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Rebuilding the Fiscal Capacity in Post-conflict Somalia: A Critical Review of Public Financial Reforms and Governance Challenges

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Abstract

Somalia is a fragile economy in which conflicts have impeded the country's overall economic performance and fiscal capacity after the fall of the central government in 1991. With an objective to study the fiscal capacity of Somalia including reforms in taxation, spending and challenges, this study utilised the available fiscal data from 2012 to 2021, with a little preview of historical fiscal data where it makes a meaning. Furthermore, reviewing literature and interviewing fiscal experts were additionally utilised to support the descriptive data. The mixed methodology was employed to capture the depth of contemporary revenue collection and expenditure management, challenges of fiscal reforms and key policy areas to address.

The study finds that the government has made remarkable progress towards rebuilding fiscal policy, but mostly in Mogadishu, in the last decade. This progress includes revenue mobilisation, public financial management reforms, execution of the budgets, and auditing financial governance. However, many areas of the country's fiscal policy still remain weak and fragile as chronic security challenges hinder the reach of many parts of the country for revenue collection. To strengthen these weaknesses, the study makes several policy recommendations – also applicable to other post-conflict economies with similar situations – to strengthen the foundation of the fiscal sector in Somalia.

Keywords: *Fiscal capacity, Expenditure, Fiscal policy, Fragile state, Public finance, Somalia, Taxation.*

1. Introduction

Fiscal capacity provides explanation of how a state is economically and politically strong. Delivery of services also depends on tapping and management of fiscal resources available to the state (IMF, 2017b). Besley and Mueller (2021) add that state collective capacity matters equally important to the fiscal capacity. Furthermore, fragility challenges most of the conflict-affected countries including Somalia, Afghanistan, Libya, Syria, etc. In those countries, the state capacity to extract revenues and finance services delivery is impeded by insecurity, political instability and weak public sector legitimacy.

Hence, how strong is the fiscal capacity of Somalia? This question remains a centre of debate to researchers and policy analysts in public, academics and international financial institutions. The question feeds the presence of importance of studying fiscal capacity as a proxy of state and institutional capacity in extracting revenue and delivering public services in Somalia. Cloutier, Hassan, Isser and Raballand (2022) further explain that strengthening Somalia's fiscal space and funding social development is key to improving the social contract.

Fiscal capacity of fragile countries has been studied. However, the fiscal capacity of Somalia remains unexplored. Although there are several taxation studies, only periodic reports (IMF, 2017-2020; World Bank, 2017-2020) have very briefly addressed the public finance situation of the country, while others (Isak & Ali, 2019; World Bank, 2015) briefly showed fiscal federalism. Missing a detailed empirical study on Somalia's fiscal capacity, this paper studies the contemporary fiscal capacity of Somalia. Additionally, it presents a brief historical perspective of Somalia's fiscal policy situation where it helps to draw attention of a reform or weakness. The paper also provides insights into the existing challenges as it puts forward policy areas to be focused.

The study uses mixed methodology. First, it utilises the available fiscal data of 10 years covering 2012 to 2021[1] of the Federal Government of Somalia and 2019 of federal member states. This is to analyse the revenue and expenditure, as well as to show the extent to which fiscal status has improved. The study also shows the current status of the available fiscal indicators to explain the structure of taxes and expenditure, capacity of the state tax extraction, dependency on aid, and spending schemes of the Federal Government of Somalia. A snapshot of historical data of selected years from the colonial time to 1990 is used to show a trend where appropriate.

Secondly, a review of the literature and information gained through interviewing six fiscal experts is used to draw a historical perspective and contemporary financial practices that could be connected to the historical legacies taxation and spending schemes in Somalia. This study also tries to highlight the modern-day fiscal weaknesses of Somalia. It presents the key policy areas needed to be considered for potential solutions to the underlined fiscal weakness and fragmentation. Additionally, the study focuses on the Federal Government of Somalia and excludes Somaliland. However, other member states are presented where subnational public

[1] The reason of starting from 2012 is the fact that the first post-war fiscal practices including tax collection and allocating these revenues through budget started within that year.

finance matters. The interviewees are anonymised and could not be disclosed for their safety.

In the following sections, the paper discusses an overview of Somalia's fiscal history before 1991, contemporary fiscal policy situation, pressing fiscal challenges and the key policy areas required to be considered for potential solutions.

2. Fiscal History of Somalia before 1991

The history of Somalia's fiscal practices, though informal, dates back to the pre-colonial era, when traditional clan administrations and sultanates, such as Adal in the former British Somaliland and Ajuuraan and Geledi in the Italian Somaliland, managed to collect charges from nomad and agricultural societies (Jalata, 2004; Mukhtar, 2003). Ajuuraan sultanate advanced to establish armed forces and collect levies coercively and continued the trend until the colonial times began (Mukhtar, 2003; Njoku, 2013; Cassanelli, 1982). Furthermore, the Indian Ocean and Red Sea coastal cities influence and control by different foreign rulers were reported. Therefore, there is highly likely to happen tax and customs collection in the coastal cities managed by those Sultans or rulers. The trend continued until the European colonies arrived the Somali soil.

