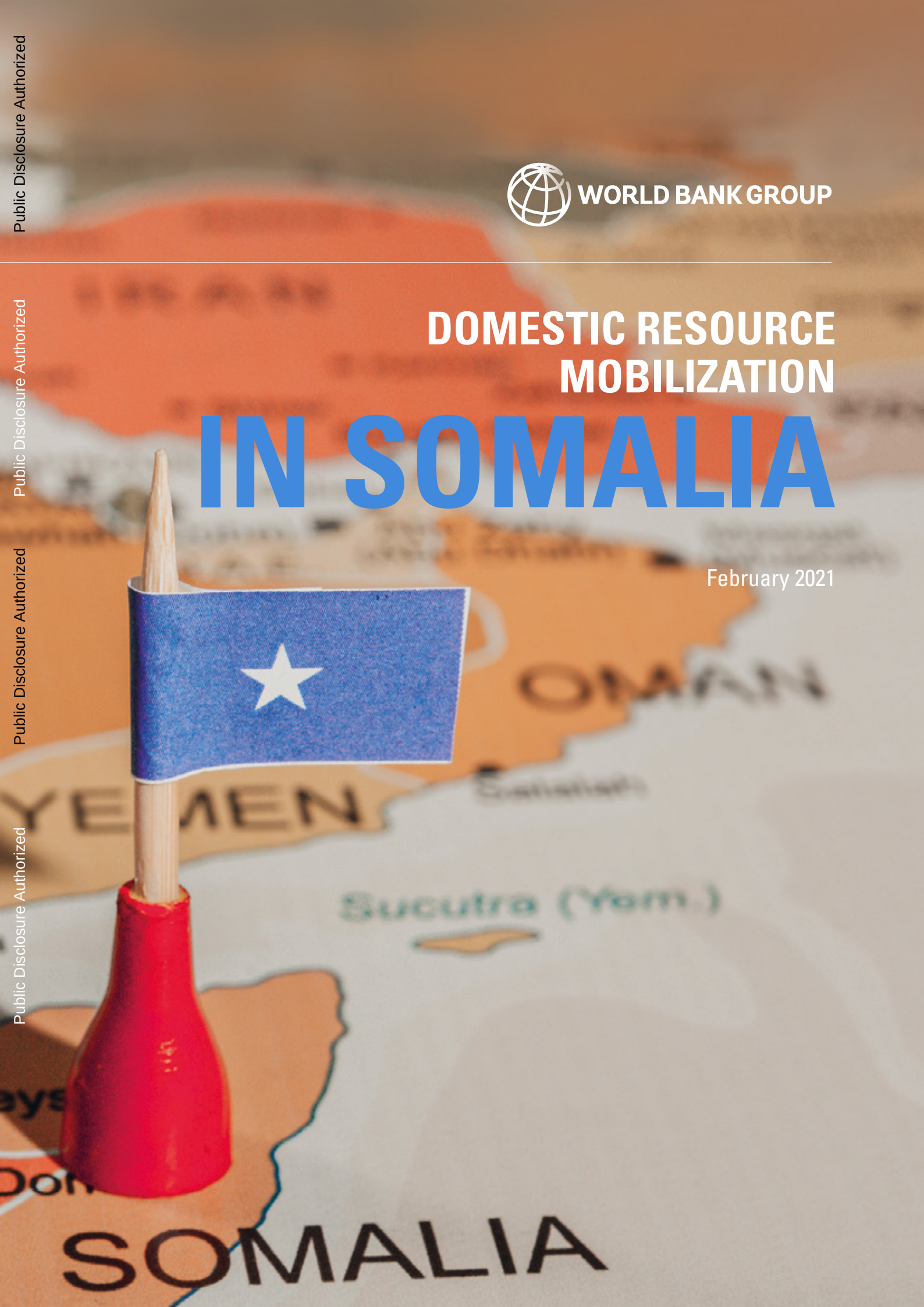
WORLD BANK GROUP

DOMESTIC RESOURCE MOBILIZATION IN SOMALIA

February 2021



1818 H Street NW
Washington, DC 20433
USA

Photos: Shutterstock and The World Bank.

DOMESTIC RESOURCE MOBILIZATION IN SOMALIA

Gael Raballand
Justine Knebelmann

Domestic revenues remain at low levels in Somalia even though they have been rapidly increasing from a low base since 2012 when the Federal Government of Somalia (FGS) was established. The ratio of revenues-to-Gross Domestic Product in Somalia is far below neighboring countries and other fragile and conflict affected states in the region. The main objectives of this report are to: (i) document actual taxation characteristics and practices in Somalia; (ii) take stock of recent taxation reforms; (iii) assess Somalia's revenue potential; and (iv) provide policy recommendations to increase revenue collection (over the short- and medium-term) taking into account multiple constraints the country faces. The report makes references to Somali history to better understand the hysteresis of the tax system, and also acknowledges recent changes. The findings demonstrate that Somalia exacerbates common characteristics in most fragile and conflict affected states, including: (i) strong heterogeneity of revenue collection and potential between the FGS and some Federal Member States (FMS), mainly due to the reliance on trade-related taxes, which leaves the FGS, Puntland and Jubbaland in a strong position compared to the other FMS; (ii) strong competition for taxation between the FGS, the FMS, communities and armed militias, which explains why citizens and/or businesses pay much more than what is captured by official data, thus making the issue of how to contribute to FGS legitimacy even more important; and (iii) a relatively limited revenue potential in the short term, but a much higher potential in the medium-term if revenues from the extraction of oil reserves start to flow.

ACKNOWLEDGEMENTS

This report was led by Gael Raballand (Lead Public Sector Specialist, EAEG1) and Justine Knebelmann (Consultant, EAEG1). The authors benefited from comments/and inputs from Fiona Davies (World Bank delegate to the Somalia Financial Governance Committee), Odd-Helge Fjeldstad (Research Professor, CHR Michelsen Institute), Geoff Handley (Senior Public Sector Specialist, EMNGU), Guenter Heidenhof (Consultant, EAEG1), Michel Mallberg (Senior Public Sector Specialist), Sher Shah Khan (Senior Public Sector Specialist, ESAG1), Jakob Rauschendorfer (International Growth Centre, Uganda), Bob Rijkers (Senior Economist, DECTI), Phil Schuler (Lead Economist, EAEM1) and Natasha Sharma (Senior Economist, EAEM1). They also would like to thank sincerely the Director General of the Revenue Department of the Federal Government of Somalia, Mr. Ahmed Jafar, the Director General of the Jubbaland State of Somalia, Mr. Aden Mohamed Hudle and the Deputy Director General of the Puntland State of Somalia: Mr. Abshir Mohamed Abshir for their tremendous help and support.

CONTENTS

BOXES

FIGURES

TABLE

1 INTRODUCTION

1. Creating the conditions for effective and sustainable revenue mobilization is a crucial step in the state-building process, allowing governments to first and foremost generate the resources needed to function and carry out their mandate of service delivery to the people. Beyond revenue collection, it is also important to generate a space for a fiscal contract between the government and its citizenry. Somalia is a fragile state and the revenue-to-gross domestic product (GDP) ratio remains very low at 10 percent[1] (or just above 5 percent without Somaliland) as compared to an average rate of 17 percent of GDP[2] for low-income African countries.

2. This paper main objectives are to: (i) document the current taxation characteristics of Somalia starting from taxation practices on the ground; (ii) take stock of recent reforms in this area; (iii) assess the country's revenue potential; and (iv) provide some policy recommendations to increase revenue collection (over the short- and medium-term perspectives) taking into account the multiple constraints (political but also lack of capacity or corruption).[3] With this end in view, references will be made to Somali history to better understand the hysteresis of the tax system, as well as to acknowledge the recent changes. References will also be made to the political economy of taxation in Somalia. More than any country, power relations and political economy are strong drivers of revenue collection characteristics in Somalia. Moreover, it is important to acknowledge that a more resilient economy with higher and more sustainable growth is less prone to shocks. As such, it should serve as the foundation for broadening the tax base and raising revenues.

3. Regarding the main findings of this paper, the Somalia case is an exacerbation of the common features of most fragile states, including: (i) strong heterogeneity of revenue collection and potential between the Federal Government of Somalia (FGS) and some federal member states (FMS) (from 1 to 40), mainly due to the reliance on trade taxes,[4] which leaves the FGS, Puntland and Jubbaland in a strong position compared to the other FMS; (ii) strong competition for taxation between the FGS, the Federal Member States, communities and armed militias, which explains why citizens and/or businesses pay much more than what is captured by official data, thus making the issue of how to contribute to FGS legitimacy even more important; (iii) a relatively limited revenue potential in the short term, but a much higher potential in the mid-term in the event of oil revenues flowing. In this context, the revenue sharing from future oil revenues and natural resources between the FGS and the FMS is critical for the future of Somalia.

[1] Using a revised downward GDP of US$4,721 million makes the ratio higher than presented. This includes tax and non-tax revenues and excludes grants. The ratio over GDP should be taken with caution due to probable future GDP computation adjustments. In this paper, Somaliland revenues are included. However, it should be noted that Somaliland authorities do not consider themselves officially part of the Somalia federation.

[2] This is the average for 20 African low-income countries (LICs) in the year 2015. Both figures correspond to total government revenues, excluding grants. Source: International Centre for Tax and Development (ICTD), Government Revenue Dataset (GRD) 2015.

[3] The paper does not develop in details tax policy measures and refers to the recent analysis done by Kalyandu et al. (2020).

[4] The share of trade taxes in total revenues is higher than what is observed in other countries in the region. However, it is common among fragile states. It is relatively comparable to the level in Somalia in the decades preceding the 1991 collapse of the government, with around 53 to 64 percent between the late 1970s and late 1980s (Purohit 1990).

4. There are at least two immediate consequences for these important findings:

1. An equalization revenue mechanism to the newest FMS will be needed.[5]
2. Due to the relatively limited revenue potential in the short-to-medium term, spending increases should be cautiously applied in the coming years. They will need to be carefully prioritized according to a new conception of the role of the state in Somalia, while avoiding a return to the initial conditions characteristic of the end of the 1980s.

5. Somalia's low level of domestic taxation stems in part from its long historical legacies, which can be traced back as far as the colonial period. Throughout the decades of its rule, the British Protectorate (1888-1960) struggled to raise revenues in its Somali territory of the British Somaliland, both because of resistance from the local population and because of a lack of economic opportunities (Kakwenzire 1986). By World War II, all attempts to establish direct taxation had failed. The protectorate was generating far less revenue than required solely to support the small colonial administration. Furthermore, the absence of a good formal education system prevented the emergence of a Somali elite that could be involved in administrative and bureaucratic matters (Kakwenzire 1986). In 1960, the year of independence of the Republic of Somalia, prospects for the strengthening of tax revenues in the short-term were grim: "Revenues from indirect taxation, graduated income tax, or the flat twenty percent tax on company profits have remained consistently inadequate, and are likely to continue so," notes a contemporary (Reyner 1960).

