increasingly unable to compete with imports. Yet in interviews with the management, marketing does not appear to be perceived as a major problem, in comparison with the perennial diesel oil and foreign exchange/spare part constraints.

Recommended Actions

3.06 In conclusion, the numerous and severe problems which affects all aspects of operation of the Somaltex mill call for comprehensive diagnostic studies in the management, technical and marketing areas and the identification of a suitable rehabilitation program. Furthermore, the possibility of attaining self sufficiency in cotton fiber should be examined anew, and the economic feasibility of integrating the cultivation of cotton in the agricultural development programs should be assessed.

4. SNAI-JOWHAR SUGAR FACTORY, JOWHAR

Background

4.01 The SNAI Jowhar agricultural estate and sugar mill, situated 90 Km. north of Mogadishu on the Shabelli river, was founded in 1917 by Italian colonists. First devoted to cotton cultivation, the estate was subsequently converted to sugar cane, and the sugar mill first came on stream in 1926. An Italian company, SNAI, ran the estate and mill until 1963, at which time the Government of Somalia acquired a 49 percent interest in the Company. The factory was subsequently nationalized in 1970 and became a wholly-owned public enterprise, under the control of the Ministry of Industry.

4.02 Production of sugar reached a peak in the 1970-71 campaign: with 5,200 ha under cane, a yield of 88.5 t/ha, an extraction rate of 10.3 percent, and production of 47,500 tons of sugar. Ten years later, this was reduced to 16,700 tons, with close to 6,000 ha under cane, but a yield of only 38 t/ha and an extraction of only 7.3 percent. In the last two years, only token productions of 638 tons and 246 tons were achieved. This catastrophic development is the result of several factors:

- gradual waterlogging and increased salinity of large parts of the estate, which led to the abandonment of more than 2,000 ha;
- lack of proper maintenance of the irrigation system and poor irrigation techniques;
- increasing difficulty in hiring cane cutters due to the low wages offered and higher earning potential of subsistence agriculture on abundant adjacent land;
- gradual breakdown of the cane transport system due to poor maintenance and age; and
- increasing difficulties in maintaining and operating the factory, due to erosion of working capital, lack of foreign exchange and difficulty in procuring spare parts, dearth of trained technical personnel, etc.

4.03 In 1983 the factory was closed for a major overhaul program, for which a loan of So. Sh. 76 million was obtained from the Government. Carried out by the factory's own technical staff, this program is still underway, with the objective of resuming production in December 1986 (only trial runs took place in 84 and 85). On the agricultural side 1,500 ha of new cane were planted in the best areas of the estate, with the objective of harvesting 100,000 t of cane and producing 5,000 t of sugar for the 1986-87 campaign.

Financial Data

4.04 The financial situation is no less catastrophic. Table 4 shows the consolidated Jowhar/SNAI-Biasa statements for the last three years. Up to 1983 accumulated losses resulted in a negative net worth roughly equal to the value of the assets. A massive injection of Government funds in 1984 reestablished a positive, albeit small, net equity. The 1984 Government contribution, amounting to some So. Sh. 300 million, was officially converted to equity the following year. In the meantime long term debt increased by about So. Sh. 130 million but losses were considerably reduced in 1985 due to the satisfactory performance of the SNAI-Biasa factory (see section 11).

Proposals for Rehabilitation

4.05 In 1983 a feasibility study was financed by the Government of the Federal Republic of Germany for the rehabilitation of the estate and factory.⁴ The plan of action recommended by the study includes the rehabilitation of the estate irrigation and drainage system over 5,300 ha, the rehabilitation of the sugar mill, the improvement of the cane transport system and the complete reorganization of the enterprise management and the provision of intensive technical training with the assistance of a large international management team. The sugar production objective is around 47,000 tpy, to be reached by 1992. The total project costs, including physical contingencies and provisions for inflation, were estimated at DM94 million. The economic rate of return, as calculated by the consultant, is stated to be in excess of 17 percent. Apparently, the Italian Government is now interested in financing a rehabilitation program for the SNAI/Jowhar sugar estate, along the general lines of the recommendations described above and is carrying out a new feasibility study for this purpose.

Main Issues

4.06 Some of the issues which appear important in considering whether considerable funds should be invested in rehabilitating the Jowhar Sugar project are the following:

- The project should be examined in the overall context of the sugar subsector i.e., taking into consideration the other important project being developed, Juba Sugar. The question as to whether it would not be more rational to concentrate all the efforts on the most modern project of the two should be addressed. When the amount of money that the Government has sunk in Jowhar in the last three years is considered, and the results obtained so far, perhaps a better course of action would have been to satisfy the financial requirements of the Juba project.

4/ Instrupa Consulting GMBH, Sir Macdonald & Partners, Ltd., HVA International BV: Jowhar Sugar Estate, Feasibility Study for Rehabilitation, April 1984.

- On the other hand, the running costs at Jowhar could be very low; irrigation is by gravity, hence does not require costly pumping; plant and machinery are almost fully depreciated; most of the equipment might still be quite serviceable once it is properly overhauled and maintained; the mill possesses some of the best trained workers in the country, especially in skilled and semiskilled categories (lathe-operators, machinists, millwrights, etc.), indeed some of the workers are third generation in the plant; it would seem a pity to destroy whatever modest industrial tradition has been established in the Jowhar region, which would happen if the plant was closed.;
- Conversion to other agroindustrial activities should be actively considered; the small SNAI-BIASA facility, which converts alcohol into perfumes and liquors (see infra) is a step in this direction; and
- Minor, essential rehabilitation, with concentration on management improvement and technical training, might be one option worth exploring, given the fact that the Shabelli waters are now intensively used, and that diverting them for sugar cane carries a high opportunity cost, it might be well to limit cane cultivation to the area necessary to ensure breakeven operations of the plant. Such an option could be considered in conjunction with a search for further diversification, both in agricultural and other industrial activities.