In the colonial period, Britain established a taxation system identical to its other colonial administrations. So, the British Somaliland shared its fiscal practices with Indian, Yemen and Kenya protectorates[2]. It was similar to the Italian Somaliland in practising fiscal laws similar to Eritrea and Libya which were under colonial respective Italian administration[3]. During the colonial administration, due to lack of formal markets and employments, income taxes were very low; Britain and Italy depended more on customs duties collectable from seaports for income (Laitin & Samatar, 1984). Table 1 provides the brief figures of revenue and expenditure of the two regions in the available fiscal years.

[2] Interview source, staff of the Ministry of Finance, anonymised.
[3] Interview source, staff of the Ministry of Finance, anonymised.

Table 1: Revenue and expenditure data of colonial Somali regions[4]

	Italian Somaliland in IL & USD		British Somaliland in GBP	
Year	Revenue	Expenditure	Revenue	Expenditure
1912/13	IL 6,931,000	IL 6,931,000	---	---
1916/17	---	---	GBP 40,000	GBP 125,000
1925/26	---	---	GBP 89,057	GBP 167,955
1926/27	IL 14,228,000	---	GBP 90,569	GBP 149,125
1927/28	IL 18,567,000	---	GBP 159,478	GBP 198,628
1928/29	IL 18,678,000	---	GBP 101,541	GBP 207,067
1929/30	IL 19,187,000	---	GBP 105,304	GBP 199,027
1930/31	IL 17,912,000	---	---	---
1935/36	IL 81,260,000	---	---	---
1951	USD 4,800,000	USD 18,300,000	---	---
1952	USD 4,800,000	USD 14,200,000	---	---
1953	USD 4,300,000	USD 12,800,000	---	---
1954	USD 5,200,000	USD 12,300,000	---	---
1955(55/56)	USD 5,800,000	USD 14,000,000	GBP 1,401,807	GBP 1,408,709
1956(56/57)	USD 6,200,000	USD 14,900,000	GBP 1,693,939	GBP 1,715,683
1957(57/58)	USD 6,900,000	USD 14,100,000	GBP 2,272,757	GBP 2,176,777
1958(58/59)	---	---	GBP 2,562,213	GBP 2,390,757

Source: Her Majesty Stationary Office (1960), Hess (1966), Kakwenzire (1986), Karp (1960).

Generally, the budgets of the two regions were managed by the respective colonies of Britain and Italy[5]. Though there was a domestic revenue

[4] Note (1): IL = Italian Lira, USD = United States Dollar and GBP = Great Britain Pound. Besides, years in brackets at the bottom of the table reflect the fiscal years of the British Somaliland.

[5] Interview source, staff of the Ministry of Finance, anonymised.

component of the budget that comes from taxes collected from the Somali community, ruling states had largely contributed to financing the fiscal needs[6]. However, there were reciprocal compliance and resistance against colonial taxes. The Somali community opposed the imposition of certain colonial rules, including imposition of taxation. For instance, in 1922, the popular Burao protested against taxation doing the popular Burao Tax Revolt (Mohamed, 2002). The colonial taxation continued without community engagement and taxpayer-friendly relations. Further, they relied on coercive enforcement, where the Italian government relied on a special division of police called "Fiscal Police" and the British administration used their armed forces[7]. Furthermore, fiscal exchange did not exist in a fair way or in manner of investing social services that has fuelled the resistance against taxation.

During the trusteeship period, the World Bank (1957) mission raised the needed economic support to the Somali state, even beyond independence. This seemed an unrealistic projection to the officials of that time. However, the World Bank's finding was later supported by UNDP (1998) claiming that the unified Somali Republic could only finance about two-thirds of the country's budgets with domestic revenue sources. The first Somali statehood period was performing consistently in terms of revenue collection, as the government relied 80% on indirect taxes while budgetary expenditure had increased approximately to 40% from 1959 to 1960 (World Bank, 1964).

However, domestic revenue reliance did not last long and, within a short period of time, the state could not maintain an appreciable fiscal performance. This was because of poor revenue administration and tax compliance, poor investment on infrastructure, overall macroeconomic instability, as well as a high trade tax burden along with weak fiscal exchange and state legitimacy (IMF, 1986; Mohamoud, 2002; Mubarak, 1996; World Bank, 1982). Also, good governance in the government's fiscal operations and transparency in the public sector were questioned (Deriye, 1984; World Bank, 2017). One can conclude that the national fiscal position increased in face value in 1960s and 1970s (World Bank, 1964; 1967; 1982). Nonetheless, Mubarak (1996) claims lack of sustainability on that trend led to an aid dependence and crowd out effect. Hence, the entirety of the

[6] Interview source, staff of the Ministry of Finance, anonymised.
[7] Interview source, staff of the Ministry of Finance, anonymised.

development projects were financed by bilateral and multilateral aids. Table 2 provides relevant fiscal information showing the extent of deficit.

