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البنك المركزي الصومالي
CENTRAL BANK OF SOMALIA

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Somalia's Government Fiscal Operations

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Somalia's Government Fiscal Operations

Policy Research & Analysis Division
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Central Bank of Somalia

June 2024

SOMALIA'S GOVERNMENT FISCAL OPERATIONS

EXECUTIVE SUMMARY

Somalia has made strides in public financial management, focusing on enhancing revenue collection and budget processes. Despite challenges in expanding the tax base and managing expenditures, fiscal reforms have stabilized the economy. In July 2023, Somalia's government approved a revised budget of US$917.3 million, prioritizing reduced spending and external grants to support national activities and complete the debt relief process. By December 2023, Somalia achieved HIPC program completion, reducing external debt from 64 percent to under 6 percent of GDP, enabling new IMF programs aimed at sustainable revenue collection.

Domestic revenues exceeded 2023 targets by 16 percent, driven by higher customs duties, particularly on luxury goods and improved tax administration. Efforts continue to refine fiscal frameworks and enhance partnerships with development agencies. Despite ongoing challenges, political and economic reforms have strengthened federal capabilities. Challenges include inadequate domestic revenue, exacerbated by a large informal sector and ineffective tax systems, with a tax revenue-to-GDP ratio of 3 percent. Somalia aims to increase this to 10 percent through reforms. Overreliance on donor grants remains a risk, with 2023 contributions falling short by 36 percent. The macroeconomic outlook is cautiously optimistic, hinging on security improvements, governance reforms, and investments in infrastructure and human capital. Continued economic reforms are vital for fostering a conducive investment climate. This Policy Brief underscores the imperative for Somalia to significantly increase domestic revenue, reduce expenditures, and lessen dependency on donor grants. Addressing these challenges will be pivotal in fostering long-term fiscal sustainability and economic growth.

1. INTRODUCTION

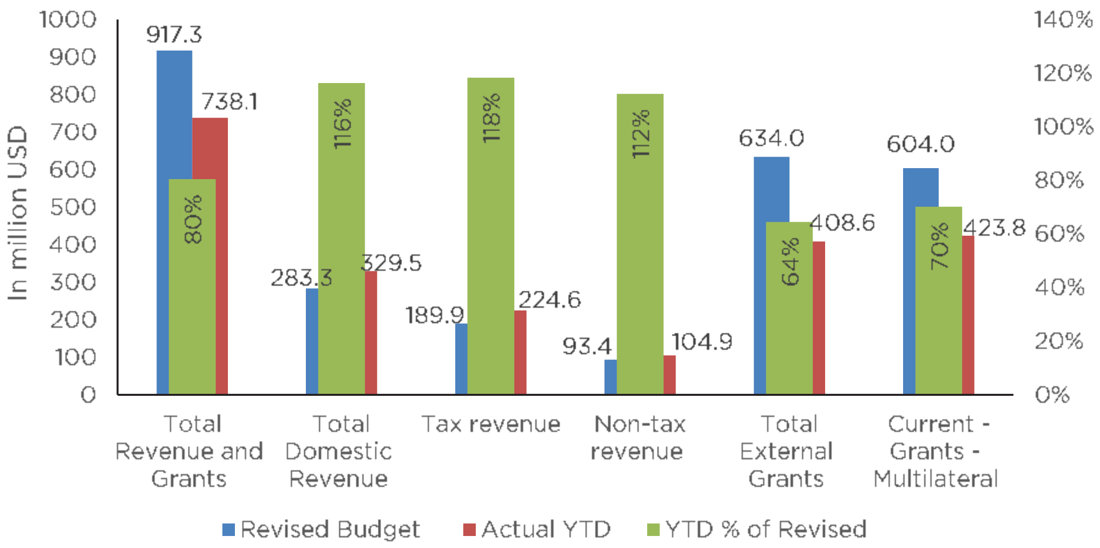
Somalia's public financial management has shown significant improvements, marked by efforts to boost revenue collection and streamline budgetary processes. However, challenges persist in expanding the tax base and effectively managing public expenditures. The Federal Government of Somalia (FGS) has implemented fiscal and monetary policy reforms aimed at enhancing macroeconomic stability. These reforms include improving tax administration, automating payments, and consolidating treasury accounts to strengthen commitment controls (NEC, 2023). The government's actions were timely, given the rise in expenditures over the past five years. In July 2023, both Houses of Parliament approved a revised budget of US$917.3 million, reduced from US$950.7 million allocated in the FGS Appropriation Act 2023. This reduction was achieved through cuts in expenditures and external grants, aimed at ensuring efficient delivery of national activities and advancing the final stage of the debt relief process. Consequently, by December 2023, Somalia completed its HIPC program, reducing external debt from 64 percent to less than 6 percent of GDP and securing a new program with the IMF. Notably, this program includes targets for domestic revenue collection to fully cover government operating costs, as well as providing opportunities for public investment and funding new areas of expenditure.

