

Cities that Work 



International
Growth Centre

An overview of municipal finance in Hargeisa, Somaliland



Astrid R.N. Haas

December 2017

DIRECTED BY



FUNDED BY



An overview of municipal finance in Hargeisa, Somaliland

Table of Contents

Executive Summary	2
Context	3
History	3
Economy.....	3
Demographics	3
Hargeisa	4
Municipal Finance	4
Overview.....	4
Political and administrative actors	5
Legislation	7
Municipal Revenue: The City Of Hargeisa	11
Main Sources.....	11
Intergovernmental fiscal transfers	13
Coverage	14
Rates and assessment.....	15
Municipal Expenditure	15
Policy Considerations.....	17
Increasing own source revenues	17
Efficiency	18
Simplicity and transparency.....	18
Revenue projections.....	19
Expenditure	19
Central and local government.....	20
References	21

Executive Summary

This paper provides an overview of the municipal finance system of Hargeisa, the capital city of the self-declared Republic of Somaliland. The city is the centre of economic activity for the whole country, and the source of most of the country's GDP. Hargeisa has undergone various reforms of its municipal finance system over the past years, to the extent that some believe it has stronger administrative capacity than at the national level. For example, with support from development partners, it has a computerised revenue management system, which allows the city to more accurately record its annual revenues, expenditures and budgets. These reforms have been associated with a substantial increase in revenue by over 80% between 2010 and 2016, with a continuing upward trend. However, in absolute terms, revenues at about 9.5 million USD for the FY 2016 remain small. This is particularly compared to the overall expenditure responsibilities of the city as a result of Somaliland's decentralised system, as well as the overall developmental needs of the city.

Therefore, as Hargeisa looks for ways to further improve its municipal finances, this paper puts forward the following policy considerations:

- Increasing Own-Source Revenue: Drafting a revenue strategy document that highlights, among other factors, which taxes and fees are going to be collected, the tax base for each of these and a transparent way for rates to be set and changed. The revenue strategy should also incorporate clear targets for the city and how these will be attained.
- Efficiency: Determining the efficiency of each tax and fee and then using this information should then be used streamline the large number of revenue sources.
- Simplicity and Transparency: Streamlining the rates, and improving communication as to how they are set and thus developing a sounder basis of setting them to benefit the system overall.
- Revenue Projections: Strengthen forecasting and therefore ensure that the city is in fact meeting its targets for collection and receiving the revenue it should be.
- Expenditure: Increasing expenditure on investments as well as on service delivery, it will improve both productivity and liveability in the city.
- Central and Local Government: Efforts to clearly delineate revenue and expenditure functions by central and local government

This paper will form one of the bases from which the work of the newly established Hargeisa City Council Tax Administration Taskforce (HTAF) will operate in assessing reforms for the cities. It should be noted from the outset that one of its limitations is that it solely focuses on the revenue and expenditure sides of the city as little information is available on other aspects such as the city's assets and debt. In future iterations, therefore, these are further aspects that can be taken into consideration.

Context

History

Somaliland was a British protectorate and therefore administered by the British Foreign Office, during colonial times, differing from Somalia, which was under Italian rule. Although it was granted independence from the British in 1960, the Somaliland legislative assembly decided that it wanted to unify Somaliland with Somalia to form the Somali Republic. From the outset this was popular decision and a referendum in 1961 actually approved the first Somali Constitution. However, following a series of military coups and ultimately the brutal regime of Siad Barre, who was in power for 21 years, many in Somaliland began to consider independence once again. This sentiment grew and Hargeisa, the capital city of what is now Somaliland, became one of the main centres of the Somali National Movement, a resistance movement, and so was a hotspot in the war and targeted by Barre's army. Following the toppling of Barre's regime, Somaliland once again declared its independence on the 18th of May 1991. As this independence was a self-declaration, however, it is still not internationally recognised. Since this time Somaliland has prevailed in relative peace, instituting a fairly successful democratic regime, resulting in its first presidential election in 2002. Its most recent presidential election was held in November 2017.

Economy¹

Most recent GDP figures for Somaliland, compiled by the World Bank, estimate that in 2012, GDP was about 1.4 billion USD or an equivalent of 347 USD per capita, making it one of the lowest in the world. A substantial portion of GDP, namely 30%, is generated from activities associated with livestock, which is as a result of Somaliland's pastoralist culture. The second most important contributor to GDP are wholesale and retail activities, at about 20%, followed by agricultural crop activities at 8% and real estate services at 6%. The importance of real estate transactions in terms of GDP may also be indicative of the rapidly growing nature of the country and cities, like Hargeisa specifically.

Demographics

The population of Somaliland is estimated to currently be about 4 million people (World Bank 2014), many of whom live in rural areas. However, following the relative peace and stability it has attained since its independence, many people have returned to the capital city Hargeisa (Tempra, Jacobs, Demissie 2007). Poverty is estimated to be higher in rural areas than in urban ones, 38% compared to 29% (World Bank 2014) also driving rural-urban migration (World Bank 2014). However, although many are coming in search of jobs, the unemployment rate is still very high; at most recent estimates from 2012, employment is only about 28% for men and 17% for women (World Bank 2014).

¹ Statistics in this paragraph are taken from: <http://www.worldbank.org/en/news/press-release/2014/01/29/new-world-bank-gdp-and-poverty-estimates-for-somaliland>

Hargeisa

With the re-advent of trade activities following the war, Hargeisa became the main centre of commerce for the country. It is also the capital city of Somaliland, and thus the seat of the government. The city itself is located at the centre of Somaliland and near the border with Ethiopia. It is situated in a valley with the Marodijeh River cutting through the city, although it is currently dry. It is the largest city in Somaliland and estimates using a GIS survey in 2007 placed the population somewhere between 350,000 and 850,000 people (Tempra, Jacobs, Demissie 2007). However, based on rural-urban migration and the city growth in general, officials believe that the current population is actually now more than 1.5 million people.

The main road in the city runs parallel to the river and many of the major urban properties are located along this. Due to the urban growth, the city is, however, sprawling outwards rather than densifying. It currently consists of 5 main districts, 3 small districts and 4 villages. Due to the low density and generally poor network of roads, the centre of Hargeisa is usually the most congested, as is also the site of the main commercial activity in the city.

The city is serviced by an underground water source, Geb-Deble, which lies 40km outside of Hargeisa. However, there are frequent outages due to the limited storage capacities and other institutional constraints. There is a main public power station, but most of the households use private means of connection. A major challenge for the city is waste collection, which is usually just disposed on vacant land (Tempra, Jacobs, Demissie 2007).