6. After Siad Barre took power in the 1969 coup d'Etat, the country first turned toward Soviet support (which lasted until the mid-1970s); later, after abandoning the Socialist doctrine, the country depended on donors, mostly international financial institutions — this at a time of extremely high levels of public debt (Powell and others 2008). As a consequence of the external sources of funding, limited investment was made in terms of domestic fiscal capacity. Additionally, under the Barre regime, the central government only weakly penetrated the Somali society, which was characterized by a mainly pastoralist population, a strong informal economy and a strong reliance on clans. In the last years of the regime, a surge in informal economic activities, accompanied by a strong mistrust in the predatory government, led to a total absence of tax culture (Jamal 1988; Mubarak 1997; and Powell and others 2008). Indeed, it was one of the lowest tax-to-GDP ratios in the late 1980s, amounting to 5-6 percent (World Bank 2017). In 1989, the ratio was at 5.3 percent (World Bank 1991).[6]

7. The idea that increased taxation can foster an engagement between the State and its citizens initially stems from the historical literature shedding light on this process in modern Europe (Levi 1988; Tilly 1990); however, more recent work has established that similar patterns are at play in contemporary developing countries, potentially leading to improvements in governance and institutions. For instance, Bräutigam and others (2008) show the strong interactions between taxation and political systems in a wide range of developing countries. They also highlight the state-building implications of increased taxation. Prichard (2015) uses three case studies of post-colonial African countries to illustrate how taxation triggered political engagement and debate leading to more accountability in the long run. Revenues raised through taxation are more likely to be spent in sectors of the economy directly responsive to citizens' needs, as opposed to revenues accruing with no tax bargaining, such as natural resource revenues and/or aid revenues (Ross 2001, 2012).

[5] Intergovernmental fiscal relations are more developed in a separate PER module.

[6] Against 5.4 percent in 2018 if Somaliland is excluded.

Indeed, a growing number of empirical studies demonstrate these mechanisms across the developing world. For instance, Gadenne (2017) shows that Brazilian local governmental spending on education and health is more efficient when financed by direct tax revenues than by natural resource revenues. Martin (2016) shows that taxation reduces citizen tolerance of governmental non-accountability in an experimental setting in Uganda. Finally, Paler (2013) shows that taxation increased citizen scrutiny of governmental activities in Indonesia.

8. There are reasons to believe that similar tax bargaining already occurs (at a local level) and could be leveraged across the various governmental entities in the Somali context — despite country specificity. Building on a case study of the parking tax in Garowe, Somalia, Varming (2017) shows how disputes over a specific local tax reveal a more general process of definition of the state's scope and authority. Eubank (2012) focused on Somaliland and demonstrated that limited external financing had positive consequences. Specifically, it created the need for revenue bargaining at the level of the Somaliland government, as well as at the more local levels, thereby contributing to the establishment of stable institutions. After many years of statelessness in the 1990s and 2000s, economic activity — which survived nonetheless — reached a stage beyond which the need and demand for an effective government was stronger (Mubarak 1997; Powell and others 2008).

9. The positive feedback loop between taxation and improved governance is not automatic. Across Somalia, informal taxation remains widespread, which creates accountability lines between citizens and local leaders that are stronger than those with federal authorities (Santoro and Van den Boogaard 2019). Along these lines, Moore and others (2018) emphasize that "who pays taxes, how they are collected, and how the government uses the revenues" are important determinants in shaping a fiscal contract. Thus, it is not only the 'how much' that is collected. This is even more salient in the Somalia context, where governmental entities were only relatively recently reestablished (between 1991 and 2012). This occurred at a time when the central government had been nonexistent or weak for more than two decades. During these years, however, some economic and social activities did not totally break down. In fact, to some extent, they thrived more easily than under the regime of Siad Barre. This created a situation in which economic agents have relied almost exclusively on informal and local institutions (including clans, pastoralist customary regulations, local militias) rather than on a formal, national State (Mubarak 1997; Powell and others 2008). This makes the task of reinforcing the federal state's legitimacy to tax — and of creating consensual revenue generation — even more delicate. Therefore, gaining a detailed and accurate understanding of the mechanisms of revenue mobilization across Somalia[7] appears to be essential in reflecting on the country's broader political economy and governance.

10. Due to the current and future revenue characteristics of Somalia, attention to revenue sharing and potential equalization of revenues between members of the federation[8] will be critical to making the federation of Somalia viable. Moreover, ongoing reforms will have to be strengthened in order to generate more revenues. More importantly, they will have to be strengthened to increase equity and transparency. Furthermore, linking them to expenditures will help to contribute to state legitimacy.

[7] Presumably in large areas of south-central Somalia, for some years, only local governments operated. Policy dialogue largely ignores local governments altogether, layering mostly two levels of government (that is, the FGS and FMS). Regarding revenue collection, local government taxation data are very difficult to collect. Further investigations should be conducted in this regard.

[8] It will also be important that FMS spending be cascaded to local governments and ultimately to citizens.

11. The paper is organized as follows: the next section presents the recent reforms and tax revenue trends for the FGS and other member states (including Somaliland). The third section offers some brief assessments of revenue potential for the FGS and the FMS. The fourth section outlines the main internal and external challenges to increasing revenue collection in Somalia. The final section describes the main policy recommendations, distinguishing between the main short- and long-term perspectives. In addition, it raises the main questions related to revenue relations between the FGS and the FMS.[9]

[9] Intergovernmental fiscal relations are developed further in a separate PER module. Further investigation is also however needed regarding taxation of local governments.

2 Taxation Reforms and Trends

A Recent Tax Reforms

12. The current legal framework for the tax system combines elements from the 2012 Provisional Constitution, and legal provisions dating from before 1990 – including some as old as the 1960s, which were established when Somalia was still a unitary State. The 2012 Constitution states that: "The responsibility for the raising of revenue shall be given to the level of government where it is likely to be most effectively exercised" (Article 50). Additionally, the FMS have their own constitutions and tax regulations or decrees.[10] The Provisional Constitution also states that pre-existing laws, which have not been completely redefined, remain in place. This creates a situation in which tax rates, valuation methods, the definition of taxable goods, lists of taxpayer categories and tax or exempted goods and services, have (for the most part) remained unchanged over the last thirty to fifty years. Some of the main tax laws include: Law No. 1 of March 31, 1961 on customs; the Legislative Decree No. 5 of November 1966 on direct taxes; and Law No. 2 of January 7, 1984 on sales tax. As an example, customs duties continue to be based specifically on packaging or units.

13. The government has taken initiatives to modernize and clarify the legal framework. The Somalia Revenue Administration Act was enacted in 2019. The enactment of the Revenue Administration Law and supporting measures to improve tax administration are expected to boost revenue collection, albeit from a low base. It enables the modernization of tax administration by covering taxpayer registration, assessment, refunds, certificates of tax clearance, tax agents (and is applicable to customs).[11] This is important for future tax revenues. The Revenue Act states that laws governing the major taxes (including taxes on international trade) should be made at the Federal level, and 'the Ministry (of Finance) is to be responsible for the administration and the implementation of the revenue laws in line with the articles of the National Revenue Law.'[12] Although the law does not stipulate which level of government will administer or retain any given tax, it nonetheless provides a legal basis for the federal government to work with the member states to harmonize tax policies across the country. It also calls for an additional law that would designate which level of government would collect the revenues from each source, keeping in line with Article 125 of the Provisional Constitution.[13] Amended legislation governing customs taxes has been approved by Parliament and signed by the President.

[10] Local governments, which continue to collect taxes, are virtually absent from the current picture.

[11] However, customs duties continue to be governed by the 1961 Act (as amended) in the same way that sales tax is still governed by the 1984 Act. For instance, the Revenue Act does not determine tax rates, tax thresholds, taxable goods or exempted items.

[12] Although the Revenue Act refers to a National Revenue Law, the taxes it refers to are those listed in the former Revenue Harmonization and Revenue Authority bills.

[13] In September 2018, a Revenue Authority (Establishment) Act was drafted, which would have established a central revenue authority responsible for administering the taxes listed in the Revenue Administration Law. These include the Customs Law (Law No. 1 of March 31, 1961); the Road Tax Law (Law No. 4 of December 28, 1965); the Income Tax Law (Law No. 5 of November 5, 1966) the Stamp Duty Law (Law No. 6 of December 6, 1966), the Sales Tax Law (Law No. 2 of January 7, 1984), and the Excise Tax Law (Law No. 3 of May 23, 1985). However, the Cabinet declined to approve the draft law. Therefore, it was not submitted to Parliament.

The Somalia Revenue Administration Act was enacted in 2019. The enactment of the Revenue Administration Law and supporting measures to improve tax administration are expected to boost revenue collection, albeit from a low base.

14. Each FMS maintains its inland revenue and customs receipts (with different tax rates across ports).[14] Furthermore, local authorities collect municipal taxes. In some cases, this results in double taxation[15] if the State (the FGS or the FMS, depending on the area) collects an equivalent tax in the same municipalities (Haas 2017; World Bank 2017).

15. The revised Constitution can be expected to clarify the approach to revenue sharing (including revenues from natural resources) between levels of government; primary legislation and regulations will then be needed to further detail this approach. If the Constitution is not revised any time soon, then primary legislation will need to be drafted to address the sharing of tax revenues. (The sharing of natural resource revenues will continue to be governed by Article 44 of the Provisional Constitution).

16. Several important tax administration (and policy) reforms have been, however, undertaken in the last two years (and explain increased tax and non-tax revenues). Some administrative measures taken in 2017 and 2018 include the creation of a Large and Medium Taxpayer Office (LMTO) in FGS (which currently has 80 registered taxpayers) (IMF 2019), as well as the transfer of the collection of fees from specific Ministries to the Ministry of Finance. In an effort to gain public trust, the Ministry of Finance also cancelled all third party revenue collection contractors. Moreover, taxpayers remit their tax obligations to the Treasury via commercial banks of their choice.

17. The FGS has recently undertaken initiatives toward increased automation. In 2016, a Financial Management Information System (the Somalia FMIS or SFMIS) was established with the support of development partners. It allows for the registration of business activities, the generation of basic revenue statistics, and the production of invoices for payroll taxes (IMF 2017; World Bank 2017). In addition, a system allowing for the automation of property transfer taxes has been piloted since 2016 and has yielded satisfactory results (World Bank 2017).

[14] *Khat* and cigarette taxation is an exception and was harmonized across ports.

[15] There is no common Tax Identification Number (TIN) across Somalia. The TIN number harmonization dialogue, supported by the World Bank, began in October 2019 between FGS and Puntland. In future, the FGS plans to extend the Puntland TIN structure to the other FMS. This important process is supported by the Domestic Resource Mobilization lending projects financed by the World Bank (P151492/P166206).