Table 4

SOMALIA - JOWHAR/SNAI-BIASA: SUMMARY FINANCIAL DATA
(Consolidated)

Operating Statement (Millions So. Sh.)	1985	1984	1983
Sales	85.5	25.8	21.2
EXPENDITURES			
Raw materials and Supplies	n/a	n/a	27.3
Wages and Salaries	n/a	n/a	22.3
Repairs and Maintenance	n/a	n/a	0.7
Depreciation	n/a	n/a	6.0
Interest Expenses	5.7	35.1	27.2
Mis. Operating Expenses	n/a	n/a	0.8
Overhead	<u>n/a</u>	<u>n/a</u>	<u>7.7</u>
TOTAL EXPENDITURES	108.6	115.1	92.0
PROFIT/(LOSS)	(23.1)	(89.3)	(70.8)
<hr/>			
Balance Sheet			
ASSETS			
Fixed Assets (Net)			
Lands and Buildings			
Plant and Machinery			
Other Fixed Assets			
Total Fixed Assets	78.8	81.6	39.2
Current Assets			
Stock	146.2	134.4	76.8
A/C Receivables and Prepayments	120.8	65.7	85.7
Cash and Bank Balance	37.8	7.9	3.3
Total Current Assets	304.8	208.0	165.8
TOTAL ASSETS	383.6	289.6	205.0
LIABILITIES			
Long Term Debt	290.0	198.8	161.5
Bank O'Draft and Short Term Loans	37.2	20.1	222.0
A/C Payable	<u>41.1</u>	<u>29.3</u>	<u>29.8</u>
TOTAL LIABILITIES	368.3	248.2	413.3
NET WORTH	15.3	41.4	(208.3)
Accounted for by:			
Paid-up Capital	333.9	25.0	25.0
Accum. Profit/(Loss)	(371.9)	(347.6)	(258.2)
Capital Reserves	53.3	364.0(1)	24.9
Exchange Equalization	<u>-</u>	<u>-</u>	<u>-</u>
TOTAL SHAREHOLDERS' EQUITY	15.3	41.4	(208.3)

5. JUBA SUGAR PROJECT

Background

5.01 The Juba Sugar Project was initiated in 1978 under financing from the Abu Dhabi Fund, the Saudi Fund for Development and the OPEC Special Fund. The initial plan called for the development of a 8,000 ha sugar estate in the Juba river valley, with an adjoining mill of 70,000 tpy mill white sugar and 30,000 tpy molasses capacity. The original foreign loan total amount was US\$213 million, but due to poor loan servicing, the loans were suspended in 1982 with only US\$190 million disbursed. The evolution of cane hectareage and sugar production since the mill came on stream is as follows:

1980	3,530 ha	7,930 t
1981	4,040	14,760
1982	4,250	22,210
1983	5,320	28,110
1984	6,370	26,950
1985	6,810	39,100
1986 (proj.)	7,600	30,500

5.02 The mill is now commissioned and has reached full capacity. Agricultural development of the estate is continuing, funded by the enterprise's cash flow.

5.03 One of the major problems faced by the Juba Sugar Project since its inception is the insufficient supply of diesel fuel for the irrigation pumps. For example, out of a total diesel fuel requirement of 13.5 million liters in 1985 only 5.0 million were obtained. As a result cane yield was 63.4 t/ha, instead of the projected 100 to 105. The low sugar production projected for 1986 in spite of increased acreage is due to continued severe shortfall in diesel. Juba management has recently requested permission from the Government to directly import diesel fuel, showing that each additional unit of currency spent on providing adequate irrigation yields nine additional units of net revenue at current domestic prices of sugar.

Financial Data

5.04 The financial performance up to 1984 has been marked by sizeable accumulated losses (So. Sh. 359 million). As shown on Table 5 results for 1985 were positive for the first time, with a net profit of So. Sh. 111 million. However, the enterprise is very heavily indebted, and is not in a position to begin amortizing its long-term debt. Recent cash flow projections show that at the current ex-factory price of sugar, short-term financing will be needed for the next two years, reaching a peak in excess of So. Sh. 700 million in 1987.

Table 5

SOMALIA - JUBA SUGAR PROJECT: SUMMARY FINANCIAL DATA

Operating Statement (Millions So. Sh.)	1985	1986 ^a
SALES		
Sugar	787.3	312.7
Molasses	53.1	5.9
EXPENDITURES		
Cost of Cane	315.7	137.2
Factory Costs	163.9	69.4
Administrative Costs	186.2	77.3
Finance Charges	33.7	32.3
Exchange Losses	<u>29.8</u>	<u>25.7</u>
TOTAL EXPENDITURES	729.3	341.9
PROFIT/(LOSS)	111.1	(23.3)
<hr/>		
Balance Sheet		
ASSETS		
Fixed Assets (Net)	1,175.6	1,045.6
Current Assets		
Stock (including standing cane)	270.6	194.3
A/C Receivables and Prepayments	131.5	62.3
Cash and Bank Balance	63.3	-
Total Current Assets	465.4	256.6
TOTAL ASSETS	1,641.0	1,302.2
LIABILITIES		
Long Term Debt	1,406.7	1,346.0
Bank O'Draft and Short Term Loans	-	
95.0		
A/C Payable	<u>322.8</u>	<u>93.4</u>
TOTAL LIABILITIES	1,729.5	1,534.4
NET WORTH	(88.5)	(232.2)
Accounted for by:		
Paid-up Capital	159.2(1)	126.6(1)
Accum. Profit/(Loss)	(247.7)	(358.8)
Capital Reserves	-	-
Exchange Equalization	-	-
TOTAL SHAREHOLDERS' EQUITY	(88.5)	(232.2)

^{a/} Subsequent GOS data presented show 1986 sales as So. Sh. 690 million and the loss as So. Sh. 12 million.

Personnel and Management

5.05 The Juba Sugar estate and mill is managed with the assistance of a specialized consultancy: Booker Agriculture International, Ltd., the firm has presently 15 expatriates on site, including the general manager, financial controller and the factory manager. Other technical assistants are distributed among the industrial (3 expatriates) and agricultural operations (7 expatriates). Total permanent employment is approximately 2,000, including 15 Somali engineers. Booker International is responsible for running an elaborate training program on site, including on-the-job and off-the-job courses, with duration of courses averaging six weeks. A few trainees have been sent overseas for more advanced studies, but several did not return to the project afterwards.

5.06 Juba Sugar is experiencing considerable difficulties in recruiting and retaining skilled employees. Yearly turnover is close to 25 percent of the permanent workforce (in 1985 there were 450 leavers and 730 starters). In addition to the general problem of low remuneration, the isolated and remote location is an obstacle in retaining staff, especially in the lower skilled and semiskilled grades. Wage increases ranging from 12 percent to 42 percent were given in 1985, and various allowances and bonuses, increased rates of promotion, have been introduced, but employees continue to leave after being trained, mostly to obtain better paid jobs in private sector companies. As in the case of Jowhar, considerable difficulty is experienced in recruiting cane cutters. Although the task rate was increased by 31 percent in 1985 (bringing the daily wage for an average worker to So. Sh. 45), turnout remained below the 1,500 that are required daily to meet production needs, and purchase of mechanical cane harvesters is prevented by lack of finance.