In 2023, Somalia demonstrated significant progress in enhancing domestic revenue collection, surpassing budget projections with a total of US$329.5 million, which marked a 16 percent increase from the projected US$283.3 million (Figure 1). This achievement was largely attributed to a 50 percent hike in customs duties on luxury goods implemented in mid-May, alongside substantial improvements in tax administration. Of the total revenue, tax revenue accounted for over 30 percent (US$224.6 million), while non-tax revenues contributed 14 percent (US$104.9 million) (see Figure 1). Quarterly comparisons also revealed a notable 14 percent uptick in total revenue and grants in 2023Q4 compared to 2022Q4, with domestic revenues specifically rising by 8 percent (Figure 2). These improvements were linked to administrative changes and stabilization efforts following the elections, which contributed to economic recovery and strengthened revenue generation (NEC, 2023).

The ongoing fiscal and monetary policy reforms have prioritized refining the intergovernmental fiscal framework and fostering closer collaborations with external development partners. Despite enduring civil conflicts, Somalia has made significant strides in building essential federal state capacities through comprehensive political, economic, and institutional reforms (NEC, 2023).

In March 2023, the National Consultative Council convened with the Federal Government of Somalia (FGS), the Presidents of four out of the five Federal Member States (FMS), and the Mayor of Mogadishu, with Puntland State as the sole absentee. Key agreements were reached during this meeting, including the establishment of a National Revenue Authority, delineation of revenue responsibilities across government levels, revenue sharing frameworks between the FGS and FMS, and other vital institutional arrangements (IMF, 2023).

Figure 1: The Performance of Government Fiscal Receipts at the End of the Fiscal Year 2023

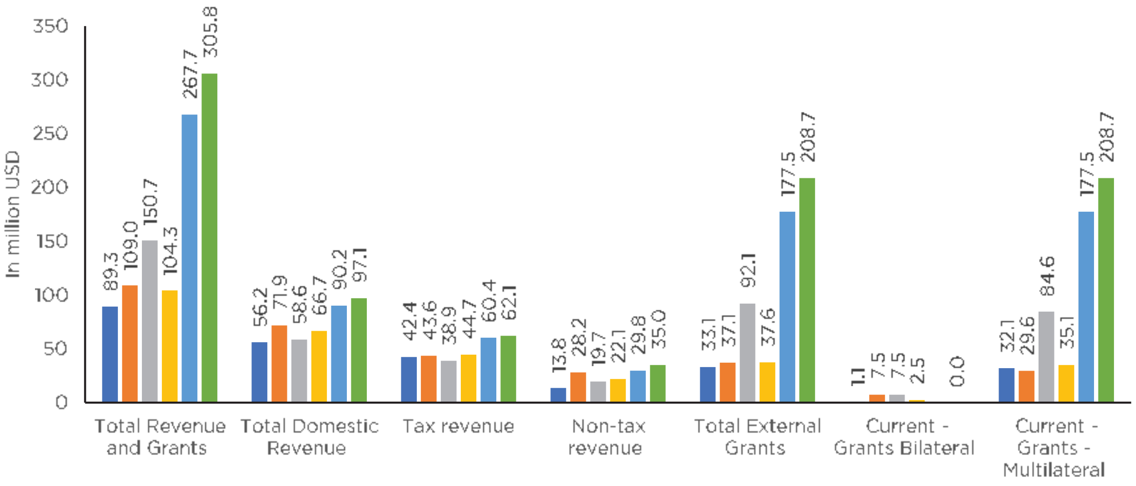


Source: MoF, 2023

Despite significant reforms, Somalia continues to grapple with inadequate domestic revenue, posing challenges in covering recurrent expenditures. In 2023Q4, total revenue and grants amounted to US$305.8 million (Figure 2), while fiscal expenditures reached US$314.6 million (Figure 4), resulting in a financing gap of US$8.8 million. This shortfall is attributed to factors such as a sizable informal sector, ineffective tax systems, and suboptimal performance in tax and customs administration, exacerbated by a fragile security environment. Somalia's tax revenue-to-GDP ratio remains below 3 percent, significantly lower than the African average of 15 percent (MoF, 2024; Volz, 2023).

Efforts are underway to achieve a target tax-to-GDP ratio of 10 percent, including the introduction of digital solutions in tax administration, showing promising initial results but requiring further steps. The FGS faces the challenge of escalating operational costs, driven by a fivefold increase in salary payments over the past decade, now surpassing domestic revenue levels.

