



*MEMORANDUM*

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**From:** RHG **Date:** 4 January 1999  
**To:** Ismail **Re:** RHG/lab  
cc: RLuckham/Lionel Cliffe

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1. H/W tax study
2. Please distribute with cover note to:
  - a. Minister Finance
  - b. Director General Finance
  - c. Minister Planning
  - d. Director General Planning
  - e. Laura
  - f. Director General Presidency (or President)
  - g. Minister Foreign Affairs
  - h. Heads Customs and Excise
  - i. Governor Central Bank
3. Indicate that if source to fund work is found and Republic Somaliland desires I could undertake the Macro Economic and Revenue Strategic Study. If there is broad Somaliland government agreement, I believe with limited formatting shifts present paper could be basis for approaches to funders perhaps with "Toward A Macroeconomic Framework For Somaliland's Postwar Rehabilitation And Reconstruction" as an Annex. (I am not competent to do detailed operational study - **might** be able to locate a Botswana candidate.)
4. Ask Drees if he wishes me to send 'unofficial' copy to Olympios who was interested in concept and might be useful 'friend in court'.

## **REVENUE BASE AND COLLECTION REHABILITATION FOR BASIC SERVICE RECONSTRUCTION BY SOMALILAND**

### **I. THE CHALLENGE**

Somaliland has since the close of the 1988-1991 Liberation War against the Barre occupation forces made major steps toward re-establishing a viable polity and economy:

1. Law, order and security have since mid 1995 been established and sustained in all major towns and in almost all rural areas. They are based on a army, a uniformed civilian police force under the Ministry of the Interior and a functioning judiciary and prison service under the Ministry of Justice;
2. National conferences of elders chosen by sub-clan and lineage groups have established a legitimate political system including (by an electoral college until universal suffrage elections are held in 2000-2002) an executive president and cabinet, an upper House of Elders and lower House of Assembly all of which function;
3. The dominantly private sector economy - focused on pastoral and agro pastoral production - has recovered (prior to the Saudi livestock import ban based on false reports of Rift Valley fever - human and livestock - in Somaliland) to levels at least equal to early 1980's peaks years and Gross Domestic Product now stands at about \$600 million or \$300 per capita;
4. This total is augmented by the order of \$500 million of remittances (from overseas workers and merchants in the Arabian Peninsula and East Africa and from the Somaliland diaspora in Europe and North America) taking Gross National Product to over \$1,000 million/\$500 per capita;
5. A non-uniformed civil service of about 6,000 has been established and most Ministries are now functional as are municipal governments and several statutory authorities (Berbera Port, Hargeisa Airport, Central Bank etc);
6. However central government revenue has stagnated at or below \$25 million a year (despite imports of the order of \$650 million a year of which over 90% pass through

two border crossings one port and one international airport). As a result ability to restore war ravaged infrastructure and basic health, education, rural water, veterinary and agricultural services is very limited. This is true both because of lack of operating funds and because civil service salaries (excluding army, police, magistracy and prisons services and certain statutory authorities) are of the order of \$10 a month in contrast to a minimum socially necessary household consumption level of \$100 a month;

7. Consolidation of and development beyond what has been achieved to date, therefore, depend in large measure on rehabilitating the flow of government revenue and in particular Customs (plus perhaps selective Excise) collections

## **II. TAXES AND COLLECTION: THE HISTORIC PROBLEM**

1. The last professional tax collection system functioning on the basis of laws and regulations operated as written in Somaliland was that of British Somaliland and its successor the 1960 independent Republic of Somaliland. That system was fairly typical late British colonial. The principal source of revenue was a broad coverage, limited number of rates import duty involving actual valuation by trained personnel (invoice documentation in Somaliland is - even more than is common in Africa - not necessarily a good base for tax assessment). The customs service was disciplined, well trained, reasonably well paid (probably the equivalent of \$200 to \$2,000 a month at present prices) and on the whole honest and professional. Secondary sources were - quite low - export duties on livestock and license fees. Total revenues were fairly low relative to output (remittances while significant for at least three centuries were qualitatively as well as quantitatively much lower until the mid to late 1970's) because British Somaliland only began serious development of basic services after the Second World War and a substantial proportion of the initial cost of build-up was met by British budgetary support.
2. The Somalia (Italian Somaliland) tax system which replaced the Somaliland one after 1961 was rather different. It too was dominated by customs revenues but these were nominally based on the 1930's Italian code so far as classification, procedures and multiplicity of rates went. That code was never either indigenised nor modernised

and - necessarily - did not operate as written. The system was a virtual culture dish for the growth of the corruption bacillus, albeit until the 1980's within limits consistent with very substantial and rising revenue collection. In fact the actual system was the old franco valuta one (or in Zanzibari Swahili terms the tax the king collects on goods from over the water related to their value). Customs officers negotiated both the value of the goods and which classification (and thus tax rate) would apply:

3. Under IMF/World Bank advisory auspices in the 1980's the system remained the same on paper but the operational franco valuta base collapsed because the Fund and Bank wrongly assumed the paper system was the operational one.
  - a. the requirement to marry an import with an import license linked to an official foreign exchange allocation which had been purely nominal was enforced. Thus most commercial imports (the means of transmitting remittances with merchants buying the goods with funds paid abroad in forex, then selling in Somaliland and paying Somali Shilling equivalent - at Jeddah bazaar rate - to beneficiaries) became illegal, thus untaxable. In practice merchants paid customs officers (substantial sums but probably less than the franco valuta assessed duty would have been) not to 'see' the goods;
  - b. increases in export taxes and forced conversion at official exchange rates (which became increasingly out of line with the market rate from the late 1970's) led both to smuggling via dhow parts and underdeclaration increasing the proportion of 'unlawful' (and thus untaxable) imports;
  - c. customs service salaries collapsed to perhaps \$10 to \$50 a month encouraging officers to seek other sources of income. As the old East African adage puts it - the tax officer is always paid: the only question is whether he is paid by the state to collect the tax or by the taxpayer not to collect it.

### **III. TAXES AND COLLECTION: THE PRESENT SITUATION**

1. Somaliland government revenue has stagnated at under \$25 million a year with import duties, export duties and licenses/fees about co-equal. On the face of it existing taxes at existing rates should be producing on the order of \$100 to 125 million a year. Not

coincidentally the cost of rapid development of basic service provision and infrastructure would be of the order of \$150 to \$175 million annually (recurrent plus capital) of which foreign assistance (primarily to capital) might total up to \$50 million. The weakness of state capacity to deliver basic services beyond law, order and personal security is in large measure the opposite side of the coin of systemic revenue collection failure;

2. The Customs and Excise Authority is a quasi autonomous statutory body with a - at least in intent - professional staff and plausible paper powers and structures. It is intended to operate a set of classifications and rates which, while perhaps overly complex, are not on their face absurd. Why has it failed (relative to Somaliland's needs and targets - no system in the former Somalia is as professional or effective)?
  - a. officers are not adequately trained - in particular in valuation;
  - b. officers lack experience in a legitimate, functioning customs service and system (which Somalia did not have after the late 1970's);
  - c. for whatever reason coverage is very partial (50% for khatt, the largest and most highly taxed import judging by an independent survey);
  - d. the use of artificial exchange rates of S Sh 650 and Sh S 1,500 to the USA\$ versus the known market rate of about S Sh 4,000 results in reducing actual revenue by 62.5% on the 1,500 rate (the S Sh 650 rate applies to few non-government imports). That is a truly breath - taking evaporation;
  - e. while less ill paid and allowanced than the civil service, the customs service is so poorly paid that need (not greed) drives many to be paid by tax payers (or rather evaders) not to pay all or most of the tax due whether by negotiating faulty valuations and classifications or simply turning a blind eye;
  - f. the effort devoted to licenses (which overlap those of municipal authorities) and export taxes (and enforcement of the artificial Sh S 1,500 exchange rate on them) dissipates policy attention analysis and personnel and encourages underinvoicing and smuggling - none conducive to optimal revenue collection;

- g. merchants find the system complex, cumbersome and uncertain. This seems not to relate so much to rates as to different treatment of near identical shipments (disastrous to merchants who have to pay in a highly competitive market), delays in assessment and clearance and the fact that municipal authorities (especially Hargeisa) also collect *de facto* import duties.

#### IV. REVENUE POTENTIAL

1. Imports are of the order of \$650 million. A very rough breakdown is:

a. khat	\$150	million
b. food	\$75-100	million
c. fuel and lubricants	\$15	million
d. construction materials	\$15	million
e. vehicles/parts	\$25-30	million
f. other (predominantly consumer goods)	£300-325	million

2. A simple rate system (which would limit problems of classification) could be:

Category	Rate	Revenue
a. khat	50%	\$75 million
b. tobacco, soft drinks, bottled water, consumer electronics, saloon cars, fuel	25%	\$20-25 million
c. all other (except pharmaceuticals and food aid/relief supplies imported by scheduled institutions)	10%	\$30-35 million
d. excise on domestic khat (levied per plant)	25%	\$12.5 million
<b>Total</b>		<b>\$137.5 to 147.5 million</b> <b>(13% to 15% of GNP)</b>

3. These estimates suggest:
  - a. phasing out export taxes (beyond port and veterinary charges);
  - b. transferring licenses to municipalities (and encouraging them to collect land rents/rates and improvement rates);
  - c. requiring municipal authorities to cease collecting customs duties (including those described as sales taxes).
  