Pricing of Products

5.07 The Juba sugar production is sold to the National Trading Agency, E.N.C. Ex-factory price is set by Government. Recent prices were as follows:

August 1984 - January 1985:	So. Sh. 12,000/t
Jan. 1985 - January 1986:	20,000
Jan. 1986 - Present:	28,000

5.08 The structure of sugar price to the consumer (also regulated) is as follows:

ex-factory price:	So. Sh. 28,000/t
excise tax (60 percent):	16,800
Adm. & handling charge by ENC:	<u>4,670/t</u>
wholesale price:	49,470
retail margin:	<u>30,530</u>
retail price:	80,000

Molasses are exported through Somali Molasses Company, a mixed ownership enterprise, with the following ownership structure:

Juba Sugar Project:	50 percent
United Molasses:	30 percent
International Finance Corporation:	20 percent

5.09 Through a long-term contract with United Molasses, production is sold at an FOB price not lower than US\$50/ton. Fifty percent of the foreign exchange thus gained can be transferred to JSP, and used for imports.

5.10 The Juba management contends that the exfactory price of sugar is set too low. A formal request has been submitted to Government to increase it to So. Sh. 35,000/t, based on the argument that import parity pricing, which the present price is supposed to reflect, is far below the average price at which sugar is traded internationally. It is further argued that world average production costs in efficient sugar mills is close to US\$230/ton, which is equivalent to So. Sh. 35,000 at the free market exchange rate. Based on the 1985 profit and loss statement, and making due provisions for capital cost and amortization of accumulated losses, the production cost of JSP is around So. Sh. 23,000/t in 1985. However such a low cost cannot be sustained for any length of time without severely jeopardizing the productive capacity of the enterprise.

Conclusion

5.11 The Juba Sugar Project looks an attractive venture which is prevented from being successful because of external constraints, mostly Government induced. This is a clear case where a few, but decisive liberalization measures would be of tremendous economic advantage. Let Juba Sugar provide reasonable wage increases to its staff to compete with the private sector, obtain all the diesel it needs, increase its price moderately and purchase foreign exchange in sufficient quantity at the market rate. In return, the enterprise could satisfy around 80 percent of the 80,000 tpy domestic sugar demand, pay for its loans, and contribute to Government finances through normal taxation and dividends.

6. SOMALI HIDES AND SKINS AGENCY

Background

6.01 The Somali Hides and Skins Agency was formed in 1981 by amalgamating the existing Hides & Skins Agency, up to then responsible for hides and skins trading only, with the following industrial facilities:

- the Mogadishu Leather & Shoe Factory (km. 7);
- the Hargeisa, Burao and Kismayo tanneries.

6.02 According to its statutes HASA enjoys a monopoly for the purchase and collection of all raw hides and skins in the country, for their supply to all tanneries, as well as for exports of raw and processed hides and skins. It also has a monopoly for the import of chemicals and other materials used by the leather industry.

Raw Material Supply

6.03 The potential output from the 4 million heads of cattle, 5 million camels and 25 million sheep and goats that constitute the resource base of the leather industry, should provide more than sufficient raw materials for all industries to work at full capacity. Yet all the Government and private factories are reported to be operating at low capacity owing to the shortage of raw materials. A recent study⁵ suggests that due to the low purchase price of hides and skins (the purchase price has been only changed twice since 1978) over 30 percent of the production is being thrown away in rural areas, rather than being dried and salted for sale to HASA. A large portion of the remainder (40-50 percent, according to some sources) is smuggled out of the country.

Technical Characteristics

6.04 The nominal capacities of the HASA factories are as follows (single shift):

- Mogadishu Km 7:	Hides:	500/day
	Skins:	2,500/day
	Shoes:	400 pairs/day
- Kismayo:	Hides:	300/day
	Skins:	3,000/day
- Hargeisa:	Hides:	100/day
	Skins:	4,000/day
- Burao:	Hides:	100/day
	Skins:	2,000/day

⁵/ International Group for Finance and Consulting, A Study of the GSDR Regulations Affecting the Private Sector, March 1986.

6.05 The Mogadishu factory (the only HASA factory visited by the mission) operates at about 55 percent capacity, while capacity utilization of the three other plants vary from 50 percent (Kismayo and Burao) to 25 percent (Hargeisa). The Mogadishu plant produces semiprocessed (wet-blue) hides and skins for the export markets, processed leather for the local market as well as footwear, mostly military shoes (an old civilian shoe line exists, but it is shut down).

6.06 The plant appears to be in a poor state of maintenance; shopfloor operations seem badly organized; shops are untidy, machinery is dilapidated and quality control is primitive. Total employment at HASA is around 700 persons, including 28 graduate engineers. About 500 persons work in the plants, and 200 are involved in the collection and trading activities.

Finances

6.07 The financial accounts show a small profit in 1985 (see Table 6); however some of the previous years were not as successful, as indicated by the sizeable accumulated loss. About 40 percent of the plant production in 1985, in value terms, was for exports.

Framework for Action

6.08 Because of the importance of hides and skins, leather and leather products there is an urgent need for an in-depth study of the whole sector. This has already been recognized, and a sectoral study of the hides and skins, leather and leather products trade and industry, financed by the World Bank and executed by UNIDO, is about to be launched. The terms of reference include a review of the legislation governing the domestic and export trade in hides and skins, leather and leather products; the formulation of recommendations to modify such legislation with a view to liberalizing the trade and providing incentives for increased value added in the sector; recommendations for rehabilitation measures needed in the industry; and recommendations for locating and attracting joint venture, management and/or trading partners.

6.09 This study, will hopefully provide a general basis for reform and rationalization of the leather subsector. However, future success in this area is partly dependent on actions taken in the agricultural/livestock sector, and also in the meat processing subsectors. It is also advisable to look at the leather subsector in the context of the whole animal-product chain, which presently constitutes the most important resource base of the country. Within that broad framework it will be necessary to examine each of the Government tanneries and recommend concrete rehabilitation measures for these establishments. This may include the closing and/or consolidation of plants, renewal of equipment, provision of management and technical training, etc. The question of ownership may prove to be of great relevance and recommendations may be made for privatizing part or all of the public industries of the leather sector.

