

The Vulnerability of Somali Shilling, Appearance of Dollarization and the Propose to Reform Currency: A Descriptive Study of Somalia After 1991

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Abstract: After the collapse of central government in 1991 Somalia did not enjoy economic and financial wellbeing. The Somali Shilling experienced vulnerability; an extreme devaluation and instability faced. The business communities preferred the use of dollar and left the national currency (So.Sh.). This paper investigated the extent of national currency vulnerability. The study found that instability of the Shilling value in recent years is the principle cause of dollarization in Somalia. The future value of So.Sh depends on how far the Central Bank of Somalia works in the monetary field. Nowadays, an idea of setting up a policy for currency reform is publicly heard, this study gives attention that market failure is inevitable if not well established and this be a big achievement if the policy succeed without economic and financial interruption.

Keywords: Somalia, Somali Shilling, Currency, Dollarization, Economy, Monetary Policy, Currency Changing.

1. INTRODUCTION

Somalia is a country of strategic geographical location in the horn of Africa. The country faced financial and economic distortion after the collapse of the Siyad Barre regime in 1991. More than two decades of lacking effective government, monetary and fiscal authorities the self regulated economy made created some obstacles as well as some successes. Although the cost of statelessness is painful among Somalis, in his study on Somalia's "Better off Stateless", Peter Leeson (2007) found that 18 indicators were better off under anarchy than under the government, he concluded that although the costs of stateless are more in other societies but Somalia is different and in some indicators stateless does not matter so much. As soon as the falling down of military regime the shilling, alongside with the acceptance of the society, experienced vulnerability, value instability and became less value which at last led the use of dollar in domestic business transactions and the market for livestock and agriculture products is the only place where So.Sh is the master currency. And now the government budget, national reserve, deposits in private banks, mobile money and even call scratch cards are US dollar due to its value stability. The authority of Central Bank of Somalia will do currency reform in the following years with a reasonable support of International Monetary Fund IMF and World Bank Group and they will be well appreciated if this policy became successful without economic disturbance.

2. A BRIEF HISTORY OF SOMALI MONETARY SYSTEM

There is no definite time that can be traced the starting of use of money in Somalia, but it is told that in early time barter trade had been using by the society of East Africa. But in the first half of 19th century the people started using a silver metallic coins called Maria Theresa Thaler, given as honor the name of Empress Maria Theresa who ruled Austria, Hungry and Bohemia. These coins are accepted by the residents of Arab World and East Africa. At the same time two currencies namely; Indian Rupee made of silver and Pesa made of copper were also circulating in the economy of

Zanzibar, Mombasa, Muscat, India and Iran which were at that time the main trade partners of Somalia. Indian Rupees mostly used in the coastal towns of Somalia namely; Zeila', Berbera, Mogadishu, Merca, Brava and Kisimayo (Central Bank of Somalia).

In the northern regions of Somalia, the British colonial officially recognized the Indian Rupees as the only medium of exchange for its previous acceptance among the society and the same currency itself is issued by the British colonial in India. Also this Rupee was used in southern regions of Somalia when Italy is defeated in the Second World War and Great Britain ruled the Southern part of Somalia. In the southern of Somalia, Italia issued bank notes of 5 Rupees for the clan leaders to attract the land owners and gradually acquire their land as a colonial, this was not real money but a promise of 5 Rupees upon the request of every clan leader, and this was in 1893. In 1905 Italy government issued a currency called Italian Lira, it was one cent as to be the exchange of Maria Theresa which is broken down into 150 cents but unfortunately this Italian Lira did not enjoy the market acceptance as medium of exchange. Alternatively they issued Italian Rupee it was silver and was 100 base and lastly was fully accepted by the society of that time. This was in 1909 but not used thoroughly until 1925 in which the Italian colonial ordered that Italian Rupee is the official currency. This currency replaced the Indian Rupee and Maria Theresa coins. In 1935 Italian colonial captured Ethiopia and soon they announced the East African Italian (African Orientale Italiana). A new currency same to the one circulating in Italy with a few modifications is issued for the East African Italian colonies consisted of Ethiopia, Somalia and Eritrea (Dalmar, 2006).

In the decade of forties the British colonial administered thoroughly the whole country and ordered that all other currencies of East African Shilling, Maria Theresa, Indian Rupees and Egyptian pound should be linked and exchanged with the Sterling Pound. In 1950 the United Nations Trusteeship Administration's decree no stated the need for issuance of new currency for Somalia named *Somalo* which equals to 0.124 grams of fine gold. This new currency was useful until early of sixties (Central Bank of Somalia).

In 1962 *Banco Nazionale Somalia* or National Bank of Somalia is established and started to provide the economic and financial service to the nation. New banknotes called Somali Shilling were issued in December 1962, this money contained 100 Shilling, 20 Shilling, 10 Shilling and 5 Shilling (Luther & White).