18. Tax policy changes passed also include the establishment of a 5 percent sales tax on goods at the point of import, and a sales tax on hotels, tickets and consumer water — both of which were enacted in 2018. Licensing fees for telecommunications companies were established. The excise rate on *khat* was also increased. Finally, a higher and more progressive rate for the tax on rental income was introduced (that is, from 5 to 15-22 percent).

19. Several additional reforms have been undertaken subsequently with tangible impact on revenue collection (see Box 1 on some concrete examples).

Box 1 The Main Tax Administration and Policy Reforms in 2019-2020 (for FGS)

Some important tax reforms have had some tangible results on tax and non-tax revenues. The list is non-exhaustive but appears to have been the most impactful:

1. introduction of a sales tax for import goods and reform of the personal income tax,
2. enforcement of Tax Identification Number (TIN) requirement and tax compliance certificate being subjected to renewal of annual licenses and anyone transacting with government,
3. restrictions and reduction of tax exemptions,
4. customs efficiency gains thanks to the introduction of electronic declarations and manifests,
5. automation of visa fees and working permits collection,
6. collection of fly-over fees (IATA collecting on behalf of the government and directly remits fees to government account).[16]

B Overview

20. Overall fiscal revenues remain at very low levels; however, they have been rapidly increasing since 2012 when the Federal Government of Somalia was established. Consolidated total revenues — including Somaliland, all five FMS,[17] and the Federal Government — amounted to US$ 484.2 million in 2018, corresponding to 10 percent of total GDP.[18] The revenue-to-GDP ratio is lower than in neighboring countries,[19] as well as in other fragile states in the region.[20] Excluding Somaliland, total revenues amount to US$254.8 million or 5.4 percent of GDP.[21] Moreover, compared to donor funding (including humanitarian aid), it amounts from 12.5 to 25 percent of total revenues, depending on whether Somaliland is included.

21. Revenues are disaggregated in the following way: 43 percent of total consolidated revenues

[16] It has also been legally agreed that airspace revenues will be collected by the International Air Transport Association (IATA) and transferred directly to the FGS from August 1, 2019.

[17] The five Federal Member States are: Galmudug, Hirshabelle, Jubbaland, Puntland, and the Southwest State.

[18] This includes tax and non-tax revenues and excludes grants. Excluding Somaliland, total revenues amount to US$254.8 million or 5.4 percent of GDP.

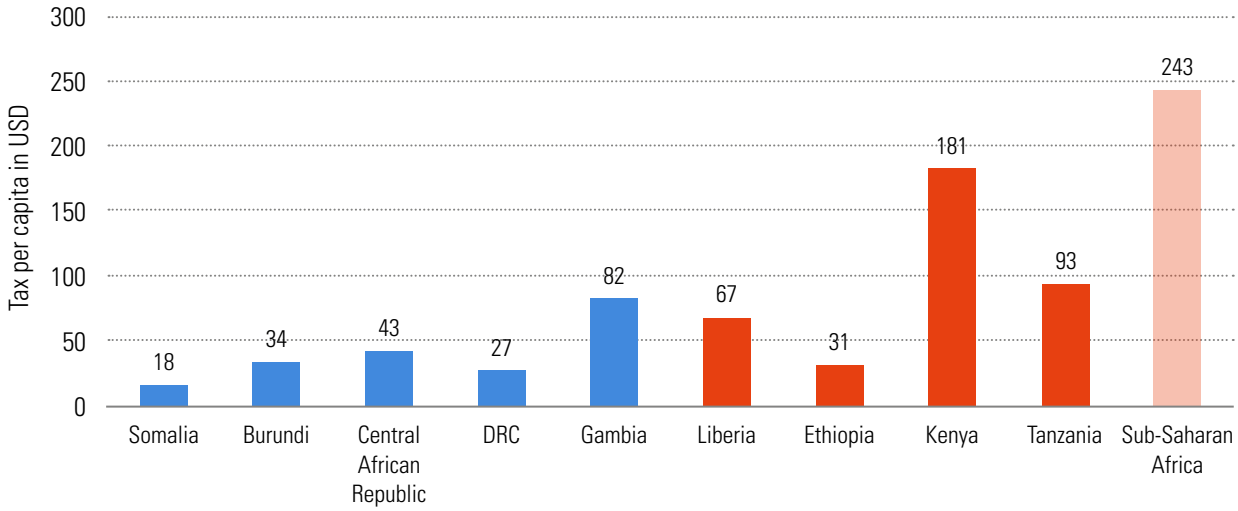
[19] Specifically, 14.4 percent in Ethiopia and 17.8 percent in Kenya. (ICTD 2015).

[20] Specifically, 10.7 percent in Sudan, 10.9 percent in the Central African Republic (2012), and 12 percent in the Democratic Republic of the Congo (2011).

[21] Somaliland figures are presented in this part to have consolidated data but, in the subsequent sections, it is not covered due to a lack of information.

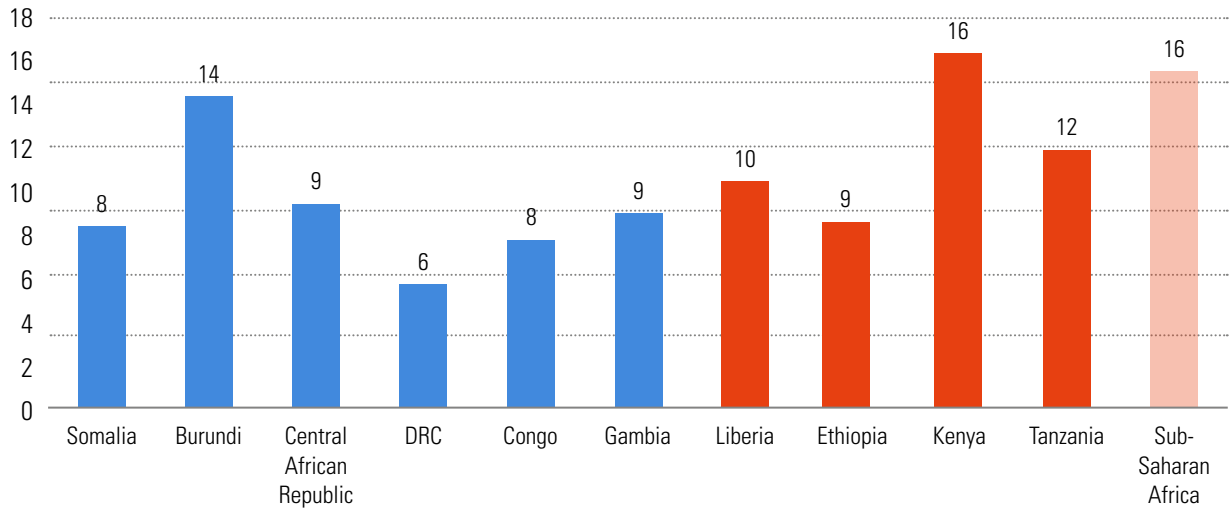
are collected by the FGS; 40 percent accrue from Somaliland; and the remaining 17 percent from the five FMS. Tax revenues account for the largest share, with US$419.6 million (79 percent of total revenues) generated from taxes in 2019. Non-tax revenues accounted for the remaining 21 percent. The relative importance of tax revenues is considered to be a positive feature in the dynamics linking revenues to governance outcomes, as well as in the tax bargaining literature more generally. Within tax revenues, trade taxes hold a dominant position, with 60 percent of tax revenues (US$253.6 million). These customs revenues are collected separately by the FMS and the FGS.

Figure 1 **Tax Revenues per Capita in Somalia and other Sub-Saharan Countries (between 2009 and 2018), in $US**



Source: Authors' computations based on official statistics and population estimates.
Note: Population figures are estimates.
DRC= Democratic Republic of Congo.

Figure 2 **Tax Revenues as a Share of GDP in Somalia and other Sub-Saharan Countries (between 2009 and 2018), in $US**



Source: Authors' computations based on official statistics and GDP estimates.
Note: DRC= Democratic Republic of Congo.

C Positive Trends in Domestic Revenue Mobilization

22. Revenues have been steadily increasing in recent years, and all tax instruments have evidenced a positive trend since 2014. Total (consolidated) revenues grew by nearly 44 percent in the last three years (from US$ 368.9 million in 2015 to US$ 531.8 million in 2018), corresponding to an increase in the tax-to-GDP ratio from 7.6 to 8.5 percent (Figure 2), as well as a stable non-tax-revenue-to-GDP ratio of around 1.5 percent. If only the FGS is considered, then the revenue-to-GDP ratio grew by 77 percent in four years (that is, from 2.2 percent in 2014 to 3.9 percent in 2018). This increase is largely driven by a rise in customs revenues, which increased from US$177 million in 2015 to US$251.9 million in 2018. Taxes on goods and services, other indirect taxes, and non-tax revenues have grown regularly since 2013. They have also grown at a similar pace and reached comparable levels (respectively, US$67.6 million, US$57.3 million, US$81.6 million, and US$246.4 million).

D Heterogeneity across States

23. Each governmental entity (FGS, Somaliland, and FMS) raises some revenues of its own, to which domestic transfers from the FGS are then added in the case of the FMS. In practice, all revenues of the FGS are collected from the Mogadishu (Benadir) region.[22] Whereas some tax instruments may be considered as transitional for FMS, numerous tax instruments are taxable in the FGS and FMS, which creates some potential for multiple taxation (Table 1).

Table 1 Breakdown of Total Revenues for the Federal Government of Somalia, Federal Member States and Somaliland (US$ millions, 2019)

					Federal Member States					
			Consolidated	FGS	Galmudug	Hirshabelle	Jubbaland	Puntland	South West	Somaliland
Domestic revenue			531.8	229.8	2.7	2.7	20.2	58.8	3.7	213.9
	Tax Revenue		419.6	173.3	2.7	2.7	19.3	43.5	3.5	174.6
		Tax on Incomes Profits and Capital Gains	31.8	11.7	0	0	1.3	0.5	0	18.3
		Tax on Goods and Services	128.2	47.1	2.7	2.7	8.3	6.1	2.2	59.1
		Tax on International Trade and Transactions	253.6	109	0	0	9.6	36.5	1.3	97.2
		Other Taxes	6	5.5	0	0	0.1	0.4	0	0
	Non-Tax Revenue		112.2	56.5	0	0	0.9	15.3	0.2	39.3

Source: Authors' compilation based on official statistics.

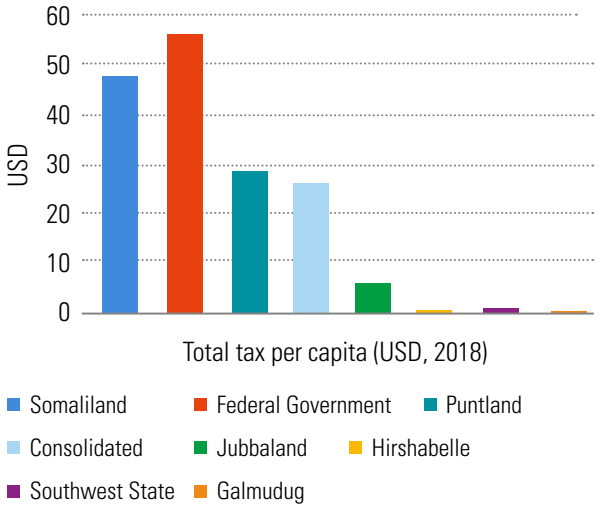
[22] If airspace overflight revenues and fisheries revenues are excluded. Somaliland could possibly request a share of these revenues.