Municipal finance

Overview

From 2009 onwards there has been a concerted effort to increase the tax revenue for the government of Somaliland (Cossios-Muñoz 2015). As a result, between 2009 and 2015 the annual real growth rate of the overall tax in the country was more than 20% (Cossio-Muñoz 2015). Perhaps even more than many developing countries, Somaliland is very reliant on revenue from customs duties and various fees and levies on imports. The Department of Inland Revenue collects taxes along 38 different line items. In fact, approximately 40% of internal revenue comes from these sources with the next biggest source being on livestock at 10%, given its importance for economic activity overall (see Table 1 for 2014 figures). This split has remained relatively stable over the past 10 years (Cossios-Muñoz 2015). However, notwithstanding the large increase in revenue, Somaliland still has one of the lowest tax to GDP ratios in the world, which was around 7.2% in 2015, compared to the African average of 19.1% in 2015² (Cossios-Muñoz 2015).

² OECD (2015) *Revenue Statistics in Africa*: <https://www.oecd.org/tax/tax-policy/revenue-statistics-africa-2017-infographic.pdf> accessed in December 2017.

Table 1 - Domestic Revenues, Customs and Inland Revenue, Somaliland (2014) in millions of USD

DESCRIPTION	Customs	Inland	TOTAL	Customs percent of total	Inland percent of total	Total in percent
Import tax	47,741	-	47,741	36.97%	0.00%	36.97%
Sales Tax	12,997	495	13,493	10.06%	0.38%	10.45%
Livestock levy	12,389	-	12,389	9.59%	0.00%	9.59%
Administration Tax	4,211	1,404	5,615	3.26%	1.09%	4.35%
Eastern Regions Dev.	4,896	-	4,896	3.79%	0.00%	3.79%
Harbour Tax	4,783	-	4,783	3.70%	0.00%	3.70%
Stamp Tax	2,513	2,466	4,979	1.95%	1.91%	3.86%
Public Payroll Tax	-	4,464	4,464	0.00%	3.46%	3.46%
Fiscal Transfer	-	3,818	3,818	0.00%	2.96%	2.96%
All other revenue	10,915	16,047	26,961	8.45%	12.43%	20.88%
TOTAL	100,445	28,695	129,140	78%	22%	100%

Source: Revenue Database, Planning and Statistics Department MoF

The largest geographic source of internal revenue for Somaliland is from the city of Hargeisa; it accounts for an estimated 85% of revenue for the whole country (Cassios-Muñoz 2016). This is due to the fact that Hargeisa is the centre of economic activity for the whole of Somaliland. Furthermore, it is a city that is rapidly urbanising, therefore increasing the tax base. As there have been various efforts over the past years to improve the tax administration for the city, many believe that Hargeisa actually commands better financial management systems than the revenue management at the national level.

In terms of budgeting, the fiscal year in Somaliland runs from January and December and thus the adoption of the budget has to happen by the 15th of September the preceding year. For the city, the Mayor is the one responsible for preparing the annual operational plan and corresponding draft budget, which he then presents to the local councillors. They in turn scrutinise it and finally adopt it, for the city to work from.

Political and administrative actors

The self-declared independence of Somaliland brought with it a strong foundation for subsequent democratic governance. In fact, it is sometimes hailed as one of the most successful democracies in Africa, having undergone six competitive and peaceful transitions of power since 1991 (The Economist 2017). Its hybrid system of democracy infused with its more traditional-clan based government is enshrined in both in the Constitution and recognised in a series of laws that set out the governance structures for Somaliland (International Crisis Group 2015). It strives for fully decentralised system. Whilst political decentralisation, through elected local governments, has largely been achieved, administrative, in terms of decision-making authority for these governments as well as fiscal decentralisation, in relation to their revenue-raising and expenditure authority, are still in transition.

Cities and districts are governed by structures laid out in Law 23 (see section on *Legislation*). From the outset, the law emphasises Somaliland's system of the self-administration of regions combined with multi-party system and the devolution of power. Although most districts are governed in a similar way, Law 23 also lays out the qualifications for districts to become self-governing. The conditions are based on the geographic area, the population size and whether they can generate up to 60% of their own budget, although in practice this last provision is not upheld. The Law 23 also distinguishes between different grades of districts. The City of Hargeisa is a so-called Grade A district, which allows it to have a Department of Administration of Finance that is responsible for preparing, storing and executing the budget. *Article 2* of Law 23 also makes reference to the fact that the capital city, i.e. Hargeisa, may be governed by a special law. However, to date no separate law for the city has been developed and passed.

The important structures in all of the districts are as follows:

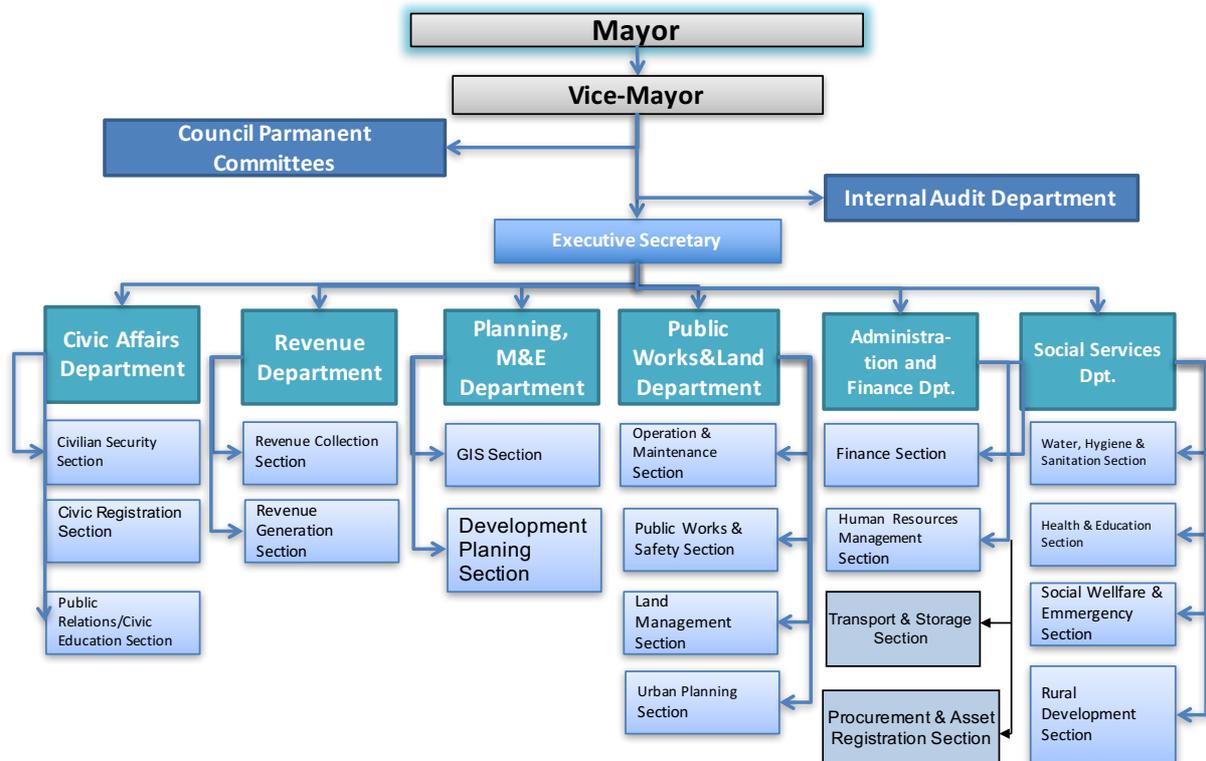
- Regional Council – this is made up of the regional executive committee, regional district mayors and heads of government departments;
- District Council – this is made up of the District Executive Committee, Heads of Government departments and Head of the District Armed Forces;
- Local Council – This body is responsible for leading administration and law-making across the district.