Table 2: Main fiscal components after independence

Years	Domestic Revenue (million So. Sh.)	Total Expenditure (million So. Sh.)	Surplus / Deficit (million So. Sh.)	Donor financing (million So. Sh.)	External Debt (million US$)
1960	105.0	247.4	-142.4	106.7	--
1965	177.5	218.6	-21.9	38.0	--
1970	288.0	299.0	-11	14.0	--
1975	624	1,500	-876	631	269
1980	1,421.4	3,058.4	1,637.1	463.0	597.6
1985	5,219.3	19,030.8	13,811.5	1,368.4	1,053.6
1990	68,157	--	--	544,382	717.5

Source: IMF (1966; 1972; 1991); World Bank (1964; 1967; 1972; 1975; 1979; 1991)

The legal framework, budgetary process and public financial documentation were the main positive legacies from the colonial administration[8]. Customs, tax laws and budget appropriation acts have been adopted historically. The common taxes collectable in Somalia included income taxes at individual and corporate levels, registration and road taxes, stamp taxes, and customs (Raballand & Knebelmann, 2020). Customs, or trade taxes, have existed in Somalia's British and Italian colonies[9]. However, the Somali authorities of post-independence neither contributed much in modernising the legal framework of existing laws nor did they extend the tax base (van den Boogaard & Isak, forthcoming).

Generally, revenue mobilisation of the country has fallen short of the national fiscal needs, and donor grants have contributed much in the budget as domestic revenue could not cover it all (Ekstrom, 1993; Mubarak, 1996). Upon the fall of the central government in 1991, the system of tax payment immediately disappeared with no official state asking for taxes and delivering the social services (Menkhaus, 2004, 2006; Webersik, 2006).

[8] Interview source, staff of the Ministry of Finance, anonymised.
[9] Interview source, staff of the Ministry of Finance, anonymised.

3 Contemporary Fiscal Situation of Somalia

This section discusses the contemporary fiscal structure. It initially addresses the absence of a national fiscal state between 1991 and 2012. Subsequently, it presents how the federal government resumed the fiscal system in 2012, current structure, and recent fiscal reforms were mostly achieved through pressure from development partners, including the International Monetary Fund and the World Bank.

3.1. Absence of a National Fiscal State

Before discussing the current fiscal policy structure, one must briefly know about the period between 1991 and 2012. This period meant a fiscal state absence in south central Somalia while it meant a re-establishment period for the Somaliland and Puntland administrations (World Bank, 2017). After 1991, public institutions collapsed; hence, the revenue collections and delivery of public services immediately disappeared (Mubarak, 1996; Isak & Mohamud, 2022).

In south central Somalia, including Mogadishu, the country's capital and largest urban city, power-struggling opposition members turned to warlords after ousting the Siyad Barre-led regime in 1991. They had their own militias collecting money – or so-called taxes – from surrounding areas and controlled roadblocks (Webersik, 2006). "Taxes, payable to a tentative local authority or strongman, are seldom more than 5%, security is another 5% (more in Mogadishu), and customs duties are next to nothing. There is no need to pay for licences, or to pay to put up masts" (Anon., 2005). This case has been common in southern and central Somalia for about three decades, while it lasted more briefly for Somaliland and Puntland. Furthermore, the public did not receive any fiscal exchange for their informal tax payment to warlord militia, leading to dissatisfaction (Leeson, 2007). Webersik (2006) even argues that transitional governments that followed could not establish a fiscal state presence (Mohamud & Isak, 2019; Raballand & Knebelmann, 2020; World Bank, 2017).

For Somaliland and Puntland, tax collection and its allocation through budgetary processes started in the late 1990s, leaving other parts of the country behind. Somaliland's many reconciliation conferences in 1990s have yielded a sense of political bargaining which led to the establishment of negotiations with city rulers as well as port-controlling clan elders to monopolise the revenue collections to the state (Eubank, 2012).

Contemporary revenue is dominated by customs taxes from Berbera Port (Bradbury, 2008; Eubank, 2012). Although external grants have contributed to Somaliland's budgets, revenue bargains promised a sustained revenue base to the administration and financing stability as well as state functions given, which are located in the currently unstable Horn of Africa. "Somaliland's revenue has grown considerably, from $19.4 million in 2002 to $123.3 million in 2013, while total expenditure followed a similar trend, recording a 22% percent average growth during this period" (World Bank, 2017: 15). Furthermore, Somaliland receives about 46% of public revenues from the customs (Raballand & Knebelmann, 2020). However, Somaliland still receives a notable amount of budgetary support from donors.

Puntland State was formed in 1998, following a community conference held in Garowe (Interpeace/PDRC 2009). Since then, the formed administration started to establish a taxation and budget procedure to financially support the entitled public services and functions (Varming, 2017; 2019). However, 62% of Puntland's revenue came from customs where Bosaso Port provides a huge revenue receipt (Raballand & Knebelmann, 2020). Puntland's fiscal position has risen considerably: 13% in revenue and 19% in expenditure from 2007 to 2013, reaching approximately $59 million of domestic revenue collection in 2019 (Raballand & Knebelmann, 2020). Other member states – built upon the provisional constitution of 2012 – were established by the federal government. Hence, they did not have any fiscal presence before this particular time.

Given south central Somalia's political and security turmoil, the jurisdictional limitedness of Somaliland and Puntland's own fiscal policies, and Somalia's recognition as a failed state, a national level fiscal system was not in place during this intense conflict period until 2012, upon the establishment of the Federal Government of Somalia. Figure 1 shows how conflicts discontinued the state fiscal presence in two decades from 1990 to 2012.

