

# **Considerations on Intergovernmental Fiscal Relations for the Finance Ministers' Fiscal Forum (FMFF)**

15<sup>th</sup> to 21<sup>st</sup> July 2016

**Ministry of Finance  
Federal Government of Somalia**

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# Considerations on Intergovernmental Fiscal Relations for the Finance Ministers' Fiscal Forum (FMFF)

## Executive Summary

The adoption of the Transitional Federal Charter on 15 September 2004, had set the country on an entirely new course towards federalism. The adoption of the Provisional Constitution in 2012 had established the Federal Government of Somalia (FGS) and had firmly entrenched and articulated the principles of federalism further cementing the country's path towards federalism.

Despite the clear articulation on the general principles of federalism, the Provisional Constitution does not explicitly define the intergovernmental fiscal relations between the Federal Government and subnational governments. However, the Provisional Constitution envisions a cooperative federalism and directs all levels of government to negotiate on both allocation of powers and revenue assignment as well as equitable allocation of resources. However, despite the success of the political process of state formation, which is a key step of forming a cohesive federal system of government, there has been a little progress in the area of fiscal federalism.

Against this backdrop, in an attempt to facilitate dialogue on intergovernmental fiscal relations between the FMS and the FGS, the Ministry of Finance convened a meeting in Nairobi between 15<sup>th</sup> to 21<sup>st</sup> of July, 2016 and an Intergovernmental Conference on Fiscal Federalism in Mogadishu on 31<sup>st</sup> October - 4 November 2015. Both events were attended by Ministers of Finance of the FMS (Jubaland, Galmudug, Puntland, and Southwest) and federal Minister of Finance

who hosted the meeting and discussed on ways to promote and enhance intergovernmental fiscal relations. One of the main outcomes of the conference was the establishment of a Finance Ministers Fiscal Forum (FMFF) to secure broad agreement on issues relating to fiscal federalism. Another outcome of the meeting was that the FMFF agreed to establish a technical committee that would support the FMFF stakeholders to discuss key fiscal policy issues that would promote the deepening of intergovernmental fiscal relations. Moreover, the technical committee would also provide recommendations to the FMFF on a fair and appropriate revenue sharing formula, expenditure and revenue assignments between the FGS and FMS. The work of the FMFF and the planned work of the technical committee are the first serious steps towards the goal of designing a workable intergovernmental fiscal framework.

In order to institute and operationalize the work of the technical committee, the Ministry of Finance through the support of the World Bank's Recurrent and Reform Financing (RCRF) Project, had held a workshop from 15 to 21 July, 2016, in Nairobi, Kenya. The workshop participants included members of the Ministries of Finance of the Federal Government of Somalia, Puntland State, Interim Jubaland State of Somalia (JSS), Interim Southwest Administration (ISWA), and the Interim Galmudug Administration to ensure that all states had an opportunity to address their views with respect to fiscal federalism (see Annex 1 for the full list of workshop participants on page 15). The workshop was facilitated by Somali speaking experts who shared intergovernmental fiscal relation theory and international practices. The presentation was very helpful to participants to have well-informed discussions on challenges and issues that impeded the deepening of intergovernmental fiscal relations in Somalia.

The outcome of the workshop was the production of a draft Terms of

Reference for a Proposed Intergovernmental Fiscal Federalism Committee (IGFFC) and this draft document entitled Considerations on Intergovernmental Fiscal Relations for the Finance Ministers Fiscal Forum (FMFF). Further, the workshop helped to produce policy suggestions to FMFF with regard to harmonizing customs tariffs in Somalia. Within this, participants hinted that customs on Khat could be a symbolic gesture to start with the harmonization exercise. (See Pages 11 to 13 for details).

This document outlines the discussion of the committee and present the outcome of the meeting including actionable policy recommendations that would facilitate and engender a conducive environment for the development of a robust intergovernmental fiscal framework.

This document is first of regular briefing and reports from the technical committee to FMFF and policy makers to inform their dialogue and decision making process. It is intended to serve as a catalyst to enhance cooperation and coordination on fiscal matters between the FGS and FMS.