Table 6

SOMALIA - KM. 7 TANNERY AND SHOE FACTORY: SUMMARY FINANCIAL DATA
(1985)

Operating Statement (Millions So. Sh.)	1985
SALES	51.8
<u>Expenditures</u>	
Raw materials and Supplies	17.5
Wages and Salaries	9.2
Repairs and Maintenance	0.9
Depreciation	8.2
Misc. Operating Expenses	2.2
Overhead	<u>9.8</u>
TOTAL EXPENDITURES	47.8
PROFIT / (LOSS)	4.0
<u>Balance Sheet</u>	
<u>ASSETS</u>	
Fixed Assets (Net)	
Lands and Buildings	10.8
Plant and Machinery	47.1
Other Fixed Assets	6.0
Total Fixed Assets	63.9
Current Assets	
Stock	44.2
A/C Receivables and Repayments	9.1
Cash and Bank Balance	0.4
Total Current Assets	<u>53.7</u>
TOTAL ASSETS	117.6
<u>LIABILITIES</u>	
Long Term Debt	54.5
Bank O'Draft and Short Term Loans	5.2
A/C Payable	<u>25.9</u>
TOTAL LIABILITIES	85.6
NET WORTH	32.0
Accounted for by:	
Paid-up Capital	25.0
Accum. Profit/(Loss)	(14.2)
Capital Reserves	-
Exchange Equalization	<u>21.2</u>
TOTAL SHAREHOLDERS' EQUITY	32.0

7. FOUNDRY AND MECHANICAL WORKSHOP

Background

7.01 The Foundry and Mechanical Workshop was founded in 1975 with the help of UNIDO. The objective was to create a nucleus for the development of metallurgical and engineering industries in Somalia. For this purpose the enterprise was not only to be a production unit, but also a training facility and a center for the development of products especially adapted to the conditions of Somalia, such as agricultural implements. In the first phase of development the plant was equipped to produce simple spare parts of grey, cast iron and nonferrous metals. It comprises a small foundry, with an oil-fired cupola furnace of 1 ton/hr capacity, and a medium-sized, and fairly well-equipped machine shop for the machining of castings and production of other metal parts by cutting, bending, forging, welding, milling, boring, etc. The equipment presently installed permits an output of approximately 450 tpy, on a single shift basis. The second phase of development, based on an annual output of 1,500 tpy, was never implemented.

Characteristics of Production

7.02 The output realized since the plant's inception ranges from 25 t in 1975 to a high of 203 t, achieved in 1982. Production was 144 t in 1984 and 50 t in 1985. Main products include steel tanks, handpumps, various cast iron parts such as manhole covers, grills and gratings, etc., handtools and agricultural implements, and various spare parts for some of the other industrial facilities of the country, such as the two sugar mills.

Finances

7.03 The firm's management claims that positive results have been achieved since the opening of the plant. However, examination of the 1984 financial accounts shows that reported income and profit figures are misleading, as additions to finished product inventory are reported as sales (inventory value in 1984 was 167 percent of turnover). In addition, depreciation provisions are not adjusted for inflation and maintenance expenses are inadequate (see Table 7). As indicated by a recent diagnostic study of the foundry,⁶ it is highly unlikely that the firm generated any real profit at the low capacity utilization levels of the last five years. In fact, the firm is going through a rapid process of decapitalization, its fine assets are being wasted due to insufficient maintenance and inadequate financial provisions for equipment renewal.

^{6/} International Science and Technology Institute Inc.: Somalia, the Foundry and Mechanical Workshop, Options for Survival, 1985.

Table 7
SOMALIA - FOUNDRY AND MECHANICAL WORKSHOP: SUMMARY FINANCIAL DATA
(1984)

Operating Statement (Millions So. Sh.)	1984
SALES	8.8
<u>Expenditures</u>	
Raw materials and Supplies	2.9
Wages and Salaries	2.6
Repairs and Maintenance	0.9
Depreciation	0.9
Misc. Operating Expenses	
Overhead	1.0
TOTAL EXPENDITURES	8.3
PROFIT/(LOSS)	0.5
<u>Balance Sheet</u>	
ASSETS	
Fixed Assets (Net)	
Lands and Buildings	2.0
Plant and Machinery	2.3
Other Fixed Assets	1.2
Total Fixed Assets	5.5
Current Assets	
Stock	14.7
A/C Receivables and Prepayments	3.6
Cash and Bank Balance	2.2
Total Current Assets	20.5
TOTAL ASSETS	26.0
LIABILITIES	
Long Term Debt	-
Bank O'Draft and Short Term Loans	0.8
A/C Payable	2.2
TOTAL LIABILITIES	3.0
NET WORTH	23.0
Accounted for by:	
Paid-up Capital	14.2
Accum. Profit/(Loss)	8.8
Capital Reserves	-
Exchange Equalization	-
TOTAL SHAREHOLDERS' EQUITY	23.0

Personnel and Training

7.04 The plant has 90 employees, including 9 engineers. All engineers are directors (Director of Steel Structures, Director of Engineering, Director of Agricultural Implements, etc.). They are young graduates from the local university, some of them with training in industrial facilities abroad (Algeria, U.S.S.R., Sudan, etc.). Those met by the mission appeared motivated, but lack training and guidance. There is one technical adviser at the plant supplied by UNIDO but it is not clear what his role is. Due to the low wage rate, the personnel turnover is very high, especially among skilled workers. The usual pattern is that untrained persons are recruited, obtain a modicum of training and skill at the plant as machine operators, welders, millwrights, etc., and then leave for higher wages in the private sector. A typical example is provided by the pattern-makers who reportedly leave the firm for more remunerative jobs in the private furniture-making business as soon as they have acquired basic skills in woodworking. In this respect, at least the Foundry and Mechanical Workshop does partly serve its initial purpose of a training center.

Major Problems

7.05 The main obstacles to the plant achieving a better utilization of capacity are the general difficulties of all public industrial facilities in Somalia:

- lack of diesel oil;
- electrical power failures. Eighty percent machine downtime reported during some periods of 1985;
- lack of raw materials. Difficulties in procuring coke for the furnace prompted conversion to charcoal, causing casting capacity to be reduced by one-half;
- lack of foreign exchange for imported supplies and spare parts; and
- turnover of skilled personnel.

7.06 In addition, it is clear lack of management and technical training and expertise on the part of the plant senior and professional staff make it quite impossible to operate such a plant even in favorable conditions, let alone in the difficult environment faced by Somalian industry. Accounting methods are faulty; systems of production planning and control, inventory control, quality control, are nonexistent or primitive; technical know-how is insufficient in all areas of the process; and the general management does not possess sufficient professional training to make up for the lack of expertise of middle-management. Marketing appears also as a serious problem area. Either due to uncompetitive pricing, bad quality, or both, products seem to accumulate in inventory (although most of them are supposed to be only made on order). Competition from private foundries is reported to be strong, but there does not appear to be any action plan to investigate the reasons for lack of sales and to identify remedial measures.

