Fiscal federalism policy in Somalia: emerging challenges and agenda for reform

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Fiscal Federalism Policy in Somalia: Emerging Challenges and Agenda for Reform

by

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Abstract

This paper examines the development of fiscal federalism in Somalia to reveal the challenges this unique country is facing and, based on the findings, propose and agenda for reform. Interviews, direct observation, and case studies were the key tools utilized in this study. The study interviewed 12 different fiscal experts (mid-level decision-makers and technical-level experts) involved in fiscal federalism issues in Somalia, and two practitioner experts experienced in various Sub-Saharan states' fiscal policies with respect to federalism. The study also analyzed the observed situation regarding fiscal-federalism issues among the federal government and member states. Two case studies of federalism are examined, showing how Nigeria and Ethiopia fared in the process of their fiscal decentralization, functions and expenditure assignments, tax-raising power, transfer policy, natural-resources management, and revenue-sharing mechanisms.

Key-words

Challenges, fiscal, federalism, Somalia

1. Introduction

Federalism is a constitutional mechanism for governance characterized by the division of power between levels of government; therefore, every level can take defined responsibilities over specific functions (Elazar 1987). There are two main levels of government: federal (national or central) in the top level; and state (provincial or regional) in the lower level. Also, some countries, e.g. South Africa and Germany, have a third level called local government (Bulmer 2017).

The effectiveness of decentralization is linked to the extent to which responsibilities are divided in a proper manner and principles are adhered to. The political, governance, and economic responsibilities are based on sharing, rather than the completely centralized decision-making of the unitary system.

In fiscal federalism each level of government has certain powers to make economic decisions within its jurisdiction. This power comes as a result of the agreed functions assignment for decisions related to resource distribution, raising revenue, grants, subsidies, transfers, borrowing, money printing, spending on public goods and services, running public corporations, and other regulatory decisions that are essential to framing the fiscal side of the federalism. All public finance functions are carried out the tier assigned to perform that particular activity. The most important consideration is how the decisions regarding economic activities are divided among the various levels of the government (Boadway & Shah 2009). In summary, a proper allocation of roles and responsibilities at different levels of government is key to policy stabilization and the establishment of proper revenue sharing (Shah 2008).

Countries in transition, Somalia for instance, face several challenges on the road to adopting a robust model of fiscal federalism, and the implementation of the above-mentioned key elements of public finance might achieved as easily as in countries with a long federal history.

In Somalia, the term '*federal*' was relatively unheard of a few decades ago; it first officially appeared in the 2004 Transitional Federal Charter of the Transitional Federal Government (TFG) and later in the Provisional Constitution adopted in August 2012, following significant support from the international community and other stakeholders. This came about after years of conflicts, inter-community mistrust, severe political instability, and a prior history of a unitary system. Despite the formation of federal member states, however, there is no comprehensive framework for power sharing between the levels of the government. The Provisional Constitution outlines some federal responsibilities such as defense, foreign affairs, immigration, and naturalization, as well as currency, while this implies that sanitation, sewage, and road building are assigned to the municipalities. In between the two, there remains a huge gap, and the levels of the government should cooperate and discuss the role of each of them (World Bank 2015).

In general, the Provisional Constitution defines the country as 'Federal,' but the problem is that it does not define some important issues regarding different aspects of federalism, specifically fiscal federalization. It defines only currency, which is an absolute responsibly of the federal government. Currently, some states are struggling to deliver services within their jurisdiction in the face of limited capacity, while the federal government is striving to ensure security, with most other activities limited to Mogadishu (World Bank 2015).Somalia has, therefore, shifted to the federal system. Politically, several good elements have been implemented and certain functions of the government have been decentralized, while the constitutionally centralized activities are run at the federal level. Additionally, several positive measures have been agreed regarding public finance issues. However, discussions and agreements on intergovernmental relations regarding the economic and fiscal aspects of federalism have not progressed as quickly as those regarding other elements of federalism. Thus, currently, fiscal responsibilities are unclear due to several reasons. First, there are no agreed tax/expenditure assignments between levels of government. States collect all accessible taxes and fees from their jurisdictions and spend them through their budget. Their collections include business taxation and port customs, while the federal government collects revenues only from Mogadishu city, Benadir region. Second, there are no formula-based transfers to the states. The current transfers, which are mostly grants from donors, are *ad hoc* distributions. Although these are external grants, they are not derivation-based, however, as they are not based on social indicators such as size of population, level of development, poverty, etc. Rather, they are based on a discretionary decision by the federal government. These practices, if continued in the broader range of revenue sharing, including natural resources, may violate the principles of fiscal imbalances, thus creating conflicts among the levels of government. To date, resource-sharing mechanisms have been agreed only for petroleum and fishery resources by the federal government, all states, and Benadir region, excluding Somaliland. Various principles of decentralization have been implemented in recent years, but fully-fledged decentralization has yet to implemented as the country is still in a transitional period. However, there are current efforts to amend the unitary-based laws enacted prior to the adoption of federalism. The amendments are required following a call from the ministry of constitutional affairs for all policies, laws, and regulations to conform, in consultation with stakeholders, to the federal system. This paper aims to study recent developments regarding fiscal federalism in Somalia, detailing pressing challenges and recommending possible solutions.

