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USAID/SOMALIA

P L 480 TITLE II, SECTION 206

PROGRAM PLAN

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References: (A) State 141038, (B) Mogadishu 04597, (C) Mogadishu 04569, (D) State 103007, (E) State 100679

I. INTRODUCTION AND SUMMARY

A. Summary

The Mission proposes the following commodities and amounts for a single year, FY 1987 Section 206 Program:

Flour	12,000 mt	at usd 172	equals	$2,064,000
Hard Wheat	6,000 mt	at usd 116	equals	696,000
Vegoil	10,000 mt	at usd 589	equals	5,890,000
-	Sub total		equals	8,658,000
Ocean frt est (28,000M/T @ $125/MT)			equals	3,500,000
	Total US dols		equals	12,158,000

The self-help conditions include the sale of 63% to 75% of the flour and vegoil to private sector traders, examinations of the domestic rice industry and of food and agriculturally related customs duties with a view toward needed policy reforms, and efforts to institute GSDR budget reform. The generated local currency will be used to meet the GSDR counterpart requirements for AID assisted agriculture and child survival activites and, when needed, to implement policy reforms.

B. Relevance to Approved Strategy

1. The primary objective of the USAID/Somalia development strategy is to establish the basis for a self-sustaining, productive economy. Policy dialogue, technical assistance, financial assistance, and food aid support Mission strategy and focuses on three primary topics: (1) economic stabilization (and, within this, balance of payments and debt); (2) expansion of domestic production (primarily agricultural) for increased export earnings and import savings; and (3) improvement of public sector efficiency (primarily through budget rationalization, tax system improvements, and civil service reform).

2. The proposed Section 206 program will contribute to the strategy in several ways: a) the PL 480 food will help alleviate balance of payments problems; b) food provided on a grant basis, instead of loan, will not add to the already staggering debt problem; c) the self-help conditions will identify areas in which the GSDR can add to the relatively impressive agricultural policy reforms they have made since 1980; d) 60 to 75 percent of flour and vegoil sold through the private sector will help improve efficiency of food distribution and nudge the GSDR toward a more private sector orientation; e) the joint USAID-GSDR programming and disbursement of the generated local currency will contribute to a more rational GSDR programming and budgeting system.; and f) the local currency will be used for development activities primarily focused on expanding agricultural production.

C. Relation of Food Aid Programs in Somalia

There are three basic food aid activities in Somalia: refugee relief, food projects, and food programs. For FY 1987, donors have agreed to provide a total of 113,000 M/T for feeding the 830,00 refugees. (donors have agreed to use this fugure, though many believe the actual number of refugee is much lower.) While some of the food, which is provided through refugee camp distribution centers, does leak into the local market, market price data lead us to believe that the amount of leakage is not sufficient to impact on food prices.

The World Food Programme has a number of food aid projects including maternal child health, school feeding, food for work, and targetted feeding in refugee camps. However, the amount of food distributed under these various projects is relatively small.

Food aid programs primarily focus on wheat, flour, rice, and to a somewhat lesser degree, vegoil. As the tables in the commodities sectio of this proposal illustrate (Section III.D.1.), several countries have conducted food aid programs in Somalia. The US has been by far the largest provider of program food aid. Other significant donors in recen years include the EEC, Italy, Netherlands, and Japan.

II. <u>CRITICAL ISSUES</u>:

A. Issues from the Somali PL 480, Title I Audit Report (No. 3-649-87-2)

The audit, completed in January 1987, made recommendations concerning four issues. The first two recommendations focused on the size and timing of Title I deliveries. The primary concern was that the program was too big and arrived during the peak harvest period, thus flooding th market, reducing prices and providing a disincentive to local production. The recommendations were to reduce the program to $10 million, review adequacy of disincentive analyses, ensure arrivals did not arrive at peak harvest times, and facilitate GSDR opening of letters of credit. The program has been reduced by 50%, less than $10 million i food commodities are proposed herein. Furthermore, the commodities requested, wheat, wheat flour, and vegoil, do not compete directly with domestic production so any possible disincentive affect will be minimized. (Note: Somalia does have a domestic sesame oil industry that provides about 30% of the overall oil demand; however, sesame oil is use somewhat differently than regular vegoil, is the preferred cooking oil, sells for a higher price, and thus does not compete directly with PL 480 vegoil.) The commodites will be loaded in September and will arrive in late October or November, thus avoiding the August - September peak harvest period. The proposed Section 206 Program is grant, therefore th GSDR will not need to open letters of credit. The Mission will take actions to facilitate their opening of letters of credit for the proposed cotton imports under Title I.

The third recommendation was that the GSDR marketing corporation (ENC) b excluded from handling commodities destined from the auction and the Agreement state that auction procedures cannot be altered after bids are invited. The Mission has already reached agreement with the GSDR that the Ministry of Finance (MOF) or its agent, not the Ministry of Commerce (MOC), would handle the sales to the private sector. ENC is part of the MOC, and we will do our utmost during the negotiation of the Agreement to exclude ENC from handling the commodities destined for the auction. However, ENC is the GSDR agency mandated to handle all donor food imports, so we may not be successful on this point. However, we will insist that the Agreement will clearly state that auction procedures cannot be altered after bids are invited.

The fourth recommendation was that the GSDR deposit an additional SoSh 14,589,000 associated with a disallowed auction expense related to salvage costs of a ship that went aground. Before signing the Agreement, the Mission will insist that the GSDR make this deposit as well as all other deposit arrearages associated with PL 480.

B. Exchange Rate

In previous years, there has been a great deal of confusion in Somalia on the exchange rate issue because of the multiple and everchanging exchange rates. Given the situation in Somalia, the previous Title I Agreements did not unambiguously and explicitly define what exchange rate should be used.