24. Moreover, there are strong heterogeneities across these regional entities, both in terms of levels of taxation and fiscal instruments. The relatively better performance of Somaliland, and to a lesser extent Puntland, are in part related to the fact that these States have existed and engaged in strategies to raise revenues for a longer period of time than the other FMS and the FGS, respectively. This has been the case since 1991 and 1998 and is possibly due to more developed economies and larger investments (Power and others 2008; Varming 2017).

25. Total consolidated revenues for Somalia amount to US$31 per capita (2018), but this ranges from US$0.4 per capita (Galmudug) to US$74 per capita (FGS),[23] followed by Somaliland with US$53 per capita (Table 1).[24] Somaliland appears to be performing relatively well compared to the FMS, with levels of *taxes* comparable to those of the FGS, that is, US$ 48 per capita as compared to US$56 per capita for the FGS. As such, taxes account for nearly 90 percent of total revenues in Somaliland as compared to 76 percent for the FGS.

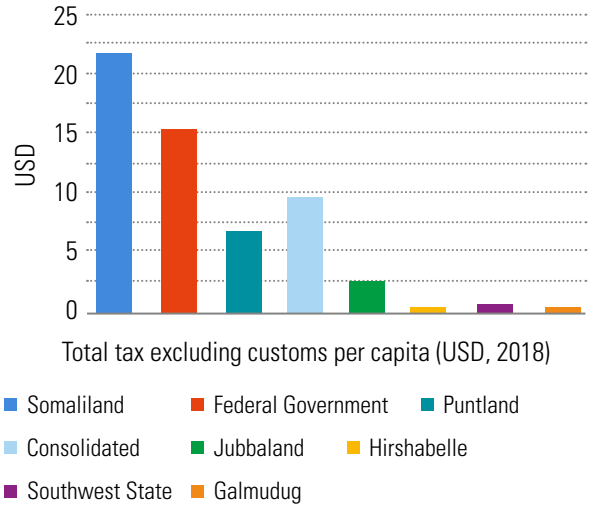
26. Among the FMS, Puntland raises the highest levels of revenues (that is US$56.3 million in total revenues, and US$42.4 million in taxes for 2018), corresponding to US$38 per capita of total revenues (respectively, US$29 in taxes). However, Jubbaland is far behind with US$6.5 per capita of revenues (respectively, US$6.2 per capita in taxes) (Figures 3 and 4).

Figure 3 **Total Tax per Capita in the Federal Government of Somalia, Federal Member States and Somaliland (in US$, 2018)**



Source: Authors' computations based on official statistics and population estimates.

Figure 4 **Total Tax per Capita (excluding customs revenues) in the Federal Government of Somalia, Federal Member States and Somaliland (in US$, 2018)**



Source: Authors' computations based on official statistics and population estimates.

[23] This has been computed over Benadir/Mogadishu population and would be much lower if compared to the whole federation population.

[24] Taxes per capita are reported because precise estimates of regional GDP are not available.

E Strong Reliance on Trade Taxes

27. Taxes on international trade amounts to a large share of total revenues, whether it be at the consolidated level or for each State when considered separately. In practice, all revenues are collected in the main ports and airports (that is, Mogadishu for the FGS, Berbera port and Hargeisa airports for Somaliland, Kismayo port for Jubbaland, and so on). In Mogadishu, import taxes are assessed through systematic physical controls and face-to-face interactions, making the process extremely cumbersome. In addition, taxes are specific and not applied on an ad valorem basis, meaning that they are assessed based on the volume, weight or number of units for each good rather than on the price. This has some advantages, among which are potentially curbing under-invoicing and requiring lesser skills for the valuation process (Cantens 2018; E&Y 2017; World Bank 2017). Export duties are also applied on a limited number of goods (including dried fish, meat products, hides and skins, and scrap metal). However, they contribute to a minuscule share of total customs revenues. In Somaliland, the system is different, with a 3 percent ad valorem tax on imports *and* exports. A livestock export levy also exists, as in some of the FMS.[25]

F Tax Instruments

28. Comparing the current situation with the prevailing situation before the 1991 breakdown of the government reveals that most of the fiscal instruments, as defined by the legal framework, remain in place. However, the relative importance of some tax instruments has evolved over the past few decades. Table 2 displays the different fiscal instruments existing at the FGS level, in each FMS, and in Somaliland for the year 2018. In the 1970s-1980s, in the midst of economic difficulties which led the Barre regime to finally abandon Socialism in the 1980s — and while starting substantial non-profitable public investment programs (Powell and others 2008) — some tools were established to foster revenue mobilization. A development levy was added to income taxes for non-governmental employees, leading to a relatively high tax burden. Jamal (1988) estimates that in 1986 an ordinary wage earner would be required to pay 50 percent of his or her income in taxes. Thus, income and property taxes contributed more strongly to total revenues in the late 1970s than today. However, this share started to decline sharply before the collapse of the regime, that is, from 20 percent in 1975 down to 12.5 percent in 1989 (Purohit 1990). In the late 1970s, the government also relied on public entities. In this context, it introduced a turnover tax on public entities and strengthened profit-share mechanisms from the public entities. The de facto turnover tax on public entities no longer exists.

[25] In Somaliland, there is both a livestock tax and a livestock export levy. It is not always clear whether livestock taxes include a livestock export levy or only taxes on livestock trade within a state.

Table 2 Existing Fiscal Instruments in the Federal Government of Somalia, Federal Member States, and Somaliland

		Consolidated	Federal Government	Federal Member States					
				Galmudug	Hirshabelle	Jubbaland	Puntland	Southwest State	Somaliland
Tax Revenue	**Tax on Incomes, Profits and Capital Gains**		Yes.			Yes.	Yes.	Yes.	Yes.
	Tax on Incomes, Wages and Salaries		Four brackets (0,6,12 and 18%).						Public payroll tax; private payroll tax; tax on income from individuals.
	Tax on Rental Income		Three rent brackets. Collected every three months.						
	Corporate Profit Tax		Ten brackets (9 to 30%). Implementation problems.			Monthly business tax + registration and licensing fees.	Biannual business tax.		Tax on income from corporations and enterprises.
	Tax on Goods and Services		Yes.	Yes.	Yes.	Yes.	Yes.	Yes.	Yes.
	Sales Tax		In 2018 introduction of a 5% sales tax at point of import, and sales tax on a small subset of goods.				Existence of a sales tax.		
	Excise Tax		Rate is supposed to depend on the good, but in reality, uniform 5% rate is being applied. Government unable to collect on a certain subset of goods.						
	Turnover Tax		Existence of a turnover tax on services. Paid only by telecommunications firms through a lump-			Existence of turnover tax.			

	Consolidated	Federal Government	Federal Member States					
			Galmudug	Hirshabelle	Jubbaland	Puntland	Southwest State	Somaliland
Tax on Telecommunications		sum payment. Since 2018, introduction of a 15% sales tax and a licensing fee.						Post and Telecommunications
Tax on International Trade and Transactions	No legal foundation for the collection of taxes on international trade by the FMS, but nonetheless they all collect some customs revenue which is not remitted to the Federal Government.	Almost all customs revenues are collected on imports. All collections at the Mogadishu port and airport. Specific valuation (based on volume, weight or unit). Revenues accrue from a limited number of traders. Face-to-face procedure and physical investigation of each bundle of good.	Yes.	Yes.	Yes.	Yes.	Yes.	Mainly from Berbera port and Hargeisa airport. Includes: Import Tax; Export Tax; Harbour Tax; Livestock Export Tax. Customs agents responsible for valuation of each item. Three percent ad valorem tax on imports and exports.
Other Taxes								
Livestock Tax	Exists under various forms.	Yes.	Yes.	Yes.	Yes.	Yes.	Yes. .	Livestock Tax (in addition to Livestock Export Levy).
Fisheries (licenses)		License for catch and local vessels.						
Land and Property Tax			Existence of land and property taxes.		Property tax paid in larger towns.	Property tax, at least in Garowe		Tax on land and building value and on property transfer (Hargeisa).
Road Tax, Transportation and Checkpoint fees	Road fees and checkpoint fees widespread across Somalia. some of them are informal (controlled by clans, militia, armed groups).	Existence of a Road Tax which yields significant revenues. Collection outsourced to a private company. Collected every four months on owners of trucks, vehicles and buses.	Existence of a road tax.	Existence of a road tax.	Transport and checkpoint fees.	Transport and checkpoint fees, although without a legal basis.	Existence of a road tax.	Road Tax. Transport and checkpoint fees.

		Consolidated	Federal Government	Federal Member States					
				Galmudug	Hirshabelle	Jubbaland	Puntland	Southwest State	Somaliland
	Stamp Duty		Existence of Stamp Duties.						Existence of Stamp Duties.
	Other Local or Municipal Taxes					Yes.			In Hargeisa: City Development Tax; Business License; Market Fees.
	Administrative Fees		Ministries, departments, and agencies collect various user fees.			Yes.			Licensing; Registrations; Concessions.
	Airport and Harbor fees		A private company has been contracted for Mogadishu port and airport.			Port docking fees in Kismayo Port.			Harbour Tax.
	Visa charges, passport and other fees		Yes.			Yes.			Yes.
	Resource Taxes								Mineral Concessions and Royalties.
	Tax on Specific Industries (Money Transfer, Light, Water)		Existence in legal framework but uncertainty regarding collections.						
Non-Tax Revenue									
	Property Income								Rent of government buildings, landing fee, oil terminal rent, port.
	Sale of Goods and Services					Yes.			Yes.
	Fines and Penalties		Yes.						Yes.
	Sale of Natural Resources and Immovable Assets								Yes.

Source: Authors' compilation from multiple sources (Cantens, T., 2018; E&Y, 2017 ; Haas, A, 2017 ; IMF, 2017 & 2019; Kalyundu, G. and Norregaard, J. 2020; PREMIS PFM, 2017 ; Santoro, F. and van den Boogaard, V., 2019; Somaliland Revenue Performance, 2019; Wold Bank 2017; World Bank Data, 2019).

Note: FGS port (harbor) and airport fees are managed under concession agreements and generate monthly revenue payments to the FGS.

29. Taxes on wages, incomes and businesses are one of the flawed areas of the current Somali fiscal system. Taxes on wages exist in the FGS and in Somaliland. Under the FGS, this tax is progressive with three non-zero tax brackets, and it is collected monthly. In 2017, the FGS managed to bring employees of hotels, telecommunications and electricity companies into the tax net. In the following year, employees of non-governmental organizations were also included.