The main staffing of each of these councils is as follows:

- District Commissioner/Mayor and Vice Mayor – these positions are elected by the local council. The District Commissioner/Mayor functions as the chairman of the district or head of the city;
- Regional Executive Secretary – this is the most senior official responsible for administration and management of a regional capital and is appointed by the Minister of Interior;
- District Executive Secretary – this is the most senior person responsible for the administration of the local government and district and is also responsible for managing finances in Grade A districts.

The general organisational chart for most Grade A municipalities is as follows:

Figure 1 - Organisational Chart of Grade A Districts in Somaliland



Source: Ministry of Interior 2012

In 2012, there were 900 staff employed by the city of Hargeisa, which increased to over 1200 by 2015 (Mohamoud 2012, Ahmed 2015). The Mayor of Hargeisa, Abdurrahman Mahmood Aidiid, was elected by the Council in April 2014 and the Vice Mayor, Abdiaziz Mohammed Hashi was elected to his position in 2012.

One particular function of the city that is important to highlight when it comes to municipal finances, is the Revenue Collection Section. This is a standalone section, separated from the rest of finance. This type of structure, where there is a department and team solely responsible for revenue collection, is fairly rare but very progressive to find in developing country city structures (Kopanyi 2015). Another Section that is important for municipal finance within Hargeisa is the Physical Planning Section. In particular, as it houses the GIS unit, it provides the foundation for assessment for property tax in the city (see separate note on *Property Tax in Hargeisa*).

Legislation

Following independence of Somaliland, it, like many other former British Protectorates, adopted many of the British tax laws. It was only in 1996 when these were first reformed. However, reforms focused on national revenue and customs laws, and largely ignored local taxes (Cossios-Muñoz 2015). Although there have been various subsequent reforms, a continuing defining feature of the tax system in Somaliland, is that no law is comprehensive to incorporate the whole tax code. Rather, the laws governing revenue collection are widely

disbursed among a number of different types of legislation, including the Constitution, laws, presidential and ministerial decrees, policies and regulations. This means that there are both legislative gaps, sometimes a lack of clarity about what takes precedent and resulting confusion and opaqueness in the system overall.

For local taxation, specifically, there two important challenges to note that stem from this unclear system. The first is that is no single law that very clearly defines the difference between central and local government taxation and therefore which level of government has the authority to collect which type of tax. This results in situations of double taxation. Secondly, reforms to coordinate taxation policy are largely undertaken at the national level, without consideration of local taxes. There have been comprehensive public financial management reforms, particularly from 2015 onwards, with the aim of moving towards enshrining the tax code in a single and comprehensive piece of legislation. Ultimately, the idea is to establish a Somaliland Revenue Authority. However, again this only focuses on revenue and customs collected at a national level, largely ignoring local taxes and the relation between the two.

A summary of the current legislation governing local taxes is as follows³:

The Constitution (2000): The Somaliland Constitution was passed by parliament in April 2000 and subsequently endorsed by the citizens of Somaliland in May 2001. It provides the broader framework under which subsequent legislation was then devised. With regards to municipal finance, the Constitution is important as it outlines the spirit under which taxes and duties should be levied. In *Article 12* it notes that every tax and fee collected needs to have a legal basis and in tandem with the well-being of society. It also quite clearly notes that at there should be an administrative demarcation between the tax levying powers of the central government vis-à-vis those of the regions and districts (Cassio-Muñoz 2016). The Constitution bestows the power of taxation to the Parliament of Somaliland. It also broadly outlines the service provision responsibility of the regions and districts, including health, education (up to intermediate school), livestock husbandry, internal security, water, electricity and communications. Finally, it notes that the regions and the districts are responsible for administering land as well as providing adequate planning of this.

Regional and Districts Self-Administration Law, Law 23 (2002): Currently, the most important law governing districts and municipalities in Somaliland is the law on *Regional and Districts Self-Administration*, more commonly known as Law 23. This regulates political, administrative and fiscal decentralisation for the whole country and sets out what each of the local administrative structures should look like. Overall, it strives to support the self-administration of regions within a multiparty structure and to do this through the devolution of power. Outside administrative structures, the law, in *Article 11*, also outlines the socio-economic services provision that districts are responsible for providing, similar to the Constitution. It does, however, caveat this with the instruction that they only need to provide this if they are able to do so.

In terms of finances, *Article 68, part A*, notes that those districts that are classified as a Grade A, which include Hargeisa municipality, must have a department of administration and finance which has the responsibility of preparing, storing and executing the budget. This part of the article also importantly enshrines the responsibility of this department to collect revenues on

³ Note: This is a summary of legislation that has been translated into English. Laws that do not yet exist in English are Law 12 and the Municipal Finance Policy, which has not been passed into law yet.

a daily, monthly and yearly basis. *Part B* of the article more specifically outlines the responsibilities of the tax departments which include:

- Collecting taxes for the local government;
- Creating and exploring new sources of revenue;
- Back collecting revenues that have not been remitted in previous years;
- Registering and collecting taxes from non-moveable assets;
- Collecting rent and leases on local government assets.

A further article that is very important in terms of municipal finances is *Article 85* which bestows the power on local governments to set appropriate tariffs based on valuation. It further notes that these can be moved upwards or downwards by passing bylaws and regulations, which are subject to the approval of the Minister of Interior.