1966 and 1968 were the creation of the second and third batches of Somalia Shilling (So.Sh.) and 1972 the fourth issued shilling is released to the market. 1975 National Bank of Somalia is converted to the Central Bank of Somalia and controlled the monetary system of the country up to the collapse of the government in 1991, after that the country's economy distorted by the absence of effective government (Symes, 2005). Northern started to separate from the whole country having their own currency, Puntland, a regional government followed and in Mogadishu the situation is worse. With no central bank large sums of money supplies printed completely by business men seized to country through the transitional governments like: Ali Mahdi's, Abdullahi Yusuf's and also in Puntland. The madness of society's acceptance of shilling notes without a monetary authority led uncontrolled inflation, volatile exchange rate and price instability of goods and services in the whole country. Now the US Dollar in the circulation is so much more than the Somali Shilling.

And recently in the last decade throughout the country a new form monetary service is launched called Mobile Money Transfer MMT. It's a dollar based electronic financial service provided the large telecommunication companies after a long time of absence of banking service (Ali, 2013)

3. REASONS OF DOLLARIZATION IN SOMALIA

Dollarization does not mean only the use of United States dollar, it is a general term used to characterize the use of any foreign currency that mostly serves as a substitution of national currency. Evidences state that the US dollar as store of value instrument is very high in Tanzania and also in East African Communities (Kessy, 2011).

Meyer, (2000) classified dollarization into three kinds. The first one is official dollarization which means a total substitution of local currency with the foreign one. In this condition a foreign currency chosen by the country is the legal tender, Panama and Ecuador are good example for this case. The second is officially semi-dollarization which is using the domestic and foreign currencies together but the foreign currency is the legal tender. The country can still issue its own domestic currency as a secondary use and public are free to use which of them is preferred, Lesotho, Swaziland and Zimbabwe can be this case's example. The third kind is unofficial dollarization which is characterized when domestic currency is the legal tender money supply but other foreign money is used in the business activities like Tanzania.

The use of dollar as medium of exchange was observed in Somalia after the collapse of former central government in 1991. A continuous devaluation and general economic turmoil are believed to be the key drivers (Nor, 2012). Private money printing, lack of regulatory body and distortion of economic activities in the last two and half decades led to crises in financial sector and commodity prices. The excessive devaluations and instabilities experienced by the Somali Shilling (So.Sh.) damaged the public confidence on the local currency which lastly enforced the business communities to use US dollar rather than So.Sh. The adoption of a foreign currency as medium of exchange is not limited to Somalia but also exists in other economies in Asia, Latin America and Eastern Europe. Sub-Saharan African countries are also experiencing dollarization in recent years, the bank deposits and loans dollarized. Sub-Sahara Africa's use of foreign currency is caused by inflation and exchange rate depreciation and also currency substitution (Mecagni et al, 2015).

There are some principle reasons behind dollarization or the adoption of dollar in the place of Somalia Shilling (So.Sh.). Firstly, lack of peoples' confidence on their national currency of Somali Shilling. Massive devaluation, currency vulnerability and not retaining a stable value in long run destroyed the confidence of society on the currency, the people left the domestic currency because they need to take a huge bundles of money when going to markets and to be safe they, instead, used dollar as medium of exchange. Only markets for livestock and agricultural products are used the local currency. Secondly, the global dollarization pressure also took its role to substitute the dollar in the place of So.Sh. In the twentieth century US government became the world super power and its currency of dollar became the one and only globally accepted currency and this also effected the local economy and business transactions that led the dollar to have a value in business community and preferred using a currency with international value to have access their businesses regionally and globally and to have a good integration with the world markets. Thirdly, the excessive inflows of dollar in the country are also subject matter. Somalia is a host of large sum of US dollar in the way of remittance, foreign aid, foreign direct investment, a hard currency of export and any other ways of businesses. These inflows of dollar started circulating in the economy and people should use it for its stability. Finally, lack of printing Somali Shilling helped the replacement of local currency. With its minimum value and vulnerability still the local currency had to work partially in the local market until now but the problem is that Somali Shilling money supply slowed down. In the period of civil war the currency was completely printed by business men and stopped doing so because the marginal cost of printing a paper currency is more than its marginal revenue. The agriculture and livestock market is the only market where national currency (So.Sh) is the medium of exchange, store of value and unit of account (Nor, 2012).