## Introduction

Somalia has made tremendous gains in the political process state formation process, which are the basic building blocks of a federal arrangement. Since 2013, Three states, Jubaland, Southwest, Galmudug, have been formed which joined Puntland state which predate the Provisional Constitution and state formation process. The

formation of the last federal state in currently on-going and determination of the status of the Capital region has recently garnered a great interest. While this is a positive step for Somalia's path towards federalism, each of the constituent Federal Member State administrations and the Federal Government of Somalia exist as fiscally autonomous entities. This is the case because both federal and state governments have not yet seriously discussed and agreed on an intergovernmental fiscal framework. Going forward, it is imperative that both the FGS and state governments agree upon and lay down the structure of fiscal federalism and the corresponding intergovernmental fiscal transfer system (i.e., a system that would facilitate the transfer of grants from federal to state governments) to entrench federalism and maintain the stability of the federal union.

It is in this context that federal and regional Ministers of Finance held a meeting between October 31<sup>st</sup> to 3<sup>rd</sup> November 2015; to discuss strategies to strengthen intergovernmental fiscal relations. Two direct outcomes from the meeting were:

- The establishment of a Finance Ministers Fiscal Forum (FMFF) that would make decisions to deepen intergovernmental fiscal relations;
- That a technical committee be established to provide policy recommendations to the FMFF that would operationalize the principles of federalism as specified in the Provisional Constitution through fiscal arrangements;

To establish the technical committee, a group of federal and regional officials from respective Ministries of Finance, met in Nairobi, Kenya, to:

- Learn about case studies on how fiscal federalism was applied in other parts of the world;

- Discuss the current status of intergovernmental fiscal relations in Somalia;
- Develop a draft ToR for the technical committee;
- Discuss possible directions for reform,
- Propose policy recommendations on customs administration;

The workshop was facilitated by Somali speaking experts from who guided and had helped participants to sensitize and conceptualize the principles of intergovernmental fiscal relations. The facilitators of the Workshop on Fiscal Relations were as follows:

- Abdulqafar Abdullahi, Senior Macro-Fiscal Economist and World Bank and the Bank's Lead on Fiscal Federalism;
- Professor Abdullahi A. Osman, Expert in Fiscal Federalism and Visiting Scholar at Pennsylvania State University;
- Dr. Abdirizak Hassan, Chief Economic Adviser to the Central Bank of Somalia's Governor;
- Hussein Siad Atto, Macroeconomic Policy Analyst, Ministry of Finance, Federal Government of Somalia;
- Jaffar Abukar, Deputy Director of Revenue, Federal Government of Somalia;

(See annex 2 for the biography of the facilitators on page 16)

The workshop was opened by Farahan Mohamoud, PFM Project Coordinator and encouraged participants to perform interactive and fruitful discussion on the subject matter during the course of the workshop. This followed by a brief background information as to what led to the culmination of the workshop by Deputy PFM Coordinator and RCRF-II Project Manager, Abdulkadir Suleiman, who spoke of the importance of designing a fair and appropriate fiscal federal framework

to firmly entrench federalism within the Somali polity. Lastly, he mentioned the key goals or objectives to be achieved from the workshop.

Nevertheless, presentations delivered at the workshop were as follows:

- Federal System Viewed as a System Represented by “Unity in Diversity”, Hussein Siad Atto;
- Advantages and Disadvantages of Federalism with Reference to Somalia, Professor Abdullahi A. Osman;
- Theory and Practice of Intergovernmental Fiscal Relation and Guiding Principles of Fiscal Federalism, Abdulqafar Abdullahi;
- Use of Single Treasury and Role of the Central Bank of Somalia within the context of Somalia’s Federal System & Monetary Policy in the Federal System with Reference to Currency Notes, Abdirizak Hassan;
- Reconstructing Somalia’s External Debt - With a Special Focus on Debt Decentralization, Mohamed-Sadaq Ahmed and Ilyas Abdullahi, Debt Management Unit (DMU), Federal Government of Somalia;
- The Principals of Expenditure and Revenue Assignment? Abdulqafar Abdullahi;
- Customs tariff harmonization as way to improve revenues from all ports of entry, Abdulqafar Abdullahi;

### Discussions on the Current Status of Intergovernmental Fiscal Relations

Participants acknowledged that each of the constituent Federal Member State administrations and the Federal Government of Somalia exist as fiscally autonomous entities. The federal government collects all its revenue from Mogadishu and delivers very limited services



throughout the country while states collect and retain all the revenues from within their borders. There are also very limited intergovernmental transfers from the center to the FMS.