Figure 2: Quarterly Government Fiscal Receipts (2018Q4 - 2023Q4)

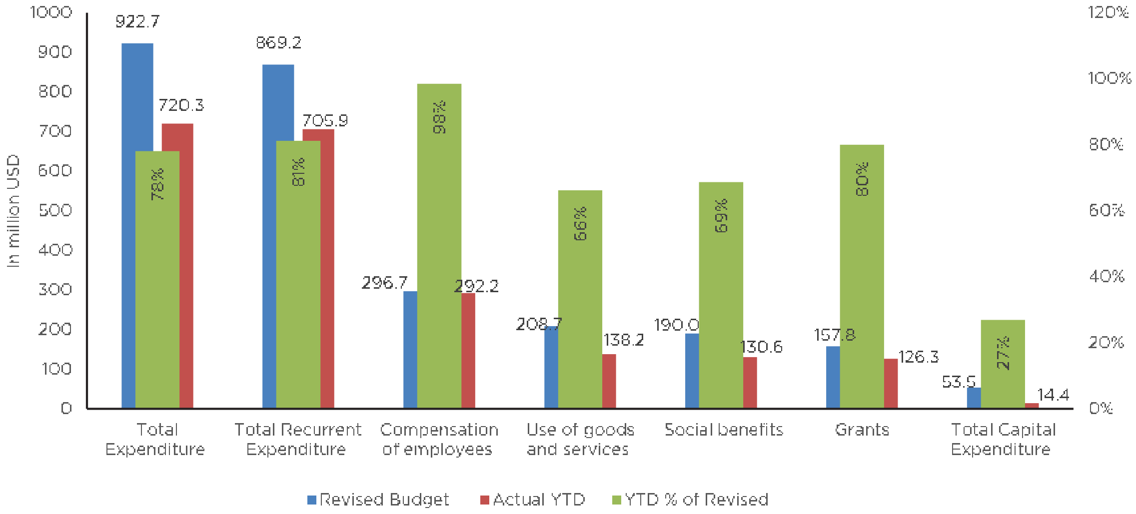


Source: MoF, 2023

In 2023, the FGS's expenditure totaled US$922.7 million, anticipating a financing gap of US$5.4 million, with 94 percent allocated to recurrent expenses and only 6 percent earmarked for capital investments.

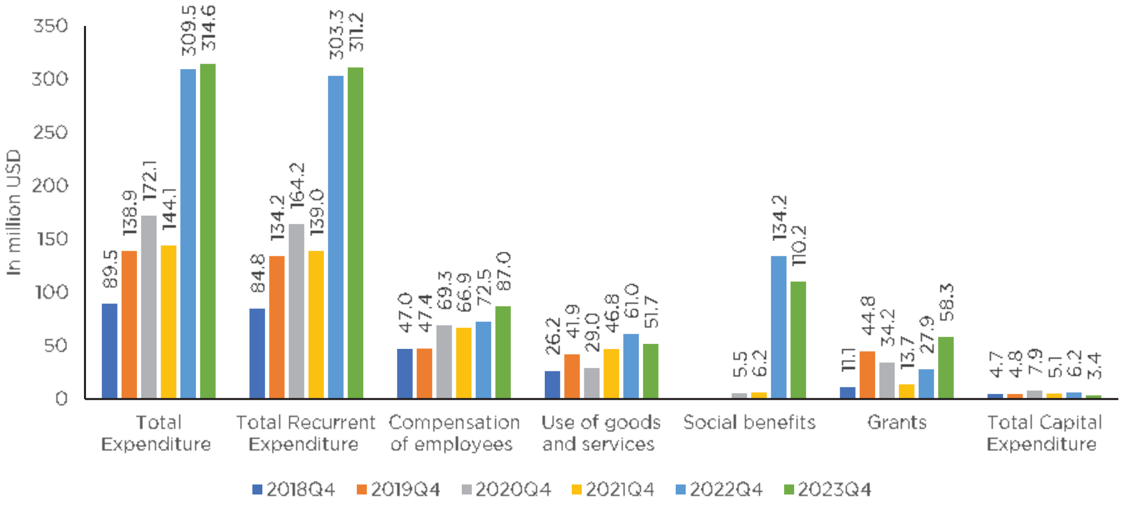
Despite an ambitious budget target of US$917.3 million, actual fiscal receipts in 2023 amounted to US$738 million (Figure 1), falling short by US$179.3 million and impacting service delivery. The country heavily relies on donor grants, projected to cover 69 percent of the budget at US$634 million, while domestic revenues, including taxes and non-tax sources, are expected to contribute the remaining 31 percent (US$283.3 million) (MoF, 2023). However, donor grants totaled US$408.5 million in 2023 (Figure 1), this is 36 percent less than budgeted and 11 percent less than the previous year's grants, underscoring the volatility of this revenue source. Despite a fourth-quarter improvement, with grants totaling US$208.7 million (Figure 2), an 31 percent increase from 2022Q4, donor funding remains unstable. The FGS's expenditure pattern reflects a prioritization of recurrent expenses, with 98 percent of total spending in 2023 (US$705.9 million) allocated to such costs, while capital expenditure amounted to a mere 2 percent (US$14.4 million). This imbalance signals limitations in funding for crucial long-term infrastructure and capacity-building projects that would intern generate future income streams to the government, as evidenced by a significant drop in capital spending compared to the previous year. In summary, while Somalia has made strides in fiscal management and institutional reforms, sustaining economic stability, debt management, capital investment and achieving fiscal balance hinges on bolstering domestic revenue, reducing reliance on donor grants, and effectively managing expenditures to prioritize sustainable development goals.