30. The taxation of corporate profits exists, but it most often occurs differently than as defined in the legal framework. In theory, under the FGS fiscal legislation, ten tax brackets exist for the annual Corporate Profit Tax. Jubbaland and Puntland also have a business tax in place (respectively, biannually and monthly), although their yields are almost negligible. Although taxes on incomes and businesses perform relatively poorly overall (they amounted to around 6 percent of total revenues in 2019), they have been growing rapidly in recent years, especially relative to their very low initial levels. For example, they increased by 82 percent between 2015 and 2018 as compared to 42 percent for trade taxes over the same period.

31. A certain number of taxes on goods and services exist, contributing to total revenues, with over two times more than taxes on wages, incomes and businesses (at the consolidated level, and separately for the FGS and Somaliland). These include: sales tax, excise tax, turnover tax and taxes on telecommunications.

32. Other types of taxes play a substantial role in total revenue collection (notably in Somaliland). As an example, livestock taxes and livestock export levies exist, and they are particularly salient in a strongly pastoralist economy (as in Jubbaland, Puntland, and Somaliland).[26] Some form of road tax and/or transportation fees exist in each State — although it does not appear that revenues collected are transferred to the Treasury (Powell and others 2008; Santoro and Van den Boogaard 2019; and Varming 2017). Checkpoints and checkpoint payments are widespread across Somalia and have been for decades. However, they do not all stem from formal governmental entities, since some are controlled by clans or militias. This is an example of an area in which citizens are long used to making payments to a ruling group for a specific activity. Paradoxically, this happens without necessarily bringing about any engagement between them and the *formal* governmental entities (Powell and others 2008).

33. Land and property taxes are defined in the legal framework of the FGS, Somaliland and the FMS, but they are mainly limited to towns and cities. Additionally, there is no clear distinction between the responsibilities of the central State governments and the municipalities with respect to these local taxes. This leads to possible cases of double taxation, and a lack of consensus about the modalities of transfers (Haas 2017; World Bank 2017).

[26] The taxation of livestock trade and exports constituted a relatively major source of revenues in Puntland and Somaliland, although the precise figure is not available.

3 SOME ELEMENTS OF REVENUE POTENTIAL IN SOMALIA AND LESSONS OF TAX REFORMS IN FCVS

34. Although revenue potential remains relatively high in Somalia, the potential remains fairly focused spatially (that is, in FGS and/or Puntland/ Jubbaland) over the short-to-medium term and for some instruments (such as trade taxes, personal income taxes, and corporate taxes (E&Y 2017), or some non-tax revenues, such as road user taxes). According to IMF forecasts, it is possible to expect in the next years a 30% increase in domestic revenues, which would be equivalent to around 1.5 percent point over GDP (or approximately 75 million). It is along what is being known on tax reforms impact on revenues for a sustainable increase in fragile states (see Box 2).

Box 2 Stylized Facts about Tax Reforms Impact on Revenues in the World

Based on a long-term analysis of revenue trends all over the world over several decades of tax reforms, Drummond and others (2012) made the following findings:

- Countries can aim at modest increases in revenue ratios in the short-to-medium term, and somewhat larger increases in the long term. The frequency distribution of changes in revenue ratios for Sub-Saharan African (SSA) Low-Income Countries (LICs) peaks at a pace of about ½–2 percentage points of GDP in the short-to-medium term, and at a pace of about 2–3½ percentage points of GDP in the long term.
- Fragility matters. Fragile countries were able to raise the revenue ratios only marginally (0–½ percentage point of GDP) compared to non-fragile ones (½–1½ percentage points of GDP) in the short term.
- Sustainability can be an issue. Most non-fragile SSA-LICs were able to sustain their short- to medium-term revenue gains, whereas fragile SSA-LICs struggled. Countries were more successful in sustaining moderate gains than gains from exceptional increases.

Source: authors' summary based on Drummond (2012).

35. In the mid-term, customs revenues have probably the highest potential due to currently very low applied rates, especially for goods such as cars or electronics. Competition between ports for some products (such as sugar between Mogadishu and Kismayo) also contributes to explain low realization of customs revenues potential. If Somaliland is excluded, applied average tariff rate for Somalia is at 7 percent of total imports according to FGS, which is low. When compared to fragile and non-fragile comparators in Sub-Saharan Africa, the trade weighted average

tariff is at 12.2 percent.[27] In theory, it could then mean that the customs revenue potential to be at par with SSA countries should be with an extra 300 million $US equivalent to multiply by almost a factor of 3.[28] This estimate is rather consistent with Cantens (2018), who had found an estimate of 385 million $US if the Common Market for Eastern and Southern Africa (COMESA) external tariff was used for Somalia.

36. However, such revenue increases are unlikely to materialize in the short-term given that Somalia has three *de facto* customs administrations with different applied rates and competing with each other for some goods.[29]

37. Regarding FMS revenue potential, a detailed study was carried out in 2017 to estimate revenue gaps (including customs duties) for four FMS[30] in 2017 (PREMIS 2017). Although the level of ambition was high, with some estimates based on several assumptions (on increasing tax administration efficiency), four main findings can be highlighted:

- Jubbaland has a revenue potential that equals all three of the other states combined.
- Customs duties are the largest source of revenues (which may create a possible tension with the FGS because customs duties are supposed to be assigned to the FGS).
- At more than 200 percent, the revenue gap is high for Jubbaland and the Southwest.
- Despite a large revenue gap, it is estimated that revenues would not be beyond US$5 million per year for the Southwest or Galmudug, and US$10 million for Hirshabelle— or less than US$2 per capita per year for the Southwest or Galmudug and US$5 for Hirshabelle. Jubbaland would have a potential of more than US$20 per capita.

38. These findings confirm the current trends related to taxation in Somalia with concentrated revenues in the FGS/Puntland and to a lesser extent in Jubbaland. These derive mostly from trade taxes (although domestic taxation has also increased). FMS without ports therefore have a limited revenue potential, which is likely to remain in the future due to current limited size of markets.[31] Moreover, the practice of 'inland tariffs' is also present between FMS and exacerbates further inequalities and impair the sustainability of the tax system (as highlighted in Kalyandu et al. 2020).

39. Finally, in terms of future revenues, oil revenues remain the most promising and should fundamentally change the taxation picture in Somalia (at the condition that oil companies are taxed adequately and revenues collected effectively). Moreover, the legal framework and revenue-sharing mechanism would need to be agreed based on good international practices[32] (see Annex 1 for more details). Production and logistical constraints also need to be considered. As such, the revenue potential is large over the long term — assuming the probable reserves are confirmed. With a minimal estimated reserve of 600 million barrels

[27] It is from 7.9 percent for Burundi to 18.1 percent for Gambia; CAR, Ethiopia, Kenya and Tanzania were also included in the sample. Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data source is World Bank (https://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS). Applied rates may be actually lower but only of a couple of percentage points.

[28] Somaliland is excluded from those computations. The total would be 439 million $US.

[29] It would also require a move to an *ad valorem* system with customs to have a well-functioning valuation system, including the possibility of detecting customs evasion based on lowered declared values.

[30] This includes Galmudug, Hirshabelle, Jubaland, and the Southwest, but excludes Puntland.

[31] It does not justify to develop large ports for each FMS as suggested by some FMS authorities

[32] An amendment to the 2008 Petroleum Act was adopted in February 2020, which establishes a revenue-sharing mechanism, which would potentially create further equity problems.

of oil equivalent, revenues are estimated at more than US$20 billion (World Bank estimates). When production begins, it could quite rapidly be the largest source of revenues in Somalia. Therefore, revenue sharing between the FGS and the FMS and at the local level will be crucial for socioeconomic development as well as for state-building (see Annex 1 for more details about desirable revenue-sharing mechanisms).

Oil revenues remain the most promising and should fundamentally change the taxation picture in Somalia (at the condition that oil companies are taxed adequately and revenues collected effectively).


HITECH
PURE TECH
HITECH
AL-TAJIR
GRBOOD Co.
Super Data

4 MAIN TAX ADMINISTRATION CHALLENGES

A FGS in Competition for Taxation

40. In general, local taxation is not necessarily prioritized by donors over the mobilization of central government revenues. However, multiple taxation at the sub-national level (that is, at the FMS, district and/or community levels) is often a major constraint for micro and small enterprises. It is these enterprises that provide income generation and growth. Multiple taxes, fees, charges, licenses, and so on make it difficult to establish new businesses and enter new markets. In this context, the various levels of government do not coordinate well regarding issues of taxation (Fjeldstad 2018).

41. Somalia is not an exception among countries in terms of multiple taxation. Indeed, in many cases, it applies to both individuals and businesses. In Somalia, in numerous areas, taxpayers are liable for federal taxes or FMS taxes. However, they may also contribute to local governments, communities and even militias.

42. From a trade tax perspective, the three main ports of Mogadishu, Kismayo and Bosasso are effectively in competition— especially Mogadishu and Kismayo. (Cantens 2018). Due to the various *de facto* tax rates[33] (exacerbated with the introduction of a sales tax in Mogadishu), it can be more profitable for a trader to import some goods to Kismayo rather than Mogadishu, especially if such goods are destined to markets in the south of the country. Consequently, at a national level, customs revenues are reduced. Furthermore, port competition is an incentive for the FMS authorities to go even further to reduce their rates to capture more flows to possibly collect more revenues — to the detriment of Mogadishu port. However, if this trend persists, import flows would continue to increase, but with an overall decline in revenues for both ports, creating a lose-lose situation.

43. Citizens pay a larger share of taxes than indicated by the data due to important informal taxation. Competition exists between formal and informal authorities. Santoro and others (2019) explain the difficulties for formal authorities in taxing because of low legitimacy and poor perception by the citizenry. In an experiment carried out in South Somalia in almost 100 rural villages, the authors highlighted the following in their baseline study. First, the bulk of taxation is informal (for instance, clan or clergy contributions). Second, the only formal tax paid is the livestock tax. Third, it is interesting to note that the most formal authorities are the least trusted at the local level. Indeed, according to the authors, district authorities are trusted by 41 percent of the surveyed population, followed by religious leaders (57 percent), clan elders (61 percent) and village councils (74 percent). Finally, taxation is usually perceived to be a social duty, but equity is also an important concern for the villagers.

44. Along the same lines, based on interviews in Mogadishu, social researchers have found that taxation is seen as linked to the colonial past by part of the population (Rift Valley 2019). As in most fragile states, in recent decades, economists have demonstrated how regressive the taxation system

[33] Duties are goods-specific and not ad valorem tax rates.

in Somalia has been. Consumers mainly bear the cost of taxation, whereas corporate or high-income individuals are significantly less taxed on a proportionate basis (Moore and others 2018 [for Somaliland]; Purohit 1990).

