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# CHALLENGES OF DOMESTIC REVENUE MOBILIZATION IN SOMALIA

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**Abstract**
*Somalia is a post-conflict state and now getting rid of a sustained civil war. It has a steady growing economy and a lot of economic and policy reforms are in place. Fiscal sector reform is the biggest responsibility of the Federal Ministry of Finance with the special focus on the revenue generation since it's the most important goal of the current government. This paper presents a very brief study on the revenue status of the Federal Government of Somalia - states are not included. The study describes the revenue status, recent successful reforms and challenges pressing the domestic revenue mobilization of Somalia. Dealing with "hard to tax" sectors, poor administration capacity, insecurity and political instability, incomplete transition to federalism, legislative and enforcement obstacles and other customs-related problems are the biggest aggressive challenges of domestic revenue mobilization in Somalia. The study recommends to Federal Government of Somalia to; (1) lessen the base informal business activities, (2) build its capacity of administration, (3) create a stable political and secure environment, (4) develop a robust fiscal federalism framework and (5) reform the customs operations with effective policy of trade facilitation and (6) update the tax legislations.*

*Keywords: Somalia, domestic revenue mobilization, taxes, revenue, challenges*

## INTRODUCTION TO DOMESTIC REVENUE MOBILIZATION

According to a report by World Bank, authored by Junquera-Varela et al (2017), Domestic revenue mobilization (DRM) was a key priority for the sustainable development agendas. The Addis Ababa Action Agenda of July 2015 emphasized the importance of DRM noting that it's essential in achieving the sustainable development goals SDGs. The only reliable and sustained sources of governments' revenue are taxes and some no-tax revenues. A huge domestic borrowing from the public sources cannot sustain the coverage of the governments expenditure desires. Also foreign borrowing can increase the interest rate of the future debt which may create a difficulty of debt payment in developing countries.

The revenue mobilization in developing countries, a paper of (IMF, 2011), addresses that the key objective of any tax system is raising the revenue. In addition to that, long-run economic growth, distributional effects and state building are some other considerable factors. Domestic revenue mobilization is broadly recognized as the supreme sustainable manner to economic development, as numerous African countries need to improve their capacity to increase and manage tax revenue and expand the tax base (see ECA, 2018).

The Addis Ababa Agenda has reintroduced the universal attention on domestic resource mobilization (DRM) as a foundation for achieving the Sustainable Development Goals (SDGs). Currently, low income countries are able to mobilize only an average of 13% of their Gross Domestic Production (GDP), compared to 20% target which is the required level set by the UN to achieve the SDGs, (Tamarappoo et al 2016).

Bhushan et al (2013) conducted a study on the role of domestic resource mobilization in financing the post-2015 development agenda or Millennium development Goals. In their study, they addressed, despite Africa's struggle to toughen its resource generation approach, there are some pressing challenges coming from structural factors, inefficient and ineffective tax systems, significant tax exemptions, tax avoidance and capital flight.

Taxes offers to the government a core opportunity;(1) to finance in poverty reduction and delivery of public goods and services, and helps (2) to lower aid dependence in developing countries, create fiscal reliance and growth sustainability. Domestic revenue mobilization allows achieving these two key objectives and helps the government to finance the operations without printing money or foreign indebtedness (Fakile, Adegbie & Faboyede, 2014).

Donors have long been funding tax reform projects, upon the rise of the Millennium Development Goals (MDGs) initiative in the 2000s. Donors and beneficiary governments have boldly put domestic resources mobilization at the focus of their efforts to overcome challenges facing against development. The issue has gained popularity in the last five years nearly the formulation of the initiative of Sustainable Development Goals (SDGs) in 2015, which aim to end extreme poverty by 2030 (Runde & Savoy 2016).