4. EVIDENCES OF SOMALI SHILLING (SO.SH) INSTABILITY

Dollar being the reliable medium of exchange did not come easily, after the eruption of civil war in 1991, the country's monetary system is totally destructed, the society accepted a shilling notes from nowhere but seen only in the markets. The voluntary acceptance was compulsory because of no alternative. At the beginning people do not know more about US dollar after the integration of world through business activities they had to use strong currency. As per following tables, a weakness of Somali Shilling is seen in the areas of price instability and exchange rate volatility which completely explains the idea of not retaining stable value across the years. Selling different prices for same bundle of goods or service and having dissimilar exchange rates over a period of time is good example that So.Sh experienced weaknesses in the last decades. The Shilling could not serve as a strong medium of exchange and had no role in international markets, this is why the society dropped the domestic money and used dollar in their activities. Data used in the tables are from Sesric website, Food Security and Nutrition Analysis Unit (FSNAU) and from SIMAD's Somali Business Review.

4.1: Food price volatility:

Table 4.1: Nine (9) Year Price Analysis of Necessary Food Items

Item	2007 (So.Sh/1kg)	2011 (So.Sh/1kg)	Variance %	2011 (So.Sh/1kg)	2015 (So.Sh/1kg)	Variance %
Rice	9,000	42,000	367%	42,000	12,000	-71%
Sugar	12,000	55,000	358%	55,000	13,000	-76%
Flour	7,500	31,000	313%	31,000	12,500	-60%
Maize	6,000	11,000	83%	11,000	8,000	-27%
Pasta	9,000	34,000	278%	34,000	22,000	-35%
Cooking Oil	4,000	47,000	1075%	47,000	22,000	-53%
Sesame Oil	30,000	64,000	113%	64,000	57,000	-11%

In the above table we saw that there is a great instability in prices of basic food items. For example: the price of rice was So.Sh.9,000 in 2007, after four years it is sold at So.Sh.42,000 which is 367% of price variance and lastly in 2015 the rice price slowed down to So.Sh.12,000, a percentage change of -71%. Generally the price of food items increase as exchange rate goes up this is because of the perceptions of business community of that price and exchange rate are significantly related each other.

As shown in the table the degree of price increase in four years (2007-2011) is three or four digits and greater than the percentage decrease between “2011-2015” which is mostly two digits only. Whether it is greediness, likelihood of profit or other factor, the business men increase the price when there is a reason but no soon slowing down after the reason went good, continuing this phenomenon in long run is the principle cause of extremely high priced goods and services in Somalia or in other words, hyperinflation. For example: if the global oil price goes up \$10 per barrel the business persons tend to push the price in same amount of ten, but as soon as it goes down to its previous level they do not do so and if happens they decrease less. This lastly led that in Somalia the oil price will be higher than any other country.

Absence of effective central bank to stabilize the price and inflation through monetary policy is the main factor of continues inflation and fluctuations in price. Somalia’s monetary policy include a policy for complete reform of national currency and overcoming the business based money printing which economists and policy analysts pay high attention.

4.2: Exchange rate volatility:

Table 4.2: Fifteen (15) Year Analysis of Exchange Rate (So.Sh/\$1)

Years	Exchange Rate	Appreciation (-) or Depreciation (+)
2000	10,500	N/A
2001	19,000	81%
2002	21,000	10.5%
2003	19,500	-7%
2004	16,000	-18%
2005	15,500	-3%
2006	14,000	-10%
2007	18,000	28.5%
2008	30,500	69%
2009	31,500	3%
2010	31,000	-1.5%
2011	30,000	-3%
2012	23,000	-23%
2013	21,000	-9%
2014	21,000	0%
2015	22,500	7%

Table 2: shows that exchange rate volatility is so high in Somalia. For example: at the end of 2000 \$1 was exchanged with So.Sh.10,500 in 2009 it was So.Sh.31,500 and in 2015 \$1 was equivalent for So.Sh.22,500. The idea of adopting the use of US dollar is a result of this continues instability and vulnerability of So.Sh. and experienced a massive devaluation that finally damaged the peoples’ confidence.

As shown above Somali Shilling is nor relatively stable currency and is difficult to gain a stable value till the monetary authority set policies to control and protect the So.Sh which is overthrown by the US dollar and Somalia cannot diagnose the financial market failure as soon as possible for several reasons. First is that its difficult for the federal government of Somalia to regulate and supervise the money supply of US here in Mogadishu. Second is that, currently, the central bank of Somalia is not well prepared and equipped to regain the authority of monetary system through effective monetary policy and completely changing those of paper currencies printed by the business men for the complete destruction in twenty five year civil war. Due these weaknesses it seems that the country will not soon overcome the dollarization problem.

5. CONCLUSION

The use of dollar in Somalia had been seen upon the collapse of the former central government in 1991. The dollarization, or in other word, adopting dollar instead of Somalia Shilling is caused by the extreme devaluation and instability of the currency which is characterized macroeconomic and financial vulnerability the country. An effective establishment of active monetary authority can solve the problems of a currency issued in Washington.

