

The Major Causes of Local Currency Depreciation in Somalia

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Abstract

This study dwelled on the major causes of currency depreciation in Somalia. The main purpose of the study was to investigate in detail the major causes of local currency depreciation in Somalia. The study used qualitative research method using descriptive research design to investigate the major causes of local currency depreciation in Somalia. The study employed documentary review data collection tool and collected the secondary data through thorough review of the articles and books related to the major causes of local currency depreciation in Somalia. The key findings of the study on the major causes of local currency depreciation in Somalia encompass: existence of large quantities of Somali shillings in the market; the fall in the revenue collection by the government in the last two years weakens the country's local currency and causes its depreciation; existing monetary problems that hinder the control of financial activities by business owners in Somalia by the central bank of Somalia and financial regulatory authority in Somalia; weak monetary control coupled with lack of effective monetary policy to regulate and control the amount of inflow and outflow of foreign currency by the financial authority in the government such as Central Bank of Somalia and ministry of finance of the Federal Republic of Somalia and lastly dollarization of the economy which has replaced local currency and depreciated it owing to the massive inflow of foreign currency in form of remittance without being monitor and controlled by the financial authority in the country. The study recommended that the Federal Government of Somalia should introduce new monetary policy to monitor, control and supervise financial activities in the country and the Federal Government of Somalia should implement financial reform that allow the use of local currency to carry out all local transactions in Somalia to enable the local currency to regain its value and reduce the increasing rate of local currency depreciation.

Keywords: Local currency, causes, depreciation, Somalia.

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1. INTRODUCTION

Currency depreciation and shortages are currently the most serious economic crisis plaguing Somalia. Since the central government's collapse in 1991, the country's private citizens and businesses have primarily exercised self-government to regulate the flow of currency throughout the economy. In Somalia, the last time native currency was issued and distributed was in 1991. As a result, the demand for local money was not met when the Central Bank of Somalia was established. For instance, the Central Bank of Somalia did not control and place the necessary amount of currency in the local market, nor did it repair damaged and defaced currency notes.

Local currency was printed by Federal Member States and private business owners at various times due to a lack of control over currency circulation in the nation, but neither of them was given a mandate by the Central Government through the Central Bank to do so (Muktar 2017, 79–81; Yusuf & Abdurrahman 2019, 42). Due to the fact that Somali Shillings only have a single denominator of thousands of shillings, the local currency suffered severe depreciation as a result, and old, damaged, and counterfeit-prone Somali Shillings continued to circulate in the economy (Muktar 2017, 79–81; Yusuf & Abdurrahman 2019, 42). Due to this, Somalia turned to using US dollars, the most suitable and reliable currency utilised as a medium of exchange throughout Somalia for a period of three decades (Nor, 2012: 596).

The unofficial dollarization was voluntarily adopted by the populace to alleviate the pressures of the ongoing local currency devaluation, the lack of a central bank with the authority to control the quantity of banknotes in circulation, and the highly unstable and risky floating exchange rate regime. However, the poorer households who do not receive their income in hard currency are suffering greatly as a result of the country's dollarization. The majority of them barely make any money; they operate extremely small enterprises and offer their goods and services in local currency, which makes it difficult for many individuals to purchase goods in US dollars. The Somali Shilling depreciated as a result, necessitating the Central Bank of Somalia to adopt an exchange rate policy in order to combat the country's growing currency depreciation and shortages (Muktar 2017, 79–81; Yusuf & Abdurrahman 2019, 42).

The Somali shilling is subject to depreciation and exchange rate increases, according to SIDRA (2021); in September 2020, the Somali shilling lost 30% of its value to dollars over the course of three weeks, and the exchange rate between the two currencies reached an all-time high of 46,000 Somali shillings per US dollar. The lack of market acceptance of Somali shillings by Somalis, an increase in the amount of money available in some states like Puntland and a shortage of the currency in some regions of Somalia, a weak and ineffective monetary policy, the economic downturn brought on by the Covid-19 pandemic, and the dollarization of the economy are the main causes of depreciation and currency shortages in some states of Somalia, including Puntland (SIDRA, 2021).

Additionally, according to SIDRA (2021), the depreciation of the local currency results in a decrease in the purchasing power of the local population, a decrease in salary earnings for employees who are paid in Somali Shillings, and a lack of access to dollars for poor families whose incomes are fixed and they do not use electronic money transfer. Due to rising inflation that limits their ability to purchase products and services with depreciating Somali shillings, the majority of the poor are unable to meet their fundamental necessities. Prices of imported items including sugar, rice, and vegetable oil have increased by 34–80% as a result of the depreciation and shortages of local currency (FSNAU and FEWS NET, 17/05/2021). In order to address the growing reasons of currency depreciation and shortages in Somalia, this study will look into the roots of those problems. It will also make practical recommendations.

2. THE PURPOSE OF THE STUDY

The main purpose of this study was to investigate in detail the major causes of local currency depreciation in Somalia and to come up with clear strategies to control the increasing causes of currency depreciation in Somalia.