Article 86 outlines the various service charges that can be levied by the district, which were later expanded upon in the Ministerial Decree of the 08 March 2011. These service are outlined in **Table 1** below:

Table 2 - Service charges that can be levied by districts

Commercial licenses	Land values	Registration
Livestock sale	Temporary structures	People registration
Signs	Street markets	Goods and qaat ⁴ production
Entertainment	Transfers	
Agriculture	Abattoir and butchery	Electricity use
Building values	Skins and hides	Specific projects

District Councils' Budgeting and Accounting Systems Regulations, Ministerial Decree, Minister of Interior (2011): The financial and expenditure relationship for each district and municipality is outlined between *Article 4* and *Article 13*. Important articles include:

- *Article 4* – outlines that the current own-source revenue of districts and municipalities should come from taxes, license fees and permits, user charges and tariffs, rents, fines and penalties, as well as loans for emergencies. It also notes that the transfers from central government should comprise of a portion of national revenue, transfers from grants in aid as well as specific sectoral transfers from ministries. Finally, *Article 4* also notes transfers from donors as a specific revenue category for districts.
- *Article 5* – summaries what the main expenditures in districts and municipalities should be. These include expenditures on general administration, maintenance and repairs, operation and maintenance of local public services, transfers and grants, subsidies to the private and the public sector as well as debt service obligations.
- *Article 13* – this article, which came into force in 2011, notes the various potential for own-source revenue for district government and more clearly specifies their obligations. What is notable about this article is that the very broad nature both of the

⁴ Qaat is a plant that functions as a stimulant. It is chewed as a part of culture across the Horn of Africa, including Somaliland. It is an important part of the everyday life and thus the economy.

revenue sources as well as the services that are districts and municipalities are responsible for. These include

○ *Revenues:*

- Taxes: livestock, property, agricultural production and cultivation, utilities;
- Licenses and fees: Businesses, hawkers and traders, commercial signs, personal registration
- User charges and tariffs: Public transport, waste collections, slaughterhouses
- Rents: Public markets, rents of local government assets
- Fines and penalties

○ *Services:*

- Operation and maintenance services
- Local investments in capital
- Urban roads and pavements
- Health services
- Education and vocational training
- Solid waste management
- Public markets
- Slaughterhouses, abattoirs and kennels
- Water supply
- Electricity and public lighting
- District policing
- Urban zoning and planning
- Agricultural extension services
- Public transport

Presidential Decree (September 2012): This outlines the spending requirements for local governments:

- 35% should go to service delivery and operation and maintenance;
- 25% on staff salaries;
- 40% on capital investment.

Revenue Act (2015): This Bill was passed in 2016 in an effort to consolidate different tax legislation in one document. It also envisages setting up a dedicated revenue authority. However, although *Article 1, §1* notes that “This Act that shall be referred to as the Revenue Act, 2015, governs taxation in the Republic of Somaliland,” it does not refer to local taxation, rather just focusing on taxes collected by the Ministry of Finance at the national level.

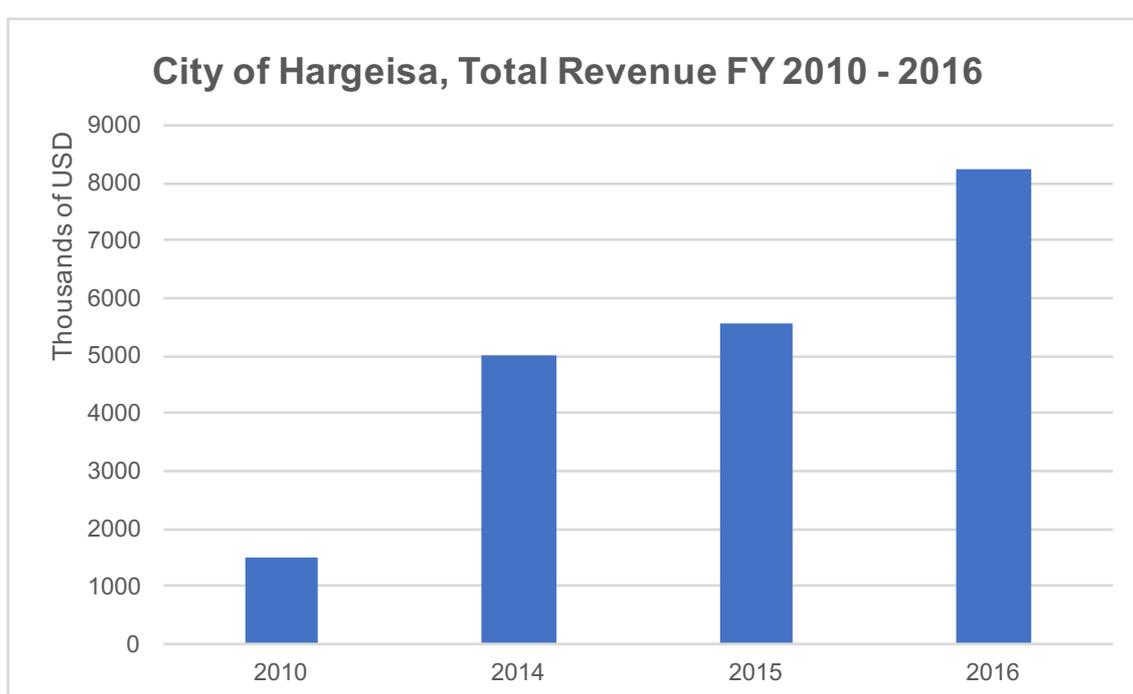
Ministerial Decree 08/2017 for the Establishment of the Hargeisa City Council Tax Administration Taskforce (HTAF): This decree was issued in order to support the process of adapting comprehensive policies and strategies for municipal finance. It is mandated to coordinate efforts in municipal finance for the City of Hargeisa and includes members from national government and the City.

Municipal revenue: the city of Hargeisa

Main Sources⁵

In 2016, the overall revenue for the City of Hargeisa was 8,222,221.89 USD⁶. Of this, 6,540,515.98 USD (79.56%) came from revenue from taxes, fees, fines and penalties collected by the city and the remaining 1,686,196.89 USD (20.44%) came from intergovernmental fiscal transfers both from the Ministry of Interior as well as the Ministry of Finance (see section on *Intergovernmental Fiscal Transfers*). This is a steady increase, by over 30% per year in 2014 and 2015 (**Figure 1**). Compared to 2010, where the revenue was 1.5 million USD, the total revenue collected by the City of Hargeisa in 2016 represents an 81% increase (Ahmed 2017).

Figure 2 – City of Hargeisa, total revenue FY 2010-2016



The City of Hargeisa revenue system is characterised by a large number of taxes and fees. However, many of them yield relatively little revenue. A majority of the taxes and fees are charged at points where citizens and firms come in contact with the government. For example, when tax collectors go to the market or a resident wants to use public transport. By 2016, there were 67 individual taxes in the city, which had increased from 42 in 2014 and 46 in 2015. As a comparison, in 2016, the Kampala Capital City Authority had 28 local tax line items (Musoke 2017). This is reflective of policies to increase the number of taxes to increase revenue. Therefore, Somaliland overall, and Hargeisa specifically, quite possibly has some of the highest number of disparate taxes and fees in the world.