A very simple approach is proposed for the Section 206 program. We would like to be able to determine the exact amount of deposits due as early as possible and include language in the Agreement that gives the GSDR a strong incentive to make the deposits as early as possible.

We are assuming that the exchange rate will be unified by June or July 1987 at a realistic rate using a cash auction mechanism. At this unified rate, U.S. commodities may not be competitive, therefore it is very possible that the commodities auctioned to the highest bidders may be sold at prices less than the local currency equivalent of the C&F value and maybe even less than the USDA (FAS) value. This being the case, we should not expect to obtain more generations than the local currency equivalent of the C&F value of the commodities. If for some reason, the commodities sold to the private sector generate more local currency than the equivalent of the C&F value, the Agreement will specify that the GSDR must report the amount of any excess shillings to USAID within three months of completion of private sector sales and these excess shillings must be credited to the Ministry of Finance budget.

For the proposed Section 206 Program, we intend to state explicitly in the Agreement that the amount of local currency to be deposited by the importing country shall be the local currency equivalent of the C&F value of the commodities converted at the highest legally obtainable exchange rate for imports at the time the Agreement is signed. By using this language, we can state right in the Agreement the actual amount of shillings to be deposited. Furthermore, we will argue strongly that 50% of the local currency must be deposited in a seperate PL 480, Section 206 account <u>before</u> we sign the Agreement. Another 25% will be due at the arrival of the first shipment. The final 25% will be due three months after the arrival of the first shipment.

Different from past years, the amount of deposits will not be linked to the auction prices, amounts, or expenses. This will greatly reduce the amount of Mission staff time required for detailed monitoring and negotiations of auction procedures (See section on Program Implmentation). In previous years, food auctions have required considerably more Mission staff time than was available with the result that monitoring had to be spotty in places.

There are several reasons why we decided to drop the language referring to exchange rate at time of deposit or arrival whichever is greater (Ref B, para 4). First, given this language, the GSDR might delay indefinitely waiting for the exchange rate to go down. Second, using the time of deposit complicates the issue for the GSDR because the amount due must always be denominated in dollars; deposits in shillings would have to be converted to dollars at the exchange rate based on the latest cash auction and subtracted from the deposits due. Accordingly, the GSDR would find it difficult to plan the deposits in shillings because of the fluctuating exchange rate. Third, using the exchange rate at the time of deposit can also be complicated. For the FY 1986 Title I shipment, the commodities arrived over a three month period. We had to calculate weighted averages of exchange rates for each commodity and then attempt to explain this to the GSDR. With an exchange rate based on a fortnightly cash auction, this would be even more complicated. Fourth, we expect the unified exchange rate to be realistic; thus the local currency generated using the exchange rate at the time the Agreement is signed should generate a relatively large amount of local currency compared to previous years when the over-valued official rate was used. The amount generated will be sufficient to meet needs.

C. Self-Help Policy Reforms

Section III.D.2 (p. 13) responds to the Project Committee response cable (Ref A, para 5) which indicated the need to strengthen the self-help policy reforms and provide more details. Specifc funding source and schedule of completion are provided for the two policy studies of rice production and custom's duties. The descriptions of the studies have also been expanded. In addition, the Mission plans to expand the conditionality to reinforce the policy reforms being pursued under our FY 1987 ESF Program. Particular attention will be focused on budgetary reform; however, this is a very sensitive topic for the GSDR and will have to be negotiated carefully.

D. Length of the Program

Section 206 is a multi-year food assistance program. The development of the Somali Section 206 proposal has focused on short term policy efforts and the immediate need to convert the previous loan funded Title I program to grant in FY 1987. Consistent with this short-term focus, we are proposing a one year program at this time instead of a multi-year program. There are a number of reasons for this position. The full ramifications of the recent drought on the food supply are not yet known. The Mission will welcome a new Director very soon and will be developing a new CDSS for submission in early CY 1988; these events could alter the Mission's assistance strategy, particularly our strategy with regard to policy dialogue. Furthermore, decisions on Section 206 program levels are made by the DCC on an annual basis, depending on commodity availability as well as self-help policy reform performance. Given all these uncertainties, we prefer a one year Section 206 proposal at this time. In FY 1988, we will either request an extension of the FY 1987 program or submit a new Section 206 proposal.

E. Timing: Short Deadline for Signing Section 206 Agreement

It is important that this Section 206 Program be approved and the Agreement signed before June 15 so that USDA can place orders for the processed commodities (flour and vegoil) in time for shipments before the end of FY 1987. Meeting this deadline will require that this proposal receive priority attention from all parties involved. The Mission has already started discussions with the GSDR and will continue these. As soon as the DCC approves the program, the Mission will start final negotiations. Before the Mission signs the Agreement, the GSDR must deposit PL 480 arrearages due from FY 84-86 (These are discussed in the recent audit; see item A above).

Assuming the Agreement is signed by June 15, the Section 206 commodities will arrive in late October or November. The 1985 EEC shipments of 10,950 M/T of flour is scheduled to arrive in October 1987 or at about the same time late the 12,000 M/T of Section 206 flour will be arriving. The arrival of these shipments at the same time potentially might have a detrimental impact on the market. However, there is no certainty that the EEC commodities will arrive as scheduled. Furthermore, the combined total (22,950 M/T) is roughly equivalent to the average Title I flour imports for FY84-86 (21,500 M/T).

III. PROGRAM DESCRIPTION

A. Problem

Though production levels are increasing, Somalia must still import relatively large quantities of food to meet its annual food and nutrition needs. By liberalizing agricultural policies and prices, Somalia has increased food production considerably in recent years and is now virtually self-sufficient in its basic grains of corn and sorghum. But still there is a need for some additional improvements and reforms as well as a need to import a considerable amount of other basic food commodities including wheat, wheat flour, vegoil, and rice.