2. Literature and Theoretical Framework of Fiscal Federalism

2.1. Definition of Fiscal Federalism

Fiscal federalism is the scope and structure in which different government tiers define and share their responsibilities, functions, and the allocation of resources among them relative to functions (Ewetan 2012). It is the mechanism by which government functions and resources are distributed among national and sub-national governments through agreement on revenue assignment, expenditure responsibility, and fiscal equalization.

Fiscal federalism is defined as a way to divide fiscal decision-making power across multi-leveled governments (Tanzi 1996). Many countries have adopted fiscal federalism as a means to improving public-sector efficiency. It is mostly related to fiscal policy, including the distribution of functions and powers between the federal government and sub-national governments (Moges 2003).

2.2. Theoretical Framework

Theories are important elements in studying this field as they provide explanations and predictions for specific cases or phenomena. How similarly or differently the principles and pillars of fiscal federalism are practiced in Somalia is highlighted using the following two theories of fiscal federalism.

2.2.1. First Generation Theory (FGT) of Fiscal Federalism

The first-generation theory (FGT) of fiscal federalism, also known as the traditional theory of fiscal federalism, was developed by two economists named Musgrave and Oates (Musgrave & Peacock 1958; Oates 1972). This theory focuses on the assignment of fiscal responsibilities among different levels of a federal government and public-sector functions (Oates 1998). Oates (1998) emphasized that the basic theory of fiscal federalism lays down the framework for assigning functions for various government levels. It concerns understanding what functions and instruments are best centralized and decentralized, while highlighting revenue and expenditure assignments in order to improve communities' well-being, based on the three core government functions of resource allocation, income distribution, and macroeconomic stabilization (Musgrave & Peacock 1958).

General services and goods should be provided by the central government, while local goods should be provided by the lower-level governments. In fact, distribution and stabilization functions should be conducted and coordinated by the federal government. This theory is applicable to most countries, even if the country is not federal. However, this theory has been criticized for several reasons, including providing limited opportunities for checks and balances among the layers of government, and ignoring the preferences of local citizens (Musgrave & Musgrave 1984).

This theory may or may not work in Somalia, depending on how the federal government of Somalia tries to adopt it. However, some scholars have attempted to modify the traditional or FGT of fiscal federalism. They have developed a theory that incorporates checks and balances within the concept of fiscal responsibility in federal countries, while giving core local functions to the lower-level authorities. Checks and balances support emerging federal countries in learning and making corrections as they gradually implement principles in an iterative manner.

2.2.2. Second Generation Theory (SGT) of Fiscal Federalism

Significant modernization efforts have been undertaken to improve the FGT, or the traditional theory of fiscal federalism, encompassing both the core benefits and motivations of fiscal federalism. These modifications have been made both by economists and political scientists to ultimately develop the SGT of fiscal federalism. It combines two respected recent theories (Oates 2005). First, Hayek (1945) proposed that local governments have more knowledge about their societies' preferences, so they are in a better position to provide and deliver the public goods and services, respectively, and should therefore take on the responsibility of providing them. Second, citizens, through local elections, put pressure on local governments to better respond to local needs and desires (Tiebout 1956).

This theory encourages local authorities to be empowered to efficiently deliver local services, while the central governments have a more limited role, including macroeconomic management, market regulation, and developing national policies (Feng et al. 2013). Oates (2005) noted that the SGT's key contribution is that it focuses on more recent theories regarding contemporary political economy and intergovernmental arrangements.

This prioritizes sub-national governments and encourages the national-level authorities to delegate the delivery of public services and goods to sub-national governments, which are closer to the communities they serve. It also emphasizes the gains in efficiency that can be made by adopting this approach. This conforms with article 50 of Somalia's constitution, which states that 'Power is given to the level of government where it is likely to be most effectively exercised.' Functionalizing this theory may allow for the possibility having constitutionally enacted principles with a theoretically framed decentralization of Somalia's public finances.

2.3. Prior Studies

Federal countries vary in the magnitude of the provision of public goods and services across levels of the government, and this is reflected in the extent of their spending power. These differences in expenditure across the levels of government reflect the allocation of responsibilities: government levels to which the most responsibilities are allocated will have a larger share of the expenditures for the delivery of goods and services. Usually, financing the public services of fiscal affairs, external affairs, national defense, and social protection lies at the federal level, while states, since they have the knowledge of local demands and preferences, provide local services, including education, safety, protection, housing, and transport. The above has been verified by Virkola (2014) in his study of fiscal federalism in Canada, Germany, Switzerland, and the US.