Across the years 2014-2016, the top 8 tax sources stay largely the same and make up over 50% of all revenue for the city (**Table 2**). However, some of the composition of taxes do

⁵ Data obtained from City of Hargeisa revenue management system, thanks to the Revenue Collection Section.

⁶ Throughout the document an exchange rate of 1USD = 7280 SOS is used

change (**Figure 2**). For example, there was a large increase between 2014 and 2016 in revenue from the tax on property transfer, which is perhaps indicative of a vibrant property market. Some of the taxes, such as the Hargeisa City Development Tax and a further tax on checkpoints in the city, supplementing the previous checkpoint tax that was levied just on vehicles, were added between 2014 and 2016. Quite notably, the market tax, which is a daily fee collected from vendors at different markets at the city, performed much better in 2014 than in 2016.

There is no specific line item in the accounting system to represent funds received from development partners. This may be due to various factors – either development partners support the national government and therefore their contributions are reflected in the intergovernmental fiscal transfers. Alternatively, the contributions in this respect could be quite negligible since Somaliland is not actually recognised as an independent country, it receives relatively little support from the international donor community.

Figure 3 – Main tax source revenue 2014 and 2016, City of Hargeisa

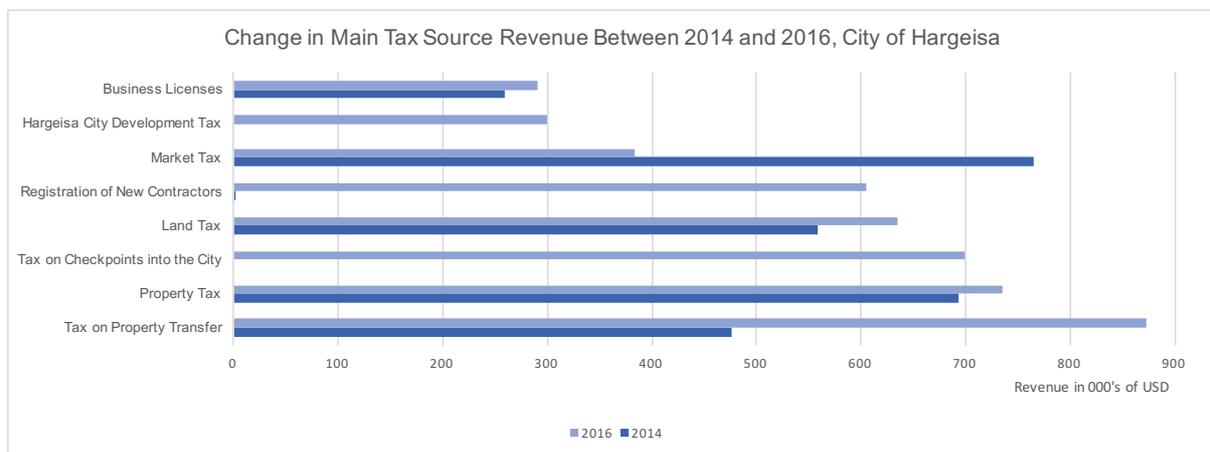


Table 3 – Top 8 tax sources 2014 and 2016, City of Hargeisa

Hargeisa Revenue FY 2016			
	Type of Tax	2016 (USD*)	% of Total
1	Tax on Property Transfer	872,126.89	10.61
2	Property Tax	735,426.01	8.94
3	Tax on Checkpoints into the City	699,826.87	8.51
4	Land Tax	634,091.04	7.71
5	Registration of New Contractors	604,690.25	7.35
6	Market Tax	383,827.98	4.67
7	Hargeisa City Development Tax	299,166.65	3.64
8	Business Licenses	289,959.19	3.53
Total Top 8 Sources		4,519,114.89	54.96
Total Revenue 2016		8,222,212.87	100.00
Hargeisa Revenue FY 2014			
	Type of Tax	2014 (USD*)	% of Total
1	Market Tax	764,702.77	15.20
2	Property Tax	692,811.60	13.77
3	Land Tax	558,363.99	11.10
4	Tax on Property Transfer	476,188.54	9.47
5	Indirect Tax	339,098.96	6.74
6	Livestock Market Tax	320,157.81	6.36
7	Tax on Vehicles Entering the City	278,933.29	5.54
8	Business Licenses	258,387.21	5.14
Total Top 8 Sources		3,688,644.17	73.33
Total Revenue 2014		5,030,488.59	100.00
*Exchange Rate: 1 USD = 7280 Somaliland Shillings			

Intergovernmental fiscal transfers

Hargeisa receives two main types of fiscal transfers from the central government. The first is a transfer from the Ministry of Finance that comprises 10% of the revenue it collects from all the customs duties within the administrative boundaries of the city. This is a transfer that all local governments receive, but that Hargeisa benefits from disproportionately compared to others. This is due to the economic activity within Hargeisa's boundaries, which accounts for 85% of all revenue collected (Cossios-Muñoz 2016). In 2014, the Ministry of Finance transfer made up only 0.65% of total revenue that was collected in the city that year. However, this substantially increased by 2016, where it was about 20.45% in total. This transfer should be remitted by the Ministry of Finance to Hargeisa on a monthly basis, based on all revenue collected in the previous month. However, there are often delays and the amount is generally unpredictable. Therefore, it is difficult for the city to forecast these finances as part of its planning because they vary substantially from month to month.

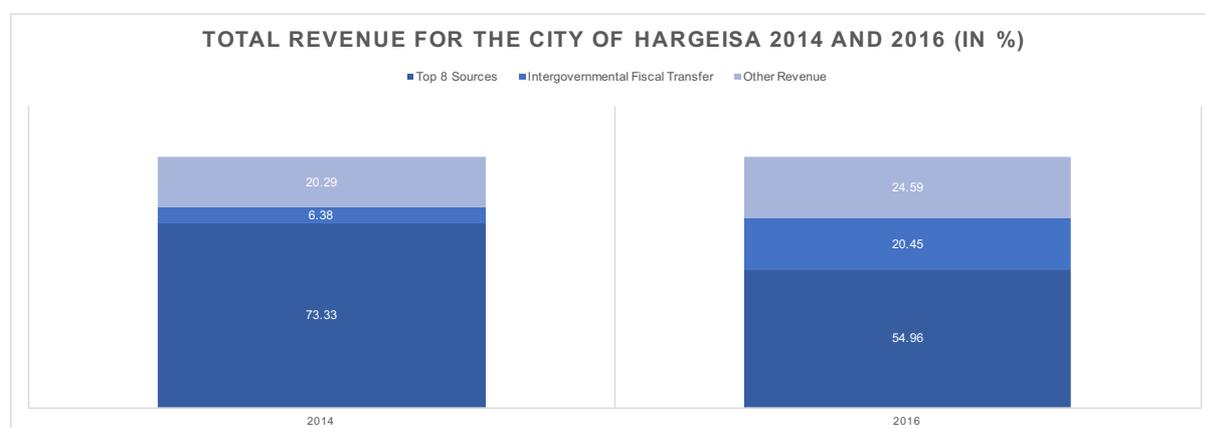
There should be a transfer from the local governments back to the Ministry of Finance, as well. This should be 15% of the fees collected on agricultural activity in the city. However, in practice, the level of agriculture is so low across Somaliland in general, especially in Hargeisa, therefore collection of this fee is low overall. For example, the tax on planned agriculture in

2016 was only about 22,485 USD and thus 0.27% of the total tax collected. This also means that in practice, this transfer is not actually transacted.