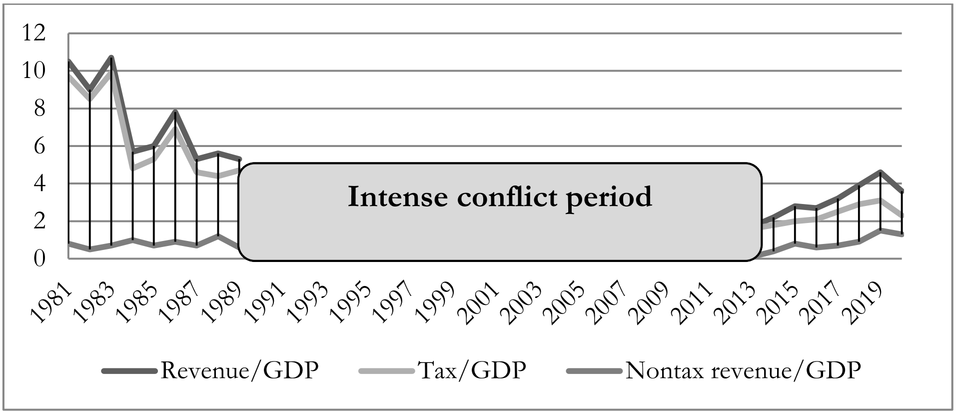

Figure 1: Fiscal presence and absence in the last four decades (WB, 1989; 1990; 2017)

The figure shows the revenue capacity, instability and decline as a pre-civil war proxy. However, it presents the state fiscal absence within the most intense period of civil war in the country. This is supported by Mubarak (1996), who argues that macro economy and stability variables worsened during the 1980s. The figure also shows how conflicts discontinued the state fiscal presence and the public financial reforms initiated in the late 1980s. Hence, one can believe that conflicts impede state capacity including fiscal instruments (Besley & Mueller, 2021). However, it is important to acknowledge the revenue collections compared to the GDP after 2013 accounts for the federal government only, statistically excluding all other subnational governments due to their limited data availability.

3.2. Resuming the Federal Fiscal System After 2012

In 1991, conflicts erupted and governance system immediately disappeared. However, upon continued state-building efforts, Somalia re-established a federal government in 2012, leading to the resumption of the fiscal system officially within the same year and enacting the first budget since 1991 (World Bank, 2015: 2017). The federal government has started with very few fiscal policy measures due to limited institutional capability, tax resistance from the business community and the presence of a hard-to-tax informal business sector (IMF, 2016; Isak, 2018). Since then, the government has made remarkable progress in re-establishing the country's fiscal policy but only in Mogadishu, the country's capital city and seat of the government. The efforts of revenue mobilisation, expenditure management and other public financial management practices were re-introduced after more than two decades (Raballand & Knebelmann, 2020).

At the starting point, collected taxes included income tax, customs and stamp duties as well as registration and road taxes (Isak, 2018). However, efforts continued to impose sales tax on services including telecommunication industry, hospitality and importation of goods (Mohamud & Isak, 2019). In addition to the narrow base taxation, non-tax revenues were collected from user charges, government services sold to the public and other regulatory and administrative fees (World Bank, 2017).

On the expenditure of the federal government, the spending scheme is dominated by recurrent expenditure (IMF, 2017). Coupled with a public financial procedural enhancement within the federal government, the spending include public employees' compensation; purchase of goods and services; purchase of non-financial assets; and transfer grants to the member states (IMF, 2018). The baseline was characterised by an absence of a clear public financial legal framework, lack commitment controls, unmatched expenditure and revenue, salary and non-salary manual payments and use of unconsolidated government accounts. Furthermore, the accounting, auditing and financial reporting system was very weak (Koshima et al., 2018) at the time of re-establishment.

Generally, the total domestic revenue of the Federal Government of Somalia was $229.8 in 2019, while it reached $531 million including all member states and Somaliland as it totalled $318, excluding Somaliland (Raballand & Knebelmann, 2020).

Figure 2 shows the federal government's revenue, expenditure and donor financing trend in the past ten years.

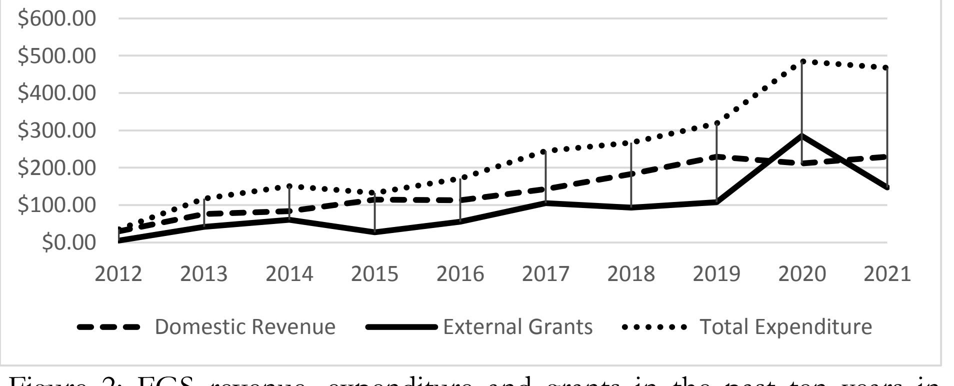

Figure 2: FGS revenue, expenditure and grants in the past ten years in millions of USD (MoF, 2021)

3.3 Recent Fiscal Reforms and Pressure from Development Partners

In light of the government re-introduction of the fiscal operations in 2012, the Ministry of Finance implemented tax policy and administration reforms including extending the base for taxes on goods and services and income tax, raising sin tax rates[10], succeeding in collections of important regulatory and administrative fees including fees on public goods and services, telecommunications spectrum and licensing and aviation charges (IMF, 2018). Further, the government enhanced tax administration by establishing a specialised office for large and medium taxpayers, adopting modern tax payments as electronic money and bank payments, centralising all government fund collections solely under the Inland Revenue Department, and automating key tax collection activities. Despite the pressing fragility and presence of huge informal economic, these reforms helped to better shape the federal government's taxation systems and mobilise domestic resources (Isak & Mohamud, 2022; Raballand & Kenebelmann, 2020).