Unfortunately, importation of basic food commodities puts a burden on the country's limited foreign exchange and exacerbates Somalia's severe economic and financial problems. Additional nongrant imports contribute to the already critical imbalance of trade. Imports are several times larger than exports. Imports financed by loans add to the already staggering debt of $1.8 billion, which is larger than GDP. The debt service burden of $190 million (unrescheduled debt service payments due in 1986), is greater than the sum of all exports and all remittances. Since the country is unable to service this debt, arrearages have grown very considerably in recent years. Given this enormous debt problem, if at all possible, the country should avoid borrowing to meet its food import requirements. For this reason, and the fact that Somalia has implemented impressive agricultural reforms (See Section III.C.1 below), PL 480 commodities should be provided as grant under Title II, Section 206 rather as loan under Title I.

B. Objectives

1. To meet basic food and nutritional needs.

2. To work toward greater domestic food production by undertaking specific analyses as necessary background for policy reforms designed to rationalize import customs duties and increase rice production.

3. To improve the efficiency of food distribution systems by channeling PL 480 commodities through the private sector.

4. To upgrade GSDR budgeting by improving Ministry of Finance programming and budgeting, procedures for generated local currency.

5. To undertake a variety of agricultural and rural development activities using the generated local currency.

C. Analyses

1. Agricultural Sector Analysis

A joint agricultural sector assessment recently was undertaken by the World Bank, USAID, GTZ, ODA, UNDP and the GSDR (IBRD, "Somalia Agricultural Sector Survey: Main Report and Strategy," January 24, 1986, DRAFT). Building on this assessment, AID developed an agricultural sector strategy (86 Mogadishu 12973, 86 State 67371). In early 1987, AID undertook a policy reform assessment which focused on agricultural policy (Goldensohn, et al; "Donor Influence and Rural Prosperity: The Impact of Policy Reform on Economic Growth in the Agricultural Sector in Somalia," January 1987). The findings of these three analyses are very briefly summarized below.

Agricultural performance in Somalia from 1970 to 1984 was extremely poor; per capita food production declined by nearly 3% per year. Dependence on imported grains and cereals increased from 40,000 to 350,000 tons.

During the first half of this decade major policy changes were introduced which significantly improved agricultural production:

- the exchange rate has floated to a more realistic level;
- domestic cereal and livestock marketing has been privatized;
- certain government and parastatal monopolies have been abolished
- imports of most goods, including most agricultural inputs, have been liberalized; and
- the GSDR reoriented its basic strategy from an urban/industrial to an agricultural one.

These reforms have had a significant impact:

- grain production has increased dramatically. Somalia now is virtually self-sufficient in corn and sorghum;
- farmer incomes and agricultural wages have risen;
- private sector investment and business activity has increased dramatically, particularly in small and medium scale enterprises
- production inputs are becoming more readily available through the private sector; and
- banana exports have risen and livestock exports are beginning to find new markets

While this performance has been impressive, additional reforms are needed and other constraints must be addressed. Due to environmental constraints, the number of livestock produced may be near its maximum. The semi-arid climate limits production in both rainfed and irrigated areas. However, large production increases can be accomplished through improved management of irrigation. Additional improvements are also needed with respect to: a) marketing (particularly livestock marketing); b) agricultural input supply; c) the remaining public sector agricultural enterprises (some of which have monopoly positions and are operating far below capacity); d) performance of GSDR agencies involved with agriculture (which can only be resolved with meaningful GSDR revenue, budget, and civil service reforms); and e) adaptive agricultural research.

Within this overall context, USAID is pursuing an agricultural strategy involving additional policy reform as well as direct interventions to improve production. The USAID policy reform agenda includes efforts to maintain a market oriented exchange rate, revenue and budget reform, civil service reform, continued expansion of price liberalization, reforms to stimulate private sector activity, and selected studies needed to obtain the background information required to identify and design new reform programs. Direct interventions include continuation of efforts to improve livestock production and export and the large new Shebelli Water Management Project which will improve irrigation water management throughout Shebelli, undertake adaptive irrigation agricultural research, and rehabilitate selected irrigation infrastructure.

2. Economic Overview

Somalia is one of the poorest countries in Africa, with a per capita income of less than $300 per year. The country has a large trade imbalance, with yearly exports being only one third to one fourth imports. With few natural resources and almost no industry, the trade deficit cannot be eliminated easily. In addition, the country entered this decade with a large and growing external debt, accumulated during a war with Ethiopia followed by a severe drought. Somalia does not have the large, potential export capacity of countries with a mineral base, e.g., copper or petroleum. Nevertheless, it still has the problems associated with dependence on one sector for export receipts. This became very apparent in 1983 when Saudi Arabia banned all livestock imports from Somalia. Although the ban was later modified to include only cattle, the recovery efforts are still being slowed by this action. Approximately 70% of Somalia's export receipts come from livestock and both an increase in livestock exports and diversification are essential, though difficult to achieve.

Since 1978, Somalia has moved from a socialist system in which virtually 100% of industry was government owned or controlled to an essentially free enterprise, market-oriented economy. Almost all price controls have been eliminated. There are also very few import or export monopolies, though some do exist in key areas. In 1985, the GSDR opened a free foreign exchange market, with the result that most foreign exchange is allocated through a market determined mechanism and the increased shilling return has increased incentives to export. (There is still an export tax and a regulation requiring that 50% of export proceeds be surrendered at the lower, official exchange rate, but the return to exporters is greater with the free market than without.) Within a month or two we expect the GSDR to unify the exchange rate at a realistic level based on a regular cash auction.