Recommended Actions

7.07 The Foundry and Mechanical Workshop is another candidate for rehabilitation that touches upon practically all aspects of the enterprise: management, engineering, production, marketing, accounting, etc. Such a program has been recommended by the study quoted above, based on hiring a qualified professional management team, training and motivating the labor force under the supervision of competent foremen and technical staff, modifying drastically the salary structure, and adopting rational, profit and market-oriented, production and sales objectives and policies. It is further argued by the authors of the study that this would be best achieved through a process of privatization, for example by leasing the assets to a private entrepreneur.

7.08 Regardless of progress in privatization, immediate measures should be taken to improve capacity utilization of equipment and to ensure its proper maintenance. The experience of other developing countries shows that foundries and workshops can play an extremely useful role in providing cheap and quickly available spare parts and components to the agriculture, industry and transport sectors. They also serve as a basis for mechanical engineering development and can be highly profitable. It is recommended that the rehabilitation program of the Foundry and Workshop be undertaken as a matter of priority to improve the contribution of this valuable facility to the Somalian economy.

8. WHEAT, FLOUR AND PASTA FACTORY

Production Characteristics

8.01 The production capacities of this 10 year old flour mill and pasta plant are as follows (on a single shift basis):

milling:	100 tpd	=	30,000 tpy
long pasta:	45 tpd	=	13,500 tpy
macaroni:	10 tpd	=	3,000 tpy

8.02 A major addition was made to the plant in 1982, with the expansion of milling capacity by 67 percent and the addition of a long pasta production line of 240 qtl/day. Production in 1984 was 11,000 t of long pasta and 1,600 t of macaroni, around 76 percent of overall capacity for these two products. It fell to 9,300 t in 1985, 56 percent of capacity. In 1984 the plant also produced as by-products 1,500 t of flour, and 3,250 t of bran.

Pricing

8.03 The main raw material, durum wheat is purchased from the Government at a price fixed for each consignment. The source of the wheat is usually food aid grants from donor countries. The transfer price of wheat between the Government Trading Company, E.N.C., is usually much below the import cost. Production of pasta is sold to E.N.C., while flour and bran are sold to private traders. Sales price of pasta is set by the Ministry of Commerce, both at the exfactory and retail levels. Competition from imported pasta is insignificant, due to its much higher retail price (So. Sh. 80/kg, compared with So. Sh. 35 for locally-made variety).

Finances

8.04 The pasta factory is wholly owned by the Government and placed under the control of the Somali Development Bank. For tax purposes, it is considered as part of the Bank, so that it is exempted from taxes on corporate profit. A profit of 10 percent of turnover or better (Table 8) has been regularly made over the last three years, and it is believed that previous performance was also satisfactory (the plant was closed from Dec. 1981 to July 1982 for expansion). The liquidity situation appears to be healthy and payments on a seven year, So. Sh. 16 million loan from the Somali Development Bank used for financing the 1982 expansion, are being regularly paid off.

Personnel

8.05 The total employment force at the plant numbers around 300. There are about 20 technicians (mechanics, welders, electricians, food processors), most of who have had some training in Italy and Germany provided by the equipment suppliers. There is only one expatriate, an Indian accountant. Remuneration is very low but an additional 5 percent of company profits, representing an average addition of 20 percent to the base salary, distributed as a bonus, is a fairly efficient incentive.

Table 8:

SOMALIA - WHEAT, FLOUR & PASTA FACTORY:
SUMMARY FINANCIAL DATA (1985 - 1983)

Operating Statement (Millions So. Sh.)	1985	1984	1983
Sales	262.8	150.0	99.5
EXPENDITURES			
Raw materials and Supplies	220.0		
Wages and Salaries	5.8		
Repairs and Maintenance	2.1	n/a	n/a
Depreciation	2.3		
Mis. Operating Expenses	6.1		
TOTAL EXPENDITURES	236.8	133.6	85.6
PROFIT/(LOSS)	26.1	16.4	13.9
<hr/>			
Balance Sheet			
ASSETS			
Fixed Assets (Net)			
Lands and Buildings	28.2	8.0	
Plant and Machinery	15.0	16.8	n/a
Other Fixed Assets	3.9	1.4	
Total Fixed Assets	47.1	26.3	28.3
Current Assets			
Stock	155.5	61.1	7.4
A/C Receivables and Prepayments	2.9	28.9	6.9
Cash and Bank Balance	3.0	16.5	21.4
Total Current Assets	161.4	106.5	35.7
Deferred Charges	2.5	5.0	7.5
TOTAL ASSETS	211.0	137.8	71.5
LIABILITIES			
Long Term Debt	13.7	15.5	18.8
Bank O'Draft and Short Term Loans	100.1	-	
A/C Payable	59.3	88.4	19.5
TOTAL LIABILITIES	173.1	103.9	38.3
NET WORTH	37.9	33.9	33.2
Accounted for by:			
Paid-up Capital	25.0	25.0	25.0
Accum. Profit/(Loss)	11.6	7.6	6.9
Capital Reserves	1.3	1.3	1.25
Exchange Equalization	-	-	-
TOTAL SHAREHOLDERS' EQUITY	37.9	33.9	33.2

Main Problems

8.06 The usual trio of current difficulties experienced by Somalian industry: shortage of fuel, frequent outages of electric power, and lack of foreign exchange for spare parts have been the main obstacles to full capacity utilization in 1985. However, because of its favorable cash flow situation, the pasta factory is able to purchase some foreign exchange at the free market rate.

Conclusion

8.07 The Wheat, Flour and Pasta Plant is one of the few public industries in Somalia which shows an acceptable performance, both from production and financial points of view. It must be recognized, however, that it is favored because it has no difficulty in obtaining raw materials: through international aid, durum wheat is available to the Government in large quantities, and resold to the plant at subsidized prices. In addition, it is well protected from import competition (pasta carries a nominal import duty of 50 percent, which is equivalent to total import charges of 76.6 percent of CIF value).

9. CIGARETTE AND MATCH FACTORY

Plant Characteristics

9.01 The Cigarette and Match Factory manufactures local cigarette brands from imported tobacco, as well as matches. It also imports Benson and Hedges cigarettes for resale on the local market. The plant was established in 1974 as a grant from the People's Republic of China. All machinery is Chinese and dates from that year except for a new line of cigarette established in 1980. The machinery is reported to be run down and in need of major overhaul and/or renewal (the factory was not visited by the mission). In 1982, So. Sh. 32 million were invested for the modernization of the cigarette machinery. Nominal production capacity of the plant is approximately of 1,000 tpy of cigarettes and 480 tpy of matches, on a single shift basis. The maximum production achieved by the plant was 511 tons of cigarettes in 1982, or approximately 50 percent of capacity. Production in 1985 was 260 tons, or 25 percent of capacity.