For expenditure management, the government established necessary reforms. The main reform target areas for the federal government include: enacting the Public Financial Management Law and issuing relevant regulations; establishing commitment controls, cash management procedure and payments through bank transfers; consolidation of the treasury single account for all federal institutions; broadening the accounting data and reporting for a national level; building operational capabilities for intergovernmental fiscal arrangements; and strengthening the audit capacity (Koshima, Jönsson, & Muir, 2019; IMF, 2020; World Bank, 2020).

The government aimed to address this by a full re-application of existing laws; although old, they could still be effective. This was achieved by enacting budget-appropriation acts, issuing ministerial regulations and, most importantly, subsequently amending the old laws and drafting new ones. These initiatives have provided the government with the legal authority to collect untapped resources.

In the past eight years, Somalia reached significant developments towards fiscal policy building. Although it is a remarkable success compared to years ago, the PFM procedures and the fiscal capacity of the country still remain very weak, which is in line with relevant studies including World Bank (2020). Nevertheless, ownership and sustainability of fiscal reforms

[10] Sin tax rates increase affected the products of which state believes may have potential negative health impacts, (See Mohamud & Isak, p. 130)

also remain a central indicator to be looked into. As highlighted by van den Boogaard and Isak (forthcoming), fiscal reforms were triggered by the international partners' pressure including the World Bank and IMF through benchmarks and conditional grants. Other reviews (Fritz, Verhoeven, & Avenia, 2017) claim that fiscal conditionalities under the debt relief programmes can show relevant literature as the fiscal reforms have been the case in Somalia through a monitored track record of administrative and policy reforms.

Despite being in a very fragile and challenging environment, the Somali government has continued to successfully handle the IMF Staff-Monitored Programs' reform benchmarks. However, there is a risk of backsliding after external incentives have gone; such as if debt relief or the provision of major donor funds has been realised. For instance, Nigeria, Tanzania and other developing countries' reforms track record relapsed after program completion (Fritz et al., 2017). Somalia's sustainability of this case needs to be seen after a while and within the experience of different political regimes.

4. Fiscal Challenges

Given the fragility of the country, just like other fragile and post-conflict countries, Somalia is currently experiencing the economic and fiscal challenges. These challenges, though prolonged, were also found in other similar conflict zones.

4.1 Weak Fiscal Capacity

The fiscal capacity of Somalia is very weak and also fragile. The average revenue-to-GDP ratio of the country is extremely low as it was 4.6% in 2019 – the lowest in the world – and causing a low spending share of the GDP (IMF, 2020). Specifically, this shows the demand to mobilise more domestic revenue to sustain the required level of economic growth and development; reduce poverty; maintain fiscal exchange; and fulfil the social state contract. Addis Ababa Tax Initiative recommends that the tax-to-GDP ratio should be more than 15% to achieve those goals (ATI, 2015).
Besley and Mueller (2021) argue that fiscal capacity comes from a helpful economy, investment in fiscal compliance and citizens' willingness to satisfy the tax demands of the state. The absence of these factors in the past and present days makes Somalia experience limited financial resources available

to the state. This argument is also stressed by Schick (2009). Weak private sector, lack of security, non-resilient and unstable economy make the taxable economic base very fragile, while state capacity and legitimacy are not at the required level (IGC, 2018). Similarly, active armed groups controlling large geographical areas and collecting their levies from the same economic base of the state threaten the state monopoly to taxation (Hiraal, 2020).

However, these features are common in the fiscal policy of fragile and lower-income economies as explained in the findings of the IMF's (2017) study that it was common among fragile states to have a tax-to-GDP ratio of below 15% during the 2005–2014 period.

Table 3: Fiscal indicators' share of the GDP								
Item	2013	2014	2015	2016	2017	2018	2019	2020
Domestic revenue	1.3	1.5	1.9	2.7	3.2	3.9	4.6	4.3
External grants	0.8	1.1	0.5	1.4	2.8	1.8	2.2	5.8
Total expenditure	2.2	2.7	2.3	3.3	5.3	5.7	6.4	9.9
External debt	--	--	--	121.1	115.1	111.3	106.0	73.3

Source: IMF (2015; 2016; 2021)

Table 3 shows how Somalia's fiscal indicators are extremely low compared to the GDP of the country. However, please, it should be noted that these figures are only meant for the federal government, excluding federal member states, Benadir Regional Administration and Somaliland.

4.2. Weak Subnational Fiscal System

Any government, whether federal or unitary, has another layer which is a subnational level. The capacity and quality of these governments' levels contribute to the national public financial shape. In Somalia, where fiscal decentralisation did not complement the country's newly taken federalism, taxation and spending responsibilities are undefined (Isak & Ali, 2019; Yusuf & Wasuge, 2021). Generally, Somaliland, with its claim of succession, has a stronger fiscal system than the federal member states.