Despite the reforms of the previous six to eight years, Somalia cannot overcome the massive debt or the trade imbalance without donor assistance. The external debt is estimated at over $1.9 billion and growing. Unrescheduled debt service payments exceed exports plus remittances. Somalia needs large amounts of donor assistance and yearly debt rescheduling to finance the trade deficit and to meet whatever debt payments are possible. Without assistance, the country will necessarily default on debt payments and imports of critical materials will either not arrive or will be sufficiently delayed to disrupt the economy.

Although Somalia suffers from many economic difficulties, including inflation, a large domestic budget deficit, inadequate budgeting practices, and a low rate of tax collections, the primary problem we are attempting to address through PL 480 assistance is the balance of payments deficit. The current account deficit is regularly around $300 million each year. Even with anticipated donor assistance, there is a deficit in the combined current and capital account in the balance of payments.

3. Social Analysis

The majority of the PL 480 commodities will help meet the food requirements of the neediest Somalies. Among the people at greatest risk are women and children in female-headed households in both rural and urban areas. Female-headed households in Somalia reflect the changes that have occurred in family structure as the result of internal and international male migration, or as the result of men away from home to meet military obligations, along with the breakdown of the extended family network. While female-headed households are perhaps the most needy, most of the Somali population can be classified as poor. Most of poor households rely to a considerable degree on market sources for many of there basic food items. Thus it is safe to say that most food entering the market is consumed by poor people. The commodities that will be sold through private sector channels, flour and vegoil, are staples that are consumed by virually all Somalis, rich and poor alike. A portion of the flour and vegoil will be distributed through government channels to civil service employees, who are amongst the poorest people in the country. Average civil service salaries are between 600 and 900 shillings per month which is equivalent to about $7 to $10 at the official rate and $4 to $6 at the free market rate. The hard wheat will be used to make pasta which is another common stable for virtually all Somalis.

D. Program Elements

1. Commodity Selection and Levels.

The Mission has selected wheat, flour and vegoil for the Section 206 program. Selection is based on country requirements (which are shown in the following tables) as well as past experience which has shown Somalia to have an absorptive capacity considerably in excess of what has been provided under Title I in past years. Our recommendation for 28,000 M/T of commodities in FY 1987 is just 43% of the FY 1986 program and is based on level limitations under Section 206 rather than a "need" requirement.

Our request for FY 1987 PL 480, Title II, Section 206 is:

Flour	12,000 mt	at usd 172	equals	$2,064,000
Hard Wheat	6,000 mt	at usd 116	equals	696,000
Vegoil	10,000 mt	at usd 589	equals	5,890,000
-	Sub total		equals	8,658,000
Ocean frt est (28,000M/T @ $125/MT)			equals	3,500,000
-	Total US dols		equals	12,158,000

Tables showing imports, pricing and related information serving as justification for the recommendation are provided below.

a. Flour

The average monthly flour requirement has fluctuated from a high of 5,421 M/T in 1984 to a low of 2,211 M/T in 1986 (based on the figures in the table below). The three year monthly average for 1984 through 1986 is 4,078 M/T. During this same time period, Title I as a percentage of total flour availability has risen from 34.5% in 1984 to 63.8% in 1986. During this same period, total availability of flour based on imports (food aid and commercial) dropped 59%-(65,051 M/T in 1984 and 26,536 M/T in 1986).

The National Planning Commission gathers consumer price information from markets in Mogadishu. From the data they collect, they published a monthly high and low price for selected foods. From this we have been able to calculate the yearly high and low for flour for the three year period (Somali Shillings per kilogram).

	1984	1985	1986
High	54.75	73.71	60
Low	24	24	38

It should be noted that bread prices have increased but this is probably due to using small generators run on expensive gasoline for power or shifting to kerosene or charcoal both of which have also had substantial increases since electrical power became more unreliable in early 1987.

We have learned that the 1985 EEC wheat flour pledge of 10,950 M/T flour is scheduled to arrive in Mogadishu in Oct. 1987. EEC and Section 206 flour combined will provide less than six months inventory of flour at a flow of 4,000 M/T a month. Part of the shortfall will be made up by flour production at the pasta plant (see hard wheat section). It is alsc likely other donors will help to make up any shortfall.

<u>Flour</u>:

Imports by Country for Period 1982-86 (M/T)

Donor Food Aid	1982	1983	1984	1985	1986
USA	13,714	15,494	22,434	25,345	16,93
CANADA	3,400	-	-	-	-
AUSTRALIA	10,400	3,066	3,000	3,000	-
JAPAN	-	-	-	-	5,508
SAUDIA	4,000	-	-	-	-
SWEDEN	7,900	-	-	-	-
FRG	-	-	7,945	-	-
NETHERLANDS	-	-	-	5,474	-
EEC	7,457	5,650	11,900	9,340	-
Other Europe	4,200	7,625	7,309	2,071	-
WFP	-	5,200	-	-	-
Subtotal	51,071	37,035	52,588	45,230	22,44
Commercial	NO DATA	NO DATA	12,463	10,000	4,09
TOTAL AVAILABLE	51,071	37,035	65,051	55,230	26,53

Commercial imports of flour, which were high in 1984 and 85 (12,463 M/T and 10,000 M/T respectively) but rather low in 1986, could possibly increase as a result of the foreign exchange being made available through the Cash Auction, if food continues to be an eligible import under the Cash Auction. In the meantime, Section 206 appears to be the most viable method available for filling the gap between flour requirements and availability.

The 25 to 37 percent of the flour that is not sold to private traders will go to ENC for distribution to public sector agencies for institutional feeding or as supplements to civil service salaries. We assume that the distribution pattern for this flour will be similar to past ENC flour distributions: military - 42%; local governments - 12%; police - 12%, ministeries/banks/parastatals - 11%; schools/hospitals - 8%; prisons - 5%; other - 10%.

b. Wheat

The GSDR has requested the USG to provide 10,590 M/T US # 3 hard amber durum wheat for use in making pasta in 1987. This type of wheat, or a suitable substitute hard wheat is required; soft bread wheat will not be appropriate.

