



Horn Institute for Peace and Development

The Somali Government's Budget Challenges

Policy Brief



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Introduction

Somalia's economy has faced huge problems while attempting to survive state collapse despite continuing to produce reasonable levels of output during the country's two-decade civil war. Over recent years, Somalia has been witnessing political recovery and transition is slowly underway, but still the country's economy faces new challenges.

Many investors from abroad have come to Somalia seeking investment opportunities since the country has achieved political stability and new markets have emerged, especially those concerning rebuilding infrastructures and abundant natural resources in areas such as agriculture, livestock, fisheries, gas, and oil. It is hoped that these developments will lay the groundwork for broader economic growth.

Following the transition government, Somalia has achieved full administrative government and the second pillar of the president's Six Pillar Strategy to stabilize the country is economic recovery. In line with this, Somalia aims to build a transparent, formalized, globally competitive economy that collects tax revenues.

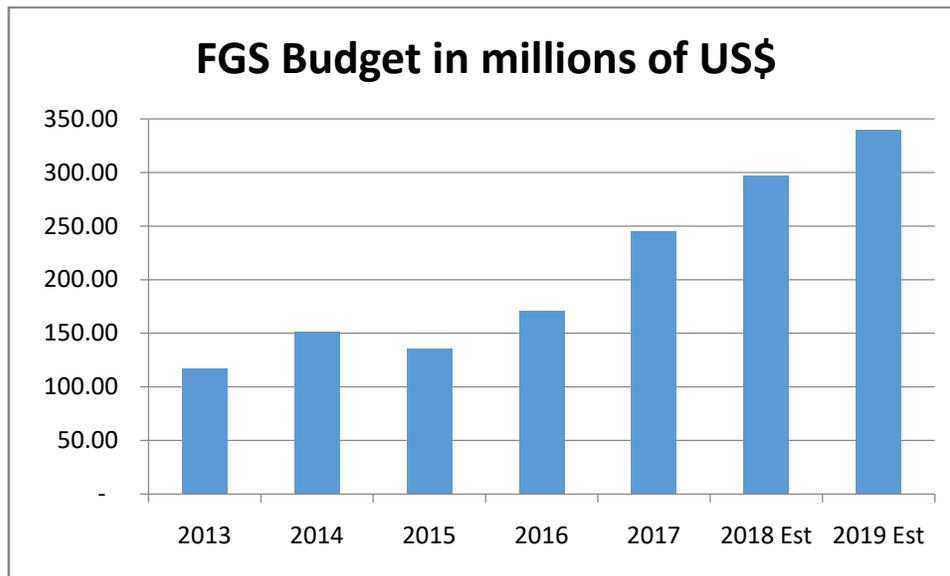
Budget Performance of the Federal Government of Somali (FGS)

A budget is a subset of a broader economic policy, which details how the government influences the economy and performs three overarching roles or functions: allocation; stabilization; and distribution. The absence of such coordinated and clear macroeconomic policy framework raises the level of uncertainty regarding the direction of the economy and thus limits the movement of capital and investments in productive sectors. A budget for an economy, therefore, is an estimation of the revenue and expenses over a specified future period. This relates to Somalia in four main ways:

1. *From US\$0 to US\$340 million budget:* Before 2012, the budgeting of Federal Government of Somalia (FGS) was not organized and even the government did not know the exact revenue or expenditure figures; every transaction was reactive, based current events rather than planned activity. Fortunately, the administration of the newly elected present in 2012 presented a four-year budget for parliamentary approval, which was first

time the government had prepared and presented to parliament a budget following the Civil War. Public expenditures have expanded almost fivefold, from US\$35.1 million in 2012 to US\$170.5 million in 2016, with budgeted figures of US\$267.4 million in 2017, US\$247 million in 2018, and US\$340 million in 2019.

2. *From unbalanced budget to balanced budget:* A balanced budget means that revenues are expected to equal expenditure. When a government plans to spend exactly what is projected, there would be neither savings nor borrowing by the government. In our practical world today, this type of budget is only theoretically possible, except for private companies or individuals. Traditionally, adjustments are made from time to time to budgets based on the budgeting goals of an economy. The FGS has tried to successfully base all planned projects on its budget and Figure 1 shows how government revenue and expenditure are very closely matched. However, although the government's budget and spending activity are closely matched, this does not mean that the government could cover all social needs or deliver all public services.
3. **Public finance management (PFM):** The FGS has attempted to improve PFM by obtaining financial support from the World Bank, the African Development Bank, the UK's Department for International Development (DFID), and the European Union (EU); the main objective of this project is "to establish and strengthen institutional capacity for the management of public funds in central finance agencies and targeted sectors, however, it is revised now as to strengthen systems of domestic revenue mobilization, expenditure control and accountability in the federal government and member of states". Meanwhile, the Cabinet of Federal Government has passed the PFM law and the lower parliament house has heard the first reading and wishes to vote on it during this term.
4. **Good execution ability:** The FGS has improved budget execution through the provision of comprehensive, reliable, timely, and accurate data for informed decision-making and transparency through the publication of reports. International donors are also cautiously optimistic about Somalia's future, where much needed groundwork has been laid for further engagement.