Financial Data

9.02 In spite of this low production the enterprise has been making a steady profit since its creation. As shown on Table 9, profit was above 10 percent of turnover (including cigarette import sales) in 1984 and decreased to 7 percent of sales in 1985. Cash flow is robust, the enterprise has no debts and the liquidity ratio is very high. The Cigarette and Match factory contributes in many ways to the finances of the Government: turnover and production tax (not shown on the accounts) amounted to So. Sh. 228 million in 1984 and So. Sh. 258 million in 1985; the firm pays tax on profits (the amounts are unknown as they are discretionary and do not appear on financial statements); and the Cigarette and Match even pays small dividends to the Government (So. Sh. 137,000 in 1985).

Main Constraints

9.03 It seems unfortunate that such a financially successful enterprise performs at a level much below its potential. Main constraints to higher production are the lack of foreign exchange to buy tobacco and spare parts, and the difficulties of hiring and retaining qualified personnel. Indeed the members of middle management interviewed appeared to be particularly inexperienced, and displayed little factual knowledge about the enterprise in their areas of responsibility. The market potential is quite favorable as the plant meets only 25 percent to 30 percent of the local demand for cigarettes and local brands, less expensive than the lawful or black-market (contraband) imports, appear to be in great favor. In the last few years there has been an effort to develop a local source of tobacco (apparently the Cigarette Factory is also managing a tobacco farm). Only 40 ha. have been planted, and although very few details were made available to the mission, the experiment does not appear to be very successful so far.

Conclusion

9.04 The Cigarette and Match Factory is in need of major rehabilitation. Similar enterprises in neighboring countries are economically and financially profitable and provide considerable excise revenue for governments. Most of the rehabilitation effort would have to be directed to the upgrading of the aging plant and developing a competent management team. Although this company is not categorized as available for sale to the private sector, such a step should be considered. It is a profitable business which could be better managed by the private sector without any loss of excise revenues to the Government.

Table 9
SOMALIA - CIGARETTE & MATCH FACTORY:
SUMMARY FINANCIAL DATA (1984-1985)

Operating Statement (Millions So. Sh.)	1985	1984
Sales ^{a/}	490.6	228.9
EXPENDITURES		
Raw materials and Supplies(1)	383.4	175.6
Wages and Salaries	12.3	6.9
Repairs and Maintenance	3.4	0.8
Depreciation	11.5	7.0
Mis. Operating Expenses	4.4	1.1
Marketing and Administration	19.2	11.7
Contribution to Min. of Fin. (2)	20.0	
TOTAL EXPENDITURES	454.2	203.1
PROFIT/ (LOSS)	36.4	25.8

Balance Sheet

ASSETS		
Fixed Assets (Net)		
Lands and Buildings	26.7	18.2
Plant and Machinery	46.7	46.2
Other Fixed Assets	12.6	7.0
Total Fixed Assets	86.0	71.4
Current Assets		
Stock	179.4	59.3
A/C Receivables and Prepayments	15.7	12.7
Cash and Bank Balance	151.7	481.5
Total Current Assets	346.8	553.5
TOTAL ASSETS	432.8	624.9
LIABILITIES		
Long Term Debt	-	-
Bank O'Draft and Short Term Loans	-	-
A/C Payable	232.0	461.7
TOTAL LIABILITIES	232.0	461.7
NET WORTH		
Accounted for by: Paid-up Capital	200.8	163.2
Profit/ (Loss)	29.2	29.2
Capital Reserves	36.4	25.8
Exchange Equalization	49.0	33.5
Accumul. Depreciation	43.2	-3.5
TOTAL SHAREHOLDERS' EQUITY	43.0	31.5
	200.8	163.2

a/ Including purchases of imported cigarettes (So. Sh. 123.3 million in 1984 and So. Sh. 114.6 million in 1985).

10. ALUMINUM UTENSILS FACTORY

Plant Characteristics

10.01 The Aluminum Utensils Factory was created in 1978 with the objective of supplying the Somali market with basic aluminum utensils--pots and pans and various household objects. The capacity of the plant is 120 t of product per annum. The facility was originally set up with the assistance of the machinery supplier, Philco Steel of India, which also provided some technical assistance until early 1986. The evolution of production in recent years was as follows:

Year	1982	1983	1984	1985
Production (t)	51	26	41	9

10.02 The equipment of this small plant is very basic, it includes a small oil-fired furnace for melting aluminum ingots or scrap, a small crude rolling mill, tamping presses, forming machines and an anodizing facility. The plant operates best from aluminum coils, but due to lack of working capital, the plant is working down a stock of aluminum ingots acquired in 1982. This is a very slow and inefficient process because the furnace is too small to melt a whole ingot and the rate of scrap in the crude rolling process is high (50 percent).

Personnel

10.03 Employment stands at 69, down from 81 in 1985. There are no engineers and the most senior technical person is a shop supervisor originally trained by Philco Steel.

Financial Situation

10.04 Low levels of output led to losses, accumulating to about So. Sh. 15 million in 1985, 50 percent of the book value of assets (revalued in 1984), and 150 percent of sales (see Table 10). The net worth of the concern is rapidly eroding. However, long-term debt amortization is kept current, and accounts are well kept.

Major Problems

10.05 The Utensils Factory has to function in a difficult environment. The following constraints were particularly binding in 1985:

- Supply of fuel for the furnace. The firm uses second-hand lubricating oil as fuel, which it purchases from the electricity company. Supply is intermittent and oil changes take place at irregular intervals, thus shortening the life of the electrical generating plant;

Table 10
SOMALIA - ALUMINUM UTENSILS FACTORY:
SUMMARY FINANCIAL DATA (1985-1983)