During CY 1986 the pasta factory produced 10,031 M/T of pasta while an additional 6,412 M/T were imported primarily from Italy. Total availability was 16,443 M/T. During 1986 the pasta factory processed 18,000 M/T of wheat. Production was as follows (M/T):

Pasta	Flour	Bran	Animal Feed	Loss	Total
10,030.7	2,116.4	3,603.2	236.7	2,013	18,000

* The 2,116.4 M/T flour shown here is not included in flour section above
Note: All figures given above for Pasta Factory are taken from monthly production records and can be considered actuals rather than estimates. Based on the foregoing figures there is a monthly pasta requirement of approximately 1,370 M/T of which 835 comes from local production.

Local Pasta Production Data: The local plant has a theoretical maximum capacity for milling 100 M/T wheat each 24 hour day. However, in reality, the maximum milling ranges between 75 and 80 M/T each 24 hour day. In actual practice this output is not reached. During CY 1986, production averaged about 30 M/T per day. Due to the shortage of power and other production difficulties, the production in recent months has been only about 10 to 15 M/T per day. However, production was unusually low during this period, we expect production levels to be somewhat higher during the remainder of 1987 and through 1988. Roughly 20,000 M/T of wheat is required for yearly production of pasta. Since it takes about two M/T of wheat to make one M/T of pasta, the 6,000 M/T requested under Section 206 will represent a 100 to 200 day supply for the pasta factory (assuming production levels of 15 M/T to 30M/T of pasta per day).

Wheat Imports

Country Food Aid	82	83	84	85	86
Saudi	3,990	-	-	-	-
USA	4,975	5,089	15,872	15,277	9,652
WFP	6,500	3,000	-	-	-
EEC	30,000	5,000	25,260	17,500	-
France	-	3,000	-	-	-
Australia	-	-	1,000	-	-
FRG	-	-	5,000	-	-
Turkey	-	-	5,000	-	-
Other Europe	-	-	-	5,600	-
JAPAN	-	-	-	5,900	11,037
India	-	-	-	10,000	-
SubTotal	45,465	16,089	52,132	54,277	20,689
Commercial	Unknown	Unknown	Unknown	Unknown	1,491
TOTAL AVAIL	45,465	16,089	52,132	54,277	22,180

It is reasonable to believe that large quantities of wheat in past years was needed for refugee feeding as well as for animal feed. In addition, we have been able to confirm that wheat stocks in the north and south at the begining of the year were approximately 1,400 M/T.

The pasta plant had no difficulty accepting the 5,250 M/T of hard wheat that arrived for the 1986 program, but the soft wheat is a different problem. The 4,402 M/T of soft wheat that arrived was mixed with rice and hard wheat. It has been sorted out, but this was time consuming and as of April 30th, 500 M/T still remained at the Mogadishu port. It is being moved slowly as it is sold by the pasta factory to small buyers.

The Mission request for 6,000 M/T of wheat will be sufficient, but not enough to allow a reserve which can be diverted for drought relief assistance in FY 1987 unless other countries are prepared to make allocations. The Mission is confident the 6,000 M/T hard wheat will be easily absorbed into the production of pasta.

c. Vegoil

Vegoil is fast becoming a necessity as people learn how much easier it is to use in cooking. The resultant shift away from animal fat or high priced sesame oil has created a high demand for vegoil. Import, usage and pricing data follows upon which a justification will be made for 10,000 M/T Section 206 vegoil.

Import Data (M/T)

Country Food Aid	1982	1983	1984	1985	1986
Saudi	1,227	-	-	-	-
Sweden/Norway	1,227	802	-	-	-
WFP	1,400	2,255	-	-	-
EEC	2,000	1,432	-	1,298	-
USA	12,453	13,951	2,210	1,600	-
ITALY	-	-	9,635	14,088	13,928
Other Europe	-	-	-	-	1,302
			3,863	2,692	-
SubTotal	18,307	18,440	15,708	19,678	15,230
Commercial	9,000	12,000	7,000	5,000	2,633
TOTAL AVAILABLE	27,307	30,440	22,708	24,678	17,863

The import data indicates the total number of countries making vegoil available to Somalia on concessionary terms is declining while at the same time overall quantities of vegoil made available are also being reduced.

The Ministry of National Planning report on vegoil pricing for three year period shows vegoil high and low prices for the year as follows:

Vegoil - Cost Shillings per Kg

	1984	1985	1986
High	179.1	157.5	128.4
Low	85.6	99.1	94.1

These prices have not been factored for devaluation or inflation to the best of our knowledge. It is surprising that the data available to the Mission indicate that in 1986 total imports were lower than average, and the price also appeared to be lower (though the ranges shown above suggest lower prices, we do not know exactly how much vegoil was sold at specific prices). Recent market prices suggest that the large amount of Title I oil that arrived at the end of CY 1986 is being put into the marketing system at a rate that is making the retail price much more beneficial to the poorer segments of the population.

Based on the total availability of vegoil for 1984, 1985 and 1986 we calculate a monthly requirement of 1,812 M/T. However, either actual usage in 1986 must have been much lower, or there were large carryover stocks at the beginning of 1986. Title I vegoil did not begin to enter the market place until November, thus if imports were relied on for total oil supply in 1986, only 3,935 M/T of vegoil was imported and available for use prior to the introduction of Title I vegoil. Without a large carryover, the monthly average reduces dramatically to about 400 M/T a month.