Note: The above figure shows that the FGS has made great changes based on previous governmental budget challenges; the budget of FGS has increased year on year since 2016, allowing the FGS to cover all its expenditure.

Budget Challenges

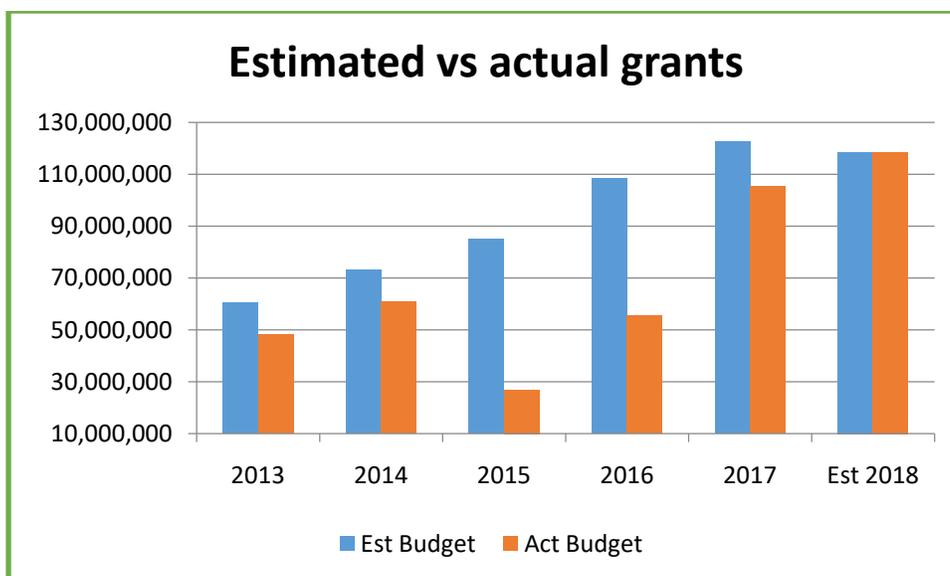
The FGS has faced numerous challenges, mostly related to strategy regarding revenue collection and improving budget management; the government wants to deliver public services in Somalia but has not created a database to facilitate the collecting of revenues from taxable sources, e.g. the commercial and agriculture sectors. Currently, the FGS is struggling with its budget management because of weak methods of revenue collection and uncollected sources of revenue, leading to it not being able to pay for public services because of budget limitations. There are many factors that affect revenue collection:

1. *Insufficient revenue:* Somalia is one of the few countries that lacks community awareness regarding tax payment. The government has faced challenges regarding tax collection because of previous long-term government instability, which has led to citizens living without taxation, e.g. property tax, income tax, etc. The FGS is unable to register all sources of commercial centers and a taxable property because of it has failed to undertake a census.

2. Many fragile countries, including Somalia, are characterized by the lack of an effective and comprehensible tariff system for assessing custom duties, leading to the misclassification of goods, inadequate documentation processes, poor border protection, and outdated customs procedures that are neither fit for customs purposes nor those of modern trade facilitation.
3. *Lack of security*: Security is another main challenge faced by the FGS's tax collection department because the FGS does not control whole country, i.e. both the capital city and its federal state members. Many tax payers do not want to pay taxes because if they give taxes to the government, they may lose their life in an attack from a militant group, leading to the government's budget shortage, since many tax payers lives in such areas.
4. *Poor administration capacity*: Public administration capacities are essential for sustainable human development in political, economic, social, and environmental contexts, particularly at three different yet interrelated levels of action. At the systems level, governance and public administration capacities are needed to design and develop institutions, processes, and policies. Capacity of the executive in priority-setting and collective decision-making is paramount for effective governance and public administration. To achieve sustainable development and effective governance, governments must keep their political capacity consistent with desired policies. For this to occur, it is crucial for government officials to know how to tap into human and material resources in their societies and use them to achieve national-level objectives. Many developing countries are hampered by inadequate or insufficient capacity to exploit these resources where they do exist. However much the systems and organizations of a society are transformed, the individuals within these structures, whether governmental or non-governmental, are still the bedrock of that society and the source of its capacity to respond to crisis. If a parliament, for example, is restructured but individual parliamentarians still believe in the appropriateness of corrupt practices, the new structure is subverted. If a new judicial system is in place but individual judges and attorneys are not deeply committed to reconciliation and justice, then the new buildings, equipment, and procedures become only a façade. For individuals to move beyond exclusionary self-interest and group interests, confusion, or incompetence, individual abilities, values, and skills must be enhanced.