The second form of intergovernmental fiscal transfer is from the Ministry of Interior to local governments to support the development of the district as well as provide equalisation for expenses not covered by revenues. Like with the transfer from the Ministry of Finance, this transfer is also haphazard in its timing and size and therefore difficult to include in planning projections. Also, similar to the other transfer, its overall importance as a percentage of total revenue has increased as well, from 5.73% of total transfers in 2014 to 10.27% in 2016.

Therefore, a notable factor is the change in relative importance of intergovernmental fiscal transfers compared to other sources of local revenue over time. In particular, the city seems to be becoming increasingly dependent on intergovernmental transfers as a source of financing overtime (**Figure 3**).

Figure 4 – Composition of total revenue for the City of Hargeisa, 2014 and 2016



Coverage

Potential: There is little data or concrete evidence to be able to discern what the potential for each of these taxes and fees is as there is no official registered database of local tax payers. The only one that exists is for property tax through a GIS survey, which was conducted by UNHabitat in 2006, to register properties. This database is only being updated again in 2017, although the city has grown substantially in the meantime. Therefore, in terms of people- or firm-based taxes, these are collected as the person or business is encountered by the tax collector. This system both results in some people being required to pay the same tax more than once but also has the very pertinent risk of a large number of people falling through the tax net.

Since 2016, the Ministry of Finance has been undertaking a large-scale tax payer registration across Somaliland. This is an exercise that will take some time to complete but will help the Ministry put together a comprehensive database of taxpayers across the country. To date, it is not envisaged that this information will be shared with the city. This lack of sharing of information from a national and local authorities exacerbates the challenge of double taxation.

Exemptions: In the official legislation there are no exemptions on the payment of local taxes. However, in discussions with the Revenue Collection Section they noted that for property tax,

certain exemptions do exist in practice. In particular, owners of impermanent structures, such as those in slum areas, do not pay property tax and neither do government-owned buildings.

Frequency of collection: Most taxes are collected on an annual basis, with one notable exception being the taxes collected at the market. These include the overall market tax which is collected from all vendors selling in Hargeisa on a daily basis and taxes on livestock. Additionally, taxes collected at checkpoints in and out of the city are collected onsite at the time of movement.

Enforcement: In theory, residents of Hargeisa are supposed to come to the city headquarters to pay all the taxes they owe. However, as few do this, the city employs over 250 tax collectors to go and collect taxes. They are employed at the district level, across 36 billing centres. These billing centres are then responsible for aggregating all the taxes collected and remitting them to the Revenue Collection Section in the city. In the legislation, there are no dedicated fines and penalties for not paying local taxes. These enforcement mechanisms only exist at a national level as part of the Revenue Act.

Rates and assessment

All taxes and fees are issued in Somaliland Shillings (SOS) except for the tax on the transfer of property, which the rates are issued in US Dollars (USD). The rates for each of the taxes are set on an annual basis by the Revenue Collection Section in the city and approved by the Minister of Interior. They are published in a booklet, available to look at the city headquarters and each of the billing centres. The rates can vary substantially between years. For example, between 2016 and 2017, the tax on business license doubled from 900,000 SOS (124 USD) to 1,800,000 SOS (247 USD). Furthermore, for the 67 taxes, there are over 2000 different classifications of how payments are set. For example, there are 121 classifications of businesses each having to pay a different license fee ranging from 91,000 SOS (13 USD) to 1,800,000 SOS (247 USD) per year.

Municipal expenditure⁷

As previously noted, Somaliland is in the process of decentralising most of the service functions to those local governments that have the capacity to take it on. These functions are already enshrined in the Constitution and Law 23. From this, the City of Hargeisa has classified their principles for its expenditure into three categories (Ahmed 2015):

- Quality of life: roads, schools, health care, water supply, public places, markets;
- Community development: gender equality, employment, social and recreational facilities, education;
- Development of structures: local council infrastructure and human resources, private sector, NGOs.

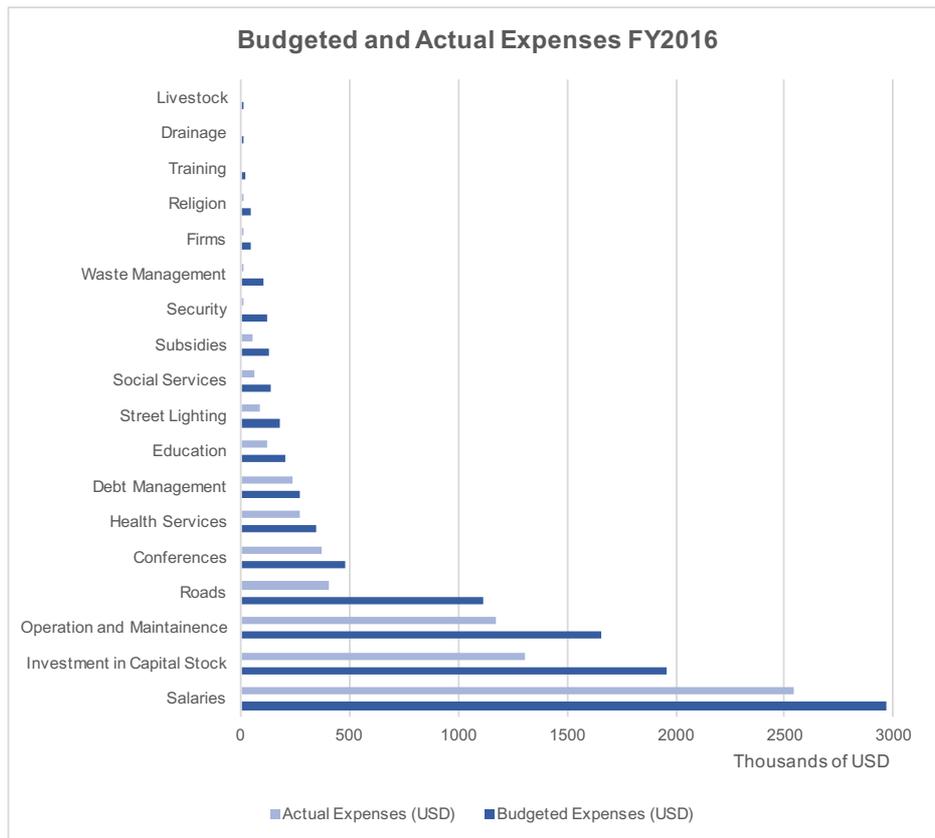
Overall, the city strives to match its investment priorities to ensure that they benefit the majority of the population.