The discussions primarily centered on:

- Borrowing;
- Monetary Policy;
- Expenditure Assignments and Management;
- Revenue Assignments and Administration with a specific focus on customs administration;

#### Borrowing:

The presentation delivered by the FGS Ministry of Finance's Debt Management Unit (DMU) provided a background on the process of reconstructing Somalia's external debt database and gave an overview on subnational borrowing. Given Somalia's arrears and debt burden, participants did not see envisage subnational borrowing to be an immediate pressing issue at this time. However, the two presenters of the DMU induced participants the need to adopt a framework for subnational borrowing that ensures that the central government has a degree of oversight and control on subnational governments ability to borrow, as most creditors would eventually turn to the federal entity in the event of defaults of subnational governments on loan obligations.

#### Monetary Policy:

As the Provisional Constitution and the Central Bank Act clearly states that there is no dispute that all issues of monetary policy are the sole responsibility of the Central Bank of Somalia. Moreover, officials acknowledged that although the Somali Shilling remains the de jure

currency in Somalia, given the economy is effectively dollarized the Central Bank of Somalia (CBS) has a challenge to affect a monetary policy or exchange rate regime. The facilitator shared with the CBS's currency reform activities. Participants commended the CBS in its initial currency reform efforts to issue new SOS 1000 banknotes, but noted that more comprehensive currency reform efforts were needed to de-dollarize the Somali economy.

#### **Expenditure Assignments and Management:**

On the expenditure side, following a presentation from the Facilitator, participants' discussion what involved is in broadening the discussion on functional assignment given its sectorial dimension. Expenditure assignment defines the roles and responsibilities of various levels of governments on to what degree of spending responsibility can be entailed on a given level of government. The discussions pointed out that expenditure assignments could be concurrent or shared responsibilities or could be the sole responsibility of federal or regional governments. It was suggested that the delineation of expenditure assignments was beyond the mandate of the Ministries of Finance and would require consultations and further discussions with other Ministries, Departments and Agencies (MDAs) at both the federal and state level.

#### **Revenue Assignment and Management with a Specific Focus on Customs Administration:**

On the revenue front, the facilitator led a wide-ranging discussion on revenue assignment among participants following a presentation that included the theory, international practices, and examples of selected countries. Participants noted that this was an important issue and deserve further discussion and concerted efforts from all levels of

government. . The potential and benefits of shared tax administration was also discussion as means of reducing collection and compliance cost. The participants and the facilitator also elaborated on the best practices and principles with respect to revenue assignment. The workshop discussed specifics on customs harmonization as it relates to Somalia. Finally, it is hoped that there would be a agreement to this matter among FGS and FMS.

### Customs Revenue Improvement Initiative

The Facilitator gave a brief presentation on the international practice on customs tariffs and revenues are treated in federal countries. This was followed by a presentation from the International practices is that customs affairs are come under central government jurisdictions since has implications for international trade agreements and obligations. However, the defect arrangement where states that control ports and the federal government set their own differential tariff rate is not sustainable in the long run.

The open discussion among participants was preceded by presentations from the Director of Mogadishu Port and a representative from the Puntland Ministry of Finance who explained the challenges they face as a result of lack of tariff harmonization. Lack of harmonized tariff limits their freedom to collect more revenue from imports due to inability to vary tariffs for fear that businesses will just move to other ports. They two experts present necessary steps before the ultimate tariff harmonization. Before tariff harmonization in all customs ports, states must agree to use the same product classification and price lists to enable them to move to ad volerum tariff assessment method. Only after these steps are successfully implemented in all region, would tariffs can be harmonized.