For states, Puntland is stronger than others in terms of tax collection and budget management because it covers most of its administration costs by itself and receiving grants mostly through the federal government, to cover the remaining fiscal gap. Jubbaland also enjoys better financial resources than other states since it comprises the coastal (port) city of Kismayo. This city provides customs revenue through its port and airport. The budgets of the other states (South West, Hirshabelle and Galmudug) are covered by the federal government. Somaliland is a special case as it is neither controlled by the federal government nor independently separated from the rest of Somalia, but manages its own fiscal and monetary systems. Other member states are experiencing a weaker fiscal position than Somaliland and Puntland, where Jubbaland, Southwest, Galmudug and Hirshabelle collections are \$20.2, \$3.7, \$2.7 and \$2.7 in millions (Raballand & Knebelmann, 2020). Besides, they, including the Banaadir region, receive a considerable amount of budgetary supports from federal government's transfer (MoF, 2020; World Bank, 2017; 2019). Similarly, Banaadir regional administration enjoys 15% of port customs revenue from Mogadishu (Isak & Ali, 2019).

Furthermore, public financial reforms implemented by the federal government have not been replicated throughout subnational governments. Figure 3 shows their revenue weakness.

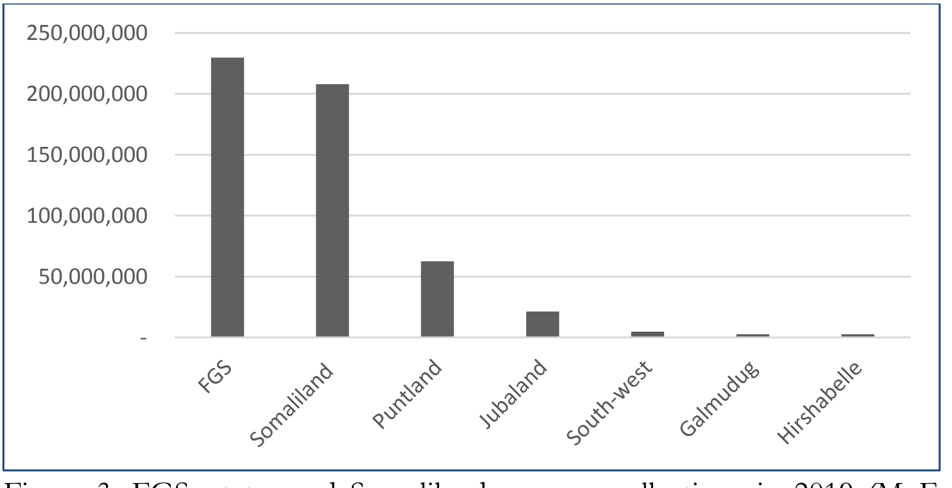

Figure 3: FGS, states and Somaliland revenue collections in 2019 (MoF, 2021)

4.3. Structure and Management of Public Expenditure

More spending on salaries and wages and goods and services but fewer on social sector and development projects is currently a practice in Somalia. The situation had been in existence even before the conflicts (Mubarak, 1996; Laitin & Samatar, 1984). A similar evidence was presented in other fragile states, where recurrent spending is much higher than capital or development financing (IMF, 2017). This is because the ability of the public sector to provide social development services including health and education services is limited by the weak fund capability and revenue inadequacy.

The composition of public spending also shows the poor fiscal capacity of the state. For example, the Federal Government of Somalia spent about 62% of its 2019 expenditure on wages while 95% was current expenditure, leaving only 5% to development financing (IMF, 2020). This is so much different than any other fragile state in the world. Though this could mean the public sector employs higher, it limits the state capacity to finance public goods and services, and long-lasting development human and infrastructural capital. Figure 4 presents the spending components of the government.

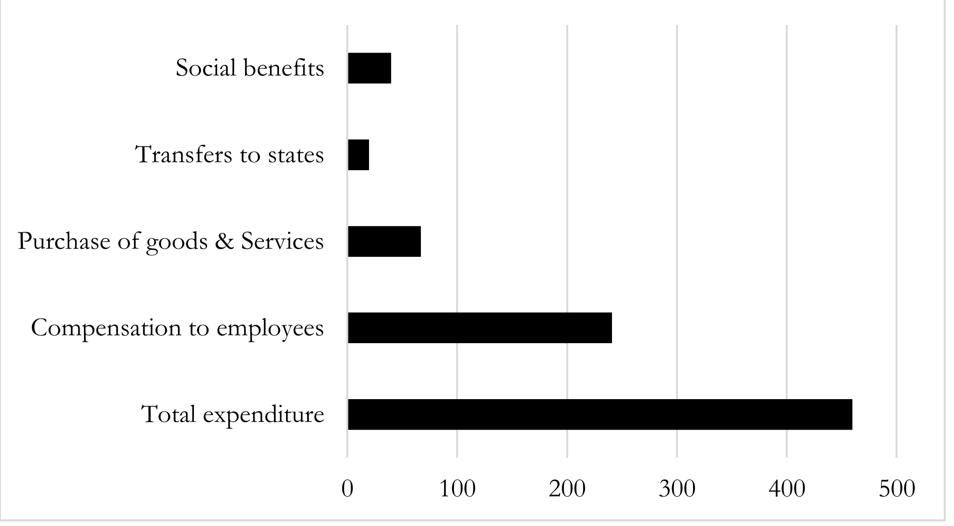

Figure 4: Main expenditure components of FGS in 2021 in Millions of USD (IMF)