Refugee receipts of vegoil for the past five years are as follows: (Not included elsewhere).

1982	1983	1984	1985	1986
9,591	8,324	7,004	10,1791	11,082

Mission believes that some of this vegoil leaks into the marketing system; however it is not sufficient to account for the monthly average swing shown above.

By limiting Section 206 levels for vegoil to 10,000 M/T with arrivals very late in 1987, current supplies (much of 1986 Title I) will have been absorbed along with the modest imports. The Cash Auction will provide foreign exchange for importing food, if food continues to be an eligible commodity, but we do not see this resulting in any substantial imports of vegoil.

We assume that the 25% to 37% of the vegoil that goes to the public sector will be distributed roughly as it was in the past: military - 45%; local governments - 31%; police - 9%; ministries - 7%; others - 8%.

2. Self-Help Conditions

The policy reform related self-help conditions under the the proposed Section 206 Program will be a component of the Mission's overall policy reform agenda (Mogadishu 01357, State 081757, Mogadishu 03545). The self-help conditions proposed for the Section 206 Program are presented below.

a. Sales to the Private Sector

The GSDR will sell 63 to 75 percent of the Section 206 flour and vegoil (14,000 to 16,500 M/T) through private sector channels. The GSDR has already agreed that Ministry of Finance (MOF) or its agent would handle the food sales to the private sector, rather than the Ministry of Commerce (MOF). This should eliminate a number of the problems experienced at previous auctions (See Implementation Plan).

b. Analysis of the Domestic Rice Industry

The GSDR will undertake an in-depth examination of the domestic rice industry. At present, domestic rice cannot compete with imports and only accounts for about 10 to 15 percent of domestic demand. The examination will investigate environmental factors (soils, moisture, diseases, pests etc.); current production practices as compared to recommended techniques; input and other production costs compared to farmgate prices marketing mechanisms and constraints; etc. The examination will make recommendations indicating whether the domestic rice industry can (or should) be made competitive in the long run, and if so, what policy reforms and other steps are needed. The study will be funded under the Mission's Policy Initiatives and Privatization (PIP) Project (649-0132). The Mission will develop the scope of work and obtain GSDR clearance by October 31, 1987. Undertaken as a direct AID contract, the study will be completed by October 31, 1988.

c. Analysis of Customs Duties

The GSDR will undertake a comprehensive analysis of customs duties related to food and agriculture. The GSDR has been concerned over the impact on domestic agriculture of donor and private imports of food. The analysis will determine the impact on domestic agriculture of custom rates on basic foods (sugar, wheat, flour, rice, vegoil, corn, sorghum, etc.) and commodities related to agricultural production (fertilizer, pesticides, mechanized sources of power, fuel, seed, etc.). Specifically, the effect of customs duties on the types of food imports that are encouraged or discouraged and the relationship to overall food needs versus incentives for domestic agriculture will be examined. To put the study into perspective and to provide necessary background for recommendations, the analysis also will review the full range of customs duties. It should be mentioned that Somalia reliance on customs duties as a percent of total revenues is extremely high compared to other countries at their level of development. Recommendations will focus on setting customs rates on food and agriculturally related products so that they support development objectives. The study will be funded under the Mission's PIP Project. By October 31, 1987, the scope of work will be developed and cleared by GSDR. The study will be undertaken as a direct AID contract and will be completed by October 31, 1988.

d. Budget Reforms

In conjunction with the conditionality of the FY 1987 ESF Program, the Section 206 Agreement will include self-help policy reform conditions on budgetary reform in the Ministry of Finance (MOF). Initial negotiations with the Minister of Finance verified the Mission's perception that the GSDR is very sensitive concerning its budget. Additional negotiations will be necessary before we can state the specifics of budget reform conditionality.

Section 206 provides a logical entre into budget reform because it will generate a sizeable amount of local currency, which must be budgeted by the MOF. Under the PIP Project, the Mission will continue to fund a Financial Advisor to the MOF who in previous years has instituted a number of positive reforms in the Domestic Development Department of the MOF, the unit that administers the generated shillings program.

Budget reform is key component of the Mission's policy reform adgenda, which we will be pursuing under our FY 1987 ESF Program and the Somali Economic Rehabilitation Program (SECOR) planned for FY 1988. An important first step to instituting budget reform will be to get the GSDR to allow donors to review their current system for allocating resources. To date they have resisted the efforts of donors to investigate their system to any degree of depth. Therefore, part of our Section 206 conditionality will be to pry the door to their budgetary system open a bit further and to take a good hard look inside.

3. Programming Local Currency Uses

A. Each year USAID and the GSDR develop a local currency Annual Program Budget Plan (APBP), which is jointly approved by Minister of Finance and the USAID Director (The APBP for 1987 is attached as an illustrative example of the Mission's local currency programming process.) The Section 206 Agreement will include explicit language related to acceptable local currency uses. The Mission and the GSDR have established a relatively good system for jointly programming generated local currency from PL 480 and ESF Programs. This system is being improved continuously. We will be establishing a Local Currency Policy Committee within the Mission to assess the relative importance of the various potential uses of local currency and determine the most appropriate priority uses for the generations available. Funding for our bilateral projects (as well as Mission operating expenses) remains our highest priority for local currency use at this stage, but we also recognize the very important role local currency potentially can play in policy dialogue and policy reform. The FY 1987 Section 206 local currency will be used in 1988 primarily to support the Mission's bilateral agricultural, rural development, and nutrition (ARDN, Section 103 of FAA) activities as well as selected child survival and policy reform initiatives. In late CY 1987, the Mission and Ministry of Finance will negotiate a detailed 1988 Annual Program Budget Plan (APBP) specifying the particular activites that will be funded from the Section 206 generations. The supported activities all help very needy people; almost everyone in rural Somalia can be classified as poor and USAID projects are targeted at those who are particularly in need of assistance. PL 480 local currency uses are provided below (in $ millions).