6. RECOMMENDATIONS

Challenges facing currency replacement are; First: Somalia's destroyed monetary policy can't be formed in one day and a national currency can't be issued one day and it will have economic implications. Second: The country, thoroughly, is not under the control of Federal Government of Somalia and distribution of the new currency through all regions will have its challenge. Third: lack strong tools for distribution of the currency as to reach all over the country, no strong states central banks and no salary-tool phenomena because the government workers are so small portion of the population. Fourth: less of technical requirements, less experts, lack of qualified staffs and also a budget matter.

The study recommends that if the biggest reasons of currency changing are (inflation, exchange & less value), and really are, the government can do a policy of **Non-Distortive Electronic Monetary Policy**, which to convert the mobile money of telecoms from US Dollar to Somali Shilling and people are now using it. Only what is required is that and I hope this will be useful until an effective monetary policy will come on the ground.

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APPENDIX - A

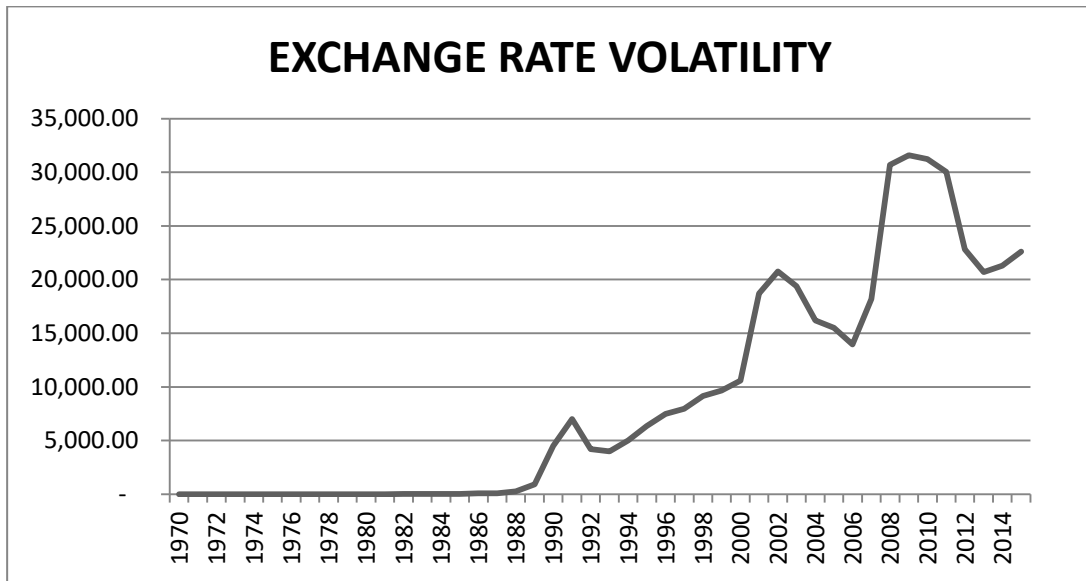


Figure1: Exchange rate volatility

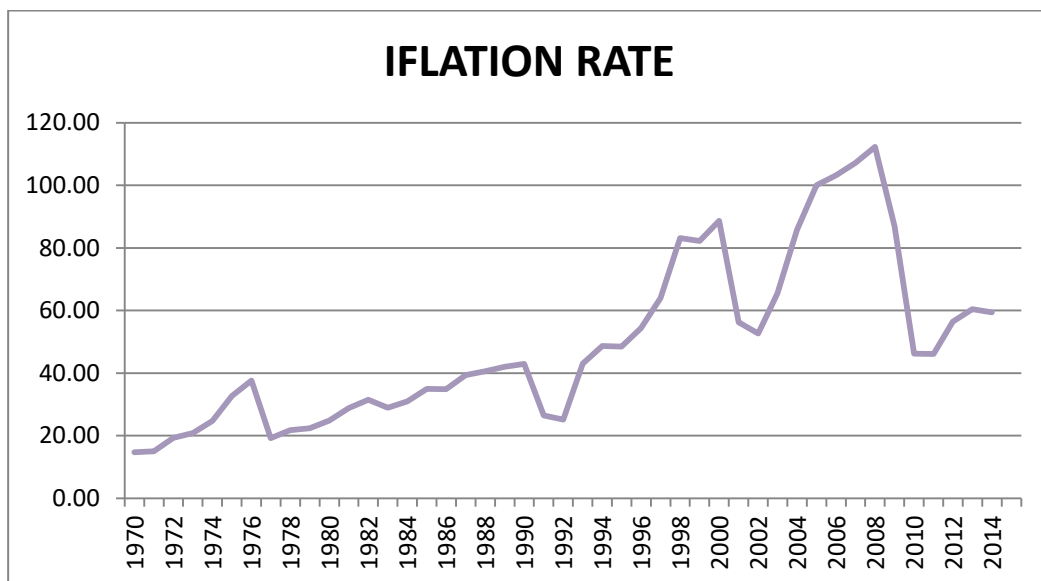


Figure2: Inflation rate