There are different approaches to assigning revenues to sub-national governments, and these approaches vary in the degree of fiscal autonomy granted. The four main aspects to consider in revenue assignment are: tax base; tax rates; who collects the taxes; and revenue administration (Martinez-Vazquez et al. 2006).

One approach, when sub-national governments have more fiscal autonomy, involves sub-national governments having the power to define the tax base and set rates, impose taxes, and administer the revenue under their jurisdiction. This, however, can lead to inconsistency, duplication of work, administrative complexity, economic biases, and tax competition among the provinces, owing to different jurisdictions imposing different taxes and rates and following different administrative methods. This approach is used by many countries, including Canada, Switzerland, and the US. In Somalia, individual states (sub-national governments) have full autonomy in setting the tax base and rates, as well as administration. There is, however, is tax harmonization bill currently being considered in parliament and awaiting legitimization, meaning that all revenues would be uniform.

A second approach is known as sub-national surcharges. Here, the federal government defines the tax base and collects its own tax, including surcharges set by sub-national governments. It prevents regions from defining the tax base in contradictory ways, setting different tax rates, and hindering business mobility across the regions. Thus, it maintains uniformity and avoids duplication of work.

A third approach, the tax-sharing approach, is perhaps not as attractive as the first two approaches. It involves sub-national governments receiving fixed fractions of specific federal-government revenues. The shared rates are mostly equal across the individual states. Therefore, this approach limits the fiscal autonomy of the regions, creating an imbalance between revenues and expenditure burden (Martinez-Vazquez et al. 2006).

According to Chandra (2012), expenditure determines revenue. As a result, the above theoretical frameworks give the federal government the ultimate authority in economic stabilization, income redistribution, and delivery of the national demand for goods and services. Similarly, Musgrave & Musgrave (1984) suggested that the federal government collect taxes related to policies for stabilization, redistribution, or taxes on mobile goods, while other taxes can be collected by regional governments.

Notably, fiscal imbalances can come about for various reasons. First, federal governments have more taxing power and relatively fewer expenditure responsibilities, while sub-national governments have less taxing power and more spending functions. This leads to sub-national governments being unable to finance their own responsibilities from their own revenue sources (Winer & Hettich 2010; Shah & Anwar 1991). Second, according to Chandra (2012) and Shah (1991), fiscal imbalance may also arise from horizontal fiscal imbalance (HFI), which occurs when some sub-national governments have more natural resources or tax revenue than others. Third, fiscal imbalances may arise from expenditure needs. Some states may have unusual spending needs due to having a greater proportion of poverty, their geographical characteristics, and/or their population density, thus resulting in a gap between the fiscal capacity and fiscal need.

Obviously, fiscal imbalance in its various guises is a challenge for most federal governments. Under these circumstances, when the federal government preserves key tax bases and sources, leaving inadequate fiscal means to sub-national governments to cover their expenditure needs, a fiscal gap can occur (Shah 1991). Intergovernmental transfers and revenue sharing are the two most important components of fiscal federalism where the central government uses as balancing instrument to cover deficits, either horizontal or vertical (Chandra 2012).

Furthermore, based on the study of Chandra (2012), intergovernmental transfers and revenue sharing are also two important components of fiscal federalism. In most countries, the federal government preserves the key tax bases and sources, leaving inadequate fiscal means for sub-national governments to cover their expenditure needs, potentially resulting in fiscal imbalance. The federal government can use such transfers to restore fiscal balance. Fiscal-federalism and public-finance experts have broadly grouped these transfers into the following two groups: specific-purpose transfers (conditional transfers); and general-purpose transfers (unconditional transfers). In specific-purpose transfers, the federal government identifies the purpose for which the beneficiary state requires funding. Such grants are usually spent on specific issues that are a priority for the federal government. In general-purpose transfers, meanwhile, the recipient states do not have any specific limitations or conditions over their spending. The main purpose of such grants is to ensure the minimum provision of public services and equalization between federal members states (Chandra 2012).

2.4. Fiscal Federalism in the Context of Somalia

As reflected in the Provisional Constitution, Somalia shifted from a unitary system of government to a federal state after the collapse of Siyad Barre's dictatorship and years of political, as well as social, struggle. The constitution clearly defines the legality of the federal system and the existence of different layers of government:

> Article 48:
> 1. In the Federal Republic of Somalia, the state is composed of two levels of government:
> (a) The Federal Government Level;
> (b) The Federal Member States Level, which is comprised of the Federal Member State government, and the local governments.