4.4. Aid Dependence and Crowd out Effect

A huge part of Somalia's budget is covered through donor financing. Somalia has been receiving both bilateral and multilateral grants to finance the fiscal deficit arising from the shortage of domestic revenues and required expenditure. Despite that, off-budget donor grants are also high,

summing up to the Official Development Assistance (ODA). Although the on-budget financing gap had been gradually declining in the recent past, it rose again in 2020 due to the pandemic expenditure crises, where donors supported all arising health emergency spending. These donors are still playing a vital role in budgetary support to Somalia. Somalia's extreme dependence on external assistance is caused by a lack of state capacity to extract fiscal resources and it affects positively and negatively.
Despite the coverage of a large part of the budget, this dependence threatens Somalia's ability to mobilise more domestic resources and seek a path to financial self-sufficiency, provide the public goods and services as it hinders exercising autonomy in decision-making regarding the country's strategic priorities.

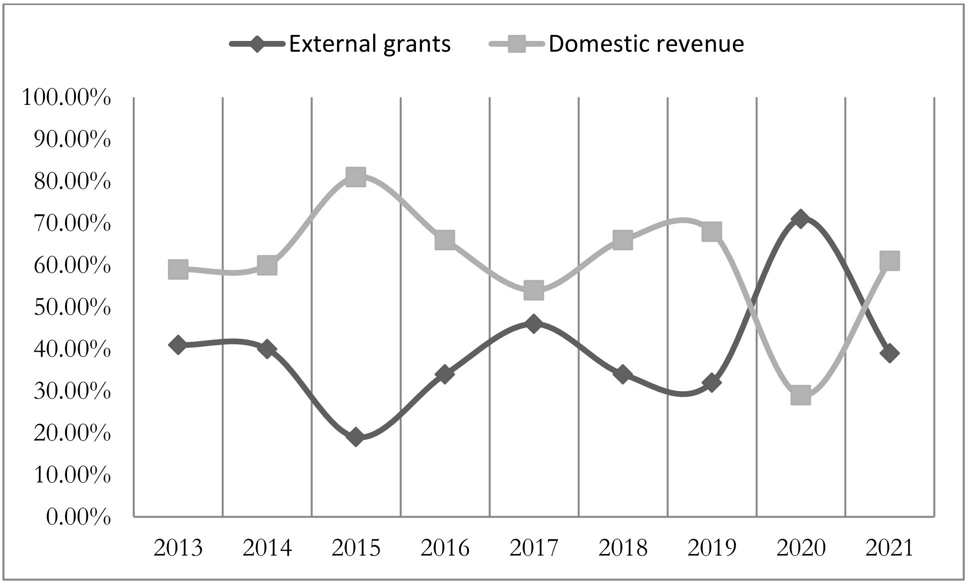

Figure 5: Domestic revenue and external grants percent of the budget (IMF, 2015-2022).

4.5. Structure of the Economy

The structure of the economy is highly unique. In East Africa, a region where the informal economy exceeds 40% of the GDP (Schneider, 2005). Given the nature of Somalia's economy, the situation is likely to worsen than in its neighbouring countries in the region (Kalyandu & Norregaard, 2019). Today, almost all economic and business transactions happen in shadow markets in Somalia (Mohamed, Isak & Roble 2019). Moreover, agriculture accounts for a large share of the economy and the unemployment rate is extremely high, with most people working in the informal sector, with no proper statistical data on which to feed quantitative studies. All these features pose difficulties to future fiscal developments.

Further, agriculture and other productive sectors are hard to tax as it enjoys more relief from taxation under existing laws – an incentive to increase agricultural production during the enactment of most fiscal laws in the Somalia post-independence time. The country's economy also has a large informal business sector, which creates a substantial challenge as it leads to widespread tax evasion/ avoidance in Somalia, which contributes to the low revenue-to-GDP ratio (Isak & Mohamud, 2022).

5. Key Policy Areas for Consideration

In the eyes of several basic reforms and pressing fiscal challenges, there are policy gaps that, if adopted, could speed up the recovery of fiscal policy in Somalia. They are of vital areas that are not given enough consideration in post-conflict zones (van den Boogaard, 2018).

5.1. Addressing Fragility and Promoting Peacebuilding

Fragility and conflicts pose unique difficulties to state-building and strengthening state fiscal capacity in war-torn economies including Somalia. These challenges create the (CSFGD [11]2018) defined symptoms of low state capacity and legitimacy, fragile business and economic sectors, insecure environment and polarised communities. All these features of fragility hinder the government's fiscal capacity by limiting the state administrative capacity and lowering the financial resources available to the state (van den Boogaard et al., 2018). Consequently, fragility in Somalia demands carefully handling, especially in those areas that have impacts on state-building and establishing fiscal contract. Conflict legacies in Somalia include: reversal of post-independence statehood; destruction of physical infrastructure; lack of state monopoly in taxation; and complexity of running the fiscal policy in such a fragile environment. Hence, the government is required to pay

[11] Commission on State Fragility, Growth and Development of International Growth Centre.

further attention to promoting peacebuilding, expanding the tax base, eliminating the parallel taxing groups, and extending the state fiscal capacity throughout the country. Moreover, in pursuit of a better fragility exit, it is essential to earmark a significant part of public spending to financing, liberation, peacebuilding, state-building and solving the pressing security challenges that hinder the collection of taxes.