Source/Purpose	1986 Actual	1987 Est.	1988 Planned	1989 Prop.
1. Agriculture	$3.7M	9.0	12.0	8.0
2. Health and Water	.6	.65	.2	.2
3. Population	.81	--	--	--
4. Other	3.62	1.66	.83	.82
TOTAL	8.73	11.31	13.03	9.02

* Includes carryover of generations from prior year generations.

IV. FINANCIAL ANALYSIS

Financial aspects of the program include the deposit into a special account of local currency generations and the disbursing of the local currency for approved development activities.

A. Deposit of Generated Local Currency

As discussed in the Issues Section above, the Agreement will state explicitly that the amount of local currency to be deposited by the importing country shall be the local currency equivalent of the C&F value of the commodities converted at the highest legally obtainable exchange rate for imports on the day the Agreement is signed. The Agreement will also require the GSDR to: (a) establish a new PL 480 Title II, Section 206 account for receiving the deposits and (b) forward reconciled bank statements for this account to USAID quarterly. The USAID Program Office and Controller will monitor/condition the deposit of local currencies.

If for some reason, the commodities sold to the private sector generate more local currency than the equivalent of the C&F value, the Agreement will specify that the GSDR must report the amount of any excess shillings to USAID within three months of completion of private sector sales and these excess shillings must be credited to the Ministry of Finance budget

B. Timing of the Deposits

We propose that as a condition precedent to the signing of the Agreement, the GSDR must deposit into the special account a first tranche of shillings equal to at least 50% of the total shillings generated. The second tranche of an additional 25% of the total shillings generated must be deposited on the date of arrival in either Mogadishu or Berbera of the first shipment of commodities. The third and final tranche (of the remaining deposits due - up to 25%) must be deposited within three months after the due date for the second tranche.

C. Disbursement of Generated Local Currency

Disbursements under the approved Annual Program Budget Plan are managed by the joint USAID - GSDR Generated Shillings Committee (GSP) and the Ministry of Finance/Domestic Development Department (MOF/DDD), which acts as a secretariat to the GSP. The GSP meets biweekly to discuss and make decisions concerning the disbursement of local currency for development activities. No funds are disbursed without written Mission concurrence. In addition, the GSP and MOF/DDD reviews the individual budget line items within approved projects and obtains expenditure information from projects. Project level audits are conducted by the MOF/DDD.

D. Audit Rights

The Agreement will indicate explicitly that the AID/IG auditors, representatives of the USAID/Somalia Controllers Office, or independent CPA firms acting as their agent will have the right to review the financial system and records dealing with the handling, deposit, and disbursement of the PL 480 commodities and the local currencies generated therefrom.

V. BELLMON ANALYSIS

Somalia has an effective storage handling and transportation system as evidenced by past Title I program implementation. The port of Mogadishu is capable of discharging 1,000 M/T per ship per day with a capacity for from five to six ships depending on the size of the ships. There is one additional berth for unloading fuel. Mission observations of the discharge of donated, commercial and food aid commodities indicates the GSDR is experiencing no difficulties receiving large amounts of commodities even in the period August to October when port congestion is a major problem. The port has three large warehouses where commodities are often held until clearance procedures are completed or until delivery can be completed.

The transportation system consisting of new, moderately old, and old trucks has been able to keep up with ship discharging whether it be sugar, Title I food, cement or fuel oil.

The system of warehouses, both commercial and government, covers the entire country. The ADC has warehouses strategically placed so that local purchases of price support grain can be made while at the same time they can store large amounts of commodities such as received under Title or for the Refugee Program.

During previous years, when as much as 65,000 M/T of Title I food came in over a period of slightly over two months, the system had no difficulty absorbing it.

The Mission has reduced its request for PL 480 food from 65,000 M/T in 1981 to 28,000 M/T in 1987. We believe that as foreign exchange becomes available through the Cash Auction there will be a definite increase in food imports by local traders. Thus, the potential disincentive that could have occurred with previously high levels of Title I will be avoided by the significantly lower levels of Section 206 food. Furthermore, the Section 206 commodities do not compete directly with domestic commodities, so any possible disincentive affect is minimized. (Note: Somalia does have a domestic sesame oil industry that provides about 30% of the overall oil demand; however, sesame oil is used somewhat differently than regular vegoil, is the preferred cooking oil, sells for a higher price, and thus does not compete directly with PL 480 vegoil.)

VI. USUAL MARKETING REQUIREMENTS (UMR)

As can be seen in the charts that provided import data, the UMR's (based on three year average) for flour, vegoil and wheat are relatively low. They are:

Flour:	8,851 M/T (3 year average)
Vegoil	4,877 M/T (3 year average)
Wheat	1,492 M/T (one year imports only)

The Mission is confident that with reduced PL 480 levels traders will fill any gap that develops in local market availability of these commodities.

VII. IMPLEMENTATION PLAN

There has been indecision as to whether there would be a Section 206 Program or a Title I Program. Therefore, the Mission only recently started negotiating with the GSDR. Nevertheless, we will attempt to negotiate the following matters to our mutual satisfaction.

A. Discharges:

1. All the hard wheat will be discharged in Mogadishu for the pasta factory.

2. The food destined for the public sector will be turned over to ENC, the GSDR parastatal that handles all government food imports, for similar sales this year. One third will be discharged in Berbera with the remaining two thirds being discharged at Mogadishu.

3. The commodities remaining will be sold to local traders by a method to be agreed up'ı the GSDR and USAID. One third will be discharged in Berbera and two thirds in Mogadishu.