4. Targets (subject to closer study) might be:
  - a. 18 months after initiation of new revenue strategy implementation - \$50 million
  - b. 30 months - \$75 million
  - c. 42 months - \$100 million

(10% of GNP)

## V. A WAY FORWARD

1. Adoption - by the Executive embodied in legislation passed by Assembly - of a strategic design for revenue levels, tax coverage and rates and collection institutions/mechanisms; following
  
2. A strategic macro and fiscal economic study by a senior consultant with operational African treasury experience and a Somaliland (probably diaspora) research officer reporting to a Committee Chaired by the Minister of Finance and including the Minister of Planning, the Director General of Finance, Planning and the Presidency, the Head of Customs and Excise and the Governor of the Central Bank;
  
3. A parallel institutional/structural/training/operational study carried out by a senior consultant with top level operational customs experience in a country like Namibia, Botswana, Swaziland, Lesotho or, perhaps, Zimbabwe again with a Somaliland

research officer reporting overall to the same government committee but in detail to a subcommittee of Directors General of Finance, Planning, Presidency and Head of Customs and Excise;

4. Abolition of the use of non-market exchange rates in tax calculations and collections - a proposal which can and should be implemented forthwith;
5. Followed by:
  - a. detailed regulations;
  - b. regulations and procedures (including customs classification);
  - c. rate structure;
  - d. identification of customs station requirements (Port of Berbera, 1 to 3 Ethiopian border posts, 1 to 2 Djibouti border post, 1 to 2 Somalia border posts, Hargeisa and Berbera international airports, perhaps 1 to 3 village dhow ports);
  - e. and consequential customs police (perhaps seconded from general police), inspection and valuation officer, senior inspectors and assessors; forensic and audit personnel; bookkeepers and accountants, statistical and analytical personnel; with
  - f. job descriptions;
  - g. evaluation of number of present personnel who would qualify (with upgrading training, possible new Somaliland recruits (for training on induction) including from the diaspora and of posts, to which initially expatriates will need to be recruited;
  - h. articulating training programmes (and sourcing trainers);
  - i. adopting a salary structure allowing tax officers to live on pay from the tax authorities **not** from tax evaders - perhaps \$50 to \$500 basic initial pay range with up to \$1,000 a month for the top handful of officers;
  - j. implementation of above.



## VI. MATTERS OF TIMING AND FINANCE

1. Clearly the sooner this agenda can be begun the better.
2. There is no reason the strategic portion (Sections IV, V 1-2-3-4) should begin later than the second quarter of 1999 nor be completed later than August 1999. In that case the preparatory work in Section V-5 could be completed by the end of the first quarter of 2000 with the new system beginning operation (parallel to retraining and recruitment) at that point;
3. Given the potential benefits it seems - at first glance - odd that initial external and capital Assistance will be needed. That is however the case because the costs are up front and the revenues follow and Somaliland cannot now afford the initial costs.
4. The Annex sketches possible cost parameters:

- Initial Studies 151,000 - 167,000
- Implementation/Articulation/Training/Expatriate Staff (over two years) 5,350,000

After the new system is operational all costs could be covered from revenues albeit limited continued personnel technical assistance would be welcome.

5. Possible sources include UNCTAD (building from its port management and trade statistics work), DFID (because of Somaliland's political history and growing British interest), the EU (if Somaliland can be 'recognised' as a **region**), the Commonwealth Secretariat (which can carry out technical assistance work for non-members under special circumstances, as it did for Mozambique for a decade and a half before its accession to the Commonwealth), USA (via Djibouti Embassy) and the UN (via Secretariat).

Reginald Herbold Green  
Falmer, UK  
1-1-99

## ANNEX - Rough Costings

### A. Macroeconomic/Strategic Revenue Study

<b>i. Senior Consultant</b>		<b>(USA \$)</b>
• 40 to 60 days at \$500		20,000 - 30,000
• Travel (2 round trips Europe or USA/Hargeisa)		3,500 - 4,500
• Local Travel/Per Diem		10,000
• Office	(Provided by Somaliland government)	
 <b>ii. Research Officer</b>		
• 3 to 4 months		4,000 - 6,000
• Travel (if from Diaspora)		2,000
• Local Travel/Per Diem		10,000
 <b>iii. Overheads/Contingencies</b>		 7,000
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<b>Sub-Total</b>		<b>57,000 - 70,000</b>
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### B. Institutional/Operational Study

<b>i. Senior Consultant</b>		
• 90 days at \$500		45,000
• Travel (2 round trips)		3,500 - 4,500
• Local Travel/Per Diem		12,500
 <b>ii. Research Officer (as at a)</b>		 23,000 - 25,000
 <b>iii. Overheads/Contingencies</b>		 10,000
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<b>Sub-Total</b>		<b>94,000 - 97,000</b>
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C. Articulation Toward Operation

• Preparations (per Section V-5)	250,000
• Training	500,000
• Buildings - Vehicles (and radio telephones) - Office and Data Processing Equipment	1,500,000
• Expatriate Salaries/Related Costs (say 8 at \$100,000 for two years)	1,600,000
• Support for Citizen Salary Upgrade Prior to Implementation (i.e. during training)	1,000,000
• Contingencies	500,000
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<b>Sub-Total</b>	<b>5,350,000</b>
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This last estimate is very approximate and cannot be quantified in detail until "A" and "B" are carried out.)

*Ref: RHG/lab/taxSomal.doc 11.01.99*