45. Beyond competition between the FGS and the FMS, taxation also fuels the ongoing conflict situation in Somalia. Militant groups — with the largest being Al Shabab — raise substantial amounts through informal taxation, notably from businesses (at the Mogadishu port) and at road checkpoints (Faruk and Bearak 2019). Al Shabab's strong enforcement power undermines taxpayer morale, and it is an obstacle to the establishment of a fiscal contract with formal authorities. A frequently told story about al-Shabaab taxation is the predictability of checkpoint fees, particularly the issuance of receipts that allow a traveler to pay once and pass through subsequent al-Shabaab posts without paying any additional amounts. It explains why some traders avoid the main roads and sometimes use al-Shabaab-controlled rough roads to reduce checkpoint costs (Rift Valley 2019). Moreover, the Panel of experts identified a new trend (in 2019) in the expansion of Al-Shabaab's revenue generation, namely the taxation of imports into Mogadishu port (UN Security Council 2019). According to the Panel's interviews with members of Mogadishu's business community, Al-Shabaab has infiltrated Mogadishu's port institutions as well as commercial shipping agents operating in the city. Consequently, Al-Shabaab has obtained access to cargo manifests, which detail the nature, value and ownership of imported goods. This trend was confirmed a year later (UN Security Council 2020). The Panel of Experts concluded that: "Al-Shabaab's ongoing ability to generate revenues in areas the group does not physically control explains, to a degree, its resilience in the face of increased security operations".

46. Private companies also play an ambivalent role vis-à-vis taxation. Numerous wealthy individuals or companies expect service delivery and investment from the FGS. However, in the meantime, they resist paying taxes and/or evade taxes in collusion with some tax collectors, which ultimately leads to lower tax collection. This is a vicious circle with a low-level equilibrium at the expense of the State, and instead profits corporates and tax collectors. Although the number of taxpayers has increased, their number remains limited to approximately 430 for FGS and 500 for Puntland according to authorities. The total number of other FMS seems higher, but with limited tax collection.

B Main Tax Administration Weaknesses

47. Apart from legal imprecisions, severe administrative weaknesses further impede revenue collection. They originate in part from the particularities of the revenue department within the FGS government. Tax gaps remain large, especially for income and corporate taxes. For both categories, collected revenues account for less than 50 percent of projected revenues (World Bank 2017). The Revenue Department (established in its current form in 2016) operates within the Ministry of Finance. It is further divided into the Inland Revenue Department, with approximately 230 employees (World Bank 2017), and the Customs Department, with approximately the same number of employees. Enforcement activities are carried out by a Fiscal Police within the Police Force (E&Y 2017). The Inland Revenue Department is divided along tax categories (for direct taxes, indirect taxes and non-tax revenues). It is a structure from which most revenue authorities in the region have diverged because it is no longer considered to be best practice.[34] The Department has 48 offices and

[34] A Large and Medium Taxpayer Office was nonetheless created in 2018 (IMF 2019).

operates in 14 districts of Mogadishu.

48. The Revenue Department suffers from a human resource gap, both in terms of formal education and job-specific professional training. Only around 20 percent of staff have a university degree, over half did not study beyond a secondary education, and 10 percent completed only their primary education (E&Y 2017). No employees in the Inland Revenue Department or in Customs have undergone formal training even though this is now being tackled.

49. The second main source of administrative weakness is the lack of automation and information systems, as well as the absence of clearly defined processes. Whether it be for domestic taxes or for customs, processes are almost entirely manual. The taxpayer registry and the tax database in the Inland Department are on paper, thereby making it subject to mistakes and loss or manipulation of information. As such, the task of producing reliable tax statistics becomes very challenging. Tax payments are made directly to tax agents, including outside of the office. In the customs area, agents are technically not supposed to directly handle cash payments, although the policy is not always fully enforced. All processes in customs are also manual: each shipment is examined physically, and there is a high level of face-to-face interactions between traders and customs agents. The latter are weakly monitored and controlled (IMF 2017).

50. These administrative weaknesses result in a situation in which some essential functions of an effective tax administration are simply not undertaken. As such, significant discretionary power is given to tax collectors/customs officers (such as revenue collecting agents in Ministries, Departments or Agencies in the FMS). This further aggravates the asymmetry between the administration's capacity and the weight of a small number of large private companies from specific sectors — notably telecommunications and financial institutions, including banking and remittance operations.

5 POLICY RECOMMENDATIONS

51. When designing tax reforms, it is crucial to highlight that some relatively easy paths to increasing revenues in fragile and conflict situations may seem appealing, but they may prevent a sustainable fiscal/social contract from emerging. As an example, governments ideally aim to raise revenues in a short period of time, but not at the cost of confronting powerful vested interests (Moore and others 2018 and Clingendael Institute 2019 for Somalia). This can translate into accepting a bargain with the largest taxpayers — such as the largest private sector actors. This could create inequities if smaller taxpayers face inflexible tax obligations which may be perceived as relatively too high, thereby undermining the legitimacy of taxation for larger segments of the population.[35] Thus, the question of taxation legitimacy, which is often overlooked, is of critical importance for sustainable taxation in Somalia.[36]

52. In fragile states where taxation legitimacy is usually very weak,[37] fairness, transparency and a clear link between tax and service provision are critical. In order to increase tax adherence, the use of resources is of critical importance. Authorities need to convince citizens that the government does not misappropriate public funds and that it will use them for service provision. The use of such funds should be more transparent in terms of revenue collection. However, it should also be more participative and transparent in the use of taxes.[38] In addition, transparency regarding budgetary and revenue exemptions should be a priority for authorities in Somalia.

53. Many citizens —especially those in fragile states — perceive tax issues as technical, complex and lacking in fairness. Yet, it is vital for the legitimacy of the tax system to secure a broad-based citizen engagement around taxation and fairness issues. In numerous fragile states, consumers, who are generally poor, are disproportionately affected by taxes on the consumption of consumer goods, food products, import duties and so on. However, the elite is usually less affected due to low effective tax collection for direct taxes, such as personal income taxes. Civil society organizations, including business associations, can help broaden the debate and bring a new focus to the discussion of fairness and pro-poor taxation regarding tax policy (Fjeldstad 2018). Somalia faces the same problem and should carefully review its tariff structure, notably for import duties — and especially for direct taxation. Moreover, representatives of the private sector are asking for an appeals board, better engagement by tax authorities, and, more broadly, adherence to the rule of law. All of these issues appear essential to improving tax legitimacy in Somalia.

54. An important lesson from international experience of tax capacity building in fragile states is the need to sequence reforms by distinguishing measures that can be achieved in the short-term from improvements that should be planned for the medium and longer term (IMF 2017). This sequencing allows policymakers to adjust their objectives to contexts in which administrative capacity is initially low but increases as the reforms

[35] Gottlieb (2018) shows that in Senegal, informing microeconomic actors about an existing reform which shifted some of the tax burden from small taxpayers to medium and large firms, and simplified processes for micro firms, led to stronger support for the government, as well as a higher propensity to vote for the incumbent.

[36] Militia, like Al Shabab, rely on very strong enforcement mechanisms and therefore do not have to improve their legitimacy.

[37] It is usually even more difficult when taxation is spread between the FGS, the FMS and local authorities, not to mention communities or militias.

[38] This should be extended to a broader transparency framework and include not only taxes but also Official Development Assistance.

are being launched. Moreover, in the short-term, customs reforms are critical to generating revenues. Subsequently, policy recommendations are presented with a short-term and then medium/long-term time perspective and finally revenue sharing principles between the FGS and the FMS are presented briefly.[39]

Table 3 Summary of Policy Recommendations in the Short and Medium-Long Term

Short-Term	Mediuem-Long Term[40]
Monitor tax reforms action plan and generate monthly detailed data by tax instruments	
Adopt secondary legislation to the Revenue administration law to clarify tax collection and administration (by streamlining taxes between FGS and FMS)[41]	Revise upward customs tariff rates and revise the tariff schedule (with a focus on luxury items along the line of COMESA tariff schedule)
Harmonize customs tariff rates and implement national valuation across the three main ports to avoid tax competition	Extend personal income to all employees
Increase transparency on tax exemptions	Introduce excise taxes on petroleum products, tobacco and motor vehicles
Increased automation of revenue instruments (tax and non-tax)	
Review staff competencies and train staff accordingly	Review HR incentives framework starting from the main collection points and implement revised framework

Source: authors' representation.

In fragile states where taxation legitimacy is usually very weak,fairness, transparency and a clear link between tax and service provision are critical. In

[39] The PER has a complementary paper on fiscal federalism.

[40] Tax policy reforms are the main objective of the recent paper published by Kalyandu et al. (2020) where measures are presented in details with a stronger focus on a medium-term horizon.

[41] Centralized revenue collection of international trade taxes could be used to finance a larger scale transfer system to FMS. For more discussions, see fiscal federalism paper of the PER.

A In the Short-Term, Harmonize Customs Rates and Clarify FGS/FMS mandates

55. In terms of general recommendations, over the short-term, the tax structure should remain simple, transparent and minimize disputes because of the weak systems currently in place.[42] Tax officers in many fragile states have discretion over important decisions, such as tax liability assessments, the selection of audits and litigation. Many administrative procedures should be transparent because businesses usually report over-assessment of tax liabilities followed by 'negotiations' with the tax officer(s), which ultimately erodes the tax base.

56. As a prerequisite, it will be crucial for the Somali authorities to monitor progress of tax reforms on a monthly basis and assess the progress of action plans. As an example, it will be important for them to monitor on a regular basis average applied tariff rates in the three ports regarding customs duties. Moreover, the expansion of number of taxpayers and average revenue for the main instruments, such as corporate or income tax will have to be monitored. Some taxpayer education will have to be organized and taxpayer surveys should be undertaken to have feedback from taxpayers.

57. Multiple taxation is usually common in FCVs. Authorities from the FGS/FMS (and possibly from local governments) are encouraged to clarify revenue collection and administration levels for the most important tax instruments in order to avoid multiple taxation for economic actors and individuals. In this regard, the Revenue administration law should be complemented by secondary legislation (or in the Constitution) to clarify rapidly tax collection and administration between the various levels of authorities.

58. Somalia has also traditionally relied on a small number of taxes and will probably continue to do so as long as enforcement capacity remains relatively weak. For the country, it will be critical to further simplify taxes by streamlining them with dozens of 'small taxes with low yields', harmonizing rates whenever possible starting with trade taxes, and eliminating double taxation between the FGS/FMS. Most of these measures do not generate large revenues, but they can be detrimental to economic activities and should be removed. A presumptive tax for small businesses should probably be introduced like in many developing countries with a large informal sector.

59. Moreover, as mentioned in Kalyandu et al. (2020), exemptions on corporate income tax or on customs duties or sales taxes on imported goods should be more transparent with a limited discretionary power left to the Minister of Finance. A well-defined, transparent and collegial process should be put in place in reality to limit exemptions and a negative impact on the competitive environment.[43]

60. On tax administration, the monitoring of tax collector behaviors and impacts is equally important to better control bad behaviors and corruption.[44] Although corruption in tax agencies is difficult to measure with accuracy, there are some indirect measures that tend to show that corruption is possibly important. For instance, the automation of revenue collection points through

[42] Although it is difficult to make them work in fragile states, tax appeal boards and tax tribunals are important mechanisms for securing taxpayers' rights, as well as in establishing fair and transparent procedures to addressing tax disputes (Fjeldstad and others 2018).