In the discussion that followed was the distinction between customs control and port management. Port management focuses on the day-to-day operations of running the port and customs management focuses on the collection of indirect taxes from imports and exports. Moreover, a further clarified that the entity managing the port could be either public or private, whereas customs management can be under the jurisdiction of the government.

It was acknowledged that while Somalia's past unitary system of governance had standard customs tariffs across the country, the collection and management of customs in modern-day Somalia is highly decentralized. The participants highlighted the need to reduce competition between ports within Somalia through harmonization of customs tariffs, as non-harmonized customs tariffs would only serve to bring forth a lose-lose situation for federal and regional governments, the private sector and the public, who often have to pay higher costs for goods and services.

Officials in the workshop hinted the possibility that in the medium to long-term that customs collection and management must be a federal competency, and that a short-term reform effort could be geared towards harmonizing the customs tariffs within Somalia. The specific recommendations with respect to customs were as follows:

- The Federal and state governments should harmonize ad valorem customs tariff rates over the medium-term; However, before harmonized tariff is adopted following issue must be resolved
  - Harmonize customs regulation, policies and procedures
  - adopt a single numeric classification of products
  - adopt single price list which as precursor to adopting ad valorem tariff based system
  - This committee to complete this work within five months

and report back to the FMFF.

Only after these steps are successfully completed can tariff harmonization be handled.

- As a symbolic gesture of its commitment to harmonization of customs tariffs, the committee recommends Ministers of Finance agree to a common tariff on Khat by the end of 2016.
- To achieve these objectives, the committee to agreed to recommend the following:

Form a five-member sub-committee from this group to study this issue and create the necessary condition for adopting a common tariff structure. This subcommittee will call in experts from the federal government and regions that are responsible for customs revenue. The sub-committee will need international donor support to engage subject matter experts to advise them.

#### **Intergovernmental Fiscal Transfers:**

Currently, outside of the World Bank's Recurrent Costs and Reform Financing (RCRF) project, there is little transfer of grants from the FGS to state governments. Participants agreed that going forward it would be critical for the central government to, in collaboration with state governments, develop a fair, transparent, and objective intergovernmental fiscal transfer mechanism that would reflect the needs and functions of the various units of government. To achieve this objective, participants concurred that further analysis and consideration through other knowledge-building workshops and potential study tours should be explored.

## Next Steps

Going forward, the FGS and FMS will need to work in concert to ensure that progress is made with respect to the development of a robust intergovernmental fiscal framework. As stated in the document, this will require the establishment of a technical committee that provides recommendations to the FMFF for their consideration.

## Recommendations

- THAT THE FMFF approve the draft Terms of Reference (ToR) for the Intergovernmental Fiscal Federalism Committee (IGFFC);
- THAT THE FMFF officially announce the names of the Committee;
- And THAT THE FMFF authorize the sub-committee of tariff harmonization to complete their work by the end of the year

## Annex 1: List of workshop participants

S/N		Title
<b>FGS Representatives</b>		
1.	Ja'far Mohamed Ahmed	Director General on Revenue, MoF
2.	Ali Mohamed Ahmed	Customs Manager at MPA
3.	Mohamed Sadaq	Head of DMU, MoF
4.	Ilyas Abdullahi Abdi	DMU Officer, MoF
5.	Abdulkadir Suleiman	Deputy PFM Coordinator and RCRF-II Project Manager, MoF
6.	Farahan Mohamoud	PFM Project Coordinator, MoF
<b>JUBBALAND STATE</b>		
1.	Mohamed Kamil Sugal	Revenue Director, MoF, JSS
2.	Adan Mohamed Hudle	Taxpayer Audit, MoF, JSS
3.	Mohamed Yusuf Said	Customs Staff, JSS, MoF
<b>SOUTH WEST STATE</b>		
1.	Abdulaziz Hassan Ibrahim	Revenue Director, MoF, ISWA
2.	Mohamed Dahir Mo'alim	Customs Officer, MoF, ISWA
<b>Puntland State</b>		
1.	Osman Haji Mire	Customs Expert
2.	Dayib Ali Mohamed	PFM advisor, MoF, Puntland
3.	Yahye Mohamed Said	Customs Director
4.	Ahmed Haji Abdullahi	Advisor to the MoF, Puntland
<b>GALMUDUG STATE</b>		
1.	Mohamed Abdi Ali	MoF Permenant Secretary, IGA
2.	Abdiaziz Mohamed Hussein	Budget Director, MoF, IGA
3.	Abdirashid Mohamed Husein	Customs and taxation Program Officer