In the above statement, we understand that local governments operate under the member states. The constitution also describes that service delivery and revenue collection is given to the most appropriate level of government and that federalism is built upon several principles, including 'a fair distribution.' Nonetheless, regarding monetary policy regulations, the Central Bank of Somalia independently enjoys the power to fulfill its national duties of formulating and implementing financial and monetary policies, including currency printing, inflation control, stabilization of exchange rates, and the establishment of a banking system. In short, the Central Bank of Somalia is the national reserve of the whole country, constitutionally speaking.

Although the country has adopted the federal system, power is yet to be fully divided among states and the federal government, owing to the constitution being incomplete. Thus, as the constitution suggests, discussions and negotiations among the different levels of government, elites, and other politicians are required. Governmental revenue collection is one of the powers that remains undivided, including taxes, natural resources, and customs. Additionally, the revenue-harmonization and public-financial-management bills, which have yet to be approved by the parliament, suggest that revenue-raising power and the collection of natural resources should be under the control of the federal government of Somalia. After negotiations, other agreements have been made, including the revenue-sharing mechanism for petroleum resources and the signing of the memorandum of understanding (MoU) regarding the management of fishery resources and licensing (Isak 2018; Mohamud & Isak 2019).

All things considered, establishing a comprehensive fiscal federalism is the only way in which the public sector can actively perform its duties. This requires different levels of government to agree on responsibilities, revenue and expenditure assignment, revenue sharing, intergovernmental transfer, and fiscal equalization. Currently, the principles and instruments of intergovernmental fiscal arrangements are properly harmonized, and things are working as planned by default, with each level of government collecting accessible revenues under its jurisdiction.

Areas that still require much more discussion and negotiation by the different levels of government are:

- *Public goods-and-services delivery and expenditure responsibilities relative to the functions assignments*. Although there is a preliminary agreement among the ministries of finance at the national and sub-national levels, a consensus among all government authorities regarding spending guidelines is still required.
- *Revenue-raising and tax-collection powers of each level of government.* This is, however, provided for in the revenue-harmonization bill that is currently before the parliament, although significant further discussion is required.
- *Revenue-sharing mechanism for business taxes and customs*. The fishery, petroleum, and mineral-resources revenue-sharing mechanisms have been agreed in different meetings by the respective authorities.
- *A sound formula-based transfer policy.* This will address what style of intergovernmental fiscal transfer Somalia will practice and how it is implemented. Some good elements have been agreed at the ministerial level but the policy-related medium- to long-term factors are still absent.

Bauer et al. (2018) proposed, for several reasons, that the federal government should manage natural resources and other revenues. First, revenue and natural-resources management by states can hinder a coherent, countrywide fiscal-regime design and economic policy. Second, it can lead to inequalities between states, i.e. some are resource-rich states while others have less resources. For instance, some states in Brazil, like Rio de Janeiro, Espirito, and Sao Paolo, generate a lot of revenues compared to the other states in the country, leading to fiscal capacity differences among states. Ultimately, the federal government of Brazil had to intervene to resolve the issue. Such issues might not happen if the federal government effectively manages fiscal affairs (Bauer et al. 2018).

Bauer et al. (2016) conducted a study of resource governance and revenue-sharing mechanisms that examined more than 30 countries. Although countries use different approaches to managing and sharing resources, the federal government usually collects all revenues from different resources before transferring back to sub-national governments. This is called a derivation-based approach and is used by many counties, e.g. Angola, Bolivia, Brazil, Cameroon, Canada (some states), Chad, China, Colombia, the Democratic Republic of the Congo (DRC), Ecuador, Ethiopia, Ghana, Guinea, India, Indonesia, Iraq, Italy, Kyrgyzstan, Madagascar, Malaysia, Mexico, Mongolia, Niger, Nigeria, Papua New Guinea, Peru, the Philippines, South Sudan, the US (some states), and Venezuela.

Several other countries, however, use indicator-based transfer, in which revenue is shared based on indicators, such as population, revenue generation, poverty level, and geographical characteristics (e.g. remoteness), regardless of which region the revenues originate from. Ecuador, Mongolia, and Mexico use this approach.

Uniquely, the US and Canada give substantial rights to provinces to collect taxes from extraction operations, which constitute a major proportion of local budgets. In this case, these states do not require being given transfers, since they are directly collecting their share as a tax (Bauer et al. 2016).

Moreover, countries like Nigeria, Uganda, and Mongolia use a mixture of indicator-based and derivation-based approaches, where a percentage of oil and gas revenue is allocated based on the place of origin, while the rest is distributed according to social indicators of such as population, revenue generation, poverty level, and geographical characteristics.

Finally, Kazakhstan uses *ad hoc* transfers in two regions rich in natural resources: Atyrau; and Mangistau. These transfers are built upon political agreements made each year rather than a law that clearly defines the share of every government of the natural-resource revenues.

In summary, formula-based allocations (derivation- and indicator-based) are more stable and predictable than *ad hoc* transfers.