[43] A report to the Auditor General is supposed to be done on weekly basis of how much exemptions were made (if any) and report to the cabinet and parliament on quarterly basis as per PFM Act.

[44] This has been relatively successful in customs with individual performance contracts, such as in Cameroon or Madagascar (Raballand and others 2017).

the financial management information system may help generate some evidence. As an example, in Puntland, after the automation of airport visa fees, collections increased by about 70 percent in one month. Confirmation would be required; however, it shows that corruption among tax collectors remains probably quite high.

61. The FGS should benefit from a full automation of processes, developing seamless information sharing between the various ports of entry in Somali territory. The import clearance process should also be simplified with supporting documents sent electronically in a short-term perspective.

62. As a successful example of increased revenues over the medium term, Afghanistan was able to increase its revenue collection in recent years. The most salient measures included the following: strong leadership with focused attention; the firing of 40 corrupt or inefficient senior staff; tight monitoring of revenue collection by the Ministry of Finance; and revised technical systems and processes (World Bank 2017).

63. As a consequence, Somalia's tax administration should also strive to recruit higher skilled staff and invest in training after having studies the competencies gaps.

B In the Mid-Term/Long-term, Expanding the Tax Base

64. Beyond revenue-sharing issues, several reforms should be gradually undertaken to expand the tax base for corporate and personal income taxes, as well as increased tax rates for trade taxes.

65. More specifically related to Somalia, the focus should be on extending the personal income tax to all employees, including more attention to service sectors such as the telecommunications companies, financial institutions and/or restaurants and hotels for corporate taxes (World Bank 2017).[45] Compliance with simpler procedures and self-assessment should be encouraged (World Bank 2017). Business licenses should be improved, possibly leading to improved revenues.

66. Also, customs duties rates could be further increased to better reflect the COMESA tariff structure (and could be harmonized across points of entry) (Cantens 2018). The equivalent rate of import duties in Somalia is low and could be revised upwards (provided the adjustment is done in the three main ports). In this mid-term perspective based on strengthened capacity and knowledge, customs could use the transactional value for customs transactions (but not in a short-term horizon). Some excise taxes could also possibly be introduced on petroleum products, tobacco or motor vehicles.

67. On tax administration, Somalia faces a human factor constraint due to the formal lack of training and a poor incentive framework; this issue will have to be tackled over several years. One possible approach could be to follow the lessons of some successful support initiatives to customs reform in Madagascar (from 2015 and in Cameroon in the early 2010s).[46] The World Bank Group-supported customs reforms had led to significantly increased revenues, a reduction in clearance time in the main

[45] Some other tax instruments are likely to give positive results, such as property tax (described in Kalyandu et al. 2020).

[46] For more information on the approach, see Raballand and others (2017). For a rather similar approach in Cameroon, see Raballand and others (2013).

port, and improved fraud detection. These results were achieved by: (i) undertaking data-driven diagnostics in key areas identified with customs management (including in human resource [HR] issues); (ii) designing operational tools/procedures to increase performance (including staff) through inclusive policy dialogue with customs at the managerial and technical levels, as well as among users (private sector) based on these diagnostics; (iii) assessing the impact of those piloted solutions; and (iv) adapting/changing pilot solutions where necessary. A similar approach, tailored to local purposes, should be undertaken for the main Somalia port of Mogadishu, and shared with the Bosaso and Kismayo ports.

68. In the medium-long term perspective, the FGS should benefit from a full automation of processes, not only for customs but also for all tax and non-tax instruments. For the "pilot" instruments already implemented, it has shown the positive impact on revenue collection.

C Potential Strategies for Setting Revenue Sharing[47] between the FGS and the FMS[48]

69. Highlighting the main theoretical principles of revenue sharing for all tax and non-tax revenues is key. A large spectrum of autonomy can be left (or not) to local authorities regarding the tax rate or tax base (Ebel 2017). International experiences point to very diverse solutions. For the future of Somalia, a number of important principles will need to be taken into account (World Bank 2015) as follows:

- Revenue sharing is a dynamic process grounded in cooperative intergovernmental relations.
- Intergovernmental financing arrangements work best when considered comprehensively.[49]
- Fiscal arrangements should support a strong and unified economic space and deter the disintegration of the economic space with taxes between the FMS.
- Equity lies at the heart of intergovernmental fiscal arrangements, which means that if the revenue-raising capacity of individual states is uneven, some form of fiscal equalization will be needed.
- Who administers taxes is a separate question from who controls the revenues. It implies that taxes can either be collected by: (i) national agencies on behalf of subnational governments (such as in Canada,[50] Germany or Uganda); (ii) separate tax administrations; or (iii) sub-national governments collecting national taxes for the central government.
- There are four main arguments for national taxation. First, the FGS plays a major role in stabilizing the economy; as such, it requires funding. Second, the FGS should play a major role in equalizing revenues across the FMS. It will be even more important when oil revenues flow because natural resources are unevenly distributed spatially, which would require even more equalization between the FGS and the FMS. This would help to avoid the random element of geography from the determination of each state's revenues. Third, revenue collection costs are said to be higher in a decentralized system because the capacity to fight evasion or fraud may be lower. Fourth, national taxation usually ensures the absence of export taxation, which is more beneficial for the economy.

[47] Revenue-sharing agreements usually allocate own-source revenues to one level of government (the FGS or the FMS) or revenues are shared. These are usually based on a formula.

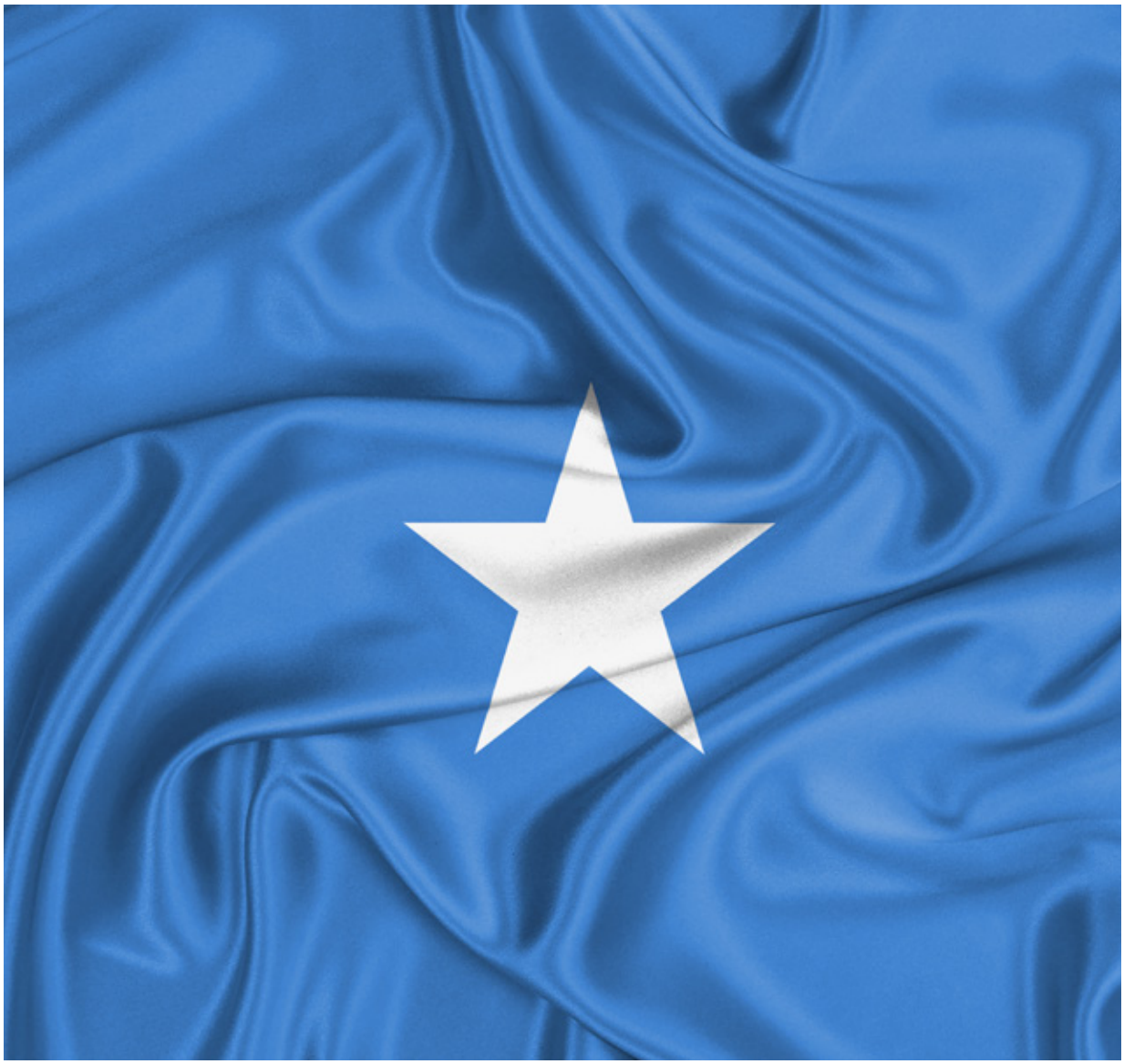
[48] The fiscal federalism module provides more detailed recommendations and should be read for any detailed interest and analysis in this area.

[49] Resources can be allocated in two ways: by assigning tax bases to different levels of government or by transferring funds from one level of government to another. Therefore, both aspects need to be considered when designing revenue-sharing mechanisms.

[50] Canada is described as a 'loose federal system', which could be of some relevance for Somalia (Ebel 2017). Canada is defined as the most fiscally decentralized member country of the Organization for Economic Co-operation and Development (OECD).

70. Somalia presents some important characteristics for future revenue-sharing mechanisms:

- *Tax competition is high between the FGS and the FMS, which creates a potential 'balkanization' of Somalia's economic space.* Corporations could be taxed multiple times using various rates. Puntland (and to a lesser extent Jubbaland) have had preexisting rights and perform (de facto) most functions of an independent state, including raising revenues. These are usually considered to be a national function, such as trade taxes.[51]
- *Taxation at the federal level remains difficult due to the poor public perception of federal institutions* (Menkhaus 2014). The FGS has difficulties in taxing outside the capital and the Benadir province.
- *There are large imbalances in revenue potential and current collection between the FGS/ Puntland and Jubbaland and the other FMS.*



[51] In almost all countries of the world, customs duties and trade taxes more broadly are considered as national taxes — especially as trade policy is a central government competency. For instance, Yemen had had difficulties in assigning revenues and expenditures between the federal government and local governments. It was decided that customs would remain a national institution and trade taxes would be administered by a national customs administration.