4. Mission emphasis will be on privatization of discharge transport and storage of commodities as a means of lessening the control of ENC on the process. If possible, ENC will be excluded from handling the commodities destined for the private sector.

5. The USAID representative was denied access to the port on several occasions during FY 1986 arrivals. More recently while trying to observe USG commodities donated to the WFP, entry to the ship was denied by GSDR representatives. During negotiation, the Mission will press on the GSDR the importance of having a representative being able to observe the conditions of USG foods as they arrive as a means of improving packaging and storing these commodities.

6. The Mission will continue to hire food aid monitors to keep track of ship arrivals and commodity discharge at Berbera and Mogadishu. The USAID food monitors will keep track of the daily discharge tallies and make comparisons between that of the ship, the GSDR, and the stevedores noting why there were differences and what actions were taken to reconcile them. They will insure commodities are properly sorted and report any poor handling or storing problems.

7. We will make every effort to have the MOF or its agent, rather than ENC, handle the commodities destined for the auction. In prior years, ENC first ceased the best quality commodities for public sector distribution and reluctantly later cleared and transported the commodities destined for the auction.

B. Distribution to the Private Sector

1. The FY 1986 auction placed an unbearable burden on Mission manpower resources, therefore our approach in FY 1987 will be to have a transfer process that is: (a) simple, (b) not manpower intensive and (c) capable of being implemented over a short period of time (weeks rather than months).

2. Prior to commodity arrivals, the food monitors will gather weekly market prices of the Section 206 type commodities in Berbera and Mogadishu. This information will be one of the major factors used in determining the value of the commodities when they are sold.

3. The Mission will insist on only two sales points; Berbera and Mogadishu.

4. The AID food monitors will also assist with the mechanics of sale of commodities and provide input on a daily/weekly basis to the Mission in order that actions can be taken to correct defects or bring about overall improvements. As critical activities happen, the Mission will have direct hire employees available for oversight and assistance.

5. The Ministry of Finance (MOF), rather than the Ministry of Commerce (MOC), will handle private sector sales. This should reduce a number of the implementation problems experienced in previous food auctions. In prior years, the MOC tried to please its constituents, the traders, by attempting to auction the food to as many traders as possible and at a bargain price. To accomplish this they unilaterally reduced the maximum amount any trader could purchase. Thus, with the higher bidders taking smaller amounts, they had to go farther down the list, reaching more traders and a lower auction cut-off price.

   In contrast, the MOF has a strong interested in achieving a high auction cut-off price. Furthermore, traders are not the constituents of the MOF, so it is doubtful that they will push hard to have the commodities reach as many traders as possible. Thus, we will negotiate that there should be no limit on the amount of commodites a trader can bid upon. Furthermore, it appears the the MOF is staffed with higher quality and better educated men and women who seem to be more qualified than MOC to implement a successful auction. Given this reality and the fact that MOF objectives in the food auction will be more closely aligned with USAID's, we would prefer to let them take primary responsibility for conducting the auction, with the Mission playing only a advising and monitoring role.

6. The method we plan to adopt for determining the amounts of local currency generations to be deposited into the special account should make our monitoring job considerably easier. In past years, we had to negotiate a long series of allowable auction expenses and closely monitor auctions to determine the exact sales price and amounts of all commodities auctioned as well as to ensure that only agreed upon expenses were being deducted. This year, we will know the exact amount to be deposited on the day that the Agreement is signed.

VIII. MONITORING AND EVALUATION

A. Commodities

As stated in Section VII above, the Mission will have two food aid monitors working under the supervision of the FFPO to monitor arrival, discharge, transport, storage of Title II Section 206 commodities. Arrival reports will be made to AID/W providing information on ship arrivals, condition of commodities, and quantities received. Reconciliation will be made between Bill of Lading amounts and amounts actually received, and sufficient data will be provided so that CCC can make claims against the shipping companies if appropriate.

The Mission will evaluate the delivery of commodities on the basis of scheduled date of arrival vs actual date of arrival, whether commodities meet specification and their condition on arrival. After arrival we will evaluate the program on the basis of expediency with which GSDR receives and sells the commodities.

B. Local Currency and Self-Help Measures

Monitoring of generated local currency is discussed in Section IV. Financial Analysis. USAID will monitor the self-help studies using existing procedures for PIP Project studies. Self-help budget reforms will be monitored in conjunction with the policy conditionality associated with the FY 1987 ESF program.

The Ministry of National Planning (MONP) has an evaluation project which will conduct evaluations of selected development activities including some of those funded from PL 480 generated local currency. In addition, the majority of the generated local currency will fund the GSDR counterpart to AID bilateral projects. These projects will be evaluated periodically according to their individual evaluation plans which are discussed in their Project Papers. These evaluations will cover all important project activities including those funded with generated local currency. The self-help activities will be evaluated in conjunction with the FY 1987 ESF program and PIP project activities.

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Commercial food imports have been hindered in past years by lack of "cheap" (subsidized) foreign exchange. Commercial imports are relative insignificant with the exception of rice with average annual commercial imports of about 30,000 M/T. Thai rice is a preferred food in Somalia and as such is more valuable than American and locally produced rice. Local production of rice accounts for only about 10 to 15 percent of demand. Virtually no flour is grown. Locally produced sesame oil, whi accounts for only about one third of total demand, is used in exactly t same ways as imported vegoil. It would appear that until demand and higher prices come into being, rural people will depend more on livesto production for income rather than crop growing. Presently, a large portion of local farm production is the result of part time farming rather than full time. Our analysis of total food availabilities food aid, refugee food and local production, convinces us there is a need fo Section 206 food as requested elsewhere in this plan. The 206 food wil prevent a food deficit from developing and will allow for sufficient reserve stocks when calculated in combination with other food coming in to handle emergencies such as the current drought situation.