## A BRIEF HISTORY OF SOMALIA'S CURRENT REVENUE STATUS

World Bank (2015) launched the first edition of a series of Somalia Economic Update publications. Accordingly, this study revealed that Somalia is doing better in the fiscal side in the history after civil war. In 2012 the Federal Government of Somalia collected $30 million in domestic revenue having tax share of 0.9% to the GDP. Nevertheless the domestic revenue for the government increased to $84.3 million financing 56% of the recurrent expenditures. A tax driven revenue contributed 70% of the revenue in the period of 2012-2014. Tax on international trade from the Mogadishu's port and airport was the key source for the government revenue contributing 91% of the domestic revenue between 2012 and 2014. While collection of the revenue performed considerably, Somalia is so far under challenging conditions including: weak collection capacity and absence of legal and regulatory framework. The problem of having low revenue is a big threat to the provision and delivery of the public services.

World Bank (2017) published the second edition of Somali Economic Update with especial focus on domestic revenue mobilization. According to the report, government failed to provide public services while the society and business entities failed to pay taxes. There is a gap between the demand of public goods and the government's ability to generate revenue to meet the pressing demands. The government implemented easy-to-adopt measures to quickly raise revenues without developing a strong revenue mobilization strategy that would combine strong transparency and accountability. Revenue mobilization will reduce the dependence of the government on aid and enables the government fund the basic service delivery, thus strengthening state/citizen relationship. There is no vibrant assignment on revenue collections between federal government and member states; presently, federal ministry of finance collects the revenue only from Mogadishu. Somalia did not update its tax laws and regulations; instead, the government updated certain tax rates. There is no a strong fiscal federalism framework which guide the fiscal issues between the main government and member states.

IMF, (2018), despite the pressing challenges, the government implemented critical tax measures to lift 2017 revenue collection through meeting with the key taxpayers and agreed to pay the taxes based on the existed legal foundations. The high dependence on the external grants with narrow tax base creates a weak fiscal discipline. Meanwhile, a fully agreed customs harmonization among the federal government and its member states is required to speed up the initiative of having unified tariff rate throughout Somalia. The domestic revenue is currently 2% of the GDP.

Somalia, despite recent performances, is characterized having low domestic revenue, thus having the lowest revenue share of the GDP (Gross Domestic Production) in the world which is 2%. The Federal Government of Somalia is collecting only taxes of Mogadishu experiencing a very narrow tax base. The federal member states are collecting taxes of their own in their jurisdiction on the basis of a state level tax acts passed by their parliaments. They use this revenue to finance their operations through the budget. However, these taxes are not the only source of revenue for them since they receive grants from donors and federal government of Somalia.

Till now, there is no a robust fiscal framework which explains the tax assignments among the governments, transfer policy and clear fiscal federalism. But there are some preliminary agreements on revenue sharing of some natural resources like fishery and petroleum and harmonization of sin tax rates. Tax harmonization process has been undertaken through discussions of the intergovernmental finance committee. This committee is built up of the ministries of finance of the federal government and member states. They often held two levels of meetings; a technical level of all revenue directors which provides an input to the second meeting of the ministers under the leadership of the federal ministry of finance.

The government is currently collecting sales taxes and corporate income tax from the businesses, individual income tax from companies, not for profit organizations and government civil servants, road taxes from vehicles owners, property transfer tax (notary), stamp duty, customs duty and non-tax revenue coming from sale of public goods and services such passport fees, visas, work permits, certificates, registrations, licenses, documentations and verifications, etc. But these taxes are only collected from Mogadishu. And even in Mogadishu, there are some sectors remain untaxed due to informality of the economy. However, the government grants tax exemption to imported goods of humanitarian, diplomacy or belonged to the government. It also grants an exemption of customs duty for the first capital of a new factory/industry and reduction of taxes to any raw material. This is aimed to encourage the domestic production sectors to partially supply the local demand.

The tax system of Somalia is experiencing a weak collection aptitude and challenges in managing the tax base. Provision of public goods and services is yet under threat of low and volatile domestic revenue. The Government's ability to collect taxes is important to fiscal practicability in the medium-term. However, due to hard conditions and insecure environment, the government focused on the implementation of easy to adopt measures to efficiently and effectively raise tax revenues without developing a tough revenue mobilization strategy that would integrate strong transparency and accountability. Tax collection has been below target up to 2016 due to uncertainty, high risk of collection and unpredictability, but 2017 the federal government reached a milestone of surpassing the target of budgeted domestic revenue. Strengthening institutional capacity in domestic revenue mobilization is the core input of the government plan to get rid of the external dependence disease.