5.2. Enhancing State and Institutional Capacity

Building fiscal institutions is an important and missing pillar in Somalia. This requires better governance and state-building that would build the foundations of public functions and strengthen the collective capacity of the state. Besley and Mueller (2021) claim that it relates to the way government institutions collectively work, including regulatory, enforcement and supporting authorities that help the fiscal authorities function properly. In the context of institutional building, establishing an appropriate legal and regulatory base is important to support mobilising more fiscal resources to the state, establish a social-state contract and create a transparent and accountable public sector (Cloutier et al., 2022; Isak, 2022). Furthermore, Somalia needs to establish an autonomous revenue authority serving at national level (Isak, 2022, Issa, 2019). This could solve the contemporary functional disorganisation of the revenue administrations, harmonise the country's balkanised fiscal system, unify the tax rates and base, and accelerate any potential fiscal decentralisation model as it coordinates external assistance. Another important factor is setting strategies and prioritising the fiscal resources and developing proper tax and budgetary administration and policies. This must reflect a future-oriented social sector investment and taxpayer-centred administration. Gupta et al. (2005) support prioritising state and institutional capacity when re-establishing a solid fiscal system.

5.3. Mobilising More Fiscal Resources

Without proper domestic resource mobilisation, Somalia cannot overcome its historic dependence on external assistance, as it cannot finance the social development targets of the modern day. Revenue generation demands the collective efforts of tax reforms, tapping potential revenue sources, advancing revenue administration and supporting such efforts in all aspects of legal, administration and policy including taxing the informal sector

(Cantens & Raballand 2021; Raballand & Knebelmann, 2020). A considerable note is that Somalia needs to establish strong income and broad-based consumption taxes throughout the economy, revamp its legal framework, and extend the geographical area of the federal fiscal base to the entire nation.

However, "a failure to enact the Somali revenue authority establishment law in 2019 is a missed opportunity" that would establish a required central fiscal authority with a sole objective of revenue mobilisation throughout Somalia (Isak, 2022). Therefore, it is not yet too late to build an autonomous revenue authority. Finally, revenue mobilisation and tax reforms can be easily challenged by the political elite, business communities and, within the system, public officials. So, political and operational objectivity is permanently required.

Extending the fiscal space at national and subnational levels could lower the fiscal weakness and provide financing opportunities for the delivery of public services, avoiding the dependence on donor grants and overcoming crowd out effects at all tiers of government.

5.4. Improving Fiscal Exchange and Governance

Fiscal transparency and accountability are key to public satisfaction regarding where money goes and what it is spent on. Answers to such questions relate to the delivery of public goods and services. Successfully answering them could increase Somalia's standing in the transparency; accelerate tax compliance and social contract and trust; and improve state legitimacy (Cloutier et al., 2022; IMF, 2017b; Raballand, Fiebelkorn, Heidenhof, & Schmidt, 2022). It is also essential to maintain the principles, procedures and best practices of public financial management rules that contribute to the transparency at the fiscal policy system, both in terms of revenue and expenditure. Lack of state service provision triggered to community-driven financing of local public services in south central Somalia (van den Boogaard & Santoro, 2022).

Government collects taxes from citizens in return for the services it is supposed to provide. Such services include health services, education, security, roads, bridges and other infrastructure. Also, government collects taxes to pay salaries to public sector employees and to run the state. Therefore, it is very important to deliver such services to citizens. This will increase the feeling of individual responsiveness to the state demands and trust to the government; it will also reduce tax evasion.

5.5. Achieving a Better Fiscal Federalism Model

Modelling a best practised design of fiscal decentralisation could be helpful. Currently, Somalia's federalism does not match the fiscal aspects of government. Although the formation of federal member states showed progress, there is a fiscal fragmentation among the Federal Government of Somalia and its regional administrations. One notable issue is the fact that five years of ongoing intergovernmental fiscal discussions achieved only little results due to political, constitutional and institutional challenges (Isak & Ali, 2019).

Therefore, the Somali authorities need to properly discuss a fiscal decentralisation model, including: clear revenue; spending responsibilities; implementation of the so-far agreed sharing scheme; and provision of the legal framework to strengthen (Yusuf & Wasuge, 2021). Finally, establishing a central fiscal authority and firming its institutional capacity to collect national taxes could solve the contemporary parallel fiscal system and raise the state monopoly to tax.

6. Conclusion

Although fragility started in 1991, some features of fiscal weakness even existed historically. Researchers have highlighted that successive administrations led by the Somalis have had narrow domestic resources from trusteeship to modern-day blaming resistance in tax payments, and lack of civic knowledge of statehood, citizen rights and obligations, and weak state legitimacy. Lack of service provision further contributed to the existence of such notion. Though revenue collection and budget execution have been re-established, the public finance of Somalia still remains weak and is in an early stage of recovering from conflicts.

With the significance of instability and insecurity challenges, reforms that were supported and monitored by international partners were satisfactory. Addressing the pressing economic and financial challenges and considering the proposed policy discussion areas could help the federal government to achieve better fiscal capacity.

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