Hence, institutions and organizations must support functioning public servants in becoming more professional in carrying out their duties. Further, corruption is rife in Somalia, leading to the government budget deficit, since the rule of law is not adhered to and many government officials are involved in corruption.

5. *Lack of intergovernmental budget transfers:* There has been an incomplete transition to the federal system. Somalia has adopted a federal system of government, while all rules, regulations, and laws, including the country's administrative laws have remained on a unitary basis, creating constant conflict between the FGS and its member states. This conflict leads to a budget deficit because the system is not working properly, under the full control of FGS, and there is a mismanagement of resources during this conflict.
6. *Incremental expenditure:* Ideally, governments should seek allocative efficiency under all fiscal conditions, whether the budget is growing or shrinking, whether incremental resources are available to finance additional spending or not, in poor countries and in affluent ones, and during boom times and when the economy is in distress. In all cases, the government should spend its limited resources on programs that yield the greatest social return. In fact, however, financial conditions can make a big difference in whether and how governments seek allocative efficiency through the budget. Incremental budgeting enables the government to respond to fresh demands without taking resources away from existing budget holders. Budgeting was previously a distributive, not a redistributive, process, but the FGS has not used incremental budgeting because of resource limitations and mismanagement, especially in the face of political conflict between different government elements; sometimes, government expenditure is not based on the functions of government but on the functions of political interest. This leads to budget shortages or budget deficit, meaning that the government cannot meet current expenditure costs and also that loan repayments cannot be made to those who have contributed to budget assistance for the FGS.
7. *International grants are not realistic:* The FGS has been receiving international grants from different international organizations like the World Bank, the IMF, the EU, etc. Unfortunately, these grants are not realistic because donors have not provided full grants to the FG (rather loans), which explains why the government is unable to pay for public service delivery and sometimes experiences a budget deficit (see Figure 2).



Note: This figure shows that the estimated budget is always higher than the actual budget and, because the budget of the FGS is dependent on international donors, this increases the GFS's budget deficit.

Conclusion and Recommendations

Over the past five years, Somalia has passed important milestones in rebuilding its economy and normalizing relations with international financial institutions. In 2012, Somalia emerged from nearly two decades of civil war. However, the post-war social and economic conditions remain difficult: poverty is widespread, and more than half of the working-age population is unemployed. Nominal GDP is estimated to have grown by 5 percent in 2015 and by 6 percent in 2016. As in the recent past, Somalia's GDP growth continues to be urban-based, consumption-driven, and fueled by remittances and donor support (IMF, 2017).

Currently, the Somali government's major domestic revenue sources are generated from custom duty (mainly from the port and airport of Mogadishu), Inland Revenue, and external grants/loans. The domestic revenue is very low, and Somalia relies heavily on external assistance, which mostly focuses on the social and security sectors.

Recommendations to the FGS

1. *Public-service delivery and transparency:* Increasing transparency will reduce the scope for corruption, improving public-service delivery and increasing the accountability of the government. We very strongly recommend that the FGS should improve public-service delivery because this will increase support both from citizens and international donors.
2. *Security reform:* The FGS and its member states should work together in the area of security because collecting revenue is depend on security; if revenue collectors do not have reliable security, this will affect government revenue, leading to the government no longer being able to afford its expenditure.
3. *Effective fiscal policy:* All taxation rules and regulations both for the FGS and its member states must be effectively aligned.
4. *Improve institutions and staff-capacity building in both revenue collection and spending:* Provide staff with capacity-building and skills-development training and apply international standards and rules for the revenue-collection and taxation system.
5. *Modernize revenue collection, including natural-resource revenues:* Prepare and implement a plan to modernize revenue collection at the federal, state, and local levels. Nowhere are the problems and potential of the Somali economy better exemplified than in the oil and gas industry. There are massive reserves and, even before the collapse of government, large firms were exploring the possibility of mining oil and gas. However, the lack of legislation and political wrangling at regional and national levels impeded development in this sector. The FGS and its member states should agree on resource sharing, how to follow up on early and current contract, and also consider interest from different foreign countries related to natural resources.