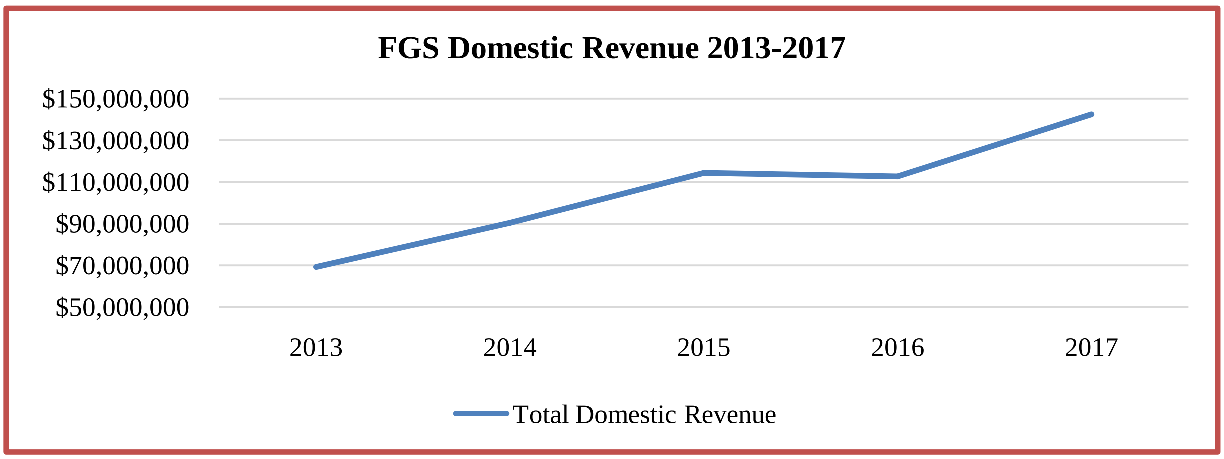
The table 1 and figure 1 show us how trend the revenue of the FGS was in recent history of Five years, in other words, years of having the government budget.

Table 1. FGS revenue table in the period of 2013-2017

| # | Year | Revenue | % Increase |
|---|---|---|---|
| 1 | 2013 | $ 69.16 million | ----- |
| 2 | 2014 | $ 90.31 million | 31% |
| 3 | 2015 | $ 114.28 million | 27% |
| 4 | 2016 | $ 112.67 million | -1% |
| 5 | 2017 | $ 142.39 million | 26% |
| 6 | 5 year Percentage Increase | | 106% |

*Source: Ministry of Finance, Federal government of Somalia*

Figure 1. FGS revenue trend graph in the period of 2013-2017




*Source: Ministry of Finance, Federal government of Somalia*

Both the table and trend graph show us that Somalia's revenue doubled in five years. In 2013 the actual revenue was $69 million, while 2017 was $142 million; this is an increase of 106% in five fiscal years. The pro rata of six-monthly report of 2018 demonstrates that the federal government is on the way to meet its budgeted domestic revenue $165 million. Revenue reforms in both sides of administration and policy with respect to the recommendation from international partners like International Monetary Fund and World Bank are key factors impacted.