Figure 3: The Performance of Government Fiscal Expenditure at the End of the Fiscal Year 2023



Source: MoF, 2023

Figure 4: Quarterly Government Fiscal Spending (2018Q4 – 2023Q4)



Source: MoF, 2023

2. KEY NOTABLE ISSUES

1. Low Domestic Revenue Collection

- Despite policy reforms improving tax compliance, Somalia's Tax Revenue-to-Gross Domestic Product ratio remains at 3 percent, well below the African average of 15 percent. Several contributors include a low tax base, absence of fiscal federalism and adequate resource sharing agreement, and concentration of government revenues to limited sources. There's a critical need to investigate further the reasons behind this underperformance and enhance revenue from the existing tax base.

2. Political Tensions and Federal State Capabilities

- Despite agreements with Federal Member States (FMS) on reforms, political tensions, particularly with Puntland State, persist, potentially hindering federal fiscal reforms.

3. Challenges in Domestic Revenue Collection

- Somalia faces challenges such as a large informal sector, ineffective tax systems, and poor tax-customs administration exacerbated by insecurity, necessitating streamlined processes for efficiency.

4. Overreliance on Donor Grants

- Donor grants constitute 69 percent of revenue, posing risks due to delays or reductions, impacting fiscal goals and economic stability.

5. High Recurrent Expenditures

- Recurrent expenditures consume 98 percent of spending, limiting funds for capital investments crucial for long-term development and income streams.

6. Inefficiencies in Budget Execution

- Inefficiencies in budget execution led to a significant increase in spending during the fourth quarter as compared to preceding quarters, with all the major expenditure categories experiencing an uptick. This highlighted existing shortcomings in planning and execution processes.
- Additionally, capital spending fell below the projected capital expenditure, indicating constraints in funding for long-term investment projects.

7. Fiscal Federalism

- The systems for fiscal transfers from the federal government to federal member states entities are often ineffective, leading to disparities in service delivery.
- There are often inadequate mechanisms for coordination and cooperation between different levels of government due political uncertainty.

8. Legal and Regulatory Framework

- The legal and regulatory framework for fiscal federalism is often underdeveloped, leading to ambiguities and conflicts.
- Even when regulations exist, enforcement mechanisms are often weak or non-existent.

3. POLICY RECOMMENDATIONS

1. Enhancing Revenue Collection

- Accelerate legislation for the Somalia Revenue Authority (SRA).
- Build capacity for revenue administration and expand the tax base.
- Implement digital solutions and enhance customs operations.
- Enhance taxes in high-revenue sectors such as telecommunications, and on luxury goods and services to capture more revenues.
- Foster the draft income tax bill.

2. Improving Budget Execution

- Enhance budget planning and execution processes.
- Utilize various communication channels, including traditional media and digital platforms, to engage with citizens and stakeholders on budgetary matters.

- Improve budget communication to enhance public awareness of government spending priorities, initiatives, and accountability.
- Monitor donor-funded projects rigorously and improve coordination for timely disbursement.

3. Controlling Recurrent Expenditures

- Implement measures to control recurrent expenses and prioritize efficient fund utilization.

4. Increasing Capital Expenditure

- Allocate more budget to capital expenditure and ensure efficient project implementation to support economic growth.

5. Reducing Dependence on Donor Grants

- Develop strategies to boost domestic revenue and promote private sector development.
- Support SMEs and reduce bureaucratic barriers to business.

6. Strengthening Fiscal and Monetary Reforms

- Refine intergovernmental fiscal frameworks and collaborate with development partners for stability and growth.

These recommendations aim to address key challenges and promote sustainable economic development in Somalia, focusing on revenue enhancement, efficient expenditure management, and reduced reliance on external funding.

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