2.5. The Case of Benadir Regional Administration

Benadir is the region that contains Mogadishu, the capital city of Somalia. Its status in the federal system is yet to be defined by the parliament, to which the constitution has given absolute authority in this matter. However, there are some on-going efforts to define the status of the region according to Benadir's wishes. The decision regarding the capital city either being federally administered or having the rights of member statehood is yet to be agreed. Presently, Benadir is directly administered by the federal government. All kinds of revenues are managed by the federal government; specifically, the ministry of finance. These revenues are income tax, sales tax, customs, stamp duties or registration taxes, and other fees on public goods and services. With the exception of certain taxes, the Mogadishu municipality collects property tax, and different kinds of permits and license fees, as well as very low-level collections with regard to small markets and hygienic issues. As a result, the federal government gives 15% of the customs revenue to the Benadir regional administration, which can be defined as unconditional transfers. It is a derivation-based revenue-sharing approach by which Mogadishu is compensated as being the source of that revenue. Also, Benadir is among the recipients of conditional transfers given by the federal government of Somalia. These funds are mostly from the World Bank, the European Union, and other donors' budgetary supports to Somalia. The conditions for these funds come from either the federal government or the donor, although grants are given in their entirety to the federal government of Somalia to keep the country's systems running and to pay the salaries of civil servants, teachers, and army forces. The fact that the case of Benadir is separately presented highlights that it's political status differs than that of other fully-fledged states, being more under the full control of the federal government than other states; therefore, the public-finance aspects of this regional administration are unique in Somalia.

2.6. Other States

There are five federal member states in Somalia: Jubbaland; South West; Hirshabelle; Galmudug; and Puntland. Ongoing discussion since decentralization has led to these states agreeing some politically related factors with the federal government but, regarding tax, there are no legally defined or agreed methods of tax collection, tax base, or administration between the federal government and member states. By default, every state collects what it is able to collect within its territory. Legally, every municipal government is allowed to collect some revenue, the same as Mogadishu's local government, but currently the states are taking full control of this role, and there is no collection authority lower than a state. Not only revenue collections, but also other instruments are not yet clear, and sub-national governments tend to provide public services to as limited a degree as possible to municipal governments from the budget of their own revenue sources; some of the fiscal gap is covered by intergovernmental transfers and grants from the federal government and donors. There is an agreement on expenditure assignment guidelines, but the responsibilities are not fully divided among levels of government.

Federal member states, like Benadir, receive transfers from the federal government of Somalia. They are made up of unconditional as well as conditional grants. Most of these grants are used for the salaries of civil servants, police forces, and other governance needs.

3. Methodology

This study's methodology for data collection is mixed and made up of three instruments, namely: interviews; observations; and case studies.

For the interviews, the study questioned 12 experts working for the ministries of finance of the federal government of Somalia and of federal member states, and the finance department of Benadir's Regional Administration. Why these representatives were chosen is based on the fact that their government agencies are directly involved in the fiscal issues of federalism, and they are members of intergovernmental fiscal forum committees entitled to continue negotiations regarding fiscal federalism until alternative measures are fully agreed by all. This study sought the views of technical mid-management and decision-makers for two reasons. First, the authors were not able to reach the policy makers – the ministers – due to limited accessibility to their offices. The second and most important reason is that technical and administrative views always have higher probability of realism than politicians' views; technocrats tend to identify the real problems and facts.

Direct observation is another research instrument that the study used, since the researchers have good knowledge of the fiscal-federalism process. They witnessed, and had an opportunity to be involved in, the fiscal responsibilities of the federal ministry of finance.

Finally, the study has utilized two case studies, from Ethiopia and Nigeria, to draw conclusions from the analysis on these countries' fiscal federalism, specifically regarding their principles, division of assignments, and existing challenges.

3.1. Case studies

The study used case-study countries whose federalism establishment can be good example to Somalia: Nigeria; and Ethiopia.

3.1.1. The Case of Nigeria

Historically, Nigeria's fiscal federalism dates back to 1940s, and many legal definitions have been used to describe and modify the intergovernmental fiscal relations among the governments. These legal documents have been issued by commissions, legislatives, decrees, and the Supreme Court (Egwaikhide et al. 2009).

The federal government exclusively looks after some high-level responsibilities: defense; foreign affairs; police and security; higher-level elections; passports and citizenship; telecommunications regulation; railways; currency and banks; taxation of income, profits, and capital gains; mines and minerals; copyright; aviation; and trade and commerce. States and federal governments share some responsibilities for health, social welfare, post-secondary education, culture, electricity, statistics, industry, research, and technology, while sewage disposal, sanitation, road maintenance, primary education, and market stalls are solely under the control of the sub-national governments (Bin 2011; Nigeria National Assembly 1999).