3. THE LITERATURE REVIEW

3.1. The definition of currency depreciation

Currency depreciation refers to the decline in value of a nation's money in comparison to other currencies as a result of supply and demand factors. The forces of supply and demand, which

result in lower prices for the nation's exports and foreign imports, and high domestic production, respectively, have a significant impact on the rate of inflation in the nation. Understanding the distinction between currency depreciation and devaluation is crucial.

A currency devaluation is a deliberate action by the government of an economy to lower the value of its currency in respect to the currencies of other countries for a variety of objectives, such as to boost exports, reduce the trade deficit over time, and so forth. For instance, Nigeria's exports to other countries are comparatively cheaper when Nigeria devalues its currency in relation to the currencies of its neighbours. By doing this, Nigeria's exports will rise since other nearby nations will be greatly motivated to buy goods from Nigeria's economy due to the country's low prices (exchange rate). A government can actively sell and actively acquire foreign currencies on the foreign exchange market to depreciate its own currency. In a floating exchange rate system, currency depreciation is the decline in value of a currency brought on by market forces, according to Bahmani and Ratha (2004). Currency depreciation can happen for a variety of reasons, including weak economic fundamentals, divergent interest rates, political unrest, investor risk aversion, and more. A declining currency is typically a sign of weak economic fundamentals, such as persistent current account deficits and high inflation rates.

3.2. The causes of currency depreciation

Dilber Caglar and Timothy A. Titiloye (2017) assert that the government, rather than market forces such as supply and demand, has a significant impact on currency depreciation. The foundation on which money may be devalued or depreciated is determined by the government. In a particular economy, a carefully planned currency depreciation can reduce a country's trade deficit and increase its competitiveness over time. Large-scale and sudden instances of currency depreciation, however, may scare foreign investors away from the country with their portfolio assets out of fear of the decline in currency value, severely pressuring the local currency.

The two main reasons of currency depreciation in a given economy are a high rate of inflation and a lax monetary policy. Due to the poor value of currency in most underdeveloped countries, hundreds of billions of dollars produce the largest yield. Furthermore, high currency depreciation is caused by charging high interest rates, such as on bank loans. High input costs make exports

from countries with high inflation uncompetitive on the global market, which leads to an increase in trade deficits and, ultimately, currency depreciation in the country. This is how high inflation rates lead to currency depreciation in countries.

Additionally, inflation makes it difficult to buy things with excessive amounts of money. Therefore, fewer goods result in lower productivity of goods produced in the nation, lower production results in lower exports and higher imports, which leads to unbalanced or negative terms of trade, which causes currency depreciation because demand for the currency of another nation would increase (Dilber Caglar and Timothy A. Titiloye, 2017).

4. THE METHODOLOGY OF THE STUDY

The study used qualitative research method using descriptive research design to investigate the major causes of local currency depreciation in Somalia. The study employed documentary review data collection tool and collected the secondary data through thorough review of the articles and books related to the major causes of local currency depreciation in Somalia.

5. THE FINDINGS AND DISCUSSIONS OF THE STUDY

The findings of the study from the various documents analysed and reviewed on the causes of currency depreciation in Somalia entail the following:

5.1. Weak monetary control

Due to Somalia's weak and ineffective monetary policy, which is unable to regulate and track the influx, outflow, usage, and circulation of both local and foreign currencies in the economy, the country's currency has been depreciating. The country's banknotes have been in free circulation since the central authority was overthrown in 1991. It was the final note that the central bank of Somalia had printed formally and sent into circulation before 1991. A solution for supplying the Somali economy with the cash it needs, such as replacing the numerous notes that are torn or damaged and circulating new money, was not left behind when the central bank of Somalia collapsed.

Despite this, at different periods, banknotes were printed by the Federal Member States or by private business owners. The banknotes were printed locally by the state and private proprietors,

while occasionally the Somali shillings were imported from overseas. The absence of a central government ultimately helped both of them, even though none of them was required to carry out the central bank's duties (Muktar 2017, 79–81; Yusuf & Abdurrahman 2019, 42). In terms of managing monetary policy, the Central Bank of Somalia, which has recently undergone resuscitation, is currently in the process of assuming complete control. The Central Bank's inability to quickly regain control of monetary policy is hampered by a lack of sufficient material and financial resources. Due to low confidence in the local currency, some of which are counterfeit, the US dollar is also widely accepted as a medium of large and high transactions in addition to the Somali shilling. Dollarization notwithstanding, the large issuance of the Somali shilling increasingly fuels price rises, especially for the low value transactions, to the extent that inflation is in the high double digits and the Som is devalued. When the Central Bank fully assumes control of monetary policy and replaces the currently in circulation currency issued by the private sector, the inflationary climate is anticipated to end. Additionally, there is no assurance that e-money would be simple to redeem. Due to this, dishonest network operators now have an opportunity to syphon money from trusting clients and invest it in foreign ventures. This is conceivable since there is no law to defend the clients by preventing some network operators from stealing such payments. World Bank 2018:19; World Bank 2017b:32–35

5.2. Large supply of Somali shillings in the market

The market's abundance of uncontrolled Somali Shillings is causing the Somalian shilling to lose value. According to the study's results, 80% of respondents concur that there was a rise in the supply of Somali shillings in Puntland in the months preceding the increase in the exchange rate. Although the printing of counterfeit money has been attributed to this increase, it is unknown if this printing occurs inside or outside of Puntland (SIDRA, 2021). Due to the abundant supply of Somali Shillings, Somalia's currency depreciated.