Ministry of finance of the federal government implemented some reforms through its short and medium term revenue mobilization strategy. Some of these reforms are:

a. Introduction of sales taxes both on imported goods collected at the air and sea ports and locally produced goods and services such as telecom sector, hotels, restaurants etc.

b. Harmonization of sin tax throughout all states, these include tax rates of tobacco, khat and also departure tax. This agreement was signed by the intergovernmental finance ministers of the federal government and states in Gerowe, Puntland, in September 2017.
c. Extension of individual income tax to additional companies, not for profit organizations and foreign workers in Mogadishu. Before this extension, the government used to collect these taxes only from its civil servants by deducting at source. This extension of the income tax base improved much better for government.
d. Establishment of Large and Medium Taxpayers Office (LMTO) which is a specialized office for collection of taxes from large and medium sized enterprises/taxpayers in Mogadishu. The office will undertake the responsibilities of registration, filing the returns, collection, tax arrears management, audit and any other tax duties of large and medium scale businesses.
e. Consolidation of revenue collections of some government agencies to the revenue department, while revenue officers with Central Bank cashiers are collecting the taxes and user fees. This is a partial implementing of the federal government plan to merely consolidate all revenue collections to the ministry of finance's revenue department.
f. Modernization of collection system, where, after assessment, the taxpayer can deposit the taxes to which of any licensed private bank or directly to the Central Bank. This is aimed to get rid of manual cash collecting and to improve transparency and accountability in the public funds through eliminating the middle persons between the taxpayer and the national treasury.

The federal government of Somalia has benefited from these reforms and revenue is significantly increasing despite some pressing challenges. The revenue performances equipped with the above effective reforms, success in economic policy benchmarks with IMF's Staff Monitoring Program (SMP) and government's commitment of the reform, all together built a strong relationship and better engagement with donors and other international partners. Tax reform is an exercise targeting not only raising the revenue but also has other objectives such as equity, efficiency, macroeconomics stability and sustainability. It should rather seek to improve the quality of tax system as a whole and sustain long-run increase of revenue (see Junquera-Varela et al, 2017).

## PRESSING CHALLENGES

Somalia faces many tax challenges. These challenges are common in fragile and post-conflict economies but they differ the level and deepness of the problem. But not limited to, here are some of the challenges.

### Dealing with "Hard to Tax" Sectors

Because of a broad informality of the economy, most of sectors remain untaxed. In addition, Somalia is dealing with sectors that are 'hard-to-tax'. This is a common phenomenon in most of developing countries having small scale businesses, including small farmers, professionals, and state-owned enterprises but particularly where administrative capacity and compliance practices are not strong. 'Informality' is widespread in developing countries (IMF, 2011). Somalia is suffering of the high costs of informality and authorities are having difficult to tax the micro trading communities and other businesses far away of the government control.

### Poor Administration Capacity

Poor capacity of administration and governance is common, not only in the revenue but also in most of government institutions of both Somalia and other fragile countries. Lack of reform financing ability, low staff skills and manual operations are the key principles of the institutions being weak and not enough to fit the purposes of revenue administration and governance. There is no comprehensive revenue system for collection and capturing the important information of taxpayers. Although the Federal Government of Somalia took some steps toward revenue administration reforms including consolidation of other agencies' collections, modernizing the mode of tax collection and establishing Large and Medium Taxpayers Office, still these are not enough to cover the gap of administration, governance and state building aspects of the revenue side. Poor administration capacity also existed in Africa's Anglophone countries as found by (Fjeldstad & Heggstad, 2012).

### Insecurity and Political Instability

Political instability and insecurity problems are also big matters. Somalia is currently getting rid of the prolonged civil war but this can be a gradual process. Insecurity followed by political instability is the biggest threat of the state building process. The government controls only Mogadishu, the capital city, and this means that it can only manage to tax one city. Also the federal member states are controlling their capital city and around, except Puntland which is the only state controlling most of its jurisdiction. Active armed groups are controlling areas out of the government control and business communities are asked to pay again so-called tax by these armed groups. The authorities are not fully controlling the border customs, clans are fighting against in somewhere and fragility is everywhere. Together, these factors are hindering the government's strategy to fully adopt a general tax policy and implementation throughout Somalia.