⁷ Data obtained from City of Hargeisa revenue management system, thanks to the Revenue Collection Section.

In 2016, the budgeted expenses were about 9,792,128.28 USD which corresponds approximately to the planned revenues of 9,781,246.64 USD and thus adheres to the principle of balancing the budget. The total expenditures for FY 2016 were 6,664,091 USD leaving a budget surplus of about 1,585,505.10 USD compared to the actual revenue. This is largely due to lower than expected investments in capital stock.

Overall, the expenditure line items were executed approximately in the same proportions as they had been planned (**Figure 4**), with the top five expenditures being on salaries, operation and maintenance, conferences, roads and health services.⁸

Figure 5 – Budgeted and actual expenses in FY 2016



When looking at the percentage of expenditure relative to the full budget and comparing it to what should be spent according to the Presidential Decree 2012, there are some notable differences, however (**Table 4**).

⁸ Note these classifications were combined into these groups from more detailed line items.

Table 5 – Comparing actual and desired spending in FY 2016⁹

Categories	Actual %	Desired %	Difference
Operation and Maintenance and Service Delivery	32.35	35.00	2.65
Salaries	44.25	25.00	-19.25
Investment	23.39	40.00	16.61

In particular, although the spending for operations and maintenance (O&M) and service delivery was largely in line with the guidelines, there was an approximately 20% overspend on salaries and an even more substantial underspend of about 34% on investment. This type of division in expenditure is a common yet potentially challenging as in general, financing infrastructure in the current period is important ensure sustainable urban development in the future. Although the exact salary breakdown for 2016 is not available, in the 2015 budget analysis it was noted that about a third of salary costs were actually for the 25 elected local councillors, which is quite substantial considering the city employs more than 1200 staff (Ahmed 2015). These figures have transformed considerably since 2015, when the spending was divided approximately to 44.2% on O&M and service delivery, 16.88% on salaries and 44.4% on capital investment and development projects (Ahmed 2015). The low capital investment may be due to the fact that the city failed to implement 24 projects that were approved in the FY 2016 budget.

Policy considerations

These are some of the policy considerations for the City of Hargeisa, based on the current assessment and system. They are not listed in order of priority. In general, reforms should be incremental, and the city should work to identify all those reforms that have the most potential to change first. Additionally, any reforms to the system will require wide stakeholder backing within the city, from the central government and very importantly from the tax payers to be able to implement. Therefore, a collaborative and transparent reform process will be key to success.

Increasing own source revenues

Hargeisa has made substantial strides in increasing its revenues over recent years and remains far ahead of all other districts and municipalities in Somaliland in this respect. However, the overall revenue levels around 9 million USD are still very small relative to the amount of investment and service delivery that is needed for the city. Furthermore, as the city continues to grow, these demands will grow as well.

The FY 2016 saw a significant increase in the proportion of the budget funded by intergovernmental fiscal transfer. Although this may be reflective of some improvements in the fiscal transfer system, more needs to be done in this respect in terms of transparency and stability. Furthermore, given the history of the instability of transfers, it will continue to be difficult for the city to plan and be reliant on this source of revenue. Instead, therefore, Hargeisa

⁹ Divisions done by description of spending line item

should rather focus on areas where it can increase its own source revenues. To do this, it will be important to draft and implement a revenue strategy document, which should highlight, among other factors, which taxes and fees are going to be collected, the tax base for each of these and a transparent way for rates to be set and changed. The revenue strategy should also incorporate clear targets for the city and how these will be attained.

One of the potential areas to increase own-source revenue in the city is to reform the property tax system. This is further analysed in a separate brief *Property Taxes: Exploring the Untapped Potential for the City of Hargeisa* (Haas 2017).

Efficiency

An urgent need for the tax system is to start better understanding the efficiency of the system, which means measuring the costs of collection of all the taxes with respect to the revenue collected. Currently there is no data about how much each tax costs to collect. However, given how small some of the incomes are versus the number of collection staff, one can infer that some taxes may actually cost more to collect than they actually render in revenue. Furthermore, this may also be one of the reasons why staff costs constitute such a high percentage of city expenditure vis-à-vis investments and service delivery. Therefore, multiple small taxes and fees actually come at a cost to the city. They are also a major burden to the tax payers, who will find themselves paying a large amount of so-called nuisance tax and not always being aware of what they have to pay. It has already been noted in previous studies, that this is one of the major causes of low tax morale in Somaliland (Cossios-Muñoz 2016). In principle, improving efficiency has already been recognised as an underlying aim for the city. In a budgeting workshop in 2015, participants already noted that in principle, the city should focus on only those sources that are the least costly to collect and can be collected consistently across each fiscal year (Ahmed 2015). However, given the large increase in tax lines in 2016 it seems that this has not been adhered to yet.

Once the efficiency of each tax and fee has been determined, this information should then be used streamline the revenue sources. For example, after the Kampala Capital City Authority went through a similar exercise of assessing the efficiency of their taxes, they cut a number of them that were not performing, electing to rather focus on their top sources (Musoke 2017).

Another benefit to ultimately consolidating the tax lines based on the efficiency of collection is that similar to making it easier for the tax payer to comply, it will also facilitate easier billing and collection. Together with improved tax morale, the advancements in billing and collection should actually result in enhanced revenue collection. These types of improvements in tax administration are similar to ones undertaken in Kampala and are seen as one of the main reasons they managed to increase their revenues by over 100% since 2011 (Andema and Haas 2017).

Simplicity and Transparency

It is currently not possible for tax payers to adequately plan for their expenditures in advance, given tax rates vary so widely over the years. Furthermore, given the rates are determined by the Revenue Collection Unit, it is not clear on which basis they are set and increased each year. This exacerbates the opaqueness of the overall system, making assessment more difficult. It also means that each liability will increasingly rely on the discretion of the tax

collector. This will also likely have an effect on tax payer morale as well, making tax-payers less willing to comply if they do not understand why they are paying. Therefore, streamlining the rates, and improving communication as to how they are set and thus developing a sounder basis of setting them will greatly benefit the system overall. Ultimately, these improvements in administration will also benefit monitoring of compliance as it will be clearer what each payer's liability is.

With these reform efforts, the city should also look to widen its tax base, to ensure the largest number of people are complying. Currently the system increasingly squeezes those payers who already comply for more money each year by increasing the rates rather than focusing on how to increase the net of payers.