Operating Statement (Millions So. Sh.)	1985	1984	1983
Sales	4.1	12.1	9.7
EXPENDITURES			
Raw materials and Supplies	1.9	5.9	5.0
Wages and Salaries	3.1	2.5	2.0
Repairs and Maintenance	1.4	1.4	1.6
Depreciation	1.3	1.3	0.9
Mis. Operating Expenses	0.2	0.2	0.2
Overhead	<u>2.5</u>	<u>1.6</u>	<u>2.0</u>
TOTAL EXPENDITURES	10.4	12.9	11.7
PROFIT/(LOSS)	(6.3)	(0.8)	(2.0)
<hr/>			
Balance Sheet			
ASSETS			
Total Fixed Assets (Gross)	25.0	25.0	17.6
Current Assets			
Stock	5.3	6.3	5.9
A/C Receivables and Prepayments	0.8	0.2	3.5
Cash and Bank Balance	<u>—</u>	<u>2.5</u>	<u>—</u>
Total Current Assets	<u>6.1</u>	<u>9.0</u>	<u>9.4</u>
TOTAL ASSETS	31.1	34.0	27.0
LIABILITIES			
Long Term Debt	9.8	10.1	10.4
Bank O'Draft and Short Term Loans	2.1	—	1.1
A/C Payable	<u>1.6</u>	<u>1.6</u>	<u>1.2</u>
TOTAL LIABILITIES	<u>13.5</u>	<u>11.7</u>	<u>12.7</u>
NET WORTH	17.6	22.3	14.3
Accounted for by:			
Paid-up Capital	10.8	10.8	10.8
Accum. Profit/(Loss)	(14.5)	(.82)	(7.4)
Accum. Depreciation	7.0	5.4	3.9
Exchange Equalization	<u>1.3</u>	<u>14.1</u>	<u>7.0</u>
TOTAL SHAREHOLDERS' EQUITY	17.6	22.3	14.3

Note: Assets were revalued in 1984.

- failures of the electrical supply;
- breakdown of machinery;
- lack of working capital and foreign exchange with which to purchase raw materials (coils, chemicals) and spare parts; and
- lack of motivation of the workforce and severe absenteeism.

10.06 The shops and grounds of this plant have a particularly untidy appearance: scrap piles lie all over the shop floors; working and safety conditions are dismal, no exhaust piping is provided for the furnace burners whose fumes fill up the main workshop and cover everything with soot. Quality of production is crude, and competition from India and Taiwan imports is said to be high, despite the 200 percent import duty on aluminum wares.

Recommended Actions

10.07 Aluminum Utensils Factory is in need of a rehabilitation program. A UNIDO team has begun to examine the functioning of the plant with a view to determining what can be done in the short term to raise production and bring the operation closer to financial profitability. Training of management, hiring, training and retaining suitable technical personnel, modest physical improvements to the plant and the process, improvements in product quality, adequate pricing and efforts in marketing are important elements of the solution. It must be noted that because of its small size, the relative lack of complexity of the process and low value of its assets, this plant is an ideal candidate for privatization.

11. SNAI-BIASA FACTORY

11.01 This small factory, adjoining the Jowhar Sugar Mill, produces pharmaceutical alcohol, liquors and perfumes, based on molasses-derived alcohol produced by the mill. It also makes detergents from imported components, and extruded plastic objects, such as pipes and tubing, jerry cans, bottles and sandals, from imported granules. This is very much a crush-and-mix facility: the plant is equipped with a few mixing vats for liquor and perfume preparation, one mixing machine for the detergent, and one extruding machine. Sales turnover in 1985 was So. Sh. 70 million against direct costs of So. Sh. 16 million. The operation is very profitable. Alcoholic products are sold to a Government agency, tourists being the official market for the three types of liquor produced: gin, rum and whisky. Other products are sold through private traders.

11.02 Despite its small size and crude technology SNAI-BIASA constitutes a commendable attempt at diversifying the declining production of sugar at Jowhar, taking advantage of the existing infrastructure associated with a long-established agro-industrial plant: transportation facilities, maintenance facilities, trained labor, etc. The idea is worth pursuing and expanding because there is potential for growing other, less demanding crops on the saline areas of the Jowhar estate. The possibility of transforming these products for the local and export markets, capitalizing on the trained labor force and existing industrial support facilities, should be explored.

12. STATE PRINTING AGENCY

Plant Characteristics

12.01 This modern, well-equipped facility satisfies all Government printing needs, including administrative forms, school books and the national, Government sponsored daily newspaper. The plant has been in existence since the country's independence. It was first set-up with assistance from USSR and East Germany, with machines and technical experts from these two countries. Today most of the original machinery has been replaced with modern equipment from West Germany and Italy. Through technical assistance agreement with the former, management and technical advisers are helping the Somali staff to run the plant. Only two German advisers are still on the premises, and they are scheduled to leave shortly. The expatriate advisers and some training provided abroad by the equipment manufacturers, have resulted in a well-trained cadre of technical staff who can run the processes used in the plant, some of them fairly advanced, such as computerized text composition and color-photo composition.

12.02 Capacity is fairly high: on a single shift basis book production can reach 2,000,000 units/month, and the offset department has a capacity of printing around 16,000 sheets/hr. The plant works at close to single shift capacity, although no precise figures were obtained. Total staff number 350, of which about half are technicians and skilled workers.

Financial Performance

12.03 Financially, the enterprise is reported to have been steadily profitable. In 1985, the only year for which financial statements were obtained, a small profit of around So. Sh. 1 million on a turnover of So. Sh. 100 million was made. However, assets have never been revalued, so the real result, after making due provision for asset renewal, is a loss. Working capital appears to be adequate, maturities on a Central Bank long-term loan are regularly paid, and charges on the sizeable overdraft facility from the Commercial Bank (So. Sh. 152 millions) regularly debited.

Main Problems

12.04 Main current problems are:

- shortage of foreign exchange to buy supplies and spare parts (the Printing Agency has the monopoly for procuring printing supplies, which it sells to a few small private printing shops, all established in the last two years). In 1985, 90 percent of the total foreign exchange obtained (US\$340,000) was purchased at the official rates. In 1986, all foreign exchange purchases were made on the free market, so that the alleged shortage really refers to cheap foreign exchange, rather than foreign exchange as such; and
- electrical supply outages which sometimes results in entire days of lost production.

Conclusion

12.05 This enterprise gives the best overall impression of competence of technical staff, orderliness and tidiness of plant, maintenance of machinery and general efficiency of the firm. However, accounting (financial accounts were of poor quality and prepared according to some questionable practices) and quality control are areas where much improvement could be made.

13. KISMAYO MEAT FACTORY

13.01 The Kismayo meat factory⁷ was established in 1964 to produce thermally-processed meat, such as canned stew and corned beef. Initially built by the Russians and operated under their technical guidance up to 1977, its production was almost solely exported to the U.S.S.R.. With the disappearance of the Russian market, production fell drastically, as the international market for canned meat products suffers from a glut. Plant capacity stands at about 22 t of processed product per day. At capacity the plant slaughtered 200 heads of cattle per day, a rate that was sustained between 1969 and 1976. Recent production figures are 100 t in 1983, 2 t in 1984 and 146 t in 1985. It seems that the enterprise has recently obtained some contracts with international aid agencies, to supply refugee camps in the region.