In Nigeria, it is clearly agreed and enacted that major sources of revenues (such as petroleum and mining revenue, royalties, corporate profit tax, customs duties, excise duties, and income taxes) lie under federal jurisdiction management, while others lie under the sub-national governments, including local government (Orji 2008).

Nigeria's revenue flows go to a federation account, which serves as a central treasury to the three levels of the government, which are federal, state, and local. These revenues are allocated and distributed to the different tiers of the government in two ways: vertical allocation; and horizontal allocation. Vertical allocation sets the percentage of revenues to be allocated to each different government tier, i.e. one federal government, 36 states, and 774 local governments. It covers and applies to all revenues in the federation account over a given period of time (Orji 2008). Horizontal allocation is a set of formulae for intra-tier sharing among the states and local governments. It can be broken down into two allocative instruments: derivation-based; and formula-based. The derivation method is based on giving a certain portion of the revenue back to the place of origin, while formula-based sharing considers certain socioeconomic indicators, such as population, poverty, landmass, access to water, health, educations, etc. (National Bureau of Statistics [Nigeria] 2017).

3.1.2. The Case of Ethiopia

Historically, Ethiopia's system of government has been centralized and most fiscal power and related decision-making has been concentrated at the center (Moges 2003). The 1995 constitution declared Ethiopia a federal republic. Several larger communities were selected to ethnically establish their federal regions, and this paved the way for other smaller communities to be utilized to alleviate potential problems regarding misunderstanding with their other ethnic counterparts. However, the government at this time had to enforce this kind of federalism on the communities chosen (Bezabih 2016).

In Ethiopia, the functions assignment is constitutionally defined. The federal government exclusively runs foreign affairs, defense, federal police, public security, overall economic and social policies and food security, fiscal and monetary policies, foreign-direct-investment policies, industry and commerce, natural resource management, air and water, transport, national health standards, education, science and technology, interstate roads, railways and highways, collecting federal taxes, and nationality and immigration responsibilities. States work on ensuring democratic order based on the rule of law, socioeconomic-development policies at the state level, maintaining rural roads, managing state-level taxes, land conservation, and implementing federal policies, laws, and policies, while local governments maintain water, sewerage, and fire protection (Negussie 2016).

Regarding tax assignment, there are three levels: federal; state; and shared. The federal level collects custom duties, personal income tax on federal and international organizations' employees, profit tax, sales, taxes on the income of air, rail, and sea transport services, tax on rental of houses and properties owned by the federal government, federal stamp duties and tax on monopolies, and collecting fees and charges related to licenses issued and services rendered by the federal government. States collect personal income tax collected from state employees and private enterprises, rural land-use fees and tax on income of private farmers and cooperative associations, profit and sales tax on individual traders, tax on income from inland water transportation, taxes on income derived from rent of houses and other properties in the state owned by state or others, income, profit, sales, and excise taxes on enterprises owned by the states, and royalties for the use of forest resources.

Although collections are made at the federal level, the following taxes are shared: profit, sales, excise, and income taxes levied on enterprises jointly established by the federal and state governments; profit, sales, and excise taxes on companies; tax on dividends due to shareholders; and profit tax and royalties on large-scale mining and all petroleum and gas operations (Negussie 2016).

4. Results

Interviews, direct observation, and case studies were key tools utilized in this study. The study interviewed 12 different fiscal experts who are mid-level decision-makers and technical-level experts involved in fiscal federalism issues in Somalia, encompassing the federal government of Somalia and all federal member states (Galmudug, South West, Jubbaland, Hirshabelle, Puntland) and Benadir Regional Administration. The Somaliland's ministry of finance was not reachable due to political reasons. The study interviewed two practitioner experts who have experience on various sub-Saharan states' fiscal policies with respect to federalism. The study also analyzed the observed situation regarding fiscal-federalism issues among the federal government and member states.

The research results are based on current ongoing efforts and meeting minutes of previous intergovernmental fiscal federalism forums. Finally, two case studies of federalism were examined in the study. The objective the case studies was to show how Nigeria and Ethiopia fared in the process their fiscal decentralization, functions and expenditure assignments, tax-raising power, transfer policy, natural-resources management, and revenue-sharing mechanisms.

4.1. Current Status

The interviews, observations, and case-study results highlighted the issues in Somalia described in the following sub-sections.

4.1.1. The Levels of Government

The constitution states that the country will have three levels of government: federal; state; and local government or municipality. However, based on the interview results and the case-study analysis, current practices and facts indicate that the roles of local governments are in fact taken over by states, which act as the sole authority from state level to the district level. The existing competition for power is only between the federal government and member states. There is no state-versus-municipality delegation or negotiation of power, and this has led to fundamental federalism features being ignored, and hence the absence of fiscal checks and balances in the lower level. There are state–municipal disputes over functions and responsibilities in some emerging countries, but it is different in Somalia, where municipalities are in the pre-existence phase, except for Mogadishu, which is the only active local government fully working.