5.3. Existing monetary problems

According to the International Monetary Fund's 2021 report, Somalia's ongoing fiscal and monetary issues are to blame for the country's currency devaluation. The study's findings suggest that the Somali shilling is losing ground as a result of free market forces, the dollarization of

markets, and cutting-edge modern financial services including mobile e-money and private banking services that are denominated in US dollars.

5.4. Fall in Revenue

In 2021, a huge drop in revenue in Somalia led to severe fiscal pressure. Domestic revenue underperformed in 2021 as a result of the following factors: (1) revenue from khat fell short by US\$25 million due to lower imports (including because of the impact of COVID-19 social distancing measures on consumption and a significant shift in sales to the black market after imports from Kenya were interrupted); (2) introduction of turnover tax; and (3) lower rate hike than planned at the first review. Importantly, budget support funds in 2021 were US\$134 million short because development partners suspended budget funding from the beginning of 2021 until the conclusion of the elections. Due to sluggish implementation in the framework of COVID-19, project award disbursements also fell short. Therefore, Somalia's currency depreciates as a result of Somalia's declining revenue, which is raising its foreign debt.

5.5. The dollarisation of the economy

The economy is becoming more and more dollarized, which weakens the local currency and causes Somalia's currency to depreciate. Somalians chose to accept dollarization following the fall of the central government, which in turn caused the collapse of banking institutions and other governmental institutions (Yusuf and Abdurrahman 2019, 43–46). The Somali shilling is used as official money in Somalia. Despite this, the currency is constrained in a market economy that is heavily dollarized. Since it is the main form of exchange in Somalia, the US dollar continues to be the most dependable and stable currency. Within the previous three decades, it has been employed for either financial or practical purposes (World Bank 2018).

To relieve the stress brought on by the ongoing devaluation of local currencies, Somalians have steadily embraced unofficial dollarization. Other problems include the absence of a central bank in charge of determining how many banknotes are in circulation at any given moment and the floating exchange rate regime, both of which make the economy extremely vulnerable and fragile to risks affecting financial stability (Yusuf & Abdurrahman 2019, 42-45). Poor

households in Somalia that don't rely on hard cash for a living suffer greatly as a result of dollarization. Most low-income families depend on small companies to provide services and sell goods using the local currency because they hardly have any other sources of income. However, they wind up utilising American dollars to pay for a lot of other things. Lack of a central bank exchange rate policy for buffering the nation against the damage during instances of excessive depreciation, a consistent case of the Somali Shilling since the 1990s, resulted in cash shortages and depreciation in Somalia (World Bank 2018).

6. CONCLUSION

The study concludes that there are many causes of local currency depreciation in Somalia encompass according to the findings of the study and the causes include: existence of large quantities of Somali shillings in the market; the fall in the revenue collection by the government in the last two years weakens the country's local currency and causes its depreciation; existing monetary problems that hinder the control of financial activities by business owners in Somalia by the central bank of Somalia and financial regulatory authority in Somalia; weak monetary control coupled with lack of effective monetary policy to regulate and control the amount of inflow and outflow of foreign currency by the financial authority in the government such as Central Bank of Somalia and ministry of finance of the Federal Republic of Somalia and lastly dollarization of the economy which has replaced local currency and depreciated it owing to the massive inflow of foreign currency inform of remittance without being monitor and controlled by the financial authority in the country.

7. RECOMMENDATIONS

The various recommendations of the study based on the findings of the study encompass the following:

7.1. Introduction of new local currency in the market.

Hence, introducing new local currency printed in different volumes and replacing the current mutilated Somali shillings will enhance people's use in different currencies.

7.2. Restoration of the value Somali currency

The central bank of Somalia should restore the value and the usage of the Somali currency. It should be done by monitoring and instructing all local commercial banks and mobile money operators to create Somali shilling accounts for customers to keep up with the advanced technology. The research findings reveal that opening new accounts will increase use, spending, and reliance on the local Somali shilling currency, which is imperative to replace the EVC-plus service in foreign currency

7.3. Introduction of financial monetary management tools and policy

The central bank of Somalia should develop practical economic tools intended to fight inflation and counterfeit crimes enhance the supply of the Somali Shilling in the economy. The government through the Central Bank of Somalia should control and supervise financial activities in the country and the Federal Government of Somalia should implement financial reform that allow the use of local currency to carry out all local transactions in Somalia to enable the local currency to regain its value and reduce the increasing rate of local currency depreciation.

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