### Incomplete Transition to the Federal System

There is incomplete transition to the federal system. Somalia adopted a federal system of government while all rules, regulations and laws, including the country's administration laws remained in a unitary basis. For example, the existing tax laws and regulations are based on unitary and socialist government having absolute power of political and large and medium businesses were run under state-owned enterprises and industries. The system has completely changed and currently Somalia is a non-socialist federal government and the fundamental regulations are not yet conformed to the federalism. In addition, there is no clear fiscal federalism framework. This framework could explain how the federalism applies in the economics of fiscal policy setting a clear strategy of both sides of the fiscal equation. In the revenue side it sets a clear strategy of tax collection assignment among the federal government and states, fiscal regime design and revenue sharing mechanism. In the expenditure side it sets the strategy of budgeting, transfers and managing the government spending in a transparent and accountable manner. There are some agreements between the federal government and member states on tax harmonization and revenue sharing model of the fishery and petroleum resources, but still these agreements-or in some cases memorandum of understanding MoU-cannot serve as a final reference since the foundation laws are not yet approved by the parliament such as: revenue law and petroleum law.

### Outdated Laws and Poor Enforcement

Somalia did not modernize or amend the outdated and old laws and regulations. This phenomenon exists not only in the revenue laws, but also in most of regulations such as: judiciary, finance, resources and administrative laws. On taxation side, some of laws are dated back to colonial era; some are based on the socialist and unitary ideologies where the government had an absolute power of tax regulations and enforcements. The federal government of Somalia did not make these laws go with the current environment and instead, it only set up some tax rates through budget appropriation law (World Bank, 2017). While other rates remain unchanged are practiced as it's in the Somali Tax Laws. On the other side, the government is facing difficulty in the enforcement. Although there is a fiscal police/guard, still the government cannot control out of Mogadishu and still courts need massive reforms of both technically and capacity to qualify the implementation of rules of the land. These police (fiscal police/guard) are part of the police under the commander in chief but specialized to enforce the tax and customs regulations.

**Customs-Related Problems**

There are customs-related problems which are also challenging. Fragile countries including Somalia are characterized by lack of a better and comprehensible tariff system for assessing custom duties, misclassification of goods, inadequate documentation of the process, poor border protection, lack of statistical role of the customs and some other old techniques which do not fit the purpose of both customs performances and modern trade facilitation. Somalia's customs do not have sophisticated customs systems like ASYCUDA and Harmonized System of goods classification compared to the region and also the world those are using these modern methods. It rather uses a preliminary systematic database which captures at least some important information but it's not better enough to go with the potential trade transactions and wider customs operations. In addition, the federal government controls the custom points of only Mogadishu, while Kismayo and Bosaaso are managed by the states of Jubbaland and Puntland and Berbera port is under Somaliland. Somalia is not practicing ad-valorem system of taxation; it rather applies specific unit method which is having a massive shortage or loss of revenue. The federal government of Somalia developed a common strategy roadmap for customs and states are waiting a federal level leadership of this matter. This will help improve the customs operations and process and also achieve a uniformed customs in the whole country.

## CONCLUSION, RECOMMENDATIONS AND WAY FORWARD

Somalia is a post-conflict economy which is characterized by a vulnerability of macroeconomic variables such as steady growing rate, high inflation, massive unemployment rate, deficit trade balance, lowest per capita income in the globe, high external shock with a dollarized business. The Federal Government of Somalia has been struggling to put the country out of these negative features and paid much effort in the process of state building. Fiscal and monetary sectors are the key components of the broad reform package. In the fiscal side, the government struggled to have a balanced and realistic budget. In addition, the finance ministry developed a short-medium term revenue strategy which explains the list of required tax reforms in 2017 and 2018. Despite of facing challenges and hard conditions existed, the government insisted to implement this strategy and the current success in revenue performance is the result of the strategy implementation. The study recommends to federal government of Somalia to; (1) lower the extent of economic informality, (2) build its administration capacity, (3) create a stable political and secure environment, (4) develop a strong fiscal federalism framework and (5) enhance the customs operations and develop an effective policy of trade facilitation and (6) update the tax legislations.

It's recommended to conduct any further research about Somalia's taxation including legal and tax policy, revenue administration and customs. Doing further studies will provide necessary information of about Somalia's revenue in particular and fiscal issues in general.

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