6 REFERENCES

Bräutigam, Deborah, Odd-Helge Fjeldstad and Mick Moore. 2008. *Taxation and State-Building in Developing Countries: Capacity and Consent.* Cambridge: Cambridge University Press.

Cantens, Thomas. 2018. "An Assessment of Somalia Customs Revenue Potential: A Way Forward for Customs Reforms". Mimeo.

Clingedael Institute. 2019. *Transnational Capital in Somalia. Available at https://www.clingendael.org/publication/transnational-capital-somalia*

Devarajan, Shantayanan, Gaël Raballand, and Tuan Minh Le. 2011. "Direct Redistribution, Taxation, and Accountability in Oil-Rich Economies: A Proposal". Working Paper No. 281. Center for Global Development, Washington, DC.

Drummond, Paulo, Wendell Daal, Nandini Srivastava, and Luiz Edgard Oliveira. 2012. "Mobilizing Revenue in Sub-Saharan Africa: Empirical Norms and Key Determinants." Working Paper 12/108, IMF, Washington, DC.

Ebel, Robert. 2017. "Intergovernmental Revenue Assignment and Mobilization Principles and Applications for Somalia." Mimeo.

Ernst & Young (E&Y). 2017. "Revenue Mobilization and Tax Administration Project - End Phase 1 Report." Mimeo.

Eubank, Nicholas. 2012. "Taxation, Political Accountability and Foreign Aid: Lessons from Somaliland" *Journal of Development Studies 48* (4): 465–480.

Faruk, Omar and Max Bearak. 2019. "'If I don't pay, they kill me': Al-Shabab tightens grip on Somalia with growing tax racket." Washington DC: Washington Post, available at: https://www.washingtonpost.com/world/africa/if-i-dont-pay-they-kill-me-al-shabab-tightens-its-grip-on-somalia-with-growing-tax-racket/2019/08/30/81472b38-beac-11e9-a8b0-7ed8a0d5dc5d_story.html.

Fjeldstad, Odd-Helge, Morten Bøås, Julie Bjørkheim, and Frida Margrethe Kvamme. 2018. "Building Tax Systems in Fragile States." CMI Report 3. Bergen: CMI.

Gadenne, Lucie. 2017. "Tax Me, but Spend Wisely? Sources of Public Finance and Government Accountability". *American Economic Journal: Applied Economics* 9(1):274–314.

Gottlieb, Jessica. 2018. "Taxation, Information, and Electoral Behavior: Evidence from a Developing Democracy." Paper presented at the Annual Meeting of the 89th Annual SPSA Conference, New Orleans, LA.

Haas, Astrid. 2017. "An Overview of Municipal Finance in Hargeisa, Somaliland" IGC Report. London: IGC.

International Centre for Tax and Development (ICTD). 2015. Government Revenue Dataset (GRD).

International Monetary Fund (IMF). 2017. "Building Fiscal Capacity in Fragile States." Policy Paper.

Washington DC: IMF.

_____. 2019. "Somalia - First Review under the Staff-Monitored Program". Washington DC: IMF.

Jamal, Vali. 1988. "Somalia: Understanding an Unconventional Economy." *Development and Change* 19 (2): 203–265.

Kalyundu, Gilbert and Norregaard, John. 2020. "Designing Federal Tax Policy for Enhanced Domestic Revenue Mobilization", *IMF technical report,* Washington DC: IMF.

Kakwenzire, Patrick. 1986. "Revenue and Development in Northern Somalia, 1905-1939". *The International Journal of African Historical Studies* 19 (4): 659–677.

Levi, Margaret. 1988. *Of Rule and Revenue.* Berkeley, Los Angeles and London: University of California Press.

Martin, Lucy. 2016. "Taxation, Loss Aversion, and Accountability: Theory and Experimental Evidence for Taxation's Effect on Citizen Behavior". Mimeo.

Meagher, Kate. 2018. "Taxing Times: Taxation, Divided Societies and the Informal Economy in Northern Nigeria" *Journal of Development Studies* 54 (1).

Menkhaus, Ken, 2014. "If Mayors Ruled Somalia: Beyond the State-building Impasse." Policy Note 2. Nordic Africa Institute. http://nai.diva-portal.org/smash/get/diva2:714676/FULLTEXT01.pdf.

Moore, Mick, Wilson Prichard and Odd-Helge Fjeldstad. 2018. *Taxing Africa: Coercion, Reform and Development (African Arguments)* London: Zed Books.

Mubarak, Jamil. 1997 "The `Hidden Hand' Behind the Resilience of the Stateless Economy of Somalia". *World Development* 25 (12): 2027–2041.

Muraf, Harun. 2018. "In Somalia, Businesses Face 'Taxation' by Militants" *Voices of America News Outlet.* December 3.

Paler, Laura. 2013. "Keeping the Public Purse: An Experiment in Windfalls, Taxes, and the Incentives to Restrain Government." *The American Political Science Review* 107(4): 706–725.

Powell, Benjamin, Ryan Ford and Alex Nowrasteh. 2008. "Somalia after State Collapse: Chaos or Improvement?" *Journal of Economic Behavior & Organization* 67:657–670.

PREMIS PFM Program. 2017. "Revenue Potential and Tax Gap Analysis". Mimeo.

Prichard, Wilson. 2015. *Taxation, Responsiveness and Accountability in Sub-Saharan Africa. The Dynamics of Tax Bargaining.* Cambridge: Cambridge University Press.

Prichard, Wilson and Mick Moore. 2018. "Tax Reform for Low-income Countries: Five Ideas for Simplifying Tax Systems to Fit Local Realities." ICTD Summary Brief Number 17. ICTD.

Prichard, Wilson, Anna Custers, Roel Dom, Stephen Davenport, and Michael Roscitt. 2019. "Innovations in Tax Compliance Conceptual Framework". *World Bank Policy Research Paper 9032.*

Purohit, Mahesh. 1990. "Tax Reform in an Unconventional Economy: A Case Study." *International Bureau of Fiscal Documentation Bulletin* 44 (4): 185–193.

Raballand, Gaël and Anand Rajaram. 2013. "Behavioral Economics and Public Sector Reform: An Accidental Experiment and Lessons from Cameroon". Policy Research Working Paper, WPS 6595. Washington, DC: World Bank

Raballand, Gaël, Cyril Chalendard, Ana Fernandes, Aaditya Mattoo, and Bob Rijkers. 2017. "Customs

Reform and Performance Contracts: Early Results from Madagascar". Governance Note No. 2. Washington, D.C.: World Bank Group.

Reyner, Anthony. 1960 "The Problems of Independence". *Middle East Journal* 14 (3):247–255.

Rift Valley. 2019. "Political Economy Analysis of Domestic Revenue Mobilization in Somalia: Focus on Mogadishu." Mimeo.

Ross, Michael. 2001. "Does Oil Hinder Democracy?" *World Politics* 53(3):325–61.

_____. 2012. *The Oil Curse. How Petroleum Wealth Shapes the Development of Nations.* Princeton: Princeton University Press.

Santoro, Fabrizio and Vanessa van den Boogaard. 2019. "Informal Taxation, Accountability and Tax Morale: Baseline Findings from Somalia". Presentation at the ICTD Annual Conference.

Tilly, Charles. 1990. *Coercion, Capital, and European States,* AD 990–1990. Malden: Basil Blackwell.

UN Security Council. 2019. "Letter dated 1 November 2019 from the Chair of the Security Council Committee pursuant to resolution 751 (1992) concerning Somalia addressed to the President of the Security", available at: http://undocs.org/S/2019/858.

UN Security Council. 2020. "Letter dated 28 September 2020 from the Chair of the Security Council Committee pursuant to resolution 751 (1992) concerning Somalia addressed to the President of the Security Council", available at: https://www.undocs.org/en/S/2020/949.

Varming, Kirstine Stroh. 2017. "The Experimental Limits of the State: Territory and Taxation in Garoowe, Puntland". DIIS Working Paper 2017:7.

World Bank. 1991. "Somalia Crisis in Public Expenditure Management". *Report No. 8727-SO.* World Bank, Washington, DC.

_____. 2015. "Somalia Economic Update: Transition amid Risks with a Special Focus on

Intergovernmental Fiscal Relations". Working Paper Number 1, World Bank, Washington, DC.

_____. 2017. "Somalia Economic Update: Mobilizing Domestic Revenue to Rebuild Somalia".

Working Paper Number 2, World Bank, Washington, DC.

ANNEXES

ANNEX 1 Potential Strategies for Adequately Sharing Future Oil Revenues

If revenue collection from oil production would flow in 5-10 years and exports remain relatively modest, they will fundamentally change the revenue picture in Somalia; as such, they should then be part of the overall design of revenue-sharing arrangements. The absence of tax bargaining in oil-rich states is considered to be one of the possible channels of the "resource curse" (Eubank 2012; Ross 2012). In oil-rich countries, it has been demonstrated empirically that accountability vis-à-vis the citizenry is even lower than in non-resource rich oil countries (with all other things being equal) (Devarajan and others 2011). This situation could possibly create growing tensions between the FGS and the FMS, as well as tensions between the FMS. Therefore, any revenue-sharing agreement would need to consider the future oil revenues.

The FGC has consistently raised this issue as part of the current Constitutional redrafting process. Some provisions in this regard can help mitigate any increasing inequality in the future. This could be done by either requiring natural resource revenue agreements to be time-limited, while also introducing an equalization mechanism that stands above the individual agreements. Alternatively, it could be done by doing away with the sectoral revenue-sharing agreements altogether, and then introducing a single revenue-sharing mechanism for all revenues, including natural resources.

Regarding oil revenue sharing, a recommended approach should follow these principles:

- Ensure that petroleum revenues are managed sustainably;
- Compensate oil-producing areas for the environmental impact of extraction;
- Ensure that resources are allocated between levels of government in line with functional responsibilities; and
- Ensure that resource allocations between authorities at the same level are guided by an agreed definition of equity.

In the current context, the Baidoa revenue-sharing agreement (signed in 2018 and now included in the 2019 Petroleum Act) delivers a skewed horizontal revenue distribution between the FMS, with an oil-producing FMS, and the producing district within it, potentially receiving anywhere between 10 to 14 times more revenue than a non-producing FMS — thereby exacerbating inequality between districts/the FMS. Vertical distribution between the FGS and the oil producing FMS/district is also potentially problematic.

Importantly, the PFM act (enacted in December 2019) addresses the issue of fiscal sustainability, and revenue sharing between FGS and FMS such as:

- The Minister shall establish fiscal rules to determine the portion of natural resource revenues that should be saved rather than spent in any given financial year.
- The fiscal rules shall be agreed between the Federal Government and the Federal Member States.
- The investment policy shall include a requirement that investments under this section shall be undertaken in a manner that does not jeopardize the macroeconomic stability of Somalia.
- All planned large-scale infrastructure investments funded by natural resource revenue savings will be agreed between the Federal Government and the Federal Member States.

WORLD BANK GROUP