13.02 Under the auspices of FAO a proposal has been made to overhaul the plant and to restore its original capacity in the present line of products. According to the study quoted above, the alternative, of converting the plant to production of chilled carcasses and frozen prime cuts is worth considering, as the economics of this process are attractive and the Gulf countries are potentially large markets. Another possible course of action would be to run frozen and thermally-processed meat lines side-by-side. However, cattle raising in Somalia is geared to exports of live mature animals rather than slaughter of young fattened animals required for prime quality meat exports. Thus the development of a frozen meat industry would require changes in ancestral traditions. Despite this obstacle it appears worth exploring as one way of obtaining more value added from the most important resource of the country.

^{7/} Information contained in this section is mostly based on: International Science and Technology Institute, Inc., an evaluation of the Kismayo Meat Factory, March 1986. The enterprise was not visited by the mission.

14. SOMALI PHARMACEUTICAL INDUSTRY

14.01 This brand new plant, completed in 1984, was financed by loans from the European Economic Community and the Italian Government (total: 8 million ECU). Only a 3-month test operation was carried out in 1985 under the supervision of an EEC-appointed expert, following which the plant was certified to meet specifications and ready for start of production. Planned production includes antibiotic capsules, syrups, ointments, tablets, suppositories, inoculation antibiotics and insecticides. In May 1986, a technical assistance contract, funded by the Italian Government, was signed between the Government of Somalia and Carlo Erba Famitalia, a well-known Italian pharmaceutical company, part of the Montedison Group. According to the agreement Carlo Erba will run the plant and train Somali personnel over a period of 31 months. During that period raw materials will be provided free of charge by the Italian Aid Fund, and production will be purchased by the latter, paid in foreign currency. Proceeds of the sale will provide a foreign exchange fund to be used in the firm's operations once the management contract runs out.

14.02 The plant, in mint condition, is well laid-out and sophisticated. The Carlo Erba people have begun preparations for starting production late in 1986. The staff presently numbers 92, including nine chemical engineers. The full complement for one-shift operation, to be reached by the end of 1986, is 100. Securing the assistance of qualified operators in the early phase of the plant's operation appears to be a prudent move. It will provide indispensable training to the highly motivated Somalian workforce and ensure that expensive machinery is well used and well maintained. For the future, it is important that planning for the following phase of the operation should start early to make the transition from present arrangements as smooth as possible and avoid disruptions in production. If the present partnership proves to be successful, its continuation after the initial period on a partnership basis might be well worth considering.

15. SOMALI GRP PRODUCTS COMPANY

15.01 The GRP Products Company is a small fiber glass boat-building company, established in 1976 through a grant from the Swedish Aid Agency, SIDA. The facility was run until 1981 as a department of the Ministry of Fisheries. It was reorganized as an autonomous parastatal under a separate law, and a management contract was signed with a Swedish boat building company, Krona Marine. Its main products are 8.5 m fishing boats with cabin, 6.4 m fishing boats, fishing canoes or "huris" and water tanks. Present staff numbers 32 employees, plus three expatriates from Krona: the general manager and two technicians. The firm has a board of directors, chaired by the Minister of Fisheries. Other members are two senior Government officials, and two private businessmen. The latter feature is an interesting departure from the usual all-official composition of boards.

15.02 Production in 1985 was 34 8.5 m boats, 17 houris and 270 water-tanks of various sizes. This represents about 80 percent of full single-shift capacity. The operation was profitable in 1984 (sales: So. Sh. 25 million; profit before SIDA contribution, So. Sh. 1.8 million) and 1985 (sales: So. Sh. 44 million; profit before SIDA contribution, So. Sh. 17.6 million). In the latter year 60 percent of sales, or So. Sh. 26.4 million, were purchased by aid agencies, paid in foreign currency and accounted for in the financial statements at the official rate (So. Sh. 83.6/US\$). Import of inputs is no problem as the enterprise is allowed to keep 50 percent of foreign exchange earned. In addition, GRP was able to benefit from the Agriculture Input Programme, under which foreign exchange was made available at the commercial rate. Negotiations are presently under way for the partial privatization of the firm. The agreement being considered would have 49 percent Swedish ownership and 51 percent ownership by the Government of Somalia. The main potential for expansion is foreign markets (Djibouti, Kenya, Mozambique) for boats and the local market for tanks.

16. SOMALFRUIT

16.01 Somalfruit is a joint-venture company created in 1983, where a majority interest (60 percent) is held by an Italian group: Gruppo de Nadai, and the balance by the Somalian Government, through the Banana Export Board. The main objective of Somalfruit is the production and export of bananas, with diversification contemplated into other tropical fruit.

16.02 Somalfruit consists of three companies:

Somalfruit: the holding and trading arm of the group;

Incas: packaging materials for exporting the production (cartons and polyethylene bags); and

RGB: agricultural services.

16.03 Banana cultivation controlled by Somalfruit covers about 6,000 ha located in the Juba and Shabelli river valleys. Of this total acreage, 30 percent is the firm's own estates and the rest is distributed among about 120 private growers (average size of farm: 35 ha). Private production is organized through contractual arrangements whereby Somalfruit does the initial land preparation work on credit, provides seedlings and fertilizers also on credit, as well as technical advice. Producer prices are the result of yearly negotiations between Somalfruit and the planters. Average yield is 15 to 16 t/ha. Approximate volume of exports was 50,000 t in 1985, and is anticipated to reach 60,000 t in 1986. The main present market is Saudi Arabia.

16.04 According to the Italian general manager, investment so far totals US\$11 million, mostly financed by interest free loans from the Italian Group. Financial results for 1984 were a combined net profit of about So. Sh. 30 million from a total turnover of So. Sh. 770 million. Total employment stands at 1,000, including 35 expatriates.

16.05 Major problems are the low yields obtained on private farms (most growers are absentee owners) and the inferior quality of production, which prevents them from obtaining top-quality prices. Foreign exchange is available through export proceeds, of which 50 percent are kept for purchase of inputs. Somalfruit has a 5-year exemption from all import duties, which will be in effect for another 2.5 years. External activities such as purchase of inputs, transportation and sales of production, is entirely taken care of by the Italian partner. Somalfruit appears to be a fairly successful operation. It has the merits of being export-oriented and promoting the development of agriculture. However, it is most important that the Somalian Government, through its 40 percent Board participation and presence on the management team, ensure that company policies maximize the returns to the national economy.