## Annex 2: Biography of the workshop facilitators



### **ABDULQAFAR ABDULLAHI, MBA, MA (Economics)**

Mr. Abdullahi is a Senior Macro Fiscal Economist with the World Bank (March 2014 – Present) with special focus on intergovernmental fiscal relations. He was a member of the Canadian public service since 2001 where he spent eight years at the Federal Department of Finance Canada as an Economist and later a Senior Economist. During this period he worked on domestic and international economic issues including four years in the federal provincial relations unit responsible for the improvement of Equalization transfer formula. He later joined the Federal Department of Aboriginal Affairs and Northern Development Canada as a Program Manager in the Aboriginal Economic Development Sector. He also worked as Senior Economic Advisor to the Governor of the Central Bank of Somalia (July 2013 to January 2014) and was member of the Board of Directors of the Central Bank of Somalia (July 2014 to September 2015). He lives in Nairobi.



**Abdulahi A. Osman (Ph.D. 2003)** Wayne State University majoring international relation and comparative politics. He is Fulbright Scholar and currently is an independent researcher in peace and security in Africa. He has over twenty years of teaching, research and consultancy. He currently teaches at Penn State University and taught at University of Georgia, University of Michigan-Dearborn, Wayne State and National University of Rwanda. His

teaching and research interest includes African politics, governance, regional and international studies, peace and conflict, internal security and wars, comparative governments in the 3<sup>rd</sup> World. He published several articles in scholarly journals, including *African Renaissance*, *Journal of Ethno-Development* and *African Journal of Conflict Resolution*. He has also edited three books, single authored titled: *Governance and internal War in Sub Saharan Africa: Exploring the Relationship*. He also contributed an entry titled *Collapsed State* in the prestigious *International Encyclopedia of Political Science*. He has done consultancy in Somalia, Tanzania, Rwanda, Ethiopia, South Africa, USA and Croatia memorandum of understanding.



Mr. Hussein Siad holds three degrees in the fields of economics and management. He completed his first degree at the Somali National University (1968). After several years of practical experience at the National Banks, he returned to academia, this time studying management for an M.S. degree (1979) at Arthur D. Little Management Institute in Massachusetts. He joined the graduate program of George Washington University, where earned another M.A. (1982) in economic development. Mr. Siad possesses a substantial record of leadership and management in both the public and private sectors. He was a senior officer of the Somali Development Bank and managed a Pasta and Wheat factory in Mogadishu. Throughout his career, he was involved in banking, finance and economic management. In 1990, he was appointed Vice Minister of Finance. He also acted as Advisor to the Minister of Finance, and as a senior bank official. His other work experiences include Deputy Cluster Leader for the Joint Needs assessment by UNDP and World Bank, Banking and Credit



Specialist for the Zambia Development Bank, Advisor to the Government of Iraq, and Capacity Building Expert for the UNDP, Somalia. Currently, he is macroeconomic consultant at the Ministry of Finance



Dr. Abdirizak Hassan is a financial specialist with solid grasp of the full ranges of development issues and challenges and the broad range of policy issues and other interventions needed to address them. Dr. Hassan has an extensive operational, analytic and management experience, Ph.D. in Financial Economics, university lecturer/Professor in Economics and Finance, and extensive practical experience in post-conflict countries, gained through work various public and private sector entities. He is now Chief Economic Advisor to Governor of Central Bank of Somalia (CBS).