4.1.2. Functions and Expenditure Assignment

There are some preliminarily agreed guidelines on functions and expenditure assignments, in addition to four constitutionally defined areas that are the exclusive responsibility of the federal government: national defense; citizenship and immigration; foreign affairs; and monetary policy. All other functions of governance are subject to discussion among levels of the government, as described by the Provisional Constitution. Currently, member states and Benadir region provide services under their own jurisdiction and finance them through the accessible revenues collected in their territory. The lack of assignment description was not a barrier for them in providing capable services. Recent examples include Benadir Regional Administration and Puntland State, whose provision of government services to their citizens has been successful. The ministers of finance of the federal government and member states agreed expenditure guidelines in their Addis Ababa meeting in September 2019. This will pave the way for future acceleration in resolving fiscal federalism issues in all their aspects.

4.1.3. Revenue Collection and Policy

Somalia has not yet established a framework for revenue collection, administration, or setting the policy for taxation; it remains a work in progress. The federal government agreed with member states some instruments, including harmonization of sin tax rates covering various products imported to Somalia. The harmonization of sin taxes included increasing tax rates for tobacco and Khat, aimed at restricting the demand from young people for drug consumption rather than increasing revenue. Going forward, there are planned customs reforms that will be expanded to Kismayo (Jubbaland State) and Bosaso (Puntland State), which is the one of the foundations for unifying nation-wide customs control. Despite these agreements, the remaining works are much harder; some critical assignments on taxation have yet to be discussed. Questions still remain to be answered regarding: who collects what; whether there will be one revenue administration channel (Revenue Authority) or whether every government level will collect taxes in its own way; and whether revenue sharing (of business taxations) will be based on the tax type's collection for each government or whether funds will be deposited to a National Reserve (constitutionally defined) and then distributed and transferred to governments. In conclusion, tax regimes are not sufficiently harmonized.

4.1.4. Intergovernmental Transfers

Current federal government transfers to sub-national governments are made on an *ad hoc* basis and are very small in number compared to actual needs. Currently, there three kinds of transfers. The first is a conditional grant given equally to all states and Benadir region. These grants are only spent on certain areas agreed by the government, such as health, education, and civil-service staff salaries. The second is general transfers, which do not have any conditions regarding what they are to be spent on. The first two transfers are grants that the country receives from donors and are given, on *ad hoc* basis, equally to all sub-national governments, including Benadir region (the capital city). The third kind of intergovernmental transfer is different from the previous two because the source of revenue is domestic. It is a portion of domestic tax revenues that the federal government transfers back to the originating city, which is Mogadishu. The federal ministry of finance gives 15% of customs revenue back to the Benadir Regional Administration.

4.1.5. Natural-resources Revenue Sharing and Management

The revenue-sharing mechanism is another important fiscal instrument of federalism. The federal and state governments have agreed on petroleum- and fishery-revenue sharing after concluding a MoU. The MoU explains that the management of these resources and collection of revenue is performed by the federal authorities, and sharing is based on this agreement. However, these agreements cannot be regarded as the final legal reference for natural resources, but rather only as a preliminary proposal for anticipated constitutional changes. Despite these improvements, several key questions still need to be addressed. For example, to date, no discussions have been held regarding the sharing of revenues from taxes and customs, or higher-level licensing fees, including telecommunications, overflight fees, etc.

4.2. Challenges

Based on the results from above analysis, these following challenges emerge.

4.2.1. Political and Security Instability

These two factors are common in Somalia. This fragility has cost Somalia much more than most other countries in the world, based on: insecurity and political instability in the country following the former government's collapse in 1991; the existence of active armed groups fighting against the government; prolonged fighting among different societies/communities; and fighting over resources among clans. The federal government controls only the capital city and its environs, while most of the states are similar in this respect (controlling their regional capitals and other limited areas), except for Puntland, which has control of most of its area of jurisdiction, and Somaliland, which is under special treatment currently. Isak (2018) revealed that these two factors challenge sources of revenue collections for the country.

4.2.2. Low Understanding Related to Federalism

Society at large, as well as many politicians, do not yet have a good understanding of federalism. Federalism has different features compared to a unitary system, most of which have not yet been fully understood. Many laws still remain unchanged from their unitary perspective, political representations are still based on a clan basis, and various social connections are still considered as having a higher value than state building. This lack of understanding regarding federalism is a hugely challenging factor (Ali et al. 2019).