Revenue projections

According to officials from the City of Hargeisa, many of the overall revenue projections during the budgeting process are done by approximation and ultimately to help balance the budget. This is due to a lack of data on the potential tax payers for each of the sources. Therefore, another reason to strengthen administration is to strengthen forecasting and therefore ensure that the city is in fact meeting its targets for collection and receiving the revenue it should be. Reforms in this area include undertaking a comprehensive registration and assessment of tax payers, including firms and properties registration. This will also facilitate having a taxpayer identification system, which in turn is important for monitoring compliance in payment.

Expenditure

In terms of expenditures, some of the general principles are outlined as part of the 2012 Presidential Decree. They were further elaborated upon among participants in the City of Hargeisa budgeting workshop in 2015. However, these need to be expanded to ensure that spending is indeed fulfilling a set of objectives. Given the level of unemployment and poverty in the city, equity principles need to be given strong consideration in this regard. This would mean, as noted in the Ministry of Interior Quarterly report for April-June 2017, prioritising policies for social and economic development (Ahmed 2017).

Currently the lowest proportion of expenditure in the city, about 23%, actually goes to investment. As noted, investments in infrastructure are needed to ensure that urbanisation is sustainable. By increasing expenditure on investments as well as on service delivery, it will improve both productivity and liveability in the city. It may also further help the city improve tax collection, as tax payers will see the resulting benefits. Lagos in Nigeria was able to escape this low-level equilibrium of low tax-collection and low-investment as well as poor service delivery. The city did this by making visible and popular public capital investments, such as in roads, and linking these directly to property tax payments. This in turn generated widespread acceptance and even popularity of property taxes and was part of the reason of a 5-fold increase in revenues between 1999-2011. Furthermore, this reform was politically acceptable reflected in the fact that there was successive re-elections of Governors Tinubu and Fashola who implemented property tax collection reforms¹⁰.

¹⁰ De Gramont, D. (2015) *Governing Lagos: Unlocking the Politics of Reform*. Washington DC: Carnegie Endowment for Peace.

Central and local government

An increased effort needs to be made to clearly delineate revenue and expenditure functions by central and local government. In terms of revenue, this is primarily to avoid double taxation of citizens. There are certain taxes, such as income taxes, that are better collected at a national level and others, such as property tax, that are best collected at a local level. Overarching principles to determine this include where, i.e. at the central or local level, public expenditures, funded by these taxes are being made and who is going to benefit from them. Once the exact determinations have been made, they need to be enshrined in a comprehensive national legislation. This will further support the effort of consolidating the tax code.

A review of intergovernmental transfers should also be undertaken to better outline and therefore support the principles of vertical equity, i.e. supporting filling the gaps in between revenue and expenditure at a local level, and horizontal equity, equalising revenue across different districts and municipalities. Although elaborating on the Somaliland government's intergovernmental transfer system further is not within the remit of this paper, the aspect of stable and regular transfers is important as this will better help municipalities, including Hargeisa, improve their projections and therefore their annual budgeting.

To support all of this, better communication between central government, both the Ministry of Interior and Ministry of Finance, and local governments should take place in order to improve and streamline the local tax system. This will also be crucial in terms of getting political backing for reforms. A good forum for this is the Hargeisa City Council Tax Administration taskforce that was established by the Ministry of Interior in 2017.

References

- ASI (2016) *Revenue Policy Tax Force: Final Report*. Adam Smith International, London.
- Ahmed, S. A. (2017) *Ministry of Interior Regions and Districts Department Quarterly Report for April to June 2017*. Ministry of Interior Somaliland, Hargeisa.
- Ahmed, S.A. (2015) *The AWP&B 2015 Elaboration and Assessment Workshop for The Hargeisa City Council – Budget Assessment Report*. Hargeisa City Council, Hargeisa.
- Andema, F. and Haas, A. (2017) *Efficient and Effective Tax Administration: A Case Study of the Kampala Capital City Authority*. International Growth Centre, London.
- Cossio-Muñoz, F. (2016) *Guidelines for the Definition of a National Tax Policy Strategy*. Adam Smith International, London.
- Cossio-Muñoz, F. (2015) *Recommendations for Policy Reforms to the Revenue System: Internal Revenue*. Adam Smith International, London.
- De Gramont, D. (2015) *Governing Lagos: Unlocking the Politics of Reform*. Washington DC: Carnegie Endowment for Peace.
- Economist, The (2017) *Why Somaliland is East Africa's Strongest Democracy*. Accessed from: https://www.economist.com/blogs/economist-explains/2017/11/economist-explains-7?mc_cid=4a5f2a3ecc&mc_eid=cd49677be3 on 13 November 2017
- International Crisis Group (2015) *Somaliland: The Strains of Success*. Accessed from: <https://www.crisisgroup.org/africa/horn-africa/somaliland/somaliland-strains-success> on 13 November 2017
- Kopanyi, M. (2015) *Local Revenue Reform of Kampala Capital City Authority*. International Growth Centre, London.
- Ministry of Interior (2012) *District Councils Reform and Capacity Development Process*. UN Joint Programme for Local Governance and Decentralised Service Delivery, Hargeisa.
- Mohamoud, A.A. (2012) *Local Governments in Somaliland: Challenges and Opportunities*. Hargeisa.
- Musoke, P. (2017) *Kampala Financial Recovery Journey*. KCCA, Kampala.
- World Bank (2014) *New World Bank GDP and Poverty Estimates for Somaliland*. Accessed from: <http://www.worldbank.org/en/news/press-release/2014/01/29/new-world-bank-gdp-and-poverty-estimates-for-somaliland> on November 13 2017
- Tempra, O., Jacobs, K. Demissie, B. (2007) *Hargeisa – First Steps Towards Strategic Urban Planning*. UNHabitat, Nairobi.

Legislation:

- District Council's Budgeting and Accounting Systems Regulations (2011)
- A bill for an Act entitled 72/2016 Revenue Act (2016)
- Regions and District Self-Administration Law (amended) – Law 23 (2002)
- The Constitution of the Republic of Somaliland (2001)
- Ministerial Decree 08/2017 for the Establishment of the Hargeisa City Council Tax Administration Taskforce (2017)

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

Find out more about our work on our website www.theigc.org

For media or communications enquiries, please contact mail@theigc.org

Subscribe to our newsletter and topic updates www.theigc.org/newsletter

Follow us on Twitter [@the_igc](https://twitter.com/the_igc)

Contact us
International Growth Centre,
London School of Economic
and Political Science,
Houghton Street,
London WC2A 2AE

IGC

International
Growth Centre

Cities that Work 

DIRECTED BY



FUNDED BY



Designed by soapbox.co.uk