4.2.3. Constitution-related Challenges

The constitution set out only four national-level functions, which are responsibilities of the foreign ministry, Immigration and Naturalization Directorate, the central bank, and the national army. Notably (and unfortunately), this leaves all other functions subject to negotiation. Further, some pre-federalism constitutions for regional administration violate the current provisional constitution. For example, the Puntland state constitution enables the head of state to conclude agreements with foreign countries and print currency notes; this has been in practice in recent times. This tends to create economic balkanization when member states negotiate concessions and infrastructure contracts individually, without national-level involvement. Somalia is also a case that is very different to other countries, with issues still to be resolved regarding Somaliland, Mogadishu's status (the capital city), and the fact that the constitution is provisional and has not yet been subject to a public referendum. All these factors highlight the existence of constitutionally related challenges.

4.2.4. Attempting to solve all the issues at once

Since the federal government of Somalia is leading the efforts for fiscal decentralization, there are some signs indicating that the government wants to resolve all outstanding issues at the same time. Currently, each government agency does not have a viable infrastructure to solve related issues with counterpart sub-national agencies because of technical deficiencies, weak institutional capacity, insecurity, and lack of funding. In addition, trying to solve at one point in time and agree on all instruments (such as tax assignment among the ministries of finance, functions and expenditure responsibilities among all government agencies, revenue sharing and transfer policy) will likely lead to these individual issues not being properly resolved. Bundling them all together at once does not make things easier; a more gradual, step-by-step approach may be more successful.

4.2.5. Tensions and Mistrust among Levels of Government

There are political misunderstandings and mistrust between federal and member states. This has interrupted the ongoing efforts to decentralize some important instruments of federalism. Some fiscal forum negotiations have been postponed, several high-level meetings have been disrupted, and one state refused to be part of the initiative for unified national secondary examination by the federal ministry of education. It has also led to several heads of state meeting with international communities and blaming the federal government. In summary, this tension, misunderstanding, and mistrust has hindered the ongoing process of building the pillars of federalism.

4.2.6. Weak Institutional Capacity

The national government institutions, as well as sub-national institutions, have been established in the last seven years, following prolonged civil unrest in the country. In addition to this, government personnel in both levels have not been equipped with the required skills to speed up state building in general and federalism in particular. These weaknesses, together with the scarcity of resources, make performing the necessary duties to fiscally build the nation extremely difficult.

5. Conclusion

In general, Somalia has been making economic progress, including GDP, economic policy reforms, advanced farming, reconnection with international organizations such as the World Bank and International Monetary Fund (IMF), and reconstruction of infrastructure. For instance, as of August 2019, there is an ongoing highway reconstruction that links Mogadishu to the neighboring regions of Lower and Middle Shabelle. On top of that, there are untapped and newly discovered offshore resources in Somalia including tuna, oil, and gas. Therefore, the country requires far-sighted leaders, inclusive governance, and effective (as well as a mutual) agreement between all stakeholders.

Meanwhile, most Somalis (in their different groups) do pay attention to the revenue-sharing ratio. This has undeniably led to mistrust between clan elders, the federal government, and some federal member states. In an effort to counteract this, there was a MoU signed by presidents of all levels of the government in Baydhabo, June 2018. This MoU explains the revenue-sharing ratio, but it is yet to be accepted by some federal member states, e.g. Puntland state.

In short, the decentralization of the federal system to the lowest level – the creation of independent local governments – is vital and inescapable. Until this is achieved, there will be a significant challenge to continued prosperity. Also, the MoU requires approval by the parliament in order to become a policy. In summary, Somalia requires a comprehensive and legitimate solution to the existing fiscal problems for the whole country if genuine and long-lasting progress is to be made.

5.1. Recommendations

Based on the previous discussions and findings, the present study recommends:

- Fostering discussions between the federal government and federal member states, as encouraged by the constitution. This will lay down the foundations of fiscal-federalism principles and instruments. Also, it is highly recommended to strengthen the capacity of sub-national governments (both institutionally and in terms of personnel) to enable them to fully exercise the responsibilities within their jurisdiction.
- A clear assignment of functions, revenue sharing, and expenditure responsibilities among the national and sub-national governments. This should be based on the likelihood of effectively performing these duties and on which assigned level of government is most closely related to the affected section of society.
- In setting policies related to the division of work, expenditure powers, tax assignment, resources management, and revenue sharing, it is highly recommended that legally sound and analytically analyzed policies are set out that are built upon expertise and take lessons from the failures and successes of federalism in other countries.
- The agreed principles are recommended to be set down in a high-level legal source such as the constitution. Somalia has been experiencing many disputes regarding previously agreed principles that were set out either in intergovernmental agreements or MoUs. Putting these principles into a low-level framework would make it vulnerable to repeated disputes. Ethiopia and Nigeria are examples of setting out the division of powers and functions of the national government in the constitution.
- To maintain the principles of public financial management in general, and transparency and accountability in particular, the terms of agreement must also be fulfilled, as this will extend the possibility of sustaining agreed principles, while also encouraging the continued solving of issues in discussion forums.

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